This letter contains redacted information which refers to details of control weaknesses that were communicated to locality management and governance but are FOIAE under Code of Virginia §2.2-3705.2 due its sensitivity and description of security controls or mechanisms.

# TOWN OF TAZEWELL, VIRGINIA

# COMMENTS ON INTERNAL CONTROL AND OTHER SUGGESTIONS FOR YOUR CONSIDERATION

## June 30, 2017

TOWN OF TAZEWELL, VIRGINIA

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BROWN EDWARDS
certified public accountants

**INDEPENDENT AUDITOR'S REPORT ON COMMENTS AND OTHER SUGGESTIONS**

Members of the Town Council
Town of Tazewell, Virginia

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, and each major fund, of the Town of Tazewell, Virginia (the "Town") as of and for the year ended June 30, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered the Town's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements and to comply with any other applicable standards, such as *Government Auditing Standards* and the regulations set forth in the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of the Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

If material weaknesses or significant deficiencies were identified during our procedures they are appropriately designated as such in this report. Additional information on material weaknesses or significant deficiencies and compliance and other matters is included in the ***Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*** which should be read in conjunction with this report.



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Additionally, during our audit, we became aware of certain other matters that provide opportunities for improving your financial reporting system and/or operating efficiency. Such comments and suggestions regarding these matters are also included in the attached report, but are not designated as a material weakness or significant deficiency. Since our audit is not designed to include a detail review of all systems and procedures, these comments should not be considered as being all-inclusive of areas where improvements might be achieved. We also have included information on accounting and other matters that we believe is important enough to merit consideration by management and those charged with governance. It is our hope that our suggestions will be taken in the constructive light in which they are offered.

We have already discussed these comments and suggestions with management, and we will be pleased to discuss them in further detail at your convenience, to perform additional study of these matters, or to assist you in implementing the recommendations. Lastly, we have provided a status of the prior year comments.

This communication is intended solely for the information and use of Town Council, management, and the appropriate state and federal regulatory agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
November 30, 2017

## COMMENTS ON INTERNAL CONTROL AND OTHER SUGGESTIONS FOR YOUR CONSIDERATION

### UTILITY LEDGER RECONCILIATION (Material Weakness)

The utility accounts receivable ledger does not agree to the general ledger and required significant alternative procedures for management to reconcile the balances. We recommend working with your software provider to make these ledgers reconcile. We also recommend performing a reconciliation of the two ledgers on a monthly basis.

### SEGREGATION OF DUTIES (Material Weakness)

Journal entries are entered and approved by the Treasurer. We recommend that the Town Manager review and approve all entries of the Treasurer. This approval should be documented through a signature on the specific journal entry which is maintained in numerical sequence.

### FEDERAL PROCUREMENT POLICY

The Town does not have a formal written policy or procedures on procurement of engineering and design services that have been approved by the Federal Highway Administration. In accordance with the Uniform Guidance, the federal government will require the Town to have policy and procedures in place next year. We recommend establishing written policy and procedures that have been approved by the Federal Highway Administration.

### BANK RECONCILIATIONS

At times, there is no evidence on bank reconciliations that a review was performed. We recommend dating and signing the bank statement when received and the bank reconciliation when prepared and reviewed.

### CASH ACCOUNTS (Part of Auditor Adjustments Material Weakness)

We noted the creation of a bank account that was not included in the trial balance and activities related to this account were not recorded in Accufund. We recommend that all bank accounts have corresponding accounts in the accounting system to track activity throughout the year.

### WATER DEPOSITS

The current water deposit rate on the Town's website for the public is out of date. We recommend that all rate changes be reflected on the Town's website in a timely manner so that the public is properly informed.

### LATE SUBMISSION OF CONFLICT OF INTEREST FORMS

The *Code of Virginia* requires submission of conflict of interest forms by members of Town Council by January $15^{th}$ of each year and, if late, the Commonwealth's Attorney must be notified within 30 days. We noted that the Commonwealth's Attorney was not notified in cases of late submissions. We suggest the Town assign a member of management to monitor these regulatory deadlines to ensure compliance.

## COMMENTS ON INTERNAL CONTROL AND OTHER SUGGESTIONS FOR YOUR CONSIDERATION
**(Continued)**

### UNCLAIMED PROPERTY

The *Code of Virginia* requires unclaimed property, such as outstanding checks, utility deposits, and unclaimed wages, held more than one year to be remitted to the State Treasurer. We recommend completing and filing an annual report listing all unclaimed property with the State Treasurer, due November 1st each year.

### TRAVEL AND CREDIT CARD EXPENDITURES

We noted that, at times, travel and credit card expenditures made by management were approved by a subordinate. We recommend that these purchases be approved by Town Council. Best practices suggest that activities related to travel or use of credit cards be reviewed by an individual in a supervisory role.

## SUMMARY STATUS OF PRIOR YEAR COMMENTS AND SUGGESTIONS

## GENERAL

### SEGREGATION OF DUTIES (Material Weakness)

In general, internal control is designed to safeguard assets and help prevent losses from employee dishonesty or error. A fundamental concept of internal control is the segregation of duties. The basic premise of this concept is that no one employee should have access to both physical assets and the related accounting records, or to all phases of a transaction. Conflicting duties being performed by employees should be avoided. While we realize that any internal control system must be cost effective, steps should be taken to eliminate performance of conflicting duties where possible. Due in part to the size of the operations of the Town, certain functions may not be fully segregated. However, compensating controls may be considered to alleviate the control weaknesses described below and others mentioned in this report.

- Limit general ledger access to those areas needed for employees to perform job responsibilities. Employees should not have access to all areas of the general ledger. We recommend that the Town develop policies and procedures regarding restricting employees' access to data and computer programs.

- Currently, the accounts payable clerk has control of all functions within the accounts payable process including vendor setup, invoice entry, check processing, and mailing payments. We recommend that personnel in the payables function be independent of the general ledger functions. This should include restrictions on vendor setup and maintenance in the system. We recommend that after disbursement checks have been signed, they are returned to an individual not involved in the disbursement process for mailing. We also recommend having the bank perform a call back after direct deposits are initiated.

- For taxes and utilities, the receipt of customer payments and the deposit of such payments are in the possession of individuals who have access to mail billings, adjust customer balances, and post to the general ledger. We recommend considering implementing controls to prevent such conflicting duties.

- Customer complaints regarding billing discrepancies should be handled by a person who does not post cash receipts or open the mail.

- Currently, the personnel with human resource functions also handles all phases of the payroll process including approval, data input of hours worked, data input of employee pay rates and updates, and posting payroll transactions to the general ledger. Where possible, these functions should be segregated so that personnel with human resource functions can be independent of the payroll process.

- We noted that reports are prepared and submitted and vendor information changed throughout the year without the performance of an internal review. The performance of such reviews should be by an individual independent of the original preparer and an individual with enough knowledge of the underlying data to detect errors or omissions. The review should be documented by initials or signatures and the date.

**Current status:** *Still applicable. We did note that the Town does review the payroll register in an attempt to mitigate some of the risks noted above. We also noted that the billing and receipt function is handled by one of three employees instead of just one. Finally, we noted the Town Manager approves the vendor listing. We continue to recommend to the Town to segregate duties as much as possible.*

## INTERGOVERNMENTAL AGREEMENT COMPLIANCE

In accordance with the agreement dated October 30, 2009 between the Town and the Tazewell County Public Service Authority ("PSA"), certain assets and a related service area were transferred from the PSA to the Town. As part of this agreement, both parties are required to contribute $1,000 per month into a reserve account to be used for unexpected capital expenditures. These deposits were to begin effective when the PSA began discharging into the related assets. This discharge period began in 2012; however, it appears the Town did not contribute the required $1,000 per month into a separate reserve. We suggest the Town review this section of the agreement, catch up on delinquent reserve contributions, and begin remitting payments timely in the future.

**Current status:** *Management is aware of reserve requirements; however, has not yet begun such contributions.*

## FINANCIAL REPORTING

## REVIEW OF TRIAL BALANCE (Material Weakness)

Often, governments incorrectly assume that the accuracy and completeness of the trial balance is the ultimate responsibility of the external auditors. As a result, they fail to spend the necessary time reviewing the trial balance for completeness and accuracy which leads to errors and omissions going unnoticed. While performing the current year audit, we detected errors in a number of account balances that did not reconcile to the subsidiary ledgers and underlying records. In addition, we noted accounts for which management did not know the purpose such as nontax receivable accounts and various other liability accounts. We recommend the Town establish a review process whereby the Town Manager and the Treasurer/Clerk perform at least a monthly review of the trial balance ensuring, as also noted below, that the subsidiary ledgers reconcile to the trial balance, month-end balances agree to statements or supporting schedules, and the purpose of each account and the balance is understood.

**Current status:** *Still applicable.*

## RECONCILE SUBSIDIARY LEDGERS TO TRIAL BALANCE ACCOUNTS (Material Weakness)

The subsidiary ledgers are not being reconciled to the trial balance on a monthly basis. The Town should adopt a policy requiring monthly reconciliation of all balance sheet accounts to their subsidiary ledgers. This would ensure the accuracy of the internal monthly financial statements and trial balance. Balance sheet reconciliations quickly identify errors and needed corrections. If reconciliations are performed infrequently, errors and adjustments can occur, resulting in the need for significant corrections when the reconciliations are performed. Any reconciling differences should be corrected before the books are closed for the month end. Due to the integrated nature of the Town's accounting software, errors noted between subsidiary ledgers and general ledger balances may be due to system errors or problems. In these cases, involvement of the software specialist may be warranted.

**Current status:** *Still applicable.*

## FINANCIAL REPORTING
(Continued)

### AUDITOR ADJUSTMENTS (Material Weakness)

We posted a number of significant journal entries which we deemed material to the financial statements and which, in our judgment, represent a material weakness in the Town's internal control over financial reporting. Adjustments which we considered material were posted to record receivables and unbilled receivables, to reflect changes in capital assets, to correctly reflect principal, and to adjust interest paid on debt obligations.

We recommend the Town address these matters through training in both accounting and in the use of its accounting software. Although it is not anticipated, given the Town's small size, that its staff will be able to prepare GAAP based external financial statements, they should be able to provide, at the beginning of the audit, a reasonably accurate trial balance that has been reconciled to the subsidiary ledgers. This would eliminate some additional cost incurred for assistance by the auditors. Additionally, adjustments needed to record basic year end accrual entries, such as for capital assets, debt and accrued expenses, should be developed for posting by the auditors, if necessary.

**Current status:** *Still applicable. The Town continues to work on the completeness trial balance reconciliation and preparation.*

### BASIS OF ACCOUNTING

The Town does not maintain internal modified accrual/accrual basis financial records throughout the year. It is generally accepted that modified accrual/accrual basis financial statements provide a more accurate reflection of an entity's economic condition than do cash basis statements. The modified accrual basis is used for governmental type funds while the accrual basis is used for proprietary type funds. A modified accrual/accrual basis general ledger would also provide greater control over accounts receivable and accounts payable. We recommend the Town consider switching to the modified accrual/accrual basis after fully training accounting staff on these methods.

**Current status:** *Still applicable. However, we continue to note improvement as new processes and procedures are put into place.*

### SOFTWARE SETTINGS

During the current year audit, we noted that there is a setting within the general ledger system that would allow the Town to post transactions to the wrong period. Per discussions with Town personnel, this setting is at times not set properly which would allow posting to the wrong period. We recommend that this setting be set appropriately to prevent posting transactions into the wrong period.

**Current status:** *No similar instances noted.*

## SUMMARY STATUS OF PRIOR YEAR COMMENTS AND SUGGESTIONS
## (Continued)

## ACCOUNTS RECEIVABLE AND REVENUE

### RECORD ALLOWANCE FOR DOUBTFUL ACCOUNTS (Material Weakness)

Receivables at year end in the general and water and sewer funds should be shown net of an allowance for doubtful accounts. We recommend the Town implement procedures to calculate, evaluate, document, and review the allowance for doubtful receivables for reasonableness throughout the year and ensure that the balances recorded and disclosed in the financial statements are reasonable based upon methodologies used in practice and adopted by the Town.

**Current status:** *Still applicable.*

### WRITE-OFF POLICY

There is a policy for the write-off of uncollectible receivables; however, this policy is not enforced. This has led to the accumulation of significant uncollectible amounts on the general ledger. Per discussion with management, accounts have not been written off for over seven years. We recommend that the policy be implemented to ensure uncollectible accounts are removed from the general ledger periodically and to provide control that only uncollectible accounts are written off. Once implemented, these policies should be enforced to ensure adherence.

**Current status:** *No similar instances noted.*

### EMS BILLINGS (Material Weakness)

As with other financial transaction cycles, we noted a segregation of duties relating to the collecting, handling, depositing, and recording of these receipts. We further recommend that the Town keep track of services performed compared to what is billed, collected, and remitted. This will ensure completeness of revenues.

**Current status:** *No similar instances noted.*

## CAPITAL ASSETS

### CAPITAL ASSET RECORDKEEPING (Material Weakness)

Capital asset protection begins with quality record keeping. Detailed property records help establish accountability and allow for the development of additional control and safeguards. The accuracy and completeness of these records can also impact the various costs (insurance, replacement, etc.) associated with owning capital assets. The Town currently does not keep system records up to date related to disposals. Capital asset additions were also not captured in an effective manner. We recommend that recordkeeping and review procedures be improved to ensure the adequacy and completeness of asset listings and depreciation schedules.

**Current status:** *Similar instances noted in current year.*

## SUMMARY STATUS OF PRIOR YEAR COMMENTS AND SUGGESTIONS
**(Continued)**

## CAPITAL ASSETS
**(Continued)**

### ADOPTION OF A CAPITAL ASSET CAPITALIZATION POLICY

We noted that the Town does not have an established guideline concerning which property and equipment acquisitions are to be capitalized. We recommend that the Town establish a useful period and dollar threshold for capitalization of assets and expense items below those criteria. This will result in a more uniform treatment of property and equipment and also eliminate unnecessary work by the accounting department in recording immaterial items.

***Current status:*** *No similar instances noted.*

### INVENTORY CAPITAL ASSETS

We recommend that the Town perform a physical inventory of property and equipment. In connection with this inventory, tags should be placed on each asset with numbers that are recorded in the detail property records. This will help improve the tracking of assets for disposal, impairment, and reporting purposes.

**Current status:** *Similar instance noted in current year.*

## ACCOUNTS PAYABLE, PAYROLL, AND EXPENDITURES

### ACCOUNTING FOR ACCOUNTS PAYABLE (Material Weakness)

Generally accepted accounting principles require that expenditures be recognized at the time services are rendered or goods are received. In our audit testing, we discovered a significant number of sizeable transactions that have been improperly excluded from accounts payable at year end. We recommend management review its policies for recording accounts payable and ensure proper guidance is communicated to Town personnel, such as department managers, who should be aware of the dates transactions occur. Finally, the finance department's review of disbursements should include consideration as to whether the transactions are recorded in the proper period.

***Current status:*** *During the current year, there were several adjustments made to the accounts payable balances that were incorrectly accrued and expenditures incurred but not paid prior to year end relating to capital projects.*

### CLASSIFICATION OF CERTAIN EXPENDITURES

We noted during the current year audit that water expense charged in the General Fund was recorded in miscellaneous expense. We recommend that the Town consider charging these types of expenses more accurately, such as to utilities expense.

**Current status:** *Still applicable regarding certain expenditures such as debt payments and capital type items.*

## SUMMARY STATUS OF PRIOR YEAR COMMENTS AND SUGGESTIONS (Continued)

## FUND BALANCE AND NET POSITION

### FUND BALANCE AND NET POSITION RECONCILIATION (Material Weakness)

We noted that the beginning General Fund's fund balance and Water and Sewer Fund's net position were off by approximately $1,000 and $1,500, respectively. As communicated in the previous year's management letter, these accounts should be compared to the prior-year financial report to ensure that all audit adjustments were posted properly.

**Current status:** *Still applicable.*

## OTHER MATTERS

### GENERAL FUND BUDGET APPROPRIATIONS

As noted in the Schedule of Expenditures – Budget and Actual – Cash Basis, Exhibit 9 of the financial report, certain general fund expenditure categories exceeded budgeted appropriations. We recommend the Town monitor expenses and adjust the budget or issue amendments if necessary.

**Current status:** *Still applicable.*

### HIGHWAY MAINTENANCE PROGRAM

During our review of the Highway Maintenance Program, we noted reimbursements for work performed on roads that were not included in the Department of Transportation's annual listing of eligible streets. Steps should be taken to ensure proper reporting of eligible expenditures.

**Current Status:** *No similar instances noted.*

### VIRGINIA RETIREMENT SYSTEM

At times there were differences between salaries reported to Virginia Retirement System and amount paid. Steps should be taken to ensure proper payment and reporting.

**Current status:** *No similar instances noted.*

### TIMELINESS OF BANK RECONCILIATION REVIEW

The Town has implemented a supervisory review process for the bank reconciliation process. However, we noted that, at times, this review did not occur until multiple months after the end of the applicable month. Similar to the need for timely reconciliations, timely reviews of reconciliations are necessary to ensure unreconciled or unusual items, errors, or other matters noted on reconciliations are detected and addressed by a supervisory individual in a timely manner.

**Current status:** *Still applicable.*

## SUMMARY STATUS OF PRIOR YEAR COMMENTS AND SUGGESTIONS
## (Continued)

## OTHER MATTERS
## (Continued)

### SUBMISSION OF CONFLICT OF INTEREST FORMS

The *Code of Virginia* requires submission of conflict of interest forms by members of Town Council by December 15$^{th}$ and, as applicable, June 15$^{th}$ of each year. We noted certain Council submissions were not made by the required date. We suggest the Town assign a member of management to monitor these regulatory deadlines to ensure compliance.

**Current status:** *Still applicable.*

## SUMMARY STATUS OF PRIOR YEAR IT COMMENTS AND SUGGESTIONS

### NO INFORMATION TECHNOLOGY (IT) DEPARTMENT

When a separate department does not exist for IT, there is often a need to cross train and have backups for various functions and to have vendors perform certain functions. Also, required vacations may not be able to be taken as consecutive days. While these factors do improve the ability to respond to Town needs and can reduce staffing requirements, it also reduces the level of controls that exist when personnel or vendors have access to several stages within the input/processing/output cycles or to access controls. A finance department employee has access to and is performing a limited system administrator role on the core financial system. Having an individual with rights to root access or system administrator's level access combined with other non-IT functions pose several potential challenges. Often, it is not possible to further segregate the duties based on resource limitations and demands. We recommend that current cross-training and personnel backup strategy be considered in terms of controls and determine if reasonable changes should be made to improve controls, or whether reviews of system administrator's and other critical logs may be considered necessary. If logs are to be reviewed, often filters can be set up to reduce the burden of the review. Based on good control structures, an individual who would perform these types of reviews should not be in a position where they might be reviewing their own work. When a government depends on a vendor solution or support to provide security and continuance in case of a disaster, the government is still responsible to ensure the security and continuance of its systems and should maintain its documented understanding about these issues.

**Current Status:** *Still applicable. An IT specialist is currently assisting the Town with various IT functions; however, the important mitigating control of reviewing administrator and other critical logs does not yet appear to have been implemented.*

### DISASTER RECOVERY

#### Disaster Recovery Plan

The Town does not have a formal written disaster recovery plan in place, although an informal plan is in place to help ensure proper and timely recovery in case of a disaster. We recommend that this plan be written and appropriately tested to assist in ensuring its viability. Scenarios should include, but not be limited to, non-availability of key staff and assumed unavailability or delay of certain key resources.

**Current Status:** *Comment no longer applicable.*

### NETWORK AND SERVER SECURITY

[redacted]

[redacted]

**Current Status:** *Still applicable.*

## SUMMARY STATUS OF PRIOR YEAR IT COMMENTS AND SUGGESTIONS (Continued)

### ACCESS SECURITY

**Access Permissions (Material Weakness)**

We noted that most of the office employees have access to the Accufund system, and the permissions for these employees are not segregated in the system. We also noted that most finance employees also have general ledger access through this process. We recommend that the Town consider further restricting permissions to help ensure segregation of duties within the system.

**Current Status:** *Steps were taken in the prior year that significantly improved the segregation of duties within Accufund, however complete segregation is difficult to implement due to the size of the Town. Access to payroll has been restricted to Human Resources and the Treasurer in current year. As described in the "NO INFORMATION TECHNOLOGY (IT) DEPARTMENT" comment above, an important mitigating control in this situation is the review of administrator and other critical logs. Currently, however, this review is not occurring. To better monitor an appropriate segregation of duties, we recommend that a non-system administrator user periodically review these logs.*

**ACCOUNTING AND OTHER MATTERS**
**June 30, 2017**

In this section, we would like to make you aware of certain confirmed and potential changes that are on the horizon that may affect your financial reporting and audit.

## GASB STATEMENT NO. 75

**GASB Statement No. 75**, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions* improves accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans, for OPEB.* Statement No. 74, *Financial Reporting for Postemployment Benefit Plans other than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. This Statement also addresses certain circumstances in which a nonemployer entity provides financial support for OPEB of employees of another entity.

In this Statement, distinctions are made regarding the particular requirements depending upon whether the OPEB plans through which the benefits are provided are administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.
- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, the OPEB plan administrator, and the plan members.

**GASB Statement No. 75** will be effective for the year ending June 30, 2018. To prepare for implementation of this new Statement, management should consult with the entity's external OPEB actuarial firm to ensure timely reporting and compliance with the requirements of this Statement.

(Continued)

## ACCOUNTING AND OTHER MATTERS
## June 30, 2017

### GASB STATEMENT NO. 81

**GASB Statement No. 81**, *Irrevocable Split-Interest Agreements* will improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split interest agreements can be created through trusts – or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements – in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate.

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

**GASB Statement No. 81** will be effective for the year ending June 30, 2018.

### GASB STATEMENT NO. 82

The objective of **GASB Statement No. 82**, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73* is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets* that are not within the scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68. Specifically, this Statement addresses issues regarding the presentation of payroll-related measures in required supplementary information, the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

The requirements of this Statement are effective for the year ended June 30, 2017, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017.

(Continued)

## GASB STATEMENT NO. 83

**GASB Statement No. 83**, *Certain Asset Retirement Obligations* addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.

This Statement requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually. In addition, it requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should re-measure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. The deferred outflows of resources should be reduced and recognized as outflows of resources (for example, as an expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset.

A government may have a minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset in which a nongovernmental entity is the majority owner and reports its ARO in accordance with the guidance of another recognized accounting standards setter. Additionally, a government may have a minority share of ownership interest in a jointly owned tangible capital asset in which no joint owner has a majority ownership, and a nongovernmental joint owner that has operational responsibility for the jointly owned tangible capital asset reports the associated ARO in accordance with the guidance of another recognized accounting standards setter. In both situations, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of this Statement.

(Continued)

**GASB STATEMENT NO. 83 (Continued)**

In some cases, governments are legally required to provide funding or other financial assurance for their performance of asset retirement activities. This Statement requires disclosure of how those funding and assurance requirements are being met by a government, as well as the amount of any assets restricted for payment of the government's AROs, if not separately displayed in the financial statements.

This Statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. If an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government is required to disclose that fact and the reasons therefor. This Statement requires similar disclosures for a government's minority shares of AROs.

**GASB Statement No. 83** will be effective for the year ending June 30, 2019.

**GASB STATEMENT NO. 84**

The objective of **GASB Statement No. 84**, *Fiduciary Activities* is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is 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 postemployment benefit arrangements that are fiduciary activities.

An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.

This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

A fiduciary component unit, when reported in the fiduciary fund financial statements of a primary government, should combine its information with its component units that are fiduciary component units and aggregate that combined information with the primary government's fiduciary funds.

This Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

**GASB Statement No. 84** will be effective for the year ending June 30, 2020.

## GASB STATEMENT NO. 85

The objective of **GASB Statement No. 85**, *Omnibus 2017,* is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). Specifically, this Statement addresses the following topics:

- Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation
- Reporting amounts previously reported as goodwill and "negative" goodwill
- Classifying real estate held by insurance entities
- Measuring certain money market investments and participating interest earning investment contracts at amortized cost
- Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus
- Recognizing on-behalf payments for pensions or OPEB in employer financial statements
- Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB
- Classifying employer-paid member contributions for OPEB
- Simplifying certain aspects of the alternative measurement method for OPEB
- Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

**GASB Statement No. 85** will be effective for the year ending June 30, 2018.

## GASB STATEMENT NO. 86

The primary objective of **GASB Statement No. 86**, *Certain Debt Extinguishment Issues* is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

## GASB STATEMENT NO. 86 (Continued)

*In-Substance Defeasance of Debt Using Only Existing Resources*

Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, requires that debt be considered defeased in substance when the debtor irrevocably places cash or other monetary assets acquired with refunding debt proceeds in a trust to be used solely for satisfying scheduled payments of both principal and interest of the defeased debt. The trust also is required to meet certain conditions for the transaction to qualify as an in-substance defeasance. This Statement establishes essentially the same requirements for when a government places cash and other monetary assets acquired with only existing resources in an irrevocable trust to extinguish the debt. However, in financial statements using the economic resources measurement focus, governments should recognize any difference between the reacquisition price (the amount required to be placed in the trust) and the net carrying amount of the debt defeased in substance using only existing resources as a separately identified gain or loss in the period of the defeasance.

Governments that defease debt using only existing resources should provide a general description of the transaction in the notes to financial statements in the period of the defeasance. In all periods following an in-substance defeasance of debt using only existing resources, the amount of that debt that remains outstanding at period-end should be disclosed.

*Prepaid Insurance Related to Extinguished Debt*

For governments that extinguish debt, whether through a legal extinguishment or through an in-substance defeasance, this Statement requires that any remaining prepaid insurance related to the extinguished debt be included in the net carrying amount of that debt for the purpose of calculating the difference between the reacquisition price and the net carrying amount of the debt.

*Additional Disclosure for All In-Substance Defeasance Transactions*

One of the criteria for determining an in-substance defeasance is that the trust holds only monetary assets that are essentially risk-free. If the substitution of essentially risk-free monetary assets with monetary assets that are not essentially risk-free is not prohibited, governments should disclose that fact in the period in which the debt is defeased in substance. In subsequent periods, governments should disclose the amount of debt defeased in substance that remains outstanding for which that risk of substitution exists.

**GASB Statement No. 86** will be effective for the year ending June 30, 2018.

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## GASB STATEMENT NO. 87

The objective of **GASB Statement No. 87**, *Leases,* is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

### *Definition of a Lease*

A lease is defined as 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. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this Statement.

### *Lease Term*

The lease term is defined as the period during which a lessee has a non-cancelable right to use an underlying asset, plus the following periods, if applicable:

- Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
- Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option
- Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option
- Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will not exercise that option.

A fiscal funding or cancellation clause should affect the lease term only when it is reasonably certain that the clause will be exercised.

Lessees and lessors should reassess the lease term only if one or more of the following occur:

- The lessee or lessor elects to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would not exercise that option.
- The lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would exercise that option.
- An event specified in the lease contract that requires an extension or termination of the lease takes place.

## GASB STATEMENT NO. 87 (Continued)

*Short-Term Lease*

A short-term lease is defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract.

*Lessee Accounting*

A lessee should recognize a lease liability and a lease asset at the commencement of the lease term, unless the lease is a short-term lease or it transfers ownership of the underlying asset. The lease liability should be measured at the present value of payments expected to be made during the lease term (less any lease incentives). The lease asset should be measured at the amount of the initial measurement of the lease liability, plus any payments made to the lessor at or before the commencement of the lease term and certain direct costs.

A lessee should reduce the lease liability as payments are made and recognize an outflow of resources (for example, expense) for interest on the liability. The lessee should amortize the lease asset in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. The notes to financial statements should include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

*Lessor Accounting*

A lessor should recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term, with certain exceptions for leases of assets held as investments, certain regulated leases, short-term leases, and leases that transfer ownership of the underlying asset. A lessor should not derecognize the asset underlying the lease. The lease receivable should be measured at the present value of lease payments expected to be received during the lease term. The deferred inflow of resources should be measured at the value of the lease receivable plus any payments received at or before the commencement of the lease term that relate to future periods.

A lessor should recognize interest revenue on the lease receivable and an inflow of resources (for example, revenue) from the deferred inflows of resources in a systematic and rational manner over the term of the lease. The notes to financial statements should include a description of leasing arrangements and the total amount of inflows of resources recognized from leases.

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## GASB STATEMENT NO. 87 (Continued)

*Contracts with Multiple Components and Contract Combinations*

Generally, a government should account for the lease and non-lease components of a lease as separate contracts. If a lease involves multiple underlying assets, lessees and lessors in certain cases should account for each underlying asset as a separate lease contract. To allocate the contract price to different components, lessees and lessors should use contract prices for individual components as long as they do not appear to be unreasonable based on professional judgment, or use professional judgment to determine their best estimate if there are no stated prices or if stated prices appear to be unreasonable. If determining a best estimate is not practicable, multiple components in a lease contract should be accounted for as a single lease unit. Contracts that are entered into at or near the same time with the same counterparty and that meet certain criteria should be considered part of the same lease contract and should be evaluated in accordance with the guidance for contracts with multiple components.

*Lease Modifications and Terminations*

An amendment to a lease contract should be considered a lease modification, unless the lessee's right to use the underlying asset decreases, in which case it would be a partial or full lease termination. A lease termination should be accounted for by reducing the carrying values of the lease liability and lease asset by a lessee, or the lease receivable and deferred inflows of resources by the lessor, with any difference being recognized as a gain or loss. A lease modification that does not qualify as a separate lease should be accounted for by re-measuring the lease liability and adjusting the related lease asset by a lessee and re-measuring the lease receivable and adjusting the related deferred inflows of resources by a lessor.

*Subleases and Leaseback Transactions*

Subleases should be treated as transactions separate from the original lease. The original lessee that becomes the lessor in a sublease should account for the original lease and the sublease as separate transactions, as a lessee and lessor, respectively.

A transaction qualifies for sale-leaseback accounting only if it includes a sale. Otherwise, it is a borrowing. The sale and lease portions of a transaction should be accounted for as separate sale and lease transactions, except that any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred inflow of resources or a deferred outflow of resources and recognized over the term of the lease.

A lease-leaseback transaction should be accounted for as a net transaction. The gross amounts of each portion of the transaction should be disclosed.

**GASB Statement No. 87** will be effective for the year ending June 30, 2021.

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## CURRENT GASB PROJECTS

GASB currently has a variety of projects in process. Some of these projects are as follows:

- ***Conceptual Framework – Recognition.*** The project's objective is to develop recognition criteria for *whether* information should be reported in state and local governmental financial statements and *when* that information should be reported. This project ultimately will lead to a Concepts Statement on recognition of elements of financial statements. The project is currently in deliberations with an exposure draft expected in March 2020, with a final statement in November 2021.

- ***Financial Reporting Model.*** The objective of this project is to make improvements to the financial reporting model, including Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and other reporting model-related pronouncements (Statements No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, No. 41, *Budgetary Comparison Schedules – Perspective Differences*, and No. 46, *Net Assets Restricted by Enabling Legislation, and Interpretation No. 6, Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*). The objective of these improvements would be to enhance the effectiveness of the model in providing information that is essential for decision-making and enhance the ability to assess a government's accounting and address certain application issues, based upon the results of the pre-agenda research on the financial reporting model. The project is currently in deliberations with an exposure draft expected in March 2020, with a final statement in November 2021.

- ***Revenue and Expense Recognition.*** The objective of this project is to develop a comprehensive application model for the recognition of revenues and expenses that arise from nonexchange, exchange, and exchange-like transactions, including guidance for exchange transactions that has not been specifically addressed in the current literature. The purpose for developing a comprehensive model is (1) to improve the information regarding revenues and expenses that users need to make decisions and assess accountability, (2) to provide guidance regarding exchange and exchange-like transactions that have not been specifically addressed, (3) to evaluate revenue and expense recognition in the context of the conceptual framework, and (4) to address application issues identified in practice, based upon the results of the pre-agenda research on revenue for exchange and exchange-like transactions. The project is currently in deliberations with an exposure draft expected in March 2021, with a final statement in June 2022.

- ***Capitalization of Interest Cost.*** The objective of this project is to reconsider the accounting and financial reporting standards for capitalization of interest cost, with the goal of enhancing the relevance of capital asset information and potentially simplifying financial reporting. In particular, the guidance will be reviewed in light of the definitions of financial statement elements now established in the GASB's conceptual framework. This project has been added to the current technical agenda, with a final statement expected in June 2018.

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**CURRENT GASB PROJECTS (Continued)**

- ***Equity Interest Ownership Issues.*** This project will address certain issues related to the reporting of majority equity ownership in legally separate entities. The project will consider improvements to the existing guidance in Statement No. 14, *The Financial Reporting Entity*, on the presentation of ownership interest in a legally separate entity. The project also will consider improvements to the recognition and measurement guidance for wholly-owned legally separate entities that are presented as component units. The project is currently in deliberations with a final statement expected in November 2018.