State Accounting Bureau

Governmental Accounting Conference

April 16, 2018

Objectives

- Enhance each attendees knowledge of Governmental Accounting Standards issued by the Governmental Accounting Standards Board (GASB)
  - Examine currently issued standards and currently issued exposure drafts
  - Examine GASB tentative decisions on the Reporting Model project and Revenue and Expense Recognition ITC
- Provide guidance for improving client/customer relationships and utilizing professional skepticism when performing their assigned functions

Topics to Cover

- What's Going On – A Current Events Look at the Accounting Profession
- Currently Issued GASB Standards
- Improving Client Relationships
- GASB Exposure Drafts
- Reporting Model Update
- Revenue and Expense Recognition ITC Update
- Professional Skepticism

State of Montana
Department of Administration

Department of ADMINISTRATION MONTANA

What's Happening Out There?

April 16, 2018

Jerry E. Durham, CPA, CGFM, CFE

Jerry E. Durham, CPA, CGFM, CFE

- Jerry is an Assistant Director for the State of Tennessee, Comptroller of the Treasury, Division of Local Government Audit. The division has statutory responsibility for audits of approximately 1800 local governments and related organizations in Tennessee. A 34-year veteran of the division, Jerry has served as an auditor, audit supervisor, training instructor, technical manager, and assistant director. Jerry is a Certified Public Accountant (CPA), Certified Government Financial Manager (CGFM), and a Certified Fraud Examiner (CFE). In his role as assistant director, he is responsible for developing professional compliance procedures and monitoring the division's quality performance under GASB, AICPA, OMB, and GAO accounting and auditing standards. Jerry also has responsibility for supervising the contract review process within the division. Most recently, Jerry assisted the division in implementing GASB Statements 67 and 68. In addition, Jerry teaches training classes for the Tennessee Department of Audit (Yellow Book and Audit Findings). He has been selected as Instructor of the Year four times. Jerry has made training presentations for several other professional organizations including the Tennessee Society of Certified Public Accountants; Tennessee Government Finance Officers Association; National Association of State Auditors, Comptrollers and Treasurers; Association of Government Accountants; County Technical Assistance Service; Southeastern Intergovernmental Audit Forums; Nashville Chapter of the Association of Certified Fraud Examiners; and various county official's associations. Jerry currently serves on GFOA's CAAFR Committee, NASACT's Financial Management and Intergovernmental Affairs Committee, and NSAA's Audit Standards and Reporting Committee, Auditor Training Committee, and Peer Review Committee. He has served the National State Auditors Association External Peer Review program as a reviewer, team leader, and concurring reviewer and serves on the Special Review Committee for GFOA's Certificate of Achievement for Excellence in Financial Reporting program. Jerry has also provided training for the New York City Comptroller's Office and state auditors in Arkansas, Idaho, Kentucky, Minnesota, Mississippi, North Dakota, Montana, Arkansas, West Virginia, and North Carolina. In addition to these duties, Jerry currently serves on the state's Interagency Cash Flow Committee which operates under the authority of the Tennessee State Funding Board.
- Jerry was a partner in the accounting firm of Crosthwaite Durham and Associates. He also served as controller for Rural Healthcare of America, Inc., and taught accounting as a member of the adjunct faculty for Columbia State Community College and Austin Peay State University.
- Jerry received his accounting degree from the University of Tennessee at Martin. He is a member of the American Institute of Certified Public Accountants (AICPA); the Association of Government Accountants (AGA) and the Nashville Chapter where he served as chair of the CGFM committee; the Government Finance Officer's Association (GFOA) and the Tennessee Government Finance Officers Association (TGFOA) where he serves as state liaison to the Board of Directors; the Association of Certified Fraud Examiners (ACFE) and the Nashville Chapter of ACFE. Jerry is also a graduate from the Tennessee Government Executive Institute (TGEI) which is a training program for government leaders through the University of Tennessee.
- Jerry is married and has three children and four grandchildren.

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The Opinions expressed during this presentation are my own. They do not necessarily represent the views of the Tennessee Comptroller of the Treasury, his representatives, or the Tennessee Department of Audit.

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What's Happening Out There?

Tax Cuts and Jobs Act

- GFOA CAAFR Committee Meetings
  - Refunding Debt
  - Private activity bonds are still here for now
  - Tax Credit Bonds such as BAB are eliminated
  - Municipal Debt is still tax exempt for now

Current Events – Accounting and _______?

Robocalypse Now – NY Times Article

Financial Management Magazine

McDonald's Example

Uber Accountants

Robo-Advisors

Robo-Advisors

Technology = End of Accounting Profession?
Author: Daniel Susskind

Robot Technology Post Script…….

Stock Market

Stock Market

Bitcoin Market

Cyber Security

No more annual evaluations

What's the price tag on your college football team?

Current Events – GASB Funding?

- Changes to Dodd-Frank Act?
  - SEC Regulations
  - GASB Funding Mechanism?

  - Appears this is not going to be an issue.

Office of the Past

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Office of the Future
Amsterdam

Office of the Future

Cyborg Employees
Stockholm

Amazon's Wristband

Lost Vacation Time

Be very careful with technology!

Instagram

The Return of ....

Questions?

Jerry E. Durham, CPA, CGFM, CFE

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Department of
ADMINISTRATION
MONTANA

Only Because I Can't Put It Off Any Longer

April 16, 2018

Jerry E. Durham, CPA, CGFM, CFE

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OPEB!!

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Effective Dates—June 30

- 2015
  - Statement 68—Pensions—Employers
  - Statement 69—Government Combinations and Disposals of Government Operations
  - Statement 71—Pension Transition for Contributions Made Subsequent to the Measurement Date
- 2016
  - Statement 72—Fair Value Measurement and Application
  - Statement 73—Pensions—Related Assets (outside scope of Statements 67 and 68)
  - Statement 76—Hierarchy of GAAP for State/Local Governments
  - Statement 79 – Certain External Investment Pools and Pool Participants

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Effective Dates—June 30

- 2017
  - Statement 73—Pensions Amendments to Certain Provisions of 67 & 68
  - Statement 74—Financial Reporting – OPEB Plans
  - Statement 77—Tax Abatement Disclosures
  - Statement 78 – Pensions Provided through Certain Multiple-Employer Defined Benefit Plans
  - Statement 79 – Certain Investment Pools and Participants
  - Statement 80 - Blending Requirements for Certain Component Units
  - Statement 82 – Pension Issues

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Effective Dates—June 30

- **2018**
  - **Statement 75—Accounting and Financial Reporting – OPEB – Employers**
  - **Statement 81 – Irrevocable Split-Interest Agreements**
  - **Statement 82 – Pension Issues (Certain Provisions related to Assumptions)**
  - **Statement 85 – Omnibus 2017**
  - **Statement 86 – Certain Debt Extinguishment Issues**

2019
  - **Statement 83 - Certain Asset Retirement Obligations**

2020
  - **Statement 84 – Fiduciary Activities**

2021
  - **Statement 87 – Leases**

2022 Tentative
  - **Final Statement XX – Reporting Model Due 1st Quarter**

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OPEB

- If you put "OPEB" in your computer, Spell Check will not like that word.

- You will come to dislike the word as well.

- Once you understand what the Governmental Accounting Standards Board (GASB) is asking you to record for Other Postemployment Benefits (OPEB), that may be an understatement.

Why?

- Because we really do have a long-term liability!

Why?

- GASB, in Concept Statement Number 4, Paragraph 17-19, issued in June of 2007, defined what a liability is:
  - A liability is a present obligation to sacrifice resources that the government has little or no discretion to avoid.
  - An obligation is a social, legal, or moral requirement, such as a duty, contract, or promise that compels one to follow a particular course of action. Example: Overtime Pay.
  - Even if the agreement may not be legally enforceable, the government may have a liability due to social, moral, or economic consequences. Examples: Vacation Pay, Sick Pay, Deferred Compensation, or Retiree Health Care benefits.

Why?

- GASB 45, Paragraph 7, States that OPEB arises from an exchange of salaries and benefits for employee services, and it is part of the compensation that employers offer for services received.
- Simply put, GASB says OPEB meets the definition of a liability.

Why? – The History

- GASB was established in 1984.
- The OPEB Project began in 1988 because of a growing concern about the potential magnitude of employer obligations.
- Pushed along by FASB Statement 81, *Disclosure of Postretirement Health Care and Life Insurance Benefits*, which was considered, Level B GAAP for Governments, because GASB did not have a standard.
- Most Governments did not apply the FASB standard.
- By 1988, FASB had issued a more comprehensive standard. FASB 106 was titled *Employer's Accounting for Postretirement Benefits Other than Pensions*. The new standard essentially reflected the same measurement for OPEB as was required in FASB 87, *Employer's Accounting for Pensions*, issued in December, 1985.
- GASB stated that governments should not apply FASB 87, because GASB was making progress on its own statement that was anticipated in the near future.

Why? – The History

- GASB issued an interim Statement - Statement 12, *Disclosure of Information on Postemployment Benefits Other than Pension Benefits by State and Local Government Employers,* in May of 1990. GASB 12 was effective for 7/1/90 to 6/30/91 financial statements.
- Statement 12 specifically stated that governmental employers were not required to implement FASB 106.
- Subsequently, GASB provided employers the option of applying GASB 27, *Accounting for Pensions by State and Local Governmental Employers*, which was issued in November of 1994.
- In November of 1994, GASB issued a second interim Statement, Statement 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*. It required separate reporting.
- Deliberations continued in 1994 and 1995. The project was placed on hold in 1997 pending completion of GASB 34.

Why? – The History

- GASB resumed discussions in 1999.
- GASB issued two exposure drafts, one for OPEB Plans and One for Employers in February of 2003. A revised exposure draft was issued in January 2004 requiring the concept of an implicit rate subsidy.
- And GASB 43, *Financial Reporting For Postemployment Benefits Plans Other Than Pensions,* was issued in April, 2004 and GASB 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* was issued in June, 2004.
- **And the rest as they say, is History.**
- GASB 74 and 75 were issued in June, 2015.
- GASB 74 was effective for June 30, 2017.
- GASB 75 is effective for June 30, 2018.
- **This history takes us from 1988 to 2015. Approximately 27 years.**

Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans

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OPEB Plans 74

- This Statement supersedes all remaining requirements of:
  - Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended
  - Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*.
  - Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended
  - Statement No. 50, *Pension Disclosures*
  - *Various other paragraphs*

Important Announcement!

- If you do not have a OPEB Trust Fund,
- If you are not accumulating assets to pay for OPEB benefits,
- Then…
- GASB 74 does not apply to you!

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OPEB Plans – 74

- Accounting for assets accumulated for OPEB that does not meet the trust criteria:
  - Single employer – continue to be reported as assets of the employer
  - Multiple-employer – report the assets in an Agency Fund
    - Exception – employer is a member of the OPEB plan (agency fund should exclude the employer amounts)

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OPEB Plans – 74

- Addresses both OPEB Plans Administered through Trusts & not administered through Trusts
- Requires reporting of liability in the Notes to the Financial Statements or on the face of the Financial Statements
  - **Trust**: Total OPEB Liability minus Fiduciary Net Position = Net OPEB Liability
  - **No Trust**: Total OPEB liability = Liability
- Discount Rate –
  - **Trust** – Single Discount rate = LTeRoR as projected sufficient
  - **No Trust** – 20-year, tax-exempt general obligation municipal bonds (AA/Aa or higher)

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2017 Montana CAFR

B. Plan Descriptions

Both healthcare OPEB plans for the State of Montana and MUS are agent multiple employer plans. In addition to the primary government, the participating employers under the State Plan are Facility Finance Authority, Montana Board of Housing, Public Employees' Retirement System, Montana State Fund, and Teachers' Retirement System. The participating employers under the MUS plan are Dawson Community College (Dawson CC), Flathead Valley Community College (Flathead CC), Miles Community College (Miles CC), Office of Commissioner on Higher Education (OCHE), Montana State University – Billings (MSU-Billings), Montana State University – Bozeman (MSU-Bozeman), Great Falls College MSU, Montana State University – Northern (MSU-Northern), University of Montana – Montana Tech (UM-MT Tech), Helena College UM, University of Montana – Missoula (UM-Missoula), and University of Montana – Western (UM-Western). Each participating employer is required to disclose additional information regarding funding policy, the employer's annual OPEB cost and contributions made, the funded status and funding progress of the employer's individual plan, and actuarial methods and assumptions used.

The healthcare OPEB plans allow retirees to participate, as a group, at a rate that does not cover all of the related costs. This results in the reporting of an "implied rate" subsidy in the related financial statements and note disclosures. While this liability is disclosed for financial statement purposes, it does not represent a legal liability of the State or any of its component units. Accordingly, reported contributions are not a result of direct funding to the plans or for associated liabilities, but are a measure of the difference in retiree payments into the plans and actual medical costs associated with those individuals paid for by the plans.

The healthcare OPEB plans are reported as agency funds. There are no assets or liabilities as only contributions collected and distributions made are reflected in these funds.

2017 Montana CAFR

The following table presents the OPEB cost for the year, the amount contributed, and changes in the OPEB plan for fiscal year 2017 (in thousands):

Annual OPEB Cost & Changes in Net OPEB Obligation

	State	MUS
Annual required contribution/OPEB cost	$ 34,107	$ 9,526
Interest on net OPEB obligation	11,605	4,892
Amortization factor	(9,102)	(3,837)
Annual OPEB cost	36,610	10,581
Retiree claims paid	(9,007)	(3,532)
Increase in net OPEB obligation	27,603	7,049
Net OPEB obligation – beginning of year	273,047	115,096
Net OPEB obligation – end of year	$300,650	$122,145

Note that the amounts in the State and MUS Annual OPEB Cost table above include component unit and community college portions and therefore, they will not match the Statement of Net Position.

The State and MUS annual healthcare OPEB cost, the percentage of annual implicit contributions toward the OPEB cost through retiree claims paid on their behalf, and the net OPEB obligation for fiscal years 2017 through 2014 was as follows (in thousands):

Contribution Ratio

	Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
State	6/30/2017	$36,610	24.6%	$300,650
	6/30/2016	36,221	24.8%	273,047
	6/30/2015	37,205	28.2%	246,643
	6/30/2014	36,823	19.1%	219,109
MUS	6/30/2017	$10,581	33.4%	$122,145
	6/30/2016	10,654	28.7%	115,096
	6/30/2015	10,624	31.3%	107,498
	6/30/2014	10,671	15.9%	99,891

2017 Montana CAFR

Other Postemployment Benefits
State Agent Multiple-Employer Plan

	Retiree/Surviving Spouse	Spouse
Contributions (in thousands):		
Before Medicare eligibility	$11,172	$4,267
After Medicare eligibility	4,454	3,545
Actuarial valuation date	1/1/2015 (ARC calculated through December 31, 2015)	
Actuarial cost method	Projected unit cost funding	
Amortization method	Level percent of payroll, open	
Remaining amortization period	30 years	
Asset valuation method	Not applicable since no assets meet the definition of plan assets under GASB 45	
Actuarial assumptions:		
Discount rate	4.25%	
Projected payroll increases	2.50%	
Participation:		
Future retirees	55.00%	
Future eligible spouses	60.00%	
Marital status at retirement	70.00%	

2017 Montana CAFR

Other Postemployment Benefits
MUS Agent Multiple-Employer Plan

	Retiree/Surviving Spouse	Spouse
Contributions (in thousands):		
Before Medicare eligibility	$8,392	$3,866
After Medicare eligibility	3,624	2,753
Actuarial valuation date	7/1/2015 (ARC Calculated through June 30, 2016)	
Actuarial cost method	Projected unit cost funding	
Amortization method	Level percent of payroll, open	
Remaining amortization period	30 years	
Asset valuation method	Not applicable since no assets meet the definition of plan assets under GASB 45	
Actuarial assumptions:		
Discount rate	4.25%	
Projected payroll increases	2.50%	
Participation:		
Future retirees	50.00%	
Future eligible spouses	60.00%	
Marital status at retirement	70.00%	

2017 Montana CAFR

In accordance with GASB Statement No. 45, the following information is presented to reflect the funding progress of the Other Postemployment Benefits Plans.

Other Postemployment Benefits Plan Information
Schedule of Funding Progress
(in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
State Agent Multiple Employer Plan						
1/1/2011	$ -	$337,274	$337,274	0.00%	$521,881	64.63%
1/1/2013	$ -	$366,739	$366,739	0.00%	$616,158	59.52%
1/1/2015	$ -	$347,935	$347,935	0.00%	$645,888	53.87%
MUS Agent Multiple Employer Plan						
7/1/2011	$ -	$191,017	$191,017	0.00%	$371,802	51.38%
7/1/2013	$ -	$114,498	$114,498	0.00%	$400,017	28.62%
7/1/2015	$ -	$110,494	$110,494	0.00%	$416,565	26.53%

What Financial Statements?

- Fund Financial Statements – Modified Accrual?
  - Or
- Government-wide Financial Statements – Full Accrual?

2017 Montana CAFR

LIABILITIES				
Accounts payable (Note 4)	760,832	18,795	779,627	79,057
Lottery prizes payable	-	3,570	3,570	-
Due to primary government	-	-	-	4,151
Due to other governments	30,539	74	30,613	24
Due to component units	1,682	-	1,682	271
Due to pension trust funds	34,451	-	34,451	-
Advances from primary government	-	-	-	39,190
Unearned revenue	33,248	2,000	35,248	94,083
Amounts held in custody for others	18,103	30	18,133	14,668
Securities lending liability (Note 3)	29,313	2,049	31,362	45,742
Other liabilities	4,065	-	4,065	23,544
Short-term debt (Note 11)	-	107,880	107,880	-
Long-term liabilities (Note 11):				
Due within one year	143,376	14,900	158,276	194,353
Due in more than one year	434,955	7,827	442,782	1,606,210
Net pension liability (Note 6)	1,789,810	14,293	1,804,103	206,646
OPEB implicit rate subsidy (Note 7)	289,175	5,132	294,307	122,245
Total liabilities	3,569,549	176,550	3,746,099	2,430,184

2017 Montana CAFR

	PRIMARY GOVERNMENT			
	GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTAL	COMPONENT UNITS
NET POSITION				
Net investment in capital assets	$ 5,873,003	$ 18,986	$ 5,891,989	$ 597,644
Restricted for:				
General government	6,873	-	6,873	-
Transportation	24,450	-	24,450	-
Natural resources	493,194	-	493,194	-
Public safety	242,570	-	242,570	-
Education	13,074	-	13,074	-
Funds held as permanent investments:				
Nonexpendable	1,596,057	-	1,596,057	391,658
Expendable	575,746	-	575,746	-
Unemployment compensation	-	298,631	298,631	-
Montana Board of Housing	-	-	-	153,326
Other purposes	-	69,103	69,103	256,566
Unrestricted	(971,795)	8,288	(963,507)	508,574
Total net position	$ 7,853,172	$ 395,008	$ 8,248,180	$ 1,907,768

The notes to the financial statements are an integral part of this statement.

OPEB Employers - 75

- Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities.

OPEB Employers - 75

- GASB 75, *Accounting and Financial Reporting for Postemployment Benefits*
- *Is effective for the year ended June 30, 2018.*
- *What should you be doing? Good question.*

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OPEB Employers – 75

- Post Employment Benefits - Employers:
  - The Gist of the Employer Standard is to require recording of the Net OPEB Liability, OPEB Expense, and related Deferred Outflows and Inflows.
  - Currently only a Net OPEB Obligation is recorded (Example, making the minimum payment on a credit card).
  - Increased Notes Disclosures and RSI (Pages and Pages).

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OPEB Employers – 75

- Post Employment Benefits - Employers:
  - In essence, just like GASB 67 and 68.
  - Except, the numbers will be much bigger!
  - Will supersede GASB Statement 45.

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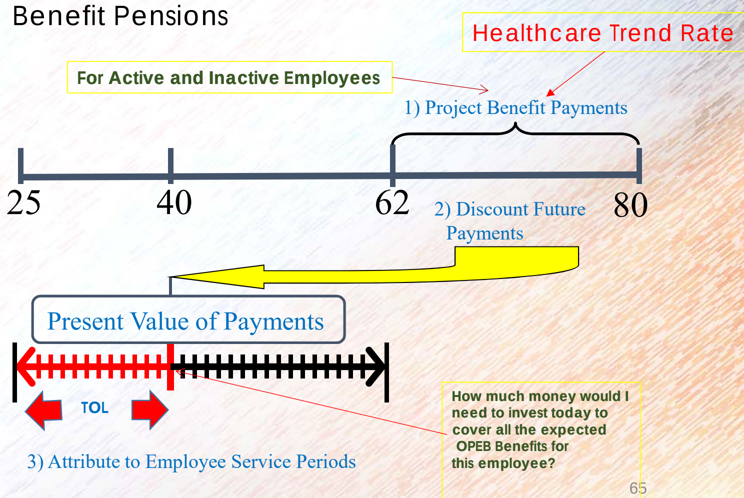
The Concept

- You take out a house mortgage of $200,000 (i.e. you promise to pay $200,000)
- The Mortgage is Payable over 20 years at $10,000 per year
- (Assume no interest for this illustration)
- $10,000 is the cash disbursed during a year, but this is not what you **owe**.
- After the first year, you still **owe** $190,000 even though you have funded your mortgage payments for the current year.

The Basic Three-Step Approach for Defined Benefit Pensions



Pension Sensitivity Disclosure

School Department's Proportionate Share of the Net Pension Liability (Asset)	1% Decrease 6.5%	Current Discount Rate 7.5%	1% Increase 8.5%
Net Pension Liability	$ 17,907,962	$ 262,670	$ (14,345,551)

The Concept

- You hire 10 new employees and promise to pay their medical insurance premiums after retirement. This is projected to cost $200,000 at some date in the future.
- You make current contributions to the plan by paying a actuarilly determined amount during the current year. (Pay as you go)
- However, if your actual contributions are not enough to cover the actuarially determined contributions, you have a liability that GASB 45 says needs to be recorded today. (but 45 has been superseded by 75)
- Under GASB 75, you owe $200,000 for the new employees. But what if you already owed $2,500,000 to current employees, that had never been recorded, what happens?

OPEB in Tennessee

- We have held meetings with Finance and Administration (F&A)
  - We have talked directly to GASB
  - F&A will provide the OPEB information
  - Will utilize a valuation and measurement date one year previous to the financial statement date.
  - An Actuarial Study will be provided (may not be individualized).
  - If it is individualized, it may not be certified by the Actuary.
  - Template Notes disclosures will be provided.
  - Information for Journal Entries will be supplied but not the Journal Entries?
  - Charter Schools are not separated at this point?

OPEB in Montana or Tennessee

- Question,
  - Do state and local governments have to provide OPEB Benefits?
- Question,
  - What can I do to reduce my Net OPEB Liabilities?

OPEB in Tennessee

- For State Employees:
  - No new OPEB employees after July 1, 2015, so what will that mean?

OPEB in Tennessee

On-Behalf Payments – Discretely Presented Perry County School Department

The State of Tennessee pays health insurance premiums for retired teachers on-behalf of the [redacted] County School Department. These payments are made by the state to the Local Education Group Insurance Plan and the Medicare Supplement Plan. Both of these plans are administered by the State of Tennessee and reported in the state's Comprehensive Annual Financial Report. Payments by the state to the Local Education Group Insurance Plan and the Medicare Supplement Plan for the year ended June 30, 2017, were $14,780 and $8,000, respectively. The School Department has recognized these on-behalf payments as revenues and expenditures in the General Purpose School Fund.

Just Like Pensions, Not!

- Still have an implicit rate subsidy calculation
- Preserves the alternative measurement calculation option for small employers and plans that have 100 employees or less – active and inactive employees
- Sensitivity disclosure is broadened to include Healthcare Trend Rate in addition to the Discount Rate in Notes to Financial Statements
- Considerations for Employers who do not have a Trust Fund are incorporated in 75 rather than by an Amendment (i.e. 73)

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Just Like Pensions, Not!

- May or may not use "service credits" in the projection of benefits. This would almost always be included in pension calculations.

45 vs. 75

- Valuation Frequency has changed:
  - Old - Employees of 200 or more = biennially
  - Old - Employees of less than 200 = triennially
  - Old – Fewer than 100 = Alternative Method (Option)
  - New – Measurement no earlier than 1 year
  - New – Valuation date of no more than 30 months and 1 one day prior to FYE
  - Actuaries must follow ASOP
  - Only one Actuarial Method

45 vs. 75

- Net OPEB Liability (75) vs. Net OPEB Obligation (45)
  - Trusted Plans vs. Non-Trusted Plans
  - Deferrals Calculated
  - Contributions after the measurement date
  - Special Funding situations
  - Etc.
- Cost Sharing Plans included
- Notes to Financial Statements (e.g. Sensitivity Analysis)
- RSI

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So What Should I Be Doing?

- Ensure that your individual payroll records are complete and up to date:
  - Hire a very good Actuary
  - Make sure the census data you present to the Actuary agrees with your employee records
  - Auditors and the Actuary will need to know how many are <u>active</u> and how many are <u>inactive</u>
  - Establish Internal Controls over the census data accumulation process
    - Correct name and identification such as social security number
    - Correct birth date
    - Male or Female listed in the record
    - Date of hire and date of termination

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So What Should I Be Doing?

- Be prepared to be hassled by your Auditors!

So What Should I Be Doing?

- Accounting:
  - The beginning GASB 45 Net OPEB Obligation will be reversed off the books and a new GASB 75 Net Pension Liability will be calculated and recorded.
  - This will be a “restatement” of beginning net position. It is a one time “hit” to your financial statements.

Other Guidance

Implementation Guide No. 2017-2, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans

Thought Question?

- Is it more difficult to estimate pension benefits into the future, or
- More difficult to estimate healthcare costs into the future?

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Questions!

Jerry E. Durham, CPA, CGFM, CFE

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Department of ADMINISTRATION MONTANA

The Latest Inventions from the Mind of GASB

81, 83, 84, 85, 86, 87

January 24, 2018

Jerry E. Durham, CPA, CGFM, CFE

The Latest Inventions from the Mind of GASB

New Statements Effective

2018 or Later

Irrevocable Split-Interest Agreements - 2018

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Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **Exposure Draft Issued June 2015**
  - **GASB 81 Issued March 2016**
  - **Effective for Periods beginning after 12/15/2016 (i.e. calendar year 2017, fiscal year 2018)**
- **Definition of Irrevocable Split-Interests:**
  - **A split-interest agreement in which the donor has not reserved, or conferred to another person, the right to terminate the agreement at will and have the donated assets returned to the donor or third party.**

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Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **Irrevocable split-interest agreements are a specific type of giving arrangement used by donors to provide resources to two or more beneficiaries, including governments. Examples include charitable lead trusts, charitable remainder trusts, charitable annuity gifts, and life-interests in real estate.**

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Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **Since there are different types of agreements, a determination has to be made about the type.**
    - **When does the interest begin and terminate?**
    - **Is the Government the intermediary or is the intermediary a third party?**
    - **If the donation is capital property (e.g. land), how do I plan to use the property? Capital Asset or Investment.**
    - **Will I use fair value or acquisition value?**

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Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **Since there are different types of agreements, a determination has to be made about the type (cont'd).**
    - **Do you have the lead interest or the remainder interest?**
    - **If the government is the Intermediary and has a remainder interest normally debit an asset, credit a liability for the lead interest, and credit a deferred inflow for the difference (i.e. the government's remainder interest).**

88

Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **Since there are different types of agreements, a determination has to be made about the type (cont'd).**
    - **If the government is the Intermediary and has a lead interest normally debit an asset, credit a liability for the remainder interest, and credit a deferred inflow for the difference (i.e. the government's lead interest).**

89

Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **Since there are different types of agreements, a determination has to be made about the type (cont'd).**
    - **If a third party is the Intermediary and the government has a beneficial interest, normally debit an asset and credit a deferred inflow when the government becomes aware of the agreement and has sufficient information to measure the beneficial interest.**

90

Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **If a third party is the Intermediary and the government has a beneficial interest, what is sufficient information:**
    - **Government is specified by name**
    - **Government has an unconditional beneficial interest**
    - **The donation agreement is irrevocable**
    - **The donor has not granted variance power to the intermediary with regard to the donated resources**
    - **The intermediary is not under the control of the donor**
    - **The government's ability to assign its beneficial interest is not subject to approval of the intermediary**
    - **The government's attempt to assign its beneficial interest does not invalidate the government's beneficial interest and thereby terminate the agreement**

91

Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **FASB Statement 136 *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others,* requires the resources held in an irrevocable trust as assets and contributions into the trust to be recorded as assets and the contributions into the trust as revenues of the beneficiary government (Para 15).**

92

Irrevocable Split-Interests

- **Practice Issue – Accounting and Reporting for Irrevocable Split-Interest Agreements:**
  - **Obviously, there are many variations of the scenarios we have looked at that require different entries and calculations.**
  - **The statement does not mention disclosure requirements!**

93

Certain Asset Retirement Obligations - 2019

83

ARO

- **Certain Asset Retirement Obligations (ARO):**
  - **Exposure Draft Issued December 7, 2015**
  - **Statement 83 Issued November 2016**
  - **Effective for periods beginning after June 15, 2018**

- **FASB Statement 143, Accounting for Asset Retirement Obligations (2001) has been followed.**
- **Should costs be capitalized, what should be disclosed?**

95

ARO

- ***Asset retirement obligation*—A legal obligation associated with the retirement of a capital asset, the unavoidable costs of retiring an asset**
- ***Retirement of a tangible capital asset*—The other-than-temporary removal of a capital asset from service (such as from sale, abandonment, recycling, or disposal)**
- **Includes:**
  - **Nuclear power plant decommissioning**
  - **Coal ash pond closure (those that are not landfills)**
  - **Contractually required land restoration such as removal of wind turbines**
  - **Sewage Treatment Facilities**
  - **Other similar obligations**
  - **But not the pollutions they cause!**
- **Excludes:**
  - **Landfills (GASB 18), However this is the most common ARO**
  - **Pollution remediation obligations from abnormal operation (GASB 49)**
  - **Conditional obligations to perform asset retirement activities, such as most asbestos removal**

96

ARO

- **Asset Retirement Obligations (ARO):**
  - **Legally enforceable liability**
  - **Internal obligating event**
  - **Associated with a tangible capital asset**
  - **Recognize a liability when incurred and reasonably estimable**
  - **Use probability weighing of all potential outcomes or if this is not available at a reasonable cost, then use most likely amount**
  - **Record a deferred outflow = to liability**
  - **Remeasure the liability for effects of inflation and deflation annually and other relevant factors. Book if significant**
  - **Special recognition for minority interests calculated under other than GASB GAAP**

97

ARO

- **Asset Retirement Obligations (ARO) - Disclosures:**
  - **Disclose funding requirements and amounts accumulated and restricted for payment of the liability**
  - **Nature of government's AROs**
  - **Methods and assumptions used for estimates of liabilities**
  - **Estimated remaining useful life of associated tangible assets**
  - **Disclose the fact and reasons why a liability is not reasonably estimable**
  - **Similar disclosures for minority interests**

98

ARO

Proposal: Recognition & Measurement

Initial Recognition	ARO liability when incurred and reasonably estimable—measured based on the best estimate	Deferred outflow of resources—same amount as the ARO liability
Subsequent Recognition	• At least annually remeasure the current value for inflation/ deflation • At least annually evaluate relevant factors for significant change	Recognize a reduction as an outflow of resources – systematic and rational manner over the useful life

Fiduciary Activities - 2020

84

Fiduciary Activities

- Statement No. 14, *The Financial Reporting Entity*, Paragraph 19
  - Include "if the primary government has a fiduciary responsibility for them"
- Statement No. 61, *The Financial Reporting Entity: Omnibus*
  - Fiduciary activities broader than reporting entity considerations –so not addressed
- Existing standards
  - Fiduciary responsibilities not defined
  - Inconsistent application
  - Business-type activities
- Governmental Accounting Standards Advisory Council (GASAC)
  - High priority to address fiduciary activities

101

Fiduciary Activities

- April 2010 –added to Pre-Agenda Research
  - Review current practices
  - Conduct survey of users
- August 2013 –added project to Current Technical Agenda
  - November 2014 –issued Preliminary Views
  - 36 Responses
  - 3 Public hearings –18 organizations and individuals testified
  - Field tests conducted
- December 2015 –issued Exposure Draft
  - 37 Responses
  - Public hearing –13 organizations and individuals testified
- October 2016 –conducted webinar on tentative revisions
- January 2017 –issued Statement No. 84
- **Effective Date, Calendar Year 2019, Fiscal Year Ended June 30, 2020**

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Fiduciary Activities

- Improve guidance regarding the identification of fiduciary activities for accounting and financial reporting
- Focus is on:
  - (1) whether a government is controlling the assets, and
  - (2) the beneficiaries with whom the relationship exists
- Separate criteria for fiduciary component units and postemployment benefit arrangements that are fiduciary activities
- 4 fiduciary funds that should be reported:
  - Postemployment trust funds
  - Investment trust funds
  - Private-purpose trust funds
  - Custodial funds

Fiduciary Activities

- Objective:
  - Improve consistency and comparability of fiduciary activities reporting
  - Increase usefulness of fiduciary activity information for assessing a government's accountability in its role as a fiduciary
- Applies to all state and local governments

Fiduciary Activities

- Defines and clarifies fiduciary activities
- Introduces "custodial" funds, eliminates agency funds

105

Fiduciary Activities

- Four paths to making this determination:
  - Component units that provide postemployment benefits
  - Component units that do <u>not</u> provide postemployment benefits
  - Postemployment benefit arrangements that are not component units
  - All other activities

Fiduciary Activities

- Primary governments (PG) and/or component units (CU) may have fiduciary activities
- Standard gives specific guidance to determine if an activity is a fiduciary activity
  - Paragraphs 6-9: Component units (fiduciary component units)
  - Paragraphs 10-11: Other activities

107

Component Units That Provide Postemployment Benefits

- Still look to criteria of GASB 14, as amended, for CU determination
  - Legal or assumed obligation to make contributions to legally separate pension and OPEB plans is considered a financial burden
  - <u>Control</u> of CU assets by PG is <u>not</u> a consideration when determining if CU is fiduciary component unit

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Component Units That Provide Postemployment Benefits

- Fiduciary activity if any one of the following:
  - Pension plan administered through a trust that meets criteria of para. 3 of GASB 67
  - OPEB plan administered through a trust that meets criteria of para. 3 of GASB 74
  - Assets from entities outside reporting entity accumulated for pensions (para. 116 of GASB 73 - i.e. Not in a trust).
  - Assets from entities outside reporting entity accumulated for OPEB (para. 59 of GASB 74 – i.e. Not in a trust)

109

Component Units That "Do Not" Provide Postemployment Benefits

- If CU but **not** pension/OPEB arrangement as previously described, CU is fiduciary activity if related assets are any one of following:
  - 1) a) administered through a trust agreement and the government is *not* a beneficiary, b) dedicated to providing benefits as per benefit terms, AND c) legally protected from creditors of the government; **or**
  - 2) for the benefit of individuals and no administrative involvement or direct financial involvement by government and assets are *not* from the government providing goods or services; **or**

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Component Units That "Do Not" Provide Postemployment Benefits

- If CU but not pension/OPEB arrangement, CU is fiduciary activity if related assets are any one of following (continued):

  or

  - 3) for the benefit of organizations or other governments outside the reporting entity and assets are not derived from the government providing goods or services to those organizations

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Component Units That "Do Not" Provide Postemployment Benefits

- Footnote 1 - When does a government have administrative control or direct financial involvement?
- Examples of administrative involvement:
  - If it monitors compliance with the requirements of the activity that are established by the government or by a resource provider that does not receive the direct benefits of the activity
  - If it determines eligible expenditures that are established by the government or by a resource provider that does not receive the direct benefits of the activity
  - If it has the ability to exercise discretion in how assets are allocated
- Example of direct financial involvement:
  - If it provides matching resources for the activities

Pension and OPEB Arrangements That Are "Not" Component Units

- Government controls the assets of an activity if that government:
  - Holds the assets
  - Has the ability to direct the use, exchange or employment of the assets
- Restrictions do not negate a government's control

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Pension and OPEB Arrangements That Are "Not" Component Units

- If **not** CU, pension and OPEB arrangements <u>are</u> fiduciary activities if the government controls:
  - Pension plan administered through a trust that meets criteria of para. 3 of GASB 67
  - OPEB plan administered through a trust that meets criteria of para. 3 of GASB 74
  - Assets from entities outside of reporting entity accumulated for pensions (para. 116 of GASB 73)
  - Assets from entities outside of reporting entity accumulated for OPEB (para. 59 of GASB 74)

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457 Plans

The Administrator is responsible for the day-to-day administration and operation of the Plan. For example, the Administrator maintains the Plan records, including your account information, provides you with the forms you need to complete for Plan participation, and directs the payment of your account at the appropriate time. The Administrator will also allow you to review the formal Plan document and certain other materials related to the Plan. If you have any questions about the Plan or your participation, you should contact the Administrator. The Administrator may designate other parties to perform some duties of the Administrator.

The Administrator has the complete power, in its sole discretion, to determine all questions arising in connection with the administration, interpretation, and application of the Plan (and any related documents and underlying policies). Any such determination by the Administrator is conclusive and binding upon all persons.

The name, address and business telephone number of the Plan's Administrator are:

Typical Government
Typical Address
Typical Zip Code

Plan Trustee Information and Plan Funding Medium

457 Plans

Plan Trustee Information and Plan Funding Medium

All money that is contributed to the Plan is held in a trust fund. The Trustee is responsible for the safekeeping of the trust fund and must hold and invest Plan assets in a prudent manner and in the best interest of you and your beneficiaries. The trust fund established by the Plan's Trustee(s) will be the funding medium used for the accumulation of assets from which benefits will be distributed. While all the Plan assets are held in a trust fund, the Administrator separately accounts for each Participant's interest in the Plan.

The Plan's Trustee is:

Typical Trust Company
Typical Address
Typical Zip Code

457 Plans

APPLICATION FOR
GROUP ANNUITY CONTRACT

Application is hereby made for a Group Annuity Contract to be issued on the basis of each completed Enrollment Form submitted by the Applicant.

1. Applicant (give exact legal name): [redacted] Municipal Water District

   Address: [redacted] (STREET)
   [redacted] (CITY) TN (STATE) [redacted] (ZIP CODE)

2. Employer:

   Address: (STREET)
   (CITY) (STATE) (ZIP CODE)

3. Nature of Employer's business: Political Subdivison, St. of Tn. - Water Utility

4. Section of Internal Revenue Code under which the Purchase Payments made are to qualify (Check one only):

   Section 404 (a): ☐ Corporation ☐ IRA Policy
   Section 403 (b): ☐ 501-(c) (3) organization ☐ Public school system
   ☒ Section 457 ☐ Section 401(k) ☐ Other
   ☐ Not applicable

5. Should notices be sent to the Employer? Yes

   If not, to whom?

6. Except as requested otherwise under item 7, normal retirement age, amount of purchase payments, and effective date will be as indicated on each Enrollment Form submitted by the Applicant. The type of annuity will be elected by each Participant.

7. Special Requests: Deferred Compensation Plan: The Group Contract holder will exercise all ownership rights under the group contract.

It is understood that this application is for a Group Annuity Contract providing fixed and variable benefits in which each employee (participant) will at all times have a 100% vested interest in his or her individual account unless specified otherwise in Special Requests above.

ANNUITY PAYMENTS (AND TERMINATION VALUES, IF ANY) PROVIDED BY THE CONTRACT ARE VARIABLE WHEN BASED ON THE INVESTMENT EXPERIENCE OF THE COMPANY'S SEPARATE ACCOUNT FOR VARIABLE CONTRACTS, AND ARE NOT GUARANTEED AS TO FIXED DOLLAR AMOUNT.

Dated at [redacted] this 1st day of January 19 96

Applicant [redacted] Municipal Water District

[redacted] Witness By [redacted]

[redacted] Title

571-86-AP-1

Fiduciary Activities – Everything Else (i.e. the kitchen sink)

- Other activities are considered fiduciary activities if ALL of the following are met:
- Government controls the assets; **and**
- Assets of the activity are **not**:
  - Derived solely from the government's own-source revenue, **or**
  - From government-mandated nonexchange or voluntary nonexchange transactions, EXCEPT for pass-through grants for which there is no administrative or direct financial involvement from the government; **and**

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Fiduciary Activities – Everything Else (i.e. the kitchen sink)

- The assets associated with the activity have one or more of the following characteristics:
  - (a) are administered through a trust agreement and the government is not a beneficiary, **AND** (b) are dedicated to providing benefits to recipients as per benefit terms, AND (c) are legally protected from creditors of the government; **or**
  - are for the benefit of individuals and the government does not have administrative involvement or direct financial involvement with the assets and the assets are not derived from the government providing goods or services.

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Fiduciary Activities – Everything Else (i.e. the kitchen sink)

- Footnote 2: For purposes of this provision, the descriptions of administrative involvement and direct financial involvement of a government that is a recipient of a pass-through grant provided in paragraph 5 of Statement 24 should be applied.
- That paragraph states, "A recipient government has administrative involvement if, for example, it
- (a) monitors secondary recipients for compliance with program-specific requirements,
- (b) determines eligible secondary recipients or projects, even if using grantor-established criteria, or
- (c) has the ability to exercise discretion in how the funds are allocated. A recipient government has direct financial involvement if, for example, it finances some direct program costs because of a grantor-imposed matching requirement or is liable for disallowed costs."

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Table 1—Flowchart for Evaluating and Reporting Potential Fiduciary Activities

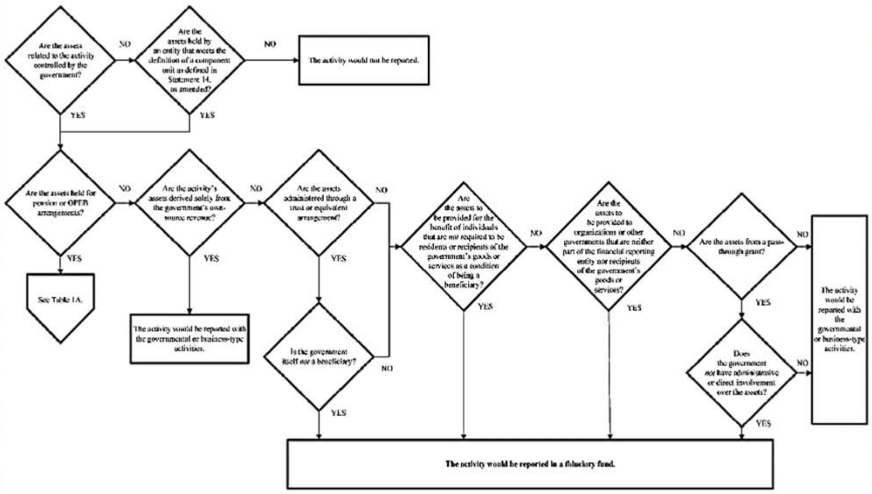
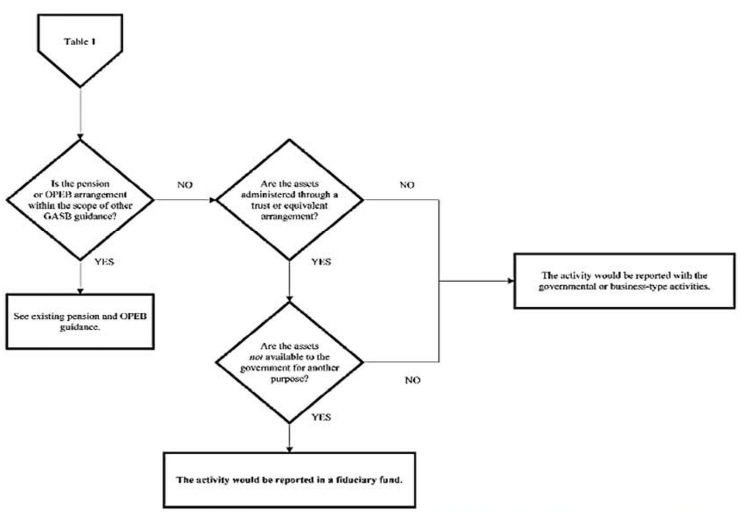


Table 1A—Flowchart for Evaluating and Reporting Potential Fiduciary Activities (Pension or OPEB Arrangements)



Own-Source Revenues

- Generated by a government itself
- Includes:
  - Exchange and exchange-like revenues
  - Investment earnings
  - Derived tax revenues
  - Imposed nonexchange revenues

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Fiduciary Activities – Type

- Four fiduciary fund types -
  - Pension (and other employee benefit; OPEB) trust funds
    - Pensions/OPEB administered through trusts that meet the criteria of para. 3 of GASB 67 or GASB 74
    - Other employee benefit plans for which resources are held in a trust that meets the criteria of para. 11c(1) and (2) of GASB 84 and the contributions and related earnings are irrevocable
  - Investment trust funds
  - External portion of investment pools and individual investment accounts are held in a trust that meets the criteria of para. 11c(1)

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Fiduciary Activities – Type

- Four fiduciary fund types (continued) -
  - Private purpose trust funds
    - Activities that are *not* required to be held in a pension/OPEB trust but are held in a trust that meets the criteria of para. 11c(1)
  - Custodial funds
    - Not required to be reported in any of the other 3 types of trust funds
    - External portion of investment pools not held in trust, report in separate column under custodial funds classification
    - Some flexibility in reporting given to business-type activities
      - Eliminates existing agency fund type
      - Will require examination of current agency funds

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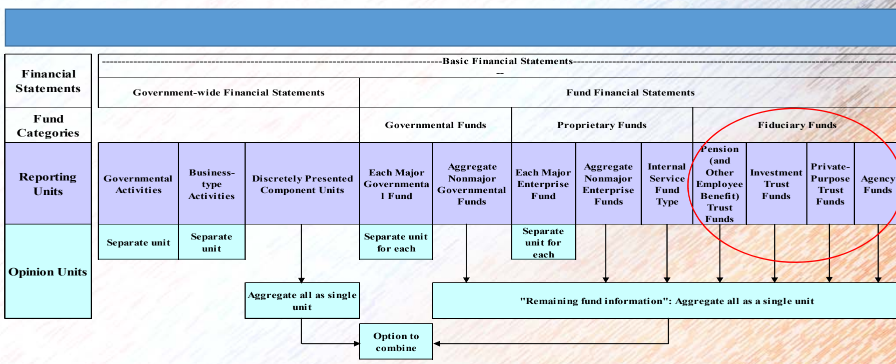
Fiduciary Activities

- Standalone business type activities:
- A stand alone BTA's fiduciary activities should be reported in separate fiduciary fund financial statements.
- Resources expected to be held 3 months or less can be reported instead in the statement of net position, with inflows and outflows reported as operating cash flows in the statement of cash flows

GASB Governments



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Fiduciary Activities

- **GASB 84**
- Memo written to CPA’s dated October 2016.
- Proposed Solution – Pension and OPEB Trust Funds:
- The Division believes current standards support the reporting of a fiduciary fund in the situations discussed above and we may question an entity’s financial statement presentation and a CPA’s audit response in certain obvious situations. However, the Division will continue to allow discretion when making determinations about fiduciary responsibility and financial statement presentation as it relates to Pension and OPEB Trust Funds until the effective date of the Exposure Draft. Our office will not require financial statements to be restated and resubmitted until the Fiduciary Activities Exposure Draft is finalized into an Accounting Standard and that Standard becomes effective.
- Effective Date (Calendar Year 2019, Fiscal Year July 1, 2019 to June 30, 2020, Earlier Application Encouraged.

128

Omnibus - 2018

85

Definition

- a bus.
- a volume containing several novels or other items previously published separately.
  - "an omnibus of her first trilogy“
- comprising several items.
  - "Congress passed an omnibus budget package"
- early 19th century: via French from Latin, literally ‘for all,’
- Omni means - all; of all things.
  - "omniscient"

Omnibus 2017

- **Statement 85 Issued March 2017**
- **Effective Date, July 1, 2017 to June 30, 2018**

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Omnibus

- **Matters to be Considered:**
  - **Clarification to Statement 14 for single column business type activities**
  - **Clarification to Statement 69 about prospective reclassification of Goodwill**
  - **Contradiction of Real Estate Valuation between GASB Statements 48 and 62 vs. GASB Statement 72. Use 72 definitions.**

132

Omnibus

- **Matters to be Considered:**
  - **The use of the word "should" in Paragraph 69c of GASB Statement 72, implies that use of the "Amortized Cost" method is "required" rather than allowed. (May was used in GASB Statement 31 Paragraph 9)**
  - **How to consider on-behalf payments that are legally required after implementation GASB 68, 73, and 75.**

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Omnibus

- **Matters to be Considered:**
  - **To provide the exception for OPEB employers similar to those provided to employers under GASB 78 (i.e. non-governmental cost sharing pension plans)**
  - **To address the issue of covered-employee payroll vs. covered payroll for OPEB.**
  - **Employer payments made to satisfy member contribution requirements under OPEB. (i.e. like GASB Statement 82 for pensions).**

134

Certain Debt Extinguishments - 2018

86

Certain Debt Extinguishment Issues

- In August 2016, the Board issued an Exposure Draft proposing guidance for certain issues related to debt extinguishments
- Research found that Statements 7 and 23 on debt refundings and Statement 62 on debt extinguishments are working effectively, but that certain issues need to be addressed
- Statement 86 was issued in May 2017
- Effective date would be periods beginning after June 15, 2017, i.e. July 1, 2017 to June 30, 2018

Certain Debt Extinguishment Issues

- In-substance defeasance using only existing resources
- Debt considered defeased in substance (like refundings) when *only* existing resources are placed in trust, if trust restricted to only essentially risk-free monetary assets (like for refundings)
- Would recognize the difference between the net carrying amount of the debt and the reacquisition price as a gain or loss in the period of defeasance (*unlike* refundings)
- Notes to the financial statements:
  - Would describe the transaction in the period it occurs (like refundings)
  - Would disclose remaining outstanding balance in each period the defeased debt remains outstanding (may combine with refunded amount)

Certain Debt Extinguishment Issues

- Prepaid insurance for *all* debt extinguishments:
  - At the time debt is extinguished/defeased, any related prepaid insurance that remains would be included in the net carrying amount of the debt for the purpose of calculating the difference between its reacquisition price and net carrying amount

Certain Debt Extinguishment Issues

- New note to financial statements for *all* in-substance defeasances (using only **existing** resources *and* refundings)
- If substitution of the essentially risk-free monetary assets in escrow with monetary assets that are not essentially risk-free is *not* prohibited, a government would disclose in the notes to the financial statements:
  - In the period of the defeasance: the fact that substitution is not prohibited
  - In subsequent periods: the amount of debt defeased in substance that remains outstanding for which that risk of substitution exists
- Effective date would be periods beginning after June 15, 2017, i.e. July 1, 2017 to June 30, 2018

Leases - 2021

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Leases

Lessee Reporting

Leases - Lessee

- **Leases:**
  - **PV issued November 2014**
  - **Exposure Draft Issued January 25, 2016**
  - **Final Standard Expected May 2017**
  - **Proposed Effective Date, Calendar 2019 or Fiscal Year Ended June 30, 2020**
- **Converge with FASB and International Standards**
- **FASB still has a dual approach**
- **GASB and International Standards are using a single approach**

143

Leases - Lessee

- **Leases:**
  - **Foundational Principle – All leases are financings of the right to use an underlying asset**
  - ***Definition of a lease – A contract that conveys the right to use a nonfinancial asset for a period of time in an exchange or exchange-like transaction***
  - **If ownership transfers, then a sale not a lease**

144

Leases - Lessee

- **Leases:**
  - **The definitions are intended to include what we currently call "Operating" leases.**
  - **"Capitalized" Leases (current guidance) will not be accounted for under leases guidance, but would be considered a "purchase" that was financed.**
  - **Operating leases would be recorded as a liability and an "intangible" asset <u>except</u> for Short-term leases.**
  - **In governmental funds, also record an "other financing source" and "capital outlay expenditure".**

145

Leases - Lessee

- **Leases:**
  - **Short-term Lease**
    - **A lease that at its beginning has a maximum possible term under the contract of 12 months or less**
    - **12 months includes options to extend**
  - **Record the short-term lease transaction like an operating lease under old standard**
    - **Debit Expenses/Expenditures**
    - **Credit Cash**

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Leases - Lessee

A. Capital Leases/Installment Purchases

Obligations under capital leases/installment purchases at June 30, 2017, were as follows (in thousands):

Fiscal Year Ending June 30	Governmental Activities	Business-Type Activities
2018	$1,901	$209
2019	1,622	208
2020	1,382	18
2021	1,019	-
2022	512	-
2023-2027	446	-
Total minimum payments	6,882	435
Less: interest	(345)	(20)
Present value of minimum payments	$6,537	$415

Assets acquired under capital leases for the primary government by asset class were as follows (in thousands):

Asset Class	
Buildings	$ 1,596
Equipment	11,524
Less: Accum Depreciation	(4,771)
Net Book Value	$ 8,349

Leases - Lessee

B. Operating Leases

Primary government rental payments for operating leases in fiscal year 2017 totaled $28.5 million. Future rental payments under operating leases are as follows (in thousands):

Over one Year??

Fiscal Year Ending June 30	Governmental Activities	Business-Type Activities
2018	$ 26,428	$ 936
2019	22,763	937
2020	18,049	588
2021	13,208	338
2022	12,402	319
2023-2027	40,827	1,389
2028-2032	18,866	-
Thereafter	11,196	-
Total future rental payments	$163,739	$4,507

Leases - Lessee

- **Leases - Measurement:**
- **Liability**
  - **Recognize a lease liability at the beginning of a lease (unless short term)**
  - **Use the present value of certain payments to be made over the lease term**
- **Asset**
  - **Recognize an intangible asset for the right to use the capital asset**
    - **Value of lease liability plus payments to lessor at or before the lease begins**
    - **Initial direct cost necessary to place the asset into service**

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Leases - Lessee

- **Leases:**
  - **Also recognize Interest expense/expenditure on the lease liability**
  - **Recognize amortization expense for the asset**
    - **Shorter of the Lease Term, or**
    - **Useful Life of the Underlying Asset**

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Statement of Net Position - Lessee

	Current Guidance	Proposed Guidance
Underlying tangible capital asset	Yes	No
Right to use underlying tangible capital asset	No	Yes
Lease payable	Yes	Yes

Leases - Lessee

- **Leases:**
  - **Lease Term:**
    - **Period during which a lessee has a noncancellable right to use an underlying asset (the noncancellable period) plus**
    - **The lessee's optional extension (if applicable) of the lease when exercise of that option is <u>reasonably</u> certain, or**
    - **The lessee's option to terminate (if applicable) the lease when the exercise of that option is <u>reasonably</u> certain.**
      - **Includes fiscal funding clauses**

Leases - Lessee

- **Leases:**
  - **Exclude certain transactions:**
    - **Contracts that transfer ownership of the underlying asset**
      - **This would be considered a sale**
    - **Leases of intangible assets**
    - **Contracts for exploration/exploitation of non-regenerative natural resources**
    - **Leases of biological assets, including timber**
    - **Contracts that meet the definition of a service concession arrangement (GASB 60)**

153

Leases - Lessee

- **Leases - Disclosures:**
  - **Description of lease agreement**
  - **Amount of lease assets**
  - **Schedule of future lease payments**

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Summary Initial Reporting?

	Assets	Liability	Deferred Inflow
Lessee	Intangible asset (right to use underlying asset)—value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use	Present value of future lease payments (incl. fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.)	NA
Lessor	• Lease receivable (generally including same items as lessee liability) • Continue to report leased asset	NA	Equal to lease receivable plus any cash received up front that relates to a future period

Summary Subsequent Reporting?

	Assets	Liability	Deferred Inflow
Lessee	Amortize over shorter of useful life or lease term	Reduce by lease payments (less amount of interest expense)	NA
Lessor	• Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition) • Reduce receivable by lease payments (less payment needed to cover accrued interest)	NA	Recognize revenue over the lease term on a systematic and rational basis

Lessor Reporting

Leases - Lessor

- **Leases - Measurement:**
- **Receivable**
  - **Recognize a lease receivable at the beginning of the lease term**
  - **Use the present value of the lease payments over the lease term**
- **Deferred Inflow of Resources**
  - **Recognize a deferred inflow at the beginning of the lease term**
  - **Use the present value of the lease payments over the lease term plus payments received at or before the lease begins that relate to future periods**
- **Asset**
  - **Continue to report the underlying asset on Lessor's books**

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Statement of Net Position - Lessor

	Current Guidance	Proposed Guidance
Lease receivable	Yes	Yes
Underlying capital asset	No	Yes

Leases - Lessor

- **Leases – Subsequent Reporting**
- **Lease Payments**
  - **Reduction of Receivable**
  - **Interest Income**
- **Reduction to Deferred Inflows – Revenue**
  - **Over the term of the lease, or**
  - **Over a systematic and rational manner**
- **Asset**
  - **Continue to report the underlying asset on Lessor's books**
  - **Continue to depreciate the asset**

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Leases – Lessor

- **Leases - Disclosures:**
  - **Description of lease agreement**
  - **Total Amount of lease Revenue**

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Leases in General

Leases - General

- **Leases:**
  - **Leases with multiple components**
    - **Separate the Lease Component from the Non-lease Component**
    - **Separate the underlying assets**
    - **May treat multiple lease components as a single lease unit in some cases**

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Leases - General

- **Leases:**
  - **Combining Leases with multiple contracts**
    - **Criteria for combined single contract**
      - **Entered into at or near the same time**
      - **Same Counterparty**
      - **Certain additional criteria met**
    - **Then evaluate as a contract with multiple components**

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Leases - General

- **Leases:**
  - **Amendments to lease contracts**
    - **Modifications**
    - **If right to use is reduced = partial termination**
  - **Accounting**
    - **Lessee**
      - **Remeasure the lease liability**
      - **Adjust lease asset accordingly**
    - **Lessor**
      - **Remeasure the lease receivable**
      - **Adjust deferred inflow**

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Leases - General

- **Leases:**
  - **Terminations**
    - **Lessee**
      - **Reduce the lease liability**
      - **Reduce the lease asset**
      - **Difference = a gain or loss**
    - **Lessor**
      - **Reduce the lease receivable**
      - **Reduce the deferred inflow**
      - **Difference = gain or loss**

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Leases - General

- **Leases:**
  - **Subleases**
    - **Lessee now becomes the lessor**
    - **Two separate lease agreements exist**

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Leases - General

- **Leases:**
  - **Sale and Leaseback**
    - **Must include a qualifying sale**
    - **Otherwise the transaction is borrowing**
  - **Separate treatment**
    - **Sale**
    - **Leaseback**
    - **Difference between carrying value of the asset sold and net proceeds = deferred inflow/outflow of resources**
    - **Amortize the deferred amount over the term of the leaseback**

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Leases - General

- **Leases:**
  - **Summary of Key Changes**
    - **No distinction between a Capital Lease and Operating Lease**
    - **Distinguish between long-term and short-term leases**
    - **Use lease accounting only if ownership does not transfer otherwise present as Financial Sale/Purchase of an Asset**
    - **Leases report intangible asset for right to use underlying asset, not the underlying asset itself**
    - **Lessors continue to report the underlying capital asset and a lease receivable**
  - **Several new Disclosures**

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Leases - General

EFFECTIVE DATE AND TRANSITION

92. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

93. Changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. If restatement for prior periods is not practicable, the cumulative effect, if any, of applying this Statement should be reported as a restatement of beginning net position (or fund balance or fund net position, as applicable) for the earliest period restated. In the first period that this Statement is applied, the notes to financial statements should disclose the nature of the restatement and its effect. Also, the reason for not restating prior periods presented should be disclosed.

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Leases - General

94. Leases should be recognized and measured using the facts and circumstances that existed at the beginning of the period of implementation. If applied to earlier periods, leases should be recognized and measured using the facts and circumstances that existed at the beginning of the earliest period restated.

However, lessors should not restate the assets underlying their existing sales-type or direct-financing leases. Any residual assets for those leases should become the carrying values of the underlying assets.

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Leases - Lessee

A. Capital Leases/Installment Purchases

Obligations under capital leases/installment purchases at June 30, 2017, were as follows (in thousands):

Fiscal Year Ending June 30	Governmental Activities	Business-Type Activities
2018	$1,901	$209
2019	1,622	208
2020	1,382	18
2021	1,019	-
2022	512	-
2023-2027	446	-
Total minimum payments	6,882	435
Less: interest	(345)	(20)
Present value of minimum payments	$6,537	$415

Assets acquired under capital leases for the primary government by asset class were as follows (in thousands):

Asset Class	
Buildings	$ 1,596
Equipment	11,524
Less: Accum Depreciation	(4,771)
Net Book Value	$ 8,349

Leases - Lessee

B. Operating Leases

Primary government rental payments for operating leases in fiscal year 2017 totaled $28.5 million. Future rental payments under operating leases are as follows (in thousands):

Over one Year??

Fiscal Year Ending June 30	Governmental Activities	Business-Type Activities
2018	$ 26,428	$ 936
2019	22,763	937
2020	18,049	588
2021	13,208	338
2022	12,402	319
2023-2027	40,827	1,389
2028-2032	18,866	-
Thereafter	11,196	-
Total future rental payments	$163,739	$4,507

- Coming Soon to a Government Near You!

Questions!

Jerry E. Durham, CPA, CGFM, CFE

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Department of ADMINISTRATION MONTANA

Improving Client Relationships

April 16, 2018

Jerry E. Durham, CPA, CGFM, CFE

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Audit Success vs. Failure

- Every auditor in this room is one mistake away from a lawsuit, or worse yet, the loss of reputation that may not be restorable.
- We are not remembered for our many audit successes, we are remembered for our failures.
- Comptroller's Policy about legislators. Five minute rule.
- Comptroller's new "no" Findings Program.

Let's be Honest

- If you haven't:
  - Had a disagreement with an audit client
  - Received an angry phone call from a client
  - Heard from a state legislator about your findings or actions
  - Been exposed to ridicule in the media
  - Had a lack of cooperation from a client
  - Been attacked personally at some level
  - Had a less than friendly exit conference
  - EtC.
- Then:
  - You probably haven't been doing your job!

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Let's be Honest

- If you haven't:
  - Made an error in judgment during an audit
  - Overlooked an immaterial fraud during an audit
  - Left out something in a letter or notes, etc.
  - Miscalculated a number
  - Failed to catch a mistake during the supervisory review
  - Failed to include adequate documentation when you did the work
  - Had numbers that failed to articulate
  - Etc.
- Then:
  - You are not human, and
  - You probably haven't been doing your job!

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Let's be Honest

- **Its how you handle all these things that is important:**
  - **Did you follow the auditing standards?**
  - **Did you react in kind?**
  - **Did you make matters worse?**
  - **Did you learn anything?**
  - **Did you get additional training?**
  - **Did you correct your mistake?**
  - **Do you have a plan for addressing these types of issues?**
- **How you deal with these types of issues has a lot to do with the level of professional respect your audit organization will receive.**

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Improving Client Relationships

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Improving Client Relationships

- **Six Dimensions of client service (aicpa – by bob veres):**
  - **Setting Clear expectations**
  - **Being responsive to client requests and messages**
  - **Making interactions with clients an enjoyable/Pleasant experience**
  - **Providing High-quality professional advise and professional service**
  - **Exhibiting exemplary conduct and character in all business interactions**
  - **Building a close, trusting, working relationship with the client and visibly caring about his/her well-being**

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Improving Client Relationships

Audit Services – Five Overarching Principles				
The audit objectives and responsibilities should be clear.	Provide high-quality professional service.	Communication: Keep the auditee informed. Be honest. Be responsive to client requests, questions, and messages.	Make interactions with auditee as Non-confrontational and Non-defensive as possible (i.e. not an us against them atmosphere)	Exhibit exemplary conduct and character in all audit interactions.

Improving Client Relationships

- **The audit objectives and responsibilities should be clear.**
  - This provides control over audit variables
  - Manages expectations
  - First step in Building trust
- **Provide High-quality professional service.**
  - Accomplishes the stated objectives
  - Builds trust
- **Communication: Keep the auditee informed. Be honest. Be responsive to client requests, questions, and messages.**
  - This demonstrates Cooperation
  - Builds trust

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Improving Client Relationships

- **Make interactions with auditee as Non-confrontational and Non-defensive as possible (i.e. not an us against them atmosphere).**
  - We are objective and fair
  - What Auditees have heard and think about an audit is not true
  - Builds trust
- **Exhibit exemplary conduct and character in all audit interactions.**
  - We are the real deal
  - We are worthy of your trust

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Improving Client Relationships

- What was the Key element in managing expectations and improving client relationships in the last two slides?

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Client Relations – Practical Application

- Let them know you are coming
- Meet with clients, audit committees, internal auditors – Who?
- Be good at what you do - YB
- Provide training
- Discuss issues early

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Client Relations – Practical Application

- Openness and honesty
- New auditors
- Reports, Letters, findings (important or picky)
- State legislators
- No surprises

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Client Relations – Practical Application

- Respect their schedules
- Prepare lists of expectations or documents
- Maintain independence
- Dress and act professionally
- No careles misstakes

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Client Relations – Practical Application

- Answer questions – with authority – no bluffs
- Be personable but avoid personal relationships
- Document all relevant communications
- Document for next year's auditors
- Remember names

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Improving Client Relationships

Audit Services – Five Overarching Principles				
The audit objectives and responsibilities should be clear.	Provide high-quality professional service.	Communication: Keep the auditee informed. Be honest. Be responsive to client requests, questions, and messages.	Make interactions with auditee as Non-confrontational and Non-defensive as possible (i.e. not an us against them atmosphere)	Exhibit exemplary conduct and character in all audit interactions.

Client Relations – Application

- Let them know you are coming
- Meet with clients, audit committees, internal auditors - Who
- Be good at what you do - YB
- Provide training
- Discuss issues early
- Openness and honesty
- New auditors
- Reports, Letters, findings
- Respect their schedules
- Prepare lists of expectations or documents
- Maintain independence
- Dress/Act professionally
- No careles misstakes
- Answer questions with authority
- Be personable avoid relationships
- Document all communications

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Client Relations

What is the point:

We know situations like these are going to arise in almost every audit.

Shouldn't we know the answers before the audit begins?

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Client Relations

- **Other considerations:**
- Never fight stupid battles.
- There are threats to independence on <u>every</u> audit.
  - The greatest threats to our independence <u>in appearance</u> are:
    - personal relationships
    - Gifts
    - Messages, especially those that use unprofessional, vulgar, or profane language
  - The greatest threats to our independence in mind are:
    - Bias
    - Familiarity
    - Nonaudit services

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Client Relations

- **Other considerations (cont'd):**
- **What is the most important ingredient in the audit process?**
  - **People. Auditors must be able to encounter and manage people (including themselves).**
  - **Auditors need to have exceptional people skills. (Do we provide any training in this area?)**
  - **We walk a fine line between empathizing with our clients and performing in accordance with standards.**

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Client Relations

- **Exceptional people called auditors:**
  - **Auditors must:**
    - **Have both vision and instinct**
    - **Be able to see the forest for the trees (big picture amongst the tiny details)**
    - **Not make mountains out of mole hills**
    - **Have exceptional people skills while maintaining professional skepticism**
    - **Have intelligence, mingled with common sense and the ability to make good decisions**
    - **Be leaders who are self-motivated**
    - **Have superior communication skills**

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Client Relations

- **Exceptional people called auditors (cont'd):**
  - **New Hires: The interview process should in some way attempt to gage personality and communication skills.**

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Why am I getting this finding?

- Ask yourself, If I were in the client's shoes, would I understand Why I was getting a particular finding?
- For example, Segregation of duties finding in a small office
- Unless the client understands the why, the client will assume he/she is being picked on or bullied by the government

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Audit Attitude

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Client Relations - Summary

- The key to good client relationships is managing expectations!
- The key to managing expectations is building trust!
- The key to both is managing <u>yourself</u>! !

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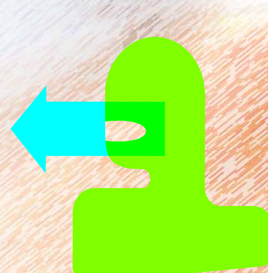
Client Relations

- **Next we will look at how we communicate!**



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Questions

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The Opinions expressed during this presentation were my own. They do not necessarily represent the views of the Comptroller, his representatives, or the Department of Audit.

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Communicating with our Audit Clients
Written Communications

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Communicating with our Audit Clients

- The ultimate goal of an audit is communication! What type of Required Communications do we normally Have?
  - Engagement Letter
  - Representation Letter
  - Various Auditor Reports
  - Communications with Attorneys
  - Communications with Component auditors
  - Financial Statements/performance reports

Communicating with our Audit Clients

- Other communications?
  - Entrance conference
  - Exit Conference
  - Requests for information
  - Confirmations
  - Audit adjustments
  - Professional letters/memos, email, etc.

Communicating with our Audit Clients

- But, for every formal written communication, we have dozens of communications that are conversational (many not written) that form the basis for our formal written communications.
- We have very precise words and technical formats for our written reports, but we concentrate very little (if any) effort on verbal skills.
- Read yellow book requirements (3.72c, page 57)
- Read article from Hassan Khosravi

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Communicating with our Audit Clients

- Who do we have the communications with?
  - Management
  - Those charged with governance
  - Legislators
  - Other regulators, contractors, Those Legally required, audit committees
  - General Public
  - Those that have relied on our audits
  - News media
  - Federal Program officials
  - Investigators (e.g. law enforcement, prosecutors)
  - Others.

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Communicating with our Audit Clients

- **Communicating with those charged with governancE**
- Requirements for the auditor to communicate with those charged with governance:
- Au-c 265 General requirements.
- Other requirements:
  - **a. paragraph .17 of section 210, Terms of Engagement**
  - **b. paragraphs .21, .38c(i), and .39—.41 of section 240, Consideration of Fraud in a Financial Statement Audit**
  - **c. paragraphs .14, .18, and .21—.23 of section 250, Consideration of Laws and Regulations in an Audit of Financial Statements**
  - **d. paragraph .11 of section 265, Communicating Internal Control Related Matters Identified in an Audit**

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Communicating with our Audit Clients

- **Communicating with those charged with governancE**
- Other requirements (cont'd):
- e. **paragraph .27 of section 550, Related Parties**
- **f. paragraphs .10b-c, .12a, .15a, .17a, and .18 of section 560, Subsequent Events and Subsequently Discovered Facts**
- **g. paragraph .19 of section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern**
- **h. paragraphs .45—.48 of section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)**
- **i. paragraphs .12, .14, .20, and .29 of section 705, Modifications to the Opinion in the Independent Auditor's Report**

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Communicating with our Audit Clients

- **Communicating with those charged with governancE**

- Other requirements:
  - **j. paragraph .09 of section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report**
  - **k. paragraphs .08, .12, .15, and .18 of section 720, Other Information in Documents Containing Audited Financial Statements**
  - **l. paragraph .06 of section 730, Required Supplementary Information**
  - **m. paragraphs .23—.28 of section 930, Interim Financial Information**
  - **n. paragraphs .36—.37 of section 935, Compliance Audits**

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Communicating with our Audit Clients

- **Auditing standard Board's intent. Two way communications!!**
- **Adequacy of the Communication process.**
  - **The auditor should evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor should evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence and should take appropriate action. (au-c 265.19)**
- **In writing or oral?**
  - **The matters required by AU-C 265 may be communicated orally.**
  - **Au-c 265.16 and A39-a41,**
  - **Chair of the committee?**

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Communicating with our Audit Clients

- **Two way communications?**
  - **Chair of committee (cont'd)**
    - **If the auditor communicates with a subgroup of those charged with governance, such as the audit committee or an individual, the auditor should determine whether the auditor also needs to communicate with the governing body.**

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Communicating with our Audit Clients

- Two way communications?
  - **Written Communications**
    - Explain what each communication is for.
      - Representation Letter
    - Explain our terminology (not in condescending manner).
      - GAAP, GASB, Auditing Standards, Yellow Book, OMB Uniform Guidance
    - Write on an 8th GraDe level when terminology is not required by standards
      - Exit conferences
    - No one should sign a document they haven't read and don't understand.

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Communicating with our Audit Clients

- Two way communications?
  - Written Communications
    - Give a copy in advance when possible.
    - Explain why whenever possible (many times it will be because of a standard)
      - Especially for immaterial amounts or noncompliance
    - Be extremely cautious about facts (especially estimates). Get it right the first time.
      - Auditors, never let a supervisor edit a finding so that it does not state the facts.
    - Use an editor for non-template language (e.g. media releases).
    - At the end of any communication, ask yourself, did I achieve a two-way communication?
    - Remember, Findings related to fraud exacerbate all the above!!

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Communicating with our Audit Clients
Verbal Communications

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Communicating with our Audit Clients

- **Oral/verbal communication**
  - **For some of us, the greatest fear we have is public speaking. Hearing the sound of our own voice is our worst nightmare. (Glossophobia)**
  - **Our lack of confidence in ourselves and in our ability to speak is never more obvious than in meetings/classes like this one.**
  - **Certainly this fear is exacerbated by the subject matter and the situation.**

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Communicating with our Audit Clients

- **Oral/verbal communication**
  - **Observation in the Government Accountants Journal**
    - **"Federal, state, and local government accountants agreed that the most notable deficiency in new accounting graduates was written and oral communication"**

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Communicating with our Audit Clients

- Oral/verbal communication
  - Some tips to improve:
    - Practice
      - Accept speaking challenges like teaching and making reports to supervisors (making a response to an exposure draft for example)
      - Attend entrance/exit conferences, legislative committee meetings, etc. seek out opportunities to speak and address clients.
      - Take a course in public speaking
      - Put yourself in settings such as external peer review where you have to communicate your professional judgment and speak out loud
      - Supervisors should provide opportunities for auditors to practice
    - Be prepared (this is the main way to overcome fear)
    - Ask open ended questions, then don't interrupt

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Communicating with our Audit Clients

- Oral/verbal communication
  - Some tips to improve (cont'd):
    - Listen to understand rather than to hear what you want to hear or hearing in preparation of your answer
    - Speak slowly and distinctly
    - Sit up
    - Look up
    - Speak up
    - Shut up
    - Think before you speak, especially when answering a question
    - Admit you don't know if you don't know
    - Keep it simple, don't tell everything you know, don't advertise your superior knowledge

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Communicating with our Audit Clients

- **Oral/verbal communication**
  - **Some tips to improve (cont'd):**
    - **Explain any technical written communication verbally in plain and simple language (e.g. the engagement letter, findings). Never assume the client understands technical information**
    - **Avoid accountant language such as GAAP, GASB, Uniform guidance, Rep. letter, etc. without explaining the terms**
    - **Don't try to explain something you don't understand**
    - **Be honest, do not be deceptive with a client (Except for rare instances, usually involving fraud or surprise audit procedures such as cash counts or inventories, etc.)**
    - **It is difficult to communicate verbally when you don't believe in what you are saying (your nonverbal cues will reveal you)**
    - **Don't speak to the news mediA**

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Communicating with our Audit Clients
Non-Verbal Communications

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Communicating with our Audit Clients

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Communicating with our Audit Clients

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Communicating with our Audit Clients

What is nonverbal communica tion?

Communicating with our Audit Clients

- **Nonverbal communication**
  - **definition:**
    - **The process of sending and receiving wordless messages by means of facial expressions, gaze, gestures, postures, and tones of voice (body language).**
    - **It also includes grooming habits, body positioning in space.**
    - **It includes advertising and marketing techniques (colors, smells, tastes, images, etc.)**
    - **It includes all expressive signs, signals, and cues which are used to send and receive messages apart from manual sign language.**
  - **The first scientific study of nonverbal communication was published in 1872 by Charles darwin in his book, *The expression of the emotions in man and animals*.**
  - **However, the study of nonverbal communication is as old as man himself, because researchers have discovered that women are better than men in decoding nonverbal cues.**

Communicating with our Audit Clients

- **Nonverbal communication**
  - Some examples:
    - Facial expressions (Happy, sad, angry, surprise, disgust)
    - Body movements and posture (Sitting, pacing, cross legs or arms, slouching or standing erect)
    - Gestures (Thumbs up, pointing, hand movement)
    - Eye contact (Interest, affection, hostility)
    - Touch (handshake, hug, tap on the shoulder)
    - Space (Distance – aggression, intimacy, or dominance)
    - Voice (Its not just what you say, its how you say it – loud, soft, tone, and inflection) can indicate sarcasm, anger, affection, confidence, interest, etc.)

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Communicating with our Audit Clients

- **Nonverbal communication**
  - Why nonverbal communication is important
    - May communicate more than your words.
    - May be used to repeat a verbal message (pointing directions)
    - May complement or contradict what you are saying (a nod, or a wink)
    - May be a substitute for the verbal message (finger to lips for quiet, a nod instead of a yes)
    - Add to the meaning of your words (tone for specific words, pause before answering)

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Communicating with our Audit Clients

- **Nonverbal communication**
  - **Some tips:**
    - **Your words will have significantly less impact than your nonverbal communication.**
    - **Its not the nonverbal cues that you use intentionally that should be of the most concern, it's the nonverbal cues that you don't realize you are using that may damage communication the most.**

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Communicating with our Audit Clients

In general, the less face to face time and the less verbal communication involved in the audit process,

the less successful the audit will be!

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Communicating with our Audit Clients

Communicating with our Audit Clients

- **communication**
  - **This discussion was not intended to paralyze you with concern about the ways we communicate. Most communication comes natural and with experience.**
  - **It is intended to make you think about the ways you communicate.**
  - **Verbal Communication Top Five:**
    - **Be prepared**
    - **Listen**
    - **Speak up (slowly and distinctly)**
    - **Look up**
    - **Be Passionate, but never demonstrate anger**
  - **Remember, nonverbal cues are intimately associated with each one of these five things verbal communication skills.**

Questions

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GASB Exposed

Department of ADMINISTRATION MONTANA

April 16, 2018

Jerry E. Durham, CPA, CGFM, CFE

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Exposure Drafts

Exposure Draft

Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements

Debt Disclosures

- **Debt Disclosures, including Direct Borrowing:**
  - Reexamination of Statements 34, 38, and 62
  - Research approved April 2015
  - Review results of research July 2016
  - Exposure Draft issued in June of 2017
  - Final Statement expected by 1st Q. 2018

  - Deals with debt disclosures in general (too many? Covenants?)
  - What transactions constitute "debt"
  - Concerns about Direct Borrowing by governments such as Direct Borrowing from a local bank

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Debt Disclosures

- This Statement defines debt for purposes of disclosure in notes to financial statements and establishes additional financial statement note disclosure requirements related to debt obligations of governments, including direct borrowings (for example, a government entering into a loan agreement with a lender) and direct placements (for example, a government issuing a debt security directly to an investor). The requirements of this Statement apply to the financial statements of all state and local governments.

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Debt Disclosures

- For purposes of disclosure in notes to financial statements, debt is defined as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of payment of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established.
- For disclosure purposes, debt does not include **leases or trade accounts payable.**

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Debt Disclosures

- Notes to Financial Statements:

In addition to other requirements to disclose information related to debt in notes to financial statements, a government should disclose in notes to financial statements summarized information about the following items:

a. Amount of unused lines of credit
b. Collateral pledged as security for debt
c. Terms specified in debt agreements related to significant: (1) Events of default with finance-related consequences (2) Termination events with finance-related consequences (3) Subjective acceleration clauses. 6. In notes to financial statements, a government should separate information in debt disclosures regarding (a) direct borrowings and direct placements of debt from (b) other debt.

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Debt Disclosures

- Notes to Financial Statements:

In notes to financial statements, a government should separate information in debt disclosures regarding (a) direct borrowings and direct placements of debt from (b) other debt.

Debt Disclosures

- The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged. This Statement applies to notes to financial statements of all periods presented. If application for prior periods presented is not practicable, the reason for not applying this Statement to prior periods presented should be disclosed.

Exposure Draft

Accounting and Financial Reporting for Majority Equity Interests

Majority Ownership Interests

- **Equity Interests Ownership Issues:**
  - **Research Project approved April 2016**
  - **Exposure Draft Issued November 1, 2017**
  - **Final Standard Expected 3rd Q 2018**
- **Objectives:**
  - **How are governments currently reporting equity interests in legally separate entities**
  - **Question, is the substance of an acquisition of an equity interest that remains legally separate significantly different from an acquisition in which the legal separation ceases and the acquired entity becomes part of the acquirer's legal entity**

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Majority Ownership Interests

- Equity Interests Ownership Issues:
  - Majority Interest?
  - Meets the definition of a component unit under GASB 14, because of financial accountability.
  - Question, if the purpose of holding a majority equity interest (i.e. an investment), does the investment meets the definition of an investment under GASB 72?
  - Report as an investment and a component unit?
  - Which Standard has the hierarchy?

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Majority Ownership Interests

- Equity Interests Ownership Issues:
  - What is the intent of ownership
    - To enhance its ability to provide services?
    - Does the equity interest have present service capacity?

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Majority Ownership Interests

- **Equity Interests Ownership Issues:**
  - **Example:**
- **Assume that Government A acquires 80 percent of the voting stock of a for-profit enterprise (the corporation). Government A appoints 8 of the 10 members of the governing body of the corporation and is able to impose its will on the corporation. Furthermore, the corporation is expected to provide financial benefits to, and impose financial burdens on, Government A. Under Statement 14, the corporation meets the financial accountability criteria for a component unit of Government A. However, if the sole purpose behind the acquisition of the corporation is to produce income or profit for Government A, should the definition of an investment in paragraph 64 of Statement 72 prevail, regardless of the fact that Government A is financially accountable for the corporation?**

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Majority Ownership Interests

- **Equity Interests Ownership Issues:**
  - **Does Statement 69, Government Combinations and Disposals of Government Operations apply?**

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GFOA Summary

- MEMORANDUM

- DATE: November 13, 2017
- TO: CAAFR
- FROM Michele Mark Levine
  Todd Buikema
- RE: GASB ED: *Accounting and Financial Reporting for Majority Equity Interests*

- On November 1, 2017, the Governmental Accounting Standards Board (GASB) issued an Exposure Draft (ED) entitled *Accounting and Financial Reporting for Majority Equity Interests* for public comments, which are due by January 19, 2018.
- The ED addresses situations where a government owns a majority interest in a *legally separate entity*, and was issued because governments were questioning if such interests should be accounted for as Investments in accordance with GASB 72 or as Component Units in accordance with GASB 14, as amended (Cod. Sec. 2100.119-144).
- The proposed guidance would distinguish between majority equity interests that are investments, as defined by Statement 72, paragraph 64 (Cod. Sec. I50.103) and those that are not.
- Investments:
  - For majority equity interest *Investments* held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, an endowment or a permanent fund, the value of the interest should be determined in accordance with the requirements in paragraph 64 of Statement 72, generally at fair value.
  - For the majority equity interest Investments of other governments, the ED proposes that they should be accounted for as investments using the Equity Method, as defined in paragraphs 205 – 209 of GASB 62 (Cod Sec. I50.116). In these cases, the entity in which the majority equity investment is held should *not* be reported as a component unit, even if the entity meets the criteria to be a component unit.

An investment is a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash.

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GFOA Summary

- Non-Investments:
  - Where the majority equity interest does not meet the definition of an investment, the entity should be reported as a component unit and the government or fund that holds the majority interest should also report an asset using the equity method. If the component unit is blended component, the asset and net position of the component unit should be eliminated as part of the blending process.
- The ED also proposes special requirements for reporting a component unit in which the primary government acquires a 100% interest.
  - Such wholly-owned component units should measure assets, liabilities, deferred items in accordance with paragraphs 29-42 of GASB 69 (Cod. Sec Co10.126-139), generally at acquisition value, at the date of acquisition.
  - The flows statements of the component unit would then only report activity that took place after the date of acquisition.
- The ED proposes to become effective for reporting periods beginning after December 15, 2018 (fiscal years beginning January 1, 2019) and that it should be applied retroactively where possible, restating prior periods with an adjustment to beginning net position in the earliest year.
- For such investments held in governmental funds, the reporting of the equity investment would be in accordance with the current financial resources/modified accrual MFBA.

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Exposure Draft

Accounting for Interest Cost during the Period of Construction

Construction Period Interest Costs

- **Construction Period Interest Costs**
  - **Exposure Draft Issued November 20, 2017**
  - **Comments Were Due by March 5, 2018**
  - **Final Standard Expected 2nd Q 2018**

  - **Objectives:**
    - **To enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period, and to simplify accounting for interest cost incurred during the period of construction.**
    - **Should interest costs be capitalized?**

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Construction Period Interest Costs

- Accounting for Interest Cost during the Period of Construction
- In financial statements prepared using the economic resources measurement focus, interest cost incurred during the period of construction should be recognized as an expense in the period in which the cost is incurred. Such interest cost should not be capitalized as part of the historical cost of a capital asset.
- In financial statements prepared using the current financial resources measurement focus, interest cost incurred during the period of construction should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

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Construction Period Interest Costs

- Prior to the issuance of this Statement, governments capitalized interest cost incurred during the period of construction in business-type activities and enterprise funds. Those requirements, as incorporated into GASB Statement 62, were based on Financial Accounting Standards Board (FASB) Statements No. 34, Capitalization of Interest Cost, and No. 62, Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants, which were issued in 1979 and 1982, respectively.

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Construction Period Interest Costs

- The approach taken with respect to incorporating FASB literature into GASB Statement 62 was to adopt accounting and reporting requirements essentially as they existed in the applicable pre-November 30, 1989 FASB and American Institute of Certified Public Accountants pronouncements. The language of those pronouncements was modified as appropriate to recognize the effects of the governmental environment without affecting the substance of the provisions. As a result, at that time, the Board did not consider consistency of the provisions with GASB Concepts Statements.

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Construction Period Interest Costs

- GASB's Conclusions in Accordance with Concepts Statement Number 4
  - Does not meet the definition of an Asset
  - Does not meet the definition of a Deferred Outflow

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Construction Period Interest Costs

- The requirements of this Statement are effective for reporting periods beginning after December 15, 2018.
- Earlier application is encouraged. Changes adopted to conform to the 2 provisions of this Statement should be applied prospectively. For construction-in-progress, interest cost incurred after the beginning of the first reporting period to which this Statement is applied should not be capitalized.

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Exposure Draft

Implementation Guide No. 201Y-X, Implementation Guidance

Update – 201Y

Implementation Guide

- **Exposure Draft Issued November 20, 2017**
- **Comments Due by February 16, 2018**
- **Final Guide Expected 2nd Q 2018**

- **Objectives:**
  - **To provide guidance that clarifies, explains, or elaborates on GASB Statements.**

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Implementation Guide

- Coverage Topics
- Pensions and OPEB
- The Statistical Section
- Utility Regulatory Basis of Accounting
- Tax Abatements
- Amendments:
  - Deposits, Investments, and Repurchase Agreements
  - Cash Flows Reporting
  - Pensions
  - MD&A
  - Restricted Net Position
  - Statistical Section
  - Tax Abatements

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Implementation Guide

CONTENTS

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Implementation Guide

- The requirements of this Implementation Guide are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged if the pronouncement addressed by the question and answer has been implemented. Changes adopted to conform to the provisions of this Implementation Guide should be applied retroactively by restating financial statements, if practicable, for all prior periods presented.
- If restatement for prior periods is not practicable, the cumulative effect, if any, of applying this Implementation Guide should be reported as a restatement of beginning net position (or fund balance or fund net position, as applicable) for the earliest period restated. In the first period that this Implementation Guide is applied, the notes to financial statements should disclose the nature of the restatement and its effect. Also, the reason for not restating prior periods presented should be disclosed.

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Implementation Guide

The requirements in this Implementation Guide need not be applied to immaterial items.

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Questions?

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Really, There's More?

April 16, 2018

Jerry E. Durham, CPA, CGFM, CFE

Financial Reporting Model

Financial Reporting Model

- **Financial Reporting Model Reexamination:**
  - Research approved August 2013.
  - **ITC Issued December 2016, PV expected July 2018, ED expected April 2020, Final Statement expected 1st Q 2022**
  - Reexamine Statements 34, 35, 37, 41, 46 and Interpretation 6.
  - Rank #1 Priority for Research by Governmental Accounting Standards Advisory Council (GASAC)
  - Objective: Evaluate the current model and issues to improve/enhance the effectiveness of the overall financial reporting model

Financial Reporting Model

- **Financial Reporting Model Reexamination:**
  - **MD&A**
  - **Government-wide F/S Format**
  - **Major Funds – Debt Service Funds**
  - **Governmental Fund F/S Measurement Focus (Near-Term Focus?)**
  - **BTA Financial Statement Format – Operating vs. Nonoperating Revenue of Expenses**
  - **Classification/Measurement Focus for Permanent Funds**
  - **Budgetary Comparisons**
  - **Reduce Complexity and Permit more timely F/S**

Financial Reporting Model

- **Financial Reporting Model Reexamination:**
  - **MD&A**
    - **Explore options for enhancing the financial statement analysis component, consider the elimination of requirements that are boilerplate and no longer necessary for understanding the financial reporting model, and clarify guidance for presenting currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations.**
    - **More analysis = the Why**

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Financial Reporting Model

- **Financial Reporting Model Reexamination:**
  - **Government-wide F/S Format**
    - Explore alternatives for the format of the statement of activities and consider whether a government-wide statement of cash flows should be required, and if so, how those cash flows should be presented.

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Financial Reporting Model

- Financial Reporting Model Reexamination:
  - Major Funds – Debt Service Funds
    - Explore options for providing additional information about debt service funds, either individual or in aggregate.
    - Debt Service Funds are sometimes not even presented when a CAFR is not presented.

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Election Time – The Candidates

- Near-Term Financial Resources Approach? 60 days?
- Short-term (Working-Capital Approach)? 1 year?
- Long-term (Total Financial Resources Approach)? No Capital Assets or Debt?
- Your call?

Financial Reporting Model

- **Financial Reporting Model Reexamination:**
  - **Governmental Fund F/S Measurement Focus (Near-Term Focus?)**
    - Current Guidance
      - Current financial resources measurement focus – modified accrual basis of accounting
    - Question:
      - Do we need a more consistent approach? Yes!
    - Suggested solution:
      - Near-term - Financial Resources Approach
      - Short-term (formerly Working Capital Approach)
      - Long-term (formerly Total Financial Resources Approach)

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Financial Reporting Model

- **Financial Reporting Model Reexamination:**
  - **Near-term financial resources approach:**
    - **Symmetrical recognition using 60 days for Assets, Liabilities, Revenues, and Expenditures**
    - **Assets:**
      - **Record receivables that are due within 60 days**
      - **Other financial resources that will convert to cash within the near-term (i.e. 60 days)**
    - **Liabilities:**
      - **Obligations normally due and payable within 60 days**

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Financial Reporting Model

- Financial Reporting Model Reexamination:
  - Near-term approach – What would change?
    - Do not report prepaids
    - Do not report inventory – (no option to use the consumption method)
    - Special assessment tax receivables would only be recognized only for the portion that is due in the near-term
    - Accrued Interest on Long-Term Debt
      - Liability for the portion that would be due and payable within the near-term
    - Short-term operational borrowings (TANs)
      - Inflow of Resources (vs. Fund Liability)

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Financial Reporting Model

- Financial Reporting Model Reexamination:
  - Near-term (Working Capital Approach):
    - Symmetrical recognition using 1 year for Assets, Liabilities, Revenues, and Expenditures
    - Assets:
      - Record receivables that are due within 1 year
      - Prepaids and inventory consumed in one year
      - Other financial resources that will convert to cash within the one year
    - Liabilities:
      - Obligations normally due and payable within 1 year including accrued interest on long-term debt and long-term debt

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Financial Reporting Model

- Financial Reporting Model Reexamination:
  - Short-term – What would change?
    - Must report prepaids and inventory if consumed within one year
    - Special assessment tax receivables would only be recognized only for the portion that is due in one year
    - Accrued Interest on Long-Term Debt
      - Liability for the portion that would be due and payable within one year
    - Long-Term Debt
      - Liability for the amount due in the following year
    - Would require a statement of Cash Flows!

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Financial Reporting Model

- Financial Reporting Model Reexamination:
  - Long-term (Total Financial Resources Approach):
    - Symmetrical recognition – Full Accrual except for Capital Assets and Capital-Related Long-Term Debt
    - Assets:
      - Full Accrual except for Capital Assets
    - Liabilities:
      - Full Accrual except for Capital-Related Long-Term Debt
      - Record OPEB and Pensions??

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Financial Reporting Model

- Financial Reporting Model Reexamination:
  - Long-term Approach – What would change?
    - Inclusion of Long-term Debt that is not capital related
    - YES, Include Net Pension and Net OPEB Liability!!
    - Would require a statement of Cash Flows!
  - This method represents a “material” difference from present accounting. Huge Change!!

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Financial Reporting Model

- Financial Reporting Model Reexamination:
  - BTA Financial Statement Format
    - Evaluate operating indicator alternatives in conjunction with evaluating the guidance for the separate presentation of operating and nonoperting revenues and expenses.
    - Current Guidance
      - Distinguish between operating and nonoperating
      - Disclose policy used to distinguish
    - Question?
      - Do we need more guidance on how to distinguish?

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Financial Reporting Model

- Financial Reporting Model Reexamination:
  - Budgetary Comparison Reporting – Presentation of Budgetary Variances
    - Current Guidance
      - Encourage reporting of budgetary variances
    - Question?
      - Should budgetary variance reporting be required?
      - If so, which variance?
        - Final Budget to Actual
        - Original Budget to Actual
        - Other

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Minutes to GASB Board meetings December 12-14, 2017

The Board next discussed suggested modifications to the near-term and short-term approaches. The Board tentatively decided that the recognition approach for governmental funds presented in the Preliminary Views should be based on a combination of the near-term and short-term recognition approaches with the following characteristics:

- One-year (operating cycle) period of availability
- Accrued interest will be recognized when payable and normally due within one year, which may not necessarily align with the recognition of principal payments on the related debt
- Recognition of tax and revenue anticipation notes as liabilities
- Exclusion of the recognition of the current portion of long-term assets and liabilities.

Minutes to GASB Board meetings
October 31-November 2, 2017

The Board then deliberated the definition of financial resources that should be presented in the PV. The Board tentatively decided to propose the following definition of financial resources– "cash, resources that are expected to be converted to cash, and resources that are consumable in lieu of cash."

Election Time – The Candidates

- Near-Term Financial Resources Approach? 60 days?
- Short-term (Working-Capital Approach)? 1 year?
- Long-term (Total Financial Resources Approach)? No Capital Assets or Debt?
  - OR
- GASB's new revised Short-term approach

- Your call?

Revenue and Expense Recognition

Revenue and Expense Recognition

- **Revenue and Expense Recognition:**
  - **ITC Expected 1st Q 2018**
  - **Preliminary Views Expected 2nd Q 2020**
  - **Exposure Draft Expected 4th Q 2021**
  - **Final Standard Expected 1st Q 2023**

- **Improve information regarding revenues and expense users need to make decisions**
- **Provide guidance regarding exchange and exchange-like transactions that have not been specifically addressed**
- **Evaluate revenue and expense recognition in the context of the conceptual framework**

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Revenue and Expense Recognition

- Revenue and Expense Recognition:
  - Should we recognize exchange transactions when the sale occurs or when (or as) the obligation (contract) is fulfilled.
  - New FASB guidance introduces a performance obligation approach for revenue. Is this useful for Governments? Should it be applied to revenue and expenses?
  - GASB 33 was issued prior to Concept Statement 4. Should the concept statement be applied to revenues?

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Revenue and Expense Recognition

- Revenue and Expense Recognition:
  - GASB provides guidance for certain exchange transactions such as compensated absences and postemployment benefits.
  - Guidance does not exist for other types of common exchange expenses, including salaries and circumstances when government is the customer. Should guidance be developed?
  - Should additional disclosures be made for revenue transactions?
  - Should additional disclosures be made for expense transactions that are not described in current GASB literature?

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Tentative Decisions

REVENUE AND EXPENSE RECOGNITION—TENTATIVE BOARD DECISIONS TO DATE

During initial deliberations, the Board tentatively agreed to present in an Invitation to Comment that:

- The scope of this project will be defined on an exclusionary basis. Topics to be initially excluded from the scope are the following:
  - Topics that were developed considering the current conceptual framework;
  - Topics related to financial transactions, such as investments, derivatives, leases, and insurance.
  - Topics related to transactions arising from the recognition of capital assets or certain liabilities.
- The scope of this project will not consider classification and presentation of revenue and expenses.
- The scope of this project will consider the measurement of revenue and expenses.
- The initial approach for developing revenue and expense measurement proposals will focus on developing a comprehensive revenue and expense recognition model based on the economic resource measurement focus.
- The development of revenue and expense measurement proposals for the governmental funds will be considered after the Board proposes a specific measurement focus for governmental funds in the financial reporting model reexamination project.

Tentative Decisions

Tentative positions to be presented in the Invitation to Comment:

- There are two comprehensive models of revenue and expense recognition: (1) a performance obligation/no performance obligation model and (2) an exchange/nonexchange model.
- The performance obligation/no performance obligation model includes the following positions:
  - Revenue and expense from transactions with performance obligation should be recognized as the performance obligation is satisfied.
  - Application issues related to recognition, which could be over time or at a point in time, would be addressed in a subsequent due process document.
  - Revenue and expense from transactions without performance obligations should be recognized based on the requirements articulated in Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

Tentative Decisions

- The working definition of a performance obligation is a promise in a *binding arrangement* between a government and *another party* to provide *distinct goods or services to a specific beneficiary*.
  - *A binding arrangement* represents a legally enforceable mutual understanding between two or more parties regarding their identifiable rights and obligations, which articulate in equivalent terms.
  - *Another party* is any legally separate entity or person that takes part in a transaction with a government, such as a customer, resource provider, vendor, or employee.
  - *Distinct goods or services* are separately identifiable and can provide benefits on their own. Distinct goods or services also can be bundled or provided in a series.
  - A *specific beneficiary* is the party that receives the benefit of the goods or services provided and with characteristics that can be explicitly defined and distinguished from the general public. A specific beneficiary can be an individual, entity, group of individuals, group of entities, or the government.

Tentative Decisions

- The right of refund is a contingency and is applicable to both goods and services.
- An unsatisfied performance obligation meets neither the definition of an asset nor the definition of a liability.
- In the earnings recognition approach, consideration of the refund period is removed and the right of refund is reported as a contingency.
- The exchange/nonexchange model includes the following positions:
  - Revenue and expense from exchange transactions would be recognized based on the earnings approach.
  - Revenue and expense from nonexchange transactions would be recognized based on the requirements articulated in Statement 33.
  - The current definition of exchange and nonexchange would be included in the Invitation to Comment, without modifications.
  - The earnings-based approach would be used for recognition of exchange transactions. The development of an earnings-based approach for recognition of revenue from exchange transactions would focus on the point in time when the government is entitled to the benefits represented by the revenue from the transaction. The development of an earnings-based approach for recognition of expense from exchange transactions would focus on the point in time when the government is obligated for the expense.

Questions?

Jerry E. Durham, CPA, CGFM, CFE

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