

COMMON REPORTING DEFICIENCIES

CALIFORNIA SOCIETY OF MUNICIPAL FINANCE OFFICERS
SACRAMENTO, CALIFORNIA
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LEARNING OBJECTIVES

Recognize the impacts of rapid changes in GAAP on financial reporting.

Learn from the mistakes of other in order to improve your government's financial reporting

Better understand the “whys” as well as the “whats” of the standards to improve both reporting and disclosures in your financial statements

FINANCIAL REPORTING

- ▶ Who sets the rules?
 - GASB is the standard setting body
 - GFOA provides a checklist award program
- ▶ Who are the users and what is the purpose?
 - Citizenry
 - Legislative and regulatory bodies
 - Investors and creditors



KEEPING PACE WITH AN EVOLVING GAAP

- GAAP is Changing Rapidly
 - Currently 83 statements
 - GASB went from Statement 73 to Statement 82 in ten months
 - Four more statements expected in 2017
 - Fiduciary Activities, Leases, Debt Extinguishments & Omnibus
 - Three implementation guides
 - GASB 74 & 75 and annual update
- The Nature of GAAP is Changing
 - GASB 76- GAAP Hierarchy has substantially elevated implementation guidance
 - Most new standards are replacements or amendments of previous standards
 - GASB 67 & 68 have been modified four times in four years
 - Investment accounting and disclosures is based on five standards
- Reliance on the Statements themselves can increase the risk of missing something.

GASB CODIFICATION IS THE BEST GAAP SOURCE

- GASB's Codification is a comprehensive one stop source
 - GASB statements, Interpretations, Technical Bulletins, Implementation Guides and Concept Statements
 - Applicable NCGA literature
 - Applicable AICPA accounting guidance
 - Consists of five parts:
 - Part 1 (1000 series) General Principles
 - Part 2 (2000 series) Financial Reporting
 - Part 3 (3000 series) Measurement
 - Part 4 (Alpha designations) Specific Topics i.e. Pensions=P20
 - Part 5 (Alpha) Stand Alone Reporting-Special Units & Activities
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- Volume 1
- Volume 2

GASB CODIFICATION IS THE BEST GAAP SOURCE

- In addition to Numeric or Alpha designation:
 - Paragraphs .101-.499-Standards (authoritative-Category A)
 - Paragraphs .501-599-Definitions (authoritative-Category A)
 - Paragraphs .601-699-GASB Technical Bulletins (authoritative-Category B)
 - Paragraphs .701-.799-GASB Implementation Guides (authoritative-Category B)
 - Paragraphs .801-.899-AICPA literature cleared by GASB (authoritative-Category B)
 - Paragraphs .901-.999-Nonauthoritative such as illustrations
- Sample References
 - 2200.102-Minimum Requirements for General Purpose External Financial Reporting
 - I50 741-11-Implementation Guide Question 11 on Investments
- References in this presentation will be based on the Codification

HOW CAN WE DO BETTER?

Best Practices

Tone at the Top

Training and CPE

Start Planning Early and
have clear "owners" for
various areas

Monthly Reporting &
Reconciliations

Utilize All Resources
and Research

Benchmarking/Confer
with Peers

Use Checklists

COMMON DEFICIENCIES-TRANSMITTAL AND MD&A

COMPREHENSIVE ANNUAL FINANCIAL REPORTING (CAFR)

Introductory Section (Required)

Transmittal Letter
Organizational
Diagram
Principal Officials

Financial Section (Required)

Auditor's Report
MD&A
Basic F/S
Notes to Basic F/S
RSI
Supplemental
Info.

Statistical Section (Required)

Financial Trends
Revenue
Capacity
Debt Capacity
Demographic
and Economic
Info.
Operating
Information
Section

Compliance Section (Optional)

Auditor Report on
IC over Fin.
Reporting and on
Compliance in
Accordance with
GAGAS
Auditor Report on
Compliance
Required by A-133
SEFA and Notes to
SEFA
Schedule of
Findings and
Questioned Costs

Continuing Disclosure Section (Optional)

GFOA Best
Practice
Includes all tables
and disclosures
needed to meet
SEC continuing
disclosure
requirements
under SEC Rule
15c2-12

TRANSMITTAL LETTER

- Common Deficiencies

- Incorrect date
- Redundant information
- Omissions

- Correct Approach

- No earlier than the date of the auditor's opinion
- Follow GFOA guidelines that reduced and shifted the scope of the TL after GASB 34 introduced MD&A
- Follow the GFOA checklist and focus on financial "condition" factors rather than just financial position. Cheerleading (within reason) is allowed.

MANAGEMENT'S DISCUSSION & ANALYSIS

• Common Deficiencies

- Elevator Analysis-Quantifying the \$ and % variances without explaining
 - Why did it happen?
 - Timing is not an explanation by itself; be sure to dive into more meaningful details
- Not explaining significant changes in major funds
- Lack of two/three year comparative data
- Amounts do not agree to financial statements
- Restatements of Net Position must be presented
- Insufficient details on the issuance of new debt
- Not including currently known facts, decisions and conditions significantly affecting financial position or results of operations (2200.109 h)
- Cheerleading or slanted to the positive

• Correct Approach

- Concise explanation of the root cause
 - No-Water revenues decreased due to declining sales
 - Yes-Water revenues decreased 8% from the previous year due to unseasonably cool, wet weather through the summer months reducing normal summer irrigation
- Significant changes in fund balances of major funds should be explained
- MD&A should always have one year more the FS. Comparative FS mean 3 year MD&A
- Slot MD&A numbers in last, assign tick & tie duties to someone who likes detail
- With all the new GASBs coming out just plan on it!
- Describe main uses for new debt, reasons for refunding
- Everything occurring between FYE and the date of the auditor's opinion is fair game and easily googled
- As Sgt. Joe Friday was known to say "the facts and only the facts"-objective and unbiased

GOVERNMENT-WIDE STATEMENTS



MISCALCULATION OF NET INVESTMENT IN CAPITAL ASSETS

► Include: (2200.118 & 2200.709-1-17)

Capital Assets, Net of Depreciation

Less: Remaining balances of direct debt used for
acquisition, construction or improvement including retainages

Less: Deferred Inflows directly associated with the debt

Plus: Deferred Outflows directly associated with the debt

MISCALCULATION OF NET INVESTMENT IN CAPITAL ASSETS

► Exclude:

Unspent proceeds and related debt & DI/DO. Put in same category as the unspent proceeds.

Debt used to finance other entities capital assets.

Deferred Inflows or outflows associated with excluded debt

Equity interest in joint venture

OTHER GOVERNMENT-WIDE ISSUES

- ▶ Failure to reclassify deferred inflows of resources for unavailable revenue
- ▶ Reporting unearned revenues (a liability) as deferred inflows (not a liability)
- ▶ Failure to report a deferred outflow/inflow of resources in connection with refunded debt
- ▶ Net Position vs. Net Assets
- ▶ Net Investment in Capital Assets vs. Invested in Capital Assets, Net of Related Debt



GOVERNMENTAL FUNDS

MAJOR FUNDS

- ▶ Not reporting a major fund when it meets the criteria for major fund status
- ▶ Not clearly identifying which funds are major
- ▶ Not updating the major fund determination analysis before issuance, and also yearly, to ensure status hasn't changed
- ▶ Not including deferred inflows and deferred outflows when calculating major funds

GASB 54 FUND BALANCE

- **Not Reporting by Purpose**
 - i.e. "Public Safety" is a Function whereas "Revenue Stabilization" is a purpose
- **Negative Assigned Fund Balance**
 - Can only be positive
 - Cannot have positive Assigned Fund Balance and have negative Unassigned Fund Balance
- **Only the General Fund can have positive Unassigned Fund Balance**
- **Outdated Terminology**
 - Reserved, Unreserved, Designated & Undesignated
- **Improper Order; Must BE:**
 - Non-spendable
 - Restricted
 - Committed
 - Assigned
 - Unassigned
- **Encumbrances should not be separately listed**

GOVERNMENTAL FUND REPORTING ISSUES

▶ **Deferred Inflows**

- amounts received prior to being earned or meeting eligibility requirements are a liability

▶ **Deferred Outflows**

- Unamortized debt issuance costs are no longer deferred; they are period expenses

▶ **Misuse of Special Revenue Funds**

- Established funds not meeting the definition in GAAP per the note disclosures

▶ **Budget Comparisons:**

- GAAP only requires General Fund and major Special Revenue Funds, if budget is legally adopted

REPORTING

- ▶ Don't report as governmental debt if:
 - Proceeds are used by the enterprise fund
 - Repayment is to be made by the enterprise fund
- ▶ Capital contributions are reported on the Statement of Revenues, Expenses and Changes in Net Position
 - Capital contributions received - should be shown below the non-operating section
 - Capital contributions to other entities or other funds – shown as non-operating expenses

COMPONENT UNITS

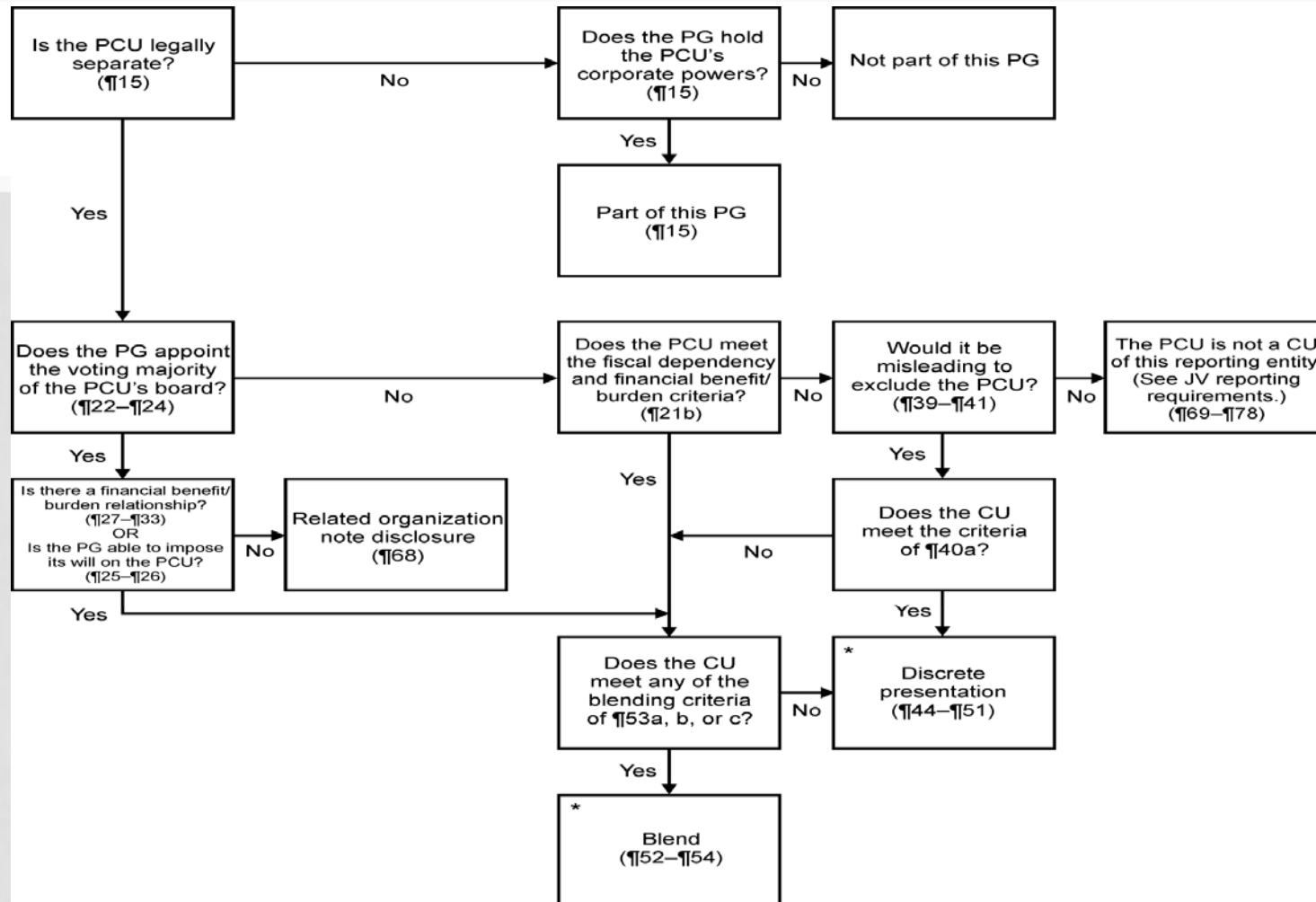
COMPONENT UNIT CONSIDERATIONS

- **Determination**

- Appoint majority of the board plus financial benefits/burden OR ability to impose will
- If did not appoint board then, financial benefit/burden AND fiscal dependency
- Report as discretely presented

- **Blend if...**

- Same governing body AND
 - Financial benefit/burden AND
 - PG operationally runs the C/U OR
 - Almost exclusively for the benefit of the PG OR
 - Almost all debt of C/U is repayable by the PG



NOTE DISCLOSURES

DISCLOSURES

- **Component Units**

- Describe criteria used for inclusion
- Detail the criteria for blending
- Specify which fiscal dependency criteria were met

- **Special Revenue Funds**

- Disclose the purpose and identify the specific revenue source(s)

- **Fund Balance**

- Describe the specific formal action taken by the government's highest decision making body to commit funds
- Identify the highest decision level making body that gives authority to assign resources

- **Revenue stabilization arrangements**

- Authority for establishing
- Minimum balance
- Conditions for spending
- Conditions for replenishing

DISCLOSURES (CONT.)

- ▶ Governments should disclose the policies that address each type of investment risk to which they are exposed including when no policy exists
 - For a deposit and investment policy to exist, it must be formally adopted either by the governing body or by state statute (I 50 736-1)
- ▶ Provide specific website location (URL) when referencing separate reports of component units and/or other plans, etc.
- ▶ Revenue Bonds:
 - Identify specific revenues and amounts pledged
 - General purpose for the debt and term of the commitment
 - Proportion of pledged revenue to total revenues
 - Comparison of pledged revenues recognized during the period to the P&I requirements for the debt directly or indirectly collateralized by those revenues
 - Segment Disclosures. Segments are not defined by lines of business but as dedicated repayment sources for specific indebtedness. (2500 101-102)

DISCLOSURES (CONT.)

- ▶ For long-term debt, the terms by which interest rates change for variable rate debt should be disclosed
- ▶ Must disclose which funds liquidate each long-term obligation other than debt including:
 - Compensated absences
 - Claims and judgments
 - Terminations benefits
 - Pension and OPEB
- ▶ Unamortized gain/loss on refunding is a deferred inflow/outflow and should **not** be displayed with the long-term debt roll forward

DISCLOSURES (CONT.)

- ▶ Notes should disclose the purpose of inter-fund balances
- ▶ Inter-fund receivables/payables that are not expected to be repaid within a reasonable time should be reclassified as a transfer(1800.102(1))
- ▶ Notes should describe the principal purposes of the entity's interfund transfers
- ▶ If the entity elects to disclose transfers by individual fund, it is recommended that the disclosure be formatted in a way that allows readers to trace the individual fund data to the corresponding column in the basic financial statements (e.g., by the use of headings or subtotals)

OTHER REPORTING ISSUES

REQUIRED AND OTHER SUPPLEMENTARY INFORMATION

- **RSI**
 - Not disclosing the budgetary basis in the notes to the RSI
 - Not presenting all required years (e.g., 10 years)
 - Not reporting the legal level of budgetary control
- **Other Supplementary Information**
 - Not reporting budgetary comparisons for non-major governmental funds that have legally adopted annual budgets
 - Not reporting at the legal level of budgetary control

INTERNAL CONSISTENCY AND STATISTICAL

- **Internal Consistency**

- Transmittal, MD&A, financial statements, footnotes, RSI, OSI and Statistical amounts do not agree

- **Statistical Section**

- Debt Capacity schedules should include premiums/discounts
- Debt Service as a Percentage of Noncapital Expenditures should use the capital outlay amount from the modified accrual/accrual reconciliation
- Include all governmental activities' debt for the direct debt in the direct and overlapping debt statistical table

PENSIONS - STATEMENT OF NET POSITION

- Common Deficiency
 - Netting of deferred inflows or outflows from liability assumption different from actual or assumption changes
 - **Not** netting deferred inflow or outflows from investment return different from expected
- Correct Approach
 - Deferred inflows must be reported separately from deferred outflows
 - Deferred inflows and outflows from investment return different from expected must be netted together

PENSION REPORTING - STATEMENT OF NET POSITION

- Common Deficiency

- Not reporting the total deferred outflows or total deferred inflows on the statement of net position that are disclosed in the notes for the employer's balances of deferred outflows and deferred inflows for pensions.

- Correct Approach

- Pretend you are a GFOA Certificate reviewer and tick and tie until you want to scream

PENSION EXAMPLES

City of Sacramento

Statement of Net Position

June 30, 2015

(in thousands)

	Primary Government		
	Governmental Activities	Business-type Activities	Total
ASSETS			
Cash and investments	\$ 441,495	\$ 224,237	\$ 665,732
Receivables, net	214,929	63,972	278,901
Internal balances	6,244	(6,244)	-
Inventories	-	4,124	4,124
Prepaid items	994	803	1,797
Restricted cash and investments	33,787	179,293	213,080
Intangible assets	-	167	167
Land and other capital assets not being depreciated	401,065	237,035	638,100
Other capital assets, net of depreciation	1,381,570	911,149	2,292,719
Total assets	2,480,084	1,614,536	4,094,620
DEFERRED OUTFLOWS OF RESOURCES			
Accumulated decrease in fair value of hedging derivative instrument	5,727	-	5,727
Loss on refunding of debt	6,357	11,887	18,244
Deferred outflows related to pensions	55,517	8,740	64,257
Total deferred outflows of resources	67,601	20,627	88,228

PENSION EXAMPLES

City of Sacramento

Statement of Net Position

June 30, 2015

(in thousands)

LIABILITIES

Payables	68,598	40,968	109,566
Unearned revenue	4,834	4,505	9,339
Long-term liabilities:			
Due within one year	47,551	28,004	75,555
Due in more than one year	<u>1,261,353</u>	<u>652,670</u>	<u>1,914,023</u>
Total liabilities	<u>1,382,336</u>	<u>726,147</u>	<u>2,108,483</u>

DEFERRED INFLOWS OF RESOURCES

Service concession arrangement	6,912	-	6,912
Deferred inflows related to pensions	<u>114,825</u>	<u>17,755</u>	<u>132,580</u>
Total deferred inflows of resources	<u>121,737</u>	<u>17,755</u>	<u>139,492</u>



PENSION EXAMPLES

City of Sacramento Notes to the Financial Statements For the Fiscal Year Ended June 30, 2015 (dollar amounts expressed in thousands)

As of June 30, 2015, the City reported total net pension liability, deferred outflows of resources and deferred inflows of resources for CalPERS (Miscellaneous and Safety Plans) and SCERS plan as follows:

	Net Pension Liability	Deferred Outflows of Resources	Deferred Inflows of Resources
Miscellaneous Plan	\$ 213,647	\$ 22,711	\$ 54,030
Safety Plan	373,931	36,638	78,550
SCERS	75,215	4,908	-
Total	<u>\$ 662,793</u>	<u>\$ 64,257</u>	<u>\$ 132,580</u>

GOVERNMENTAL ACTIVITIES

Other Long-term Liabilities:

Accrued claims and judgements	66,109	19,299	(11,626)	73,782
Compensated absences	31,965	32,204	(31,448)	32,721
OPEB liability	131,124	35,646	(12,668)	154,102
Net Pension liability	679,691	50,979	(157,646)	573,024

BUSINESS-TYPE ACTIVITIES:

Other Long-term Liabilities:

Compensated absences	6,842	7,186	(7,308)	6,720
OPEB liability	23,073	5,665	(1,856)	26,882
Net Pension liability	104,795	10,005	(25,031)	89,769

PENSION REPORTING - STATEMENT OF NET POSITION

- Common Deficiency:
 - Netting the net pension liability and the net pension asset on the statement of net position when a government participates in multiple pensions.
 - Splitting the NPL between current and non current liabilities
- Correct Approach
 - Each pension plan should be kept separate so as to not understate the liability or assets
 - Full amount reported as "due in more than one year"

PENSION NOTE DISCLOSURES

- Deficiency: Does not disclose whether the pension plan is a single-employer, agent multiple-employer, or cost-sharing multiple-employer defined benefit plan.
- Deficiency: Missing disclosure on whether the pension plan issues a stand-alone financial report. Also, should disclose how to obtain the report if it's available (i.e URL link).

PENSION NOTE DISCLOSURES

- Common Deficiency:
 - Not disclosing the total amounts for the total pension liabilities, pension assets, deferred outflows of resources and deferred inflows of resources, pension expense/expenditure for the period associated with net pension liabilities if the total amounts are not otherwise identifiable from information presented in the financial statements.

PENSION EXAMPLE

Pension Expense and Deferred Outflows/Inflows of Resources Related to Pensions

For the year ended June 30, 2015 the City recognized pension expense of \$45,477 attributable to the CalPERS plans. At June 30, 2015, the City reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to measurement date	\$ 59,349	\$ -
Net differences between projected and actual earnings on plan investments	-	132,580
Total	<u>\$ 59,349</u>	<u>\$ 132,580</u>

The amount of \$59,349 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. Other amounts reported as deferred inflows of resources related to pensions will be recognized as reductions of pension expense as follows:

Fiscal Year Ended June 30,	
2016	\$ (33,145)
2017	(33,145)
2018	(33,145)
2019	(33,145)
Total	<u>\$ (132,580)</u>

PENSION EXAMPLE

Pension Expense and Deferred Outflows/Inflows of Resources Related to Pensions

For the year ended June 30, 2015, the City recognized pension expense of \$19,235 attributable to the SCERS plans. At June 30, 2015, the City reported deferred outflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources
Net differences between projected and actual earnings on plan investments	\$ 4,908
Total	<u>\$ 4,908</u>

Amounts reported as deferred outflows of resources related to pensions will be recognized as pension expense as follows:

Fiscal Year Ended June 30,	
2016	\$ 1,227
2017	1,227
2018	1,227
2019	1,227
Total	<u>\$ 4,908</u>

PENSION NOTE DISCLOSURES

- Deficiency:
- For the sensitivity analysis netting the amounts from multiple plans that an employer participates in, for example netting a net pension liability and a net pension asset

	<u>Miscellaneous</u>	<u>Safety</u>
1% Decrease	6.50%	6.50%
Net Pension Liability	\$ 361,536	\$ 582,633
Current Discount Rate	7.50%	7.50%
Net Pension Liability	\$ 213,647	\$ 373,931
1% Increase	8.50%	8.50%
Net Pension Liability	\$ 91,999	\$ 202,344

	<u>1% decrease (5.5%)</u>	<u>Current Discount Rate (6.5%)</u>	<u>1% increase (7.5%)</u>
SCERS net pension liability	\$ 110,440	\$ 75,215	\$ 45,119

PENSION NOTE DISCLOSURES

- Common Deficiency:
 - Participating in a cost-sharing multiple-employer plan and including the plan's net pension liability rather than the employer's proportionate share of the net pension liability
 - Not including the disclosure for the changes in net pension liability for a single employer or agent multiple-employer plan in the notes to the financial statements.
 - Not required for cost-sharing plans but is for agent and single-employer
 - Inclusion in RSI is insufficient
 - Not distinguishing pension amounts between primary government and discretely presented component units (i.e. sensitivity analysis and changes in the net pension liability)

PENSION EXAMPLE

Changes in the Net Pension Liability - The changes in the Net Pension Liability for each Plan for the measurement date of June 30, 2014 are as follows:

Miscellaneous Plan:

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability/(Asset)
Balance at June 30, 2014	\$ 949,465	\$ 678,261	\$ 271,204
Changes in the year:			
Service Cost	23,110	-	23,110
Interest on the total pension liability	70,942	-	70,942
Contribution - employer	-	21,613	(21,613)
Contribution - employee	-	11,670	(11,670)
Net investment income	-	118,326	(118,326)
Benefit payments, including refunds of employee contributions	(30,240)	(30,240)	-
Net changes	63,812	121,369	(57,557)
Balance at June 30, 2015	\$ 1,013,277	\$ 799,630	\$ 213,647

Safety Plan:

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability/(Asset)
Balance at June 30, 2014	\$ 1,447,520	\$ 994,493	\$ 453,027
Changes in the year:			
Service Cost	29,539	-	29,539
Interest on the total pension liability	107,189	-	107,189
Contribution - employer	-	27,935	(27,935)
Contribution - employee	-	16,094	(16,094)
Net investment income	-	171,795	(171,795)
Benefit payments, including refunds of employee contributions	(66,215)	(66,215)	-
Net changes	70,513	149,609	(79,096)
Balance at June 30, 2015	\$ 1,518,033	\$ 1,144,102	\$ 373,931

PENSION EXAMPLE

Net Pension Liability (Continued)

Changes in the Net Pension Liability - The changes in the Net Pension Liability for the SCERS Plan for the measurement date June 30, 2015 is as follows:

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability/(Asset)
Balance at June 30, 2014	<u>\$ 372,670</u>	<u>\$ 312,414</u>	<u>\$ 60,256</u>
Changes in the year:			
Service Cost	131	-	131
Interest	23,134	-	23,134
Change of assumptions	23,117		23,117
Differences between expected and actual experience	(8,783)		(8,783)
Contribution - employer	-	9,183	(9,183)
Contribution - employee	-	82	(82)
Net investment income	-	13,375	(13,375)
Benefit payments, including refunds of employee contributions	(33,791)	(33,791)	-
Net changes	<u>3,808</u>	<u>(11,151)</u>	<u>14,959</u>
Balance at June 30, 2015	<u>\$ 376,478</u>	<u>\$ 301,263</u>	<u>\$ 75,215</u>

PENSION NOTE DISCLOSURES

- Common Deficiency:
 - Missing actuarial assumptions and other inputs, for example, the dates of the experience studies, the source of mortality assumptions, etc.
 - The schedule of deferred outflows and deferred inflows that will be recognized in pension expense for each of the subsequent five years and aggregate does not appear to include the correct amounts, does not articulate to the balances of deferred outflows and deferred inflows when calculated by the reviewer. Also, includes the current year amount that was recognized in pension expense in addition to the subsequent amounts.

REQUIRED SUPPLEMENTARY INFORMATION – PENSIONS

- Common Deficiency:

- Missing the schedule of employer contributions or mislabeling statutory for actuarially determined
- Including data for the schedule of employer contributions as of the measurement date

- Correct Approach

- It is statutory for all C-S and others if you cap your contributions at the statutory amount even if an actuarial valuation is performed
- All actuarially based schedules are as of measurement date, contribution schedule is as of FYE which will result in two different amounts for covered payroll

REQUIRED SUPPLEMENTARY INFORMATION – PENSIONS

- Common Deficiency:
 - Not including ten years for the schedule of employer contributions as required in paragraph P20.145c.
 - Not including all the data for the schedule of changes in net pension liability and related ratios or the schedule of the employer's proportionate share of the net pension liability, for example missing some of the ratios. Net pension liability does not trace to the statement of net position or the notes.

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QUESTIONS?