2015 GOVERNMENTAL ACCOUNTING AND AUDITING UPDATE

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ALTEC

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ABOUT THE AUTHOR

J. Michael Inzina, CPA, CGFM, CGMA is founder and chief executive officer of Audit Litigation Training and Efficiency Consulting, Inc. (ALTEC), a consulting company serving public accounting firms and other accounting and auditing organizations on matters of audit efficiency, continuing education, litigation and ethics. He has over 35 years of public accounting experience, and remains a partner in the firm of Stagni & Company, LLC, whose practice is concentrated in government and nonprofits organizations. Mike holds a BBA in accounting from the University of Louisiana (Monroe), where he graduated summa cum laude in May 1976. He is a member of the American Institute of CPAs, Society of Louisiana CPAs, Government Finance Officers Association of Louisiana, and the Association of Government Accountants. Mike earned the CEA in governmental in 1990, was awarded the Certified Government Financial Manager (CGFM) designation in 1996, and the Chartered Global Management Accountant (CGMA) designation in 2012. He is a past chapter president and member of the Society of Louisiana CPAs Board of Directors and served two terms as chairman of the Governmental Positive Enforcement Program of the Louisiana State Board of CPAs. He has served on a number of committees of the Society of Louisiana CPAs, and currently serves on its Ethics Committee. Mike also served on the GASB Service Efforts and Accomplishments Task Force.

Mike has twice been a member of the AICPA Professional Ethics Executive Committee (1989-1992 and 2000-2003), and served on the Auditing Standards Board from 1997 to 2000. From 1986 to 1993, he also served as a member of AICPA Independence and Behavioral Standards Subcommittee, and as Subgroup Chairman of the Governmental Technical Standards Committee. During this time he conducted numerous investigations of complaints filed by federal, state and local agencies alleging substandard performance of audits of governmental and nonprofit entities, and represented the Professional Ethics Division at hearings of the Joint Regional Trial Board.

He contributed to the *Implementation Guide* for GASB Statement 34, AICPA Statement of Position 98-3, *Audits of States, Local Governments and Not-for-Profit Organizations Receiving Federal Awards*, revisions to the AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, the AICPA Practice Aid *Fraud Detection in a GAAS Audit*, revisions to the Louisiana Governmental Audit Guide and in drafting state legislation affecting governmental accounting and auditing requirements. He has served as technical consultant and instructor for the Louisiana Division of Administration (Office of Community Development) and as consultant to the Louisiana Department of Education. Mike frequently appears as moderator and panelist on the Accountants' CPE Network. (ACPEN).

Mike has been named twelve times as an Outstanding Instructor by the American Institute of CPAs and several state societies, and received a Special Recognition Award from the Society of Louisiana CPAs Board of Directors for his contributions to continuing education in 1994. In addition, he was awarded the 2001 National Education and Training Award from the Association of Government Accountants and in 2009 was named national Beta Alpha Psi Business Information Professional of the Year.

Other Materials Published by Audit Litigation, Training and Efficiency Consulting, Inc. (ALTEC)

Obtaining and Evaluating Audit Evidence
Testing Compliance with Laws and Regulations in a Governmental Audit
Conducting Government Audits under GAAS, GAGAS and the Single Audit
Accounting and Auditing Update
Not-for-Profit Accounting and Auditing Update
OMB Circulars A-87, A-133 and the Compliance Supplement
Audit Documentation
Single Audit Testing and Documentation
The Pillars of Professional Skepticism
Government Auditing Standards: The Yellow Book
Performing Effective and Efficient Audit Testing
The New Single Audit Supercircular
Internal Controls – Identifying and Reporting Deficiencies
Common Blunders in Audits of Government Entities
GASB Questions and Answers
Identifying and Responding to the Risk of Material Misstatement

2015 Governmental Accounting and Auditing Update

Author/ Instructor: J. Michael Inzina, CPA, CGFM, CGMA
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Description: The *Governmental Accounting and Auditing Update* is designed to provide its participants with a comprehensive, in-depth review of what's happening at the GASB, AICPA, GAO and OMB, including GASB Statements and Interpretations, Statements on Auditing Standards, Auditing Interpretations, Statements on Standards for Accounting and Review Services, Ethics Interpretations, and exposure drafts, with emphasis on the practical application and impact on practitioners in small to medium sized firms and members in government.

Delivery method: Live presentation.

Learning objectives: To enable participants to understand and apply the recently adopted pronouncements of the GASB, Auditing Standards Board, Professional Ethics Executive Committee, Accounting and Review Services Committee, GAO, OMB and other bodies whose pronouncements affect the preparation and audit of financial statements of state and local governments.

Experience/Prerequisites: Minimum to intermediate level of auditing experience.

Program level: Minimum to overview.

Who should attend: Partners and managers responsible for planning and supervision of governmental engagements, audit staff members who need to understand the changes which have occurred to enable them to conduct governmental engagements, and persons in government responsible for accounting, financial statement preparation, and internal audits.

Advance preparation: None.

Recommended CPE Credit: 8 hours (400 minutes) (Accounting and auditing/Yellow Book)

The author is deeply grateful to Lynn Andries, CPA for his technical review and commentary on the content of this course.

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I. GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) PRONOUNCEMENTS

STATEMENT 68 ***ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS***

In June 2012, the GASB adopted Statement 68 to address several issues regarding public pension plans. It amends Statement 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement 50, *Pension Disclosures*, as they relate to governmental employers that account for pensions that are provided through trusts or equivalent arrangements that meet certain criteria. The requirements of those Statements remain applicable to employers whose pensions are not covered by this Statement.

This Statement establishes a definition of pension plans that reflects the primary activities of a fund that is used to provide pensions – the accumulation and management of assets dedicated for pensions and the payment of pensions to plan members as the benefits become due. A trust (or equivalent arrangement) that is used to administer a pension plan and that has all of the following characteristics is referred to as a *qualified trust*:

- Employer contributions to the plan, including contributions made on behalf of the employer by a nonemployer contributing entity, and earnings on those contributions are irrevocable;
- Plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms;
- Plan assets are legally protected from the creditors of the employer, nonemployer contributing entities, and the plan administrator. If the plan is a defined benefit plan, plan assets are also legally protected from the creditors of the plan members.

Scope and applicability

Statement 68 establishes financial reporting standards for state and local governmental pensions (whether defined benefit or defined contribution plans). Pension plans should continue to follow all other accounting and financial reporting requirements applicable to the transactions and other events reported in their basic financial statements, including notes, and required supplementary information.

The provisions of the Statement apply to the financial statements of all state and local government employers whether the government's financial statements are presented in stand-alone financial reports or the plan is included in the financial statements of another government.

The term *pensions* as used in the Statement includes retirement income and postemployment benefits other than retirement income, such as death benefits, life insurance and disability benefits *that are provided through a pension plan*.

Pensions do not include postretirement healthcare benefits or termination benefits. When postemployment benefits other than retirement income are provided through a plan other than a pension plan, they are classified as "other postemployment benefits" (OPEB) and the plans from through which those benefits are provided should be accounted for and reported as OPEB plans. For financial reporting purposes, assets accumulated and managed for the purpose of providing postemployment healthcare benefits should be accounted for and reported as part of an OPEB plan.

Defined benefit pensions are those for which the income or other benefits that the plan member will receive at or after separation from employment are defined by the benefit terms. The pensions may be stated as a specified dollar amount or as an amount that is calculated based on one or more factors such as age, years of service and compensation.

Defined contribution plans are pensions having terms that:

- Provide an individual account for each plan member
- Define the contribution that an employer is required to make (or credits that it is required to provide) to an active member's account for periods in which that member renders service to the employer
- Provide that the pensions a plan member will receive will depend only on the contributions (or credits) to the plan member's account, actual earnings on investments of those contributions (or credits), and the effects of forfeitures of contributions (or credits) made for other plan members, as well as pension plan administrative costs, that are allocated to the plan member's account.

If the pensions to be provided are a function of factors other than those described in the last section, the plan through which the pensions are provided should be classified as a defined benefit pension plan.

Defined benefit plans are classified according to:

- The number of employers whose employees are provided with benefits through the plan, and
- Whether pension obligations and pension plan assets are shared

For purposes of this classification, a primary government and its component units are deemed to be one employer. If a defined benefit pension plan is used to provide pensions to the employees of only one employer, the plan should be classified for financial reporting purposes as a single-employer defined benefit pension plan (or "single-employer pension plan"). Single-employer pension plans should follow the guidance specific to single-employer pension plans.

If a defined benefit plan provides pensions to the employees of more than one employer, the plan is classified as a *multiple-employer defined benefit pension plan* ("multiple-employer plan"). If the assets of the multiple-employer plan are pooled for investment purposes, but separate accounts are maintained for each individual employer so that each employer's share of the pooled assets is legally available to pay the benefits of only its employees, the plan should be classified as an *agent multiple-employer defined benefit pension plan* ("agent pension plan"). Agent pension plans follow the guidance specific to agent pension plans.

In a multiple-employer defined benefit pension plan, if the pension obligations to the employees of more than one employer are pooled and pension plan assets can be used to pay the benefits of the employees of any employer that provides pensions through the pension plan, the plan is considered to be a *cost-sharing multiple-employer defined benefit pension plan* ("cost-sharing pension plan"). Cost-sharing pension plans should apply the guidance specific to cost-sharing plans.

<u>Defined benefit pension plans</u>

Number of plans

If, on an ongoing basis, all assets accumulated in a defined benefit pension plan for the payment of benefits may legally be used to pay benefits to any of the plan members, the total assets should be reported as assets of one defined benefit pension plan even if administrative policy requires that separate reserves, funds or accounts for specific groups of plan members, employers or types of benefits be maintained (such as a reserve for plan member contributions, a reserve for disability benefits or separate accounts for the contributions of state governments versus local government employers) or separate actuarial valuations are performed for different classes of plan members or different groups of plan members because different contribution rates may apply for each class of group depending on the applicable benefit structures, benefit formulas or other factors. A separate defined benefit pension plan should be reported for a portion of the total assets, even if the assets are pooled with other assets for investment purposes, if that portion of the assets meets both of the following criteria:

- The portion of assets is accumulated solely for the payment of benefits to certain classes or groups of plan members or to plan members who are the active or inactive employees of certain entities (such as state government employees), and
- The portion of assets may not legally be used to pay benefits to other classes or groups of plan members or other entities' plan members (such as local government employees)

<u>Special funding situations</u>

Special funding situations are circumstances in which an entity other than the employer (nonemployer entity) is legally required to contribute *directly* to a pension plan that is used to provide pensions to the employees of another entity or entities and either of the following conditions exists:

- The amount of contributions for which the nonemployer contributing entity legally is responsible is *not* dependent upon one or more events or circumstances unrelated to the pensions. Examples of such conditions include:

  - A circumstance in which the nonemployer entity is required by statute to contribute a defined percentage of an employer's covered-employee payroll directly to the pension plan and
  - A circumstance in which the nonemployer entity is required by the terms of a pension plan to contribute directly to the pension plan a statutorily defined proportion of the employer's required contributions to the pension plan

  Examples of circumstances in which the amount of the contributions is dependent upon an event or circumstance that is unrelated to pensions include:
  - A circumstance in which the nonemployer entity is required to make contributions to the pension plan based on a specified percentage of a given revenue source and
  - A circumstance in which the nonemployer entity is required to make contributions to the pension plan equal to the amount by which the nonemployer entity's ending fund balance exceeds a defined threshold amount

- The nonemployer entity is the only entity with a legal obligation to make contributions directly to a pension plan

Separate guidance is provided for:

- Single and agent employers with no special funding situations
- Cost-sharing employers with no special funding situations
- Single and agent employers with special funding situations
- Cost-sharing employers with special funding situations

Defined benefit pensions

Single and agent employers with no special funding situations

Net pension liability - A *net pension liability* should be recognized in financial statements prepared using the economic resources measurement focus and the accrual basis of accounting (the GWFS and proprietary fund statements). The net pension liability is the total pension liability less the amount of plan net position restricted for pensions (the plan net position) as of the end of the reporting period. The total pension liability is the portion of the present value of projected benefit payments that is attributed to the employees' past periods of service.

Timing and frequency of actuarial valuations - Actuarial valuations of the total pension liability would be required as of (a) the measurement date or (b) the use of update procedures to roll forward to the measurement date amounts based on an actuarial valuation performed no more than 30 months and one day prior to the employer's most recent year-end. If update procedures are used and significant changes occur between the actuarial valuation date and the measurement date, professional judgment should be applied to determine the extent of procedures needed to roll forward the actuarial valuation to the measurement date, considering whether a new valuation is needed. For purposes of this determination, the effects of changes in the discount rate resulting from changes in the plan's fiduciary net position or from changes in the municipal bond rate, if applicable, should be among the factors evaluated. For accounting and financial reporting purposes, an actuarial valuation of the total pension liability should be performed at least biennially, with more frequent valuations encouraged.

Selection of assumptions - All *plan assumptions* (unless otherwise specified by the proposed Statement) are required to be made in conformity with the Actuarial Standards of Practice issued by the Actuarial Standards Board of the American Academy of Actuaries. The plan, employer and if any, governmental nonemployer entities should use the same assumptions when measuring similar or related pension information.

Projection of benefit payments - *Projected benefit payments* to employees would be based on the then-existing benefit terms and legal agreements and would incorporate projected salary increases (for benefit formulas based on compensation levels) and service credits (for benefit formulas based on years of service), as well as projected automatic cost-of-living adjustments (COLAs) and other automatic postemployment benefit changes. Projections would also include ad hoc COLAs and other ad hoc postemployment benefit changes, if they are considered to be substantively automatic.

Benefit payments to be provided by means of an allocated insurance contract should be excluded from projected benefit payments if:

- The contract irrevocably transfers to the insurer the responsibility for providing the benefits
- All required payments to acquire the contract have been made, and
- The likelihood is remote that the employer or the plan will be required to make additional payments to satisfy the benefit payments covered by the contract.

Discount rate - Projected benefit payments would be *discounted to their present value* using the single rate that would reflect (1) the long-term expected rate of return on plan investments to the extent that plan net position is projected to be sufficient to pay pensions and the net position projected to remain after each benefit payment can be invested long-term, and (2) a tax-exempt, high-quality municipal bond index rate to the extent that the conditions in (1) are not met.

Comparing projections of the pension plan's fiduciary net position to projected benefit payments - For purposes of applying the discount rate, the amount of the pension plan's projected fiduciary net position and the amount of projected benefit payments should be compared in each period of projected benefit payments. Projections of the pension plan's fiduciary net position should incorporate all cash flows for contributions from the employer and nonemployer entities, if any, intended to finance benefits of current active and inactive employees and all cash flows for contributions from current active employees. It should not include:

- Cash flows for contributions from the employer or nonemployer entities intended to finance the service cost of future employees or
- Cash flows for contributions from future employees, unless those contributions are projected to exceed service costs for those employees.

In each period, contributions from employers and nonemployer entities should be considered to apply first to service costs of employees in the period and second to past service costs, unless the effective pension plan terms related to contributions indicate that a different relationship between contributions to the pension plan from nonemployer entities and service costs should be applied. Employee contributions should be considered to be applied to service costs before contributions from the employer and nonemployer entities.

Professional judgment should be applied to project cash flows for contributions from the employer and nonemployer entities in circumstances in which the contribution amounts are established by statute or contract or by formal written policy related to those contributions. Application of professional judgment should consider the most recent five-year contribution history of the employer and nonemployer entities as a key indicator of future contributions from those sources and should reflect all other known events and conditions.

Calculating the discount rate – for each future period, if the amount of the pension plan's fiduciary net position is projected to be greater than or equal to the benefit payments that are projected to be made in that period and pension plan assets up to that point are expected to be invested using a strategy to achieve the long-term expected rate of return, the actuarial present value of benefit payments projected to be made in the period should be determined using the long-term expected rate of return on those investments. The long-term expected rate of return should be based on the nature and mix of current and expected pension plan investments over a period representative of the expected length of time between:

- The point at which an employee begins to provide service to the employer and
- The point at which all benefits to the employee have been paid

The long-term expected rate of return should be determined net of pension plan investment expenses but without reduction of plan administrative expense. The municipal bond rate discussed above should be used to calculate the actuarial present value of all other benefit payments.

Attribution of the actuarial present value of projected benefit payments to periods - The attribution of the actuarial present value of benefit payments is accomplished using the *entry age normal actuarial cost me*thod as a *level percentage of pay*. The actuarial present value is attributed for each employee individually, from the period when the employee first accrues pensions under the benefit terms. The service costs of all pensions should be attributed through all assumed exit ages, through retirement. In plans where benefit terms include a deferred retirement option program (DROP), the date of entry into the DROP should be considered to be the employee's retirement date. Each employee's service costs should be determined based on the same benefit terms reflected in that employee's actuarial present value of projected benefit payments.

Pension expense, deferred outflows of resources and deferred inflows of resources related to pensions, and support of nonemployer entities

Changes in the net pension liability should be recognized in pension expense in the current reporting period except as follows:

- Each of the following should be recognized in pension expense, beginning in the current period, using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees provided pension benefits through the plan (active and inactive employees) determined as of the beginning of the measurement period:
    - Differences between expected and actual experience with regard to economic or demographic factors in the measurement of the total pension liability
    - Changes of assumptions about future economic or demographic factors or of other inputs

  The portion of the above items not recognized in pension expense should be reported as deferred outflows or deferred inflows of resources related to pensions.

- The difference between projected and actual earnings on investments should be recognized in pension expense using a systematic and rational method over a closed five-year period, beginning in the current reporting period. Amounts not recognized in pension expense should be reported as deferred outflows or deferred inflows of resources. Deferred outflows or deferred inflows of resources arising from such differences should be aggregated and reported as a net deferred outflow or deferred inflow of resources related to pensions.

- Contributions from the employer should not be recognized in pension expense.

- Contributions from nonemployer entities that are not in a special funding situation should be recognized as revenue.

Contributions from the employer subsequent to the measurement date of the net pension liability and before the end of the reporting period should be recognized as a deferred outflow of resources related to pensions.

Financial statements prepared using the current financial resources measurement focus and the modified accrual basis of accounting - In financial statements prepared on the current financial resource measurement focus and modified accrual basis of accounting, a net pension liability should be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. Pension expenditures should be recognized equal to the total of amounts paid by the employer to the plan and the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources. Net pension liabilities are normally expected to be liquidated with expendable available financial resources to the extent that benefit payments have matured, that is benefit payments are due and payable and the plans fiduciary net position is not sufficient for payment of those benefits.

Notes to the financial statements of single and agent employers - Single and agent employers who provide pensions through a qualified trust would provide descriptive information, such as the types of benefits provided and the composition of the employees covered by the benefit terms. In addition, single and agent employers should disclose:

- Assumptions and other inputs, including those about inflation, salary changes, ad hoc benefit changes (such as COLAs), with the source of the assumptions (such as mortality tables) disclosed, along with dates of experience studies on which significant assumptions are based; discount rate assumptions include the rate applied in measurement of the total pension liability and the change in the rate since the previous measurement, if any, assumptions made about projected cash flows into and out of the plan, the long-term expected rate of return and how it was determined, whether the discount rate includes a municipal bond rate, and if so, the rate used and the source of that rate; the periods to which each rate has been applied; the assumed asset allocation of the plan's portfolio, the long-term expected real rate of return for each major asset class; measures of the net pension liability calculated using (1) a discount rate that is 1-percentage point higher than that required by the Statement and (2) a discount rate that is 1-percentage point lower than that required by the Statement.

- The plan's fiduciary net position

- A schedule of changes in the net pension liability, showing:
  - The beginning balances of the total pension liability, fiduciary net position and net pension liability
  - The effects of
    - Service cost
    - Interest on the total pension liability
    - Changes in benefit terms
    - Differences between expected and actual experience in the measurement of total pension liability
    - Changes in assumptions or other inputs
    - Contributions from the employer
    - Contributions from nonemployer entities
    - Contributions from employees
    - Plan net investment income
    - Benefit payments, including refunds of employee contributions
    - Plan administrative expense
    - Other changes, separately identified if individually significant
  - The ending balances of the total pension liability, fiduciary net position and net pension liability

- If the employer has a special funding situation, the nonemployer entities' total proportionate share of the collective net pension liability, and the employer's proportionate share of the collective net pension liability.

- In addition, the following information, if applicable, should be disclosed:

- The measurement date of the net pension liability, date of the actuarial valuation on which the total pension liability is based, and if applicable, the fact that update procedures were used to roll forward the total pension liability to the measurement date
- If the employer has a special funding situation, the employer's proportion of the collective net pension liability, the basis on which the proportion was determined, and the change in its proportion since the prior measurement date
- A brief description of changes of assumptions or other inputs that affected measurement of the total pension liability since the prior measurement date
- A brief description of changes of benefit terms that affected measurement of the total pension liability since the prior measurement date
- The amount of benefit payments in the measurement period attributable to the purchase of allocated insurance contracts, a brief description of the benefits for which such contracts were purchased in the measurement period, and the fact that the obligation for the payment of benefits covered by allocated insurance contracts has been transferred from the employer to one or more insurance companies
- A brief description of the nature of changes between the measurement date of the net pension liability and the employer's reporting date that are expected to have a significant effect on the net pension liability and the amount of the expected resultant change, if known
- The amount of pension expense recognized by the employer in the reporting period
- The employer's balances of deferred outflows and deferred inflows related to pensions, classified as follows, if applicable:
    - Differences between expected and actual experience in the measurement of the total pension liability
    - Changes of assumptions or other inputs
    - Net difference between projected and actual earnings on pension plan investments
    - If the employer has a special funding situation, changes in the employer proportion and differences between the employer's contributions and the employer's proportionate share of contributions
    - The employer's contributions to the plan subsequent to the measurement date of the net pension liability
- A schedule showing:
    - For each of the subsequent five years, and in the aggregate thereafter, the net amount of the employer's balances of deferred outflows and deferred inflows that will be recognized in the employer's pension expense
    - If the employer does not have a special funding situation, the amount of the employer's balance of deferred outflows that will be included as a reduction of the net pension liability
    - If the employer has a special funding situation, the amount of the employer's balance of deferred outflows that will be included as a reduction of the collective net pension liability

- The amount of revenue recognized for the support provided by nonemployer entities, if any

Required supplementary information for single and agent employers - The Statement requires single and agent employers to present the following schedules covering each of the past 10 years as RSI:

- Changes in the net pension liability
- Information about the components of the net pension liability and related ratios as of the employer's year-end that presents (1) the total pension liability, (2) the amount of plan net position, (3) the net pension liability, (4) plan net position as a percentage of the total pension liability, (5) the amount of covered-employee payroll, and (6) net pension liability as a percentage of covered-employee payroll.

If the employer contributions are actuarially determined, the employer would present in RSI a schedule covering each of the past 10 years that includes (1) the actuarially calculated employer contribution, (2) the amount of employer contributions made, (3) the difference between (1) and (2), (4) the amount of covered-employee payroll, and (5) employer contributions made as a percentage of covered-employee payroll.

Employers would also identify significant methods and assumptions used in determining the actuarially calculated contributions as notes to the schedules, if not disclosed elsewhere, and would explain factors that significantly affect the identification of trends in the amounts reported in the schedules, such as changes in benefit provisions, the size or composition of the population covered by the benefit terms, or assumptions used.

Cost-sharing employers with no special funding situations

Proportionate share of the collective net pension liability - A cost-sharing employer reports a net pension liability, measured as of a date no earlier than the end of the employer's prior fiscal year, consistently applied from period to period. The employer's proportionate share of the collective net pension liability should be measured by:

- Determining the employer's portion **–** a measure of the proportionate relationship of (1) the employer (and to the extent associated with the employer, nonemployer contributing entities, where the employer is not in a special funding situation) to (2) all employers and all nonemployer contributing entities
- Multiplying the collective net pension liability by the employer's proportion calculated above

The employer's portion should be established as of the measurement date, unless the employer's proportion is actuarially determined, in which case a proportion established at the date of the actuarial valuation used to determine the collective net pension liability may be used.

Proportionate share – Pension expense and deferred outflows and deferred inflows of resources related to pensions should be recognized for the employer's proportionate shares of the collective pension expense and collective deferred outflows and deferred inflows of resources related to pensions.

Change in proportion – If there is a change in the employer's proportion of the collective net pension liability since the prior measurement date, the net effect of that change on the employer's proportionate shares of the collective net pension liability and collective deferred outflows and deferred inflows of resources, determined as of the beginning of the measurement period, should be recognized in the employer's pension expense, beginning in the current reporting period, using a systematic and rational method over a closed period. For this purpose, the length of the expense recognition period should be equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan (active and inactive employees) determined as of the beginning of the measurement period. The amount not recognized in the employer's pension expense should be reported as a deferred outflow of resources or deferred inflow of resources related to pensions.

Contributions during the measurement period – For contributions other than those to separately finance specific liabilities of an individual employer or nonemployer contributing entity to the plan, the difference during the measurement period between (1) the total amount of such contributions from the employer (and amounts associated with the employer from nonemployer contributing entities that are not in a special funding situation) and (2) the amount of the employer's proportionate share of the total of such contributions from all employers and all nonemployer contributing entities should be recognized in the employer's pension expense, beginning in the current period, using a systematic and rational method over a closed period. For this purpose, the length of the expense recognition period should be equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan (active and inactive employees) determined as of the beginning of the measurement period. The amount not recognized in the employer's pension expense should be presented as a deferred outflow or deferred inflow of resources related to pensions.

For contributions to the plan to separately finance specific liabilities of the individual employer to the plan, the difference between (1) the amount of such contributions from the employer (and associated nonemployer contributing entities not in a special funding situation) and (2) the amount determined using the employer's proportionate share of the collective net pension liability, should be recognized in the employer's pension expense.

Employer contributions subsequent to the measurement date – Contributions to the plan from the employer subsequent to the measurement date of the collective net pension liability and before the end of the employer's reporting period should be reported as deferred outflows of resources related to pensions.

Support of nonemployer contributing entities that are not in a special funding situation – Revenue should be recognized in an amount equal to (1) contributions to the plan from nonemployer contributing entities that are not in a special funding situation to separately finance specific liabilities of the individual employer to the plan and (2) the employer's proportionate share of the contributions to the plan from nonemployer contributing entities for purposes other than the separate financing of specific liabilities to the plan.

Measurement of the collective net pension liability – The collective net pension liability should be measured as the total pension liability, net of the plans fiduciary net position. The plan's fiduciary net position should be determined using the same valuation methods that are used by the plan for purposes of preparing its statement of fiduciary net position.

Timing and frequency of actuarial valuations - Actuarial valuations of the total pension liability would be required as of (a) the measurement date or (b) the use of update procedures to roll forward to the measurement date amounts based on an actuarial valuation performed no more than 30 months and one day prior to the employer's most recent year-end. If update procedures are used and significant changes occur between the actuarial valuation date and the measurement date, professional judgment should be applied to determine the extent of procedures needed to roll forward the actuarial valuation to the measurement date, considering whether a new valuation is needed. For purposes of this determination, the effects of changes in the discount rate resulting from changes in the plan's fiduciary net position or from changes in the municipal bond rate, if applicable, should be among the factors evaluated. For accounting and financial reporting purposes, an actuarial valuation of the total pension liability should be performed at least biennially, with more frequent valuations encouraged.

Selection of assumptions - All *plan assumptions* (unless otherwise specified by the proposed Statement) are required to be made in conformity with the Actuarial Standards of Practice issued by the Actuarial Standards Board of the American Academy of Actuaries. The plan, employer and if any, governmental nonemployer entities should use the same assumptions when measuring similar or related pension information.

Projection of benefit payments - *Projected benefit payments* to employees would be based on the then-existing benefit terms and legal agreements and would incorporate projected salary increases (for benefit formulas based on compensation levels) and service credits (for benefit formulas based on years of service), as well as projected automatic cost-of-living adjustments (COLAs) and other automatic postemployment benefit changes. Projections would also include ad hoc COLAs and other ad hoc postemployment benefit changes, if they are considered to be substantively automatic.

Benefit payments to be provided by means of an allocated insurance contract should be excluded from projected benefit payments if:

- The contract irrevocably transfers to the insurer the responsibility for providing the benefits
- All required payments to acquire the contract have been made, and
- The likelihood is remote that the employer or the plan will be required to make additional payments to satisfy the benefit payments covered by the contract.

Discount rate - Projected benefit payments would be *discounted to their present value* using the single rate that would reflect (1) the long-term expected rate of return on plan investments to the extent that plan net position is projected to be sufficient to pay pensions and the net position projected to remain after each benefit payment can be invested long-term, and (2) a tax-exempt, high-quality municipal bond index rate to the extent that the conditions in (1) are not met.

Comparing projections of the pension plan's fiduciary net position to projected benefit payments - For purposes of applying the discount rate, the amount of the pension plan's projected fiduciary net position and the amount of projected benefit payments should be compared in each period of projected benefit payments. Projections of the pension plan's fiduciary net position should incorporate all cash flows for contributions from the employer and nonemployer entities, if any, intended to finance benefits of current active and inactive employees and all cash flows for contributions from current active employees. It should not include:

- Cash flows for contributions from the employer or nonemployer entities intended to finance the service cost of future employees or
- Cash flows for contributions from future employees, unless those contributions are projected to exceed service costs for those employees.

In each period, contributions from employers and nonemployer entities should be considered to apply first to service costs of employees in the period and second to past service costs, unless the effective pension plan terms related to contributions indicate that a different relationship between contributions to the pension plan from nonemployer entities and service costs should be applied. Employee contributions should be considered to be applied to service costs before contributions from the employer and nonemployer entities.

Professional judgment should be applied to project cash flows for contributions from the employer and nonemployer entities in circumstances in which the contribution amounts are established by statute or contract or by formal written policy related to those contributions. Application of professional judgment should consider the most recent five-year contribution history of the employer and nonemployer entities as a key indicator of future contributions from those sources and should reflect all other known events and conditions.

Calculating the discount rate – for each future period, if the amount of the pension plan's fiduciary net position is projected to be greater than or equal to the benefit payments that are projected to be made in that period and pension plan assets up to that point are expected to be invested using a strategy to achieve the long-term expected rate of return, the actuarial present value of benefit payments projected to be made in the period should be determined using the long-term expected rate of return on those investments. The long-term expected rate of return should be based on the nature and mix of current and expected pension plan investments over a period representative of the expected length of time between:

- The point at which an employee begins to provide service to the employer and
- The point at which all benefits to the employee have been paid

The long-term expected rate of return should be determined net of pension plan investment expenses but without reduction of plan administrative expense. The municipal bond rate discussed above should be used to calculate the actuarial present value of all other benefit payments.

Attribution of the actuarial present value of projected benefit payments to periods - The attribution of the actuarial present value of benefit payments is accomplished using the *entry age normal actuarial cost me*thod as a *level percentage of pay*. The actuarial present value is attributed for each employee individually, from the period when the employee first accrues pensions under the benefit terms. The service costs of all pensions should be attributed through all assumed exit ages, through retirement. In plans where benefit terms include a deferred retirement option program (DROP), the date of entry into the DROP should be considered to be the employee's retirement date. Each employee's service costs should be determined based on the same benefit terms reflected in that employee's actuarial present value of projected benefit payments.

The measurement of the collective net pension liability, pension expense, and other key information would follow the same standards that apply to single and agent employers. The effects of a change in an employer's expected proportion of total employer-related contributions (as well as the differences between the expected and actual proportionate share of total employer-related contributions each period) would be reported as a deferred outflow of resources or a deferred inflow of resources and recognized in the employer's pension expense in a systematic and rational manner over a closed period that is representative of the expected remaining service lives of employees, beginning with the current period.

Cost-sharing employers would disclose in the notes descriptive information about the pensions they provide and would identify the discount rate and other assumptions made in the measurement of their net pension liabilities, similar to the disclosures required by single and agent employers. Cost-sharing employers would also disclose information about how their actual contributions were determined.

RSI presented by cost-sharing employers would include 10-year schedule of:

- Changes in the collective net pension liability
- Information about the components of the collective net pension liability and related ratios
- Information about the components of the net pension liability and related ratios for the individual employer, and
- If the employer's contributions are actuarially determined, collective employer contribution information and contribution information for the individual employer, all as of the employer's year-end.

<u>Defined contribution pensions</u>

An employer whose employees are provided with defined contribution pensions would recognize pension expense equal to the amount of contributions or credits to employees' accounts that are defined by the benefit terms as attributable to employees' services in the current period, net of forfeited amounts that are removed from employees' accounts. A pension liability would be recognized for the difference between the amounts recognized as expense and actual contributions made to a pension plan. In governmental fund financial statements, an employer would recognize pension expenditures equal to the total of (1) amounts contributed to a pension plan and (2) amounts normally expected to be liquidated with expendable available financial resources, and a liability to the extent the liability is normally expected to be liquidated with expendable available financial resources.

In notes to the financial statements, an employer would describe the plan and benefit provisions, the contribution rates and how they are determined, and the amounts attributed to employee service and forfeitures in the current period.

Effective date and transition

The Statement is effective for periods beginning after June 15, 2014 (June 30, 2015 and later year-ends). Earlier application is encouraged.

AICPA WHITE PAPER ***GOVERNMENTAL EMPLOYER PARTICIPATION IN COST-SHARING MULTIPLE-EMPLOYER PLANS: ISSUES RELATED TO INFORMATION FOR EMPLOYER REPORTING***

In early 2014, the SLGEP released a white paper related to the responsibilities of the auditor of an employer participating in a cost-sharing multiple-employer plan.

The white paper notes that under Statement 67, the plan's financial statements include only the net pension liability for the plan as a whole, but do not include deferred outflows of resources or deferred inflows of resources by category, or pension expense for all participating employers. In addition, the plan financial statements do not include each participating employer's share of the collective pension amounts. Participating employers will need information beyond what is provided in the audited plan financial statements to determine their proportionate share of the collective amounts.

The collective amounts must be allocated to the participating employers, and the allocation method should be consistent with the manner in which contributions are determined. Although Statement 68 encourages an allocation method, often prepared by an actuary, based on the employer's projected long-term contribution efforts to that of all employers, the standard allows for other allocation methods to be used, including allocations based on historical measures such as actual contributions or covered payroll. Allocations based on historical measures are likely more easily substantiated than the actuarial method.

It is unlikely that employers' auditors would have access to information needed to determine the employer's shares of the collective pension information. The SLGEP therefore suggests that the plans and their actuaries are in the best position to provide information to the participating employers necessary to record their respective shares of the collective amounts. It therefore recommends that cost-sharing plans calculate each employer's allocation percentage and collective pension amounts. Such an approach will promote consistency in the calculation, and minimize the overall effort and costs incurred by all parties involved.

The SLGEP recommends that cost-sharing plans prepare and include a schedule of employer allocations and related notes to the schedule. The schedule would display the proportionate relationship of each employer to all employers and each employer's allocation percentage. The SLGEP further recommends that the plan's auditors obtain reasonable assurance and report on the schedule in accordance with AU-C 805, *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*. The plan auditor would thus form and express an opinion on the schedule, as opposed to the "in relation to" opinion on supplemental information provided for under AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*. This is because the limited assurance provide under AU-C 725 would not be deemed sufficient for employers and their auditors to use for purposes of determining that allocation percentages are accurate and reliable.

With such a schedule, subject to an opinion by the plan's auditors, the employer and employer auditor may use the plan auditor's report on the schedule to provide evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated. The employer auditor should determine that the plan auditor's report and accompanying schedules are adequate and provide the appropriate information. In addition, the employer's auditor should determine that the plan's auditor has the necessary competence and independence for the employer auditor's purposes. In addition, the employer and employer's auditor have a responsibility to verify and recalculate amounts specific to the applicable employer, including the employer amount used in the allocation percentage, recalculate the allocation percentage for the employer, and recalculate the pension amounts allocated to the employer based on the allocation percentage.

Unless the SLGEP's recommendations are implemented, the SLGEP concludes that it is unlikely that employer auditors will be able to accumulate the sufficient appropriate evidence necessary to provide unmodified opinions on the opinion units of the government financial reporting entity that have material allocated pension amounts.

STATEMENT 71 — *PENSION TRANSITION FOR CONTRIBUTIONS MADE SUBSEQUENT TO THE MEASUREMENT DATE*

In November 2013, the GASB adopted Statement 71, which amends Statement 68 (the employer standard). The stated objective of the standard is to address an issue regarding application of the transition provisions of the employer standard, related to amounts associated with contributions, if any, made by a state and local government employer (or nonemployer contributing entity) to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

Statement 68 requires a state of local government employer or NCE to recognize a net pension liability measured as of a date no earlier than the end of its previous fiscal year. If the employer or NCE makes a contribution to the defined benefit plan between the measurement date and the reporting date, Statement 68 requires that the government recognize such a contribution as a deferred outflow of resources. In addition, Statement 68 requires recognition of deferred outflows and deferred inflows for changes in the net pension liability that arise from other types of events (such as differences in actual and expected experience).

At transition, if it is not practical for the employer or NCE to determine the amounts of all deferred outflows or deferred inflows related to pensions, paragraph 137 of Statement 68 required that beginning balances for deferred outflows and deferred inflows not be reported.

This Statement amends paragraph 137 of Statement 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement 68, as amended, continues to require that beginning balances for other deferred outflows of resources or deferred inflows of resources related to pension be reported at transition only if it is practical to report *all* such amounts.

The provisions of the standard are to be applied simultaneously with the provisions of Statement 68.

CONCEPTS STATEMENT 6 ***MEASUREMENT OF ELEMENTS OF FINANCIAL STATEMENTS***

In March 2014, the GASB released a Concepts Statement on measurement of the elements of financial statements.

Measurement approaches

The document identifies two primary measurement approaches:

- Initial-transaction-date-based measurement ("initial amount") – the transaction price or amount assigned when an asset was acquired or a liability was incurred, including subsequent modifications to that price or amount, such as through amortization or depreciation.
- Current-financial-statement-date-based measurement ("remeasured amount") – the amount assigned when an asset or liability is remeasured as of the financial statement date, including fair value, current acquisition, sales and settlement price, replacement cost, and value-in-use.

Initial amounts are the more appropriate measure for assets that are used directly in providing services, and provide better information about the cost of current-year services. Remeasured amounts provide better information about the remaining service potential of these assets. Remeasured amounts are the more appropriate measure for assets that will be converted to cash (such as financial assets), and the more appropriate measure for assessing financial position and the ability to satisfy obligations as they become due. Remeasured are also the more appropriate measure for variable-payment liabilities (such as compensated absences), as they are closer to the amount necessary to settle the liability than are initial amounts.

Qualitative characteristics

Understandability – Recognizes that users of financial statements have varying levels of knowledge about financial reporting and that information should be presented as simply as possible. It does not preclude presenting information only because it may be difficult to understand. Remeasurement of assets and liabilities and the reporting of unrealized gains and losses from remeasurement may be less understanding than use of initial amounts for some types of assets and liabilities, such as capital assets.

Reliability – information about assets and liabilities reported using initial amounts is usually very reliable. However, determining initial amounts may involve complexities that affect the faithful representation of initial amounts. The need to allocate initial amounts of certain assets to periods may decrease reliability of the information because judgments may be needed to determine allocation periods. This concern can be addressed through communication methods other than recognition and display in financial statements.

Assessing reliability of remeasured amounts is complex in some cases, depending on circumstances. Certain assets and liabilities can be remeasured reliably, such as those for which there are active markets. Others can be measured because there is a valuation methodology that is widely accepted and reasonably free from bias, such as financial instruments remeasured by computing the present value of expected cash flows, although there may be uncertainty about the appropriate discount rate that might arise due to changes in the creditworthiness of the payer. Some assets and liabilities are so unusual that estimates used in determining remeasured amounts are uncertain to the extent that the resulting remeasured amounts would not be sufficiently reliable.

Relevance – requires the presence of many of the other qualitative characteristics. For example, if information provided is not timely or reliable, it may not be relevant. To be relevant, there should be a close logical relationship between the information provided and the purpose for which it is needed.

Timeliness – does not limit measurement to the use of initial amounts. The effect that using remeasured amounts has on the ability to provide timely information may vary depending on the extent of the measurement procedures and availability of the information needed.

Comparability – is provided when information presented using same accounting principles among governments. Initial amounts provide greater comparability for cost of services information, which include cost of the use of capital assets in providing services. Remeasured amounts provide greater comparability than initial amounts for information reported in a statement of financial position, including information that can be used to assess the service potential of the resources reported.

Cost-benefit limitations

The cost of producing information should be considered in relation to the expected benefit provided by that information. Costs associated with continuing to report assets and liabilities at their initial amounts general are minimal and do not limit the use of initial amounts. The cost of determining a remeasured amount is low when there are active markets for the asset or liability such that remeasurement can be made by reference to recent transaction prices. Such cost may be higher for assets and liabilities that do not trade in active markets or for which complex methodologies are required to determine the remeasured amounts. However, a significant cost for remeasurement does not automatically rule out use of a remeasured amount. Failure to use a remeasured amount may lead to incomplete or misleading information being reported. This is the case for liabilities associated with significant uncertainties, such as pollution remediation obligations.

EXPOSURE DRAFT

ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS THAT ARE NOT ADMINISTERED THROUGH TRUST – AN AMENDMENT OF STATEMENTS 67 AND 68

This proposed statement would establish requirements for pension plans that are not within the scope of Statement 68, and for pension plans that are used to provide those pensions. In addition, it would establish requirements for defined contribution pensions that are not within the scope of Statement 68. It also amends certain provisions of Statements 67 and 68 for pension plans and employers that are within their respective scopes.

The requirements in the proposed standard apply the approach to accounting and financial reporting established in Statement 67 and 68 to all pensions, with modifications as necessary to reflect that for accounting and financial reporting purposes, any assets accumulated for pensions that are provided through plans that are not administered through a qualified trust should *not be* accounted for as pension plan assets. It also proposes that information similar to that required by Statements 67 or 68, as applicable, should be included in notes to financial statements and RSI by all similarly situated employers, NCEs and pension plans.

This standard also proposes clarification of the application of certain provisions of Statements 67 and 68 with regard to:

- Information that is required to be presented as notes in the 10-year schedules of RSI about investment-related factors that significantly affect trends in the amounts reported
- Accounting and financial reporting for separately financed specific liabilities of individual employers and NCEs for defined benefit pensions
- Timing of employer recognition of revenue for the support of NCEs *not* in special funding situations

Effective date

The requirements of the proposed standard that address accounting and financial reporting for plans, employers and governmental NCEs that are *not within the* scope of Statements 67 or 68 would be effective for periods beginning after June 15, 2016. The requirements for pension plans, employers and governmental NCEs that are *within the scope* of Statements 67 or 68 would be effective for periods beginning after June 15, 2015.

EXPOSURE DRAFT ***THE HIERARCHY OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR STATE AND LOCAL GOVERNMENTS***

In December 2013, GASB released an exposure draft of a standard that would supersede Statement 55 of the same name. It also amends portions of Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA* Pronouncements. The objective of the standard is to collapse the hierarchy (from the categories A through D of Statement 55) into two authoritative categories. "Other literature" would remain as nonauthoritative guidance.

The hierarchy provides the following authoritative sources of GAAP for state and local governments:

- Category A pronouncements (officially established accounting principles) – Governmental Accounting Standards Board Statements. These pronouncements are the subject of Rule 203 of the AICPA Code of Professional Conduct, i.e., AICPA and state society members are required to follow pronouncements in this category. All current GASB Interpretations are considered a part of this category until they are altered, amended, supplemented, revoked or superseded.
- Category B – GASB Technical Bulletins, GASB Implementation Guides, and literature of the AICPA if specifically cleared by the GASB.

If the accounting treatment for a transaction or other event is not specified by a pronouncement in Category A, a governmental entity should consider whether the accounting treatment is specified by a source in Category B. If both categories contain accounting treatments for a transaction or other event, the governmental entity should follow the accounting treatment specified by the Category A pronouncement.

If the accounting treatment is specified in neither category, the governmental entity should first consider accounting principles for similar transactions or other events within a source of authoritative literature and then may consider nonauthoritative accounting literature from other sources that does not conflict with or contradict authoritative GAAP. The governmental entity should not follow the accounting treatment specified in authoritative GAAP for similar transactions or other events in cases in which those accounting principles either prohibit the application of the accounting treatment to the particular transaction or other event or indicate that the accounting treatment to the particular transaction or other event should not be applied by analogy.

Sources of nonauthoritative literature include:

- GASB Concepts Statements
- Pronouncements and other literature of the FASB, International Public Sector Accounting Standards Board, International Accounting Standards Board, and other AICPA literature (not cleared by the GASB)
- Practices that are widely recognized and prevalent in state and local government
- Literature of other professional associations and regulatory agencies
- Accounting textbooks, handbooks and articles

In evaluating the appropriateness of nonauthoritative accounting literature, a governmental entity should consider the consistency of the literature with the GASB Concepts Statements, the relevance of the literature to particular circumstances, the specificity of the literature, and the general recognition of the issuer or author as an authority.

The proposed standard would be effective for periods beginning after June 15, 2015, with earlier application permitted. Accounting changes adopted to conform to the provisions of the standards should be applied retroactively by restating financial statements, if practical, for all periods presented. If restatement is not practical, the cumulative effect of applying the standards should be reported as a restatement of beginning net position (or fund balance) for the earliest period restated. Upon initial adoption, the financial statements should disclose the nature and effect of the restatement.

PRELIMINARY VIEWS ***ECONOMIC CONDITION REPORTING: FINANCIAL PROJECTIONS***

In November 2011, GASB released a PV document that from its inception has created considerable controversy.

The document summary notes that it presents the GASB's current views on what it believes are the most fundamental issues associated with the reporting of financial projections and related narrative discussions that will assist users in assessing a government's economic condition. The Board believes that decision makers need information with which to assess a government's economic condition – its financial position, fiscal capacity, and service capacity. *Fiscal sustainability* is the forward-looking aspect of the government's economic condition. It is defined as "a government's ability and willingness to generate inflows of resources necessary to honor current service commitments and to meet financial obligations as they come due, without transferring financial obligations to future periods that do not result in commensurate benefits."

The Board believes that five components of information are necessary to assist users in assessing a government's fiscal sustainability:

- Projections of the total cash inflows and major individual cash inflows, in dollars and as a percentage of total cash inflows, with explanations of the known causes of fluctuations in cash inflows;
- Projections of the total cash outflows and major individual cash outflows, in dollars and as a percentage of total cash outflows, with explanations of the known causes of fluctuations in cash outflows;
- Projections of the total financial obligations and major individual financial obligations, including bonds, pensions, other postemployment benefits, and long-term contracts, with explanations of the known causes of fluctuations in financial obligations;
- Projections of annual debt service payments (principal and interest);
- Narrative discussion of the major intergovernmental services interdependencies that exist and the nature of those service interdependencies.

Financial projections would be (1) based on current policy, (2) informed by historical information, and (3) adjusted for known events and conditions that affect the projection periods. Current policy includes policy changes that have been formally adopted by the end of the reporting period but that will not be effective until future periods. Inflows and outflows would be projected on a cash basis of accounting, and financial obligations would be projected on an accrual basis of accounting.

The assumptions employed in making projections would be based on relevant historical information, as well as events and conditions that have occurred and affect the projection periods. The assumptions would be (1) consistent with each other (where appropriate) and with the information used as the basis for the assumptions, and (2) comprehensive by considering significant trends, events and conditions. Disclosure of assumptions would be required. Annual projections would be made for a minimum of five individual years beyond the reporting period for the purpose of external reporting.

All of the components of fiscal sustainability information are believed to be essential for placing the basic financial statements and notes to the basic financial statements in an operational or economic context and therefore would be required and communicated as required supplementary information (RSI). All governments would be required to report the components of fiscal sustainability information.

The components of fiscal sustainability information would be reported for the primary government, including both governmental activities and business-type activities with net subtotals (inflows less outflows) for the general fund, other governmental activities, total governmental activities, total business-type activities and a net total for the entire primary government. Notes to RSI would be necessary in instances when one or more activities may significant affect (either positively or negatively) the fiscal sustainability of the primary government.

An individual cash inflow, cash outflow and financial obligation of a governmental or business-type activity would be separately projected if it is considered "major" – meaning it represents at least 10 percent of total cash inflows, total cash outflows or total financial obligations, respectively, for all activities of that type in any of the projection periods reported. All cash outlays for capital and capital-related cash inflows from bond proceeds, capital grants or other sources restricted or committed to capital outlays would be considered major and reported separately. Any other cash inflow, cash outflow or financial obligation may be reported as major if the government believes that information is particularly important to users when making an assessment of the primary government's economic condition, including fiscal sustainability. Determination of which intergovernmental service interdependencies are major is a matter of professional judgment.

It is important to note that projections based on current policy do not represent a forecast or prediction of the most likely outcome. Financial projections may be based on assumptions regarding changes in social, economic and demographic events and conditions that are inherently subject to uncertainties. Therefore a cautionary notice would precede the displayed financial projections and related narrative discussions advising reader that actual results may vary from the financial projections reported.

Status

This project has thankfully been placed on "hold." No dates were provided as to when an exposure draft or final document is expected.

PRELIMINARY VIEWS ***FAIR VALUE MEASUREMENT AND APPLICATION***

In June 2013, the GASB released the preliminary views document, its first on the subject of fair value.

Fair value is defined as the price that would be received to sell an asset or paid to settle a liability in an orderly transaction between market participants at the measurement date. The objective of fair value measurements is to estimate the exit prices of assets and liabilities using observable and unobservable inputs.

In determining an appropriate fair value measurement, characteristics of the asset or liability, such as its condition and location, would be considered. Markets are also considered. In a fair value measurement, the sale of an asset or transfer of a liability is assumed to occur in the principal market, or in the absence of a principal market, the most advantageous market to which a government has access. Transaction costs, such as commissions, do not meet the definition of an asset, and therefore should be recognized when incurred.

Market conditions may make quoted prices less reliable for fair value measurements. For example, if there has been a significant decrease in the volume of activity for an asset or liability in relation to normal activity for the asset or liability (or a similar asset or liability), further analysis of transactions or quoted prices would be needed.

Similarly, if evidence indicates that a transaction is **not orderly** (i.e. a forced sale), a government would place little, if any, weight on that transaction price. Evidence that a transaction is not orderly would include:

- Inadequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary
- The seller marketed the asset or liability to a single market participant, when there was a usual and customary marketing period
- The seller was in or near bankruptcy
- The seller was required to sell to meet regulatory or legal requirements
- The transaction price was an outlier when compared with other recent transactions for the same or a similar asset or liability

Valuation techniques used to estimate fair value of an asset or liability should be appropriate in the circumstances. The objective of using a valuation technique is to estimate the price at which an orderly sale of an asset or transfer of a liability would occur between market participants as of the measurement date, under current market conditions. Valuation techniques would maximize the use of observable inputs and minimize the use of unobservable inputs. Selected inputs would be consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability.

Valuation approaches would include:

- **Market –** Would use prices and other relevant information generated by market transactions involving identical or similar assets, liabilities, or a group of assets and liabilities.
- **Cost –** Would reflect the amount that would be required currently to replace the service capacity of an asset.
- **Income –** Would convert future amounts (such as cash flows, income or expenses) to a single discounted amount. When the income approach is used, the fair value measurement would reflect current market expectations about those future amounts.

To increase consistency and comparability in fair value measurements and related disclosures, the document establishes a **hierarchy** that would categorize inputs to the valuation techniques used to measure fair value into three levels:

- **Level 1 –** Highest priority would be given to quoted market prices in active markets for the identical asset or liability.
- **Level 2 –** Other than quoted market prices that are observable for the asset or liability, either directly or indirectly. Quoted market prices from third parties, such as pricing services or brokers, would be allowed if a government has determined that the quoted market prices provided by those parties are developed in accordance with the provisions of the document.
- **Level 3 –** Unobservable inputs (based on the entity's assumptions).

When fair value measurements are applied to nonfinancial assets (physical property), those assets would be valued based on their highest and best use, which would take into account the best use of the asset that is physically possible, legally permissible, and financially feasible.

As a practical expedient, a government would be permitted to estimate fair value of an investment that does not have a readily determinable fair value using the net asset value per share (or its equivalent), provided that the net asset value per share of the investment is calculated in a manner consistent with the measurement principles for investment companies as of the government's measurement date.

Fair value may also apply to certain liabilities, such as an interest rate swap that is in a liability position to a government. The fair value of such a liability would be the price to transfer it to a market participant at the measurement date. The liability would be assumed to remain outstanding, requiring the assuming market participant to fulfill the obligation. Additionally, the fair value measurement would take into account the effect of nonperformance risk, which includes the government's own credit risk and any other factors that might influence the likelihood that the obligation would or would not be fulfilled.

Investments generally are to be fair valued, which suggests that the definition of *investment* is a significant issue. An *investment* is defined as a security or other asset that a government holds primarily for the purpose of income or profit, and the present service capacity of which is based solely on its ability to generate cash, to be sold to generate cash, or to procure services for the citizenry.

Certain investments are **excluded from fair value measurements** and continue to be measured following existing GASB standards:

- Investments in Rule 2a7-like pools
- Investments in money market instruments with remaining maturity at purchase of one year or less
- Investments in certain life insurance contracts
- Investments in common stock that are eligible for the equity method
- Investments in non-participating interest earning contracts

The Board concluded that the measurement requirements for **donated fixed assets** should be **revised**. Donated capital assets currently measured at fair value at the time of donation would be measured at *acquisition value*, the price that would be paid for acquiring similar assets having similar service capacity as of the acquisition date. Likewise, acquisition value would replace fair value measurements for donated works of art, historical treasures and similar assets, as well as capital assets received in a service concession arrangement, and nonmonetary assets acquired in an exchange when the value of the asset received is used to measure the cost of the asset acquired.

The Board rejected the use of a blockage factor – a premium or discount for the size of a government's holding of an asset – as an input in pricing an asset. When considering inputs based on bid and ask prices, when no price is more representative than another, the Board believes that use of a bid price for an asset and an ask price for a liability should be permitted but not required.

Disclosures

- For recurring and nonrecurring fair value measurements:
  - The fair value measurement as of the end of the reporting period
  - The level of the hierarchy within which the fair value measurements are categorized in their entirety
  - A description of the valuation techniques and inputs used in the fair value measurement

- For recurring fair value measurements within Level 3 only, a narrative description of the sensitivity of such measurements to changes in unobservable inputs.

- For nonrecurring fair value measurements, the reasons for the measurement.

- For investments in entities that calculate a net asset value per share or its equivalent, information to assist users in understanding the nature and risks of the investments and whether the investments are likely to be sold at amounts different from the net asset value per share.

EXPOSURE DRAFT ***ACCOUNTING AND FINANCIAL REPORTING FOR POST-EMPLOYMENT BENEFITS PLANS OTHER THAN PENSIONS***

This proposed Statement would supersede Statement 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pensions*, as amended by Statement 57, *OPEB Measurements by Agent Employers and Agent Multiple-employer Plans.* It also includes requirements for defined contribution OPEB plans that would replace the requirements for those OPEB plans in Statement 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement 50, *Pension Disclosures*.

OPEB plans within the scope are those that are administered through a trust that meets the following requirements:

- Contributions from employers and nonemployer contributing entities to the plan and earnings on those contributions are irrevocable;
- OPEB plan assets can only be used to pay benefits to plan members in accordance with the benefit terms;
- OPEB plan assets are legally protected from the creditors of the employers, nonemployer contributing entities, the OPEB plan administrator and the plan members.

The proposed standard also addresses financial reporting for defined benefit plans that are not administered through a qualified trust.

<u>Defined benefit OPEB plans</u>

Financial statements

For defined benefit OPEB plans that are administered through a qualified trust, the standard would require two financial statements:

- Statement of fiduciary net position
- Statement of changes in fiduciary net position

Plans would continue to follow all other GASB pronouncements, as applicable.

Notes to financial statements

Distinctions are made regarding information that would be required to be included in notes to financial statements, depending on the type of OPEB plan administered.

All defined benefit plans would provide information about the types of OPEB provided, the classes of plan members covered and the composition of the OPEB plan's board. The standard would also require disclosure of investments, including investment policies, a description of how fair value is determined, concentrations of investments of 5% or more of fiduciary net position, and the annual money-weighted rate of return on OPEB plan investments. Other disclosures would include information about contributions, reserves, and allocated insurance contacts.

Single-employer and cost-sharing OPEB plans administered through qualified trusts would disclose:

- Information about the components of the net OPEB liability and related ratios, including the OPEB plan's fiduciary net position as a percentage of the total OPEB liability, and the net OPEB liability as a percentage of covered-employee payroll
- Significant assumptions and other inputs used to measure to the total OPEB liability and information about the sensitivity of the measure of the net OPEB liability to changes in the discount rate, changes in the healthcare cost trend rate, and combinations of changes in the two rates.

Required supplementary information (RSI)

All OPEB plans would present as RSI information covering each of the 10 most recent fiscal years including the annual money-weighted rate of return on OPEB plan investments for each year.

Single-employer and cost-sharing plans administered through qualified trusts, the 10-year information include:

- Sources of changes in the net OPEB liability
- Information about the components of the net OPEB liability and related ratios, including the OPEB plan's fiduciary net position as a percentage of the total OPEB liability, and the net OPEB liability as a percentage of covered-employee payroll

If an actuarially determined contribution is calculated for employers or NCEs in a single-employer or cost-sharing OPEB plan administered through a qualified trust, the OPEB plan would be required to present in RSI a schedule for each of the 10 most recent fiscal years that includes information about the actuarially required contribution, the actual contributions to the OPEB plan, and related ratios. Significant methods and assumptions used in calculating the actuarially required contributions would be presented in the schedules.

In addition, all OPEB plans, including agent plans, would explain certain factors that significantly affect trends in the amounts reported in the schedules of RSI, such as changes in benefit terms, changes in the size or composition of the population covered by the benefit terms, or the use of different assumptions.

Measurement of the net OPEB liability

The net OPEB liability is the total OPEB liability, less the amount of OPEB plan's fiduciary net position. The total OPEB liability is determined through an actuarial valuation (unless the alternative measurement method, discussed below, is applied). Actuarial valuations (or alternative measurements) are required at least every two years, with more frequent valuations encouraged. If the valuation or measurement is not performed as of the OPEB plan's fiscal year-end, the total OPEB liability would be rolled forward the amounts from an earlier valuation or alternative measurement, performed as of a date no more than 24 months prior to the OPEB plan's fiscal year-end. Unless otherwise specified, all assumptions underlying the determination of the total OPEB liability must meet Actuarial Standards of Practice as established by the Actuarial Standards Board.

Projections of benefit payments would be required to be based on claims cost, or age-adjusted premiums approximating claims cost, and the benefit terms and legal agreements existing at the OPEB plan's fiscal year-end. Evaluation of the benefit terms would also include communications between the employer and plan members and an established pattern of practice with regard to the sharing of benefit-related costs with inactive plan members. Certain legal or contractual caps on benefit payments to be provided would be considered in projections of benefit payments.

Projected benefit payments would incorporate projected salary increases (if the OPEB formula incorporates compensation levels) and service credits (if the OPEB formula incorporates service periods), as well as projected automatic postemployment benefit changes (including automatic COLAs). The effects of ad hoc postemployment benefit changes (including ad hoc COLAs), if considered to be substantively the same as automatic, would be included in the projections. The projection of benefit payments should include taxes or other assessments expected to be imposed on benefit payments and benefit payments should not be reduced by subsidies expected to be received for making benefit payments, other than those received for providing Medicare benefits.

Projected benefit payments are discounted to their actuarial present value using a single rate that reflects (1) the long-term expected rate of return on OPEB plan investments, to the extent that the OPEB plan's fiduciary net position is projected to be sufficient to make projected benefit payments and OPEB plan assets are expected to be invested using a strategy to achieve that return, and (2) a tax-exempt, high-quality municipal bond rate to the extent that those conditions are not met.

The actuarial present value of projected benefits is attributed to periods of plan member service using the entry age normal method, with each period's service cost determined as level percentage of covered employee payroll. The actuarial present value is attributed to each plan member individually, from the period when the plan member first accrues OPEB benefits through the period when the plan member retires.

Alternative measurement method

The standard includes an option for use of a specified alternative measurement method in lieu of an actuarial valuation for OPEB plans in which there are fewer than 100 plan members (active and inactive). The alternative measurement method is an approach that includes the same broad measurement steps as an actuarial valuation (projecting benefit payments, discounting projected benefit payments to present value, and attributing the present value of benefit payments to periods using an actuarial cost method). It would permit simplification of certain assumptions so that the method could be applied by nonspecialists.

Defined benefit plans that are not administered through a qualified trust

For accounting and reporting purposes, assets accumulated for purposes of providing OPEB through OPEB plans that are not administered through a qualified trust are not accounted for as OPEB plan assets. Instead, if a single-employer OPEB plan is not administered through a qualified trust, any assets accumulated for OPEB purposes would continue to be reported as assets of the employer or NCE.

If a multiple-employer defined benefit OPEB plan is not administered through a qualified trust, a government that holds assets accumulated for OPEB purposes in a custodial capacity would report those assets in an agency fund. The amount of assets accumulated in excess of liabilities for benefits due to plan members and accrued investment and administrative expenses would be reported as liabilities to participating employers or NCEs. If the agency fund is included in the financial statements of an employer whose employees are provided with benefits through the OPEB plan or a NCE that makes benefit payments as OPEB comes due, balances reported by the agency fund would exclude amounts that pertain to the employer or NCE that reports the agency fund.

A government that reports (in an agency fund) assets accumulated for OPEB purposes and held in a custodial capacity would disclose in its notes to financial statements information about the number of participating employers and, if any, NCEs; a description of how the fair value of investments is determined; and that each employer that provides benefits through the OPEB plan and NCEs are required to disclose additional information, including the total OPEB liability for benefits provided through the OPEB plan.

<u>Defined contribution plans administered through a qualified trust</u>

In the notes to financial statements, defined contribution OPEB plans administered through a qualified trust would disclose the classes of plan members covered, the number of plan members, participating employers, and if any, NCEs; and the authority under which the OPEB plan is established or may be amended.

Effective date

The standard is effective for fiscal years beginning after December 15, 2015. Earlier application is encouraged.

EXPOSURE DRAFT ***ACCOUNTING AND FINANCIAL REPORTING FOR POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS***

This proposed Statement would supersede Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended by Statement 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans.*

The standard would establish standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources and expenses/expenditures. For defined benefit OPEB, the standard identifies the methods and assumptions that would be used to project benefit payments, discount projected benefits to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and RSI requirements are also included.

Distinctions are made regarding the requirements depending upon whether the OPEB plans through which the benefits are provided are administered through *qualified trusts*:

- Contributions from employers and nonemployer contributing entities to the plan and earnings on those contributions are irrevocable;

- OPEB plan assets can only be used to pay benefits to plan members in accordance with the benefit terms;
- OPEB plan assets are legally protected from the creditors of the employers, nonemployer contributing entities, the OPEB plan administrator and the plan members.

<u>Defined benefit OPEB</u>

Defined benefit OPEB provided through OPEB plans that are administered through qualified trusts

For OPEB administered through a qualified trust, the proposed requirements differ based on the number of employers whose employees are provided with OPEB through the plan, and whether OPEB obligations are plan assets are shared by the employers. Employers are classified as follows:

- Single employers are those whose employees are provided with OPEB benefits through a single employer plan – where benefits are provided to the employees of only one employer.
- Agent multiple-employer plans are those whose employees are provided OPEB benefits through plans where the assets are pooled for investment purposes, but separate accounts are maintained by employer, so that each employer's share of the pooled assets is legally available to pay benefits to only its employees.
- Cost-sharing multiple-employer plans are those whose employees are provided OPEB benefits through OPEB plans in which the OPEB obligations to employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides benefits through the plan.

Measurement of the OPEB liability to employees for benefits

The standard would require the liability of employers and nonemployer contributing entities to the employees for defined benefit OPEB (the net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (the total OPEB liability), less the amount of the OPEB plan's fiduciary net position.

The total OPEB liability would be determined through an actuarial valuation (unless the plan has fewer than 100 participants, as discussed below). Actuarial valuations (or the alternative measurement method) would be required to be performed at least every two years, with more frequent valuations encouraged. If the valuation is not performed as of the measurement date, the total OPEB liability would be based on update procedures to roll forward the amounts from the most recent valuation (or alternative measurement method calculation) no more than 30 months and one day prior to the employer's most recent fiscal year-end.

Unless otherwise specified, all assumptions used in determining the total OPEB liability and related measures must meet the Standards of Practice issued by the Actuarial Standards Board.

Projections of benefit payments would be based on claims costs, or age-adjusted premiums approximating claims cost, and the benefit terms and legal agreements existing as of the measurement date. In evaluating the benefit terms, consideration would be required to be given to the written plan document, as well as other information, including communications between the employer and employees and an established pattern of practice with regard to the sharing of benefit-related costs with inactive employees. Certain legal or contractual caps on benefit payments would be considered in projections of benefit payments.

Projections of benefit payments would require the incorporation of projected salary changes and service credits (assuming the OPEB formula incorporates future compensation levels or periods of service), as well as projected automatic postemployment benefit changes, including automatic cost-of-living adjustments (COLAs). Ad hoc postemployment benefit changes (including ad hoc COLAs), if considered to be substantively the same as automatic benefit changes, would also be included in the projections.

Projections of benefit payments would also include certain taxes or other assessments expected to be imposed on the benefit payments and projected benefit payments would not be reduced by subsidies expected to be received for making benefit payments, other than those received for providing Medicare benefits.

Projected benefit payments would then be discounted to their actuarial present value, using a single rate reflecting (1) the long-term expected rate of return on plan assets, to the extent such assets are sufficient to make the projected benefit payments *and that OPEB plan assets are expected to be invested using a strategy to achieve that return*, and (2) a tax-exempt, high-quality municipal bond rate to the extent that plan assets are expected to be insufficient.

The actuarial present value would be determined using the entry-age normal method, with each period's service cost determined as a level percentage of payroll. The present value would be attributed for each employee individually, from the period when the employee first accrues OPEB benefits through the period when the employee retires.

Alternative measurement method

For OPEB plans with fewer than 100 participants (active and inactive), the proposed standard allows an option for use of a specified alternative measurement method, in lieu of an actuarial valuation. The alternative measurement would be an approach that includes the same broad measurement steps as an actuarial valuation (projecting benefit payments, discounting projected benefit payments to a present value, and attributing the present value of projected benefit payments to periods using an actuarial cost method). It would permit simplification of certain assumptions so that potentially the method could be applied by nonspecialists.

Single and agent employers

In financial statements prepared using the economic resource measurement focus and accrual basis of accounting, a single or agent employer (with no special funding situation, as discussed below) would recognize a liability equal to the net OPEB liability. The net OPEB liability would be required to be measured as of a date no earlier than the end of the employer's previous fiscal year (the measurement date), consistently applied from period to period.

OPEB expense and deferred outflows and inflows related to OPEB that would be required to be reported by an employer primarily would result from changes in the components of the net OPEB liability, i.e. changes in the total OPEB liability and in the plan's fiduciary net position.

Changes in the net OPEB liability would be included in OPEB expense in the period of the change. Projected earnings on OPEB plan investments would also be included in the determination of OPEB expense immediately. Certain other changes in the net OPEB liability would be included in OPEB expense in current and future periods:

- Differences between actual and expected experience, included in OPEB expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees provided with benefits (both active and inactive), beginning with the current period.
- Differences between actual and projected earnings, included in OPEB expense in a systematic and rational manner over a closed period of five years, beginning with the current period.

Changes in the OPEB liability that are not included in OPEB expense are reported as deferred outflows of resources or deferred inflows of resources related to OPEB. Employer contributions subsequent to the measurement date, including amounts paid directly by the employer for OPEB as the benefits become due, would be reported as deferred outflows of resources.

In governmental funds, a net OPEB liability would be recognized to the extent the liability is normally expected to be liquidated with expendable available resources. OPEB expenditures should be recognized equal to the total of (1) amounts paid by the employer to the OPEB plan, including amounts paid directly by the employer for OPEB as the benefits become due, and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available resources.

Notes to financial statements

Single and agent employers would provide descriptive information, such as the types of benefits provided and the number and classes of employees covered by the benefit terms, as well as:

- For the current year, sources of changes in the net OPEB liability
- Significant assumptions and other inputs used to calculate the total OPEB liability, including those about inflation, the healthcare cost trend rate, salary changes, ad hoc postemployment benefit changes (including ad hoc COLAs), and inputs to the discount rate, as well as information about mortality assumptions, and the dates of experience studies.

- The date of the actuarial valuation used to determine the total OPEB liability, information about changes of assumptions or other inputs and benefit terms, the basis for determining employer contributions to the OPEB plan, and information about the purchase of allocated insurance contracts, if any.

Required supplementary information

The proposed standard would require the single and agent employer to present RSI, to include, for each of the 10 most recent fiscal years:

- Sources of changes in the net OPEB liability
- The components of the net OPEB liability and related ratios, including the OPEB plan's fiduciary net position as a percentage of the total OPEB liability, and the net OPEB liability as a percentage of covered-employee payroll

If the actuarially determined contributions is calculated for a single or agent employer, the employer would be required to present in RSI a schedule covering each of the 10 most recent fiscal years that includes information about the actuarially determined contribution, actual contributions to the plan, and related ratios.

If a single or agent employer does not have information about an actuarially determined contribution, but has a contribution requirement that is established by statute or contract, the employer would present a schedule covering each of the 10 most recent fiscal years that includes information about the statutorily or contractually required contribution rates, the actual contributions and related ratios.

Significant methods and assumptions used in calculating the actuarially determined contributions, if applicable, would be required to be presented as notes to RSI. In addition, the employer would be required to explain certain factors that significantly affect trends in the amounts reported in the schedules, such as changes in benefit terms, changes in the size or composition of the population covered by the benefit terms, or the use of different assumptions.

Cost-sharing employers

In the economic resource measurement focus/accrual basis statements, a cost sharing employer with no special funding situation would recognize a liability for its proportionate share of the net OPEB liability of all employers (the collective net OPEB liability). The employer's proportion would be determined on a basis consistent with the manner in which contributions to the OPEB plan (including amounts paid directly by the employer for OPEB as the benefits come due) are determined, and consideration would be required to be given to separate rates, if any, related to separate portions of the collective net OPEB liability. The use of the employer's projected long-term contribution effort as compared to the total projected long-term contribution effort of all employers as the basis for determining the employer's proportion would be encouraged.

A cost-sharing employer recognizes OPEB expense and reports deferred outflows of resources and deferred inflows of resources related to OPEB for its proportionate share of the collective OPEB expense and deferred items related to OPEB.

The effects of (1) a change in the employer's proportion of the collective net OPEB liability and (2) differences during the measurement period between the employer's contributions and its proportionate share of the total of certain contributions from employers included in the collective net OPEB liability would be required to be determined. These effects would be recognized in the employer's OPEB expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees provided with OPEB benefits (active and inactive). The portions of the effects not recognized in the employer's OPEB expense would be reported as deferred outflows or deferred inflows related to OPEB. Employer contributions to the OPEB plan subsequent to the measurement date of the collective net OPEB liability, including amounts paid directly by the employer for OPEB as the benefits become due, would also be reported as deferred outflows of resources related to OPEB.

In governmental fund financial statements, the cost-sharing employer's proportionate share of the collective net OPEB liability would be recognized to the extent the liability is normally expected to be liquidated using available expendable resources. OPEB expenditures would be recognized equal to the total of (1) amounts paid by the employer to the OPEB plan, including amounts paid directly by the employer for OPEB as the benefits come due, and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with available expendable resources.

Notes to financial statements

Notes would include descriptive information about the OPEB plans through which OPEB benefits are provided. Cost-sharing employers would also disclose the discount rate and the assumptions made in the measurement of their proportionate shares of the net OPEB liabilities, similar to the disclosures to be made by single and agent employers. Likewise, cost-sharing employers would disclose how the contributions to the OPEB plan were determined.

Required supplementary information

Cost-sharing employers' RSI would present 10-year schedules containing (1) the net OPEB liability and related ratios, and (2) if applicable, information about statutorily or contractually required contributions, actual contributions to the OPEB plan and related ratios.

Defined benefit plans that are *not* administered through a qualified trust

For employers providing OPEB benefits through an arrangement whereby premiums are paid to an insurance company while employees are in active service, in return for which the insurance company unconditionally undertakes an obligation to pay the OPEB for those employees, the standard would require recognition of OPEB expense/expenditures equal to the annual contributions or premiums required in accordance with their agreement with the insurance company. In addition to the amount of OPEB expense/expenditure recognized in the current period, a brief description of the benefits provided through the arrangement would be disclosed.

For defined benefit OPEB other than insured benefits through OPEB plans that are not administered through a qualified trust, the standard would require an approach to measurement of OPEB liabilities, OPEB expense, and deferred outflows and inflows parallel to that which would be required for OPEB provided through OPEB plans that are administered through a qualified trust. In essence, similar note disclosures and RSI would be required to be presented. However, the requirements would incorporate modifications to reflect the absence of OPEB plan assets for financial reporting purposes.

Defined contribution OPEB

Employers whose employees are provided with defined contribution OPEB recognize OPEB expense for the amount of contributions or credits to employees' accounts that are defined by the benefit terms as attributable to employees' services in the period, net of forfeitures that are removed from employees' accounts. A change in the OPEB liability would be required to be recognized for the difference between amounts recognized in expense and amounts paid by the employer to a defined contribution OPEB plan

In governmental funds, OPEB expenditures would be recognized equal to the total of (1) amounts paid by the employer to an OPEB plan and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with available expendable resources. An OPEB liability would be recognized to the extent the liability is normally expected to be liquidated with available expendable resources.

Notes to financial statements for an employer with a defined contribution OPEB plan would be required to include descriptive information about the OPEB plan and benefit terms, contribution rates and how they are determined, the amounts attributed to employee service and forfeitures during the current period.

Special funding situations

Special funding situations exist when a nonemployer contributing entity (NCE) is legally responsible for providing certain forms of financial support for OPEB of the employees of another entity. Relevant forms of financial support would be contributions directly to an OPEB plan administered through a qualified trust, including benefit payments as OPEB comes due for OPEB provided through such a plan, and benefit payments made as due, whether directly or through use of NCE assets held by others for purposes of providing OPEB through an OPEB plan that is not administered through a qualified trust. Such support would be a special funding situation if either (1) the amount of contributions or benefit payments, as applicable, for which the NCE is legally responsible is not dependent on one or more events unrelated to the OPEB or (2) the NCE is the only entity with a legal obligation to make contributions directly to an OPEB plan or to make benefit payments as OPEB comes due, as applicable.

Employers with special funding situations would recognize an OPEB liability and deferred outflows and inflows with an adjustment for the involvement of NCEs. The employer would be required to recognize its proportionate share of the collective OPEB expense, as well as additional OPEB expense and revenue, for the support of the NCE.

The employer would disclose, in its notes to financial statements, information about the amount of support provided by NCEs and present similar information about the involvement of those entities in 10-year schedules of RSI.

The information required to be disclosed in the notes to financial statements and presented in RSI depends on the amount of involvement of the NCE. If the governmental NCE recognizes a substantial portion of the collective net OPEB liability, it would be required to disclose in the notes a description of the OPEB, including types of benefits provided and the employers covered, the discount rate and assumptions made in the measurement of the net OPEB liability. The governmental NCE would also present RSI similar to those required of a cost-sharing employer. Reduced note disclosures and RSI would be required or governmental NCE that recognize a less-than-substantial portion of the collective net OPEB liability.

There are also requirements related to special funding situations for defined contribution OPEB.

Effective date

The standard would be effective for fiscal years beginning after December 15, 2016, with earlier application encouraged.

EXPOSURE DRAFT ***TAX ABATEMENT DISCLOSURES***

GAAP financial statements provide citizens and taxpayers, legislative and oversight bodies, municipal bond analysts, and others with information needed to evaluate the financial health of governments, make decisions and assess accountability. The information provided by GAAP financial statements helps users assess:

- Whether current year revenues were sufficient to pay for current services (sometimes referred to as *interperiod equity*)
- Whether a government complied with finance-related legal and contractual provisions
- Where a government's financial resources come from and how they were used, and
- A government's financial position and economic condition and how they have changed over time.

Users also need information about certain limitations on a government's ability to raise revenues. This includes limitations on revenue-raising capacity resulting from government programs that use tax abatements to induce behavior by individuals and entities that is beneficial to the government or its citizens. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, the proposed standard defines a tax abatement as resulting from an agreement between a government and a taxpayer in which the government promises to forgo tax revenues and the taxpayer promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens.

Although many governments offer tax abatements, little information is publicly available about the provisions of tax abatement agreements or the magnitude of the effect those agreements will have on a government's ability to raise resources in the future. The proposed Statement would require governments that are subject to tax abatement agreements to disclose

- General descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligible criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients;
- The number of tax abatement agreements entered into during the reporting period and the total number in effect as of the end of the period;
- The dollar amount of taxes abated during the period; and
- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement.

The disclosures required would distinguish between a reporting government's own tax abatement agreements and those entered into by other governments that reduce the reporting government's tax revenues. For its own tax abatements, the reporting government would be able to disclose tax abatement information for individual tax abatement agreements or aggregate the information by major tax abatement program. Tax abatement agreements of other governments that affect the reporting government could be combined.

Effective date

The requirements would be effective for fiscal years beginning after December 15, 2015. Earlier application is encouraged.

PRELIMINARY VIEWS ***FINANCIAL REPORTING FOR FIDUCIARY RESPONSIBILITY***

This document presents the Board's preliminary views about the reporting of activities in which a government has a fiduciary responsibility. The Board believes that users of financial statements need information to enable them to assess the government's accountability for activities as a fiduciary. The Board further believes that a government should be required to report on its fiduciary responsibilities when certain conditions exist.

A government is a fiduciary and has a fiduciary responsibility when it controls assets:

- From a pass-through grant for which the government does not have administrative or direct financial involvement;
- In accordance with a trust agreement or equivalent arrangement in which the government itself is not a beneficiary; or

- For the benefit of individuals that are not required to be part of the citizenry as a condition for being a beneficiary, or organizations or other governments that are not part of the financial reporting entity.

A government *controls assets* in a fiduciary capacity if those assets:

- Are used by the government (or its assignee) to provide benefits to specified or intended beneficiaries and
- Have present service capacity that can be used, exchanged for another asset (such as cash), or employed in any other way that provides benefits

There are a variety of legal structures or custodial arrangements that define the relationship of a governing body to a fiduciary activity, including:

- Directly holding the assets
- Serving as the trustee for the assets held in a trust agreement or equivalent arrangement, or
- Being legally separate from the entity (other than a trust) that holds or administers the assets.

In addition, one of the key responsibilities highlighted in the definition of control in Concepts Statement No. 4, *The Elements of Financial Statements*, relates to a government's responsibility for administering the exchange of assets. The Board believes that when a government can make decisions about the types of assets held, assign the responsibility for those decisions and reassign the responsibility for those decisions, it would be considered to have sufficient responsibility for administering the exchange of assets.

The Board's preliminary view is that a government's control of fiduciary assets should be determined by a combination of the legal structure that defines the relationship of the governing body to the fiduciary activity and whether the government has a responsibility for administering the assets, as follows:

- A government has control of assets if:
  - It is directly holding the assets, regardless of its responsibility for administering the exchange of those assets
  - It is directly responsible for administering the exchange of assets, regardless of the legal structures that might separate the government and the entity that is holding the assets
  - It has assigned its responsibility for administering the exchange of assets (such as to an asset manager) but maintains the ability to reassign that responsibility, regardless of the legal structures that might separate the government and the entity that is holding the assets

- A government does not have control of assets if:
    - It is acting as a trustee for assets and only has a responsibility to establish parameters (such as providing a selection of investment options) for those that have responsibility for administering the exchange of assets
    - It is neither directly holding nor acting as a trustee for assets and only has responsibility to establish parameters for those that have the responsibility for administering the exchange of assets
    - It is not directly holding assets and has no responsibility for administering the exchange of assets

Fiduciary funds would continue to report the fiduciary activities of a government in its basic financial statements. The Board is proposing that the classification of fiduciary activities as a particular fiduciary fund would be determined in part by the presence or absence of a trust agreement or equivalent arrangement. To be reported in an investment trust fund or private-purpose trust fund, a fiduciary activity would need to be administered through a trust agreement or equivalent arrangement in which both of the following conditions are met:

- Trust assets are dedicated to providing benefits to recipients in accordance with the benefit terms
- Trust assets are legally protected from the creditors of the government that is acting as the fiduciary

The Board is further proposing a new custodial fund type to report any fiduciary activity that is not administered through a trust agreement or equivalent arrangement. A custodial fund would be reported as a fiduciary fund and would include certain funds previously classified as agency funds or as trust funds, but for which there is no trust agreement or equivalent arrangement.

A liability would be recognized in fiduciary funds when an event has occurred that compels a government to disburse fiduciary resources. A government would be compelled to disburse fiduciary resources when no further action or condition is required to be met by the beneficiary to be entitled to receive the resources.

All fiduciary funds would report additions and deductions in the statement of changes in fiduciary net position in the basic financial statements. The Board believes that users need detailed information about the additions to and deductions from fiduciary funds. Therefore, governments engaged in fiduciary activities would present (1) additions disaggregated by source, and if applicable, by net investment income, including separate display of investment income and investment costs, and (2) deductions disaggregated by type and, if applicable, separate display of administrative costs.

Some special-purpose governments engaged only in fiduciary activities that are component units of another government have component units of their own that are engaged only in fiduciary activities. Fiduciary fund financial statements of a primary government would include the combined information of that component unit and its component units that are fiduciary in nature.

Finally, the Board believes that a stand-alone business-type activity also engaged in fiduciary activities should present fiduciary fund financial statements within its basic financial statements.

PRELIMINARY VIEWS ***LEASES***

Definition of a lease

This document is predicated on the basic notion that all leases are financings of the right to use an underlying asset. A lease would be defined as "a contract that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like transaction." Any contract that meets this definition would be accounted for under the lease guidance, unless specifically excluded. Leases that transfer ownership or that contain bargain purchase options would be accounted for as financed purchases and would not be accounted for under the lease guidance.

Lease term

The lease term is defined as the period during which a lessee has a noncancelable right to use an underlying asset, plus the following, if applicable:

- Periods covered by a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
- Periods covered by a lessee's option to terminate the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option

Fiscal funding or cancelation clauses would continue to be disregarded for financial reporting purposes if the possibility of cancelation is remote. A government would reassess the lease term only if the lessee does one or both of the following:

- Elects to exercise an option to extend the lease even though the government had previously determined that it was not probable that the lessee would do so
- Does not elect to exercise an option to terminate the lease even though the government had previously determined that it was probable that the lessee would do so.

Lessee accounting

Lessees would recognize a lease liability and an intangible lease asset at the inception of a lease, unless it is a short-term lease, as defined below. The liability would be measured at the present value of certain lease payments to be made over the lease term. The lease asset would be measured at the value of the lease liability plus any prepayments and certain initial direct costs. A lessee would recognize interest expense on the lease liability and amortization expense on the lease asset. Disclosures would include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

Lessor accounting

Lessors would recognize a lease receivable and a deferred inflow of resources at the inception of a lease, unless it is a short-term lease as defined below. The receivable would be measured at the present value of certain lease payments to be received over the lease term. The deferred inflow of resources would be measured at the value of the lease receivable, plus the amount of any payments received at or prior to the beginning of the lease that relate to future periods. A lessor would recognize interest revenue on the lease receivable and also would recognize revenue over the term of the lease from the deferred inflow of resources. A lessor would not derecognize the underlying asset in the lease. Disclosures would include a description of leasing arrangements, the total amount of revenue recognized from leases, and a schedule of future lease payments to be received.

Short-term lease exception

A short-term lease is defined as a lease that, at the beginning of the lease, has a maximum possible term under the contract, including any options to extend, of 12 months or less. A lessee in a short-term lease would not follow the regular accounting for leases, but instead, would recognize lease payments as expenses or expenditures, based primarily on the payment terms of the contract. A lessor in a short-term lease would not follow the regular accounting for leases, but instead, would recognize lease payments as revenue based primarily on the terms of the contract.

Lease terminations and modifications

An amendment to a lease contract would be considered a modification unless the lessee's right to use the underlying asset decreases, in which case it would be a partial termination. A lease termination would be accounted for by adjusting the balances of the lease liability and lease asset by a lessee, or the lease receivable and deferred inflow of resources or a lessor, with any difference being recognized as gain or loss. A lease modification would be accounted for by adjusting the balances of the related lease liability and lease asset by a lessee, or the related lease receivable and deferred inflow of resources by a lessor. However, if the modification is due to the refunding of related debt, other guidance would apply.

Subleases and leaseback transactions

Subleases would be treated as transactions separate from the original lease. A government that has sublet an asset would recognize separately the liability and lease asset as lessee in the original lease and the receivable and deferred inflow as lessor in the sublease. A sale-leaseback transaction would be accounted for under sale-leaseback accounting if there is a qualifying sale. In that case, the sale would be accounted for as any other sale, except that any gain or loss would be reported as a deferred outflow or inflow, and recognized over the term of the leaseback. The leaseback would be accounted for in the same manner as any other lease. A lease-leaseback transaction would be recognized as a net lease liability or lease receivable, with disclosure of the gross lease liability and lease receivable.

Leases with related parties and intra-entity leases

A lease between related parties would continue to be recognized based on the substance instead of the form of the transaction. Leases within financial reporting entities would continue to be treated like any other transaction between component units. Leases with blended component units would be eliminated in the financial statements of the reporting entity, while leases with discretely presented component units would be presented separately from other leases.

II. AICPA

AUDITING STANDARDS BOARD (ASB) PRONOUNCEMENTS

AU-C Section 9500 ***AUDITOR OF PARTICIPATING EMPLOYER IN A GOVERNMENTAL COST-SHARING MULTIPLE-EMPLOYER PENSION PLAN***

Question – GASB Statement 68 requires governmental entities participating in governmental cost-sharing multiple-employer pension plans to present certain pension amounts in employer financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

Do the audited financial statements of the plan prepared in accordance with GAAP and additional unaudited information from the plan necessary to calculate the employer's net pension liability provide the auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?

Interpretation – No. GASB Statement 67 requires only the disclosure of the collective net pension liability for all participating employers in GAAP financial statements of cost-sharing plans, not each employer's proportionate share of the collective net pension liability. Further GAAP does not require the plan to present deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's share of collective pension amounts. Unaudited information provided by the plan to the employers to support allocations of pension amounts that has not been subjected to further audit procedures would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's financial statements related to the pension amounts, including the required disclosures.

Therefore, absent additional audit evidence from the cost-sharing plan (for example, auditor's opinions on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts), the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements, and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the audit opinion pursuant to AU-C section 705, *Modifications to the Auditor's Opinion in the Independent Auditor's Report*.

Question – A plan has engaged its auditor to audit and report on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts, as described in the AICPA's State and Local Governments Expert Panel white paper

Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting. May an employer auditor use the plan auditor's report as evidence for the audit of the employer's financial statements?

Interpretation – Yes. The employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor's report on the schedules as evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated.

Before using the report of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedules are adequate and appropriate for the employer auditor's purposes. For example, the employer's auditor may review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes. Further, the employer auditor has a responsibility to verify and recalculate amounts specific to the applicable employer, including the employer amount used in the allocation percentage, (that is the numerator of the calculation), to recalculate the allocation percentage for the employer, and recalculate the pension amounts allocated to the employer based on the allocation percentage.

AU-C Section 9600 ***AUDITOR OF PARTICIPATING EMPLOYER IN A GOVERNMENTAL PENSION PLAN***

Question – Many governmental entities (employers) provide pension benefits to their employees through governmental pension plans. In order to report pension amounts in accordance with GASB Statement 68, employers obtain certain information (for example, net pension liability) from the governmental pension plan. In this circumstance, is the governmental pension plan considered a component of the employer for purposes of AU-C section 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*?

Interpretation – No. In this circumstance, a governmental pension plan is not a component of the employer for purposes of AU-C section 600. Accordingly, it would not be appropriate for an employer auditor to make reference to the audit report of the governmental pension plan auditor.

AU-C Section 9805 ***AUDITOR OF GOVERNMENTAL COST-SHARING MULTIPLE-EMPLOYER PENSION PLAN***

Question – Management of a governmental cost-sharing multiple-employer pension plan (cost-sharing plan or plan) has calculated and prepared a schedule of employer allocations and a schedule of pension amounts, as described in the AICPA's State and Local Government Expert Panel white paper *Governmental Employer Participation in Cost-Sharing Multiple-Employer*

Plans: Issues Related to Information for Employer Reporting. If the plan auditor is engaged to perform an audit on schedules such as those illustrated in exhibit 1, "Schedule of Employer Allocations," and either exhibit 2(a), "Schedule of Pension Amounts by Employer," or exhibit 2(b), "Schedule of Collective Pension Amounts," of this interpretation, what type of audit report may be issued?

Interpretation – As the information in the above schedules are considered elements or items of the cost-sharing plan or participating employer's financial statements, the elements included in these schedules may be audited under AU-C section 805, *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. An illustrative auditor's report on the schedule of employer allocations and schedule of pension amounts by employer prepared pursuant to AU-C section 805 follows (abbreviated below).

Independent Auditor's Report

[appropriate addressee]

Report on schedules

We have audited the accompanying schedules of employer allocations of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes. We have also audited the total for all entities of the columns titled net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense (specified column totals) included in the accompanying schedule of pension amounts by employer of ABC Pension Plan as of and for the year ended June 30, 20X5 and the related notes.

Management's responsibility for the Schedules

Management is responsible for the preparation and fair presentation of these schedules in accordance with…….

Auditor's responsibility

Our responsibility is to express opinions on the schedule of employer allocations and the specified column totals included in the schedule of pension amounts by employer based on our audit…….

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule of employer allocations and specified column totals in the schedule of pension amounts by employer……

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinions

In our opinion, the schedules referred to above present fairly, in all material respects, the employer allocations and net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the total of all participating entities of ABC Pension Plan as of and for the year ended June 30, 20X5, in accordance with accounting principles generally accepted in the United States of America.

Other matter

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of ABC Pension Plan as of and for the year ended June 30, 20X5, and our report thereon, dated October 15, 20X54, expressed an unmodified opinion on those financial statements.

Restriction on use

Our report is intended solely for the information and use of ABC Pension Plan management, [identify those charged with governance], ABC Pension Plan employers as of and for the year ended June 30, 20X5, and their auditors, and is not intended to be and should not be used by anyone other than these specified parties.

Auditor's signature
Auditor's city and state
Date of the auditor's report

Question – In planning and performing the audit of the schedules illustrated in exhibits 1 and 2(a) or 2(b) of this interpretation, may the plan auditor use the same materiality as used for the audit of the plan's basic financial statements?

Interpretation – No. AU-C section 805 states, in part:

> In the case of an audit of one or more specific elements of a financial statement, the auditor should determine materiality for each individual element reported on, rather than the aggregate of all elements or the complete set of financial statements.

Accordingly, the plan auditor would determine materiality separately for the schedule of employer allocations as well as each of the elements upon which the auditor opines from the schedule of pension amounts (that is, the column totals for net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense).

Exhibit 1, 2(a) and 2(b) Schedules of employer allocations, collective pension amounts and pension amounts by employer follow.

Exhibit 1 – Schedule of Employer Allocations

Example Cost-Sharing Pension Plan
Schedule of Employer Allocations
As of and for the Year Ended June 30, 20X5

Employer	**20X5 Actual Employer Contributions**	**Employer Allocation Percentage**
Employer 1	$ X	X.XX%
Employer 2	X	X.XX
Employer 3	X	X.XX
Employer 4	X	X.XX
Employer 5	X	X.XX
Total	$ X	100.00%

Exhibit 2(a) – Schedule of Collective Pension Amounts

Example Cost-Sharing Pension Plan
Schedule of Collective Pension Amounts
As of and for the Year Ended June 30, 20X5

	Deferred Outflows of Resources			
Net Pension Liability	**Differences Between Expected and Actual Experience**	**Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments**	**Changes of Assumptions**	**Total Deferred Outflows of Resources, exclusive of Employer Specific Amounts**
$X	$X	$X	$X	$X

	Deferred Inflows of Resources			
Differences Between Expected and Actual Experience	**Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments**	**Changes of Assumptions**	**Total Deferred Inflows of Resources, exclusive of Employer Specific Amounts**	**Pension Expense**
$X	$X	$X	$X	$X

Exhibit 2(b) – Schedule of Pension Amounts by Employer

Example Cost-Sharing Pension Plan
Schedule of Pension Amounts by Employer
As of and for the Year Ended June 30, 20X5

		Deferred Outflows of Resources			
Employer	**Net Pension Liability**	**Differences Between Expected and Actual Experience**	**Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments**	**Changes of Assumptions**	**Total Deferred Outflows of Resources, exclusive of Employer Specific Amounts**
1	$X	$X	$X	$X	$X
2	X	X	X	X	X
3	X	X	X	X	X
4	X	X	X	X	X
5	X	X	X	X	X
Total	$XX	$XX	$XX	$XX	$XX

		Deferred Inflows of Resources			
Employer	**Differences Between Expected and Actual Experience**	**Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments**	**Changes of Assumptions**	**Total Deferred Inflows of Resources, exclusive of Employer Specific Amounts**	**Pension Expense**
1	$X	$X	$X	$X	$X
2	X	X	X	X	X
3	X	X	X	X	X
4	X	X	X	X	X
5	X	X	X	X	X
Total	$XX	$XX	$XX	$XX	$XX

AU-C Section 9570 ***THE AUDITOR'S CONSIDERATION OF AN ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN***

Definition of *Substantial Doubt About an Entity's Ability to Continue as a Going Concern*

Question – AU-C section 570 refers to the terms *substantial doubt about an entity's ability to continue as a going concern* but does not define it. For example, AU-C 570 requires the auditor to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for *a reasonable period of time*. In applying AU-C 570, how should an auditor apply the term *substantial doubt about an entity's ability to continue as a going concern* when the term is defined in the applicable financial reporting framework?

Interpretation – AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* requires the auditor to form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. As a result, when the applicable financial reporting framework includes a definition of *substantial doubt about an entity's ability to continue as a going concern*, that definition would be used by the auditor when applying AU-C 570. For example, if an entity is required to comply with. Or has elected to adopt, FASB ASC 205-40 early, the definition of *substantial doubt about an entity's ability to continue as a going concern* set out in FASB ASV 205-40 would be used by the auditor.

Definition of *Reasonable Period of Time*

Question – AU-C section 570 requires the auditor to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. AU-C section 570 defines *reasonable period of time* as "a period of time not to exceed one year beyond the date of the financial statements being audited." How should an auditor apply this definition when the applicable financial reporting framework requires management to evaluate whether there are conditions and events that raise substantial doubt for a period of time greater than one year from the date of the financial statements?

Interpretation – As noted in the previous Interpretation, the auditor is required to form an opinion on whether the financial statements present fairly, in all material respects, in accordance with the applicable financial reporting framework. As a result, when the applicable financial reporting framework requires management to evaluate whether there are conditions and events that raise substantial doubt for a period of time greater than one year from the date of the financial statements, the auditor's assessment of management's going concern evaluation would be for the same period of time as required by the applicable financial reporting framework in forming an opinion on whether the financial statements present fairly, in all material respects, and determining whether an emphasis-of-matter paragraph is required.

Interim Financial Information

Question – AU-C section 570 states that the objective of the auditor when performing an engagement to review interim financial information is to obtain a basis for reporting whether the auditor is aware of any material modification that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework through performing limited procedures. AU-C 930 addresses the auditor's responsibility about when to make an inquiry concerning an entity's ability to continue as a going concern.

What are the auditor's responsibilities when the applicable financial reporting framework contains explicit requirements concerning management's responsibilities related to evaluating the entity's ability to continue as a going concern for interim financial information (for example, if an entity is required to comply with, or has elected to adopt, FASB ASC 205-40 early, management is required to comply with FASB ASC 205-40 when preparing interim financial information, including, when applicable, providing disclosures if substantial doubt about an entity's ability to continue as a going concern exists or has been alleviated?

Interpretation – In accordance with AU-C 930, if (a) conditions or events that may indicate substantial doubt about an entity's ability to continue as a going concern existed at the date of prior period financial statements, regardless of whether the substantial doubt was alleviated by the auditor's consideration of management's plans, or (b) in the course of performing review procedures on the current period interim financial information, the auditor becomes aware of conditions or events that might be indicative of the entity's possible inability to continue as a going concern, the auditor is require to:

a. Inquire of management about its plans for dealing with the adverse effects of the conditions and events, and
b. Consider the adequacy of the disclosure about such matters in the interim financial information.

The consideration of the adequacy of management's disclosures about the entity's ability to continue as a going concern in the interim financial information includes a consideration of whether the entity's financial statements are presented in accordance with the applicable financial reporting framework. As a result, when the applicable financial reporting framework includes explicit requirements for management to evaluate the entity's ability to continue as a going concern in preparing interim financial information, the auditor is required to perform interim review procedures related to management's evaluation of the entity's ability to continue as a going concern and the adequacy of the related disclosures in the interim financial information.

Consideration of Financial Statement Effects

Question – AU-C section 570 establishes requirements for the auditor to consider the possible effects on the financial statements and the adequacy of the related disclosure in situations when the auditor concludes there is substantial doubt or when concern about substantial doubt has been alleviated after consideration of management's plans. In addition, in assessing the adequacy of the disclosures, the related application guidance in AU-C 570 provides examples of matters that management might disclose in the financial statements. How should an auditor apply this guidance when the applicable financial reporting framework contains disclosure requirements related to management's going concern evaluation?

Interpretation – As noted in the first Interpretation above, the auditor is required to form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. As a result, when the applicable financial reporting framework provides disclosure requirements related to management's evaluation of substantial doubt, the auditor's assessment of the financial statement effects under AU-C 570 would be based on the disclosure requirements of the applicable financial reporting framework.

EXPOSURE DRAFT ***AN AUDIT OF INTERNAL CONTROL OVER FINANCIAL STATEMENT REPORTING THAT IS INTEGRATED WITH AN AUDIT OF FINANCIAL STATEMENTS***

The Auditing Standards Board has concluded that because engagements performed under extant AT section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That is Integrated with and Audit of Its Financial Statements*, as well as related attestation Interpretation No. 1, *Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act*, are required to be integrated with an audit of financial statements, it would be appropriate to move the content of extant AT section 501 from the attestation standards into GAAS.

The exposure draft is presented in columnar form, in which requirements and related application guidance are presented side-by-side, instead of the more customary sequential presentation. The final SAS will be issued in the customary format.

The Board notes that its intent was to adhere as closely as possible to the extant AT section 501, while aligning the GAAS and avoiding unintended consequences in practice. A number of amendments are proposed to integrate the standard into GAAS:

- The auditor will be *required* to report directly on the effectiveness of internal control over financial reporting. There is no option to report on management's assertion about the effectiveness of internal control over financial reporting.

- The standard assumes that management uses the 2013 *Internal Control – Integrated Framework* (COSO). It therefore includes specific requirements for evaluating the five components of internal control by assessing the principles in the 2013 COSO framework. It does, however, allow the auditor to adapt and apply the standard when management applies other internal frameworks, such as those standards promulgated by the U.S. Government Accountability Office.

- The term *significant account or disclosure* used in extant AT section 501 has been changed to *significant class of transactions, account balance or disclosure* to align with terminology used in GAAS and clarify that the risk factors the auditor is required to evaluate in the identification of significant classes of transactions, account balances, and disclosures and their relevant assertions are the same in the audit of internal control over financial reporting as in the audit of financial statements.

- The proposed standard would continue to allow the auditor to use the work of internal auditors and others in obtaining evidence about the effectiveness of internal over financial reporting.

OTHER AICPA DOCUMENTS

AUDIT RISK ALERTS (Excerpted) ***STATE AND LOCAL GOVERNMENT DEVELOPMENTS (2014)***

Understanding the entity and its environment and Assessing the risk of material misstatement

Auditors are required to obtain an understanding of the entity and its environment, including internal control, and to assess the risk of material misstatement in the financial statements, whether caused by error or fraud. Based on that understanding and assessment, the auditor must then design the nature, timing and extent of further procedures. An understanding of the entity and its environment includes comprehension of the following aspects:

- Industry, regulatory and other external factors
- Nature of the entity
- Objectives and strategies and the related business risks that may result in a material misstatement in the financial statements
- Measurement and review of the entity's financial performance
- Internal control, including the selection and application of accounting policies

State and local governments may be subject to specific risks of material misstatement arising from the nature of their activities, the degree of regulation or other external forces (political, economic, social, technical and competitive forces).

Understanding and properly addressing the matters discussed below assists the auditor in obtaining a better understanding of the client's environment, better assessing the risk of material misstatement and improving the integrity of audits performed.

Economic indicators

The following economic indicators illustrate the state of the U.S. economy entering 2014:

- Real GDP increased at an annual rate of 2.6% in the fourth quarter of 2013, compared to an overall increase of 4.1% in the third quarter. The overall rate for 2013 was 1.9%, compared to a 2.8% increase in 2012.
- The unemployment rate declined from 7.8% to 6.7% (approximately 10.4 million unemployed).
- Overall the economy is showing slow signs of recovery, although manufacturing remained flat.
- Both the S & P 500 and the Dow Jones Industrial Average were at or near their highest points since December 2007
- The federal funds rate remains at 0.25% where it has been since the onset of the recession. The Federal Reserve has described the economic recovery as follows:
    - Household spending and business investment have continued to advance.
    - Although the rate is declining, unemployment remains elevated.

- Housing has shown signs of improvement.
- Inflation remains at a lower than expected level.

State of the states' economies

The Rockefeller Institute published preliminary data showing declines in personal income tax collections in the first quarter of 2014. The fourth quarter 2013 was disappointing for many states with declines in both personal income and overall tax collections. States reported a 0.4% growth in income taxes, down from 10.9% a year prior.

State and local government health care concerns

Health care spending remains a main source of fiscal pressure:

- State and local government health care spending increased by 8% in 2012, according to the latest date from the Centers for Medicare and Medicaid Services, consuming about $3 of every $10 in revenue, increasing from 16% of expenditures in 1987 to 31% in 2012. Combined health care expenditures by state and local governments increased at an inflation-adjusted 260% during that period.
- The Centers for Medicare and Medicaid Services projects that state and local government spending will rise by 49% in inflation-adjusted dollars from 2012 to 2022.
- The Government Accountability Office warns that health care spending is the primary long-term fiscal challenge state and local governments will face.

Auditors should evaluate the risks that anticipated reductions in funding and pressures related to the government's ability to meet program needs of its citizens may impose on the control environment and on financial statement reporting.

Mixing financial statement presentations

Auditors are cautioned about reporting on an entity that has multiple frameworks, such as where some of the opinion units report on a GAAP basis, while others report on the cash basis framework. The auditor's opinion must be modified to address such a situation, as an unmodified opinion is not permitted to address multiple frameworks. If other auditors are involved, the provisions of AU-C 600 (discussed below) also apply.

Related party footnotes

Paragraphs 54-57 of GASB Statement 62 provide guidance on related party disclosures. Related party transactions include those that occur between a government and trust for the benefit of the government's employees (e.g. pension and OPEB trusts) that are managed by or under the trusteeship of the government's management. This means that the government should disclose:

- The nature of the relationship
- A description of the transactions occurring between the government and any related party, whether or not there are dollar amounts ascribed to such transactions, for each

period presented, and any other information to enable the user to understand the effects of such transactions on the financial statement

- The dollar amounts of transactions for each of the periods presented, and the effects of any changes in the method of establishing the terms from that used in the preceding period
- Amounts due to or from related parties as of the date of each financial statement, and if not otherwise apparent, the terms and manner of settlement.

Group audit considerations

AU-C 600 prescribes the procedures to be followed in group audits, those that involve the audit of financial statements that include more than one component. An audit of group financial statements involves identifying the components that are part of the group and considering the effect of the components on the overall group audit strategy and group audit plan, including the extent to which the group engagement team will use the work of component auditors.

Applicability of AU-C 600 depends on whether more than one component is identified. If only one auditor is responsible for all of the opinion units in the financial reporting entity and no components are included, the requirements of AU-C 600 would not apply. A *component* may include subsidiaries, geographical locations, divisions, investments, products or services, functions, processes, or component units of state of local governments. The purpose of AU-C 600 is to manage the aggregation risk inherent in the preparation of group financial statements. Accordingly, the auditor should obtain an understanding of the governmental reporting entity, how its activities are managed, the governance structures and how financial information is recorded in the accounting system and aggregated into the financial statements.

One unique aspect of financial reporting by governmental entities is that the financial statements generally include multiple opinion units, which are reported on separately, based on separate audits performed in accordance with the respective performance materiality of each opinion unit. As such, it can be analogized that each opinion unit is equivalent to its own group, and there would be no additional requirements under AU-C 600, unless the opinion unit contains components or is audited by other auditors (component auditors).

For example, an enterprise fund, which is reported as a major fund of a city, has historically operated on an autonomous basis from the city. It has different management accountable to a utility board. Accounting information included in the city's financial statements is prepared separately by management of the enterprise fund. Although the activity appears to meet the definition of a component, there would be no additional requirements under AU-C 600, since the enterprise is being audited as a major fund, and the enterprise fund has no components. On the other hand, if the enterprise is not a major fund, the requirements of AU-C 600 would apply, since the enterprise fund would be a component of the aggregate remaining fund information. In this situation, the group engagement partner would establish component materiality for the utility and perform audit procedures based on the significance of the component and the assessed risk of material misstatement of the group (the aggregate remaining fund information).

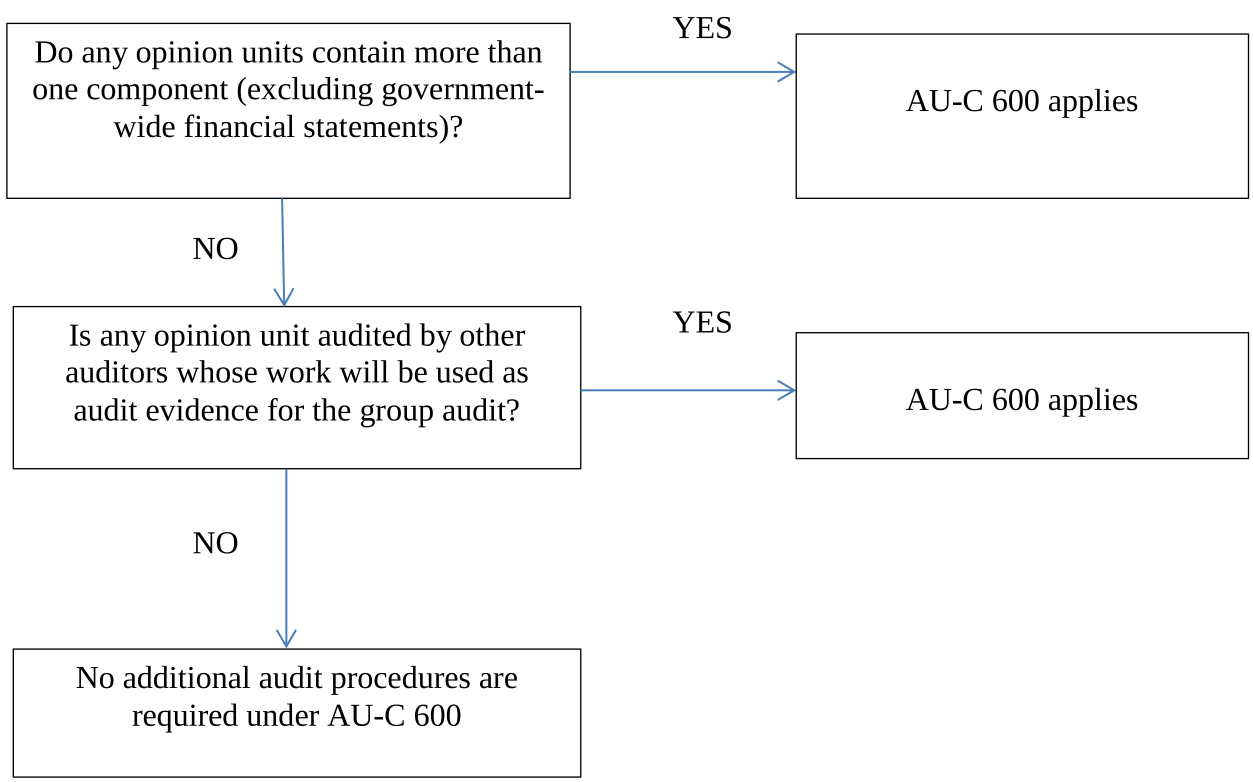
The financial information of the governmental and business-type activities (in the government-wide financial statements) would not normally need to be considered when identifying components. These financial statements are created by combining the financial statements of the underlying major funds and aggregate remaining fund information, all of which are separate opinion units for which the auditor expresses separate opinions. Accordingly, there would be no additional procedures to be performed under AU-C 600.

If an opinion unit, or component thereof, is audited by a component auditor whose work on the financial information will be used as audit evidence for the group audit, the opinion unit or the component unit would be considered a component under AU-C 600, and the group engagement partner should follow AU-C 600 guidance related to component auditors.

Common opinion units that have more than one component include the aggregate remaining fund information and aggregate discretely presented component units.

The following guidance is provided:

APPLYING AU-C 600 IN AUDITS OF GOVERNMENTAL ENTITIES



The group engagement partner decides to act as such by evaluating whether the group engagement team will be able to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors, considering:

- Individual financial significance of the components for which the auditor of group financial statements will be assuming responsibility
- Extent to which significant risks of material misstatement of the group financial statements are included in the components for which the auditor of the group financial statements will be assuming responsibility, and
- Extent of the group engagement team's knowledge of the overall financial statements.

In addition, in audits of state and local governments, additional factors include:

- Engagement by the primary government as the auditor of the financial reporting entity, and
- Responsibility for auditing (at least) the primary government's general fund.

Regardless of whether reference will be made to the work of the component auditor, the group engagement team should obtain an understanding of:

- Whether the component auditor understands and will comply with the professional and ethical requirements
- The component auditor's professional competence
- The extent, if any, to which the group engagement team will be able to be involved in the work of the component auditor
- Whether the group engagement team will be able to obtain information affecting the consolidation process from a component auditor
- Whether a component auditor operates in a regulatory environment that actively oversees auditors.

When the group engagement team has serious concerns about the professional competence of the component auditor, or the component auditor does not meet the independence requirements that are relevant to the group audit, the group auditor cannot use the work of the component auditors or make reference to the component auditors in his or her report. This requirement may have significant implications in audit of governmental entities because of the potentially separate legal status and governance structure of entities included within the reporting entity and the inability of group management to control or influence the contracting relationship between component management and component auditors. In these cases, the group auditor may not have the ability to "step in" and perform the necessary audit work for the component, *resulting in a scope limitation*.

After obtaining an understanding of each component auditor, the group engagement partner determines whether to make reference to a component auditor in the auditor's report on the group financial statements. Even when making reference, the group engagement partner still has certain responsibilities, and he or she should carefully follow the guidance in AU-C 600.

Timely communications are required between the group engagement team and the component auditor and documentation of the communications are required. If effective two-way communication does not exist between the group engagement team and the component auditor, a risk exists that the group engagement team may not obtain sufficient appropriate audit evidence. Engagement letters should be appropriately modified to provide for timely unlimited communications between the group engagement team and component auditors.

The Alert contains a number of FAQ's related to AU-C 600 (pp. 30-35) that auditors will find helpful.

PROFESSIONAL ETHICS EXECUTIVE COMMITTEE (PEEC)

REVISED AICPA CODE OF PROFESSIONAL CONDUCT

Effective December 15, 2014, the revised Code of Professional Conduct became effective. The revision completely restructures and codifies the Code so that members and other users can apply the rules and reach correct conclusions more easily and intuitively. The new Code:

- Restructures the Code into several parts organized by topic
- Edits the Code using consistent drafting and style conventions
- Incorporates a conceptual framework for members in public practice and in business
- Revises certain Code provisions to reflect the *conceptual framework* approach, and
- Where applicable, references existing nonauthoritative guidance to the relevant topic

It was the PEEC's intent to maintain the substance of the previous ethics standards; however, some areas were identified where revision was believed to be needed, and accordingly there are some substantive changes.

New structure of the Code

The restructured Code is divided into separate parts:

> **Preface –** Applicable to all members, addresses topics such as the structure of the Code, the principles of professional conduct, definitions, nonauthoritative guidance and new, revised and pending interpretations (numbering system begins with 0).
>
> **Part 1 –** Applicable to members in public practice (numbering system begins with 1).
>
> **Part 2 –** Applicable to members in business (numbering system begins with 2).
>
> **Part 3 –** Applicable to all other members (such as those who are retired or unemployed) (numbering system begins with 3).

The PEEC believes the structure will enable members to easily identify what provisions apply to them. For members who are both in public practice and in business, content that is relevant to both parts appears in the corresponding citation, with the actual content differing only where necessary (such as Part 1 referring to a "firm" where Part 2 might refer to "employer").

Numbering system – The system begins with a single digit that identifies the part of the Code in which the content resides, e.g. guidance applicable to members in public practice will appear as "1.XXX.XXX." The additional digits identify topics and subtopics. A review of the table of contents for members in public practice, for example, presents the following:

1.110 Conflicts of Interest

1.110.010 Conflicts of Interest
1.110.020 Director Positions

Definitions and cross references – Defined terms are shown in italics throughout the Code. For purposes of the exposure draft, these terns are also hyperlinked to the definition; hyperlinks that do not appear in italics are cross references. If a hyperlink is selected, a user can return to their previous location by selecting "alt ←." When a defined term is used in the Code but is not shown in italics, the definition (in section 0.400) would not be applicable.

Rules of conduct – The bylaws of the AICPA require all members to comply with the Code. That remains unchanged with the restructured Code, but specific rule numbers are no longer being used. For example, Rule 101, *Independence* is now referred to as the "Independence Rule." In addition, the manner in which the interpretations are aligned with the rules has changed. In the current Code, the interpretations are aligned under the applicable rules; in the restructured Code, the rules are aligned with the interpretations under a broad topic. For example, the "Contingent Fees Rule" and "Commission and Referral Fees Rule" and related interpretations appear under ET Section 1.500, "Fees and Other Types of Remuneration."

Because of how the Code is structured, there are some situations in which the rule appears multiple times. For example, "Integrity and Objectivity" appears in both Parts 1 and 2. The interpretations of this rule do not necessarily appear in both parts, but are aligned with the member's status as either in public practice or in business. All current rulings are redrafted as interpretations and codified under the appropriate topic.

Drafting conventions – A number of drafting conventions were used to enhance the clarity of the Code. One such convention is the use of "should consider" which is used to indicate that consideration of the procedure is presumptively required. The member may or may not perform the procedure or action, based on the results of the consideration and the member's judgment. Alternatives include:

- "Should consider" – when the member is presumptively required to think about several matters
- "Should evaluate" – when the member is presumptively required to assess and weigh the significance of a matter
- "Should determine" – when the member is presumptively required to conclude and make a decision

Other drafting conventions were used to eliminate inconsistencies and clarify the intent of interpretations:

- Using the phrase “independence would be impaired”
- Avoiding legalistic terms, such as “including but not limited to”
- Using content in ethics rulings as examples in interpretations
- Drafting interpretations in active voice
- Avoiding use of present tense in an interpretation with regard to member actions or procedures that the member performs (e.g. “the member should” rather than “the member does”
- Limiting requirements to the member, and not to others, such as a client or management
- Refraining from use of qualifiers, such as *generally, ordinarily, normally,* and *usually*
- Keeping footnotes to a minimum

Conceptual frameworks – Two frameworks are included; one for members in public practice and one for members in business. In addition, for members in public practice who provide attest services to clients, there is a conceptual framework for independence (a redraft of the existing framework).

In addition to the two conceptual frameworks, certain interpretations were recast to reflect the conceptual framework approach that represents a significant change. For example, the existing interpretation that prohibits a covered member from having a direct financial interest in a client is proposed to read as follows:

> “If a covered member had or was committed to acquire any direct financial interest in an attest client during the period of the professional engagement, the self-interest threat to the covered member’s compliance with the “Independence Rule” would not be at an acceptable level and could not be reduced by the application of safeguards. Accordingly, independence would be impaired.”

Some interpretations, such as those related to acts discreditable, false advertising and confidentiality, do not lend themselves to a conceptual framework and have not been recast. For those interpretations, PEEC applied only drafting and style conventions.

Substantive changes – The following are areas in which substantive changes are proposed:

> **Conceptual framework –** As stated above, two conceptual frameworks are proposed. To apply the frameworks, PEEC incorporated new interpretations under each rule that require application of the appropriate conceptual framework when there is no guidance to address a particular relationship or circumstance. These interpretations conclude that the member would be in violation of the respective rule if the member cannot demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

> **Self-review threat –** The definition of *self-review threat* was expanded to include judgments made or work performed by an individual currently with the firm who was previously associated with the client.

Ethical conflicts – The existing nonauthoritative *Guide for Complying with Rules 102-505* contains a discussion on ethical conflict resolution which has been included in both Parts 1 and 2.

Attest client – Since members need not be independent of all clients, PEEC decided that the term *attest client* should replace the existing term *client* to distinguish between circumstances, and has developed a definition of *attest client*.

Director positions – The previous ruling 85, *Bank Director*, provides guidance that the PEEC believes should be applied by a member in public practice when serving as a director of any entity, and has drafted the interpretations accordingly (included under the "Integrity and Objectivity Rule" and the "Confidential Client Information Rule."

Tax power of attorney and Prospective clients confidential information – Based on frequently asked questions in the Professional Ethics Division, PEEC has included interpretations that conclude that having a tax power of attorney for an attest client (limited to tax matters) does not impair independence, as long as the general requirements of the previous Interpretation 101-3 are met, and further, that disclosure of confidential information of a prospective client without consent would constitute a violation of the "Acts Discreditable Rule."

False, misleading or deceptive acts – While approving the previous Interpretation 501-10, *False, Misleading or Deceptive Acts in Promoting or Marketing Professional Services*, applicable to members in business, PEEC agreed that the guidance should be applied to all members. As such, PEEC added the interpretation to Parts1 and 3 of the restructured Code as a new interpretation.

Billing for a subcontractor's services –Previous Ruling 186, *Billing for Subcontractor's Services*, concluded that when a member contracts with a computer-hardware maintenance servicer to provide support for a client's computer operations, any increase in fee charged by the member would not be considered a commission. When recasting the guidance, PEEC believed it was appropriate for the guidance to be presented more broadly so that it would apply when billing for any subcontractor's services, and has revised the restructured interpretation accordingly.

Attest engagement performed with former partner –Previous Ruling 136, *Audit with Former Partner*, concludes that an audit report should be presented on plain paper when a firm consisting of one certified and one non-certified partner has been dissolved and the two individuals retain the audit to service together. When recasting the guidance, PEEC concluded it was appropriate for the guidance to be presented more broadly, so that it would not only apply to audits, and has revised the restructured interpretation accordingly.

Use of AICPA awarded designation –Previous Ruling 183, *Use of the AICPA Personal Financial Specialist Designation*, concluded that use of the PFS designation on a firm's letterhead and marketing material was permissible provided that all partners or shareholders of the firm have the designation and that an individual who holds the designation may use it after their name. When recasting, PEEC concluded that the guidance should be presented more broadly to apply to any AICPA-awarded designation, and has revised the restructured interpretation accordingly.

Loans and lending institutions – The definition of *loan* was clarified to align with that of the FASB:

> **Loan** A loan is a contractual obligation to pay or right to receive money on demand or on a fixed or determinable date and includes a stated or implied rate of return to the lender. For purposes of this definition loans, the characteristics of which generally include, but are not limited to, and agreement that provides for repayment terms and a rate of interest. A loan includes, among other things, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment. However, for purposes of this definition, a loan would not include debt securities (which are considered a financial interest) or a lease arrangement.

PEEC also decided to change the term *financial institution* to *lending institution*, to include banks, credit unions, certain retailers, insurance and finance companies.

Blind trusts – PEEC decided to delete the blind trust example, previously included in Interpretation 101-15, *Financial Relationships*. The example included in the Interpretation assumes that the investments in the blind trust will ultimately revert to the grantor, and the grantor is assumed to have the right to amend or revoke the trust. PEEC is concerned that members reading the example might not be aware that this is only one way in which a blind trust could be structured. The example has been moved to a nonauthoritative FAQ and only the guidelines are included in the restructured guidance.

Effective date – The revised Code was effective December 15, 2014, with an exception for the two broad conceptual frameworks, which would be effective December 15, 2015.

A complete copy of the Code is available on the AICPA web site.

REVISED DEFINITION ***THOSE CHARGED WITH GOVERNANCE***

PEEC adopted a definition of *those charged with governance* as that term is used throughout a number of provisions (including the interpretation on affiliates, confidential information obtained from employment or volunteer activities, management responsibilities, and internal audit sections). The new definition was effective upon publication.

> **Those charged with governance –** the persons or organizations (such as a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the

obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include members of management.

When an interpretation required communicating with those charged with governance, the member should determine, considering the nature and importance of the particular circumstances and matter to be communicated, the appropriate person(s) within the entity's governance structure with whom to communicate. If the member communicates with a subgroup of those charged with governance (such as an audit committee or an individual) the member should determine whether communication with all of those charged with governance is also necessary, so that they are adequately informed.

REVISED AND NEW INTERPRETATION *CONFLICTS OF INTEREST*

Conflicts of Interest for Members in Public Practice - A member in public practice or his or her firm may be faced with a conflict of interest when performing a professional service. In determining whether a professional service, relationship or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the Integrity and Objectivity rule. For example, threats may be created when:

- The member or member's firm provides a professional services related to a particular matter involving two or more clients whose interests with respect to that matter are in conflict, or
- The interests of the member or the member's firm with respect to a particular matter and the interests of the client for whom the member or member's firm provides a professional service related to that matter are in conflict.

Certain professional engagements, such as audits, reviews and other attest services, require independence. Independence impairments under the Independence rule, its interpretations and rulings cannot be eliminated by the safeguards provided in this interpretation or by disclosure and consent.

The following are **examples** of situations in which conflicts of interests may arise:

- Providing corporate finance services to a client seeking to acquire an audit client of the firm, where the firm has obtained confidential information during the course of the audit that may be relevant to the transaction
- Advising two clients at the same time who are competing to acquire the same company, where the advice might be relevant to the parties' competitive positions

- Providing services to both a vendor and a purchaser who are clients of the firm in relation to the same transaction
- Preparing valuations of assets for two clients who are in an adversarial position with respect to the assets
- Representing two clients regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership
- Providing an attest report for a licensor on royalties due under a license agreement when at the same time advising the licensee of the correctness of the amounts payable
- Advising a client to invest in a business in which, for example, the immediate family member of the member has a financial interest
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client
- Advising a client on the acquisition of a business which the firm is also interested in acquiring
- Providing forensic investigation services to a client for the purpose of evaluating or supporting contemplated litigation against another client of the firm
- Providing tax or personal financial planning services for several members of a family whom the member knows to have opposing interests
- Referring a personal financial planning or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement to do so

Identification of conflicts of interest

Before accepting a new client relationship, engagement, or business relationship, a member should take reasonable steps to identify circumstances that might create a conflict of interest including identification of:

- The nature of the relevant interests and relationships between the parties involved; and
- The nature of the service and its implication for relevant parties

The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a member is asked to conduct an engagement for a client in a situation that may become adversarial with respect to another client or the member or member's firm, even though the parties who engage the member may not initially be involved in a dispute. A member should remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a member in identifying actual or potential conflicts of interest that may create significant threats to compliance with the Integrity and Objectivity rule prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example, clients or potential clients. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of a member being able to apply safeguards to eliminate or reduce significant threats to an acceptable level. The process to identify actual or potential conflicts of interest will depend on such factors as:

- The nature of the professional services provided
- The size of the firm
- The size and nature of the client base, and
- The structure of the firm, for example, the number and geographic locations of offices

If the firm is a member of a network, the member is not required to take specific steps to identify conflicts of interest of other network firms; however, if the member knows or has reason to believe that such conflicts of interest may exist or might arise due to interests and relationships of a network firm, the member should evaluate the significance of the threat created by such conflicts of interest as described below.

<u>Evaluation of a conflict of interest</u>

When a conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. Members should consider both qualitative and quantitative factors when evaluating the significance of the threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. In evaluating the significance of an identified threat, members should consider both of the following:

- The significance of relevant interests or relationships
- The significance of the threats created by performing the professional service of services. In general, the more direct the connection between the professional service and the matter on which the parties' interests are in conflict, the more significant the threat to compliance with the rule will be.

If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include the following:

- Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include:
    - Using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality
    - Creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential information from one practice area to another within a firm
    - Establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners of the firm and the physical and electronic separation of confidential information
- Regular review of the application of safeguards by a senior individual not involved with the client engagement or engagements

- Having a member of the firm who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate
- Consulting with third parties, such as a professional body, legal counsel or another professional accountant

In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest, or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

<u>Disclosure of a conflict of interest and consent</u>

When a conflict of interest exists, the member should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their consent to perform the professional services. The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

Disclosure and consent may take different forms, for example:

- General disclosure to clients of circumstances in which the member, in keeping with common commercial practice, does not provide services exclusively for any one client (for example, in a particular service in a particular market sector) in order for the client to provide general consent accordingly. Such disclosure might be made in a member's standard terms and conditions for the engagement.
- Specific disclosure to affected clients of the circumstances of the particular conflict including an explanation of the situation and any planned safeguards, sufficient to enable the client to make an informed decision with respect to the matter and to provide specific consent.

The member should determine whether the nature and significance of the conflict of interest is such that specific disclosure and specific consent is necessary. For this purpose, the member should exercise professional judgment in evaluating the circumstances that create a conflict of interest, including the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.

When a member has requested specific consent from a client and that consent has been refused by the client, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest, or (b) terminate the relevant relationships or dispose of the relevant interest to eliminate the threat or reduce it to an acceptable level, such that consent can be obtained, after applying the additional safeguards, if necessary.

The member is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to acceptable level, and the consent obtained.

When addressing conflicts of interest, including making disclosures and seeking guidance of third parties, a member should remain alert to the requirements of Rule 301, *Confidential Client Information*, and Interpretation 501-9, *Confidential Information Obtained from Employment or volunteer Activities*, under Rule 501, *Acts Discreditable*. In addition, federal, state or local statutes or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in the Code of Professional Conduct.

When practicing before the IRS or other taxing authorities, members should ensure compliance with any requirements that are more restrictive. For example, Treasury Department Circular 230, *Regulations Governing Practice before the Internal Revenue Service*, provides more restrictive requirements concerning written consent by the client when a conflict of interest exists.

Conflicts of Interest for Members in Business – A member in business may be faced with a conflict of interest when undertaking a professional service. In determining whether a professional service, relationship, or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the Integrity and Objectivity rule. For example, threats may be created when:

- A member undertakes a professional service related to a particular matter involving two or more parties whose interests with respect to that matter are in conflict, or
- The interests of the member with respect to a particular matter and the interests of a party for whom the member undertakes a professional service related to that matter are in conflict.

A party may include an employing organization, a vendor, a customer, a lender, a shareholder or another party.

The following are examples of situations in which conflicts of interest may arise:

- Serving in a management or governance position for two employing organizations and acquiring confidential information from one employing organization that could be used by the member to the advantage or disadvantage of the other employing organization
- Undertaking a professional service for each of two parties in a partnership employing the member to assist in dissolving the partnership
- Preparing financial information for certain members of management of the employing organization who are seeking to undertake a management buy-out
- Being responsible for selecting a vendor for the member's employing organization when the member or his or her immediate family member could benefit financially from the transaction
- Serving in a governance capacity or influencing an employing organization that is approving certain investments for the company in which one of those specific investments will increase the value of a personal investment portfolio of the member or his or her immediate family

<u>Identification of a conflict of interest</u>

In identifying whether a conflict of interest exists or may be created, a member should take reasonable steps to determine:

- The nature of the relevant interests and relationships between the parties involved, and
- The nature of the services and its implication for relevant parties

The nature of the relevant interests and relationships and the services may change over time. The member should remain alert to such changes for the purposes of identifying circumstances that might create a conflict of interest.

<u>Evaluation of a conflict of interest</u>

When a conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. Members should consider both quantitative and qualitative factors when evaluating the significance of the threat, including the extent to which existing safeguards already reduce the threat to an acceptable level.

In evaluating the significance of an identified threat, members should consider the following:

- The significance of relevant interests or relationships
- The significance of the threats created by underrating the professional service or services. In general, the more direct the connection between the member and the matter on which the parties' interests are in conflict, the more significant the threat to compliance with the rule will be.

If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include the following:

- Restructuring or segregating certain responsibilities and duties
- Obtaining appropriate oversight, for example, acting under the supervision of an executive or non-executive director
- Withdrawing from the decision making process related to the matter giving rise to the conflict of interest
- Consulting with third parties, such as a professional body, legal counsel or another professional accountant

In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest, or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

<u>Disclosure of conflict of interest and consent</u>

When a conflict of interest exists, the member should disclose the nature of the conflict to the relevant parties, including to the appropriate levels within the employing organization and obtain their consent to undertake the professional service. The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

The member is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to an acceptable level, and the consent obtained.

When addressing a conflict of interest, a member is encouraged to seek guidance from within the employing organization or from others, such as a professional body, legal counsel, or another professional accountant. When making disclosures and seeking guidance of third parties, the member should remain alert to the requirements of Interpretation 501-9, *Confidential Information Obtained from Employment or Volunteer Activities*, under Rule 501, *Acts Discreditable*. In addition, federal, state and local statutes or regulations concerning confidentiality of employer information may be more restrictive than the requirements contained in the Code of Professional Conduct.

A member may encounter other threats to compliance with the integrity and Objectivity rule. This may occur, for example, when preparing or reporting financial information as a result of undue pressure from others within the employing organization or financial, business or personal relationships that close or immediate family members of the member have with the employing organization. Guidance on managing such threats is covered by interpretations 102-1, *Knowing Misrepresentations in the Preparation of Financial Statements or Records*, and 102-4, *Subordination of Judgment by a Member* under the Integrity and Objectivity rule.

The PEEC has overturned one longstanding interpretation and added several others related to political campaigns and political parties. The text of the revised interpretations is summarized below.

For purposed of this interpretation, a *campaign treasurer* would also include individuals with similar responsibilities. Other campaign positions may result in threats to compliance with the Independency Rule, such positions are not covered by this interpretation. Members should consult the Conceptual Framework for independence if partners or professional employees are involved in campaign positions not specifically addressed herein.

Campaign organization is attest client

If, during the period of the professional engagement, or during the period covered by the financial statements, a partner or professional employee of a member's firm serves as a campaign treasurer and the campaign organization is an attest client, the management participation threat to the member's compliance with the Independence Rule would not be at an acceptable level, and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

Candidate Running for Election of a Governmental Entity That is an Attest Client

If, during the period of the professional engagement or the period covered by the financial statements, a partner or professional employee serves as a campaign treasurer for either (a) an elected official of a governmental entity that is an attest client, or (b) for a candidate who is running for election but is not yet an elected official of such attest client, then advocacy, adverse interest, and familiarity threats to compliance with the Independence Rule would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

Political Party is Attest Client

If, during the period of the professional engagement or during the period covered by the financial statements, a partner or professional employee serves as a campaign treasurer for a candidate and the political party for which the candidate is a member is an attest client, advocacy and familiarity threats may exist. Accordingly, a responsible individual within the firm should evaluate the significance of the threats to determine if the threats are at an acceptable level. If the responsible individual within the firm determines that threats are not at an acceptable level, he or she should apply safeguards to eliminate or reduce the threats to an acceptable level. However, threats would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards, and independence would be impaired if the candidate is a member of one of the political parties' governing bodies.

General

In the state and local government environment, members should consult the "Entities Included in State and Local Government Financial Statements" interpretation to determine which entities related to their attest client require the member's independence. Also refer to the "Conflicts of Interest for Members in Public Practice" interpretation of the Integrity and Objectivity Rule for additional guidance. In addition, members in such positions should consider their obligations as members in business under Part 2 of the Code.

Grandfathered positions

Independence would not be impaired as a result of the more restrictive requirements of this interpretation that are effective April 30, 2015, and the member was in compliance with the preexisting requirements of this interpretation.

NEW DEFINITION *ATTEST CLIENT*

In order to distinguish between a client for whom independence is required and any other client, the PEEC adopted the following definition of *attest client*.

> "A client that engages a member to perform an attest engagement, or with respect to which a member performs an attest engagement."

EXPOSURE DRAFT *FIRM MERGERS AND ACQUISITIONS*

This proposed interpretation, under the Independence Rule, provides guidance to members in situations where independence with respect to an attest client may become impaired as a result of a firm merger or acquisition. The guidance would apply when either of the following occurs:

- A member's firm merges with or acquires another firm or entity or all or part of the business thereof, or
- A member's firm, or all or part of the business thereof, is merged with or acquired by another firm.

The proposal is focused on two types of relationships that would impair independence.

Employment or association with an attest client - The proposed interpretation requires safeguards to be in place in order for independence to be maintained when a partner or professional employee of one firm is employed by or associated with an attest client of the other firm as a result of the merger or acquisition. The safeguards require that the partner or professional employee terminate the relationship prior to the effective date of the merger or acquisition and be prohibited from participating on the attest engagement team or being in a position to influence the attest engagement team if the engagement covers any period in which the partner or employee was employed or associated with the attest client. The partner or employee must also comply with the applicable safeguards under the provisions of the interpretation “Former Employment or Association with an Attest Client,” such as the requirement that any *covered member* must cease participation in the attest client’s employee benefit plans.

The PEEC also believes that to safeguard independence, a responsible individual within the firm should assess the prior relationship that the partner or professional employee had with the attest client, as well as the position that the individual will hold at the firm to determine if threats are at an acceptable level. If threats are determined not to be at an acceptable level, the responsible individual will need to be satisfied that safeguards are applied that will eliminate or reduce the threats to an acceptable level.

In certain circumstances, PEEC has concluded that threats to independence will not be at an acceptable level. In particular, in situations where the partner or professional employee will have interaction with the attest engagement team or where the attest engagement team will evaluate work performed by the partner or professional employee while he or she was employed by or associated with the attest client, additional safeguards must be applied. Under those circumstances, an individual within the firm with the appropriate stature, expertise and objectivity must review the subsequent attest engagement *before issuance of the attest report*, to determine whether the attest engagement team maintained integrity, objectivity and an appropriate level of professional skepticism.

Another safeguard that will need to be applied relates to communication between the firm and those charged with governance at the attest client. Specifically, the proposed interpretation requires that the nature of the relationship and any safeguards applied be discussed with those charged with governance and that such discussion take place as soon as practicable under the circumstances, but in any case, prior to the issuance of the attest report. Documenting such discussion is encouraged.

Nonattest services – The proposal also provides guidance on situations in which one firm provided prohibited nonattest services to an attest client of the other firm. The PEEC believes that the significance of the threats differ, depending on whether the prohibited services were provided by the acquirer firm with respect to the attest client of the acquiree, or by the acquiree firm with respect to an attest client of the acquirer.

In situations in which the acquirer firm provided prohibited nonattest services to an attest client of the acquiree during the period of the professional engagement or the period covered by the financial statements, the PEEC believes that the threats created would be so significant that they could not be reduced to an acceptable level by application of safeguards. In those situations, the acquiree’s attest client would become an attest client of the acquirer (the survivor) upon merger or acquisition, and any prohibited nonattest services performed by the acquirer for such attest client would impair independence if the attest engagement were to continue.

Conversely, when the acquiree provided the prohibited nonattest services to an attest client of the acquirer during the period of the professional engagement or the period covered by the financial statements, the PEEC believes the acquirer’s independence will not be impaired provided certain steps are taken. One such step is for the acquiree to either terminate the prohibited services or modify the nonattest services such that the services will no longer be considered to impair independence. Another step is for the firm to perform an evaluation to determine if threats are either at an acceptable level or can be reduced to an acceptable level through the application of safeguards. The extent of the evaluation performed would be based on whether or not the prohibited nonattest services will be attributable to the acquirer. The nonattest services would be attributable to the acquirer if the acquirer assumes responsibility (that is, be held liable or accountable, or both) for the results of the prohibited nonattest services performed by the acquiree.

In evaluating the significance of the threats, the proposal provides various factors that should be considered and where threats are determined to be at an unacceptable level, examples of safeguards are also provided. In cases where there are no safeguards that can be applied to eliminate or reduce threats to an acceptable level, independence would be impaired.

The proposal also would require a responsible individual within the firm to discuss with those charged with governance the nature of any prohibited services performed that are subject to the above evaluation, along with any safeguards applied. Documentation of such discussion is encouraged.

Normal effective date rules would apply.

ACCOUNTING AND REVIEW SERVICES COMMITTEE (ARSC)

SSARS 21 ***STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES: CLARIFICATION AND RECODIFICATION***

In December 1978, the AICPA Accounting and Review Services Committee adopted SSARS 1. Under that standard, *submission* of financial statements was defined as "presenting to management financial statements that the accountant has prepared." Since SSARS 1 was adopted, the environment has changed considerably, mainly because of technology. Today, many times it may be difficult to determine who has prepared the financial statements.

For example, an accountant performing bookkeeping services for a client may have access to the client's cloud-based computing system, making certain entries and adjustments to information created by the client's personnel. At the end of the month, the client's personnel print, from the cloud accounting software, a copy of the financial statements to present to the owner or manager. Has the accountant prepared the financial statements, or did the client prepare the financial statements themselves? The answer is unclear.

SSARS 21 eliminates the need for an answer, by eliminating "submission" of financial statements as the determinant. The new standard is engagement-driven. The applicable section of the standards is completely dependent on what the accountant was engaged to do.

SSARS 21 supersedes all existing AR sections, except for AR 120, *Compilation of Pro Forma Financial Information*, which will likely be superseded in 2015 or 2016.

This SSARS separates the standards into four sections:

- AR-C § 60 – General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services
- AR-C § 70 – Preparation of Financial Statements
- AR-C § 80 - Compilation Engagements
- AR-C §90 – Review of Financial Statements

§60 – This section provides general principles for engagements under SSARS, and is intended to assist accountants better understand their professional responsibilities when they are performing an engagement.

It requires that for any engagement under SSARS the accountant must apply the guidance of the section, as well as:

- Ethical requirements
- Professional judgment
- Conducting the engagement in accordance with SSARS
- Engagement quality controls
- Acceptance and continuance of client relationships and engagements

One new requirement is that the accountant must obtain a written engagement letter, *which must be signed by the accountant or accounting firm, and by management or those charged with governance*. This is an attempt to ensure that management (or those charged) has read and understand the terms of the engagement.

§70 – This section applies when the accountant is engaged to prepare financial statement without reporting on them.

Preparation of financial statements is a non-attest service. This meets two major objectives:

- Conforms preparation of financial statements (even in an audit, review or compilation) to the treatment of preparing financial statements as a "nonaudit" service under Government Auditing Standards;
- Conforms with revisions to the AICPA Code of Professional Conduct interpretation "Nonattest Services" (previously Interpretation 101-3).

As a nonattest service, it must now meet the requirements of any other nonattest service (subject of written understanding with management, wherein the understanding describes the nature of the nonattest service, objectives of the service, management's agreement to designate a person of suitable skill, knowledge and experience to oversee, make any required management decisions, and take responsibility for the result of the services, and the limitations of the service). Accountants and auditors should be certain that their engagement letters are modified to include the necessary language.

Since preparation is a nonattest service, there is no requirement that the accountant be independent. The financial statements prepared may omit substantially all disclosures, and a statement to that effect may appear on the face of the financial statements, or in a "selected" note to the financial statements. An example of such a presentation on the face is as follows:

ABC Corporation
Balance Sheet
Substantially All Disclosures Required by
U.S. Generally Accepted Accounting Principles Omitted
December 31, 2015

The use of "selected disclosures" – with substantially all disclosures required by the applicable financial reporting framework omitted is still available.

There is generally no report issued when the accountant has prepared the financial statements. Rather, the financial statements (on each page) must include a legend to the effect that "No assurance is provided on these financial statements," which may also indicate "No CPA provides any assurance on these financial statements," "These financial statements have not been subjected to an audit, review or compilation engagement, and no assurance is provided on them." Any other comparable "no assurance" legend is acceptable. Should, for any reason, the CPA be unable to include such a statement on each page, there are two alternatives:

- Issue a disclaimer that makes it clear that no assurance is provided, or
- Perform a compilation engagement.

When financial statements are prepared on a basis other than U.S. GAAP, the accountant must include a description of the framework on the face of the financial statements or in a note. An example of such inclusion in the title to the financial statements is as follows:

ABC Corporation
Statement of Assets and Liabilities – Modified Cash Basis of Accounting
December 31, 2015

§80 – For the most part, the compilation standards a mostly unchanged from earlier standards.

Compilation remains an attest service, and thus determination of the accountant's independence is still required, and if not independent, the compilation report must disclose that fact. Reports are now required for all compilation engagements, since SSARS 21 eliminates the "management-use-only" compilation (under what was previously SSARS 8).

Probably the most evident change is the report, which was changed partially to distinguish the compilation report from the revised auditor's opinion and review report, both of which express some degree of assurance on the financial statements. Thus, there are no subheadings. The new report is as follows:

> Management is responsible for the accompanying financial statements of ABC Corporation, which are comprised of the balance sheet as of December 31, 2015, and the related statement of income, changes in stockholders' equity and cash flows for the year then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. We have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Standards Committee of the AICPA. We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.
>
> Signature
> City and state

Date of accountant's report

Additional paragraphs would be required when:

- The accountant is not independent
- Management elects to omit substantially all disclosures required
- There is a known departure from the financial reporting framework
- Supplementary information is presented

The following table compares attributes of the SSARS sections 70 and 80:

	Compilation (§80)	**Preparation (§70)**
When does the standard apply?	When the accountant is engaged to perform a compilation	When the accountant is engaged to prepare financial statements
Is an engagement letter required?	Yes	Yes
Is the accountant required to determine if he or she is independent?	Yes	No
If not independent, must that fact be disclosed?	Yes	N/A
Does the engagement require a report?	Yes	No[1]
May the financial statements go to users outside management?	Yes	Yes
May the financial statements omit notes?	Yes	Yes

§90 – This section provides that standards for performance of a review of financial statements, although an accountant may review other historical information (other than financial statements), such as specified elements, accounts or items of a financial statement, supplementary information, required supplementary information, and financial information included in a tax return.

The review report more closely resembles the auditor's report, as it now includes subheadings describing management's responsibility, the accountant's responsibility, and the limited assurance provided in the review.

For the most part, the revisions are principally the old review standards, redrafted for clarity, and very few changes.

[1] When the accountant is engaged to prepare financial statements, the accountant is required to include an adequate statement on each page of the financial statements indicating that no CPA provides any assurance on the financial statements. If the accountant is unable to do so, the accountant is required to issue a disclaimer on the financial statements

III. OFFICE **OF MANAGEMENT AND BUDGET**

Final revisions to Single Audit Requirements – Uniform Guidance: Cost Principles, Audit and Administrative Requirements for Federal Awards, Subpart F – Audit Requirements

On December 26, 2013, the OMB finalized revision to Circular A-133 that will provide substantial administrative relief to smaller entities who expend federal funds. The planned effective date is for periods beginning after December 2014. Major provisions of the revisions are as follows:

Streamlining of Related Circulars and Guidance. The revision streamlines eight existing OMB Circulars into one document (a total of 103 pages) including Circular A-133 and the various Cost Principles. Superseded documents include the following OMB Circulars:

- A-21, Cost Principles for Educational Institutions
- A-87, Cost Principles for State, Local, and Indian Tribal Governments
- A-89, Federal Domestic Assistance Program Information
- A-102, Awards and Cooperative Agreements with State and Local Governments
- A-110, Uniform Administrative Requirements for Awards and Other Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations
- A-122, Cost Principles for Non-Profit Organizations
- A-133, Audits of States, Local Governments and Non-Profit Organizations
- It will also supersede those sections of A-50, Audit Follow-Up, related to Single Audits

Single Audit Threshold for Audit Proposed to Increase to $750,000. Entities that expend less than $750,000 in federal awards would not be required to undergo a single audit. This would represent an increase from the current $500,000 threshold for single audits which was established in 2003. The guidance states that any entity that falls below the $750,000 threshold must make records available for review or audit by appropriate officials of the Federal agency, pass-through entity, and the Government Accountability Office.

Changes to the Major Program Determination Process - Type A/B Threshold. Key provisions of the major program determination process have been revised. For example, the minimum threshold for the Type A/B program determination was raised from $300,000 to $750,000. The uniform requirements now establish specific steps to follow, which incorporate the guidance below on establishing the high-risk type A and type B programs.

Changes to the Major Program Determination Process – High-Risk Type A Programs. The criteria for Type A programs to qualify as high-risk are being revised such that for a Type A program to be designated as high-risk it must have, in the most recent period, failed to receive an unqualified opinion; had a material weakness in internal control; or had questioned costs exceeding five percent of the program's expenditures.

Changes to the Major Program Determination Process - Type B Programs. The guidance reduces the number of high-risk Type B programs that must be tested as major programs from at least one-half to at least one-fourth of the number of low-risk type A programs. Additionally, small Type B programs would be considered those that are a flat 25% of the Type A/B program threshold.

Percentage of Coverage Changes. The percentage of coverage required in a single audit is reduced from the current 50% (normal) and 25% (low-risk auditees) to 40% (normal) and 20% (low-risk auditees).

Criteria for Low-Risk Auditee Status. The criteria for low-risk auditee status has been revised. For example, it would now more clearly include data collection form submission within required timeframes as a criteria and adds a criteria that the auditor did not report a substantial doubt about the auditee's ability to continue as a going concern. It also removes the previous options for waivers in this area.

Reduction in Types of Compliance Requirements to be Tested. The number of types of compliance requirements to be tested in a single audit is reduced from the current 14 types of compliance requirements to 6 types of compliance requirements. Those requirements include: (1) Activities Allowed or Unallowed and Allowable Costs/Costs Principles; (2) Cash Management; (3) Eligibility; (4) Reporting; (5) Subrecipient Monitoring; and (6) Special Tests & Provisions. The OMB may permit the federal agencies to request that certain of the deleted types of compliance requirements be added to the Special Tests & Provisions requirement for programs where they could be considered essential to the oversight of the program. This is not reflected in the revisions, but would be implemented through the first OMB *Compliance Supplement* to be issued after the change becomes effective.

Findings More detail will be required to be reported in auditor findings. However, the questioned cost threshold for reporting will be increased from $10,000 to $25,000.

Indirect Costs and Time and Effort Reporting A number of changes are being implemented in these complex areas that are expected to have impact on auditors performing single audits.

Responding to recent bad press? As (presumably) a result of scandals such as the General Services Administration and the Internal Revenue Service, “employee morale costs” are now nonallowable costs.

The Federal Register detailing the revisions can be located at:

http://www.gpo.gov/fdsys/pkg/FR-2013-12-26/pdf/2013-30465.pdf

2015 *Compliance Supplement*

Most of the changes to the 2015 *Compliance Supplement* relate to the programs added and deleted from the 2014 version. Other changes are identified in an Appendix and should be monitored to ensure that current requirements have been met.