2016 Governmental GAAP Update

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Recent GASBs Applicable For 2016 and Beyond

Recent GASBs

- **GASB Pronouncements through February 2016:**
  - Fair Value Measurement and Application (GASB #72)
  - Accounting and Financial Reporting for Pensions that are Not Within Scope of GASB #67/68 (GASB #73)
  - Financial Reporting for Postemployment Benefit Plans Other Than Pensions (GASB #74)
  - Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (GASB #75)
  - The Hierarchy of GAAP for State and Local Governments (GASB #76)
  - Tax Abatement Disclosures (GASB #77)
  - Pensions Provided through Certain Multiple-Employer Defined Benefit Plans (GASB #78)
  - Certain External Investment Pools and Pool Participants (GASB #79)
  - Blending Requirements for Certain Component Units (GASB #80)

GASB Statement No. 72 – Fair Value Measurement and Application (“GASB #72”)

GASB #72

- Effective for periods beginning after June 15, 2015 (FY 2016).
- The purpose was to provide guidance for determining a fair value measurement for financial reporting purposes and to provide guidance for applying fair value to certain investments and disclosures related to all fair value measurements.
- Minimal impact to state and local governments ("SLG") in our state due to the investment requirements of the SC Code of Laws.
- Early implementation is encouraged.

GASB #72

- Definition of fair value:
  - The price that would be *received to sell an asset* or *paid to transfer a liability* in an orderly transaction between market participants at the measurement date
    - *Exit* price vs. *entry* price
    - Market-related vs. entity specific
  - Consistent with GASB Concepts Statement No. 6, *Measurement of Elements of Financial statements*, and other standard-setting bodies (i.e. FASB, etc.)
  - No new items are required to be reported at fair value due to this Statement.

GASB #72

- Exit Price:
  - Excludes transaction costs
  - Includes transportation costs
    - If location is a characteristic of the asset (commodity)
    - If costs incurred to transport from current location to principal or most advantageous market

GASB #72

- Market-Related:
  - Financial assets
    - Principal market - typically the market in which the government would normally enter into a transaction
    - Most advantageous market (if no principal market) - determination takes into account both transaction and transportation costs
  - Nonfinancial assets
    - Highest and best use that maximizes the items value regardless of the market participant that would achieve that use. Must consider whether it is (a) physically possible, (b) legally permissible (current zoning), and (c) financially feasible.

GASB #72

- Three Approaches to Fair Value:
  - Market approach
    - Based on market transactions involving identical or similar assets and liabilities
      - Quoted prices from an active market
      - Market multiples (price earnings ratios of similar companies)
      - Matrix pricing
  - Cost approach
    - Based on amount required currently to replace present service capacity of an asset
  - Income approach
    - Based on related future amounts converted to a single amount
      - Present value of projected cash flows
      - Option pricing models

GASB #72

- Type of Inputs:
  - *Observable* inputs (independently verifiable)
  - *Unobservable* inputs
- Basic principle: maximize use of observable inputs and minimize use of unobservable inputs
- Hierarchy of Inputs (very similar to FASB #157):
  - Level 1 inputs – (highest quality)
    - Most local government investments in South Carolina
  - Level 2 inputs
  - Level 3 inputs – (lowest quality)
    - Would primarily relate to non-traditional and alternative investments (pension plan)

GASB #72

- Basis of Investment Classification:
  - Level 1 – *Directly observable* inputs
    - Quoted prices in active markets for identical assets or liabilities
  - Level 2 – Inputs *observable* for the asset or liability either *directly or indirectly*
    - Quoted price for similar assets or liabilities in active markets
    - Quoted prices for identical or similar assets or liabilities in markets that are not active
    - Other observable inputs (yield curves, credit spreads)
    - Market-corroborated inputs (by observable data, correlation, or other means)

GASB #72

- Basis of Investment Classification (Continued):
  - Level 3 – *Unobservable* inputs
    - Begin with internally generated data
      - Adjust for factors as would other market participants and for something only available to the entity (an entity-specific synergy)

GASB #72

- Generally applicable to investments (including restricted investments)
  - An investment is a security or other asset that a government *holds primarily* for the purpose of *income or profit*, and its present service capacity is based solely on its ability to generate cash or to be sold to generate cash.
    - Purpose determined by government's own usage
    - Result can be different determinations by different governments
  - Investments exclude student loan receivables, mortgage loan receivables, and property held to preserve the natural environment (even if related rights sold to generate income (i.e. timber)).

GASB #72

- Exceptions to Fair Value:
  - **Money market investments** and **participating interest-earning investment contracts** with a remaining maturity at purchase of one year or less (held by entities other than external investment pools)
  - Investments in **2a7-like pools**
  - Investments in **life insurance** (use cash surrender value)
  - Investments in **common stock** that meet the criteria for applying the equity method of accounting
  - **Nonparticipating interest-earning investment contracts, unallocated insurance contracts,** and **synthetic guaranteed investment contracts** that are fully benefit responsive
- Special Cases:
  - Investments in a nongovernmental entity without a readily determinable fair value may use net asset value (NAV) per share (or its equivalent)

GASB #72

- Fair Value versus Acquisition Value:
  - Fair value = *exit* price
  - Acquisition value = *entry* price
- Change from fair value to acquisition value for:
  - Donated capital assets
    - Including works of art, historical treasures, and similar assets
  - Capital assets received in a service concession arrangement

GASB #72

- Note Disclosures:
  - Applicable to both recurring and nonrecurring fair value measurements
    - Fair value at the end of the reporting period
    - Level of inputs used
    - Description of valuation techniques used
      - Including any change in a technique and reason for the change (if result is significantly impacted)
    - The effect on investment income for the reporting period for assets with fair value measurements made using Level 3 inputs.
  - The reason for nonrecurring fair value measurements (capital asset impairment)
  - Certain specific disclosures for investments in entities that calculate NAV per share (or its equivalent)

GASB Statement No. 73 – Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB #67/68 ("GASB #73")

GASB #73

- Effective Date:
  - Plans not administered through trusts
    - Fiscal year ending 6/30/17
  - Amendments to GASB #67/68
    - Fiscal year ending 6/30/16
- The purpose was to establish a single framework for the presentation about pensions (defined benefit and defined contribution pension plans).
- Minimal impact to state and local governments ("SLG") in our State as very few pension plans are setup this way.
- Early implementation is encouraged.

GASB #73

- GASB #67/68 applied to Plans administered through trusts or *equivalent arrangements*:
  - Contributions are irrevocable
  - Assets may be used only to provide pensions to plan members in accordance with plan terms
  - Legally protected from creditors

GASB #73

- Applies to Pension arrangements not administered through a trust or equivalent arrangement
  - Same objectives as other pension arrangements
  - Only difference = no fiduciary net position ("FNP")
- Conclusion
  - Apply the provisions of GASB 67 and GASB 68 accordingly
    - No netting of related assets against employer liability
      - *Total* pension liability vs. *net* pension liability
    - Use discount rate for an unfunded liability
      - High-grade municipal rate

GASB #73

- Treatment of Assets
  - Employers
    - Single-employer plan
      - Report as employer assets in the appropriate fund.
    - Multiple-employer plan
      - Report employer's proportionate share of accumulated resources as employer assets in the appropriate fund.
  - Assets Held for Others in Fiduciary Capacity
    - Report in an agency fund (much like OPEB)

GASB #73

- Key Technical Amendments to GASB #67/68
  - Notes to the RSI Pension Schedules
    - Original requirement
      - Information about investment-related factors that significantly affect trends in the amounts reported
    - Clarifying amendment
      - Limited to those factors over which the pension plan or participating governments have influence
        - Changes in investment policies? Yes
        - Changes in market prices? No
  - Special Funding Situation
    - Recognize revenue in the reporting period in which the contribution of the nonemployer contributing entity is reported as a change in the net pension liability (or collective net pension liability)

GASB Statement No. 74 – Financial Reporting for Postemployment Benefit Plans Other Than Pensions ("GASB #74")
GASB Statement No. 75 – Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions ("GASB #75")

GASB #74/75

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

GASB #74/75

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

GASB #74/75

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

GASB #74/75

- Current Employer Liability:

  Annual Required Contribution (ARC)

  <u>Less: Actual Contributions</u>

  Net OPEB Obligation (NOO)

- New Employer Liability:

  Total OPEB Liability (TOL)

  <u>Less: Fiduciary Net Position (FNP)</u>

  Net OPEB Liability (NOL) *

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

GASB #74/75

EMPLOYER LIABILITY ILLUSTRATION

Current Guidance - Funding Method

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

New Guidance - Total Cost Method

	Total OPEB Liability (TOL)	$ 10,000,000
Less:	Fiduciary Net Position (FNP)	(5,000,000)
	Net OPEB Liability (NOL)	$ 5,000,000

Liability Reported by Employer:

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

GASB #74/75

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

GASB #74/75

Components of OPEB Expense

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

GASB #74/75

Discount Rate

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

GASB #74/75

Actuarial Method

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

GASB #74/75

Amortization

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

GASB #74/75

Amortization (Continued)

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

GASB #74/75

Amortization (Continued)

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

GASB #74/75

Disclosures and RSI

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

GASB Statement No. 76 – The Hierarchy of GAAP for State and Local Governments ("GASB #76")

GASB #76

- Effective for periods beginning after June 15, 2015 (FY 2016) and should be applied retroactively.
- The purpose was to clearly identify the hierarchy of generally accepted accounting principles.
- Early implementation is permitted.

GASB #76

- Current hierarchy - four levels of GAAP under GASB #55:
  - GASB Statements and Interpretations.
  - GASB Technical Bulletins and (a) AICPA Industry Audit, (b) AICPA Accounting Guides, and (c) AICPA Statement of Positions if specifically made applicable to state and local governments and cleared by the GASB.
  - AICPA Practice Bulletins (if specifically made applicable to state and local governments and cleared by the GASB).
  - Implementation Guides published by the GASB staff as well as practices that are widely recognized and prevalent in state and local governments.

GASB #76

- New hierarchy – two levels of GAAP:
  - Category A – requires GASB approval:
    - GASB Statements and Interpretations (including codification)
  - Category B – requires GASB clearance:
    - GASB Technical Bulletins, GASB Implementation Guides, and applicable AICPA literature cleared by the GASB
- No future GASB Interpretations as this role will be filled by statements/technical bulletins
- All other accounting literature and resources are no longer authoritative

GASB Statement No. 77 – Tax Abatement Disclosures ("GASB #77")

GASB #77

- Effective for periods beginning after December 15, 2015 (CY 2016 and FY 2017).
- The purpose was to provide users of the financial statements with needed information about certain limitations on a government's ability to raise resources. 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.
- Requires only note disclosures if significant tax abatements exist.
- Early implementation is permitted.

GASB #77

- "Opportunity cost" of foregoing the collection of taxes for which you would have otherwise been entitled to
- Subcategories - tax exemptions, tax deductions and *tax abatements*
- Definition of a Tax Abatement:
  - A reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments

GASB #77

- Type of revenue
  - A *tax* (*not* a fee or charge for service) - a nonexchange revenue
- Existence of an agreement
  - Identifiable agreement with a specific individual or entity
    - Government or another government promises to reduce the counterparty's tax liability
    - The counterparty promises to take certain actions
  - Must *precede* any reduction in taxes
    - Does not have to be in writing
    - Does not have to be legally enforceable
- Purpose
  - To promote economic development or otherwise benefit the government or its citizens

GASB #77

Note Disclosures

- Distinguish:
  - Government's own agreements
  - Agreements of others that reduce the government's revenue
- Individual display must be based on a quantitative threshold
  - Different thresholds may be used for government's own agreements and agreements of others
- Required only as long as abatements are outstanding
- Governments are *not* required to present information if they are legally prohibited from doing so (although that fact must be disclosed)

GASB #77

Note Disclosures (Continued)

- Agreements of the government organized by major tax abatement program:
  - Names and purposes of tax abatement programs
  - Specific taxes being abated
  - Authority for entering into the tax abatement agreement
  - Eligibility criteria for recipients
  - Abatement mechanism
    - How taxes are reduced (reduction of tax liability, rebate, reduction of assessed value)
    - How the amount is determined (specific dollar amount or percentage of taxes owed)
  - Provisions for recapturing abated taxes ("claw-back" provisions) and the conditions for recapture
  - Type of commitments made by recipients

GASB #77

Note Disclosures (Continued)

- Agreements of the government organized <u>by major tax abatement program (Continued)</u>:
  - Gross dollar amount of revenue reduction in period (accrual basis)
  - If amounts received/receivable from other governments
    - Names
    - Authority
    - Dollar amount received/receivable
  - Commitments in addition to tax reduction (until fulfilled)
    - Types
    - Most significant individual commitments
  - If agreements are disclosed individually, a brief description of the quantitative threshold used to determine which agreements to disclose
  - Description of general nature of information omitted because of legal prohibition and specific source of latter

GASB #77

Note Disclosures (Continued)

- Agreements of others that reduce the government's revenue <u>organized by government and specific tax abated:</u>
  - A brief description that includes:
    - Names of governments
    - Specific taxes being abated
  - Gross dollar amount of revenue reduction in period (accrual basis)
  - If amounts received/receivable from other governments
    - Names
    - Authority
    - Dollar amount received/receivable
  - If agreements are disclosed individually, a brief description of the quantitative threshold used to determine which agreements to disclose
  - Description of general nature of information omitted because of legal prohibition and specific source of latter

GASB #77

Note Disclosures (Continued)

- Discretely Presented Component Units
  - Essential to fair presentation?
    - Yes – then disclose like an agreement of the government
    - No – then disclose like an agreement of another government

GASB Statement No. 78 – Pensions Provided through Certain Multiple-Employer Defined Benefit Plans (“GASB #78”)

GASB #78

- Effective for periods beginning after December 15, 2015 (CY 2016 and FY 2017).
- The purpose was to address a particular practice issue encountered when applying GASB #68. The issue was associated with certain pensions provided through certain multiple-employer defined benefit pension plans.
- Practically no impact within our State as it addresses some unique circumstances in other states.
- Early implementation is encouraged.

GASB #78

Issue

- GASB #68 covers all employer pension benefits administered through a trust or equivalent arrangement
- Some multiple-employer plans that are used to provide benefits to government employees are *not* themselves state or local government plans
  - Taft-Hartley plans and similar arrangements
- It may be difficult to obtain the necessary information to comply with GASB #68 if the government itself (or some combination of governments) is *not* the predominant employer
  - Governments typically are only a small subset of all participating employers

GASB #78

Solution

- Exclude qualifying plans from the scope of GASB #68
- Mandate treatment similar to that used for employers participating in cost-sharing plans prior to GASB #68
  - Report required employer contributions related to the period as pension expense/expenditure
  - Report liability for deficiencies in required employer contributions

GASB Statement No. 79 – Certain External Investment Pools and Pool Participants ("GASB #79")

GASB #79

- Effective for periods beginning after June 15, 2015 (FY 2016) with additional six months for certain credit risk requirements.
- The purpose was to provide criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost, instead of relying on SEC rule 2a7.
- May result in some additional note disclosures for external investment pools and pool participants.
- Early implementation is encouraged.

GASB #79

- Amortized cost would be expected to approximate fair value for money market funds
  - Nature of money market investments limits deviation
- Consequently:
  - Such investment pools have been permitted to report all of their investments at amortized cost
  - Participants in such pools have been permitted to report their position based on share value prices that reflect amortized cost
- Until now, SEC rule 2a7 has provided the criteria for defining qualifying pools
- Recent changes make it impractical to continue to rely on SEC rule 2a7 (doing away with it)

GASB #79

- Criteria for being permitted to report at Amortized Cost
  - Stable net asset value (NAV) per share
  - Additional requirements
    A. Meets portfolio ***maturity*** requirements
    B. Meets portfolio ***quality*** requirements
    C. Meets portfolio ***diversification*** requirements
    D. Meets portfolio ***liquidity*** requirements
    E. Meets ***shadow price*** requirements
- *Significant* noncompliance with any criterion - disqualified from using amortized cost for that period unless there were exceptional circumstances (except you may always still report short-term debt investments with remaining maturities at reporting date ≤ 90 days at amortized cost)

GASB #79

Maturity Requirements

- Remaining maturity ≤ 397 days
- Weighted average maturity ≤ 60 days
  - *Takes into account* maturity shortening features
- Weighted average life ≤ 120 days
  - *Ignores* maturity shortening features

Quality Requirements

- Denominated in U.S. dollars
- Highest credit rating category at acquisition

GASB #79

Diversification Requirements

- Single issuer ≤ 5% total assets
- Not applicable to U.S. government securities

Liquidity Requirements

- Acquisition of illiquid* security
  - Liquid must remain ≥ 95% total assets
- Acquisition of any security
  - *Daily liquid** must remain ≥ 10% total assets
  - *Weekly liquid** must remain ≥ 30% total assets

* As Defined.

GASB #79

Shadow Price Requirements

- Definition of *shadow price*
  - NAV per share calculated using total investments measured at fair value at the calculation date
- Calculate at least monthly
  - Earliest – 5 business days prior to end of month
  - Latest – end of month
- Deviation ≤ 0.5% price/share at amortized cost

GASB #79

Disclosure Requirements

- External Investment Pools
  - Disclosure already required for fair value measurement per GASB #31 and GASB #72
  - Any limitations or restrictions on participant withdrawals
    - Notice periods
    - Maximum transaction amounts
    - Pool's authority to impose liquidity fees or redemption gates
- Pool Participants
  - Any limitations or restrictions on withdrawals
    - Notice periods
    - Maximum transaction amounts
    - Pool's authority to impose liquidity fees or redemption gates

GASB Statement No. 80 – Blending Requirements for Certain Component Units ("GASB #80")

GASB #80

- Effective for periods beginning after June 15, 2016 (FY 2017).
- The purpose was to improve financial reporting by requiring blending of not-for-profit corporations for which the primary government is the sole corporate member.
- May result in certain previous discretely presented component units being shown as blended component units going forward.
- Early implementation is encouraged.

GASB #80

- Theory
  - Blending should be used if a component unit functions essentially as part of the government
- Solution – establish an additional criterion for blending:
  - If a component unit is incorporated as a not-for-profit corporation (but not included for blending based on GASB #39) and the primary government is the sole corporate member – then the component unit should be blended in the primary government.

GASB Technical Agenda – Key Items

- Irrevocable Split-Interest Agreements (GASB #81)
- Pension Issues (GASB #82)
- Conceptual Framework – Measurement of Assets and Liabilities, Financial Projections, and Economic Condition Reporting – projects are on hold.
- Asset Retirement Obligations
- Fiduciary Responsibilities
- Leases (an intangible lease asset and liability will generally be recorded at the beginning of any long-term lease)
- Financial Reporting Model
  - Expansion of major fund reporting and possible special treatment for debt service funds
  - Reclassification of some statements from basic financial statements to RSI or SI.
  - Modification or elimination of use of the current financial resources measurement focus and modified accrual basis of accounting.
  - Provide more guidance on the MD&A
  - More meaningful and understandable government-wide statement of activities
  - Government-wide statement of cash flows
- Debt Refundings