

## Government Accounting & Auditing Issues

**Cherry, Bekaert & Holland, L.L.P.**  
**June 16, 2009**

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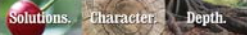
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### Course Subject Matter

- Year in Review-Hot Topics
- Risk Assessment Matters
- Yellow Book Revisions
- GASB Pronouncements and Projects
- Standard Setting Overview

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### Year in Review-Hot Topics

- Fall of Bear Stearns, Lehman, etc.
- Investment valuation
- Stability of financial institutions
- Credit crunch and debt compliance
- Budget concerns and structural changes
- Federal government stimulus packages

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**Solutions. Character. Depth.**

### Investment Valuation

- **Investment return/safety issues are causing organizations to revisit investment policies and practices and more closely monitor news and markets**
- **Illiquid investments increasingly difficult to value and assess as to risk. FASB regulations have been increasingly focused on valuation**

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### Stability of Financial Institutions

- **Continued issues with bond ratings**
- **Includes issues with letters of credit securing bond issues**
- **High degree of uncertainty remaining**

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### Credit Crunch and Debt Compliance

- **Increase in debt defaults as revenue streams diminish**
- **Inability to issue additional debt**
- **Increased focus on streamlining operating costs/realigning costs with revenues**
- **Deferral of capital projects**
- **Other ramifications – Pension costs, etc.**

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**Budget Concerns and Structural Changes**

- **Doing more with less**
- **Deferral of expenditures**
- **Impact on operations**
  - **Changes in programs and personnel**
- **Impact on control structure**
  - **Changes in responsibilities and segregation**
  - **Potential for abuse and fraud**

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**Federal Government Stimulus**

- **Recovery act funding distributed to states and local governments**
- **Separate accountability and reporting for recovery act funding**
- **Considerable increase in grants and compliance requirements expected, with a corresponding audit requirement increase**

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**Continuing Accounting Issues**

- **Revenue Recognition**
  - **Modified accrual availability criteria**
  - **Matching versus current resources focus**
  - **Capital Assets**
  - **Grants and contributions**
- **OPEB Contributions**
- **GASB 48 Disclosures**
- **Capitalized Interest**

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**New Yellow Book Requirements**

- **July 2007 Yellow Book revisions are applicable for periods beginning January 1, 2008 (applicable for fiscal 2009 audits)**
- **External audit organizations must have peer review publicly available**
- **Specifies nonaudit services that impair independence**
- **Chapter 5 includes new requirements associated with restatement of previously issued financial statements.**

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**YB Independence Impairment Services**

- **Recommend a single individual for a position or conduct a recruitment program for the entity or supervise employees**
- **Post or authorize transactions**
- **Design, develop, install or operate the accounting system or develop material performance measurement system**
- **Develop policies, procedures and internal control or provide material payroll services**

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**YB Restatement Requirements**

- **Auditors should advise management to make appropriate disclosures if its likely previously issued financial statements are materially misstated**
- **Auditors should evaluate the timeliness and appropriateness of management's disclosure and management's actions to determine and correct the misstatements**

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### YB Restatement Requirements

- **Auditors should evaluate whether management disclosed the nature and extent of known or likely misstatements on Web pages where management published the auditors' report**
- **Disclosure in restated financials includes the line items affected, the affect on MD&A information, impact on financial statements as a whole, specific financial stmt affected**

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### YB Restatement Requirements

- **Disclosure in financial statements includes the nature and cause of the misstatement, management's actions taken after discovering the misstatement**
- **Auditors should perform sufficient procedures to reissue or update the auditors' report on restated financials, regardless if separately issued or issued on a comparative basis**

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### YB Restatement Requirements

- **Auditor is to include an explanatory paragraph in the auditors' report that says the previously issued financials have been restated, that the previously issued financials cannot be relied on because they were materially misstated, that the previously issued auditors' report is replaced with the report on restated financials and reference to the note to the financial statements and internal control report containing any internal control comments**

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### GAAP Standard Setting Highlights

- **GASB**
- **Governments implementation of OPEB requirements, with implementation in 2009 or 2010**
- **New standard for derivatives**
- **New standard for fund balance/definitions**
- **Standards for intangible assets and pollution remediation costs**

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## GASB Accounting Pronouncements

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### Two Statements on OPEB Reporting

- **Statement 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (reporting on employer costs and employer OPEB disclosures)**
- **Statement 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans (reporting on Plan assets and liabilities)**
- **Jim Burdick will discuss these standards**

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**GASB 48**

- **Already effective**
- **Requires disclosure of pledged revenue and comparison to principal and interest requirements of pledged debt**

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**GASB 49-Pollution Remediation Obligations**

- **Addresses the recording of liabilities for pollution remediation costs**
- **Requires liabilities to be measured at the beginning of the period of adoption, with restatement of net assets**
- **Effective for periods beginning after December 15, 2007**

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**GASB 49-Pollution Remediation Obligations**

- **Does not apply to pollution prevention or obligations related to current operations**
  - **Does not apply to landfill closure and post closure care, which are addressed in GASB 18**
  - **Does not apply to power plant decommissioning**

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### GASB 49 - Pollution Remediation Obligations

- **Requires estimation of the components of expected pollution remediation costs and recording such costs as liabilities if any of the following occur:**
  - **Pollution provides imminent danger to the public or environment and there is little discretion to avoid fixing the problem**
  - **A pollution prevention permit or license has been violated**

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### GASB 49-Pollution Remediation Obligations

- **If a regulator has identified or evidence indicates it will identify that the government is responsible for cleaning up or paying for clean-up**
- **If the entity is named in a lawsuit, compelling it to address the pollution**
- **If the entity legally obligates itself to begin clean-up or post-clean-up activities it is legally required to complete**

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### GASB 49-Pollution Remediation Obligations

- **Requires use of expected cash flows measurement technique to predict expected outlays**
- **Requires disclosure of information regarding pollution remediation obligations and clean-up efforts**

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### GASB 51-Intangible Assets

- Addresses accounting and presentation of intangible assets
- Includes easements, water rights computer software, rights, patents, licenses, etc.
- Troy Manning will discuss this standard

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### GASB 52-Real Estate Investments

- Does not apply to quasi-endowments
- Currently endowments present real estate investments at cost
- If legal limitations imposed externally, requires endowments to present investments in land and other real estate at fair value
- Changes in fair value should be included in investment income

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### GASB 52-Real Estate Investments

- Requires disclosure of methods and assumptions used for valuation
- Changes made to comply with this Statement should be reported as a restatement of beginning net assets if restatements of prior period financial statements is not practical
- Effective for periods beginning after 6/15/08

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### GASB 53-Accounting and Financial Reporting for Derivative Instruments

- **Supcodes GASB TB 2003-1**
- **Amends GASB 7, 23, 25, 31, 40 and 43**
- **Provides for accounting and disclosure of derivative instruments**
- **Effective for periods beginning after 6/15/09**

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### GASB 53-Accounting and Financial Reporting for Derivative Instruments

- **Derivatives are financial instruments or contracts that have settlement factors, leverage, and a settlement**
- **Excludes forward contracts that relate to normal course of business, insurance contracts, certain guarantee contracts, loan commitments**
- **Settlement factors include the reference rate, notional amount and payment provisions**

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### Examples of Derivatives

- **Interest Rate Swap**
  - Variable-rate to fixed-rate
  - Fixed-rate to variable-rate
- **Basis Swap**
  - Exchange payments based on the changes of two variable rates
- **Swaption**
  - Gives the purchaser of the option the right, but not the obligation, to enter into an interest rate swap
- **Commodity swap**
  - Reduce exposure to a commodity's price risk

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**GASB 53-Accounting and Financial Reporting for Derivative Instruments**

- **New accounting will require presentation of fair value on the statement of net assets**
- **No affect on fund level accounting**
- **Present as deferred revenue if an effective hedge**
- **Present as investment revenue if not an effective hedge**

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**GASB 53-Accounting and Financial Reporting for Derivative Instruments**

- **Hedgeable items include single assets or liabilities, groups of assets or liabilities and expected transactions, such as swaps and commodities**
- **Evaluate for effectiveness, which exists if changes in cash flows or fair value of the potential hedging instrument substantially offsets those of the hedgeable item**

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**Solutions. Character. Depth.**

**GASB 53-Accounting and Financial Reporting for Derivative Instruments**

- **Effectiveness should be evaluated at the end of the reporting period. If a potential hedging derivative is deemed ineffective in the first reporting period, it is ineffective for all future periods**
- **If effective in the first period, evaluate each subsequent period for continuing effectiveness**

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### GASB 53-Accounting and Financial Reporting for Derivative Instruments

- **Effectiveness is first evaluated based on the critical terms method and, if not effective using critical terms, by using the synthetic instrument, dollar offset, regression or other qualifying quantitative method**
- **The critical terms method provides that the notional amount, reference rate, settlement and other critical terms will result in the hedging instrument substantially affecting cash flows or fair value of the hedgeable item**

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### Critical Terms Method

- **Notional and principal amounts must be the same**
- **Fair value of derivative is zero at inception**
- **Benchmark rates are based on the same index**
- **Additional requirements are based on whether it is a fair value hedge or cash flow hedge**

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### GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions

- **Clarifies the definition of existing fund types**
- **Changes how fund balances are identified to nonspendable, restricted, committed, assigned, unassigned and specific purpose**
- **Fund balance reclassifications to conform should be applied retroactively by restating fund balance for all prior periods presented**
- **Stat section can stay same but explanation is necessary**

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### GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions

- **Removes confusion between restricted and reserved fun balance by reclassifying reserved to restricted**
- **Provides more understandable fund balance definitions and disclosures**
- **Adds more consistency and comparability**
- **Effective for periods beginning after 6/15/10**

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### GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions

- **General Fund-Used to account for and report all financial resources not accounted for and reported in another fund.**
- **Special Revenue Funds-Used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects.**

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### GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions

- **Capital Projects Funds-Used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets.**

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### GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions

- **Debt Service Funds**
  - Used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest
- **Permanent Funds**
  - Used to account for and report resources that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs

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### GASB 54-Current Requirements

- **Fund balance presented as unreserved or reserved, based on availability for appropriation**
- **Reserved may be because resources can not be spent (long-term receivables, prepaids) or are restricted**
- **Unreserved may be designated or undesignated**

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### GASB 54-Current Requirements versus Future

- **Reserved that cannot be spent becomes nonspendable**
- **Reserved that is restricted becomes restricted**
- **Reserved due to constraint on use imposed by highest level of government becomes committed**
- **Unreserved that is designated due to intent becomes assigned**
- **Unreserved becomes restricted in other than the general fund**

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**GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions**

- Revenues should be recognized in the fund where they will be spent, even if received in another fund
- Discontinue use of special revenue fund if revenue is no longer substantially derived for restricted purposes

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**GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions**

- For fund balance purposes, nonspendable can not be spent because of legal or contractual requirements or if not in spendable form (inventories, prepaid, long-term assets and property held for resale); nonspendable fund balance is determined before restricted committed, assigned, etc.

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**GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions**

- Restricted-constrained by external parties, constitution or enabling legislation
- Committed-amounts constrained by a government using the highest authority
- Assigned-the amount a government intends to use for a particular purpose
- Unassigned-amounts not constrained, including negative residuals

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**Solutions. Character. Depth.**

**GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions**

- **Assigned can be based on governing body, a committee or authorized official**
- **Reduce assigned for any amount that would create a negative restricted or committed balance**
- **Report stabilization amounts (rainy day funds) in the general fund as restricted, committed or unassigned**

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**Solutions. Character. Depth.**

**GASB 54-Fund Balance Reporting and Governmental Fund Type Definitions**

- **Report encumbrances for which resources are restricted, committed or assigned as part of those classifications (do not separately display)**

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**Solutions. Character. Depth.**

**GASB 54-Note Disclosures**

- **Description of authority and actions that lead to committed and assigned fund balance**
- **Government's policy regarding order of spending**
  - **Restricted and unrestricted fund balance**
  - **Committed, assigned, and unassigned**

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### GASB 54-Note Disclosures

- Encumbrances, if significant, are disclosed in conjunction with other disclosures of significant commitments
- Stabilization arrangements
  - Authority for establishing
  - Requirements for additions
  - Conditions under which amounts may be used
- Minimum fund balance policies

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### GASB 55-The Hierarchy of GAAP for State and Local Governments

- Incorporates the GAAP hierarchy into the GASB authoritative literature in an effort to codify all GAAP for state and local governments so that they derive from a single source
- No change to heirarchy previously provided
- Effective immediately

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### GAAP Hierarchy

- GASB and NCGA Statements and Interpretations and private sector standards adopted
- Technical bulletins
- Implementation guides and widely recognized prevalent practice
- Concepts Statements

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**GASB 56-Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards**

- **Incorporates the existing AICPA guidance for related parties, subsequent events and going concern consideration into GASB Standard**
- **Does not establish new accounting standards**
- **Effective immediately**

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**GASB Concepts Statement No. 5, Service Efforts and Accomplishments Reporting**

- **Amends GASB Concepts Statement No. 2**
- **Includes a clarification that it is beyond the scope of the GASB to establish the following:**
  - **The goals and objectives of state and local governmental services**
  - **Specific nonfinancial measures or indicators of service performance**
  - **Standards of, or benchmarks for, service performance**

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**GASB's Current Projects**

- **Pension Accounting and Financial Reporting**
- **Public Private Partnerships**
- **Service Efforts and Accomplishments Reporting**
- **Statement 14 (Reporting Entity) Reexamination**

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### GASB's Current Projects

- **Concepts Statement: Recognition and Measurement Attributes**
- **Chapter 9 Bankruptcies**
- **Financial Instruments Omnibus**

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## GASB 43 and 45

### OPEB Financial Reporting and for Plans and Employers

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### Statement 43 (for Plans)

- **Reporting requirements of a trust established to account for plan assets. It applies to:**
  - **A trustee or plan administrator that is a governmental entity (stand-alone plan reporting)**
  - **An employer or plan sponsor that includes the plan as a trust or agency fund in its own financial report**

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**GASB Statement 45 (for Employers)**

- **Accounting and reporting by employers for their annual cost and obligations associated with retiree healthcare and other forms of OPEB provided as compensation for employee services**
- **Applies to all employers that pay all or part of the cost of benefits—based on claims paid, or age-adjusted premiums, for retirees (a.k.a. “implicit rate subsidies”)**

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**GASB Statement 45 (for Employers) (continued)**

- **Requires a change:**
  - **From pay-as-you-go accounting—in which expense is not recognized until OPEB obligations are finally paid after retirement**
  - **To accrual-basis accounting—in which expense is recognized during years of active service (OPEB is part of the compensation package)**

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**GASB Statement 45 (for Employers) (continued)**

- **Requires actuarial valuations every 2 or 3 years for accounting and financial reporting purposes (sooner if something major changes)**
  - **Calculations using an alternative measurement method are a possibility if < 100 total plan members**
- **Requires measurement and disclosure of funded status information, including:**
  - **The total actuarial accrued liabilities for past service costs**
  - **The net unfunded actuarial accrued liabilities after subtracting plan assets, if any**
  - **The plan’s funded ratio**

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### Postemployment Benefits: Substance of the Transaction

- Postemployment benefits (pensions and OPEB) are part of the compensation for services rendered by employees; they are part of an exchange transaction between employer and employees
- Benefits are “earned,” and obligations accrue or accumulate, during employment, but benefits are not taken until after employment (long time lag between incurring and paying the obligation)
- The accrual-basis cost of benefits for a period is part of the total cost of government services for that period, whether or not the employer chooses to fund it concurrently

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### Measurement approach illustrated

#### Employee Age Timeline

The diagram illustrates an employee's age timeline from 25 to 80. A bracket above the timeline from age 25 to 40 is labeled "Service Period". Below the timeline, four key ages are marked: 25 (Age when hired), 40 (Present age), 62 (Assumed age at retirement), and 80 (Life Expectancy).

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### Financial Reporting Objectives of Statement 45

- Recognize OPEB cost (expense) systematically over periods approximating employees' years of service\*
- Provide relevant information about:
  - Actuarial accrued liabilities for promised benefits associated with past service
  - The annual cost of OPEB —and its effect on the total cost of government services
  - The progress made in funding the plan

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### OPEB Subsidies

- **Two types of OPEB subsidies that create an OPEB obligation:**
  - **Explicit or Direct-Employer covers a portion of the retiree premiums.**
  - **Implicit- An employer permits retirees to participate in the same group as active employees by paying the blended premium results in a real cost to the employer**

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### Implicit Rate Subsidies

- **Almost all governments in Florida have at least an implicit OPEB liability. Florida Statutes 112.0801 states**
  - **Retirees must be given access to the group healthcare policy**
  - **Retirees must be comingled with active employees in calculating the premium.**
    - For example, if claims costs are \$6,000 per retiree, and the retiree pays a blended premium of \$3,600, the employer generally pays the difference, or \$2,400 per retiree
- **This is a function of the significant effect of age on claims costs (that is, claims costs for retirees in a combined group generally will be significantly higher than claims costs for active employees in the group)**

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### Example Sole Employer: Expense and Liability Recognition

- **Year one (for most employers):**
  - **Beginning F/S liability ("net OPEB obligation") is zero, based on prospective implementation provision of Statement 45**
  - **Expense (annual OPEB cost) = ARC (normal cost + an amount to amortize the total UAAL over a period not to exceed 30 years)**
  - **Expense – amount actually contributed = net OPEB obligation at end of year**
- **Year two (if a beginning net OPEB obligation):**
  - **Expense (annual OPEB cost) = ARC + interest on beginning net OPEB obligation – an "ARC adjustment" to prevent double accrual of previous contribution shortfalls and keep accounting and actuarial funding calculations in synch**
  - **Expense – amount actually contributed = addition to the net OPEB obligation**

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### What Do the ARC and the Net OPEB Obligation Tell a Reader of the Financial Report?

- The ARC expressed as a % of covered payroll represents the level of employer contribution that would be needed on a sustained, consistent basis to cover normal cost and amortize the UAAL over not more than 30 years:
  - An indicator of the “size” of the employer’s commitment
  - An indicator of potential long-term demands on future cash flows
- The net OPEB obligation indicates whether since implementation of Statement 45 an employer has contributed less (more) than the ARC

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### Funded Status Information: Illustration (Two Employers)

- Information Disclosed in Notes to Financial Statements and Presented in RSI

	Govt. A Unfunded (PAYGO)	Govt. B Partially Funded
Actuarial accrued liabilities (AAL) (a)	\$ 13,500,000	\$ 13,500,000
Actuarial value of plan assets (b)	-	9,000,000
<b>Unfunded actuarial accrued liabilities (UAAL) (a-b)</b>	<b>13,500,000</b>	<b>4,500,000</b>
<b>Funded ratio (b/a)</b>	<b>0.0%</b>	<b>66.7%</b>
Covered payroll (c)	\$ 6,000,000	\$ 6,000,000
<b>UAAL as a % of covered payroll (a-b/c)</b>	<b>225.0%</b>	<b>75.0%</b>

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### What Does the UAAL Tell Me as a Reader of the Financial Report?

- The UAAL is the portion of the present value of projected benefits attributed to past periods
- It’s a measure of the value of employee services that were received by the employer and tax/rate payers or constituents in past periods but not paid or funded
- Other things being equal, the higher the UAAL, the higher will be the following going forward:
  - Amortization component of the ARC
  - The ARC
  - Annual OPEB cost, or expense
  - Demands on future cash flows, or budgets

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### Note Disclosure of Actual Employer Contributions as a Percentage of Annual OPEB Cost

- A key factor affecting the funded status of the benefits is the level of employer contributions
- Accordingly, employers also should disclose for each of the past three years:
  - The annual OPEB cost (\$895,000 and \$911,500 in Years 1 and 2 of the illustration)
  - The percentage of annual OPEB cost actually contributed (27.5% and 27.4% in Years 1 and 2 of the illustration)
  - The ending net OPEB obligation (\$650,000 and \$1,311,500 at the end of Years 1 and 2 of the illustration)

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### To Summarize Reporting

- Some key elements of information that Statement 45 requires a sole or agent employer to report
- On the face of all accrual-basis financial statements (government-wide, proprietary fund, and fiduciary fund)—
  - Expense equal to annual OPEB cost
  - Net OPEB obligation
- In the notes to financial statements—
  - Annual OPEB cost and its components, amount actually contributed, and change in net OPEB obligation
  - Funded status of the plan (including UAAL and funded ratio)
  - Annual OPEB cost and percentage actually contributed
  - Disclosure of key methods and assumptions
- In required supplementary information (RSI)—multi-year schedule of funding progress, with notes regarding any changes affecting users' interpretation of trends

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### Potential Problem Areas

- Plan provisions
- Demographic Information
- Actuarial assumptions
- Employer contributions

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### Plan Provisions and Demographics

- **Plan provisions- Need to be consistent with the District Plan in place.**
- **Demographics-Need an accurate count of employees and retirees. Demographic projections are also used. Are they reasonable for district?**

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### Actuarial Assumptions

- **Main actuarial assumptions**
  - **Healthcare rate trend**
  - **Retirement Age**
    - What is your district experiencing?
  - **Discount rate-long term investment return of the district. General range as follows:**
    - Funded - 7% to 8%
    - Unfunded - 4% to 5%
  - **Termination rate**
  - **Mortality/Disability rate**
  - **Payroll growth**
  - **Participation rate**
    - Who will use benefit-what has district experienced?

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### Employer Contributions

- **An employer contribution includes:**
  - **Payments made directly to or on behalf of a retiree**
  - **Premium payments to an insurer.**
  - **Irrevocably transferred assets to a qualifying trust**

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### Contribution Example-Fully Insured Plan

- **Components of employer contributions are:**
  - **Age adjusted premium payments to an insurer for retirees and their dependents- Actuary provides**
  - **Less- Retiree premiums paid to employer.- District records.**

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### Contribution Example-Self Insured Plan

- **Employer payments of self-insured health claims directly to or on behalf of retiree.-TPA**
- **Plus-Employer payments of Stop-loss premiums.**
- **Plus-Administration costs.**
- **Minus-Stop loss reimbursements**
- **Minus-Retiree premiums paid to employer.**

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### Separate Accounting for Active-Employee and Retiree Healthcare Benefits When Both Provided through Same Plan (continued)

- **Answer: Active and retiree benefits should be accounted for separately, under GASB 10 and GASB 45, respectively**
  - **Employer's share of the current coverage cost for each group should be calculated based on the claims costs, or age-adjusted premiums, for that group**
    - **Employer's share for retiree benefits is the difference between claims costs or age-adjusted premiums for retirees and the amount contributed by retirees (i.e., it includes implicit rate subsidies)**
    - **Possible exception: community rated plan may qualify to use unadjusted rates**
    - **Employer's share of current-year cost for retiree coverage—determined in that manner—establishes the relevant starting point, or basis, for the actuarial projection of benefits for financial accounting purposes**

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**Example**

- **Single-employer plan**
- **500 plan members:**
  - **400 actives**
  - **100 retirees**
- **Employer's policy is to allow retirees to continue participating in healthcare group with actives at the blended premium rate**
- **Employer pays blended rate for each active employee**
- **Retirees pay blended premium rate for their coverage**

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**Example (continued)**

- **Blended premium rate = \$2,880 / member**
- **Total premiums for group = \$1,440,000**
- **Contributions at blended rates:**

	400 Active Employees	100 Retirees	Total
Total blended premiums	\$ 1,152,000	\$ 288,000	\$ 1,440,000
Less: Member contributions	-	288,000	288,000
Employer contributions	\$ 1,152,000	\$ -	\$ 1,152,000

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**Example (continued)**

- **Total premiums for group = \$1,440,000**
- **Age-adjusted premiums (determined by actuary):**
  - **Retirees: \$4,810 / retired member**
  - **Actives: \$2,397.50 / active member**

	400 Active Employees	100 Retirees	Total
Total age-adjusted premiums	\$ 959,000	\$ 481,000	\$ 1,440,000
Less: Member contributions	-	288,000	288,000
Employer contributions	\$ 959,000	\$ 193,000	\$ 1,152,000

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**Example (continued)**

- Note that the employer's nominal contribution for active-employee benefits (\$1,152,000) exceeds the actual cost of providing coverage to active employees (\$959,000) by \$193,000
- The \$193,000, therefore, has nothing to do with insuring active employees but reflects the increase in blended rates as a result of the inclusion of retirees in the group
- The \$193,000 is an actual cash contribution by the employer toward the cost of covering retirees in the plan for the current year

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**How to Record the Annual Activity for OPEB?**

- Measure the ARC (or annual OPEB cost)
- Measure current year payments
- Record the difference
  - Governmental activities by function
  - Proprietary Funds by Fund
  - Fiduciary Funds by Fund
- Payments can come from employer's records, or the actuary. But the amount needs to include the implicit rule subsidy.
- Any reasonable allocation method can be used.

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**What questions do you have?**

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# SAS 115

## Communication of Internal Control Matters

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### SAS 115 Communication of Internal Control Matters

- **Effective for periods ending on or after December 15, 2009. Early Implementation permitted (Required for fiscal 2010 audits)**
- **Amends and supersedes SAS 112.**
- **Modifies the definitions of material weaknesses and significant deficiencies to conform to the PCAOB standard.**
- **Provides more guidance on the determination as to whether a deficiency is a material weakness or significant deficiency. More professional judgment.**

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### Control Deficiency

- **A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.**
- **A deficiency in design exists when a control necessary to meet the control objective is missing; or an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met.**
- **A deficiency in operation exists when a properly designed control does not operate as designed; or the person performing the control does not possess the necessary authority or competence to perform the control effectively.**

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### Material Weakness

- A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected on a timely basis.

**Note:** There is a reasonable possibility of an event, as used in this Statement, when the likelihood of the event is either "reasonably possible" or "probable," as those terms are used in Financial Accounting Standards Board Statement No. 5, Accounting for Contingencies

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### The Significant Deficiency

- Definition of significant deficiency – “A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.”
- Removes “more than a remote likelihood” which gives the auditor more professional judgment

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### Deficiencies

- As with SAS 112, nothing is an automatic material weakness or significant deficiency
- Professional judgment must be applied.
- Indicators of a material weakness include:
  - Fraud by senior management
  - Restatement of previously issued financial statements for a material error or fraud.
  - Auditor found material adjustments that would not have been detected by control procedures.
  - Ineffective oversight of financial reporting and internal controls by those charged with governance.

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### Deficiency Severity

- **Depends on:**
  - The magnitude of potential misstatement, and
  - Whether there is a reasonable possibility that the controls will fail to prevent, or detect and correct a misstatement.
  - Can consider compensating controls to limit severity but does not eliminate deficiency.
  - Does not depend on whether a misstatement occurred.

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### Reporting under SAS 115

- **Still required to communicate in writing significant deficiencies and material weaknesses.**
- **Revise some wording related to the auditors consideration of internal control and the definition of material weakness**

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# What questions do you have?

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## GASB 51

### Accounting and Financial Reporting for Intangible Assets

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### GASB 51 - Reasons for Issuance

- **Reduce inconsistencies in accounting and reporting**
- **Establish guidance for internally generated intangible assets**

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### GASB 51 - Effective Date

- **Periods beginning after June 15, 2009**
- **Provisions applied retroactively**
  - **Required for Phase I and II**
  - **Encouraged but not required for Phase III**
  - **Permitted but not required for intangible assets that are internally generated or have indefinite useful lives**

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### GASB 51 - What Is An Intangible Asset?

1. **Lack of physical substance**
2. **Nonfinancial in nature**
3. **Useful life beyond one year**

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### GASB 51 - Exceptions to the Standard

- **Does not apply to:**
  - **Intangibles acquired or created primarily for income or profit**
  - **Capital lease transactions**
  - **Goodwill**

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### GASB 51 - Examples of Intangible Assets

- **Easements (right-of-way, permissive, restrictive)**
- **Computer software**
- **Land use rights (water, timber, mineral, air rights)**
- **Patents, trademarks, copyrights**
- **Licenses, permits and other rights**

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Work Request No. 3099838

**EASEMENT**

This Instrument Prepared By

Sec. 24, Twp 29 S, Rge 36 E Name: Casey Sheffield

Parcel I.D. 29-36-24-00-00001.0 Co. Name: Florida Power & Light Company

(Maintained by County Appraiser) Address: 9001 Ellis Rd.

Form 3722 (Stocked) Rev. 7/94 Melbourne, FL pg. 1 of 3

The undersigned, in consideration of the payment of \$1.00 and other good and valuable consideration, the adequacy and receipt of which is hereby acknowledged, grant and give to Florida Power & Light Company, its licensees, agents, successors, and assigns, an easement forever for the construction, operation and maintenance of overhead and underground electric utility facilities (including wires, poles, guys, cables, conduits and appurtenant equipment) to be installed from time to time; with the right to reconstruct, improve, add to, enlarge, change the voltage, as well as, the size of and remove such facilities or any of them within an easement 10 feet in width described as follows:

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### GASB 51 – Software Internally Generated

- **Software is considered internally generated if developed:**
  - **In-house**
  - **By a third party contractor**
  - **Purchased commercial software that is modified using more than minimal incremental effort before being placed in operations**

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### GASB 51 – Stages in Internally Generated Computer Software

- **Preliminary project stage**      ➤ **Expense**
- **Application development stage**      ➤ **Capitalize**
- **Post-implementation / Operation stage**      ➤ **Expense**

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### GASB 51 – Modification of Computer Software

- **Outlays should be capitalized if modification result in ANY of the following:**
  - **Increase in functionality**
  - **Increase in efficiency**
  - **Extension of the estimated useful life**

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### GASB 51 - Amortization

- Life may be limited by contract, law or regulation
- Renewal period should be considered
- Intangible asset with indefinite useful life should not be amortized

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### GASB 51 - Accounting and Financial Reporting

- Existing capital asset authoritative guidance applies
  - Recognition and measurement
- Intangibles are a separate class of capital assets
  - May need to further classify based on nature and usage

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### GASB 51 - Your Action Plan for Implementation

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_

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## Accounting For Capital Assets

*A Guide for State and Local Governments*



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## Management of Capital Asset System

- Control, stewardship
- Maintenance
- Replacement
- Insurance
- Cost recovery and rate setting
- Financial reporting



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## Capital Assets – System Maintenance Challenges

- Inadequate design and/or scope
- Overburdening – collection of too much information
- Inability to sustain ongoing maintenance of the capital asset system

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### Accounting Challenges . . . An example

A new school is built with an estimated useful life of 50 years.

The roof is replaced within 25 years. How would your district account for the cost of the new roof – as an improvement or repairs and maintenance?

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### Improvements vs Repairs and Maintenance

- Improvement provides additional value, such as :
  - Lengthening estimated useful life
  - Increasing ability to provide service
- Repair and maintenance retains value rather than providing additional value

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## GFOA

### Recommend Practices



Government Finance Officers Association

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**GFOA Recommended Practices**

- **Body of recommended practices in functional areas of public finance**
- **A source of sound guidance on financial management practices**

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**Categories of Recommended Practices**

- **Accounting, auditing and financial reporting**
- **Budgeting and fiscal policy**
- **Debt management**
- **Economic development and capital planning**
- **Retirement and benefit administration**
- **Treasury and investment management**

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**Recommended Practices**

1. **Web site presentation of official financial documents**
2. **Considerations for prefunding OPEB obligations**
3. **Risk management**
4. **Public participation in planning, budgeting and performance management**

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**Recommended Practices**

5. Bank account fraud prevention
6. Use of lockbox services
7. Use of local government investment pools
8. Pricing bonds in a negotiated sale

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**Recommended Practices**

9. Role of the finance officer in privatization
10. Enhancing management involvement with internal control
11. Communicating health-care benefits to employees and retirees
12. Strategic health-care plan design

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**What questions  
do you have?**

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**GASB 51 - Your Action Plan**

- 1. Identify and compile list of intangible assets that meets GASB 51 reporting requirements**
- 2. Determine reporting threshold for intangible capital assets**
- 3. Modify capital assets policies and procedures**
- 4. Record intangible assets**



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## Government GAAP Update Quiz

### 1. The following are true

- (a) There are 56 GASB Statements
- (b) GASB 51 and GASB 53 have required implementation in fiscal 2010
- (c) GASB 54 has required implementation in fiscal 2011
- (d) All of the above

### 2. Accounting pronouncements possibly required to be implemented in fiscal 2009 include

- (a) GASB 49, Pollution Remediation Obligations
- (b) GASB 52, Real Estate Investments
- (c) GASB 43 and 45, OPEB, for Phase II governments
- (d) All of the above

### 3. GASB 49, Pollution Remediation Obligations

- (a) Does not apply to landfills and power plant decommissioning
- (b) Requires restatement of net assets, if applicable
- (c) Is applicable if an entity legally obligates itself to begin clean up that is legally required
- (d) All of the above

### 4. Government Accounting Principles

- (a) Require estimated claims and judgments to be accrued in governmental funds
- (b) Refer to the Blue Book as Level 1 authoritative literature
- (c) Are defined in GASB Statement 55
- (d) Are International Public Sector Accounting Standards

### 5. Under current standards, restricted net assets for governmental funds

- (a) Should always be presented as reserved fund balance in individual funds
- (b) Need only be presented as reserved in individual funds if the restriction is more limited than the purpose of the fund as a whole
- (c) Should be reported as restricted net assets on the entity-wide financial statements
- (d) Both b and c

### 6. Restricted assets

- (a) Include designations made by the governing board
- (b) Are limited to external restrictions, such as statutes, contracts and grant agreements
- (c) Should be reported as such on all financial statements
- (d) Are subject to penalty if acquired

### 7. Capitalized interest

- (a) Applies only to enterprise funds
- (b) Applies to enterprise funds and government activities on entity wide financial statements
- (c) Is more significant than normal interest
- (d) Must be expensed in the current period

## Government GAAP Update Quiz (continued)

### 8. Capitalized interest

- (a) Is capitalized based on the weighted average of accumulated expenditures if tax exempt debt was not issued specifically for the project
- (b) Is capitalized based on the interest incurred on tax exempt debt outstanding, less interest income on unspent proceeds, to the extent tax exempt debt was specifically issued for the project
- (c) Is capitalized under FASB 34 or 62, depending on whether tax exempt debt was specifically issued for the project
- (d) All of the above

### 9. GASB 52, Real Estate Investments

- (a) Requires all endowments to record real estate at cost
- (b) Requires endowments to record real estate at fair value if legal limitations imposed externally
- (c) Is an exposure draft under consideration
- (d) All of the above

### 10. Restricted assets need to be separately presented

- (a) On each fund level financial statement
- (b) When the restrictions change the nature or normal understanding of the availability of the asset
- (c) On both fund level and entity wide financial statements
- (d) Both a and c

### 11. GASB 49 pollution remediation obligations are recorded when

- (a) A regulator has identified that the entity is responsible for fixing the problem
- (b) The entity is identified in a lawsuit that requires the clean-up or a pollution permit has been violated
- (c) There is imminent danger to the public and there is little discretion to fix the problem
- (d) All of the above

### 12. GASB 54, Fund Balance Reporting and Government Fund Type Definitions

- (a) Relates only to governmental fund types and does not affect government wide statements
- (b) Fund balance may include nonspendable, restricted, committed, assigned and unassigned
- (c) The general fund is the only fund that should report a positive unassigned fund balance
- (d) All of the above

### 13. GASB 54, Fund Balance Reporting and Government Fund Type Definitions

- (a) Removes the reserved component of fund balance in favor of a restricted classification
- (b) Is applicable in fiscal 2011
- (c) Eliminates ability to record an amount as restricted in one fund and unrestricted in another
- (d) All of the above

## Government GAAP Update Quiz (continued)

### 14. FASB Fair Value Accounting Standards

- (a) Are required to be implemented by all government entities
- (b) Provide guidance that can be useful in establishing fair values for government entities
- (c) Include level 1, 2 and 3 disclosure requirements applicable to government entities
- (d) Are very clear and have been widely accepted without controversy

### 15. GASB 45 OPEB contributions

- (a) Include pay as you go payments of the current period
- (b) Include amounts paid into a legally separate trust, in addition to pay as you go payments
- (c) Include implicit contributions for insurance premiums related to retirees
- (d) All of the above

### 16. GASB 43 and 45 OPEB standards

- (a) Require an actuarial valuation at least biennially if more than 200 people in the plan
- (b) Require an actuarial valuation each year if less than 200 people in the plan
- (c) Require an obligation to be reported in government funds for short-term portion
- (d) All of the above

### 17. OPEB trust funds are presented

- (a) When GASB 43 and 45 are required to be adopted
- (b) When OPEB contributions are made
- (c) When contributions are made to a legally separate trust account
- (d) When pension trust funds are presented

### 18. OPEB liabilities are presented

- (a) For the amount of unfunded annually required contributions
- (b) For the amount of estimated unfunded obligations
- (c) At the governmental fund level if a trust fund is presented and on accrual basis financial statements if no trust fund is presented
- (d) Both a and c

### 19. GASB 51, Intangible Assets

- (a) Requires intangible assets to be categorized with capital assets
- (b) Requires presentation as an other asset
- (c) Requires retroactive restatement of all indefinitely lived intangible assets
- (d) Was designed to address assets that could be physically identified

### 20. GASB 51, Intangible Assets

- (a) Requires the intangible asset to be identifiable
- (b) Requires retroactive restatement for intangible assets with limited lives
- (c) Does not require restatement of intangible assets with indefinite lives
- (d) All of the above

## How Well Does Your School District Account for Capital Assets?

	<i>Needs Improvement</i>				<i>Excellent</i>
	1	2	3	4	5
<b><u>Capital asset management system:</u></b>					
1. Meets the school district's needs for information	_____	_____	_____	_____	_____
2. Is not overburdened	_____	_____	_____	_____	_____
3. Is adequately maintained	_____	_____	_____	_____	_____
<b><u>Capital asset policy and procedures:</u></b>					
4. Are complete, accurate and clear	_____	_____	_____	_____	_____
5. Have been recently reviewed and updated	_____	_____	_____	_____	_____
6. Are consistent with GAAP and applicable laws and regulations	_____	_____	_____	_____	_____
7. Defines what is considered a repair versus an improvement/betterment	_____	_____	_____	_____	_____
8. Includes strong internal controls including reconciliation procedures	_____	_____	_____	_____	_____
9. Are consistently followed	_____	_____	_____	_____	_____
<b><u>Financial reporting:</u></b>					
10. Capital assets reported in financial statements are reconciled to the subsidiary records	_____	_____	_____	_____	_____
11. No control deficiencies have been identified in recent audits	_____	_____	_____	_____	_____
<b>Total Score:</b>					_____



## RECOMMENDED PRACTICE

### Web Site Presentation of Official Financial Documents (2009) (ALL)

**Background.** The Government Finance Officers Association (GFOA) has long encouraged governments to demonstrate accountability and transparency by making financial information of the highest quality readily accessible to citizens and other interested parties. A government's web site is especially well suited for this purpose. Benefits of using the government's web site to communicate financial information include:

- **Heightened awareness.** Many potential users of a government's financial information may only discover that it is available because they find it on the web site.
- **Universal accessibility.** Information furnished on a web site is readily available to a wide range of potential users (e.g., citizens, rating agencies, regulatory agencies, other governments, and the press) without charge.
- **Increased potential for interaction with users.** A web site can offer two-way, multi-conversational, or interactive formats. This capacity may be especially helpful for proposed documents or for citizen surveys.
- **Enhanced diversity.** A web site may offer the possibility of providing the same financial information in a variety of languages, which may be needed pursuant to the policies of a particular governmental entity.
- **Facilitated analysis.** Computerized tools can be used to find, extract, and analyze data presented in electronic form.
- **Increased efficiency.** Presenting all financial information in a single location can help to avoid calls for redundant specialized reports (e.g., reproducing data already presented in the comprehensive annual financial report or the budget document).
- **Lowered costs.** Electronic publication can be accomplished relatively quickly and can reduce or eliminate many of the costs associated with producing a hardcopy report, including those associated with handling and mailing the reports.
- **Contribution to sustainability.** Using a web site to disseminate financial information may reduce paper consumption, thereby contributing to the core value of sustainability.
- **Broadened potential scope.** The use of hyperlinks allows for easy referencing of relevant information from other sites.

While posting financial documents on a web site is a tremendous resource to citizens and an important investor relations tool, governments should be reminded that it does not meet the continuing disclosure responsibilities for issuers of municipal debt set forth in Securities and Exchange Commission Rule 15c2-12.<sup>1</sup>

**Recommendation.** The GFOA encourages every government to use its web site as a primary means of communicating financial information to citizens and other interested parties. Furthermore, the GFOA recommends that a government comply with the following guidelines when presenting official financial documents on its web site:

**Formatting.** The practical usefulness of a document is enhanced when a government observes the following formatting conventions:

- **Consistency with hardcopy version (if any).** If a document is issued in hardcopy form, the web site version should be identical.<sup>2</sup> Any subsequent changes should be made to both.

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<sup>1</sup> Governments with public debt outstanding are urged to consult GFOA's recommended practice *Using a Web Site for Disclosure*. Issuers of public debt also should familiarize themselves with SEC's Interpretive Release on the "Use of Electronic Media" (see [www.sec.gov/rules/interp/34-42728.htm](http://www.sec.gov/rules/interp/34-42728.htm)).

- **Legibility.** Font size, page layout (i.e., portrait versus landscape), and direction should be consistent throughout the report.
- **Pagination.** Pages should be numbered sequentially.
- **File size.** A single electronic file should be presented for the entire document. Individual files for the various components of large reports might also be presented in view of the limitations that some users face when attempting to download or receive large files. In such situations, the number of individual files should not be so great as to make it difficult to review the material or relate the various sections to one another.

**Technological Infrastructure.** A number of issues related to a government’s technological infrastructure should be considered when presenting financial documents on the government’s web site:

- **Security.** The security of the web site should be evaluated and all reasonable steps should be taken to protect documents from unauthorized changes.
- **Placement.** A link to the document should appear prominently on the homepage or there should be some other tool for easily locating the document (e.g., internal search tool).
- **Software compatibility.** The software used should be suitable for the particular information being presented and be broadly compatible with other commonly used software.
- **Features.** The downloaded file should allow for basic features such as zooming and continuous page format (e.g., so rows on financial schedules can be viewed on facing pages). A search mechanism should also be available within the document.
- **Instructions.** General user instructions (e.g., how to download Adobe software) should be provided. A notation also may be needed to direct the user on how best to view the document (e.g., laptop or desktop computer versus a handheld device).
- **Linking.** The table of contents should allow the user to go to specific pages with a click of the mouse. The inclusion of bookmarks also can enhance flexibility and maneuverability in navigating the document.
- **Testing.** Web site-based financial documents should be tested to ensure that they will function with different computer operating systems.

**Electronic financial reporting language.** Governments should monitor developments in standardized electronic financial reporting (e.g., extensible business reporting language [XBRL]) and apply that language to their electronic document process when appropriate.

**Distribution.** Electronic publication can also help the government meet the objective of providing financial information on a timely basis. Once published electronically, potential users should be informed that financial documents are available at the web site. Local newspapers, cable television, council meetings, mailings, and the printed document itself (if prepared) can be used for this purpose. For users without access to the Internet, other electronic media (e.g., CDs or flash drives) should be made available at locations such as local libraries or the city hall. Before electronic publication, the government should consult with their counsel to ensure that any legal issues related to the distribution of the financial information have been appropriately addressed, including compliance with all applicable provincial, state and federal laws and regulations (e.g., American Disabilities Act).

**Information disclaimer.** If applicable, the web site should prominently notify users that the information in the financial document has not been updated for developments subsequent to its issuance.

**Historical information.** If a government elects to present documents of prior years, the web site should identify those documents as “dated information for historical reference only” and clearly segregate them from current information. A “library” or “archive” section of the web site is advisable for this purpose.

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<sup>2</sup> However, slight variations that may be necessary for practical reasons to prepare the hardcopy information for publication as an electronic document are acceptable. In cases where there is some type of auditor association with a document, it can be helpful to reach an upfront agreement with the auditor on the nature of the revisions that are acceptable in the preparation of the electronic document.

## **References.**

- GFOA Recommended Practices
  - Improving the Timeliness of Financial Reports (2008)
  - Using a Web Site for Disclosure (2002)
  - Sustainability (2002)
- *Extensible Business Reporting Language (XBRL) web site*, <http://www.xbrl.org/Home/>

Approved by the GFOA's Executive Board, February 27, 2009.