GFOASC Fall Conference
GASB Update

elliott davis

Ryan D. Miller, CPA
Senior Manager
Ryan.Miller@elliottdavis.com
803.255.1207

October 8, 2018

Disclaimer

elliott davis

This material was used by Elliott Davis during an oral presentation; it is not a complete record of the discussion. This presentation is for informational purposes and does not contain or convey specific advice. It should not be used or relied upon in regard to any particular situation or circumstances without first consulting the appropriate advisor. No part of the presentation may be circulated, quoted, or reproduced for distribution without prior written approval from Elliott Davis.

GASB Statements on the Horizon

elliott davis

Upcoming GASB Statements

- No. 83, *Certain Asset Retirement Obligations*
- No. 84, *Fiduciary Activities*
- No. 86, *Certain Debt Extinguishment Issues*
- No. 87, *Leases*
- No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*
- No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*
- No. 90, *Majority Equity Interests – An Amendment of GASB Statements No. 14 and No. 61*

GASB No. 83, *Certain Asset Retirement Obligations*

elliott davis

- What: The GASB issued Statement No. 83 to establish accounting and financial reporting standards for **legal obligations to retire certain capital assets**, such as decommissioning nuclear power plants and removing sewage treatment plants

- Why: Statement No. 18 only addressed municipal landfills but governments have retirement obligations for other types of capital assets

- When: Effective for fiscal years beginning after June 15, 2018; earlier application is encouraged

GASB No. 83 - Definitions and Scope

elliott davis

- **Asset retirement obligation (ARO) –** legally enforceable liability associated with the retirement of a tangible capital asset

- **Retirement of a tangible capital asset –** the permanent removal of a capital asset from service (such as from sale, abandonment, recycling, or disposal)

- **Includes:**
  - Nuclear power plant decommissioning
  - Contractually required land restoration, such as removal of wind turbines
  - Removal of sewage treatment plants
  - Removal of x-ray machines

GASB No. 83 - Recognition and Measurement

elliott davis

Initial Recognition	ARO liability when incurred and reasonably estimable. Incurrence manifested by both external and internal obligating events. Measured based on the best estimate of the current value of outlays expected to be incurred.	Deferred outflow of resources—same amount as the ARO liability
Subsequent Recognition	• At least annually, adjust for general inflation or deflation • At least annually, evaluate relevant factors to determine if there is a significant change in the estimated outlays; remeasure liability when significant	An outflow of resources (such as expense) in a systematic and rational manner over the estimated useful life of the capital asset. Immediately expense if capital asset is abandoned.

GASB No. 83 - Scope Exclusions

elliott davis

The provisions of Statement No. 83 would not apply to the following:

- Obligations arising ***solely from a plan to sell*** or otherwise dispose of a tangible capital asset
- Activities ***necessary to prepare*** a tangible capital asset for an alternative use
- Obligations for **asbestos** removal that result from the *other-than-normal operation* of a tangible capital asset, *i.e.*, contamination obligations covered under **GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations***
- Obligations associated with ***maintenance****, rather than retirement*, of a tangible capital asset
- The ***cost of a replacement*** *part* that is a component of a tangible capital asset

GASB No. 83 - Measurement Exception for a Minority Owner of a Jointly Owned Capital Asset

elliott davis

- May have minority share (less than 50%) of ownership interest in an undivided interest arrangement in which:
  - A government and one or more other entities jointly own a tangible capital asset to the extent of each entity's ownership interest
  - Each joint owner is liable for its share of the ARO
  - None of the joint owners have a majority ownership
  - A non-governmental joint owner has the operational responsibility for the jointly owned tangible capital asset

GASB No. 83 - Measurement Exception for a Minority Owner of a Jointly Owned Capital Asset

elliott davis

- Initial and Subsequent Measurement Exception
  - The governmental minority owner should report its minority share of the ARO using the measurement produced by the non-governmental majority owner or the non-governmental minority owner that has operational responsibility
- The measurement date of such an ARO should be no more than one year and one day prior to the government's financial reporting date
- There are specific disclosure requirements in this circumstance

GASB No. 83 - Effects of Funding and Assurance

elliott davis

- If legally required to provide funding and assurance, disclose that fact
- Do not offset ARO with assets restricted for payment of the ARO
- Costs to comply with funding and assurance provisions are period costs separate from the ARO expense

GASB No. 83 - Disclosures

elliott davis

- **General description** of ARO and associated tangible capital assets
  - Include source of AROs (federal, state, or local laws and regulations, contracts, or court judgments)
- **Methods and assumptions** used to measure ARO liabilities
- **Estimated remaining useful life** of tangible capital assets
- How **financial assurance requirements**, if any, are being met
- Amount of **assets restricted** for payment of ARO liabilities, if not separately displayed in the financial statements
- If a government has an ARO (or portions of an ARO) that is incurred but **not yet recognized because it cannot be reasonably estimated**, that fact and the reasons therefore

GASB No. 84, *Fiduciary Activities*

elliott davis

- What: GASB issued Statement No. 84 to establish criteria for identifying fiduciary activities of all state and local governments
- Why: This Statement improves guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported
- When: Effective for reporting periods beginning after December 15, 2018; earlier application is encouraged

GASB No. 84 – Criteria

elliott davis

The Statement's criteria generally focuses on:

1. Whether a government is controlling the assets of the fiduciary activity; and
2. The beneficiaries with whom a fiduciary relationship exists

Separate criteria are included to identify fiduciary component units and post-employment benefit arrangements that are fiduciary activities.

GASB No. 84 – Criteria

elliott davis

- If the government's activity meets the criteria it should be reported in a fiduciary fund in the basic financial statements
  - Statement of Fiduciary Net Position
  - Statement of Changes in Fiduciary Net Position

- Exception for business-type activity that normally expects to hold custodial assets for 3 months or less

- Four fiduciary fund types:
  - Pension (and other employee benefit) trust funds
  - Investment trust funds
  - Private-purpose trust funds
  - Custodial funds

GASB No. 87, *Leases*

elliott davis

- What: GASB issued Statement 87 to establish a single approach to accounting for and reporting leases by state and local governments

- Why: The single lease approach is based on the principle that leases are financings of the right to use an underlying asset

- When: Effective for reporting periods beginning after December 15, 2019; earlier application is encouraged

GASB No. 87 – Scope and Applicability

elliott davis

- Provides guidance for lease contracts for non-financial assets
  - Vehicles
  - Heavy equipment
  - Buildings
- Excludes non-exchange transactions, including donated assets, and leases of intangible assets (such as patents and software licenses)
- Provides exceptions for short-term leases, financial purchases, leases of assets that are investments, and certain regulated leases
- Addresses accounting for lease terminations and modifications, sale-leaseback transactions, non-lease components embedded in lease contracts (such as service agreements), and leases with related parties.

GASB No. 87 – Major Changes

elliott davis

- Leases will be classified as "short-term," "contracts that transfer ownership," and "all other"
- Leases that extend beyond 12 months will have a balance sheet impact on both the lessee and lessor
- For all leases other than short-term, the lessee will recognize the intangible-use asset, and the lessor will continue to depreciate and account for the lease asset
- Financial statement disclosures and schedules will be required for contracts that transfer ownership and non-short-term leases
- There will be no disclosure requirement for short-term lease outflows

GASB No. 87 – Definition of a Lease

elliott davis

- "A contract that conveys control of the right to use another entity's non-financial (the "underlying asset") as specified in the contract for a period of time in an exchange or exchange-like transaction."
- Need to assess whether the entity has both the ability and rights to use the asset

GASB No. 87 – Three Categories of Leases

elliott davis

- Leases are currently classified as either “operating” or “capital” based on a four-factor test
- Statement No. 87 will sort the lease agreements into three categories:
  - Short-term leases
  - Contracts that transfer ownership
  - All other leases
- The four-factor test will be eliminated, as will the terminology of operating and capital leases

GASB No. 87 – Short-term Lease

elliott davis

- A short-term lease is a lease that, at the beginning of the lease, has a ***maximum possible term of 12 months or less***, including any options to extend, regardless of its probability of being exercised

- A lessee should recognize short-term lease payments as outflows of resources (expenses) based on the payment provisions of the contract

- For a lease that is cancelable by either the lessee or the lessor, such as a month-to-month lease or a year-to-year lease, the ***maximum possible term is the non-cancelable period***, including any notice periods

GASB No. 87 – Contracts That Transfer Ownership

elliott davis

- If ownership of the underlying asset transfers to the lessee by the end of the contract, the transaction should be reported as a financed purchase of the underlying asset by the lessee, or sale of the asset by the lessor

GASB No. 87 - Lessee Accounting

elliott davis

- Lessee government is required to recognize a lease liability and an intangible asset representing the lessee's right to use the leased asset
- Lability should be the present value of the payments covered by the contract, and its value should be reduced as payments are made over the lease's term
- Asset should equal the initial measurement of the liability
- Lease liabilities will be considered long-term debt, and lease payments will capital financing outflows in the statement of cash flows
- In the statement of activities, lessees will no longer report rent expense for today's operating-type leases, but will instead report interest expense on the liability and amortization expense related to the lease asset

GASB No. 87 - Lessee Accounting, Continued

elliott davis

- Lessee also will report the following in its financial statements:
  - Amortization expense for using the lease asset (similar to depreciation) over the shorter of the term of the lease or the useful life of the underlying asset
  - Interest expense on the lease liability
  - Note disclosures about the lease, including a general description of the leasing arrangement, the amount of lease assets recognized, and a schedule of future lease payments to be made

GASB No. 87 - Lessor Accounting

elliott davis

- Lessor government is required to recognize a lease receivable and a deferred inflow of resources
- Lessor will continue to report the leased asset in its financial statements
- Lease revenue will arise from amortizing the deferred inflow of resources in a systematic and rational manner over the lease term
- The new rules exclude leases associated with investment assets carried at fair value (e.g., investment rental property), which will continue to be accounted for as they are today
- Lessor also will report the following in its financial statements:
  - Interest revenue on the receivable
  - Note disclosures about the lease, including a general description of the leasing arrangement and the total amount of inflows of resources recognized from leases

GASB No. 87 – Lease Term

elliott davis

- The non-cancelable portion of the lease plus those periods that both the lessee and lessor are reasonably certain will remain in the lease, which includes:
  - Periods that the lessee or lessor is able to extend to the lease and is reasonably certain to do so
  - Periods that the lessee or lessor is able to extend to the lease, but is reasonably certain not to terminate the lease
- Fiscal funding/cancellation clauses should not be taken into consideration unless the clause is reasonably certain of being exercised

GASB No. 87 - Lease Accounting

elliott davis

Example Entries

Transaction date	Lessee			Lessor		
1/1/17	Lease liability		33,617	Deferred inflow		33,617
	Lease asset	33,617		Lease receivable	33,617	
2/1/17	Interest expense	126		Interest income		126
	Lease liability	874		Lease income		874
	Cash		1,000	Cash	1,000	
2/1/17	Amortization expense	934		Deferred inflow	874	
	Accum. amortization		934	Lease receivable		874

Assumptions:

Term:	36 months
Interest rate (Lessee cost of funds):	4.50%
Monthly lease payment:	$1,000

Lessor does not derecognize underlying capital asset

GASB No. 87 – Key Impacts

elliott davis

- Right-of-use assets may amortize more quickly than the liabilities under the GASB model, negatively impacting net position
- Lessees will report lease liabilities as long-term debt, heightening concerns about compliance with restrictive debt covenants
- Lessees will report interest expense on the liability and amortization expense related to the asset, thus front-loading the expense recognition
- Within the statement of cash flows, lease payments will be classified as capital financing outflows by lessees

GASB No. 88 – Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements

elliott davis

- What: GASB issued Statement 88 to improve consistency in the information that is disclosed in the notes to government financial statements related to debt
- Why: Governments entering into certain debt arrangements have the potential to introduce additional risks to its credit profile
- When: Effective for reporting periods beginning after June 15, 2018; earlier application is encouraged

GASB No. 88 – Scope and Applicability

elliott davis

- For purposes of disclosures in notes to financial statements, debt is defined as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established
- For disclosure purposes, debt does not include leases, except for contracts reported as a financed purchase of the underlying asset or accounts payable

GASB No. 88 – Scope and Applicability

elliott davis

- In addition to other requirements to disclose information related to debt in notes to financial statements, a government should disclose in notes to financial statements summarized information about the following items:
  - a. Amount of unused lines of credit
  - b. Assets pledged as collateral for debt
  - c. Terms specified in debt agreements related to significant (1) events of default with finance-related consequences, (2) termination events with finance related consequences and (3) subjective acceleration clauses

GASB No. 88 – Scope and Applicability

elliott davis

- In notes to financial statements, a government should separate information in debt disclosures regarding (a) direct borrowings and direct placements of debt from (b) other debt
  - Direct borrowing – A government enters into a loan agreement with a lender
  - Direct placement – A government issues debt security directly to an investor
- Both direct borrowings and direct placements have terms negotiated directly with an investor or lender and are not offered for public sale.

GASB No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*

elliott davis

- What: GASB issued Statement 89 to establish accounting requirements for interest cost incurred before the end of a construction period.

- Why: The objectives of Statement 88 are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

- When: Effective for reporting periods beginning after December 15, 2019; earlier application is encouraged.

GASB No. 89 – Scope and Applicability

elliott davis

- Financial statements prepared using the economic resources measurement focus
  - Interest cost incurred before the end of a construction period should be recognized as an expense during the period in which the cost is incurred.
  - Such interest cost should not be capitalized as part of the historical cost of a capital asset.
- Financial statements prepared using the current financial resources measurement focus
  - Interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

GASB 90, *Majority Equity Interests – An Amendment of GASB Statements No. 14 and No. 61*

elliott davis

- What: GASB issued Statement 90 to (1) modify previous guidance for reporting a government's majority equity interest in a legally separate organization and (2) to provide guidance for reporting a component unit if a government acquires a 100% equity interest in that component unit.

- Why: The objectives of Statement 90 are (1) to improve the consistence in the measurement and comparability of the financial statement presentation of majority equity interests in legally separate organizations and (2) to improve the relevance of financial statement information and certain component units.

- When: Effective for reporting periods beginning after December 15, 2018; earlier application is encouraged.
  - Applied retroactively except for the provisions related to (1) reporting a majority equity interest in a component unit and (2) reporting a component unit if the government acquires a 100% equity interest

GASB No. 90 – Scope and Applicability

elliott davis

- Equity interest - Financial interest in a legally separate organization evidenced by the ownership shares of the organization's stock or by otherwise having an explicit, measurable right to the net resources of the organization that is usually based on an investment of financial or capital resources by a government.

- An equity interest is explicit and measurable if the government:
  - Has a present or future claim to the net resources of the entity, and
  - The method for measuring the government's share of the entity's net resources is determinable.

GASB No. 90 – Reporting a Majority Equity Interest in a Legally Separate Organization

elliott davis

- Own or acquire a majority of the equity interest in a legally separate organization through:
  - Acquisition of voting stock of a corporation
  - Acquisition of interest in a partnership
- Equity interest that meets the definition of an investment per GASB Statement No. 72
  - Reported as an investment and measured using the equity method in accordance with GASB Statement No. 62
  - Legally separate organization is not reported as a component unit

GASB No. 90 – Reporting a Majority Equity Interest in a Legally Separate Organization

elliott davis

- Equity interest that meets the definition of an investment per GASB Statement No. 72
  - Also applies to special-purpose governments only engaged in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund

GASB No. 90 – Reporting a Majority Equity Interest in a Legally Separate Organization

elliott davis

- Equity interest that does not meet the definition of an investment per Statement 72
  - The majority equity interest results in the government being financially accountable for the organization
  - Legally separate organization is reported as a component unit

GASB No. 90 – Reporting a Majority Equity Interest in a Legally Separate Organization

elliott davis

- Majority equity interest reported as a component unit
  - Reported as an asset of the government or fund that holds the equity interest, measured using the equity method in accordance with Statement 62
  - For blended component units, the asset and net position associated with the equity interest held by the government or fund should be eliminated in the blending process.
  - In governmental fund financial statements, the asset representing the government's equity interest should be limited to amounts appropriately reported under the current financial resources measurement focus

GASB No. 90 – Reporting a Component Unit if a Government Acquires 100% Equity Interest

elliott davis

100% equity interest reported as a component unit

- Component unit should measure its assets, deferred outflows of resources, liabilities and deferred inflows of resources in accordance with Statement No. 69, *Government Combinations and Disposals of Government Operations*, at the date the Government acquires the 100% equity interest

- In applying the measurement provisions, the consideration provided should include the net resources exchanged in order to complete the acquisition plus the balances of any equity interest asset and deferred outflow of resources recognized prior to the completion of the acquisition.

- The net position acquired should equal to the net position of the component unit after measuring its assets, deferred outflows of resources, liabilities, and deferred inflows of resources in accordance with Statement No. 69.

Ryan D. Miller, CPA

Email: Ryan.Miller@elliottdavis.com

Phone: 803.255.1207

Website: www.elliottdavis.com

Elliott Davis provides comprehensive assurance, tax and consulting solutions to diverse businesses, organizations and individuals. With a network of forward-thinking professionals in major U.S. markets and alliance resources across the globe, the firm ranks among the top 40 and fastest-growing accounting firms in the U.S. visit elliottdavis.com for more information.