



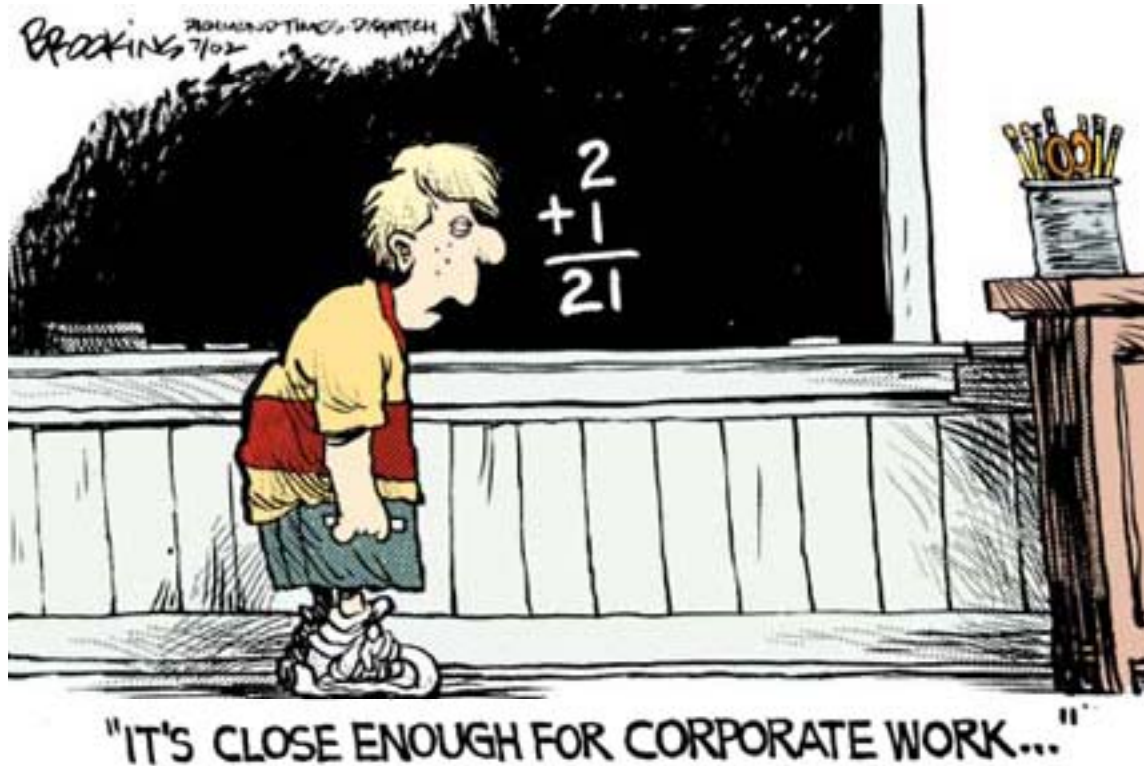
# **Virginia Government Finance Officers Association**

**2008 Spring Conference  
May 22, 2008  
Virginia Beach**

# **GASB Update—Spring 2008**

**Presented by  
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Richmond, VA**





**...and Wall Street work!!**



## **Session Topics**

### **Recent Standards**

**Effective for June 30, 2008:**

**GASB 43/45 Other Postemployment Benefits**

**GASB 48—Sales and Pledges of Receivables and Future Revenues**

**GASB 50—Pension Disclosures**

**Effective for later years:**

**GASB 49—Accounting and Financial Reporting for  
Pollution Remediation Obligations**

**GASB 51—Accounting and Financial  
Reporting for Intangible Assets**

**GASB 52---Land and Other Real Estate Held as Investments by  
Endowments**





## **Session Topics (Continued)**

# **Outstanding Exposure Drafts**

### **Accounting and Financial Reporting for Derivative Instruments**

- **Exposure Draft issued June 29, 2007**
- **Final Standard planned for June 2008**

### **Fund Balance Reporting and Governmental Fund Type Definitions**

- **Exposure Draft issued February 29, 2008**
- **Comment Deadline: June 30, 2008**



## **Session Topics (cont'd)**

# **Recent GASB Concepts Statements, Other Current Projects, and Research Projects**

**CONS 4—Elements of Financial Statements**

**Other Current GASB Projects:**

**Service Efforts and Accomplishments**

**Recognition and Measurement Attributes**

**GASB Research Projects**





## **Suggested Participant Goals for Session**

- **Gain overview understanding of requirements**
- **Know when standards become effective**
- **Anticipate how financial statement preparation and audit requirements may change**
- **Think about how financial statement preparers and audit teams should prepare**



## Effective Dates—June 30 FYE

### June 30, 2007

- Statement 27, Amortization period
- Statement 34, Retroactive infrastructure—Phase II
- Statement 43—Phase I

### June 30, 2008

- Statement 43—Phase II
- Statement 45—Phase I
- Statement 48
- Statement 50

### June 30, 2009

- Statement 43—Phase III
- Statement 45—Phase II
- Statement 49
- Statement 52

### June 30, 2010

- Statement 51 (with qualifications)
- Statement 45—Phase III





## **First Topic Area**

# **GASB Standards Effective for June 30, 2008**

- 1. Policies, procedures and systems should already be in place!**
- 2. What actions and activities will you personally need to carryout?**
- 3. Is your Government fully prepared?**



## **Other Postemployment Benefits**

**Statements 43 & 45 Improve Financial Reporting by:**

- 1. requiring systematic, accrual-basis measurement and recognition of OPEB cost over employees' years of service,**
- 2. providing information about actuarial accrued liabilities associated with OPEB,**
- 3. providing information on progress in funding**



## **GASB 45 Objectives**

**To faithfully represent the financial effects of the underlying financial transaction that creates OPEB**

The Board concluded that the underlying transaction is an **exchange transaction between an employer and employees in which an employer:**

- **Acquires employee services, *for which it***
  - Pays or provides **salaries, active-employee healthcare, etc., and promises to pay or provide after employment a pension and OPEB such as retiree healthcare, all as components of a total compensation package**



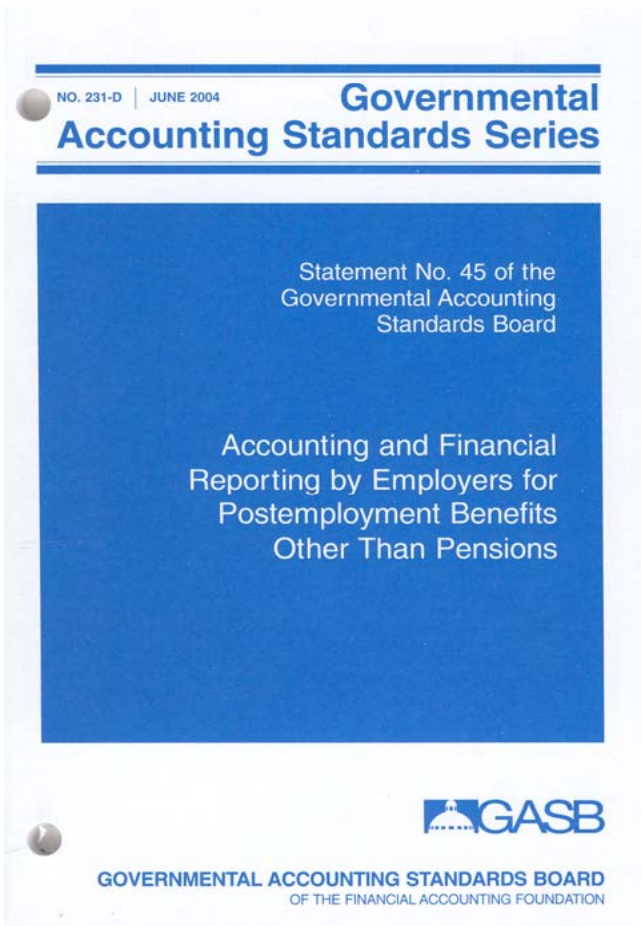
## **“Postemployment Benefits” As Defined in GASB Statements**

**“Postemployment benefits”—benefits provided after separation from employment as part of the total compensation for services, including:**

- **Pension benefits—**
  - Retirement income
  - Other benefits (except postemployment healthcare) if provided through a defined benefit pension plan
- **Other postemployment benefits (OPEB)—**
  - Postemployment healthcare benefits
  - Other forms (for example, life insurance) if provided separately from a defined benefit pension plan



## Statement 45 (for Employers)



**Subject: accounting and reporting by employers for their OPEB expenses and obligations (does not require funding)**

**Applies to all employers that provide OPEB (that is, the employer pays all or part of the cost of the benefits, including implicit rate subsidies)**

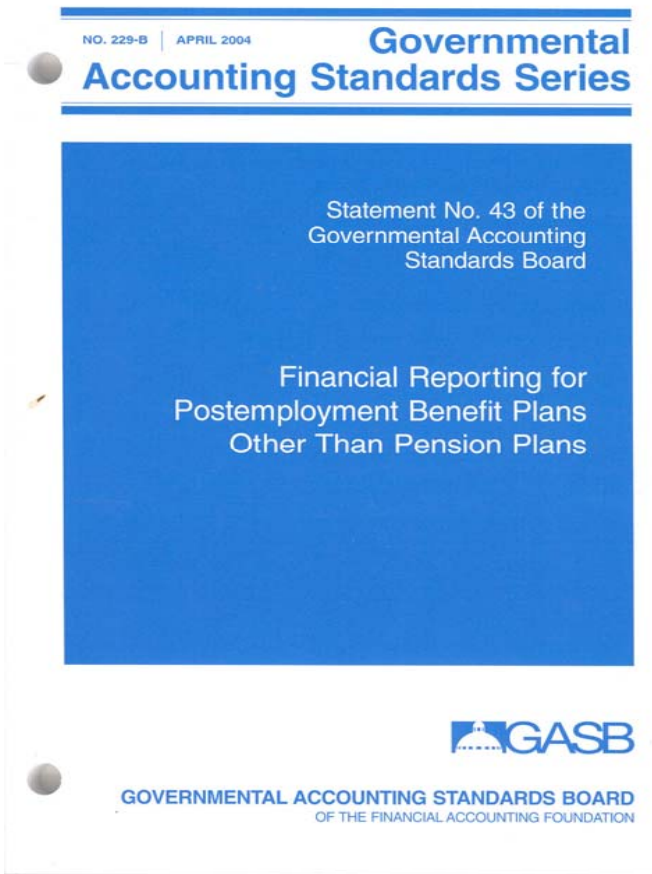
**Requires accrual-basis accounting for expense**

**Requires measurement and disclosure of actuarial accrued liabilities and funded status (UAAL)**





## Related Statement: Statement 43 (for Plans)



**Subject: reporting on stewardship of plan assets by**

- a. trustee or plan administrator that is a governmental entity (stand-alone plan reporting) or**
- b. an employer or plan sponsor with a fiduciary responsibility for the plan assets that includes the plan as a trust or agency fund in its own financial report**

**Includes provisions for reporting of**

- a. plans administered as trusts and**
- b. multiple-employer plans that are not administered as trusts**





## OPEB “Plan”— Predominant Meanings in Statements 45 and 43

### In Statement 45 (employer reporting):

- **“Plan” usually refers to an employer’s substantive commitment or agreement to provide OPEB—including, for example, provisions or understandings regarding plan membership, eligibility for benefits, types of benefits, points at which benefits will begin and end, and method of financing benefits**

### In Statement 43 (plan reporting):

- **“Plan” usually refers to a trust or agency fund used to administer the financing of OPEB and the payment of benefits (that is, to assets under the stewardship of an administering entity)—regardless of the financing policy adopted**



## The Substantive Plan

**Benefits should be projected based on the current substantive plan (the plan as understood by the employer and plan members), including changes made and communicated to plan members, at the time of the actuarial valuation**

**Anticipated future changes in plan design should not be included in the projection of benefits**

**A legal or contractual benefit cap (as distinguished from a cap on contributions), should be considered in the projection of benefits if the cap is deemed effective**



## Implicit Rate Subsidies

**An employer's commitment to permit retirees to participate in the same group as active employees by paying the blended premium involves a real cost to the employer**

- **For example, if claims costs are \$6,000 per retiree, and the retiree pays a blended premium of \$3,600, the employer generally pays the difference, or \$2,400 per retiree**

**The preceding is a function of the significant effect of age on claims costs (that is, claims costs for retirees in a combined group generally will be significantly higher than claims costs for active employees in the group)**



## **Statement 45: Broad measurement steps**

- a. Project cash outflows for benefits**
- b. Discount projected benefits to present value (PV)**
- c. Allocate the PV of projected benefits to periods using an acceptable actuarial cost method**

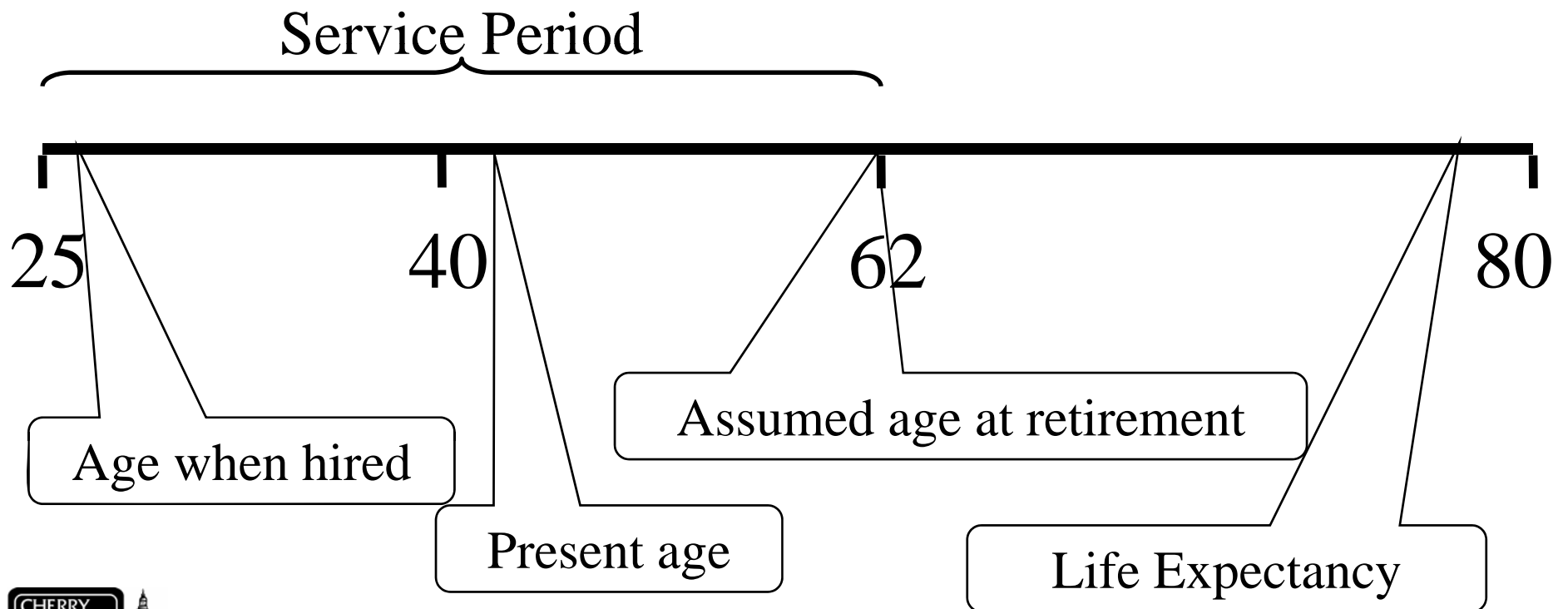
### **Items to consider:**

- Experience rate**
- Remaining service lives of employees**
- Funding policy**



## Measurement approach illustrated

### Employee Age Timeline





## Annual OPEB Cost and Net OPEB Obligation: Illustration (Employer in Year 2 of Applying Statement 45)

<b>Normal cost (current service cost)</b>	<b>350,000</b>
<b>Amortization of the UAAL (for past services)</b>	<b><u>600,000</u></b>
Annual required contribution (ARC)*	950,000
<b>Interest on beginning net OPEB obligation*</b>	<b>50,000</b>
<b>ARC adjustment*</b>	<b><u>(58,500)</u></b>
Annual OPEB cost* = expense	941,500
<b>Actual employer contribution* (PAYGO method of financing)</b>	<b><u>(250,000)</u></b>
<b>Increase in net OPEB obligation*</b>	<b>691,500</b>
Net OPEB obligation—beginning*	<u>650,000</u>
Net OPEB obligation—ending*	<b><u>1,341,500</u></b>

\* The ARC, the annual OPEB cost and its components, actual employer contributions, and changes in the net OPEB obligation are required to be disclosed in the employer's notes to the financial statements.



## What Does the UAAL Tell Me as a Reader of the Financial Report?

**The UAAL is the portion of the present value of projected benefits attributed to past periods**

**It can be thought of as a measure of the value of employee services that were received by the employer and tax/rate payers or constituents in past periods but not paid or funded**

**Other things being equal, the higher the UAAL, the higher will be the following going forward:**

- **Amortization component of the ARC**
- **The ARC**
- **Annual OPEB cost, or expense**
- **Demands on future cash flows, or budgets**



## **Sales and Pledges of Receivables and Future Revenues**

**Statement 48 Improves Financial Reporting By:**

- 1. Establishing consistent measurement, recognition, and disclosure requirements.**
- 2. Contributing to the measurement and reporting of interperiod equity through accounting for sales of future revenues on a deferral basis**



## Sales and Pledges

**Standard Focuses on when:**

**Governments receive proceeds in exchange for the rights to future cash flows from:**

- **Receivables:**
  - Delinquent property taxes
  - Uncollected fines
  - Mortgages
  - Student loans
- **Future revenues**
  - Tobacco settlement revenues



## **Sales and Pledges**

### **Key Accounting Issue:**

**Is the Transaction a Sale or Borrowing?**

### **Standard's Guidance:**

**Borrowing by default, unless specific criteria are met relating to continuing involvement and control (i.e.)**

- **Does the transferor government retain control, or is control relinquished? With separate criteria established for:**
  - receivables
  - future revenues



## Receivables Continuing Control Questions

Are *receivables* sold or pledged?

Is the transferee able to sell or pledge?

Are the receivables and cash collected *isolated* from seller (and its creditors)

- Legally separate
- No access to cash
- Source and timing of payments
- Satisfaction of accounts
- Bankruptcy protection

No **option or ability** to replace or repurchase accounts



## Receivables Sale as a Borrowing

If sale criteria are not met then the transaction is a collateralized borrowing, with the following requirements:

### Pledging government:

- Does not de-recognize receivables
- Recognizes liability for the proceeds received
- Payments reduce liability (G/F expenditure)

Transferee government recognizes a receivable



## Recording “Sale” of Receivables

**If the conditions for sale treatment are met:**

### **Selling government:**

- **De-recognizes receivables**
- **Recognizes revenue/gain (loss) in the government-wide statements or enterprise funds for the difference between proceeds and carrying value.**
- **Proceeds are recognized as revenue in governmental funds (net carrying value assumed to be zero)**

### **Purchasing government:**

- **Intra-entity--Purchased receivables are reported at carrying value**
- **Outside of the reporting entity--receivables at cost**





# Future Revenues Continuing Control Questions

Are *future revenues* sold or pledged?

Is the transferee able to sell or pledge?

Does the transferor continue to have *active* involvement in the generation of the revenues?

- **By nature, own-source revenues involve continuing active involvement. e.g.**
  - Taxes
  - User charges
- **Some grants, entitlements, shared revenues, rents, royalties may meet the criteria for sale treatment, depending on *active* involvement**



## **Future Revenues Sale as a Borrowing**

**If sale criteria are not met then the transaction is a collateralized borrowing, with the following requirements:**

### **Pledging government:**

- **Continues recognition of revenues pledged**
- **Recognizes liability for the proceeds received**
- **Payments reduce liability (G/F expenditure)**

**Transferee government recognizes a receivable**



## Recording “Sale” of Future Revenues

If the conditions for sale treatment are met:

**Selling government:**

- Has no asset to de-recognize for future revenues
- Proceeds will usually be recognized as deferred revenue and amortized over the life of the agreement
  - Deferral depends on *why* revenue had not been previously recognized by the seller

**Purchasing government:**

- Intra-entity--Payment to selling government for rights to future revenues is reported as a deferred charge (and amortized)
- Outside of the reporting entity--asset (rights) reported at cost

**Applied prospectively**



## **Pension Disclosures**

**Statement 50 Improves Financial Reporting By:**

- 1. Improving the transparency and usefulness of pension related financial reporting, and**
- 2. Conforming Statements 25 and 27 to the applicable note disclosure and RSI modifications adopted in OPEB Statements 43 and 45**



## Pension Disclosures

**Note disclosure and RSI requirements in Statements 25 & 27 are generally parallel to those in Statements 43 & 45; however, those for OPEB are stronger on some points**

**Accordingly, the Pension Standards were modified.**



## **Second Topic Area**

# **GASB Standards Effective for Years Ending June 30, 2009 and 2010**

**1. Have you determined if these new standards will apply to your government?**

**2. When will you begin planning for required changes in policies, procedures, and systems?**



# **Accounting and Financial Reporting for Pollution Remediation Obligations**

**Statement 49 Improves Financial Reporting By:**

- 1. Enhancing comparability between governments**
- 2. Displaying previously unreported obligations**
- 3. Requires reporting obligations when “reasonably estimable” rather than when “judged probable of occurrence (under SFAS 5)**



## Types of Remediation Obligations

- **Pre-cleanup activities: site assessment, feasibility study, design**
- **Cleanup activities: neutralization, containment, disposal activities**
- **Oversight and enforcement costs**
- **Operation and maintenance of the remedy and monitoring**



## Recognition Threshold

One of more components of a pollution remediation obligation are recognizable as a liability when both . .

- An entity knows or reasonably believes that a site is polluted, and
- One of five obligating events occurs



## **Obligating Events Occur When a Government**

- 1. Is compelled to take remediation action because of pollution-caused imminent endangerment**
- 2. Violates a pollution-prevention permit**
- 3. Is named, or evidence indicates govt. will be named, as responsible party or potentially responsible party (PRP) for remediation**



## Obligating Events Occur When a Government

**4. Is named, or evidence indicates government will be named, in lawsuit to remediate**

- **Excludes lawsuits having no merit**

**5. Commences, or legally obligates self to commence, remediation**

- **Limited to portion legally required to complete**



## Recognition Guidance

**Requires a component approach:**

- **Recognize components of liability as they become reasonably estimable**
- **Recognition benchmarks include:**
  - **Receipt of administrative order**
  - **Participation in site assessment or investigation**
  - **Completion of corrective measures feasibility study**
  - **Issuance of authorization to proceed by regulatory body**
  - **Remediation design, implementation, operation and monitoring**

**Liabilities should be measured :**

**At current value, not present value**

**By utilizing the expected cash flow technique**



# **Accounting and Financial Reporting for Intangible Assets**

## **Statement 51 Improves Financial Reporting By:**

- 1. Reducing inconsistencies in reporting**
- 2. Clarifying the classification of intangibles as capital assets**
- 3. Establishing authoritative guidance for internally generated intangible assets (e.g. computer software)**
- 4. Improving comparability between governments and the reasonableness of period costs for usage of service capacity**



## Introduction

Intangible assets were included in description of capital assets in GASB 34

However, inconsistency in practice developed on how intangible assets are treated for accounting and financial reporting. For example, whether:

- As capital assets
- As intangible assets as considered in APB 17
- Or expensed in period that costs are incurred



## Definition

**For purposes of the Statement 51, intangible assets are assets that possess the following characteristics:**

- **Lack of physical substance**
- **A Non-financial nature**
- **Initial useful life extending beyond a single reporting period**

**Examples may include:**

- **Easements (right-of-way, permissive, restrictive)**
- **Land use rights (water, timber, mineral, air rights)**
- **Computer software**
- **Patents, trademarks, copyrights**
- **Licenses, permits and other rights**



## **Classification**

**All intangible assets subject to provisions of the Statement should be classified as capital assets**

**Existing guidance related to capital assets should be applied to intangible assets as appropriate:**

- **Recognition**
- **Measurement**
- **Depreciation (amortization for intangibles)**
- **Impairment**
- **Presentation**
- **Disclosure**

**The Statement provides guidance specific to intangibles that should be applied in addition to, or in lieu of if appropriate, capital asset guidance (e.g. internally generated assets)**



## Internally Generated

**Outlays incurred related to an internally generated intangible asset that is considered identifiable should be capitalized only upon the occurrence of all of the following:**

- **Determination that an objective for the project is to create a specific internally generated intangible asset;**
- **Determination of the nature of the service capacity that is expected to be provided by the asset upon its completion;**
- **Demonstration of the technical or technological feasibility for completing the project so that the asset will provide its expected service capacity;**
- **Demonstration of the current intention, ability, and presence of effort to complete or, in the case of a multiyear project, continue development of the intangible asset.**



## Recognition

**An intangible asset should only be recognized if it is identifiable.**

**That is:**

- **The asset is separable from the government; or**
- **The asset arises from contractual or other legal rights, regardless of whether rights are separable**



## **Land and Other Real Estate Held as Investments by Endowments**

### **Statement 52 Improves Financial Reporting By:**

- 1. Aligning valuations with purpose of endowment funds.**
- 2. Promoting comparability among similar entities.**
- 3. Facilitating evaluation of investment performance.**



## **Third Topic Area GASB Exposure Drafts**

- 1. Does your government engage in the use of derivatives?**
- 2. Will you submit a letter of comment regarding the reporting of fund balances in Governmental Funds?**



# Accounting and Financial Reporting for Derivative Instruments

**Issued as an Exposure Draft in June 2007**

- **Anticipated Final Standard – June 2008**
- **Anticipated Effective Date – reporting periods beginning after June 15, 2009**



# What is a Derivative Instrument for Financial Reporting Purposes?

## A derivative instrument has:

- One or more reference rates (underlyings) and one or more notional amounts
- Leverage
- Net settlement



## Examples of Derivatives

### Interest rate swap

- Variable-rate to fixed-rate
- Fixed-rate to variable-rate

### Basis swap

- Exchange payments based on the changes of two variable rates

### Swaption

- Gives the purchaser of the option the right, but not the obligation, to enter into an interest rate swap

### Commodity swap

- Reduce exposure to a commodity's price risk



# Proposed Accounting

## Fair value with hedge accounting

- **Derivative instruments would be measured on the statement of net assets at fair value**
- **Fair value changes would be reported on the “change statement” as investment income**
- **Exception: HEDGES!**
  - **Changes in fair value of derivative instruments would be reported on the balance sheet as deferrals—either deferred charges or deferred credits, e.g.**
    - **Swap asset, deferred inflows**
    - **Swap liability, deferred outflows**



## Hedge Effectiveness Tests Must Be Applied

These tests include:

- a. Consistent critical terms**
- b. Quantitative techniques:**
  - **Synthetic instrument**
  - **Dollar offset**
  - **Regression**
  - **Other qualifying methods**



# Fund Balance Reporting and Governmental Fund Type Definitions



## **Fund Balance Components**

**The ED propose two categories of fund balance:**

**Nonspendable**  
**Spendable**



## Fund Balance Components

**Nonspendable Fund Balance includes amounts that cannot be spent because they are either:**

- **Not in spendable form (e.g. inventories and prepaid items) or are**
- **Legally or contractually required to be maintained intact (e.g. the corpus of a permanent fund)**



## Fund Balance Components

**Spendable fund balance includes the following classifications:**

- **Restricted**
- **Limited**
- **Assigned**
- **Unassigned**



## Fund Balance Components

### Restricted Fund Balance:

Amounts that are restricted to specific purposes, pursuant to the definition of *restricted* in paragraph 34 of Statement 34, as amended by Statement No. 46.

- External parties
- Constitution
- Enabling legislation

May include “Rainy Day Reserves”



## Fund Balance Components

### Limited Fund Balance:

**Amounts that are committed for specific purposes by formal action of the government's highest level of decision-making authority.**

**May include “Rainy Day Reserves”**



## Fund Balance Components

### Assigned Fund Balance:

Amounts that are *intended* by the government to be used for specific purposes, but are neither restricted nor limited.

- All amounts in other governmental funds not restricted or limited.
- Amounts in general fund intended for specific use



## Fund Balance Components

### Unassigned Fund Balance:

#### Residual classification for the general fund

- Has not been assigned to other funds and is not restricted, limited, or assigned to specific purposes within the general fund.
- Residuals for expired purposes in other funds
- May include “Rainy Day Reserves” not reported elsewhere



## The ED: Spendable and Nonspendable categories

	General Fund	Major Special Revenue Funds		Major Debt Service Fund	Major Capital Projects Fund	Other Funds	Total
		Highway Fund	School Aid Fund				
Fund balances:							
<b>Non-Spendable:</b>	125,000	108,000	16,000			164,000	413,000
<b>Spendable:</b>							
<b>Restricted for:</b>							
Social services	240,000	—	—	—	—	—	240,000
Parks and recreation	80,000	—	—	—	—	—	80,000
Education	55,000	—	—	—	—	—	55,000
Highways	—	—	—	—	444,000	—	444,000
Pothole repairs	—	24,000	—	—	—	—	24,000
Debt service reserve	—	—	—	206,000	—	—	206,000
School construction	—	—	—	—	301,000	—	301,000
Law enforcement	—	—	—	—	—	214,000	214,000
Other capital projects	—	—	—	—	51,000	—	51,000
Other purposes	30,000	—	—	—	—	—	30,000
<b>Limited to:</b>							
Regulatory boards	16,000	—	—	—	—	—	16,000
Economic Stabilization	210,000	—	—	—	—	—	210,000
Municipal Bond Bank Activities	110,000	—	—	—	—	—	110,000
Education	50,000	—	103,000	—	—	—	153,000
Health and Welfare	75,000	—	—	—	—	—	75,000
<b>Assigned to:</b>							
Parks and recreation	50,000	—	—	—	—	—	50,000
Library acquisitions	50,000	—	—	—	—	—	50,000
Highway resurfacing	—	258,000	—	—	—	—	258,000
Debt service	—	—	—	306,000	—	—	306,000
Public pool	—	—	—	—	121,000	—	121,000
City Hall renovation	—	—	—	—	60,000	—	60,000
Other capital projects	50,000	—	—	—	471,000	—	521,000
Other purposes	80,000	—	73,000	—	—	176,000	329,000
<b>Unassigned:</b>	525,000	—	—	—	—	—	525,000
Total fund balances	1,746,000	390,000	192,000	512,000	1,448,000	554,000	4,842,000

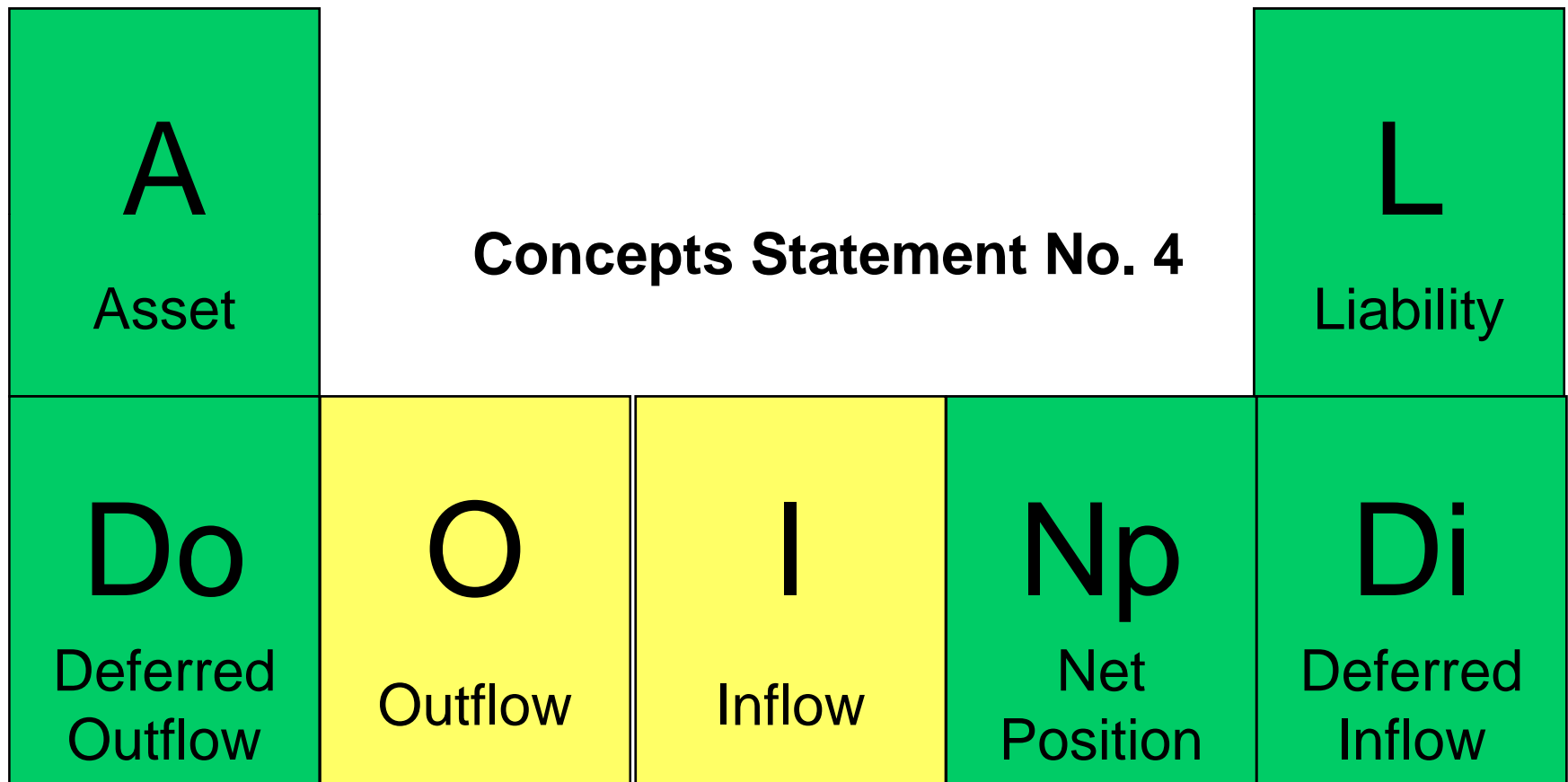


## **Fourth Topic Area Recent GASB Concepts Statement, Other Current Projects and GASB Research Projects**

- 1. How might this apply to your Government?**
- 2. Will the issues raised be important to the users of your Government's financial statements?**



# **GASB's Periodic Table of Elements of Financial Statements**





## Other Current Projects

### Service Efforts and Accomplishments Reporting

- **Concepts 2 update – ED in 1<sup>st</sup> quarter 2008**
- **Guidelines – due process document in 2<sup>nd</sup> quarter 2008**
- **Project scope – reporting, guidelines, GASB’s role**
- **Not-in-scope – establishing performance measures, benchmarks, or reporting standards**

### Concepts Statements

- **Recognition and Measurement Attributes**
  - **Deliberations to begin later this year**
  - **Includes focus on purpose and value of “funds”**



## Research Agenda

- **Economic Condition Reporting, including Intergovernmental Financial Dependency Risk**
- **Electronic Financial Reporting**
- **Pension Accounting and Reporting**
- **Public and Private Partnerships**
- **Reporting Units/Statement 14 Revisited**
- **AICPA Omnibus – accounting guidance currently presented only in SASs.**
- **Investment Omnibus**



# What questions do you have?



**Appreciation is expressed to the Governmental Accounting Standards Board for permission to use selected materials from its library of public educational presentations.**

**Official positions of the GASB are determined only after extensive due process and deliberation and are only published in its formal Statements and Interpretations.**



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