

2018 A&A UPDATE



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GOALS FOR TODAY



Auditing Updates (GAGAS & GAAS)



Recently issued pronouncements



Projects in process



How to stay informed

2018 YELLOW BOOK REVISIONS

- Generally Accepted Government Auditing Standards (Yellow Book)
 - GAO released new revisions of Yellow Book on July 17, 2018
 - Changes include (but are not limited to):
 - Updated independence guidelines for auditors who prepare client financial statements of audit clients
 - New guidance/definitions on waste and abuse

Yellow Book Independence Changes

- New Yellow Book guidelines indicate that when an auditor prepares the auditee's financial statements from a client-provided trial balance or other underlying accounting records, it generally results in a significant threat to the auditor's independence
 - This has historically been considered a nonattest service
 - Some auditors may not have considered this a significant threat in the past

Yellow Book Independence Changes

- Further indicates auditor's should document threats and safeguards used to reduce/eliminate threats to an acceptable level
- Common safeguards include:
 - Independent review of attest engagement
 - Separate personal for attest and nonattest services
 - Secondary independent review of nonattest service
 - Secondary independent review of impacted audit areas
 - Discuss independence with those charged with governance
 - Education management on nonattest services
 - Cleansing audit by another firm

Yellow Book: Waste and Abuse

- **Waste** – “The act of using or expending resources carelessly, extravagantly, or to no purpose. Waste can include activities that do not include abuse and does not necessarily involve a violation of law.”
- Examples of Waste:
 - Making travel choices that are contrary to existing travel policies or are unnecessarily extravagant or expensive
 - Making procurement or vendor selections that are contrary to existing policies or are unnecessarily extravagant or expensive

Yellow Book Waste and Abuse

- **Abuse** – “Behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements.”
- Examples of Abuse:
 - Creating unneeded overtime
 - Requesting staff to perform errands or work tasks for a supervisor or manager
 - Misusing the official's position for personal gain

Effective Date of 2018 Yellow Book Revisions

- Effective for financial audits, attestation engagements and reviews for periods ending on or after June 30, 2020 (i.e. December 31, 2020)
- Early implementation is not permitted

SUPER CIRCULAR REMINDERS

- Procurement Guidelines became for fiscal years beginning on/after December 26, 2018
 - Originally effective for federal awards made after December 26, 2014
 - September 10, 2015 – Two-year grace period granted, changing effective date to fiscal years beginning on/after December 26, 2016
 - May 17, 2017 – Correcting amendment issued extending effective date for nonfederal entities to fiscal years beginning on/after December 26, 2017
 - No additional grace period anticipated

SAS NO. 133, *AUDITOR INVOLVEMENT WITH EXEMPT OFFERING DOCUMENTS*

- Effective for exempt offering with which the auditor is *involved* that are initially distributed, circulated or submitted on or after June 15, 2018
- Prior to SAS 133, auditing standards did not include specific requirements for auditors with respect to auditor involvement with exempt offerings
 - Auditors typically followed applicable AICPA A&A Guides

SAS 133 Applicability

- Addresses auditor responsibilities when both of the following exist:
 - The auditor's report on financial statements or review report on interim information is included or incorporated by reference in an offering document of securities that are exempt from registration under *Securities Act of 1933*
 - The auditor performs one or more of the following activities (not a complete listing):
 - Assisting entity in preparing information included in the exempt offering document
 - Reading a draft of the exempt offering document **at the entity's request**, even if auditor does not provide comments
 - Issuing a comfort of or similar letter, or an agreed-upon procedures report on information included in the exempt offering document
 - Providing written agreement for the use of the auditor's report in the exempt offering document

RECENTLY ISSUED PRONOUNCEMENTS

GASB Statement No. 86,
*Certain Debt Extinguishment
Issues*

GASB Statement No. 88, *Certain
Disclosures Related to Debt, including
Direct Borrowings and Direct
Placements*

GASB Statement
No. 84, *Fiduciary
Activities*

GASB Statement
No. 87, *Leases*

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

GASB 86 – CERTAIN DEBT EXTINGUISHMENT ISSUES

- Applies when a government places cash or other monetary assets from existing resources in irrevocable trust to extinguish debt
- Effective for periods beginning after June 15, 2017

GASB 86 – CERTAIN DEBT EXTINGUISHMENT ISSUES

- Allows for in-substance defeasance accounting treatment for circumstances in which a government places only existing resources in trust for the extinguishment of debt
 - Trust must be restricted to only essentially risk-free monetary assets
 - Difference between net carrying amount & reacquisition price is recognized as a gain or loss in the period (unlike refundings)
 - Notes to financial statements
 - Describe the transaction in the period it occurs
 - Disclose remaining outstanding balance in each period defeased debt remains outstanding

GASB 86 – CERTAIN DEBT EXTINGUISHMENT ISSUES

- Guidance for treatment of prepaid insurance for all extinguishments
 - Include in the net carrying amount of debt
- Note disclosure on substitution risk is required for all extinguishments
 - Substitution of essentially risk-free monetary assets with monetary assets that are not essentially risk free is not prohibited
 - Fact that substitution is not prohibited in the period of the defeasance
 - Amount of debt defeased in substance that remains outstanding for which the risk of substitution exists in subsequent periods

GASB 88 – CERTAIN DISCLOSURES RELATED TO DEBT, INCLUDING DIRECT BORROWINGS AND DIRECT PLACEMENTS

- Defines debt for disclosure purposes
- Establishes additional note disclosure requirements
- Effective for reporting periods beginning after June 15, 2018

GASB 88 – CERTAIN DISCLOSURES RELATED TO DEBT, INCLUDING DIRECT BORROWINGS AND DIRECT PLACEMENTS

- For purposes of disclosures in notes to financial statements
 - Debt is
 - 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 established
 - Debt does not include
 - Leases, except for contracts reported as a financed purchase of the underlying asset, or
 - Accounts payable

GASB 88 – CERTAIN DISCLOSURES RELATED TO DEBT, INCLUDING DIRECT BORROWINGS AND DIRECT PLACEMENTS

- New disclosures
 - Amount of unused lines of credit
 - Assets pledged as collateral for debt
 - Terms specified in debt agreements related to significant
 - Events of default with finance-related consequences
 - Termination events with finance-related consequences
 - Subjective acceleration clauses
- Separate disclosures

GASB 84 – FIDUCIARY ACTIVITIES

- Definition of fiduciary activity
- Report fiduciary funds
 - Trust funds
 - Custodial funds
- Fiduciary fund financial statements
- Effective for periods beginning after December 15, 2018

GASB 84 – IMPLEMENTATION GUIDE

- Anticipated timeline
 - Comment period January–February 2019
 - Final guide cleared in May 2019
- Potential issues addressed
 - Interaction with Statement No. 14, *The Financial Reporting Entity*, as amended
 - Application to pension & OPEB arrangements
 - Application to activities that are not pension & OPEB
 - Determination of fiduciary fund type
 - Reporting fiduciary activities in fiduciary fund financial statements
 - Reporting of fiduciary activities by standalone BTAs

WHEN SHOULD A GOVERNMENT REPORT ASSETS IN A FIDUCIARY FUND?

Four paths to the determination

- 1 Component units that provide postemployment benefits
- 2 Component units that do not provide postemployment benefits
- 3 Postemployment benefit arrangements that are not component units
- 4 Other activities


Appendix C of the Statement provides a nonauthoritative flowchart to aid in the application


COMPONENT UNITS THAT HOLD ASSETS FOR POSTEMPLOYMENT BENEFITS (PATH 1)


- Fiduciary if they are one of the following arrangements
 - A pension plan administered through a trust that meets the criteria in paragraph 3 of Statement 67
 - An OPEB plan administered through a trust that meets the criteria in paragraph 3 of Statement 74
 - Assets from entities that are not part of the reporting entity are accumulated for pensions as described in paragraph 116 of Statement 73
 - Assets from entities that are not part of the reporting entity are accumulated for OPEB as described in paragraph 59 of Statement 74
- If not, activity would be reported with governmental or business-type activities

COMPONENT UNITS THAT HOLD ASSETS *NOT* FOR POSTEMPLOYMENT BENEFITS (PATH 2)

Fiduciary if assets are one or more of the following

- 
- Administered through a trust or equivalent arrangement in which the government is not a beneficiary
 - Dedicated to providing benefits to recipients
 - Legally protected from creditors of the government

- 
- For the benefit of individuals
 - Government does not have administrative or direct financial involvement
 - Not derived from government's provision of goods or services to those individuals

- 
- For the benefit of organizations or other governments that are not part of the financial reporting entity
 - Not derived from government's provision of goods or services to those organizations or other governments

If none of the criteria described above are met, the activity would be reported with the governmental or business-type activities

ADMINISTRATIVE OR DIRECT FINANCIAL INVOLVEMENT

- Administrative involvement examples
 - Monitors compliance with the requirements of the activity that are established by the government or by a resource provider that does not receive the direct benefits of the activity
 - Determines eligible expenditures that are established by the government or a resource provider that does not receive the direct benefits of the activity
 - Ability to exercise discretion in how the assets are allocated
- Direct financial involvement example
 - Provides matching resources for the activities

POSTEMPLOYMENT BENEFITS THAT ARE NOT COMPONENT UNITS (PATH 3)

- Fiduciary activity if the government **controls** the assets of the arrangement & the arrangement is one of the arrangements described in Path 1
- A government controls the assets if
 - The government holds the assets
 - The government has the ability to direct the use, exchange or employment of the assets in a manner that provides benefits to the specified or intended beneficiaries
- If the assets are not held by a component unit & the government does not control the assets, the activity is **not reported**

OTHER ACTIVITIES (PATH 4)

- If the assets are not held by a component unit & are not held for a pension or OPEB arrangement, the activity is fiduciary if **all three** of the following are met
 - The government controls the assets
 - The assets are *not* derived either
 - Solely from the government's own-source revenues, or
 - From government-mandated or voluntary nonexchange transactions (except pass-through grants for which the government does not have administrative or direct financial involvement)
- One of the criteria in Path 2 are met
 - Assets are administered through a trust or equivalent arrangement, dedicated to providing benefits, legally protected
 - Assets are for benefit of individuals, no administrative or direct financial involvement, not derived from provision of goods or services
 - Assets are for benefit of organizations or other governments, not derived from provision of goods or services

FIDUCIARY FUND TYPES

- Pension trust funds, investment trust funds, private-purpose trust funds
 - Trust agreement or equivalent arrangement should be present
 - If not, & is a fiduciary activity, report in a custodial fund
- Custodial funds
 - Trust or equivalent arrangement is not present
 - External portions of investment pools that are not held in trust should be reported in a separate column under the custodial fund umbrella

GASB 87 – LEASES

- Current – operating or capital leases
 - GASB 87 eliminates operating lease category

New definition of a lease

A contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction

GASB 87 – LEASES

- Scope exceptions
 - Short-term leases – defined as leases with maximum possible term of 12 months or less, including options to extend
 - Contracts for services
 - Leases that transfer ownership (financed purchase)
 - Leases of inventory, intangible assets, biological assets
 - Contracts that meet the definition of service concession arrangements
 - Supply contracts such as power purchase agreements
 - Leases of investment assets & certain regulated leases (lessor only)

GASB 87 – LEASES

- Lessee will recognize lease liability & intangible right-to-use asset
 - Asset is reported as a capital asset
- Rent expense replaced with interest & amortization expense
 - Interest recognized on lease liability & amortization on intangible lease asset over lease term (or underlying asset useful life, if shorter)

GASB 87 – LEASES

- Lessor will recognize lease receivable & deferred inflow at lease inception
 - Lease revenue recognized over lease term with corresponding reduction in deferred inflow
 - Interest income on lease receivable recognized using the effective interest method
 - Lessor will not derecognize the underlying asset
- Lessees & lessors need to disaggregate non-lease components, *i.e.*, service components, & contracts with multiple lease components

GASB 87 – LEASES

- Between blended component units & primary government
 - Reporting requirements of GASB 87 do not apply
 - Assets & related debt included in governmentwide financial statements

GASB 87 – LEASES

- Between discretely presented component units & primary government
 - Same treatment as any other lease under GASB 87
 - Receivables & payables under leasing transactions
 - Should not be aggregated with other receivables & payables between the governments
 - Should not aggregated with lease receivables & payables with organizations outside the reporting entity

GASB 87 – LEASES

- Effective for periods beginning after December 15, 2019
- Implementation guide tentative timeline
 - Exposure draft – March 2019
 - Final – June 2019
 - Potential topics
 - Scope & application of definition of a lease
 - Lease term & short-term leases
 - Recognition, measurement, disclosure
 - Leases with multiple components
 - Intra-entity & related-party leases

GASB 89 – Accounting for Interest Cost Incurred before the End of a Construction Period

- Interest cost during period of construction be expensed as incurred
- No longer included in the historical cost of a capital asset in BTA or enterprise funds going forward
- Effective for periods beginning after December 15, 2019
- Apply prospectively- early application encouraged

PROJECTS IN PROCESS

PRACTICE ISSUES

- *Conduit Debt—Reexamination of Interpretation 2*
 - Consider improvements related to
 - Diversity in current reporting
 - Whether conduit debt obligation are liabilities & should be reported in the financial statements
 - Usefulness of required notes
 - Exposure draft Issued July 30, 2018
 - Comments due November 2, 2018

Major Project – REVENUE & EXPENSE RECOGNITION

- Objective
 - Develop a comprehensive application model for the classification, recognition & measurement of revenues & expenses
- Purpose of comprehensive model
 - Improve information for users to make decisions & assess accountability
 - Provide guidance regarding exchange & exchange-like transactions
 - Evaluate revenue & expense recognition in the context of the conceptual framework
 - Consider application issues identified in practice

MAJOR PROJECT – REVENUE & EXPENSE RECOGNITION

- Invitation to comment
- Three components of a comprehensive model
 - Classification
 - Recognition
 - Measurement
- Two potential models proposed

MAJOR PROJECT – REVENUE & EXPENSE RECOGNITION

	Exchange/Nonexchange Model	Performance Obligation/No Performance Obligation Model
Classification	Is the transaction an exchange?	Does the transaction contain a performance obligation?
Recognition	<i>Exchange Transaction</i> Recognize based on earnings recognition approach	<i>Transaction contains performance obligation(s)</i> Recognize based on performance obligation recognition approach
	<i>Nonexchange Transaction</i> Recognize based on Statement 33 provisions	<i>Transaction does not contain a performance obligation</i> Recognize based on Statement 33 provisions
Measurement	<i>Measurement is not addressed in this Invitation to Comment but will be addressed in a later due process document.</i>	

MAJOR PROJECT – REVENUE & EXPENSE RECOGNITION

Exchange/Nonexchange Model							
Classification	Is the transaction an exchange?						
Recognition	<table border="1"> <thead> <tr> <th>Yes</th> <th>No</th> </tr> </thead> <tbody> <tr> <td><i>Exchange Transaction</i></td> <td><i>Nonexchange Transaction</i></td> </tr> <tr> <td> <p>Recognize based on the earnings recognition approach:</p> <ul style="list-style-type: none"> • Government controls a resource, or incurs an obligation to sacrifice a resource, <i>and</i> • The change in net assets is not applicable to a future reporting period </td> <td> <p>Recognize based on Statement 33 provisions for:</p> <ul style="list-style-type: none"> • Derived tax revenues • Imposed nonexchange revenues • Government-mandated nonexchange transactions • Voluntary nonexchange transactions </td> </tr> </tbody> </table>	Yes	No	<i>Exchange Transaction</i>	<i>Nonexchange Transaction</i>	<p>Recognize based on the earnings recognition approach:</p> <ul style="list-style-type: none"> • Government controls a resource, or incurs an obligation to sacrifice a resource, <i>and</i> • The change in net assets is not applicable to a future reporting period 	<p>Recognize based on Statement 33 provisions for:</p> <ul style="list-style-type: none"> • Derived tax revenues • Imposed nonexchange revenues • Government-mandated nonexchange transactions • Voluntary nonexchange transactions
	Yes	No					
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MAJOR PROJECT – REVENUE & EXPENSE RECOGNITION

Performance Obligation/No Performance Obligation Model

Classification	Does the transaction contain a performance obligation in a binding arrangement?
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	Yes	No
	<i>Performance Obligation</i>	<i>No Performance Obligation</i>
Recognition	<p>Recognize based on performance obligation recognition approach:</p> <ul style="list-style-type: none"> • Determine consideration • Allocate consideration to performance obligation(s) • Recognize revenue or expense as each performance obligation is satisfied (at a point in time or over time) and the transaction is applicable to the reporting period(s) 	<p>Recognize based on Statement 33 provisions for:</p> <ul style="list-style-type: none"> • Derived tax revenues • Imposed nonexchange revenues • Government-mandated nonexchange transactions • Voluntary nonexchange transactions

MAJOR PROJECT – REVENUE & EXPENSE RECOGNITION

- Task force meetings – April 2019 & August 2021
- Preliminary Views – May 2020
- Public Hearings – October 2020
- Field test – June—November 2020
- Exposure Draft – December 2021
- Final Statement – March 2023

MAJOR PROJECT – FINANCIAL REPORTING MODEL

- Invitation to Comment, *Financial Reporting Model Improvements – Governmental Funds*
 - Issued in December 2016
 - Focused on recognition approaches for governmental funds
 - Near-term financial resources
 - Short-term financial resources
 - Long-term financial resources

MAJOR PROJECT – FINANCIAL REPORTING MODEL

- Preliminary Views document
 - Anticipated in September 2018
 - Comment period will continue through January 2019
 - Public Hearings & User Forums will be held in February 2019
 - Expected to consider several topics

FINANCIAL REPORTING MODEL – PRELIMINARY VIEWS DOCUMENT TOPICS

- Governmental Fund Financial Statements
 - Financial resources = cash, resources that are expected to be converted to cash & resources that are consumable in lieu of cash
 - Reflect a shorter time perspective than government-wide financial statements
 - Facilitate comparison with budgetary information
 - Use a recognition approach referred to as short-term financial resources

FINANCIAL REPORTING MODEL – PRELIMINARY VIEWS DOCUMENT TOPICS

- Governmental Fund Financial Statements – Short-term Financial Resources Characteristics
 - One-year (operating cycle) period of availability
 - Accrued interest recognized when payable & normally due within one year
 - May not necessarily align with recognition of related principal payments
 - Tax & revenue anticipation notes recognized as liabilities
 - Long-term assets & liabilities are not recognized

FINANCIAL REPORTING MODEL – PRELIMINARY VIEWS DOCUMENT TOPICS

- Budgetary comparison information
 - Required supplementary information
 - Variances between
 - Final budget & actual
 - Original budget & final budget
- Government-wide statement of activities
 - Existing format
 - Schedule of natural classification of expenses by function or program (SI)

FINANCIAL REPORTING MODEL – PRELIMINARY VIEWS DOCUMENT TOPICS

- Business-type activities & proprietary funds
 - Continue to distinguish between operating & nonoperating revenues & expenses
 - Resource flows statements & cash flows statements should use the same definition of operating activities
 - Nonoperating revenues & expenses directly defined
 - Derive the definition of operating from the definition of nonoperating

FINANCIAL REPORTING MODEL – PRELIMINARY VIEWS DOCUMENT TOPICS

- Business-type activities & proprietary funds
 - Nonoperating revenues & expenses
 - Subsidies received & provided
 - Revenues & expenses of financing
 - Resources from the disposal of capital assets & inventory
 - Investment income & expenses
 - Subsidies
 - Resources provided by another party or fund for the purpose of keeping the rates lower than otherwise would be necessary for the level of goods & services to be provided

HOW TO STAY INFORMED

- GASB Website
- BKD Thoughtware®



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Questions?

Thank You!