GASB Update / Changes in the State and Local Government Environment

2012 Kansas GFOA Fall Conference
October 10, 2012

Shelly Hammond & Mike Lowry
Allen, Gibbs & Houlik, L.C.

Objectives

- GASB pension standards
- SEC & other pension updates
- GASB – other GAAP updates
- Municipal advisor registration update
- Auditing standards update

GASB Pension Standards
No. 67 and 68

Effective dates

- GASB 67, *Financial Reporting for Pension Plans* – for the plans themselves
  - Effective: year-ends June 30, 2014 and after
- GASB 68, *Accounting and Financial Reporting for Pensions* – for employers
  - Effective: year-ends June 30, 2015 and after

GASB 68: Acctg. and Financial Reporting for Pensions (amends GASB 27)

Change in focus – shift from a “funding” approach to an “earnings” approach

- Pension liability will be reported as employees earn their pension benefits by providing services
- Changes in liability will be recognized immediately or deferred, depending on nature of the change
- Impact is at entity-wide level

Pension liability

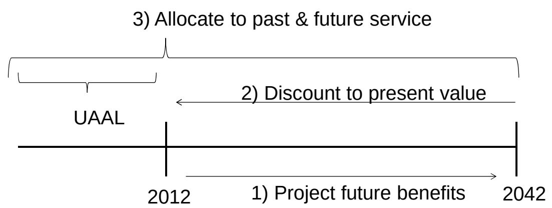
- Net pension liability (NPL) to be recorded equal to the unfunded accrued actuarial liability (UAAL).
- For cost-sharing employers (participants in KPERS for example), they will recognize their proportionate share of the collective liability for the Plan as a whole.
  - State piece for USDs will be recorded by the State.

Determining liability: 3-step process

1) Projecting future benefit payments
2) Discounting the amount in 1) to present value
3) Attributing 2) to past and future periods

AGH

3-step process



AGH

Step 1: Projecting future benefit payments

- Assumptions to be consistent with Actuarial Standards of Practice
- Include automatic COAs
- Include ad hoc COLAs and other changes that are *substantively automatic* (not included under prior GASB)

AGH

Step 2: Discounting to present value

- *Single rate* reflective of:
  a) Use the LT expected rate of return (LTEROR) on plan investments that are expected to be used to finance the payment of pension benefits to the extent that plan net position is projected to be sufficient to make payments
  b) Yield or Index rate for 20-yr. tax-exempt general obligation municipal bond rated AA/Aa or higher, to extent that conditions for LTEROR not met.

AGH

Example

Year	Projected Plan Net Position	Projected Benefit Payments	Funded Portion	Unfunded Portion
1	1,500,000	150,000	150,000	0
2	1,000,000	200,000	200,000	0
3	500,000	300,000	300,000	0
4	350,000	375,000	350,000	25,000

AGH

Step 3: Attributing present value to past and future periods

- Use of actuarial cost method to allocate costs to specific periods
- Previously: GASB allowed use of 7 different actuarial methods
- Now: Only the Entry-Age Normal method is allowable, to be based on a level percentage of payroll

AGH

Step 3 (continued)

- Net pension liability measured as of date no earlier than end of the employer's prior fiscal year-end
  - If actuarial valuation performed as of another date, would require use of "rollforward" procedures to update amounts
    - Allowed only for actuarial valuation dates that are no more than 30 months and one day prior to FYE
  - Use of year-end includes employers participating in multiple-employer plan
- Actuarial valuation at least biennially

AGH

Determining pension expense

- Certain aspects recognized immediately; others deferred and included in expense over time
- Immediate:
  - Changes in benefit terms
  - Service costs

AGH

Determining pension expense

- Deferred over remaining service lives of active and inactive employees (including retirees):
  - Effects of actuarial differences and changes in assumptions related to economic or demographic factors
- Deferred over 5 years:
  - Differences between actual and projected earnings on investments

AGH

Cost-sharing plan allocation

- Proportionate share of liability to be recorded by each participating employer.
  - Proportion is a measure of the employer's expected LT relative contribution effort compared to the total contribution effort of all participating employers
- Required to be measured as of a date no earlier than the end of the employer's prior fiscal year

AGH

Note disclosures

Significantly expanded:

- Info on how the discount rate was determined, including how the LT expected rate of return was estimated for each asset class
- The effect of a 1% increase / decrease in the discount rate on the liability
- Detail of changes in the net pension liability
- Reconciliation of beginning & ending balances of deferred pension inflows / outflows
- RSI expanded to 10-year historical info
- RSI requirements similar for cost-sharing plans

AGH

GASB 67: Financial Reporting for Pension Plans (amendment of GASB 25)

- Recognition, measurement and presentation of financial statement amounts generally similar to current guidance
- Note disclosures and RSI: Similar to disclosures for the employer
- Net pension liability is not recognized by the Plan (rather, by the employer) – add'l. disclosures about the liability, though

AGH

Anticipated impact

- Could result in negative unrestricted net assets (net position) at the entity-wide level
- More volatile net pension liability (due to less smoothing of changes in assets and liabilities)
- Impact on bond ratings?
- Going-concern issues / evaluations?
- Explaining to governing body and taxpayers

AGH

SEC & Other Pension Updates

AGH

SEC oversight

- Government securities are exempt from the Securities Acts of 1933 and 1934 – except for antifraud provisions of the 1933 Act.

AGH

SEC oversight

- July 31, 2012: SEC Report on the Municipal Securities Market released
- Primary concerns with timeliness of financial reporting, comparability between financial statements (due to different accounting principles being used by entities of different size and complexity)

AGH

SEC oversight

- SEC recommendations to Congress:
  - Authorize the SEC to require continuing disclosure while debt is outstanding (replacing MSRB), including the timeframes and frequency of disclosure
  - Authorize the SEC to establish the form and content of financial statements for municipal governments that issue debt (including conduit debt)
  - Mandated audits by independent auditor or state auditor

AGH

Other pension matters

Moody's Investor Service issued a Request for Comment on July 2, 2012 regarding proposed adjustments to pension disclosures in securities offering documents. Key changes:

- Multiple-employer cost-sharing plan liabilities to be reported for all participating employers
- Accrued actuarial liability would be adjusted based on a high-grade LT corporate bond index discount rate (5.5% for 2010 and 2011)
- Asset smoothing will be replaced by fair value at actuarial date

AGH

GASB Update - Other

AGH

GASB 60: Service Concession Arrangements (SCAs)

- Effective for years ending December 31, 2012 (applied retroactively)
- Often discussed as "public-private partnerships"
- An SCA is an arrangement between a transferor (gov't) and an operator (gov't or nongov'tal entity)
- Disclosures relate to description of the arrangement, amounts of assets / liabilities recognized, and nature / extent of rights retained by the transferor or granted to the operator

AGH

GASB 60 – what is an SCA?

- Criteria for determining whether transferor has control over the facility (all must be met):
  - The transferor conveys to the operator the right and related obligation to provide services thru the use of infrastructure or other public asset in exchange for *significant consideration*
  - The operator collects and is compensated by fees from third parties
  - The transferor determines or has the ability to modify or approve what services the operator is required to provide, to whom they are required to provide the services, and prices / rates that can be charged
  - The transferor is entitled to *significant residual interest* in the service utility of the facility at the end of the arrangement

AGH

GASB 60 – transferor reporting

Transferor (gov't) reports:

1) Asset for up-front payments, or present value of installment payments. This may also be receipt of a new facility or improvements to an existing facility, which would be recorded at fair value when placed into operation.
2) Present value of any contractual obligations as liabilities
   – For example, an obligation for capital improvements, insurance or maintenance of the facility
   – For example, a commitment to provide a specific level of police and emergency services or providing a minimum level of maintenance to areas around the facility

AGH

GASB 60 – transferor reporting

3) A corresponding deferred inflow / outflow equal to the difference between 1) and 2)

-- to be amortized & recognized as revenue over the term of the agreement

Transferor also continues to report an existing facility as a capital asset, even if operated by another party.

AGH

GASB 60 – government is the operator

- Gov'tal operator reports an intangible asset at cost for its right to access the facility and collect third-party fees
  - "cost" = up-front payment or cost of contributed asset
  - Amortize over term of the arrangement
- Improvements made to the facility by the government operator increases the intangible asset if the improvements increase the capacity or efficiency of the facility

AGH

GASB 60 – other provisions

Revenue sharing arrangements:

- Government operator reports all revenues earned and expenses incurred
- Transferor recognizes conditional amounts when earned according to the agreement

Disclosures:

- Description of the arrangement
- Nature and extent of rights retained or transferred
- Nature and amounts of recognized assets & liabilities

GASB 61: Financial Reporting Omnibus

Effective for periods ending June 30, 2013

Most significant effects:

- Increases the emphasis on financial relationships
  - Raises the bar for inclusion
- Refocus and clarify the requirements to blend certain component units
- Improve the recognition of ownership interests
  - Joint ventures
  - Component units
  - Investments

GASB 61: Inclusion criterion

GASB 14 requires inclusion if CU is fiscally dependent. That is, if the PG has authority over:

- Budget
- Setting taxes and charges, or
- Issuing debt

GASB 61 adds requirement: fiscal dependency is a basis for inclusion *only if there is also fiscal interdependence* – i.e. a potential financial benefit or burden between the 2 entities

GASB 61: Inclusion criterion

GASB 14 requires inclusion of a CU if exclusion would make the reporting entity's statements "misleading or incomplete."

GASB 61 eliminates "incomplete", and emphasizes that the determination would normally be based on financial relationships (such as a significant financial benefit / burden that is other than temporary)

AGH

GASB 61 – criteria for blending

GASB 14 requires blending of CU if its governing board is substantially the same as the board of the primary gov't

GASB 61 expands requirement; at least one of the following must also be met:

- The primary gov't and CU are financially interdependent (financial benefit or burden)
- Management responsible for day-to-day operations of the primary gov't also manages the CU's day-to-day activity in much the same way (operational responsibility)

AGH

GASB 61 – criteria for blending

GASB 61 adds an entirely new criterion for blending in addition to the prior slide:

- CU will be blended if its total debt will be repaid entirely, or almost entirely, from resources of the primary government

AGH

GASB 62: Codification of Private-Sector Guidance

- Effective for periods ending December 31, 2012
- Application is to preparers of enterprise fund financial statements
- Standard needed due to FASB Codification, which eliminated references to standards issued before November 30, 1989
- Eliminates option to follow relevant FASB guidance issued after November 30, 1989
- May use FASB guidance as *other accounting literature* in situations not addressed by GASB
- Not expected to have much impact, as few gov'ts were using the option to follow FASB

AGH

GASB 63: Deferred Inflows, Deferred Outflows and Net Position

- Effective for periods ending December 15, 2012 with earlier application encouraged
- Provides for a new Statement of Net Position for reporting assets, deferred outflows, liabilities, deferred inflows and net position (formerly known as net assets)

AGH

GASB 63 (cont'd)

- Deferred outflow:
  - A consumption of net assets that is applicable to a future reporting period
  - Has a positive effect on net position, similar to assets
- Deferred inflow:
  - An acquisition of net assets that is applicable to a future reporting period
  - Has a negative effect on net position, similar to liabilities
- Assets + deferred outflows – liabilities – deferred inflows = Net Position

AGH

GASB 63 (cont'd)

- Reporting:
  - Deferred inflows and outflows are reported in separate sections following assets & liabilities
  - Net position components resemble net asset components under GASB 34
  - At the Fund Level, still report fund balance

AGH

GASB 63 (cont'd)

- Deferrals are limited to those instances specifically identified by GASB
  - GASB 53 – Derivative Instruments
  - GASB 60 – Service Concession Arrangements
- GASB 65 (discussed later) identifies deferrals that would be subject to GASB 63 "deferral" treatment

AGH

GASB 65: Items Previously Reported As Assets and Liabilities

Reclassifies certain items to be deferred inflows or outflows.

Effective: year ends December 15, 2013 and after. Applied by retroactively restating the financial statements of prior periods.

Some provisions apply at the fund level.

AGH

GASB 65

Moving to deferred inflows / outflows:

- Deferred refunding amounts (currently netted against bond liability balance)
- Deferred revenue from property tax receivables
- Deferred revenue from resources received prior to completion of time or other requirements (i.e., unearned revenue) – for example, from grants received in advance to time period to be used in
- Deferred revenue resulting from receivables that are not “available” – deferred revenue that offsets special assessments receivable

AGH

GASB 65

Remain as liabilities (items triggered by “performance”):

- Resources received in advance of an exchange transaction
- Grants received in advance of meeting eligibility requirements (such as expenditure of funds)
- Derived tax revenue received in advance (for example, income tax receipts which may have adjustments later)

Remain as assets:

- Prepayments – for example, net pension asset

Other changes:

- Debt issuance costs (except insurance) will be expensed

AGH

GASB 65

Major Fund Determination:

- Consider deferred inflows / outflows as assets / liabilities for purposes of calculating major funds

AGH

GASB 64

Derivative Financial Instruments – Application of Hedge Accounting Termination Provisions – An Amendment of GASB Statement No. 53

Effective: years ending June 30, 2012 and after

AGH

GASB 66: Technical Corrections

- Amends GASB 10 by removing the provision that limits fund-based reporting of risk financing activities to the general funds and internal service fund types.
- Misc. other items related to loans and servicing fees on loans

Effective: years ended December 15, 2013 and later

AGH

Dodd-Frank:

Municipal Advisor Registration

AGH

Municipal advisors

- Imposes registration and other obligations, including fiduciary activities, upon "municipal advisors"
  - Requirement effective October 1, 2010 to register with the SEC and MSRB
  - In December 2010, the SEC issued proposed rules related to who must register, and included their interpretation of who is a "municipal advisor."

AGH

Municipal advisors

- **Municipal advisor** = A person that provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such financial products or issues.

AGH

Municipal advisors

Excluded:

- Accountants "preparing financial statements, auditing financial statements or issuing letters for underwriters"
- Any employee of a municipal entity, including elected members of an entity's governing body to the extent that such persons are acting within the scope of their role as elected members
- Governmental pension plan employees

AGH

Municipal advisors

Included:

- Appointed members of a governing body of a municipal entity that are not ex officio members
  - Example: pension plan board has members who are appointed, and who are not employees or ex officio members

AGH

Status update

In September 2012, the U.S. House of Representatives approved a bill that would prevent CPAs who perform "customary and usual" accounting services from being defined as municipal advisors.

Overall legislation still not final.

AGH

Auditing Standards Update

AGH

Audit standards update

Changes in auditing standards will impact your 2012 audits. Key areas:

- Changes to form / content of engagement letters
- Changes in form of auditors' report
- Potential effect of significant deficiencies / material weaknesses will be included in written communications
- Changes in auditor communication with "other auditors" involved in aspects of the audit
  - This will also require more work for management: responsibility for consolidation of F/S; responsibility for identification and communication related to subsequent events

AGH

Questions?

Thank you!

Shelly L. Hammond
Vice President, Assurance Services
shelly.hammond@aghlc.com

Mike D. Lowry
Senior Manager, Assurance Services
mike.lowry@aghlc.com

Allen, Gibbs & Houlik, L.C.
(316) 267-7231

AGH