Governmental Accounting Conference

State Financial Services Division

April 27, 2016

Objectives

Training Topics:

- GAO Green Book – Internal Controls
- Federal Grant Regulations
- Ethics
- GASB Updates

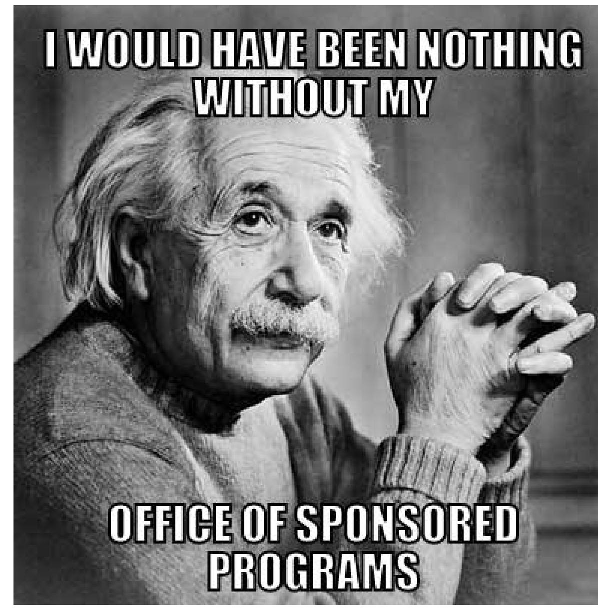
Working with MUS Institutions of Higher Education (IHE)

MONTANA STATE UNIVERSITY

UNIVERSITY OF MONTANA

Offices of Sponsored Programs: UM and MSU

- Assigned by academic departments
- Authorized Institutional Officials
  - Signature authorities – official authorized to legally bind (2 CFR 200.415)
- Administer funds that significantly contribute to economic impact of State and region



MSU Office of Sponsored Programs (OSP)

- ~350 active researchers
- Submits ~1,000 proposals / year
- Manages ~$100 M in research expenditures
- Approximately $9 M of that supports students
- Pre/post staff of 16 FTE
- Research includes precision agriculture, mental health, rural highways, Shakespeare in the Parks, childcare in MT

UM Office of Research & Sponsored Programs (ORSP)

- ~350 active researchers
- Submits ~600 proposals / year
- Manages ~$64 M in research expenditures
- Approximately $4 M of that supports students
- Pre/post staff of 14 FTE
- Research includes biomedical sciences, environmental sciences, social and behavioral issues, disabilities

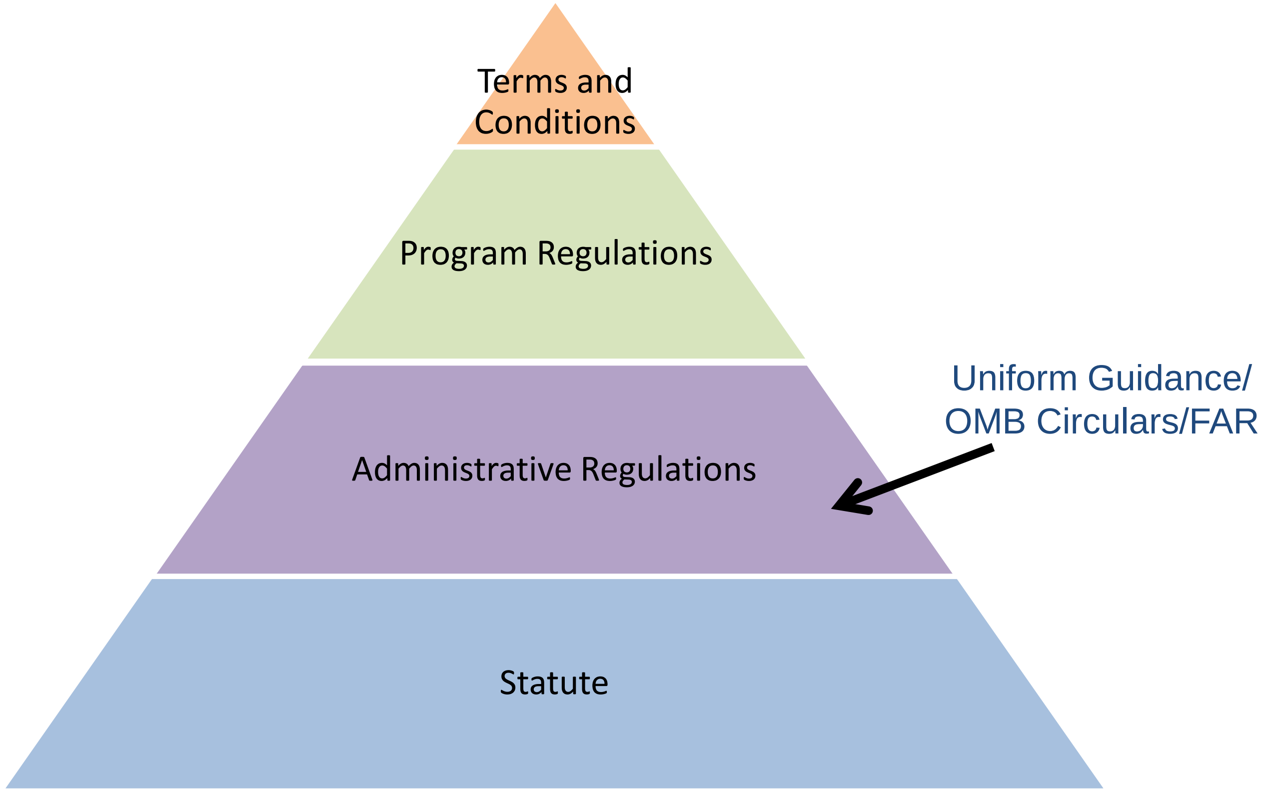
Staff Training and Development

- National Council of University Research Administrators (NCURA)
  - www.ncura.edu
  - www.youtube.org
    - NCURA1959
- Federal Demonstration Partnership
  - www.thefdp.gov
- Council on Governmental Relations
  - www.cogr.gov
- Society of Research Administrators International (SRA)
  - www.srainternational.org

Rules & Regulations: Sponsor, University, State, Federal

- Follow terms and conditions of award
- Meet sponsor requirements
- Follow University policy
- Accountable to Montana Board of Regents
  - BOR 404
  - Reimburses institutions for expenses incurred
- IHEs part of State of Montana
  - Regularly audited by Legislative Audit Division (LAD) for A-133 compliance

Order of Precedence



Issuing Funds to IHEs

- State funds vs. federal flow-through funds
- Period of performance vs. date of last signature
- Beginning work without fully-executed agreement
- Other areas
  - Type of activity: research, instruction, other
  - Fixed price vs. cost reimbursable
  - Allowable direct costs and F&A at the appropriate rate/base
  - Intellectual property
- Streamline/standardize (agreements, budget modification requests, reporting, invoicing, other)?

Council on Financial Assistance Reform (COFAR)

https://cfo.gov/cofar/

- Created in 2011
- Lead the crafting of the OMB Uniform Guidance (UG)
- Continues to lead efforts to improve policies and practices related to federal grants and cooperative agreements.
- UG replaces eight OMB Circulars
- COFAR UG https://cfo.gov/cofar/uniform-guidance/
  - FAQs
  - Training information

- **A-21** Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions
- **A-50** Audit Follow-Up
- **A-87** Cost Principles for State, Local, and Indian Tribal Governments
- **A-89** Federal Domestic Assistance Program Information
- **A-102** Grants and Cooperative Agreements with State and Local Governments (Administrative Procedures)
- **A-110** Uniform Administrative Requirements for Grants and Other Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations
- **A-122** Cost Principles for Nonprofit Organizations
- **A-133** Audits of States, Local Governments, and Nonprofit Organizations (2009 Compliance Supplement and Addendum)

Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (UG)

2 CFR 200 www.ecfr.gov (includes Corrections & FAQs)
Effective December 26, 2014

- Subpart A – Acronyms and Definitions | 200.0-200.99
- Subpart B – General Provisions | 200.100-200.199
- Subpart C – Pre-Federal Award Requirements and Contents of Federal Awards | 200.200-200.299 (information mostly for Federal sponsors)
- Subpart D – Post-Federal Award Requirements | 200.300-200.399 (formerly A-110)
- Subpart E – Cost Principles |200.400-200.499 (formerly A-21)
- Subpart F – Audit Requirements | 200.500-200.599

Objectives of Uniform Guidance

Streamline guidance for Federal awards to ease administrative burden
Strengthen oversight over Federal funds to reduce risks of waste, fraud, and abuse
Focus on performance over compliance to provide accountability for Federal funds
Encouraging efficient use of information technology and shared services

Subpart A – Acronyms and Definitions

- §200.00 Acronyms
  - IHE = Institutions of Higher Education (colleges and universities)
  - PTE = Pass-through Entity (prime awardee, i.e. a sponsor issues an award and if that awardee issues a subaward, they are a PTE)
  - FAIN = Federal Award Identification Number

- §200.1-200.99 Definitions
  - §200.13 Capital expenditures
  - .32 Data Universal Numbering System (DUNS) number
  - .68 Modified Total Direct Cost (MDTC)
  - . 99 Voluntary committed cost sharing

Highlight from Subpart A – Acronyms & Definitions:

§200.80 Program Income

- Gross income earned by the non-Federal entity as the result of the award
- Program income must be reported to the governments
- For IHE (unless otherwise specified), Program Income must be:
  - Added to funds committed to the project
  - Used to finance the non-Federal share of the project
  - Deducted from the total cost to determine net allowable costs

Highlights from Subpart C – Pre-Award Requirements:

§200.203 Notices of Funding Opportunities

- The Federal awarding agency must make funding opportunities available for at least 60 days, but can be less than 30 days under specific circumstances
- Must state whether there is required cost sharing or matching (the portion of the project costs not paid by Federal funds)
  - §200.306 "… voluntary committed cost sharing is not expected. It cannot be used as a factor during the merit review of applications or proposals."
- Risk assessment required now by sponsoring agency

§200.206 Pre-Award Activities

- Budget preparation
- Forms (§200.206)
- Debarment and suspension (§200.205(d))
- Certifications and representations (§200. 208)

Highlights from Subpart D – Post-Award Requirements:
§200.308 Revision of Budget & Program Plans

- Request prior approval required for:
  - Change in scope
  - Change in key personnel
  - The need for additional funding
  - Disengagement of PI from project for more than 3 months or 25% time reduction
  - Changes in the amount of cost sharing by non-Federal entity
- Agencies can waive cost related and administrative prior approvals (e.g., expanded authorities) for:
  - Pre-award costs (90 days prior to award)
  - One time 12 month no cost extension of time
  - Carry forward of balances
  - Budget Revisions

§200.301-337 Additional Post-Award Activities

- Financial and Program Management (§200.301-309)
- Property Standards (§200.310-316)
- Procurement Standards (§200.317 – 326)
- Performance and Financial Monitoring (§200.327 – 332)
- Record Retention and Access (§200.333 – 337)

- Basic expectation – written procedures for determining reasonableness, allocability and allowability of costs supported by strong internal controls.

§200.327-328 Reports

- Financial reports (§200.327)
  - Must use form SF 425 Federal Financial Report
  - Not to be required more frequently than quarterly nor less often than annually
- Performance reports (§200.328)
  - Research Performance Progress Report (RPPR) still acceptable
  - Required annually
  - Due 90 days after grant year (may be different if NSF/NIH)

§200.330 Subrecipient vs. Contractor

- A procurement action is the purchase of goods/services, but no intellectual contribution to the project (ie contractor)
- A subaward transfers a portion of a sponsored award to another entity for the purpose of programmatic effort on the project
- The new UG offers specific guidance on the difference between a subrecipient and a contractor (e.g., vendor)

Subrecipient vs. Contractor (Vendor)

- Subrecipient
  - Performance measured against whether the objectives of the federal program are met
  - Has responsibility for programmatic decision making
  - Has responsibility for adherence to applicable Federal program compliance requirements
- Contractor (Vendor)
  - Provides the goods and services within normal business operations
  - Provides similar goods or services to many different purchasers
  - Operates in a competitive environment
  - Not subject to compliance requirements

§200.331 Subrecipient Monitoring and Management

- Prime awardee acts in the role of the sponsor in reviewing the progress and financial activity of the award
- Subrecipient monitoring has been a requirement in past circulars, however it has been significantly strengthened in the UG.
- Evaluation of risk level associated with doing business with the subrecipient
- Pass-through F&A to Subrecipient per Sub's federal negotiated F&A Rate, or 10% de minimis (§200.331.a.4)

Highlights from Subpart E – Cost Principles:

§200.403 Documenting Expenses

- Concept of allowability (§200.403)
- Concept of direct benefit/reasonableness (§200.404)
- Concept of source documentation (§200.403(g))
- Receipts with enough details to support the charge
- Written explanation of how the expenses benefited the project (good internal control)

- Bottom line: Written documentation is necessary and offers protection during an audit

§200.413 Administrative Costs

- The salaries of administrative and clerical staff should normally be treated as indirect (F&A) costs. Direct charging may be appropriate only if all of the following conditions are met:
  1. Admin or clerical services are integral to the project
  2. Individuals involved can be specifically identified with the project or activity
  3. Such costs are explicitly included in the budget or have written approved of the Federal awarding agency
  4. The costs are not also recovered as indirect costs

§200.430(i) Standards for Documentation of Personnel Expenses

- Based on standards, not limited to prescribed methods.
- Comply with institutional policies, support multiple activities, encompass all activities, based on official records, reflect total activity (100%), estimates are OK if reasonable, but need to be reviewed and adjusted as necessary.
- It is recognized that teaching, research, service and administration are often inextricably intermingled in an academic setting. When recording salaries and wages charged to Federal awards for IHE’s, a precise assessment of factors that contribute to the costs is therefore not always feasible, nor is it expected.

§200.453 Computing Devices

- Computing devices under $5,000 = supplies
- Under the UG, are allowable if “essential and allocable, but not solely dedicated”
  - Included in budget as materials and supplies
  - Described in budget justification

Highlights from Subpart F:

Audit Requirements

- Fiscal years beginning after December 26, 2014, will be subject to a single audit under the UG, not A-133
- Awards prior to UG
  - If sponsor did not adopt and incorporate UG, these awards fall under prior circulars

Seven Appendices

- Appendix I – Full text of Notice of Funding Opportunity
- Appendix II – Contract Provisions for Non-Federal Entity Contracts Under Federal Awards
- Appendix III – Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Institutions of Higher Education (IHEs)*
- Appendix IV – Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Nonprofit Organizations
- Appendix V – State/Local Government and Indian Tribe-Wide Central Service Cost Allocation Plans*
- Appendix VI – Public Assistance Cost Allocation Plans
- Appendix VII – States and Local Government and Indian Tribe Indirect Cost Proposals

Appendix III – F&A Costs for IHEs

- The UG provides that “Federal awards bear their fair share of cost”
- Genesis of Federally-negotiated F&A rates
  - After WWII, US government strategically increased research activity; clearly, appropriate facilities and accompanying administrative infrastructure would be necessary
  - Recognized that universities and other entities across the nation already had laboratories and administrative components (accounts payable, human resources, etc.) in place
  - Decision made to outsource projects and reimburse for use of facilities and administrative processes
  - Equitable and justifiable mechanism required

Appendix V – State/Local Government and Indian Tribe-Wide Cost Allocation Plans

- Scope
- Documentation
- Certification
- Negotiation

Hot Topics

- Procurement standards
  - Proposed decrease of micro purchase threshold from $5 K to $3 K
  - Implementation delayed
- Other?

GAO Green Book Internal Controls

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Presentation Objectives

Participants will be able to:

- Describe the foundation for the Green Book (i.e., COSO framework).
- Define internal control per the Green Book.
- Explain the internal control framework (i.e., components of internal control, categories of objectives, & levels of organizational structure).
- Describe the 5 components & 17 principles of internal control.
- Explain the significance of control deficiencies.
- Describe the documentation requirements.
- Explain the limitations of internal control.

Green Book - 2014 Revision

- Effective beginning fiscal year 2016
- Management may elect early adoption

- Supersedes 1999 GAO/AIMD-00-21.3.1 *Standards for Internal Control in the Federal Government*

Standards for Internal Control in the Federal Government (the “Green Book”)

- Internal control system for federal agencies
- Framework for designing, implementing, & operating effective internal control system
- Help achieve entity’s operational, reporting, & compliance objectives

“The Green Book may be applied as a framework for an internal control system for state, local, & quasi-governmental entities, as well as not-for-profit organizations. If management elects to adopt the Green Book as criteria, management follows all relevant requirements presented in these standards.”

OV4.10

Internal Control - Integrated Framework
COSO 1994
COSO 2013

- Internal controls are essential for achieving entity's objectives
- Standard for implementing & evaluating internal control
- Evaluate compliance with SOX , AICPA auditing standards, & PCAOB Standards

Committee of Sponsoring Organizations (COSO) of the Treadway Commission

- American Accounting Association (AAA)
- American Institute of Certified Public Accountants (AICPA)
- Financial Executives International (FEI)
- Institute of Internal Auditors (IIA)
- Institute of Management Accountants (IMA)

Definition of Internal Control

Internal control is a *process*, effected by an entity's board of directors, management and other *personnel*, designed to provide *reasonable assurance* regarding the achievement of *objectives* relating to operations, reporting, and compliance.

(COSO Framework)

Internal control is a process

It's a means to an end, not the end itself

(COSO Framework)

IC is effected by people

- Not merely policy manuals & forms
- People at every level of an organization

(COSO Framework)

Internal Control

is a process effected by an entity's oversight body, management, & other personnel that provides reasonable assurance that the objectives of an entity will be achieved

- Is the objective identified?
- Are controls designed?
- Are controls in place?
- Objective is achieved

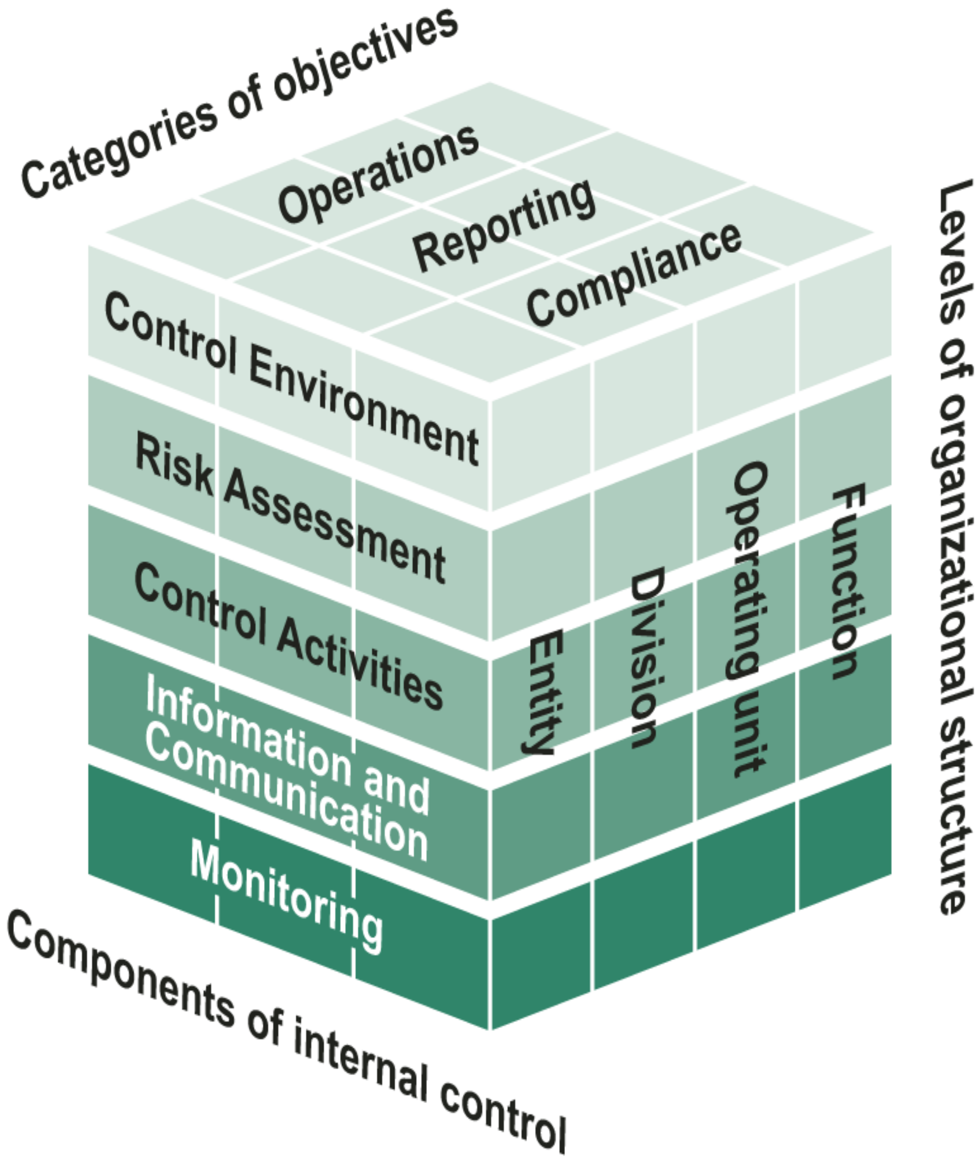
"Internal control helps managers achieve desired results through effective stewardship of public resources."

Green Book

“Internal control is a dynamic, iterative, & integrated process in which components impact the design, implementation, & operating effectiveness of each other. No two entities will have an identical internal control system because of differences in factors such as mission, regulatory environment, strategic plan, entity size, risk tolerance, & information technology, & the judgment needed in responding to these differing factors.”

OV2.13

Internal Control Framework



Sources: COSO and GAO. | GAO-14-704G

Categories of Objectives & Risks

- Operations - Effectiveness & efficiency of operations
- Reporting - Reliability of reporting for internal & external use
- Compliance - Compliance with applicable laws & regulations

Components of Internal Control

- All 5 components must be *present* and *functioning*
- Components supported by 17 principles
- Each principle has attributes that support its effectiveness

- Management is responsible for internal control

Components of Internal Control

- Control Environment
- Risk Assessment
- Control Activities
- Information & Communication Systems
- Monitoring

Control Environment

"The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization."

- *Foundation* for other components of internal control

http://www.coso.org

Control Environment Principles

- Oversight body & management demonstrate commitment to integrity & ethical values
- Oversight body oversees control system
- Management establishes structure, assigns responsibility, & delegates authority
- Commitment to competence (attract, develop, & retain employees)
- Individuals are held accountable for internal control responsibilities

(1) Control Environment Principle 1: Commitment to Integrity & Ethical Values

Attributes

- Tone at the Top
- Standards of Conduct
- Adherence to Standards of Conduct

(2) Control Environment Principle 2: Exercise Oversight Responsibility

Attributes

- Oversight Structure
- Oversight for the Internal Control System
- Input for Remediation of Deficiencies

(3) Control Environment Principle 3: Establish Structure, Responsibility, & Authority

Attributes

- Organizational Structure
- Assignment of Responsibility & Delegation of Authority
- Documentation of the Internal Control System

(4) Control Environment Principle 4: Demonstrate Commitment to Competence

Attributes

- Expectations of Competence
- Recruitment, Development, & Retention of Individuals
- Succession & Contingency Plans & Preparation

(5) Control Environment Principle 5: Enforce Accountability

Attributes

- Enforcement of Accountability
- Consideration of Excessive Pressures

Risk Assessment

"Involves a dynamic & iterative process for identifying and assessing risks to the achievement of objectives."

http://www.coso.org

Risk Assessment Principles

- Management specifies suitable objectives so risks can be identified
- Identifies, analyzes, & responds to risk
- Assesses fraud risk
- Identifies, analyzes, & responds to significant changes that could impact internal control system

(6) Risk Assessment Principle 1: Define Objectives & Risk Tolerances

Attributes

- Definitions of Objectives
- Definitions of Risk Tolerances

(7) Risk Assessment Principle 2: Identify, Analyze, & Respond to Risks

Attributes

- Identification of Risks
- Analysis of Risks
- Response to Risks

(8) Risk Assessment Principle 3: Assess Fraud Risk

Attributes

- Types of Fraud
- Fraud Risk Factors
- Response to Fraud Risks

(9) Risk Assessment Principle 4: Identify, Analyze, & Respond to Changes that Could Impact Internal Control System

Attributes

- Identification of Change
- Analysis of & Response to Change

Control Activities

"Actions established through *policies* and *procedures* that help ensure that management directives to mitigate risks to the achievement of objectives are carried out."

http://www.coso.org

Control Activities Principles

- Management selects & develops control activities to achieve objectives & respond to risks
- Select & develop general controls over information system
- Implement control activities through policies & procedures

(10) Control Activities Principles 1: Selects & Develops Control Activities To Achieve Objectives & Respond To Risks

Attributes

- Response to Objectives & Risks
- Design of Appropriate Types of Control Activities
- Design of Control Activities at Various Levels
- Segregation of Duties

(11) Control Activities Principles 2: Select & Develop General Controls Over Information System

Attributes

- Design of the Entity’s Information System
- Design of Appropriate Types of Control Activities
- Design of Information Technology Infrastructure
- Design of Security Management
- Design of Information Technology Acquisition, Development, & Maintenance

(12) Control Activities Principles 3: Implement Control Activities Through Policies & Procedures

Attributes

- Documentation of Responsibilities through Policies
- Periodic Review of Control Activities

Information & Communication

"Information is necessary for the entity to carry out internal control responsibilities to support the achievement of its objectives."

"Communication is the continual iterative process of providing, sharing, & obtaining necessary information."

(both internal & external)

http://www.coso.org

Information & Communication Principles

- Obtain/generate & use relevant, quality info to support functioning of entity's objectives
- Communicates internally to support functioning of entity's objectives
- Communicates externally regarding matters that affect functioning of entity's objectives

- Flow of information up, down, & across entity
- Communicate s "Tone at the top"

(13) Information & Communication Principles 1: Quality Info To Support Objectives

Attributes

- Identification of Information Requirements
- Relevant Data from Reliable Sources
- Data Processed into Quality Information

(14) Information & Communication Principles 2: Communicates Info Internally

Attributes

- Communication throughout the Entity
- Appropriate Methods of Communication

(15) Information & Communication Principles 3: Communicates Externally

Attributes

- Communication with External Parties
- Appropriate Methods of Communication

Monitoring

“Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of the 5 components of internal control, including controls to effect the principles within each component, is present & functioning.”

http://www.coso.org

Monitoring Principles

- Conducts ongoing and/or separate evaluations
  - components of internal control *present* & *functioning*
- Remediate internal control deficiencies in timely manner

(16) Monitoring Principles 1:
Conducts Ongoing &/or Separate Evaluations

Attributes

- Establishment of a Baseline
- Internal Control System Monitoring
- Evaluation of Results

(17) Monitoring Principles 2: Remediate Internal Control Deficiencies In Timely Manner

Attributes

- Reporting of Issues
- Evaluation of Issues
- Corrective Actions

Evaluation of Internal Control

- Federal Agency
- OMB guidance in OMB Circular No. A-123

- Nonfederal Entities
- Refer to applicable laws & regulations for guidance in preparing statements regarding internal control

Deficiency in Internal Control

Design, implementation, or operation of a control

- Does not allow management/personnel
- Normal course of performing assigned functions
- Achieve control objectives & address related risks

Significance of Identified Deficiencies

Relative importance of deficiency to entity's ability to achieve a defined objective

- Management evaluates
- Oversight body reviews

- Effect at both entity & transaction level
- Magnitude of impact
- Likelihood of occurrence
- Nature of deficiency

Documentation Requirements

- Rationale if any principle deemed not relevant
- Policies note internal control responsibilities of entity
- Ongoing monitoring & separate evaluations to identify issues
- Internal control issues noted & corrective actions
- Documentation on a timely basis

Cost-Benefit of Internal Control

- Management determines
- Must still meet control objectives

Limitations of internal control

- Suitability of objectives
- Mistakes (human error)
- Collusion
- Faulty or biased human judgment in decision making
- Top management override of controls
- External events beyond organizational control

Discussion

Thank You

2016 ETHICS UPDATE

Presented by Stefeni S. Freese, CPA
Shareholder, Anderson | ZurMuehlen
April 27, 2016

Meet Your Speaker

- *Stefeni S. Freese, CPA* is a shareholder in the Billings office of Anderson ZurMuehlen & Co., P.C. with twenty eight years of public accounting with an emphasis in the government, non-profit and employee benefit industries. She is a 1990 graduate of Montana State University.
- Stefeni performs peer reviews throughout the country and currently services as the Chairman of the MSCPA Peer Review Committee. She is a member of the Anderson ZurMuehlen Board of Directors and Vice-Chairman of the Boys and Girls Clubs of Yellowstone County.
- Stefeni has been married for 28 years and has two sons. She is a diehard Boston Red Sox fan and loves to read, cook, garden and travel.
- Contact Stefeni at: sfreese@azworld.com

Course Objectives

1. Review Professional Standards of the CPA Profession
2. Review recent changes to the professional standards and Montana Rules in the area of ethics
3. Focus on Integrity, Objectivity & Skills
4. Review recent developments in Ethics

Ethics

Well here we go again – Another Ethics Update!

Before you go there, consider –

- Reputation can be built or broken almost instantly in this age of increased transparency, government regulation and public scrutiny.
- Social media enables unhappy taxpayers, legislators, clients, customers, employees and competitors to reach a global audience instantly.

Ethics

- Perceived unethical performance can be a more powerful catalyst for reputation business damage than ever before and

  ✓ There is extreme difficulty and expense to restore a damaged reputation

2015 Regulatory Oversight

– The Employee Benefit Securities Administration (EBSA) under the DOL serves similar role as PCAOB under the SEC. Charged with, among other things:

  - Reviewing the work performed by independent qualified public accountants (IQPA)
  - Since 1-1-2013 EBSA has made 257 referrals to AICPA Ethics Division and 41 to licensing boards-

EBSA Monitoring and Assessment

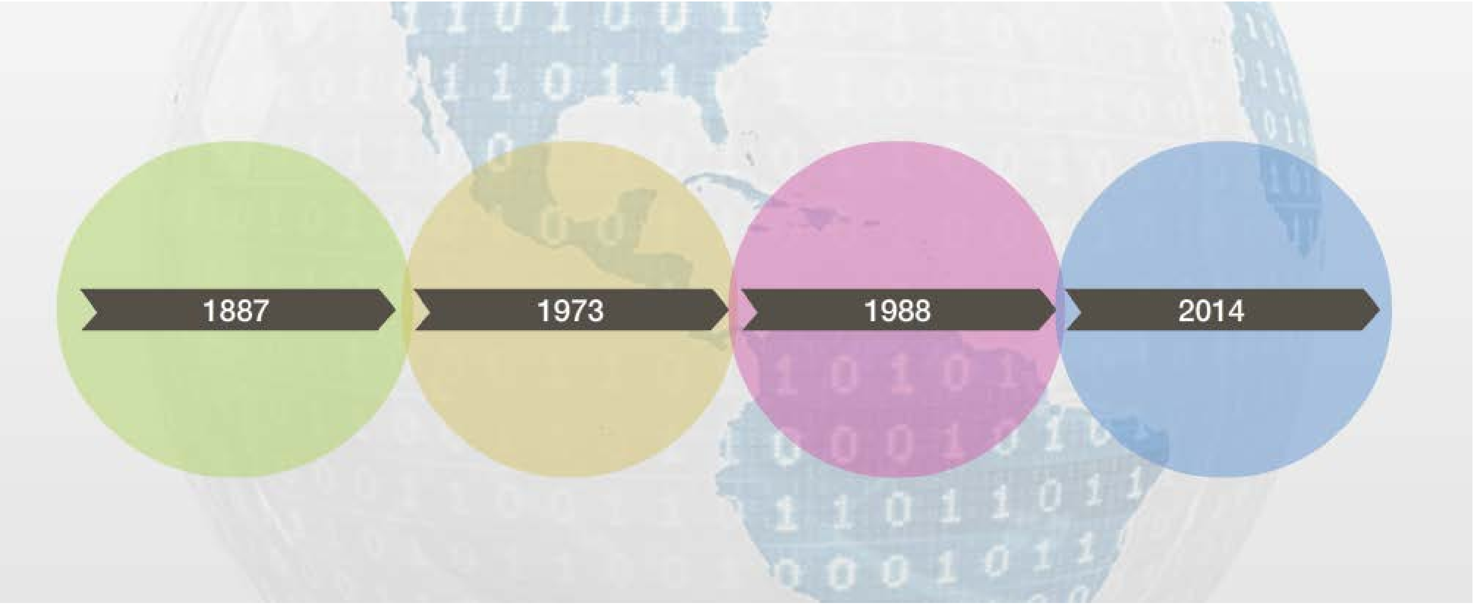
- EBSA noted deficiency rates:
  - Overall Deficiency Rate –
  - 2014- 39%
  - 2004- 33%
  - 1997- 19%
  - 1988- 23%
- Nearly 4 out of 10 had "Unacceptable Major Deficiencies"

ETHICS

When something is ethical it is in accordance with the accepted principles that govern the conduct of a group, especially of a profession.

American Heritage Dictionary, third ed.

Ethics in the Accounting Profession Timeline



1900's

- We began with 8 Ethics rules covering specific situations such as negligence in the preparation of financial statements, commissions and encroachment

- Over time, the AICPA developed and passed new rules, often to address what was deemed to be unprofessional behavior.

1900’s

- As the century wore on, the AIPCA Code and the federal securities laws were implemented, both of which focused heavily on auditor independence.

- Initially, authorities gave the profession broad scope to regulate itself-including in the audits of public companies. State accountancy boards regulated CPA’s and firms in their states.

1973

- AICPA adopted a new code of professional conduct, The Code.
- The Code had a preface that contained a Principles Section.
- The AIPCA based the code on a set of virtues or characteristics of a good CPA.
- Because many of the rules existed by then, the AICPA discerned the principles behind the rules, creating aspirational principles of conduct.


INTEGRITY
ETHICS
PRINCIPLES
ACCOUNTABILITY

1988

- The AICPA overhauled the code and the principles were expanded and updated

- Over time several other standard setters, government, banking and insurance regulators, and quasi- governmental regulators (PCAOB) developed specific independence requirements that apply in various contexts.

2014

- AICPA’s Professional Ethics Executive Committee (PEEC) adopted a complete overhaul of the code, an ethics codification of the rules of conduct

AICPA Code of Professional Conduct-Professional Standards

- All AICPA Members agree to comply with the AICPA Code of Professional Conduct.

- AICPA Ethics Division – Professional Ethics Executive Committee (PEEC) disciplines CPAs when complaints are filed, investigated and CPA determined to be in violation

AICPA Code of Professional Conduct-

- Principles
  - Provide framework for the Rules
- Rules
  - Govern performance of services by members
  - Changes require vote by AICPA membership
- Ethics Interpretations
  - Provide guidance on scope/application of Rules
  - Changes require exposure to membership
- Ethics Rulings
  - Summarize application of Rules and Interpretations to specific set of facts and circumstances
  - Changes require exposure to membership

Ethics Codification Structure

Preface - Applies to all members:

- Principles
- Defined terms
- New, revised and pending interpretations

Part 1 - Members in Public Practice

Part 2 - Members in Business

Part 3 - All others, retirees or unemployed

Ethics Codification

- Numeric Citations – ET Section X.XXX.XXX
  - Preface – 0.xxx.xxx
  - Part 1 – 1.xxx.xxx
    - Topic 1.230 (Fees); 1.240 (Financial interests)
    - Section 1.230.010 (unpaid fees)
- Rule numbers eliminated
  - Rule 101 is now Independence Rule
  - Rules are aligned with interpretations under the topic
  - Interpretations aligned with Topic – Public vs. Business

Ethics Codification

- Most of the Code interprets the small number of rules in the Code.
- Members are required to apply these interpretations unless they can justify their noncompliance.
- A member who departs from the interpretations shall have the burden of justifying such departure in any disciplinary hearing.

Underlying the code are several principles. These principles apply to all services performed by members whether they are employed in public practice, private, government, or academia.

Responsibilities

- In carrying out their responsibilities as professionals, CPAs should exercise sensitive professional and moral judgments in all their activities. 0.300.020

The Public Interest

- CPA’s should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism. 0.300.030

Integrity

To maintain and broaden public confidence, CPA's should perform all professional responsibilities with the highest sense of integrity.

0.300.040

Objectivity and Independence

- A CPA should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. When providing attest services, a CPA should be independent in fact and in appearance. 0.300.050

Due Care

- A CPA should observe the profession’s technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of his or her ability. 0.300.060

Scope and Nature of Service

- A CPA in public practice should observe the principles of the Code of Professional Conduct in determining the scope and nature of services to be provided. 0.300.070

Due Care and Competence in the Performance of Professional Services

The following rule in the Code relates directly to this principle of Competence:

1.300.001 General Standards Rule

A member shall comply with the followng standards and with any interpretations thereof by bodies designated by Council:

a. Professional Competence. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

b. Due Professional Care. Exercise due professional care in the performance of professional services.

c. Planning and Supervision. Adequately plan and supervise the performance of professional services.

d. Sufficient Relevant Data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

1.300.010 Competence

.01 Competence, in this context, means that the *member or member's* staff possess the appropriate technical qualifications to perform *professional* services and that the *member*, as required, supervises and evaluates the quality of work performed. Competence encompasses knowledge of the profession's standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of professional services.

.02 A *member's* agreement to perform professional services implies that the *member* has the necessary competence to complete those services according to professional standards and to apply the *member's* knowledge and skill with reasonable care and diligence. However, the *member* does not assume a responsibility for infallibility of knowledge or judgment.

.03 The *member* may have the knowledge required to complete the services in accordance with professional standards prior to performance. A normal part of providing professional services involves performing additional research or consulting with others to gain sufficient competence.

.04 If a *member* is unable to gain sufficient competence, the *member* should suggest, in fairness to the *client* and public, the engagement of a competent person to perform the needed *professional service*, either independently or as an associate. (Prior reference: paragraph .02 of ET section 201)

Ethics Codification

Words and their meaning:

- **Should Consider -** Consideration is presumptively mandatory- Whether you do it is your judgment
- **Should Evaluate** – *Assess weight and significance*
- **Should Determine** - *Conclude and make decision*

Principles and Conceptual Framework

- Apply the Conceptual Framework
- Analyze potential threats to your compliance with the code
- Consider whether or not threats to compliance are significant
- Implement the safeguards that would reduce or even eliminate those threats to your compliance.

Two New Conceptual Frameworks

The new Ethics Codification incorporates the Conceptual Framework approach throughout, providing two new frameworks—one for all rules other than independence for members in public practice, and one that applies to the ethics requirements imposed on members in business.

If a rule addresses your situation, you should comply with it.

If you encounter a potential issue that the rules do not address, apply the Conceptual Framework.

Effective December 15, 2015

Conceptual Framework for Members in Business

Applying the conceptual framework involves at most, three steps.

- Be on the lookout for threats.
- Evaluate the significance of any threats.
- Consider and as needed, apply safeguards.

Threats include the following:

- Self-review
- Self-interest
- Advocacy
- Familiarity
- Undue influence
- Adverse interests

Adverse Interest Threat

The threat that a member will not act with objectivity because the member's interest are opposed to the interest of the employing organization. Examples include:

a. A *member* has charged, or expressed an intention to charge, the *employing organization* with violations of law.
b. A *member* or the *member's immediate family* or *close relative* has a financial or another relationship with a vendor, customer, competitor, or potential acquisition of the *employing organization.*
c. A *member* has sued or expressed an intention to sue the *employing organization* or its officers, directors, or employees.

Advocacy Threat

The *threat* that a *member* will promote an *employing organization's* interests or position to the point that his or her objectivity is compromised. Examples include:

a. Obtaining favorable financing or additional capital is dependent upon the information that the *member* includes in, or excludes from, a prospectus, an offering, a business plan, a financing application, or a regulatory filing.

b. The *member* gives or fails to give information that the *member* knows will unduly influence the conclusions reached by an external service provider or other third party.

Familiarity Threat

The *threat* that, due to a long or close relationship with a person or an *employing organization*, a *member* will become too sympathetic to their interests or too accepting of the person's work or *employing organization's* product or service. Examples include:

a. A *member* uses an *immediate family's* or a *close relative's* company as a supplier to the *employing organization.*

b. A *member* may accept an individual's work product with little or no review because the individual has been producing an acceptable work product for an extended period of time.

c. A *member's immediate family* or *close relative* is employed as a *member's* subordinate.

d. A *member* regularly accepts gifts or entertainment from a vendor or customer of the *employing organization.*

Self-interest Threat

The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, the *employing organization* or persons associated with the *employing organization.* Examples include:

a. A *member's immediate family* or *close relative* has a *financial interest* in the *employing organization.*
b. A *member* holds a *financial interest* (for example, shares or share options) in the *employing organization*, and the value of that *financial interest* is directly affected by the *member's* decisions.
c. A *member* is eligible for a profit or other performance-related bonus, and the value of that bonus is directly affected by the *member's* decisions.

Self-review Threat

The *threat* that a *member* will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the *member*, or an individual in the *employing organization* and that the *member* will rely on that service in forming a judgment as part of another service. Examples include:

a. When performing an internal audit procedure, an internal auditor accepts work that he or she previously performed in a different position.
b. The *member* accepts the work previously performed by the *member*, alone or with others, that will be the basis for providing another *professional service*.

Undue Influence Threat

The *threat* that a *member* will subordinate his or her judgment to that of an individual associated with the *employing organization* or any relevant third party due to that individual's position, reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member.* Examples include:

a. A *member* is pressured to become associated with misleading information.
b. A *member* is pressured to deviate from a company policy.
c. A *member* is pressured to change a conclusion regarding an accounting or a tax position.
d. A *member* is pressured to hire an unqualified individual.

Safeguards

Safeguards that may eliminate a *threat* or reduce it to an *acceptable level* fall into two broad categories:

a. *Safeguards* created by the profession, legislation, or regulation

b. *Safeguards* implemented by the *employing organization*

Safeguards Created by the Profession, Legislation, or Regulation

a. Education and training requirements on ethics and professional responsibilities
b. Continuing education requirements on ethics
c. Professional standards and the threat of discipline
d. Legislation establishing prohibitions and requirements for entities and employees
e. Competency and experience requirements for professional licensure
f. Professional resources, such as hotlines, for consultation on ethical issues

Safeguards Implemented by Employing Organizations

a. A tone at the top emphasizing a commitment to fair financial reporting and compliance with applicable laws, rules, regulations, and corporate governance policies
b. Policies and procedures addressing ethical conduct and compliance with laws, rules, and regulations
c. Audit committee charter, including independent audit committee members
d. Internal policies and procedures requiring disclosure of identified interests or relationships among the *employing organization*, its directors or officers, and vendors, suppliers, or customers
e. Internal policies and procedures related to purchasing controls
f. Internal policies and procedures related to customer acceptance or credit limits

Safeguards Implemented by Employing Organizations

g. Dissemination of corporate ethical compliance policies and procedures, including whistle-blower hotlines, the reporting structure, dispute resolution, or other similar policies, to promote compliance with laws, rules, regulations, and other professional requirements
h. Human resource policies and procedures *safeguarding* against discrimination or harassment, such as those concerning a worker's religion, sexual orientation, gender, or disability
i. Human resource policies and procedures stressing the hiring and retention of technically competent employees
j. Policies and procedures for implementing and monitoring ethical policies
k. Assigning sufficient staff with the necessary competencies to projects and other tasks

Safeguards Implemented by Employing Organizations

l. Policies segregating personal assets from company assets
m. Staff training on applicable laws, rules, and regulations
n. Regular monitoring of internal policies and procedures
o. A reporting structure whereby the internal auditor does not report to the financial reporting group
p. Policies and procedures that do not allow an internal auditor to monitor areas where the internal auditor has operational or functional responsibilities
q. Policies for promotion, rewards, and enforcement of a culture of high ethics and integrity
r. Use of third-party resources for consultation as needed on significant matters of professional judgment

Knowledge Check

Mark Alto identified potential threats to his compliance with the Code and is weighing whether or not the threats are significant. Which of the following best describes what Mark should consider in evaluating the significance of the threats?

a) Whether Mark has sufficient time to apply safeguards if he thinks the threats are significant.
b) Whether Mark has documented the threats adequately.
c) Whether threats are at an acceptable level.
d) Whether threats have been disclosed to the appropriate parties.

Knowledge Check

Which of the following statements about the revised AICPA Code of Professional conduct is true?

a) Citations for the rules and interpretations are as they were before.
b) In restructuring the Code, the PEEC made very few substantive changes to the interpretations.
c) The Code now appears in two distinct parts—one for members in public practice and another for all other members.
d) The definitions section has been eliminated from the Code.

Latest Revisions to the Code

- **Breach of an Independence Interpretation**

  Effective March 2016, or earlier if a member chooses to early implement, the AICPA adopted a new interpretation that helps members evaluate and address the consequences of a breach of an independence interpretation.

  Application of the new interpretation does not guarantee that the AICPA will not investigate a matter and find the member(s) in violation of the Code.

Breach of an **Independence Interpretation**

Key principles

- A firm must have adequate quality control policies and procedures in place over independence compliance.

- If a breach results in a significant threat to independence which compromised the attest team's integrity, objectivity, or professional skepticism, no actions could mitigate the impact of the breach.

- In certain circumstances, for example, the lead engagement partner committed the breach, applying the interpretation will not sufficiently address the breach.

Breach of an **Independence Interpretation**

Steps in the interpretation:

1. Identifying and communicating the breach
2. Evaluating the breach's significance (that is, the impact on the attest team's integrity, objectivity, and professional skepticism [if any])
3. Addressing the consequences of the breach (for example, whether to terminate the engagement)
4. Communicating with those charged with governance
5. Required documentation

If the attest report has not yet been issued, the member should evaluate the propriety of releasing the report. The member will also need to evaluate whether to withdraw any previously issued reports.

Firms, Mergers, and Acquisitions

This interpretation addresses the independence threats that may be created as a result of two firms joining.

Two independence issues:

- employment or other associations persons in one firm may have in the attest clients of the other firm
- tax or consulting services one firm provided to the other firm's audit client prior to the acquisition

The reason services and employment are problematic is that they are considered to create independence threats *not only* during the period of the professional engagement (when the firm begins to do work or accepts a new attest job) *but also* during the period covered by the financial statements under audit, and so on.

Firms, Mergers, and Acquisitions- Employment type matters

- The individual must disassociate prior to the closing date of the merger or acquisition and avoid working on the attest engagement for that client for any periods in which he or she was associated.

- Disassociation must occur before the transaction closes.

- Before issuing the attest report, the firm should assess the facts and circumstance to ensure that if any significant threats to independence persist, they are mitigated through safeguards. In these cases, the firm should engage in a discussion with those charged with governance at the client.

Firms, Mergers, and Acquisitions

In those instances where previously provided nonattest services have impaired the firm's independence with respect to the period covered by the financial statements, the firm could complete the attest engagement and still be considered independent when both of the following apply:

- The attest engagement covers only periods prior to the acquisition or merger.

- The firm stops providing financial statement attest services to the acquirer.

Effective April, 2015

Employee Benefit Plan “affiliate”

Clarifies the definition of "affiliate" when an employee benefit plan has more than one sponsor.

- Distinguishes between different types of arrangements.
- In certain cases, add a materiality threshold.
- Adds a new example indicating that a participating employer that acts as the plan administrator is an affiliate of the plan.

Effective October 31, 2015

Client Affiliates Independence Rule

The Code requires members to be independent of attest clients as well as certain affiliates of a financial statement attest client.

A *financial statement attest client* is an entity whose financial statements are audited, reviewed, or compiled (if the member's compilation report does not include a disclosure regarding lack of independence).

"Affiliates" of the Client

- The code defines the types of relationships that are deemed to be “affiliates” of the client. The code lists 11 types of relationships.
- Under the interpretation, the firm and its people should apply the same independence rules to clients and their affiliates unless one of the rule's exceptions applies.
- The rule also says that nonattest services provided to an affiliate that do not threaten independence with respect to the attest client under the Conceptual Framework are permitted.

11 Relationships

1. An entity that a F/S Attest client (AC) can control;
2. An entity in which F/S AC, or entity controlled by F/S AC, has direct financial interest that gives F/S AC significant influence over entity and is material to F/S AC;
3. An entity that controls a F/S AC when the F/S AC is material to such entity;
4. An entity with a direct financial interest in F/S AC when that entity has significant influence over the F/S AC and the interest in the F/S AC is material to such entity;
6. A sister entity of a F/S AC if the F/S AC and sister entity are each material to the entity that controls both.
7. The trustee of a trust F/S AC;

11 Relationships

8. The sponsor of single employer employee benefit plan F/S AC;
9. Any union or participating employer that has significant influence over a multiple or multiemployer employee benefit plan F/S AC;
10. An employee benefit plan sponsored by either a F/S AC or entity controlled by the F/S AC. A multiemployer employee benefit plan when the client or entity the client controls has significant influence over the plan *and* the plan is material to the entity (revised 2015)
11. An investment adviser, general partner, or trustee of an investment company client (fund), if the fund is material to the investment adviser, general partner, or trustee, and the adviser, general partner, or trustee either controls or has significant influence over the fund

Knowledge Check

Kim is a senior accountant in a privately held retailer. The company has plans to "go public" over the next one to two years. Once public, and leading up to the initial public offering, the company will need accounting staff who have experience applying SEC accounting and reporting requirements. Kim is well-liked at the company and asked to take over the Controller position in three months in anticipation of the offering. While in public accounting, Kim audited a public company, but that was 15 years ago. The CFO, a CPA with heavy SEC experience, would oversee Kim's work. She would like to take the job, but is concerned that her technical skills are dated. Which of the following actions would be most appropriate for Kim to take under the Code?

a) Accept the job, but immediately begin attending seminars and take self-study to sharpen her skills.

b) Accept the job, which will allow day-to-day "hands on" learning.

c) Accept the job, but defer to the CFO on any complicated issues.

d) Accept the job, but assign the more complex work to the company's audit firm.

RECENT CHANGES IN OUR PROFESSIONAL ETHICS

Other New Standards

- Broker-Dealers and PCAOB Independence Rules

- AICPA Statements on Standards for Tax Services

AICPA Plain English Guide to Independence Issued March 31, 2015

- Provides guidance on independence
- This guide is intentionally concise and does not cover all the rules (some of which are complex), nor does it cover every aspect of the rules. Nonetheless, this guide should help you identify independence issues that may require further consideration.
- It's a great tool to start your research and documentation of a potential conflict of interest or independence question
- http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Plain%20English%20Guide.pdf

Definitions
Confidential Client Information

- Definition: Any information that is not in the public domain or not available to the public
  - Information in public domain includes: books, periodicals, commercially available databases, client documents released by client or subject to FOIA, documents maintained or filed with regulatory bodies, web sites, etc.

Definitions
Confidential Client Information

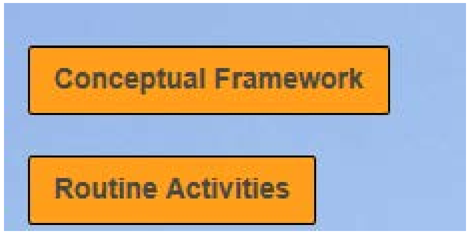
- ***Client information that is in the public domain***
  - Not considered confidential; client consent not required
- ***Client information not in the public domain***
  - Considered confidential; client consent required even if information is de-identified
- ***Other information in the member's possession***
  - Any information relating to the member's judgments, decisions, and actions; client consent not required

Recent Developments in Ethics

- **Confidential information obtained from employment** – A member is deemed to have committed an act discreditable to the profession if a member uses information obtained through employment without proper authority or specific consent of the employer, unless a legal or professional responsibility exists to use or disclose such information.

GAO Yellow Book

The GAO independence rules, like the AICPA's, has a Conceptual Framework for assessing situations in which specific guidance does not exist in the Yellow Book.



GAO Conceptual Framework

The auditor should determine whether providing such a service would create a threat to independence, either by itself or in the aggregate. Critical to the determination is management's ability to effectively oversee the nonaudit service to be performed.

The auditor should establish and document the understanding with the client's management or those charged with governance regarding the following:

- Objectives of the nonaudit service
- Services to be performed
- Client's acceptance of its responsibilities
- Auditor's responsibilities
- Any limitations of the nonaudit service

Routine Activities

- The Yellow Book differentiates routine activities that auditors perform in conjunction with an audit; for example, providing advice or assistance to the entity on an informal basis as part of the audit and nonaudit services.

- If the nonaudit services were performed in the period to be covered by the audit, the auditor should
  1) determine if the nonaudit service is expressly prohibited by Government Auditing Standards (GAS), and
  2) determine whether a threat to independence exists and address any threats noted in accordance with the Conceptual Framework.

Must Document - GAS Related to Independence

Requirements:

- List out all non attest services during the period of audit
- Determine if 2011 Yellow Book prohibits
- Determine if service requires auditor to make management decisions
- Determine threats using the conceptual framework
- Document safeguards to reduce threats to acceptable level
- Identify individuals to oversee, evaluate adequacy and be responsible
- Document skills, knowledge and or experience
- Document management's agreement to oversee

INDEPENDENCE - GOVERNMENT AUDITING STANDARDS (GAS)

- Requires more documentation

❖ For each Nonattest service performed, documentation must include the auditee's SKE – This differs from Ethics Interpretation 101-3 where you can simply include this in the engagement letter and representation letter. Documentation not required in GAAS audits. This documentation must address who possesses the SKE for each service- See practice aid at AICPA. Org –Interest area GAQC website- Free download of PDF version, need to pay for interactive tool.

❖ For each nonattest service document the threat and safeguard to mitigate the threat. Again this must be documented in the WPs and more important, must be done at the time the service is initiated

Knowledge Check

Anthony, a manager with Dean Garrett, CPAs, is on an engagement to audit a small city, and is responsible for addressing independence matters with the audit partner as they arise. The client recently lost a key employee and is soliciting his firm's help to close its books on a temporary basis. The client would like Anthony to maintain the books and records by keeping the depreciation and amortization records and doing all of the related adjusting and closing entries. Which of the following statements best describes what Anthony should do before discussing the situation with the audit partner?

a) Determine whether providing this service would create a threat to independence, either by itself or in the aggregate with other nonaudit services provided to the client.

b) Determine the amount of fees the client would be willing to pay for this service and for how long the services will be needed.

c) Discuss with the client whether they would like some additional assistance recruiting a new employee to fill the accounting position that was lost.

d) Seek the CFO's input as to whether he or she would like the services performed on a day-to-day basis, monthly, or quarterly.

Knowledge Check

Which of the following would be considered a "routine activity" under the Yellow Book independence standards?

a) Preparing a client's financial statements.
b) Converting financial statements from a cash basis to an accrual basis.
c) Performing account reconciliations for the client.
d) Providing advice or assistance to the entity on an informal basis as part of the audit.

State Board – Regulatory

- Rules for licensed CPAs
- http://bsd.dli.mt.gov/license/bsd_boards/pac_board/board_page.asp

State Board – Regulatory

- Use of CPA Designation - **Rule 24-201.415**
  - If not in public accounting but you provide financial or consulting services to the public, must have permit to practice.
  - Must not use your CPA designation to outside parties without a permit

- All firms who perform and audit, review, compilation or AUP must enroll with the MSCPA peer review program

State Board – Regulatory

- Definitions - Rule 24.201.301
  - Defines key terms such as client, financial statement, professional services, report

What happens if you violate these rules?

- State Board of Public Accountants disciplines CPAs when complaints are filed, investigated and CPA determined to be in violation

Montana Board Rules - 2015

- Montana Governor Steve Bullock has signed HB44 which eliminates the CPA certificate only level of licensure in Montana.
- Montana will not issue certificate only licenses after July 1, 2015
- All **certificate only licensees** must meet the 2000 hour experience requirement and make application for an initial permit to practice by December 31, 2017 in order to retain a Montana license.
- By December 31, 2017, you must hold a permit to practice or you will not be licensed as your Montana CPA certificate will terminate on December 31, 2017.

ETHICS IN THE NONPROFIT SECTOR – Form 990

- Section on governance on the annual information return filed by nonprofits Form 990
- Requires Organizations to disclose if a conflict of interest policy has been established and whether it regularly and consistently monitors and enforces compliance.
- Did the Organization become aware of a material diversion of the Organization’s assets. Fraud

ETHICS IN THE NONPROFIT SECTOR – Form 990

- Requires disclosure of **independent board members** that have authority to elect members, approve or reject board decisions.
- Requires Organizations to disclose the process used to **compensate the CEO** and other officers and key employees; include a review and approval by independent persons; comparability data and contemporaneous substantiation of the deliberation and decision.

ETHICS IN THE NONPROFIT SECTOR – Form 990

- Board Relationships - Requires Organizations to disclose family and business relationships existing between directors, officers , trustees and key employees
- Requires the Organization to disclose whether it has a written whistleblower policy

ETHICS & INTEGRITY

- Integrity is an element of character - **Fundamental to our professional recognition**
- Integrity mandates each of us to be honest and candid
- Integrity allows us to make inadvertent errors
- It mandates honest difference of opinions – but can't allow for deceit

INTEGRITY

A common challenge to integrity occurs when CPAs, whether working in public practice or performing internal accounting or internal auditing services, are pressured by a supervisor to concur with a misleading or inaccurate transaction or position regarding an accounting or financial reporting issue

So, what do you do?

- Don't subordinate your professional judgment –

- Ask yourself after every decision:
  - Have I subordinated by judgment?
  - Have I retained my integrity?

INTEGRITY

- The threat to integrity and objectivity has one common element – the attempt by a superior to influence the professional judgment of subordinates

"Integrity is doing what you know is right even when nobody's looking"

ETHICS & PROFESSIONALISM

- **The <u>general public's</u> expectation of how a person acts is predicated on the person's education, experience and position in society**
- **What is professionalism?**
  - Striving for excellence in all you do
  - Having a positive attitude
  - Willingness to be accountable for your actions
  - Adhere to the prudent person concept - Act in good faith

ETHICS & PROFESSIONALISM

- **Professionals agree to strive for excellence – but they rarely agree to be held strictly <u>accountable</u> for it.**
- **Organizations should hire for <u>attitude</u> and train for skill. Skills you can teach-attitudes and character are inherent.**
- **Sign of a sick organization – When an employee is <u>afraid to speak out,</u> not because they don't know who to approach but because of the consequences to speaking out.**

Excerpts from the book; "True Professionalism"

Sound Ethical Behavior Mandates the CPA to **Know the Rules!**

- AICPA Code of Professional Conduct
- State of Montana CPA Licensing Regulations
- Regulatory requirements under the GAO, FDIC, OTS, NCUA, DOL, SEC (PCAOB)
- **Firm's policies and procedures**
- Applicable Professional Standards

Final Thoughts!

In Our Great Profession, the most common means of embedding an ethical culture in any organization is to stress the importance of conforming to standards and rules.

There should be zero tolerance for those that intentionally promote non conformance

AICPA Ethics Hotline

- Hotline #: **(888) 777-7077** or ethics@aicpa.org
- A service provided by the Division staff responding to member inquiries on ethics issues
  - Staffed by technical managers
- About 4000-5000 calls and emails are answered annually

“Ethics” Resources Available

- AICPA.org - Code of Conduct and Professional Ethics
- Plain English Guide to Independence
- AICPA Independence and Ethics Risk alert updated annually.
- Montana Board of Public Accountants web site.

Thank You!

2016 Governmental Accounting Update

Presented by Stefeni S. Freese, CPA
Shareholder, Anderson | ZurMuehlen
April 27, 2016

Meet Your Speaker

- *Stefeni S. Freese, CPA* is a shareholder in the Billings office of Anderson ZurMuehlen & Co., P.C. with twenty eight years of public accounting with an emphasis in the government, non-profit and employee benefit industries. She is a 1990 graduate of Montana State University.
- Stefeni performs peer reviews throughout the country and currently services as the Chairman of the MSCPA Peer Review Committee. She is a member of the Anderson ZurMuehlen Board of Directors and Vice-Chairman of the Boys and Girls Clubs of Yellowstone County.
- Stefeni has been married for 28 years and has two sons. She is a diehard Boston Red Sox fan and loves to read, cook, garden and travel.
- Contact Stefeni at: sfreese@azworld.com

Learning Objectives

- After completing this program, you should
  - Have a better understanding of recent accounting and reporting developments and issues impacting state and local governments
    - To address applicable standards in the preparation of the financial statements of a state or local government reporting entity
    - To prepare for implementation of applicable standards with future effective dates

Agenda and topics

- Accounting and reporting standards – GASB update
  - Recently issued standards
  - GASB technical agenda projects

Accounting and financial reporting for pensions

- GASB 68 – employers - effective for periods beginning after June 15, 2014
  - Significant and material impact on FS for most employers
  - Project, discount then attribute pension amounts
  - Additional disclosures on elements of pension expense and deferred inflows/outflows of resources
- GASB 71 – pension transition for contributions made subsequent to the measurement date
  An amendment of GASB Statement No. 68 - required to be implemented with GASB 68
- GASB 82 Pension Issues
  - Issued March 2016
  - Effective for periods beginning after June 15, 2016

GASB 82 – Pension issues

- Amends GASB Statement No. 67, 68 and 73
- Address practice issues that have been raised as a result of implementation of 67, 68 and 73:
  - Presentation of payroll related matters in RSI
  - Selection of assumptions and deviations from guidance in Actuarial Standards of Practice
  - Classification of payments made by employers to satisfy the employee's required contribution

GASB 82 – Pension issues (continued)

- Presentation of payroll-related measures in RSI
  - The measure of payroll that is required by paragraph 32 of Statement 67 and paragraphs 46 and 81 of Statement 68 to be presented in RSI should be covered payroll
    - Covered payroll - the portion of compensation paid to active employees on which contributions to a pension plan are based
  - Covered payroll should also be used in the ratios required to be presented

GASB 82 – Pension issues (continued)

- Selection of assumptions - the selection of assumptions used in determining the total pension liability, a *deviation*, as the term is used in Actuarial Standards of Practice issued by the Actuarial Standards Board, from the guidance in an Actuarial Standard of Practice should not be considered to be in conformity with the requirements of Statement 67, Statement 68, or Statement 73

GASB 82 – Pension issues (continued)

- Classification of employer-paid member contributions – payments made by the employer to satisfy contribution requirements that are identified by the pension plan terms as plan member contribution requirements
  - Statement 67 – these should be classified as plan member contributions; would not be considered a part of the employer's contribution when computing employer's proportionate share of the NPL
  - Statement 68 – these should be classified as employee contributions; reported as expense in the period the payment is made; disclosure of the arrangement

GASB 72 – Fair value measurement and application

- Issued – February 2015
- Effective – periods beginning after June 15, 2015.
  - Earlier application is encouraged
- Objective – improve financial reporting by clarifying the definition of fair value for financial reporting purposes, establishing general principles for measuring fair value, providing additional fair value application guidance, and enhancing disclosures about fair value measurements
  - Standard **does not** change the measurement requirements for account balances and transaction not reported at fair value

GASB 72 – Fair value measurement and application (continued)

- Definition of fair value
  - The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date
    - An exit price
    - Based on the principal market or the government's most advantageous market

GASB 72 – Fair value measurement and application (continued)

- Fair value application
  - Applies to most investments
  - Definition of an investment
    - A security or other asset that a government holds primarily for the purpose of income or profit and has a present service capacity based solely on its ability to generate cash or to be sold to generate cash
  - Investment asset
    - Service capacity
      - Refers to a government's mission to provide services; an <u>indirect</u> versus direct relationship to the services
    - Held primarily for income or profit
      - Acquired first and foremost for future income and profit
      - Evidence can be found based on the fund holding the asset

GASB 72 – Fair value measurement and application (continued)

- Valuation approaches and techniques
  - Valuation technique used to measure fair value should be appropriate to the circumstances and should maximize the use of relevant observable inputs (assumptions that market participants would use in pricing an asset or liability)
  - Three basic approaches:
    - Market approach – uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities, or group of assets and liabilities – quoted market prices, market multiples technique and matrix pricing techniques
    - Cost approach – amount that would be required currently to replace the service capacity of an asset
    - Income approach – converts expected future amounts (for example, cash flows) to a single current discounted amount – present value, option pricing model and multi-period excess earnings technique

GASB 72 – Fair value measurement and application (continued)

- Net asset value (NAV) - A government is permitted in certain circumstances to establish the fair value of an investment that does not have a readily determinable fair value by using the NAV per share (or its equivalent) in a manner consistent with measurement principles for investment companies as outlined by FASB.
  - Should be measured at the measurements date; if not provided the adjustment of the value may be necessary
  - Should not be applied if the government will sell the investment for an amount different from NAV

GASB 72 – Fair value measurement and application (continued)

- Investment exemptions
  - Money market investments and participating interest-earning investment contracts that have a remaining maturity at time of purchase of one year or less, other than external investment pools (amortized cost)
  - Investment held by 2a7-like external investment pools (amortized cost)
  - Investment in 2a7-like external investment pools (NAV (or its equivalent) as determined by the pool)
  - Investments in common stock that meet the criteria for applying the equity method

GASB 72 – Fair value measurement and application (continued)

- Investment exceptions (continued)
  - Non-participating interest-earning investment contracts (cost based measure)
  - Unallocated insurance contracts (cost based measure)
  - Synthetic guaranteed investment contracts that are fully benefit responsive
  - Life insurance contracts (cash surrender value)
  - Investments reported under the equity method

GASB 72 – Fair value measurement and application (continued)

- Acquisition value – price paid to acquire an asset with equivalent service potential or liquidate a liability in an orderly market transaction at the acquisition date is referred to acquisition value. The following items which were previously required to be measured at fair value should be measured at acquisition value:
  - Donated capital assets
  - Donated works of art, historical treasures, and similar assets
  - Capital assets received through a service concession arrangement

GASB 72 – Fair value measurement and application (continued)

- Hierarchy of <u>inputs</u>
  - Level 1: quoted prices in active markets for identical asset or liabilities that can be accessed at the measurement date
  - Level 2: inputs, other than quoted market prices included in Level 1, that are observable (either directly or indirectly)
    - Market quotes for similar assets/liabilities in active or inactive markets
    - Interest rates and yield curves that are observable at commonly quoted intervals
    - Market corroborated inputs
  - Level 3: unobservable inputs
    - Midmarket consensus price for a swap that uses data that are not directly observable and cannot be corroborated by the observable market data

GASB 72 – Fair value measurement and application (continued)

- Note disclosures
  - Disclosures should be organized by type or class of asset or liability; table or narrative format
  - Specific disclosures (recurring and nonrecurring)
    - Fair value measurement at the end of the reporting period
    - Level of the fair hierarchy (except those measured at NAV)
    - Description of the valuation techniques and the inputs used in the fair value measurement
    - Change in valuation technique that has a significant impact on the result and the reason for the change
  - Specific disclosures (nonrecurring)
    - Reason(s) for the measurement

GASB 72 – Fair value measurement and application (continued)

- Note disclosures for investments in entities that meet all of the following criteria:
    - Calculate NAV
    - Do not have a readily determinable fair value
    - Measured at fair value on a recurring or nonrecurring basis
  - Description of significant investment strategies of investees
  - Investment that can never be redeemed but a government receives a distribution through the liquidation of the underlying assets of the investees
  - Unfunded commitments related to the investment type

GASB 72 – Fair value measurement and application (continued)

- Note disclosures: NAV and Level 3
  - Description of the terms and conditions upon which a government may redeem investments
  - Circumstances when the investment may not be redeemable i.e. lockup or gate; when the restriction may lapse and how long the restriction has been in place
  - Any other significant restriction on the ability to sell the investments at the measurement date
  - If it is probable the government will sell the investment for something other than NAV

GASB 73 – Accounting and financial reporting for pensions and related assets not within the scope of GASB 68 and amendments to GASB 67 & 68

- Issued – June 2015; effective as follows:
  - Employers and non-employer contributing entities - periods beginning after June 15, 2016
  - Financial reporting for assets accumulated for purpose of providing the pensions – periods beginning after June 15, 2015
  - Amendments to GASB 67 & 68 – periods beginning after June 15, 2015
- Objective – improve financial reporting by establishing a single framework for the presentation of information about pensions, enhance the comparability of pension-related information reported

GASB 73 (continued)

- Scope
  - Defined benefit ***<u>and</u>*** defined contribution pension plans provided to employees of state and local governments that are not within the scope of GASB 68
    - Not administered through trusts
    - Retirement income
    - Postemployment benefits other than retirement income that are provided through a pension plan such as death benefits, life insurance and disability benefits
  - Excluded: postemployment healthcare benefits or termination benefits provided separate from a pension plan

GASB 73 (continued)

- Defined benefit pensions provided through plans not administered by a trust
  - Income or other benefits that the employee will receive at or after separation from employment are defined by benefit terms
    - Specific dollar amount or an amount that is calculated based on one or more factors such as age, years of service and compensation

GASB 73 (continued)

- Scope
  - Defined benefit ***and*** defined contribution pension plans provided to employees of state and local governments that are not within the scope of GASB 68
    - Not administered through trusts
    - Retirement income
    - Postemployment benefits other than retirement income that are provided through a pension plan such as death benefits, life insurance and disability benefits
  - Excluded: postemployment healthcare benefits or termination benefits provided separate from a pension plan

GASB 73 (continued)

- Defined benefit pensions provided through plans not administered by a trust
  - Income or other benefits that the employee will receive at or after separation from employment are defined by benefit terms
    - Specific dollar amount or an amount that is calculated based on one or more factors such as age, years of service and compensation

GASB 73 (continued)

- Defined contribution pensions provided through plans not administered by a trust that
  - Provide an individual account for each employee
  - Define the contributions that an employer or non-employer contributing entity is required to make to an active employee's account for periods the employee renders service
  - Provided that the pensions an employee will receive will depend only on the contributions to the employee's account, actual earnings on investments of those contributions and effects of forfeitures of contributions made for other employees and plan administrative costs that are allocated to the employee's account

GASB 73 (continued)

- Recognition and measurement in financial statement of defined benefit plans not administered through a trust; government-wide and proprietary fund financial statements:
  - Total pension liability – actuarial present value of projected benefit payments
    - Measurement date – no earlier than the end of the employer's prior fiscal year
    - Actuarial valuation as of the measurement date or an actuarial valuation that has been rolled forward to the measurement date. Actuarial valuation date should be no more than 30 months and one day earlier than the employer's most recent fiscal year end

GASB 73 (continued)

- Total pension liability (continued)
  - Assumptions should be in conformity with actuarial standards of practice
  - Projected benefit payments – should include the effects of automatic postemployment benefit changes including automatic cost-of-living adjustments (COLA), COLA if substantively automatic, projected salary changes and projected service credits
  - Discount rate – yield or index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher

GASB 73 (continued)

- Pension expenses deferred
  - Expense would be deferred and recognized over a period equal to the average remaining service periods of active and inactive (including retirees) employees for:
    - Differences between expected and actual changes in economic and demographic factors
    - Changes in assumptions about future economic and demographic factors
- Pension expense
  - Costs incurred related to the administration of the pensions
  - Change in liability other than the amounts that are amortized as outlined above

GASB 73 (continued)

- Notes to the financial statements, RSI and notes to RSI requirements mirror the requirements outlined in GASB 68

GASB 73 (continued)

- Recognition and measurement in financial statement of defined benefit plans not administered through a trust; primary governments and component units that provide pensions through the same defined benefit plan:
  - Liability should be recognized for the government's (or component unit's) proportionate share of the collective total pension liability
    - Basis for the proportionate share should be consistent with the manner in which the amounts that are paid as benefits come due are determined. The use of projected payments as benefits come due over the long term as compared to the total projected payments of all entities that make benefit payments as benefits come due is encouraged.

GASB 73 (continued)

- Deferred outflows of resources related to pensions should be reported for the following:
  - Amounts paid by the government for pensions as the benefits come due subsequent to the measurement date of the collective total pension liability
  - Amounts incurred by the government for pension administrative expenses subsequent to the measurement date of the collective total pension liability

GASB 73 (continued)

- Defined contribution pension amounts to be reported within the government wide and proprietary fund financial statements
  - Pension expense equal to the amount of credits to employees accounts that are defined by the benefit terms as attributable to employees services in the period net of forfeited amounts
  - A change in pension liability equal to the difference between amounts recognized as pension expense and amounts paid by the employer as the benefits come due during the fiscal year
- Disclosures similar to disclosures required for defined benefit pension plans
- Special funding situations

GASB 73 (continued)

- Assets accumulated for purposes of providing pensions through defined benefit pension plans that are not administered through trusts
  - Any asset accumulated for pension purposes should continue to be reported as assets of the employer or non-employer contributing entity
  - Assets accumulated for pension purposes in a fiduciary capacity should report the assets in an agency fund

GASB 73 (continued)

- Amendments to GASB 67 & 68
  - Notes to RSI
    - Information about investment related factors that significantly affect trends in the amounts reported should be limited to those factors over which the pension plan or participating government have influence i.e. changes in investment policies
  - Payables to defined benefit pension plans
    - Separately financed specific liability is a specific contractual liability for a one-time assessment to an individual employer
    - Information presented in RSI for contributions, should exclude amounts specific contractual liabilities

GASB 74 – Financial reporting for postemployment benefit plans other than pensions

- Issued – June 2015
- Effective for periods beginning after June 15, 2016
- Replaces GASB 43 and 25 (specifically as it relates to defined contribution plans)
- Scope – OPEB **plans** (defined benefit and defined contribution) that meeting the following criteria:
  - Contributions made into the plan are irrevocable
  - Assets are dedicated to plan members for benefits
  - Assets are legally protected from employer and plan member creditors
- Requirements to address reporting for assets accumulated that are not administered through a trust

GASB 74 – Financial reporting for postemployment benefit plans other than pensions (continued)

- OPEB as defined by the standard includes the following:
  - Postemployment healthcare benefits include medical, dental, vision, hearing and other health-related benefits whether provided separately from or through a pension plan
  - Other forms such as death benefits, life insurance, disability and LT care when provided separately from a pension plan

GASB 74 – Financial reporting for postemployment benefit plans other than pensions (continued)

- The following are excluded
  - Insured plans - the requirements of this Statement are not applicable to defined benefit OPEB Plans in which benefits are financed through an arrangement whereby premiums are paid to an insurance company while employees are in active service, in return for which the insurance company unconditionally undertakes an obligation to pay the OPEB of those employees as defined in the OPEB plan terms.
  - Termination benefits or termination payments for sick leave

GASB 74 – Financial reporting for postemployment benefit plans other than pensions (continued)

- Financial statements
  - Statement of fiduciary net position
  - Statement of changes in fiduciary net position
- Notes to the financial Statements
  - Type of benefits provided
  - Eligibility of plan members
  - Composition of the board
  - Plan investment information; policies, concentration of investments equaling or exceeding 5% and annual money-weighed rate of return
  - Contributions, reserves and allocated insurance contracts
  - Additional items required for single-employer and cost sharing plans

GASB 74 – Financial reporting for postemployment benefit plans other than pensions (continued)

- Required supplementary information – 10 years
  - Weighted average rate of return on investments
  - Sources of changes in net OPEB liability
  - Components of the net OPEB liability and related ratios
  - Actuarially determined contributions, contributions made, related ratios
  - Significant assumptions
  - Factors that significantly affect trends
- Notes to RSI
  - Significant methods and assumptions used to calculate the contributions, factors that significantly affect trends in the amounts reported

GASB 75-Accounting and financial reporting for postemployment benefits other than pensions

- Issued – June 2015
- Effective – periods beginning after June 15, 2017
- Replaces GASB 45 and replaces GASB 57
- This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures
- Single employer, agent employer, cost-sharing employer (proportionate share)
- Special funding situations

GASB 74 & 75 - Financial reporting for postemployment benefits other than pensions

- Measurement of OPEB liability
  - Total OPEB liability net plan assets
    - Actuarially calculated
      - Performed at least every 2 years
      - Roll forward of liability required if actuarial valuation isn't as of the Plan's year-end.
      - In accordance with Actuarial Standards of Practice issued by the Actuarial Standards Board; *deviations* will not be considered in conformity with the requirements of the standard
    - Alternative method – less than 100 plan members (both active and inactive)

GASB 74 & 75 - Financial reporting for postemployment benefits other than pensions (continued)

- Projected plan benefits
  - Claims costs or age-adjusted premiums based approximating claims costs
  - Plan benefits provided through plan document and past practice
  - Legal or contractual agreements and caps
  - Projected salary changes and service credits including COLA
  - Taxes and assessments imposed on benefit payments
- Discounted to actuarial present value
  - Long term rate of return
  - Tax-exempt high quality municipal rate when conditions for using the long term rate aren't met

GASB 74 & 75 - Financial reporting for postemployment benefits other than pensions (continued)

- OPEB expense - immediate
  - CY service cost
  - Interest on the liability
  - Changes in benefit terms
- OPEB expense - deferred
  - Changes of economic and demographic assumptions or of other inputs
  - Differences between expected and actual experience are
  - Differences between actual and expected earnings on plan assets
  - Employer contributions subsequent to measurement date
  - Changes in proportionate share for cost sharing employer plans

GASB 74 & 75 - Financial reporting for postemployment benefits other than pensions (continued)

- Assets accumulated for purposes of providing OPEB through defined benefit OPEB plans that are not administered through trusts
  - Any asset accumulated for OPEB purposes should continue to be reported as assets of the employer or non-employer contributing entity
  - Assets accumulated for OPEB purposes in a fiduciary capacity should report the assets in an agency fund

GASB 74 & 75 - Financial reporting for postemployment benefits other than pensions (continued)

- Disclosures required for a defined contribution OPEB plan that is administered through a trust:
  - Identification of an OPEB plan as a defined contribution plan
  - Authority under which the plan was created and can be amended
  - Classes of plan members covered
  - Number of plan members, participating employers and non-employer contributing entities

GASB 76 – The hierarchy of generally accepted accounting principles for state and local governments

- Issued – June 2015
- Effective – periods beginning after June 15, 2015
  - This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

GASB 76 – The hierarchy of generally accepted accounting principles for state and local governments

- Category A - Officially established accounting principles—Governmental Accounting Standards Board (GASB) Statements
  - When codified retains it's status
- Category B –
  - GASB Technical Bulletins
  - GASB Implementation Guides
  - Literature of the AICPA cleared by the GASB

GASB 76 – The hierarchy of generally accepted accounting principles for state and local governments

- Nonauthoritative accounting literature include
  - GASB Concepts Statements;
  - Pronouncements and other literature of the Financial Accounting Standards Board, Federal Accounting Standards Advisory Board, International Public Sector Accounting Standards Board, and International Accounting Standards Board
  - AICPA literature not cleared by the GASB
  - Practices that are widely recognized and prevalent in state and local government
  - Literature of other professional associations or regulatory agencies; and accounting textbooks, handbooks, and articles. (Blue Book)

GASB 77 – Tax abatement disclosures

- Issued – August 2015
- Effective – periods beginning after December 15, 2015
- Assist users of financial statements in assessing (1) whether a government's current-year revenues were sufficient to pay for current-year services, (2) whether a government complied with finance-related legal and contractual obligations, (3) where a government's financial resources come from and how it uses them, and (4) a government's financial position and economic condition and how they have changed over time

GASB 77 – Tax abatement disclosures

- Tax abatement defined -
  - A reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments.

GASB 77 – Tax abatement disclosures

- Note disclosures:
  - General information regarding the abatements
  - Amounts related to the tax abatement agreements
  - General and financial information of other governments impacted by an agreement
  - Detailed information related to the disclosure requirements can be found in the standard

GASB 78-Pensions provided through certain multiple employer defined benefit pension plans

- Issued – December 2015
- Effective – periods beginning after December 15, 2015
- Amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan)

GASB 78-Pensions provided through certain multiple employer defined benefit pension plans

- Government-wide and proprietary - pension expense should be recognized equal to the employer's required contributions to the pension plan for the reporting period, and a payable should be reported for unpaid required contributions at the end of the reporting period.
- Governmental fund – pension expense recognized for contributions made based on pay periods in the reporting period, and a payable should only be recognized to the extent it is due and payable
- Note disclosure and RSI requirements

GASB 79-Certain external investment pools and pool participants

- Issued – December 2015
- Effective – periods beginning after June 15, 2015 except for certain provisions on portfolio quality, custodial credit risk, and shadow pricing. Those provisions are effective for reporting periods beginning after December 15, 2015
- Establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes.

GASB 79-Certain external investment pools and pool participants

- External investment pool - an arrangement that commingles (pools) the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio; one or more of the participants is not part of the sponsor's reporting entity

GASB 79-Certain external investment pools and pool participants

- An external investment pool may elect to measure for financial reporting purposes all of its investments at amortized cost if it meets all of the following criteria:
  - Transacts with its participants at a stable net asset value per share (for example, all contributions and redemptions are transacted at $1.00 net asset value per share)
  - Meets the portfolio maturity requirements
  - Meets the portfolio quality requirements
  - Meets the portfolio diversification requirements
  - Meets the portfolio liquidity requirements
  - Meets the shadow pricing requirements

GASB 79-Certain external investment pools and pool participants

- Participants in an external investment pool should value its investment in the pool as follows:
  - Amortized cost if the pool meets all of the criteria outlined in the standard
  - Fair value if it does not meet the criteria outlined in the standard.
- Note disclosures for pools valued at amortized cost should include any redemption restrictions, maximum transaction amounts and authority to impose liquidation fees or gates

GASB 80 – Blending requirements for certain component units

- Issued – January 2016
- Effective – periods beginning after June 15, 2016
- Establishes an additional blending requirement for the financial statement presentation of component units
- Applies to component units that are organized as not-for- profit corporations in which the primary government is the sole corporate member

GASB 80 – Blending requirements for certain component units

- A component unit should be included in the reporting entity financial statements using the blending method if the component unit is organized as a not-for-profit corporation in which the primary government is the sole corporate member, as identified in the component unit's articles of incorporation or bylaws, and the component unit is included in the financial reporting entity pursuant to the provisions in paragraphs 21–37 of Statement 14, as amended

GASB 81 – Irrevocable split interest agreements

- Issued – March 2016
- Effective – periods beginning after December 15, 2016 applied retroactively
- Improve accounting and financial reporting by establishing recognition and measurement requirements for **irrevocable split-interest agreements**
- Enhance the transparency and decision-usefulness of general purpose external financial reports, and their value for assessing accountability, by more clearly identifying resources that are available to a government

GASB 81 – Irrevocable split interest agreements

- Irrevocable split-interest agreements created through trusts—or other legally enforceable agreements with characteristics that are equivalent to irrevocable split-interest agreements—in which a donor irrevocably transfers resources to an **intermediary.** The intermediary administers these resources for the **unconditional benefit** of a government and at least one other beneficiary

GASB 81 – Irrevocable split interest agreements

- A typical irrevocable split-interest agreement has two components: a **lead interest** and a **remainder interest.**
  - Lead interest **-** provide resources to a government throughout the term of the agreement in the form of periodic disbursements. The amount of the disbursement can be a pre-established amount or a variable amount, for example, a specific percentage of the fair value of the assets measured at the disbursement date (a unitrust)
  - Remainder interest – provide resources to a government as a final disbursement at the termination of the agreement.

GASB 81 – Irrevocable split interest agreements

- If a government is <u>*both*</u> the intermediary and the remainder interest beneficiary of an irrevocable split-interest agreement, the government should recognize the following:
  - Assets for resources received or receivable
  - A liability for the lead interest that is assigned to other beneficiaries
    - Measured based on a settlement amount (the stream of payments that is expected to be provided to other beneficiaries).
    - Re-measured at each financial reporting date, based on changes in the assumptions used to determine the settlement amount. The change resulting from the re-measurement of the amount recognized as the liability should be recognized as an increase or a decrease in the related deferred inflow of resources
  - A deferred inflow of resources for the government's unconditional remainder interest.
    - Changes in assets recognized pursuant to irrevocable split-interest agreements—such as those resulting from interest, dividends, and changes in fair value—should be recognized as an increase or a decrease in the related deferred inflow of resources

GASB 81 – Irrevocable split interest agreements

- If a government is *both* the intermediary and the lead interest beneficiary of an irrevocable-split interest agreement, the government should recognize the following:
  - Assets for resources received or receivable
  - A deferred inflow of resources for the government's unconditional lead interest
    - Measured based on a settlement amount (the stream of payments that is expected to be provided to the government beneficiary)
    - Benefit payments received during the period should be recognized as revenue and decrease the deferred inflow
    - Amount reported as a deferred inflow of resources should be re-measured at each financial reporting date
  - A liability for the remainder interest that is assigned to other beneficiaries.
    - Changes in assets such as those resulting from interest, dividends, and changes in fair value should be recognized as an increase or a decrease in the related liability

GASB 81 – Irrevocable split interest agreements

- If a third party is the intermediary of an irrevocable split-interest agreement, assets should be recognized for beneficial interests that meet *all* of the following criteria:
  - The government is specified by name as beneficiary in the legal document underlying the donation.
  - The donation agreement is irrevocable
  - The donor has not granted **variance power** to the intermediary with respect to the donated resources.
  - The donor does not control the intermediary
  - The irrevocable split-interest agreement establishes a legally enforceable right for the government's benefit (an unconditional beneficial interest)

GASB 81 – Irrevocable split interest agreements

- The beneficial interest asset initially should be measured at fair value and re-measured at fair value at each financial reporting date. Changes in the fair value of the beneficial interest asset also should be recognized as an increase or a decrease in the related deferred inflow of resources
  - Lead interest beneficiary - the government should recognize revenue for the beneficial interest applicable to the reporting period as stipulated in the irrevocable split-interest agreement
  - Remainder interest beneficiary - the government should recognize revenue for the beneficial interest at the termination of the agreement, as stipulated in the irrevocable split-interest agreement

GASB – Technical agenda projects

- Major projects
  - Asset retirement obligations
  - Fiduciary responsibilities
  - Financial reporting model re-examination
  - Leases
- Practice issues
  - Certain debt extinguishments using existing resources
  - Implementation guidance
  - Implementation guide for statements 74 and 75
  - User guides update
- Conceptual framework
  - Recognition

GASB – Pre-agenda research

- Debt disclosures, including direct borrowing – re-examination of Statements 34, 38 and 62
- Going concern disclosures – re-examination of Statement 56
- Revenue recognition for exchange and exchange-like transaction – re-examination of specific statement 62 provisions

Thank You!