

2018 Governmental GAAP Update

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Recent GASBs

■ GASB Pronouncements:

- Financial Reporting for Postemployment Benefit Plans Other Than Pensions (GASB #74)
- Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (GASB #75)
- The Hierarchy of GAAP for State and Local Governments (GASB #76) – PY Slides
- Tax Abatement Disclosures (GASB #77) – PY Slides
- Pensions Provided through Certain Multiple-Employer DB Plans (GASB #78) – PY Slides
- Certain External Investment Pools and Pool Participants (GASB #79) - PY Slides
- Blending Requirements for Certain Component Units (GASB #80) – PY Slides
- Irrevocable Split-Interest Agreements (GASB #81) – PY Slides
- Pension Issues (GASB #82) – PY Slides
- Certain Asset Retirement Obligations (GASB #83)
- Fiduciary Activities (GASB #84)
- Omnibus 2017 (GASB #85)
- Certain Debt Extinguishment Issues (GASB #86)
- Leases (GASB #87)
- Certain Disclosures Related to Debt (GASB #88)

**GASB Statement No. 74 – Financial
Reporting for Postemployment
Benefit Plans Other Than Pensions
 (“GASB #74”)**

**GASB Statement No. 75 –
Accounting and Financial Reporting
for Postemployment Benefits Other
Than Pensions
 (“GASB #75”)**

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GASB #74/75

- Effective for Plans for periods beginning after June 15, 2016 (FY 2017) and for Employers for periods beginning after June 15, 2017 (FY 2018)
- The purpose was to improve the usefulness of information about other postemployment benefits (primarily retiree medical benefits) other than pensions (“OPEB”) in external financial reports.
- Approach is very similar and consistent with recent pension standards.
- Significant impact on state and local governments in our State and in the nation.
- Early implementation is encouraged.

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GASB #74/75

- Background:
 - Economic substance of OPEB:
 - Employee compensation earned during their work career but paid in a later period
 - Substantively equivalent to pensions
 - Treatment until GASB #67/68:
 - Parallel treatment for pensions and OPEB
 - Treatment after GASB #67/68:
 - Compromised - no longer the same treatment for pensions and OPEB
 - New GASB OPEB standards (GASB #74/75)
 - Restore parallel and consistent treatment between pensions and OPEB

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GASB #74/75

- Fundamental OPEB Changes:
 - Employer liability
 - Net OPEB liability versus liability for only unfunded contributions (see next two slides)
 - Employer expense
 - Recognition divorced from funding
 - Cost-sharing plans
 - Employer's proportionate share of total liability and expense

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GASB #74/75

- **Current Employer Liability:**
 - Annual Required Contribution (ARC)
 - Less: Actual Contributions
 - Net OPEB Obligation (NOO)
- **New Employer Liability:**
 - Total OPEB Liability (TOL)
 - Less: Fiduciary Net Position (FNP)
 - Net OPEB Liability (NOL) *

* Very similar to the Unfunded Actuarial Accrued Liability ("UAAL")

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GASB #74/75

EMPLOYER LIABILITY ILLUSTRATION

Current Guidance - Funding Method

	Annual Required Contribution (ARC)	\$ 500,000
Less:	Actual Contributions (AC)	<u>(250,000)</u>
	Net OPEB Obligation (NOO)	<u>\$ 250,000</u>

New Guidance - Total Cost Method

	Total OPEB Liability (TOL)	\$ 10,000,000
Less:	Fiduciary Net Position (FNP)	<u>(5,000,000)</u>
	Net OPEB Liability (NOL)	<u>\$ 5,000,000</u>

Liability Reported by Employer:

Current Guidance	\$ 250,000
New Guidance	\$ 5,000,000

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GASB #74/75

- Other Observations:
 - It incorporates guidance on pensions not administered through a trust.
 - It retains requirement to consider an implicit rate subsidy (occurs when retirees do not pay the real cost for retiree coverage) as OPEB.
 - Actuarial valuations should be performed at least every two years (used to be three years for plans with membership under 200).
 - The alternative measurement method for small employers and plans (less than 100 active and inactive employees) may still be used but must be performed at least every two years.
 - NOL and deferred inflows and outflows of resources related to OPEB should be allocated to applicable proprietary/fiduciary funds (see NCGA Statement 1, paragraph 42).

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GASB #74/75

Components of OPEB Expense

- Annual service cost
- Interest on the net OPEB liability
- Projected earnings on plan investments
- The full effect of any changes in benefit terms
- Amortization of deferred outflows of resources and deferred inflows of resources

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GASB #74/75

Discount Rate

- Current Guidance:
 - Estimated long-term investment yield for the plan, with consideration given to the nature and mix of current and expected plan investments
- New Guidance:
 - Modification necessary if it is expected that FNP will *not* be sufficient to pay benefits to active employees and retirees (use 20-year tax exempt high quality bond rate for insufficient portion)
 - Single blended rate

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GASB #74/75

Actuarial Method

- Current Guidance:
 - Whatever actuarial method is used for funding must be used for accounting and reporting
 - Six acceptable methods (i.e., entry age, frozen entry age, attained age, frozen attained age, projected unit credit, aggregate cost method)
 - Must be applied within parameters defined by GASB
- New Guidance:
 - Does not have to agree to actuarial method used for funding, but all employers will use the entry age method for accounting and financial reporting purposes (with service cost determined as a percentage of pay)

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GASB #74/75

Amortization

- Background
 - Circumstances that could affect the NOL
 - A. Changes in benefit terms
 - B. Changes in economic and demographic assumptions
 - C. Differences between economic and demographic assumptions and actual experience (other than investment returns)
 - D. Differences between expected and actual investment returns

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GASB #74/75

Amortization (Continued)

- Current Guidance:
 - Effect amortized over a period not to exceed 30 years
- New Guidance:
 - Effect to be amortized over a much shorter period
 - Different periods depending on the circumstances noted (see next slide)

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GASB #74/75

Amortization (Continued)

- Amortization Period To Use for Each Circumstance:
 - Change in benefit terms - immediate recognition
 - Changes in economic and demographic assumptions – closed period equal to average remaining service period of plan members
 - Differences between economic and demographic assumptions and actual experience (other than investment returns) - closed period equal to average remaining service period of plan members
 - Differences between expected and actual investment returns - closed 5-year period

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GASB #74/75

Disclosures and RSI

- Disclosures are Primarily the Same as Pension Guidance Plus:
 - Broadened sensitivity disclosure
 - +/- 1% in the discount rate (Pensions and OPEB)
 - +/- 1% in the health-care trend rate (OPEB)
- RSI – To be provided for 10 years for:
 - Changes in net OPEB liability (single employer and agent multi-employer plans)
 - Funding progress (All OPEB Plans)
 - Employer contributions (cost sharing plans)

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GASB #74/75

Considerations/Action Items

- Single Employer/Agent Multiple-Employer Plans:
 - Local governments that provide health insurance for retirees through their own plans or those who participate in the State Health Plan/Employee Insurance Plan (per discussions with the GASB) have a single-employer plan or agent multiple-employer plan but have no requirements related to GASB #74 unless you are presenting plan financial statements.
 - Make sure you have contacted your actuary and that they have prepared a new actuarial valuation based on the provisions of GASB #74/75.
 - Emphasis of Matter (“EOM”) paragraph will be included in our Independent Auditor’s Report in FY 2017 for the implementation of GASB #74 (if significant). GASB #74 will result in new and expanded note disclosures and required supplementary information on the OPEB Plan financial statements (but should have no impact on the amounts reported on the employer’s financial statements).

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GASB #74/75

Considerations/Action Items

- Cost-Sharing Multiple-Employer Plans:
 - The State, State Agencies, and School Districts participate in a cost-sharing multiple-employer plan (if you are paying a retiree surcharge – then you are participating in the cost-sharing plan). The State Health Plan was funded at 7.6% (\$1.1 billion) of the total actuarial accrued liability (of approximately \$14.7 billion) as of June 30, 2017 (last available actuarial). NOL liability will be allocated to each entity based on their proportionate share of total payroll (estimated to be around 1.7 times payroll at 6/30/16 and 1.6 times payroll at 6/30/17).
 - The State makes contributions into the retiree health insurance trust – and thus “Contributions from Non-Employer Contributing Entities” is present (does this qualify as a special funding situation).
 - Based on my discussions with the PEBA, information on the total net OPEB liability, your proportionate share of the net OPEB liability, and other OPEB should become available on the PEBA website in June 2018.

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GASB #74/75

Considerations/Action Items

- All Plans for GASB #75:
 - Emphasis of Matter (“EOM”) paragraph will be included in our Independent Auditor’s Report in FY 2018 for the implementation of GASB #75 (if significant). GASB #75 will result in a restatement (a cumulative change in accounting principle) of your beginning net position for FY 2018 (i.e. 7/1/17) along with a charge to your current income statement for the change in the NOL from the beginning of the year to the end of the year. This change for the current year will need to be charged to the applicable income statements based on covered payroll/contributions. There will also be significant new and expanded note disclosures and required supplementary information.

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GASB #74/75

Considerations/Action Items

- Communicate the coming changes to your Board/Council.
- Most of these OPEB plans are severely underfunded. If you have your own OPEB Plan, please discuss with your Management/Board your funding policy (see GFOA Best Practice on this topic). Try to fund the Actuarially Determined Contribution each year.
- Bond Ratings (greater impact if poorly funded and its your own OPEB Plan, less impact if poorly funded and it’s a cost-sharing plan).
- If you have not already made these changes with the new pension standards:
 - If you have business-type/enterprise fund activities (with no revenue pledged to outstanding debt), you may want to consider switching from Enterprise Funds to Special Revenue Funds.
 - Bond Covenants – begin to determine the impact these statements may have on your bond/rate covenants and work with your attorneys to address any changes that might need to be made.

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GASB Statement No. 83 – Certain Asset Retirement Obligations (“GASB #83”)

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GASB #83

- Effective for periods beginning after June 15, 2018 (FY 2019).
- GASB #18 dealt with landfill closure and postclosure care costs and GASB #49 with pollution remediation.
- The purpose was to provide uniform criteria for governments to recognize and measure asset retirement obligations that may have not been previously reported and to provide enhanced note disclosures.
- Early implementation is encouraged.

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GASB #83

- Asset Retirement Obligation (“ARO”)
 - Legally enforceable liability associated with the retirement of a tangible capital asset
 - Retirement = sale, abandonment, recycling, other types of disposal
 - Results from the normal operations of capital assets
 - Examples – costs associated with:
 - Decommissioning nuclear reactors
 - Dismantling and removing a sewage treatment plant, wind turbine, or mine.
 - Dismantling hospital X-ray machines, radiation treatment facility, etc.

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GASB #83

- Three Criteria of Recognition
 - Liability incurred and is reasonably estimable
 - Incurrence of a liability is manifested when there is an occurrence of an *external obligating event*
 - Source of (potential) obligation
 - Incurrence of a liability is manifested when there is an occurrence of an *internal obligating event*
 - Circumstances that trigger the obligation

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GASB #83

- External Obligating Events
 - Existing laws and regulations
 - Legally binding contracts
 - Court judgments
- Internal Obligating Events
 - Occurrence of contamination from normal use (nuclear power plant)
 - Events other than contamination
 - Obligation based on use – placing the asset into operation and consumption (mine)
 - Obligation *not* based on use – placing the asset into operation (wind turbine)
 - Permanent abandonment before ready for use (sewer treatment facility)
 - Acquiring an asset that has an existing ARO (acquisition)

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GASB #83

- Elements Recognized
 - Credit – ARO Liability
 - Debit – Deferred Outflows for Resources
 - Generally recognize as expense in a systematic and rational manner over useful life of the tangible capital asset
 - Expense immediately (if asset is abandoned before asset is ready for use)
- Initial Measurement
 - Best estimate of *current value* (not *present value*) of outlays expected to occur
 - Probability weighting of potential outcomes should be used if sufficient evidence is available or can be obtained at reasonable cost (otherwise use most likely amount in range of possible outcomes)

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GASB #83

- Initial Measurement (Minority Owner)
 - Government has minority share (<50%) in a joint operation
 - Government and one or more entities jointly own a tangible capital asset
 - Each owner is liable for their share of the ARO
 - Nongovernmental entity is majority owner
 - None of owners have majority ownership of jointly owned capital asset
 - Nongovernmental entity has operational responsibility
 - Use nongovernmental entity's measurement of ARO using that entity's accounting standards (FASB)
 - Measurement date no more than one year and one day prior to the government's financial reporting date

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GASB #83

- Remeasurement
 - Annual adjustment for effects of inflation/deflation
 - Annual evaluation of effect of all other relevant factors
 - Adjustment if effects on estimated asset retirement outlays are significant
 - Examples
 - Change in price not attributable to inflation or deflation
 - Change in technology
 - Change in legal requirements
 - Change in type of equipment, facilities, or service
- Exception for minority ownership
 - Use nongovernmental entity's measurement of ARO using that entity's accounting standards
 - Measurement date no more than one year and one day prior to the government's financial reporting date

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GASB #83

- Treatment of Changes in Estimates
 - Prior to retirement of capital asset:
 - Prospective change in amortization
 - After retirement of capital asset
 - Immediate recognition.

- Governmental Funds
 - Recognize liabilities only for goods and services when received to the extent due and payable

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GASB #83

- Note Disclosures
 - Financial assurance requirements (i.e. how those requirements are being met, amounts of assets restricted for payment, if not displayed separately, etc.)
 - Descriptive information about the nature and timing of AROs
 - Methods and assumptions used to estimate AROs
 - Estimated remaining useful life of associated assets
 - Any liability for an ARO has not been recognized only because it is not yet reasonably estimable (and the reason)

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GASB Statement No. 84 – Fiduciary Activities (“GASB #84”)

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GASB #84

- Effective for periods beginning after December 15, 2018 (CY 2019 and FY 2020).
- The objective was to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.
- Early implementation is encouraged.

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GASB #84

■ Background/Issues

- I. Fiduciary Funds/Activities
- II. Fiduciary Fund Types
- III. Liability Recognition
- IV. Level of Detail – Additions and Deductions

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GASB #84

I. Fiduciary Funds (Fiduciary Activities)

- Fiduciary component units (“CU”)
- Pension and OPEB arrangements (that are not CUs) for which the local government in question has “Control”
- All other fiduciary activities for which the local government has “Control” plus two other criteria.

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GASB #84

■ Fiduciary CU

- Meets the CU criteria of GASB #14 (as amended)

and

- The fiduciary activity is one of the following arrangements:
 - Pension plan administered through a trust (GASB #67)
 - OPEB plan administered through a trust (GASB #74)
 - Assets accumulated for pensions not in a trust from entities that are not part of the reporting entity.
 - Assets accumulated for OPEB not in a trust from entities that are not part of the reporting entity.

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GASB #84

■ Fiduciary CU - Criteria of GASB #14 (as amended)

- Legally separate entity *
- Fiscal Accountability
 - Board Appointment
 - Financial Benefit or Burden (if you are legally required or if you have assumed the obligation to make pension contributions)
 - OR
 - Ability to Impose Will
- Fiscal Dependence
 - Financial Benefit or Burden (if you are legally required or if you have assumed the obligation to make pension contributions)

* Note: Pension/OPEB plans that are in GASB #67/74 compliant trusts are generally considered legally separate entities.

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GASB #84

- Additional Fiduciary CUs:
 - If not a Pension or OPEB Arrangement – Considered a Fiduciary CU if the assets have one or more of the following characteristics:
 1. Administered through a trust or equivalent arrangement, government is not the beneficiary, dedicated to provide benefits to recipients per the benefit terms, and legally protected from the government's creditors.
 2. For the benefit of individuals, the government does not have administrative or financial involvement with the assets, and not derived from government's provision of goods and services to those individuals.
 3. Benefit of organizations or other governments not part of the reporting entity and not derived from the provision of goods and services to those organizations or other governments.
 - Control of assets is not a factor for determining fiduciary CU.

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GASB #84

- Pension and OPEB arrangements that are not CUs for which the local government controls the assets
 - In one of the following arrangements:
 - Pension plan administered through a trust (GASB #67)
 - OPEB plan administered through a trust (GASB #74)
 - Assets accumulated for pensions not in a trust from entities that are not part of the reporting entity.
 - Assets accumulated for OPEB not in a trust from entities that are not part of the reporting entity.
 - See later slide on “Control”

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GASB #84

- Fiduciary Activity if the following three criteria are met:
 - Assets controlled by the government (see next slide)
 - The assets associated with the activity are *not* derived from either:
 - Solely from the government's own-source revenue (i.e. water charges, sewer charges, property taxes, sales taxes, etc.)
 - From government-mandated nonexchange transactions or voluntary nonexchange transactions (i.e. grants, contributions, etc.) except for pass-through grants where the government has no administrative or direct financial involvement
 - Assets have one or more of the following:
 - Administered through a trust or equivalent arrangement, government is not the beneficiary, dedicated to provide benefits to recipients per the benefit terms, and legally protected from the government's creditors.
 - For the benefit of individuals, the government does not have administrative or financial involvement with the assets, and not derived from government's provision of goods and services to those individuals.
 - Benefit of organizations or other governments not part of the reporting entity and not derived from the provision of goods and services to those organizations or other governments.

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GASB #84

- Control of Assets
 - Two possibilities
 - The primary government holds the assets or
 - The government has the ability to *direct* the use, exchange, or employment of the assets
 - Clarifications
 - *Direct* = designate a third party to perform a government's fiduciary duties without assuming them does not eliminate control.
 - Unaffected by restrictions on use

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GASB #84

SUMMARY CHART – USE OF FIDUCIARY FUNDS

CU FIDUCIARY IN NATURE	CONTROL		
	PENSION OR OPEB PLAN ASSETS	NOT OWN-SOURCE REVENUE	
		NATURE OF ARRANGEMENT	IDENTITY OF BENEFICIARIES
			PASS-THROUGH GRANTS

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GASB #84

II. Fiduciary Fund Types (“FFT”)

■ Trust Funds

- Pension (and other employee benefit) Trust Funds (“PTF”)
 - Employee benefit plans
 - Contributions irrevocable
- Investment Trust Funds (“ITF”)
 - External portion of pools and investment accounts
- Private-Purpose Trust Funds (“PPTF”)
 - All other trust activities

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GASB #84

II. FFT (Continued)

■ Custodial Funds

- All other fiduciary activities not in a Trust Fund.
- Replace *agency funds* with *custodial funds*
- Subcategory “external investment pool” for pool assets *not* held in a trust or equivalent arrangement
- Business-type activities (including enterprise funds) custodial funds may report asset and liability (rather than a fiduciary fund) for assets held for 3 months or less (additions and deductions = *cash flows from operating activities*)

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GASB #84

III. Liability Recognition

- Demand for the resources has been made, or
- No further action or condition is required to be met to be entitled to receive the resources
 - Example, tax collections on behalf of other governments
- PTF follow guidance of GASB #67/74

IV. Level of Detail – Additions/Deductions

- Statement of Changes in Fiduciary Net Position for all FFT (all FFT may have net position)
 - Additions by source, but separately report
 - Investment income, investment costs (that is, costs that are separable from both investment income and administrative expense), and net investment income
 - Deductions by type
 - Report administrative costs
- PTF follow guidance of GASB #67/74

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GASB Statement No. 85 – Omnibus 2017 (“GASB #85”)

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GASB #85

- Effective for periods beginning after June 15, 2017 (FY 2018 and CY 2018).
- The objective was to address practice issues that have been identified in the implementation of various GASB Statements.
- Early implementation is encouraged.

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GASB #85

Blending Component Units (“CU”)

- Primary government is a business-type activity, uses single column for financial statements. Two options for reporting a blended CU are currently being used:
 - Present blended CU as an additional column as a separate fund of the primary government (discretely presented), or
 - Consolidate the blended CU information into the single column of the primary government.
- Can only use blending for CUs (into a single column) that meet the criteria for blending
 - GASB 14, paragraph 53, as amended
 - **If CUs do not meet criteria for blending – discretely presented must be used**

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GASB #85

Goodwill

- GASB #69 guidance for goodwill:
 - Goodwill: Difference between price paid and *net position* acquired
 - Positive amount (\$ paid > *net position* acquired) – deferred outflow of resources
 - Negative amount (\$ paid < *net position* acquired) – reduction in value of nonfinancial assets acquired
- Acquisitions prior to GASB #69 – need to eliminate goodwill from statements of net position
 - Positive goodwill = reclassify as *deferred outflow of resources*
 - Negative goodwill = eliminate by an adjustment to *net position*

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GASB #85

Fair Value Measurement and Application

- Real estate held by insurance entities
 - Investment vs. capital asset
 - Old guidance = classify based on “predominant use”
 - New guidance = classify based on GASB 72 definition of *investment* (*held primarily for the purpose of income or profit and has present service capacity based solely on its ability to generate cash or to be sold to generate cash*)
- Money market investments and interest-earning investment contracts
 - Clarify that amortized cost is an *option* rather than a requirement

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GASB #85

Postemployment Benefits

- Measurement of Pension/OPEB liabilities and expenditures in *governmental funds*
 - Liabilities to employees measured as of the end of the reporting period
 - Expenditures measured as of the end of the reporting period
 - Amounts payable to Pension/OPEB plan
 - Employer administrative costs for Pension/OPEB
- On-behalf payments for postemployment benefits in *governmental funds*
 - Issue – GASB 68, 73, and 75 did not explicitly say on-behalf revenues/expenditures to be recorded in governmental funds
 - Contributions made on employer’s behalf
 - +/- Adjustments to nonemployer payable
 - + Benefits paid on employer’s behalf
 - On-behalf Expenditures/revenues

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GASB #85

Postemployment Benefits (Continued)

- Payroll-Related Measures in RSI by OPEB Plans and Employers that provide OPEB
 - OPEB Plan Statements
 - Contributions to OPEB Plan based on pay – covered payroll
 - Contributions to OPEB Plan NOT based on pay – no payroll measure disclosed
 - Employers that offer OPEB
 - Trust used
 - Contributions to OPEB Plan based on pay – covered payroll
 - Contributions to OPEB Plan NOT based on pay – covered-employee payroll
 - Trust not used – covered-employee payroll, regardless of how benefit payments are based

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GASB #85

Employer-paid Member Contributions - OPEB

- OPEB Plan should treat as employee contributions
 - For GASB #75 purposes (including for purposes of determining a cost-sharing employer's proportion), those amounts should be classified as employee contributions as well.
- Employer should record as salaries, wages, or fringe benefits

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GASB #85

Alternative Measurement Method for OPEB

- Increase in the number of simplified assumptions permitted
 - Expected point in time when employees will exit from active service
 - Employee turnover

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GASB #85

OPEB Provided Through Private-Sector Plans

- Same approach as for pension plans participating in cost-sharing private-sector plans
 - Expense – Required contributions for the reporting period
 - Liability – unpaid required contributions at the end of reporting period
- Note disclosures
 - Information about the plan
 - Description of benefits and contribution requirements
- RSI – 10 year schedule of employer's required contributions to OPEB plan

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GASB Statement No. 86 – Certain Debt Extinguishment Issues ("GASB #86")

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GASB #86

- Effective for periods beginning after June 15, 2017 (FY 2018 and CY 2018).
- The objective was to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources (resources other than the proceeds from refunding debt) are placed in an irrevocable trust for the sole purpose of extinguishing debt (like an advance refunding)
- Early implementation is encouraged.

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GASB #86

In-Substance Defeasance of Debt (Using only Existing Resources)

- Debt defeased in substance
 - Cash and other monetary assets (*not* proceeds of refunding debt) with an escrow agent in a trust
 - Only for principal & interest payments of defeased debt
 - Possibility of government make future payments is remote
 - Essentially risk-free monetary assets (U.S. government obligations/securities): amount, timing, and collection of interest and principal
 - Cash flows for the monetary assets coincide to debt service payments
 - If securities in escrow pay before scheduled maturities (i.e. callable securities) then not risk-free as to timing. *Does not qualify for defeasance*
- Defeased debt no longer a liability

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GASB #86

Recognition in Financial Statements (“FS”)

- Economic resources (no deferral of recognition)
 - Reacquisition price
 - Net carrying value of debt*
 - (Loss)/Gain (reported separately in full-accrual FS.)
- Current financial resources (governmental fund FS)
 - Reacquisition price = debt service expenditures

* Include amount of any remaining prepaid insurance in calculating net carrying amount of extinguished debt (applies to legal and in-substance defeasance)

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GASB #86

Note Disclosure

- Period of Defeasance
 - General description of the transaction (examples)
 - Amount of debt extinguished
 - Amount placed in trust
 - Reasons for defeasance
 - Cash flow required to service the defeased debt
- Later Periods
 - Amount of in-substance defeased debt that remains outstanding
 - May be combined with amount reported in connection with other in-substance refundings

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GASB #86

Note Disclosure (Continued)

Disclosure for Debt Defeased “In Substance”

- If nothing prohibits the substitution of essentially risk-free monetary assets with monetary assets that are not essentially risk free
 - In the period
 - Disclose that fact
 - In all periods the defeased debt remains outstanding
 - Disclose the amount of outstanding defeased debt for which the risk of substitution remains

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GASB Statement No. 87 – Leases (“GASB #87”)

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GASB #87

- Effective for periods beginning after December 15, 2019 (FY 2021 and CY 2020).
- The objective was to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments by providing one single model for lease accounting based on the foundational principle that leases are “financings of the right to use an underlying asset”.
- Early implementation is encouraged.

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GASB #87

Current Lease Accounting

- Lessee determines type of lease – Capital or Operating
 - Capital Lease
 - Capital Lease if it meets one of the following criteria:
 - Transfer of Ownership at End of Lease
 - Bargain Purchase Option at End of Lease
 - Lease Term \geq 75% of Estimated Economic Life of Asset
 - Present Value of Minimum Lease Payments \geq 90% of Fair Market Value
 - Debit capital assets and credit long-term obligation (disclose future minimum capital lease payments)
 - Operating Lease (all other)
 - Expense payments when made (disclose future noncancelable rent payments)

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GASB #87

Scope

- Definition of a “Lease”

A contract that conveys the right to use another entity’s nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction
- Contract – legally enforceable (written or verbal)
- Right to use underlying asset
 - Obtain present service capacity
 - Determine nature and manner of use
- Nonfinancial asset – (i.e. land, buildings, vehicles)
 - Not securities (financial assets)

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GASB #87

Scope (Continued)

- No more capital or operating leases
- Leases excluded from Scope of GASB #87:
 - Leases for intangibles (*including computer software*) – except for sublease of intangible right to use leased tangible asset.
 - Leases for biological assets
 - Leases for inventory
 - Leases where underlying asset financed with conduit debt – except underlying asset and conduit debt reported by lessor
 - Service concession agreements
 - Supply contracts – power purchase agreements
- Other exclusions:
 - Short-term leases
 - Contracts that ultimately transfer ownership of the underlying asset to the lessee

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GASB #87

Lease Term

- Period during which Lessee has:
 - Noncancelable right to use underlying asset
 - Plus periods where
 - Lessee or Lessor option to extend (if exercise is reasonably certain)
 - Lessee or Lessor option to terminate (if *not* exercising is reasonably certain)
 - Includes fiscal funding clauses (but only if you think it is reasonable certain that the local government will exercise this clause).

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GASB #87

Lessee Accounting – Economic Resources Measurement Focus (Full Accrual)

- Initial recognition
 - Lease asset – intangible right-to-use capital asset
 - Lease liability
- Subsequent accounting
 - Amortization of lease asset
 - Shorter of lease term or useful life of underlying asset
 - Lease payments
 - Reduction of liability
 - Interest expense

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GASB #87

Measurement – Lessee

- Lease liability
 - Present value (PV) of payments over lease term
 - Interest rate charged by lessor, or
 - Lessee's borrowing rate
- Lease asset
 - PV of payments over lease term (lease liability)
 - Add: Payments made at or before the beginning of the term to lessor
 - Less: Lease incentives received from lessor beginning of the term
 - Add: Certain direct costs to put asset into service

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GASB #87

Lessee Accounting – Current Financial Resources Measurement Focus (Modified Accrual)

- Initial recognition (same as current guidance)
 - Expenditure – capital outlay
 - Other financing source

- Subsequent accounting (same as current guidance)
 - Lease payments – debt service expenditures

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GASB #87

Note Disclosure – Lessee

- Description of leasing arrangements
- Amount of lease assets
- Schedule of future lease payments
 - Principal and interest listed separately

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GASB #87

Measurement – Lessor

- Lease receivable
 - PV of lease payments over lease term

- Deferred inflow of resources
 - PV of lease payments over lease term
 - Add: Payments received at or prior to the beginning of the lease that relate to future periods

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GASB #87

Lessor Accounting – Current Financial Resources Measurement Focus (Modified Accrual)

- Initial recognition
 - Lease receivable at PV of payments
 - Deferred inflow of resources

- Subsequent reporting
 - Lease payments
 - Reduction of receivable
 - Interest revenue
 - Reduction of deferred inflow of resources → revenue
 - Over term of lease
 - Systematic and rational manner, if available

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GASB #87

Note Disclosure – Lessor

- Description of leasing arrangements
- Total amount of lease revenue for current year

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GASB #87

Leases Excluded – Short-Term Leases

- Definition – A lease that, at its beginning, has a maximum possible term under the contract of 12 months or less including all options to extend (regardless of probability to extend).
 - For a lease that is cancelable, the maximum lease term is the noncancelable period including any notice periods.
- Accounting
 - Lessee
 - Expense based on the payment provisions of the contract
 - No expense for rent holidays
 - Lessor
 - Revenue based on the payment provisions of the contract
 - No revenue for rent holidays

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GASB #87

Leases Excluded – Contracts that Transfer Ownership

- Defined as contract that:
 - Transfers ownership of the underlying asset to the lessee at the end of contract, and
 - Contains no termination options
 - Fiscal funding clause not applicable if reasonably certain it will not be exercised
- Treat as financed purchase of asset

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GASB #87

Lease Incentives

- Payment to or on-behalf of the lessee from lessor
 - Lessee has right of offset – payments are reduced
 - A rebate or discount
- Lessee reduces the amount of the underlying asset and liability at beginning lease term

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GASB #87

Contracts with Multiple Components

- Contract with lease and nonlease components
 - Separate lease component from nonlease component
 - Treat as separate contracts
- Multiple underlying assets in same lease and assets have different lease terms
 - Each underlying asset treated as separate component (lessee and lessor)
 - Allocate contract price to each component using reasonableness and professional judgment
 - Prices for each component in the contract
 - Stand-alone prices for similar assets
 - If cannot determine allocation, treat as a single-lease unit

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GASB #87

Contract Combinations

- Criteria for treating as a single contract
 - Entered into at or near the same time with the same counterparty and one of the following:
 - Negotiated as a package with a single objective
 - Consideration paid in one contract depends on the price or performance of the other contract
- Then, evaluate as a contract with multiple components

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GASB #87

Lease Modifications

- Amendments to lease contracts
 - Normally a modification
 - If right to use reduced = partial termination
- Treatment of modification
 - Separate lease
 - or
 - Remeasurement of existing lease
- Treat as separate lease if both exist:
 - Lessee receives one or more underlying assets not part of original lease
 - Increased payments for additional asset are not unreasonable
- If both not met, then remeasurement

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GASB #87

Lease Modifications (Continued)

- Remeasurement
 - Lessee
 - Remeasure lease liability
 - Adjust lease asset – difference between remeasured liability and liability before lease modification
 - Lessor
 - Remeasure lease receivable
 - Adjust deferred inflow of resources – difference between remeasured receivable and receivable before remeasurement

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GASB #87

Terminations

- Lessee's right to use asset is reduced
 - Lease term shortened
 - Number of assets reduced
- Treatment
 - Lessee
 - Reduce lease liability and asset
 - Difference = gain/loss
 - Lessor
 - Reduce lease receivable and deferred inflow
 - Difference = gain/loss

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GASB #87

Subleases

- Treated as a separate transaction
 - Lessee now also the lessor
 - No offset of transactions
 - Original lessee
 - Right to use asset and liability (original lease)
 - Receivable and deferred inflow of resources (sublease)

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GASB #87

Implementation Considerations

- It will be Applied Retroactively:
 - Facts and circumstance of the lease in period of implementation of GASB #87 (*not inception of the lease*)
 - Use remaining lease payments at beginning of period
 - Restate beginning net position in period of implementation
- **Begin analysis now**
 - Need to accumulate all lease contracts
 - It could lead to potential issues with debt limits, compliance with debt covenants, and statutes

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GASB Statement No. 88 – Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements ("GASB #88")

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GASB #88

- Effective for periods beginning after June 15, 2018 (FY 2019 and CY 2019).
- The primary objective was to improve the information disclosed in the notes related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.
- Early implementation is encouraged.

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GASB #88

Proposed Definition of Debt

- “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.”

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GASB #88

Definition of Debt (Continued)

- Interest that accrues or is variable does not preclude the liability from being considered debt
 - Capital appreciation bonds
 - Variable rate debt
- Does *not* include
 - Leases (GASB #87) – except for contracts reported as a financed purchase of the underlying asset.
 - Trade accounts payable

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GASB #88

Debt Note Disclosures

- If applicable, following debt related items to be included in notes to financial statements (in addition to current required debt disclosures)
 - Amount of unused lines of credit
 - Collateral pledged as security for debt
 - Terms specified in debt agreements related to significant:
 - Events of default with finance-related consequences
 - Termination events with finance-related consequences
 - Subjective acceleration clauses

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GASB #88

Debt Note Disclosures (Continued)

- Information about Direct Borrowings and Direct Placements should be separate (distinct category) from other Debt:
 - Changes in long-term debt
 - Repayment schedules
 - Collateral secured for debt
 - Significant of events of default with finance-related consequences
 - Termination events with finance-related consequences
 - Subjective acceleration clauses

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GASB Technical Agenda – Key Items

- Financial Reporting Model – Tentative Decisions
 - Possible special treatment for non-major debt service funds.
 - Defining “Nonoperating Revenues and Expenses” with all else being Operating.
 - Budgetary comparison schedules will probably be shown as RSI.
 - Modification of the current financial resources measurement focus and modified accrual basis of accounting statements to a near-term or short-term approach and will be called the “Short-Term Approach” (amounts that are generally available or due within one year). Exclusion of the recognition of the current portion of long-term assets and liabilities.
 - A schedule on the statement of activities by natural classification of expenses by function or program.
 - Provide more guidance on the MD&A (as they want more meaningful and understandable financial analysis)
 - Final statement may be issued in 1st half of 2022.
- Conceptual Framework (Recognition) – will pick up speed after the Financial Reporting Model pronouncement has been finalized.
- Revenue and Expense Recognition, Capitalization of Interest, Conduit Debt, and Equity Interest Ownership Issues.

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