

## **2007 GASB UPDATE**

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## ABOUT THE AUTHOR

**J. Michael Inzina, CPA, CGFM** is founder and chief executive officer of Audit Litigation Training and Efficiency Consulting, Inc. (ALTEC), a consulting company serving public accounting firms and other accounting and auditing organizations on matters of audit efficiency, continuing education, litigation and ethics. He has over 30 years of public accounting experience, and remains a partner in the firm of Stagni & Company, LLC, whose practice is concentrated in government and nonprofits organizations. Mike holds a BBA in accounting from the University of Louisiana (Monroe), where he graduated summa cum laude in May 1976. He is a member of the American Institute of CPAs, Society of Louisiana CPAs, Government Finance Officers Association of Louisiana, and the Association of Government Accountants. Mike earned the CEA in governmental in 1990, and was awarded the Certified Government Financial Manager (CGFM) designation in 1996. He is a past chapter president and member of the Society of Louisiana CPAs Board of Directors and served two terms as chairman of the Governmental Positive Enforcement Program of the Louisiana State Board of CPAs. He has served on a number of committees of the Society of Louisiana CPAs, and currently serves on its Ethics and Litigation Support Committees. Mike also serves on the GASB Service Efforts and Accomplishments Task Force.

Mike has twice been a member of the AICPA Professional Ethics Executive Committee (1989-1992 and 2000-2003), and served on the Auditing Standards Board from 1997 to 2000. From 1986 to 1993, he also served as a member of AICPA Independence and Behavioral Standards Subcommittee, and as Subgroup Chairman of the Governmental Technical Standards Committee. During this time he conducted numerous investigations of complaints filed by federal, state and local agencies alleging substandard performance of audits of governmental and nonprofit entities, and represented the Professional Ethics Division at hearings of the Joint Regional Trial Board.

He contributed to the *Implementation Guide* for GASB Statement 34, AICPA Statement of Position 98-3, *Audits of States, Local Governments and Not-for-Profit Organizations Receiving Federal Awards*, revisions to the AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, the AICPA Practice Aid *Fraud Detection in a GAAS Audit*, revisions to the Louisiana Governmental Audit Guide and in drafting state legislation affecting governmental accounting and auditing requirements. He has served as technical consultant and instructor for the Louisiana Division of Administration (Office of Community Development), and as consultant to the Louisiana Department of Education. Mike frequently appears as moderator and panelist on the Accountants' CPE Network. (ACPEN).

Mike has been named twelve times as an Outstanding Instructor by the American Institute of CPAs and several state societies, and received a Special Recognition Award from the Society of Louisiana CPAs Board of Directors for his contributions to continuing education in 1994. In addition, he was awarded the 2001 National Education and Training Award from the Association of Government Accountants.

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## *2007 GASB Update*

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**Publisher/vendor: Audit Litigation, Training and Efficiency Consulting, Inc. (ALTEC)**

**Description:** The *GASB Update* is designed to provide its participants with a comprehensive, in-depth review of GASB Statements and Interpretations, exposure drafts and projects in progress, with emphasis on the practical application and impact on practitioners in small to medium sized firms and members in government.

**Learning objectives:** To enable participants to understand and apply the recently adopted pronouncements of the GASB which will affect the preparation and audit of financial statements of state and local governments.

**Experience/Prerequisites:** Minimum to intermediate level of auditing experience.

**Who should attend:** Partners and managers responsible for planning and supervision of governmental engagements, audit staff members who need to understand the changes which have occurred to enable them to conduct governmental engagements, and persons in government responsible for accounting, financial statement preparation, and internal audits.

**Recommended CPE Credit:** 4 hours (200 minutes)

## **STATEMENTS 43 AND 45**

## ***FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFIT PLANS OTHER THAN PENSION PLANS***

## ***ACCOUNTING AND FINANCIAL REPORTING BY EMPLOYERS FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS***

The GASB has issued two Statements on Other Postemployment Benefits (OPEB). Statement 43 addresses financial reporting for OPEB plans (“the plan Statement”) and Statement 45 addresses accounting and financial reporting by employers for postemployment benefit plans (“the employers’ statement”).

### **OPEB defined**

Employees of state and local governments are typically provided retirement benefits as a result of their employment. The Board has provided for the reporting of pension benefits by employers and pension plans in previous statements. As the name “OPEB” implies, these standards address benefits other than pensions. These may include post-retirement health care, dental, vision or prescription insurance, life insurance, legal services, or other benefits.

### **Why these standards were issued**

As indicated, GASB issued guidance applicable to pension benefits some time ago (1994), but no similar guidance had existed to date for other types of benefits. Consistent with the GASB’s position on pensions, the Board considers other postemployment benefits to be part of employee compensation, even though they are not realized by employees until after retirement. These costs, as part of compensation, are a component of the current cost of services (i.e., during the periods in which the benefits are earned by employees).

Current reporting practice is that most governments only report their current outlays for OPEB for a given year, rather than the actual cost to the employer of the benefits earned by employees during that same period. Since the benefits are realized in future years when the benefits will probably cost considerably more than the current cost for the same services, the reporting of cash outlays can be expected to be substantially less than the actual (actuarial) cost of the benefits earned by employees.

In addition, the Board noted that most governments do not report information about the nature and size of their long-term obligations and commitments related to OPEB. The result is that users of financial statements do not get the complete picture of the cost of government services.

## **Types of OPEB plans**

In general, employers provide two overall types of benefit plans:

- Defined benefit plans, which specify the amount of benefits to be provided to employees upon retirement, and
- Defined contribution plans, which specify only the amount that the employer will contribute to the plan member's account annually, and do not guarantee any specific benefit or level of benefits employees will receive post-retirement.

Plans are also distinguished by the number of sponsoring employers:

- Single-employer plans are sponsored by only one government
- Cost-sharing multiple-employer plans are sponsored by more than one government, in which the participating governments pool or share both the cost of benefits and the assets of the plan that are accumulated to satisfy the benefit obligations
- Agent multiple-employer plans are sponsored by more than one government, but there is no pooling of benefit costs – separate actuarial calculations are made for each sponsoring employer, and separate accounting is done to make certain that a given employer's contributions are used to provide benefits only to the employees of that employer.

## **How governments finance OPEB**

Some governments apply an *actuarial approach* to paying for pension and OPEB. Under this approach, the government transfers to the benefit plan an amount that, invested now, can be expected to be sufficient to pay for future benefits. This approach is commonly used to finance pension costs.

In the case of OPEB, most governments have been following a *pay-as-you-go* approach, transferring only the resources required to satisfy the current benefits distributed or claimed in any given year.

The actuarial approach relies on actuarial science, using assumptions about factors such as retirement ages, mortality schedules, investment returns, inflation rates and demand for the benefits. This approach produces an estimate (“valuation”) of the cost of the benefits actually earned by employees, to determine the amount that the employer should currently contribute to the plan to provide the benefits established by the plan.

## **How the Statements require that employers account for OPEB**

The standards require accounting for and report the cost of OPEB and the related obligations and commitments in a manner consistent with that already required for pension benefits. The cost of OPEB is actuarially determined based on valuations performed in accordance with parameters established by the GASB at least every two years (for OPEB plans with 200 or more participants)

or three years (for plans with fewer than 200 participants). Such valuations generally follow accepted actuarial practice established by the Actuarial Standards Board.

In general, future cash outlays for OPEB are projected based on economic and demographic assumptions, and those outlays would be discounted to their *actuarial present value* using a discount rate equal to an assumed long-term rate of return on investments. That actuarial present value would be spread over a period approximating the anticipated length of service for an average employee, using any one of six acceptable actuarial methods. The part of the actuarial present value allocated to a given year is called the *normal cost*. The portion of the actuarial present value allocated to future years are future normal costs.

Although any of six acceptable methods are allowed, the Board believes that governments should use the same method for both funding and financial reporting. If the funding and financial reporting methods are not consistent, the government would select from the six alternatives for financial reporting purposes.

Because OPEB plans have existed for years, actuarial calculations must consider the future benefits to be earned, but those benefits that have already been earned, referred to as the *actuarial accrued liability*. Cash, investments and other resources that constitute OPEB plan assets may be applied to satisfy the actuarial accrued liability, and are referred to as the *actuarial value of [plan] assets*. The excess of the actuarial accrued liability over the actuarial value of assets is the *unfunded actuarial accrued liability* (sometimes simply the “unfunded liability”). This unfunded liability would be amortized over a period of as much as thirty years, either in level dollar amounts or as a level percentage of projected payroll. The level dollar amount approach divides the unfunded liability into equal amounts, including both principal and interest. The level percentage of payroll approach calculates payments so that they equal a constant percentage of payroll over time, as payroll increases.

The normal cost and the portion of the unfunded actuarial accrued liability to be amortized in the current period are combined to make up the *annual required contribution* (ARC) for the period. Thus, the ARC is the amount determined to provide sufficient resources to fund both the benefits earned by employees during the period, and those benefits earned in past service.

An employer’s annual OPEB cost is the ARC, with adjustments made (up or down) if the employer’s actual contributions over time differ from the ARC. The cumulative differences between an employer’s annual OPEB cost and the amounts the employer actually contributes are the employer’s *net OPEB obligation*.

### **Implicit rate subsidies**

In medical benefit plans, where retirees are insured in the same plan with current employees, premiums paid by retirees may be less than the amount of premiums that would be required if the retirees were separately insured. This is referred to as an *implicit rate subsidy*. In the original exposure draft, the employer would not have been required to account for an implicit rate subsidy as OPEB, if the retirees paid all (100%) of their premiums without an employer

contribution. Based on comments received relative to the original ED, the employer is now required to treat the implicit rate subsidy as OPEB, whether employer contributions are required or not. As a result, postemployment healthcare benefits must be projected based on claims costs for retirees or on *age-adjusted premiums*, approximating claims costs. The difference between the retirees' claims costs or age-adjusted premiums, and the amounts paid by retirees would be required to be accounted for as an employer expense, whether the contribution is made in an "implicit" or "explicit" manner.

However, when an employer provides healthcare benefits to active employees and retirees through participation in a *community-related* plan, it would be appropriate to project postemployment healthcare benefits based on unadjusted premiums, to the extent permitted by actuarial standards. In addition, all employers using the alternative measurement method would be required to adjust premiums for age when only blended premiums covering active employees and retirees are known. A simplified procedure is provided for that purpose.

### **Small plan provisions**

Earlier it was noted that the standards allow for less frequent actuarial valuations for plans with fewer than 200 participants. The Board also considered the potential cost of hiring actuaries and other consultants to provide for the actuarial valuations, and the burden on small plans. The Board concluded that plans with fewer than 100 participants should be permitted to estimate the actuarial accrued liability and the ARC themselves, using simplified methods and assumptions, referred to as "the alternative measurement method", discussed in paragraphs 33 through 35 of Statement 45.

### **OPEB presentations in employer financial statements**

**Single-employer and agent multiple-employer plans** In accrual-based financial statements (the government-wide financial statements and proprietary fund financial statements) a government is *not required* to establish an initial liability in the statements of net assets at its implementation date. Governments *may* report as a liability the accumulated differences between their actual contributions and the ARC for prior years, to the extent they have the information required to do so.

All employers (whether or not they report an initial liability at transition) report OPEB expense equal to the annual OPEB cost. The net OPEB obligation (liability) is increased if actual contributions were less than the OPEB expense, and decreased if actual contributions exceeded the OPEB expense.

In modified accrual presentations, governments report OPEB expenditures equal to the amount contributed to the plan or amounts expected to be contributed from current available resources. Since governmental fund presentations focus on current financial resources, the net OPEB obligation (or any other long-term liability) would not be presented.

**Cost-sharing multiple-employer plans** In both accrual and modified accrual presentations, governments report OPEB expense/expenditures equal to the contractually required contribution to the plan, which may or may not be the same amount as the ARC that would be required if separate valuations were performed for each individual employer. OPEB assets and liabilities result from actual contributions made and the contractually required contributions.

## **Note disclosures**

The standards require two types of information concerning OPEB – plan description and funding policies as follows:

### Plan description

- Name of the plan, identification of the PERS or other entity that administers the plan, and identification of the plan as single-employer, agent multiple-employer or cost-sharing multiple-employer defined benefit OPEB plan
- A brief description of the types of benefits provided and the authority under which benefit provisions are established or may be amended (such as that the plan provides retirement, disability and death benefits or plan members and their beneficiaries, and that a specific section of state law regulates the changing of benefit provisions)
- Whether the OPEB plan issues a stand-alone financial report or is included in the report of a PERS or other entity, and if so, how to obtain a copy of the report

### Funding policies

- Authority (such as state statute) under which the obligations of the plan members, employers and other contributing entities to contribute to the plan are established
- Required contribution rates of active members of the plan
- Required contribution rates of the employer in accordance with the funding policies, either in dollars or as a percentage of current-year active payroll. If the plan is a single-employer or agent plan and the rate differs significantly from the ARC, a government must disclose how the rate is determined. If the plan is a cost-sharing plan, a government must disclose the required contributions in dollars, the percentage of that amount contributed for the current year and each of the two preceding years, and how the required contribution rate is determined.

Additional requirements are established for single and agent employers, since governments participating in such plans are solely responsible for financing the OPEB cost of their employees and retirees:

- For the current year, annual OPEB cost and the dollar amount of contributions actually made. If a net OPEB obligation exists, the employer must disclose the components of annual OPEB cost, the increase or decrease in the net OPEB obligation, and the net OPEB obligation at the end of the year
- For the current year and two preceding years, annual OPEB costs, percentage of annual OPEB cost contributed that year, and the net OPEB obligation at the end of each year

- The funded status of the plan (the same information disclosed in RSI [see below], but only for the most recent valuation date)
- Information about actuarial methods and assumptions used in valuations on which reported information about the ARC, annual OPEB cost, and the funded status and funding progress of OPEB plans is based

### **Required supplementary information**

Single-employer and agent multiple-employer plans are also required to disclose, as RSI, for the three most recent actuarial valuations:

- The actuarial valuation date, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded actuarial accrued liability (or funding excess), the actuarial value of assets as a percentage of the actuarial accrued liability (called the *funded ratio*), the annual covered payroll, and the ratio of the unfunded actuarial accrued liability (or funding excess) to annual covered payroll
- Factors that significantly affect the identification of trends in the amounts reported, including, for example, changes in benefit provisions, the size or composition of the population covered by the plan, or the actuarial methods and assumptions used

### **Employers with defined contribution plans**

As is customary, the reporting for defined contribution plans are relatively simple. The annual OPEB expense/expenditure is equal to its required contribution to the plan as prescribed in the plan documents. OPEB liabilities or assets would result from differences between the required contributions and those actually made.

### **Financial reporting by OPEB plans**

Financial statements required for OPEB plans are two:

- A statement of plan net assets, presenting the plan's assets, liabilities and net assets at year-end
- A statement of changes in plan net assets, presenting additions to, deductions from and net increases or decreases in plan net assets for the year

Additions to plan net assets include employer and member contributions, and investment income. Deductions from plan net assets are benefits and administrative expenses.

### **Note disclosures**

Defined benefit OPEB plans are required to present information about the plan description, accounting policies, contributions and reserves, investment concentrations, funded status and funding progress of the plan:

### Plan description

- Identification of the plan as single-employer, agent multiple-employer or cost-sharing multiple-employer defined benefit OPEB plan, and disclosure of the number of participating employers and other contributing entities
- Classes of employees covered and information on the current members, including the number of retirees and beneficiaries currently receiving benefits, terminated members entitled to but not yet receiving benefits, and current active members
- A brief description of benefit provisions

### Accounting policies

- Basis of accounting, including the policy regarding recognition of contributions, benefits paid and refunds paid
- A brief description of how fair value of investments is determined

### Contributions and reserves

- Authority under which the obligations of the plan members, employer(s) and other contributing entities are established or may be amended
- Funding policy, including a brief description of how the contributions of the plan members, employer(s) and other contributing entities are determined and how the administrative costs of the plan are financed
- Required contribution rates of active plan members, in accordance with the funding policy
- A brief description of the terms of any long-term contracts for contributions to the plan and disclosure of the amounts outstanding at the reporting date
- The balances in the plan's legally required reserves at the reporting date, and a brief description of the purpose of each reserve and designation disclosed, and whether the reserve is fully funded

### Investment concentrations

- Information to assist users in assessing the potential risk of loss of the fair value of the plan's investments
- Identification of investments (other than those issued or guaranteed by the U.S. Government) in any one organization that represent five percent or more of plan net assets

### Funded status and funding progress

- The funded status of the plan as of the most recent valuation date
- Disclosure of information about actuarial methods and assumptions used in valuations on which reported information about the ARC, annual OPEB cost, and the funded status and funding progress of OPEB plans are based

## Required supplementary information for plans

Following the note disclosures, plans must present two schedules as RSI:

- The schedule of funding progress, showing historical trend information for the past three actuarial valuations about the funded status of the plan and efforts to accumulate sufficient resources to pay benefits when they become due (note that the information may cover a three-year period if valuations are done annually, or as much as nine years if valuations are triennial). The presentation would include the actuarial valuation date, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded actuarial accrued liability, the actuarial value of assets as a percentage of the actuarial accrued liability (the funded ratio), the annual covered payroll, and the ratio of the unfunded actuarial accrued liability to annual covered payroll
- The schedule of employer contributions, showing historical trend information comparing the ARC with actual employer contributions for the years covered by the three most recent actuarial valuations. This includes the dollar amount of the ARC that was recognized in the plan's statement of changes in plan net assets for each year as contributions from employers

## Effective dates

Similar to the staggered implementation dates established for Statements 34 and 35, the Board has established the following effective dates *for employers*:

- Phase 1 governments (those with revenues of \$100 million or more in the first fiscal year ending after June 15, 1999) would implement in periods beginning after December 15, 2006 (December 31, 2007 year-ends and later)
- Phase 2 governments (those with revenues of \$10 million or more, but less than \$100 million in the first fiscal year ending after June 15, 1999) would implement in periods beginning after December 15, 2007 (December 31, 2008 year-ends and later)
- Phase 3 governments (those with revenues of less than \$10 million in the first fiscal year ending after June 15, 1999) would implement in periods beginning after December 15, 2008 (December 31, 2009 year-ends and later)

[Note that the various phases of entry are the same as for the implementation of Statement 34.]

The implementation dates for OPEB plans is one year *prior to the implementation date for the employer* (single-employer plans) or for the largest participating employer (multiple-employer plans).

## **STATEMENT 46**

## ***NET ASSETS RESTRICTED BY ENABLING LEGISLATION***

In December 2004, the GASB adopted Statement 46 to amend Statement 34 and to clarify that a legally enforceable enabling legislation restriction is one that a party external to a government (such as its citizens, public interest groups or the courts) can compel a government to honor.

The determination of legal enforceability requires the use of professional judgment, considering such matters as the underlying legislation itself to determine if it meets the qualifying criteria, reviewing determinations made for similar legislation of the government or other governments, or the opinion of legal counsel. The standard notes that ultimately enforceability cannot be proven unless tested through the judicial process, which may never occur.

Legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if a government has other cause for reconsideration. The determination that a restriction is not legally enforceable may cause a government to review the enforceability of other restrictions; however, it should not necessarily lead a government to the same conclusion for all enabling legislation restrictions.

Should a government enact new enabling legislation that replaces original enabling legislation by establishing new legally enforceable restrictions on the resources raised by the original enabling legislation, from that period forward, the resources accumulated under the new enabling legislation should be reported as restricted to the purpose recited in the new enabling legislation. Professional judgment should be applied regarding whether the remaining balances accumulated under the original enabling legislation should continue to be reported as restricted for the original purpose, restricted to the purpose recited in the new enabling legislation, or unrestricted.

The notes to financial statements should disclose the portion of the primary government's net assets at the end of the reporting period that are restricted by enabling legislation.

Statement 46 is effective for periods beginning after June 15, 2005, with earlier application encouraged. Accounting changes related to the adoption of the standard should be applied retroactively by reclassification of net assets (if practical) for all prior periods presented. In the period in which the standard is first applied, the notes should disclose the nature of any reclassification and its effect. If it is not practical to reclassify net assets for all prior periods, the substantive reasons should be explained.

## STATEMENT 47

## ACCOUNTING FOR TERMINATION BENEFITS

In June 2005, the GASB adopted Statement 47, which addresses the provision of benefits intended to hasten an employee's voluntary termination (*early retirement incentives*) that may be offered (*voluntary termination benefits*) or as a consequence of the involuntary termination of services (*involuntary termination benefits*). Examples of such incentives are one-time (or a series of) cash payments, severance benefits, enhancements to defined benefit pension or other post-employment benefit formulas, or healthcare coverage, where none was previously provided. Governments may also provide benefits terminated employees whose employment was ended involuntarily (such as by layoffs), such as severance pay, continued access to healthcare coverage, career counseling or outplacement services.

An employer would be required to account for *healthcare-related* termination benefits (including healthcare continuation under COBRA) by calculating the discounted present value of expected future cash outflows for benefit payments as follows:

- Employers providing termination benefits by permitting a terminated employee to continue participation in the same healthcare plan that covers active employees should segregate the benefits provided to terminated employees and their beneficiaries from those provided to active employees for measurement purposes, and should project the employer's future benefit payments based on the projected total claims cost, or age-adjusted<sup>1</sup> premiums approximating claims cost for terminated employees. The benefit payment is the difference between the projected claims cost (or age-adjusted premiums which approximate claims cost<sup>2</sup>) for terminated employees and the payments (if any) to be made by the terminated employees.
- The projected future benefit payments should include an assumption about the healthcare cost trend rate for the periods covered by the employer's commitment to provide the benefits.
- The discount rate should be determined by considering the estimated yield, over the period of time the benefits are to be provided, on the investments that are expected to be used to finance the payment of benefits (generally, the unrestricted investments of the employer), considering the nature and mix of current and expected investments.

Employers would account for the cost of *non-healthcare-related* benefits by calculating the discounted present value of expected future payments if the benefit terms establish an obligation to pay specific amounts on fixed or determinable dates. For such benefits for which the amount or timing of benefit payments is not fixed or determinable, discounting of expected future cash payments is neither required nor prohibited.

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<sup>1</sup> See Statement 45 discussion of *implicit rate subsidies*.

<sup>2</sup> If the event giving rise to the healthcare-related termination benefits is not a "large-scale, age-related program", the employer may use unadjusted premiums as the basis for the projection of future benefit payments.

If discounted, the discount rate should be determined considering the estimated yield, over the benefit period, on the investments expected to be used to finance the benefit payments (generally, the unrestricted investments of the employer), considering the nature and mix of current and expected investments.

The liability and related expense for *voluntary* termination benefits should be recognized in accrual basis financial statements (the GWFS and proprietary fund statements) when the employees accept the offer and the amount can be reasonably estimated. The liability should be remeasured at each reporting period, and any incremental liability and expense (increase or decrease) recognized.

For *involuntary* termination benefits, the liability and related expense should be recognized in accrual basis financial statements then a plan of termination has been approved by those having the authority to commit the employer to the plan, and the plan has been communicated to the employees and the amounts can be estimated. The liability should be remeasured at each reporting period, and any incremental liability and expense (increase or decrease) recognized.

A *plan of involuntary termination* means a plan that:

- Identifies (at a minimum) the number of employees to be terminated, their job classifications or functions that will be affected and their locations, and when the terminations are expected to occur
- Establishes the terms of the termination benefits in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated.

If, however, a plan of involuntary termination requires the employee to render future service in order to receive benefits, a liability and expense for the involuntary termination benefits should be recognized ratably over the future service period. The liability should be remeasured at each reporting period, and any incremental liability and expense (increase or decrease) recognized.

In governmental fund financial statements, liabilities and expenditures for termination benefits should be recognized to the extent the liabilities are expected to be liquidated with expendable available resources.

The effects of a termination benefit on an employer's pension or OPEB obligation (incurred through an existing defined benefit or OPEB plan) should be accounted for in accordance with the requirements of Statement 27 or Statement 45, respectively.

The notes to financial statements should include:

- A description of the termination benefit arrangement
- In the period in which the employer become obligated for termination benefits, the cost of termination benefits, if not otherwise identifiable on the face of the financial statements
- Employers providing termination benefits through a defined benefit pension or OPEB plan should disclose in the notes to the financial statements the change in the actuarial accrued liability for the pension or OPEB plan attributable to the termination benefits.

The effective date for non-OPEB termination benefits is for periods beginning after June 15, 2005, with earlier application encouraged. For OPEB benefits, Statement 47 should be applied concurrent with the application of Statement 45.

## **STATEMENT 48**

## ***SALES AND PLEDGES OF RECEIVABLES AND FUTURE REVENUES***

In September 2006, the GASB adopted a new standard that addresses circumstances in which governments exchange future cash flows from specific receivables or specific future revenues for immediate cash payments (generally a single lump sum). The issue is whether the transaction should be accounted for as a sale of the receivable (or future revenue) or a secured borrowing, which would result in recognition of a liability. The Board noted that there has been widely diverse practice in accounting for such transactions and the information about them included in governmental financial statements.

The Statement supersedes paragraphs 16-23 of Technical Bulletin 2004-1, *Tobacco Settlement Recognition and Financial Reporting Issues*, and amends Statement 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, paragraphs 58, 61 and 100.

A transaction within the scope of the proposed statement would be reported as a *collateralized borrowing*, unless the criteria below are met. These criteria require an assessment of a government’s *continuing involvement* with the receivable or future revenue rights transferred. Central to that assessment is consideration of the degree to which the transferor (government) retains or relinquishes (to the transferee) control over the receivable or future revenue rights.

### **Assessing continuing involvement**

**Receivables** - A transaction in which a government receives (or is entitled to) proceeds in exchange for the rights to future cash flows from receivables should be reported as a sale if the governments continuing involvement with those receivables is effectively terminated. *Effective termination* means that all of the following criteria are met:

- The transferee’s ability to subsequently sell or pledge the receivables is not limited by constraints imposed by the transferor government.
- The transferor does not have the option or ability to unilaterally substitute for or reacquire specific accounts from among the receivables transferred. However, the ability to substitute for defective accounts, at the option of the transferee, would not violate this criterion.
- The sale agreement is not cancelable by either party, including cancellation through payment of a lump sum or transfer of rights or other assets.
- The receivables and the cash resulting from their collection have been isolated from the transferor government (see following section).

The determination of whether receivables are isolated from the transferor government should be based on whether:

- The transferee has legal standing separate from the transferor. Legal separation should be assessed using the criteria established in Statement 14, *The Financial Reporting Entity*, as amended.
- Banking arrangements are designed to eliminate access by the transferor and its component units (other than the transferee) to the cash generated by collection of the receivables. In general, payments on individual accounts would be made directly to a custodial account maintained for the benefit of the transferee; however, if the transferor continues to service the accounts, (1) the payments to the transferee should be made only from the resources generated by the specific receivables rather than from the transferor’s own resources (the transferor should have no obligation to advance amounts to the transferee before it collects equivalent amounts from the underlying accounts), (2) cash collected by the transferor on behalf of the transferee should be remitted to the transferee without significant delay (and any earnings thereon should be passed on to the transferee), and (3) the transferor should consider proceeds received from the transferee as satisfaction of individual accounts, indicating in its records which accounts have been transferred and which collections pertain to those accounts.<sup>3</sup>
- Provisions in the transfer agreement protect the transferee from claims of the transferor’s creditors.

**Future revenues** – A transaction in which a government receives proceeds in exchange for cash flows from specific future revenues should be reported as a sale if the government’s continuing involvement with those revenues meets all of the following criteria:

- The transferor government will not maintain an active involvement in the future generation of those revenues (see discussion of *active involvement* below).
- The transferee’s ability to subsequently sell or pledge the future cash flows is not limited by constraints imposed by the transferor government.

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<sup>3</sup> For example, in a transaction involving delinquent tax liens, the proceeds from the transferee should be accepted by the taxing body as satisfaction of the delinquent taxes owed by the individual property owners, and the tax rolls should indicate that those taxes have been paid (or “sold”) and are no longer delinquent.

- The cash resulting from collection of the future revenues has been isolated from the transferor government (banking arrangements should eliminate access by the transferor and its component units, other than the transferee, to the cash generated by collection of the future revenues). Generally, the revenues would be received directly by the transferee or into a custodial account maintained for the benefit of the transferee.
- The contract, agreement or other arrangement between the original resource provider (such as a grantor organization) and the transferor government does not prohibit the transfer or assignment of the resources.
- The sale agreement is not cancelable by either party, including cancellation by payment of a lump sum or transfer of other rights or assets.

A government may cease active involvement in the generation of specific future revenues, but remain passively involved. For purposes of determining whether the first criteria above is met, the following distinction is made between *active involvement* and *passive involvement*.

*Active involvement* generally requires a substantive action or performance by the government, and would be evidenced by any of the following:

- The government produces or provides the goods or services that are exchanged for the revenues
- The government levies or assesses taxes, fees or charges and can directly influence the revenue base or the rate applied to that base to generate the revenues<sup>4</sup>
- The government is required to submit applications for grants or contributions from other governments, organizations or individuals to obtain the revenues
- The government is required to meet grant or contribution performance contingencies to qualify for those revenues

*Passive involvement* requires no substantive actions or performance by the government, such as:

- Holding title to revenue-producing assets (for leases, rents, royalties)
- Owning a contractual right to a stream of future revenues (such as tobacco settlement revenues)
- Satisfying the “required characteristics” eligibility criterion in paragraph 20 of Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions*
- Agreeing to refrain from specified acts or transactions (such as noncompetition agreements)

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<sup>4</sup> For example, the revenue bases for property or sales taxes are taxable real estate parcels or retail sales. The taxing government can directly influence either of these bases by establishing minimum taxable levels, granting exemptions, providing credits, or excluding certain transactions. The taxing government may also initiate, activate or determine tax rates pertaining to each revenue base.

### **Transactions that do not qualify as sales**

If the above criteria are not met, the transaction is accounted for as a collateralized borrowing. The receivables or future revenues should be considered as pledged, rather than sold. Proceeds received by the transferor government should be reported as a liability in its statement of net assets and as an other financing source in governmental funds (if proceeds are received by governmental funds). Likewise, a transferee government should recognize a receivable for amounts paid to the pledging (transferor) government.

Pledged receivables should continue to be reported as assets in the transferor government's statement of net assets, and pledged revenues continue to be reported as revenue. Collections of the pledged revenues or receivables paid to the transferee reduce the liability in the transferor's statement of net assets. Those payments are also reported as expenditures (rather than reductions of revenue) in the transferor government's governmental funds (if governmental funds are used to report the transaction). Payments received by a transferee government reduce the transferee's receivable.

### **Transfers that meet the criteria to be reported as sales**

If the sale criteria are met, the selling government (transferor) should no longer recognize as assets the receivables sold, removing the individual accounts at their carrying value. The difference between the proceeds (excluding amounts that may be refundable) and the carrying value of the receivables sold should be recognized as gain or loss.

In a sale of future revenues, the selling government should report the proceeds as revenue or deferred revenue. In general, revenue should be deferred and recognized over the duration of the sale agreement; however, there may be circumstances in which recognition in the period of sale is appropriate.

Deferral is required for all transactions within the same financial reporting entity ("intra-entity" sales). For transactions with outside parties, deferral is required if the future revenue sold was not recognized previously because the event that would have resulted in the revenue recognition had not yet occurred (such as an exchange of goods or services, or satisfaction of the applicable criteria for nonexchange revenues). Consummating the sale of future revenues is not a substitute for a revenue recognition event, and therefore, deferral is required. Revenue should be recognized at the time of the sale only if the revenue sold was not recognized previously because of uncertainty of realization or the inability to measure the revenue.

In intra-entity transfers of assets, the transferee should recognize the transferred assets at the carrying value of the transferor. Therefore, in an intra-entity sale of receivables, the purchasing government should record the receivables acquired at the carrying value of the selling government. The difference between the carrying value and the amount paid (excluding refundable amounts) is reported as a gain or loss by the purchasing government.

In an intra-entity sale of future revenues, the selling government has no carrying value for the rights sold, because the asset recognition criteria had not been met. Consequently, the purchasing government should not recognize an asset for the future revenues until such time as the asset recognition criteria are met. The purchasing government records the amount paid as a deferred charge, to be amortized over the duration of the transfer agreement.<sup>5</sup>

If the transferee is a government outside the financial reporting entity, and the transaction involves the transferee's acquisition of:

- Receivables, the purchasing government recognizes the acquisition at its purchase price
- Future revenues, the purchasing government recognizes the acquisition at cost and amortizes the balance over the life of the transfer agreement. The purchasing government, as owner of the future revenues, should recognize receivables and revenue when the criteria appropriate to the specific type of revenue have been met.

### **Residual interests**

If, as part of the proceeds received, a selling government acquires a subordinate or junior note or a residual certificate representing the rights to collections that exceed a stipulated level, the selling government should recognize a note or residual certificate as an asset representing a residual interest in:

- Excess receivable collections, considering the likelihood of realization
- Excess future revenues, to the extent that asset recognition criteria appropriate to the specific type of revenue underlying the note or certificate have been met.

Similarly, a purchasing government should recognize a liability for its obligation to remit residuals to the selling government, based on the recognition criteria (following) related to recourse and other obligations.

A selling government should recognize an estimated liability arising from the purchase and sale agreement when information available prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statement and the amount can be reasonably estimated. Examples of such liabilities are recourse obligations or repurchase commitments.

### **Pledges of future revenue when proceeds from related debt are not received by the pledging government**

A government may pledge future cash flows of specific revenues, but not receive resources in exchange for that pledge. For example, some governments may be prohibited from issuing debt or be limited in the amount of debt they may issue by charter, statutes, or constitutional

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<sup>5</sup> Deferred revenues and charges resulting from intra-entity sales of future revenues and the periodic amortization of those balances should be accounted for in the same manner as internal balances and intra-entity activity within the financial reporting entity.

restrictions. Those governments may create component units or use existing component units to issue debt on their behalf that will benefit their constituencies, programs or functions. As security for the debt issued by a component unit, the government may pledge all or a portion of a specific future revenue stream to the debt-issuing component unit, without being primarily or secondarily liable for the component unit's debt. The debt-issuing component unit then pledges those future payments as security for its debt.

At the time the pledge agreement is made, the pledging government should not recognize a liability and the debt-issuing component unit should not recognize a receivable for the future revenues pledged. The pledging government should continue to recognize revenue from the pledged amounts and should recognize a liability to the debt-issuing component unit and an expenditure or expense at the same time it recognizes the revenues that are pledged. The debt-issuing component unit reports payments from the pledging government as revenue.

## **Disclosures**

For disclosure purposes, the term *pledged revenues* means revenues that have been formally committed to directly collateralize or secure debt of the pledging government, or directly or indirectly collateralize or secure debt of a component unit. Pledging governments should disclose the following information about specific revenues pledged:

- Identification of the specific revenue pledged and the approximate amount of the pledge, if determinable
- Identification of, and the general purpose for, the debt secured by the pledged revenue
- The term of the commitment, i.e., the period during which the revenue will not be available for other purposes
- The relationship of the pledged amount to the total for that specific revenue, if determinable (the proportion of the specific revenue stream that has been pledged)
- A comparison of the pledged revenues recognized during the period to the principal and interest requirements for the debt directly or indirectly collateralized by those revenues

In the year off sale, governments that sell future revenue streams should disclose in the notes information about the specific revenues sold, including:

- Identification of the specific revenue sold, including the approximate amounts, if determinable
- The period to which the sale applies
- The relationship of the sold amount to the total for that specific revenue, if determinable (the proportion of the specific revenue stream that has been sold)
- A comparison of the proceeds of the sale and the present value of the future revenues sold, if determinable

## **Effective date**

The Statement is effective for periods beginning after December 15, 2006, with earlier application encouraged. In the first period of application, earlier periods presented should be restated, if practical; if not, the cumulative effect of application should be reported as a restatement of beginning net assets, fund balance, or equity, as appropriate.

## **STATEMENT 49**

## ***ACCOUNTING AND FINANCIAL REPORTING FOR POLLUTION REMEDIATION OBLIGATIONS***

In December 2006, the GASB adopted a new statement that requires governments to consider the occurrence of any one of five specified obligating events:

- Because of imminent endangerment, the government is compelled to take pollution remediation action
- The government violates a pollution prevention-related permit or license
- The government is named, or evidence indicates that it will be named by a regulator as a responsible party or potentially responsible party (PRP) for remediation, or as a government responsible for sharing costs
- The government is named, or evidence indicates that it will be named in a lawsuit to compel participation in pollution remediation
- The government commences or legally obligates itself to commence pollution remediation

The statement amends paragraphs 42 and 43 of NCGA Statement 1, paragraph 14 of NCGA Statement 4, paragraph 5 of NCGA Interpretation 6, paragraph 1 of GASB Statement 10, paragraphs 9, 11 and 14 and footnote 7 of GASB Interpretation 6. The statement does not apply to landfill closure and post-closure care obligations, within the scope of GASB Statement 18, or to other, future pollution remediation activities that are required upon retirement of an asset (such as the decommissioning of a nuclear power plant) during the periods preceding the retirement. In addition, the proposed statement does not apply to recognition of asset impairments, liabilities for unpaid claims by insurance activities, or accounting for nonexchange transactions.

## **Accounting**

Once any of these events occurs, a government is required to estimate the components of expected pollution remediation outlays and determine whether such outlays should be accrued as a liability or, if appropriate, capitalized when goods or services are acquired.

*Pollution remediation obligations* are obligations to address the current or potential detrimental effects of existing pollution by participating in a pollution remediation activity. For example, obligations to clean up spills of hazardous wastes or hazardous substances and obligations to remove contamination such as asbestos are pollution remediation obligations. Pollution remediation activities include:

- Pre-cleanup activities, such as site assessment, site investigation, corrective measures feasibility studies and design of a remediation plan
- Cleanup activities, such as neutralization, containment or removal and disposal of pollutants, and site restoration
- External government oversight and enforcement-related activities, such as work performed by an environmental regulatory authority dealing with the site and chargeable to the government
- Operation and maintenance of the remedy, including required monitoring of the remediation effort

Not all pollution remediation obligations will involve all of the above activities.

*Pollution remediation outlays* do not include pollution prevention or control obligations related to current operations (such as installation of smokestack scrubbers, treatment of effluent, or the use of environment-friendly products, such as low-sodium road salts). Pollution remediation outlays include all direct outlays that are attributable to pollution remediation activities, such as:

- Payroll and benefits
- Equipment and facilities
- Materials
- Legal and other services
- Indirect outlays, including general overhead

Outlays related to natural resource damage are included only if incurred as part of a pollution remediation effort. Certain outlays are specifically excluded from pollution remediation outlays:

- Fines and penalties
- Toxic torts (civil wrongs arising from exposure to a toxic substance)
- Product and process (workplace) safety outlays
- Litigation support
- Outlays borne by society at large, rather than a specific government

### **Recognition and measurement framework**

Statement 49 establishes a framework for recognition and measurement of pollution remediation liabilities that incorporates the following interrelated features;

- *Obligating events* – once an obligating event occurs, a government should determine whether one or more components of a pollution remediation obligation are recognizable as a liability (see obligating events above).
- *Components and benchmarks* – components of a liability should be recognized as they become reasonably estimable.

- *Measurement, including expected cash flow technique* – measurement is based on the current value of outlays expected to be incurred. The components of the liability should be measured using the expected cash flow technique, which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amounts (the estimated mean or average).

### **Recognition benchmarks**

Pollution remediation liabilities should be recognized as the ranges of their components become reasonably estimable. In some instances, the government may not be able to reasonably estimate the ranges of all components of the liability. If not, the government should recognize the liabilities as the range of each component of the liability becomes reasonably estimable. In other cases, the government will be able to reasonably estimate a range of all components of the liability early in the process, because the site situation is common (such as removal of underground tanks) or is similar to situations at other sites with which the government has previous experience. If so, the government should recognize the entire estimated liability at this stage.

The range of an estimated remediation liability may be defined and periodically refined as different stages of the remediation process occur. At a minimum, the estimate of a pollution remediation liability should be evaluated as each of the following benchmarks occur:

- Receipt of an administrative order, compelling the government to take responsive action at a site or risk penalties;
- Participation as a responsible party or PRP in the site assessment or investigation;
- Completion of a corrective measures feasibility study;
- Issuance of an authorization to proceed;
- Remediation design and implementation, through and including operation and maintenance and post-remediation monitoring.

### **Measurement based on expected outlays**

Pollution remediation liabilities should be measured based on the pollution remediation outlays expected to be incurred to settle the liabilities. Profits and risk premiums that another party would demand to perform pollution remediation work should be included in the measurement of the government's liability only if the government expects to utilize another party to perform the work.

### **Measurement at current value**

Pollution remediation liabilities should be measured at their current value. Because settlement of a pollution remediation liability is not always possible in the current period, settlement may involve future events. The current value of a pollution remediation liability should be based on reasonable and supportable assumptions about future events that may affect the eventual settlement of the liability, such as the applicable federal, state and local laws and regulations that have been approved, regardless of their effective date, and the existing technology expected to be

used for the cleanup. The probabilities and probability-weighted measurement of the liability using expected cash flow techniques apply.

### **Measurement of expected cash flow**

Pollution remediation liabilities should be measured using the expected cash flow technique, which measures the liability as the sum of the probability-weighted amounts in a range of possible estimated amounts. This technique uses all expectations about possible cash flows. Some such estimates will be limited to a few scenarios or a single scenario, such as an amount specified in a contract for pollution remediation services. Other estimates will have many scenarios.

A government may have access to considerable data and be able to develop many cash flow scenarios. However, even in cases where the government has access to only limited data about the possible cash flows within a range, a limited number of scenarios and probabilities should be developed that capture the array of possible cash flows. In developing those scenarios, a government could use actual cash flows for other pollution remediation projects, if available, adjusted for changes in circumstances. Each application of expected cash flows will differ based on the facts and circumstances of each measurement situation, available information and judgments applied. Such judgments will include determination of whether to apply a continuous or discrete probability distribution and, if a discrete probability distribution is applied, the number of discrete scenarios.

### **Remeasurement**

Estimates of a pollution remediation liability should be adjusted when benchmarks are met or when new information indicates changes in estimated outlays, due to changes in the remediation plan or operating conditions. These changes may include the type of equipment, facilities and services that will be used, price increases or reductions for specific outlay elements, such as ongoing monitoring requirements, changes in technology and changes in legal or regulatory requirements.

### **Accounting for recoveries**

Under the expected cash flow technique, the measurement of a government's pollution remediation liability should include all remediation work that the government expects to perform, including work expected to be performed for other responsible parties or PRPs, whether the government is required to do that work. Expected recoveries from those other parties or expected insurance recoveries that indemnify the government for its pollution remediation obligations should also be included in the measurement, by reducing the expense, and affecting the liability as follows:

- If the expected recoveries are not yet realized or realizable, they should reduce the measurement of the government's pollution remediation liability
- If the expected recoveries are realized or realizable, they should be recognized separately from the liability as recovery assets (e.g., cash or receivables)

Expected recoveries from other parties, PRPs and insurers should be measured consistently with the related pollution remediation outlays (based on current value and using the expected cash flow technique). An insurance recovery is generally realizable when the insurer admits or acknowledges coverage, potentially before covered outlays take place. Governments should refer to paragraphs 21 and 22 of Statement 42 for additional guidance.

If recoveries become expected in periods following the completion of all remediation work, such that a pollution remediation liability no longer exists, those transactions should be recorded, for example, as revenue and cash or accounts receivable, when they are realized or realizable.

### **Capitalization of pollution remediation outlays**

Except as provided below, pollution remediation outlays, including those for property, plant and equipment, should be reported as an expense when a liability is recognized. For example, a pump-and-treat system to be installed for pollution remediation generally would be reported as an expense at the time a liability is recognized.

Some projects (such as land improvements, remodeling and periodic dredging of a waterway for shipping) for which the primary objective is other than pollution remediation, may include pollution remediation activities. Except as provided below, incremental outlays attributable to pollution remediation activities (outlays that would not be incurred absent pollution) should be reported as an expense when a pollution remediation liability is recognized.

Pollution remediation outlays should be capitalized in government-wide and proprietary fund statements, subject to limitations, only if the outlays are incurred (1) to prepare property for sale in anticipation of a sale, (2) to prepare property for use when the property was acquired with known or suspected pollution that was expected to be remediated, (3) to perform pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment, or (4) to acquire property and equipment that have a future alternative use to remediation efforts.

### **Display**

In government-wide and proprietary fund financial statements, pollution remediation costs (or revenues, in the case of recoveries following completion of remediation work) should be reported in the statement of activities and statement of revenues, expenses and changes in net assets as a program or operating expense (or revenue), special item or extraordinary item as prescribed by Statement 34.

In governmental fund financial statements, amounts that are normally expected to be liquidated with expendable available financial resources should be recognized as liabilities upon receipt of the related goods or services. In the statement of revenues, expenditures and changes in fund balances, any facilities and equipment acquired for pollution remediation activities should be reported as expenditures. Estimated recoveries from insurers and other responsible parties or

PRPs or which the government is performing remediation activities should reduce any associated pollution remediation expenditures when the recoveries are measurable and available.

## **Disclosures**

Governments should disclose:

- The nature and source of pollution remediation obligations (e.g., federal, state and local laws and regulations)
- The amount of the estimated liability (if not apparent in the financial statements themselves)
- The methods and assumptions used for the estimate
- The potential for changes in estimates (for example, due to price increases, technology or applicable laws and regulations)
- Estimated recoveries that reduce the measurement of the liability
- A general description of the nature of pollution remediation activities for liabilities that are not reasonably estimable

## **Effective date**

The requirements of Statement 49 are effective for periods beginning after December 15, 2007, with measurement of the pollution remediation liabilities required at the beginning of that period, so that beginning net assets can be restated. Governments with sufficient objective and verifiable information to apply the expected cash flow technique to measurements in prior periods are required to apply the provisions retroactively for all such prior periods presented. Governments that do not have sufficient information should apply the Statement as of the effective date. In that case, pollution remediation liabilities should be measured at the beginning of that period so that beginning net assets can be restated. In the period Statement 49 is first applied, the financial statements should disclose the nature of any restatement and its effect. Also, the reason for not restating the prior periods presented should be explained. Early application is encouraged.

In June 2006, the GASB issued TB 2006-1 to clarify application of existing standards to payments that an employer or a defined benefit OPEB plan receives from the federal government pursuant to Medicare Part D. The TB provides the following questions and answers on the topic:

- Q. How should an employer account for and report a payment from the federal government pursuant to the retiree drug subsidy (RDS) provisions of Medicare Part D?
- A. An RDS payment to the employer is a *voluntary nonexchange transaction* described in paragraph 7 of Statement 33. Accordingly, the employer should recognize an asset and revenue for the payment received following the applicable recognition requirements of Statement 33. The payment is a separate transaction from the exchange of salaries and benefits (including postemployment prescription drug benefits) for services between the employer and employees. The accounting for postemployment benefits other than pension benefits, including prescription drug benefits, is addressed in Statement 45. A sole or agent employer should apply the measurement requirements of Statement 45 to determine that actuarial accrued liabilities, the annual required contribution (ARC) of the employer, and the annual OPEB cost *without reduction* for RDS payments.
- Q. How does an RDS payment from the federal government to an employer affect the accounting and financial reporting by a defined benefit OPEB plan?
- A. An RDS payment does not affect accounting for employer contributions or the financial reporting presentation by a defined benefit OPEB plan in which an employer participates. An OPEB plan should apply the measurement requirements of Statement 43 to determine the actuarial accrued liabilities, the ARC, and the annual OPEB cost *without reduction* for RDS payments.
- Q. How should an employer account for and report an RDS payment from the federal government to the defined benefit OPEB plan?
- A. An RDS payment from the federal government to a defined benefit OPEB plan that is administered as a qualifying trust (or equivalent arrangement) is an *on-behalf payment for fringe benefits* as discussed in paragraph 7 of Statement 24. The employer should recognize revenue and expense or expenditures for the payment in accordance with the recognition and measurement requirements of paragraph 8b pertaining to an employer that is legally responsible for contributions to the OPEB plan. That is, the employer “should follow accounting standards for that type of transaction to recognize expenditures or expenses and related liabilities or assets.” The employer also should disclose the amounts recognized for the on-behalf payment as required by paragraph 12 of that Statement. An employer should apply the requirements of paragraph 8b of Statement 24 by following the

measurement requirements of Statement 45 to determine OPEB expense or expenditures (that is, no reduction should be made of RDS payments).

If a multiple-employer OPEB plan is not administered as a qualifying trust (or equivalent arrangement), paragraph 41 of Statement 43 requires that the plan be reported as an agency fund, and paragraph 22 of Statement 45 requires that employers in such a plan apply the requirements of Statement 45 pertaining to employers participating in agent plans. RDS payments to such a plan should be considered as payments to the employers. Accordingly, an employer in such a plan should account for its RDS payments as discussed in the response to the first question of this Technical Bulletin.

- Q. How should a defined benefit OPEB plan account for and report an RDS payment from the federal government to the plan?
- A. Paragraph 34 of Statement 43 provides that “a plan and its participating employer(s) should apply the same actuarial methods and assumptions in determining similar or related information included in their respective financial reports.” Accordingly, a defined benefit OPEB plan that is administered as a qualifying trust (or equivalent arrangement) should measure the actuarial accrued liabilities, the ARC, and the annual OPEB cost consistent with the related measurements by the employer(s) discussed in the response to question 3, that is, without reduction for RDS payments. In the statement of changes in plan net assets, the plan should display separately contributions from the employer(s) and the on-behalf payment from the federal government, as required by Statement 43, paragraph 27. In the schedule of employer contributions, the plan should apply the requirements of paragraph 36 of Statement 43 by including RDS payments as on-behalf contributions from the federal government and titling the schedule the *schedule of contributions from the employer(s) and other contributing entities*. The plan should present the ARC without reduction for RDS payments. The plan may present separately the percentages of the ARC recognized as additions to plan net assets from employer contributions and the on-behalf payment, respectively. That is, the plan’s schedule should present the ARC in dollars and may present in separate columns the contributions recognized by the plan *in relation to the ARC* from the employer(s) and from the federal government on behalf of the employer(s), each expressed as a percentage of the ARC. In addition, the plan may present in another column the combined percentage of the ARC contributed by the employer(s) and by the federal government on behalf of the employer(s). Alternatively, the plan may present only the combined percentage.

### **Effective date**

The TB is effective upon issuance, except for portions of answers pertaining specifically to measurement, recognition or required supplementary information requirements of Statements 43 or 45. Those provisions should be applied simultaneously with the implementation of Statements 43 or 45.

## EXPOSURE DRAFT

## PENSION DISCLOSURES

In December 2006, the GASB issued an exposure draft of a proposed standard that would more closely align the financial reporting requirements with those for other postemployment benefits (OPEB) and enhance information disclosed in notes to financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits.

The proposed reporting changes would amend applicable note disclosure and RSI requirements of Statements 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform with requirements of Statements 43 and 45. Those Statements were developed using Statements 25 and 27 as models. The Board believes that Statements 43 and 45 improve the transparency and decision usefulness of financial reporting as a result of decisions by the Board to modify, for financial reporting by OPEB plans and employers, certain requirements related to note disclosures and RSI. The proposed Statement would similarly improve the transparency and usefulness of financial reporting by pension plans and employers by amending Statements 25 and 27.

Defined benefit pension plans and sole and agent employers would be required to make the following changes related to note disclosures or RSI:

- Notes to financial statements would disclose the funded status of the plan as of the most recent actuarial valuation date. Defined benefit pension plans also would disclose actuarial methods and significant assumptions used in the most recent actuarial valuation in notes to financial statements, instead of RSI.
- If the aggregate actuarial cost method is used to determine the annual required contribution (ARC), notes to financial statements would disclose the funded status of the plan, and a schedule of funding progress would be presented as RSI, using the entry age actuarial cost method. Plans and employers also would disclose that the purpose of doing so is to provide information that approximates the funded status and funding progress of the plan.
- Notes to financial statements would include narrative disclosures of an informative nature regarding the actuarial measurement process and a reference linking the funded status disclosure in the notes to the required schedule of funding progress in RSI.
- If applicable, notes to financial statements would disclose legal or contractual maximum contribution rates. In addition, if relevant, they would disclose that the maximum contribution rates have not been explicitly taken into consideration in the projection of pension benefits for financial accounting measurement purposes.
- If an actuarial assumption is different for successive years, notes to financial statements would disclose the initial and ultimate rates.

The proposed Statement would amend Statement 25 to require defined benefit pension plans and defined contribution plans to disclose in the notes to financial statements the methods and assumptions used to determine the fair value of investments, if the fair value is based on other than quoted market prices.

Statement 27 would be amended to require cost-sharing multiple employers to include, in the note disclosure of the required contribution rates of the employer(s) in dollars and the percentage of that amount contributed for the current year and each of the two preceding years, how the contractually required contribution rate is determined (for example, by statute or by contract, or on an actuarially determined basis) or that the cost-sharing plan is financed on a pay-as-you-go basis.

The proposed Statement would also amend Statement 27 to require that, if a cost-sharing plan does not issue a publicly available stand-alone financial report prepared in accordance with the requirements of Statement 25, as amended, and the plan is not included in the financial report of another entity, an employer in that plan would present as RSI the schedules of funding progress and employer contributions for the plan (and notes to these schedules). The employer would disclose that the information presented relates to the cost-sharing plan as a whole, of which the employer is one participating employer, and would provide information helpful for understanding the scale of the information presented relative to the employer.

### **Effective date**

The proposed Statement would be effective for periods beginning after June 15, 2007, with early implementation encouraged. In the initial year of implementation, defined benefit pension plans and sole and agent employers that use the aggregate actuarial cost method to determine the ARC would be required to present elements of information in the schedule of funding progress using the entry age actuarial cost method as of the most recent actuarial valuation date. In subsequent years, plans and employers would add to that schedule information as of subsequent actuarial valuation dates, until the requirements of Statements 25 and 27, as amended, with regard to the minimum number of years or actuarial valuations to be included have been met.

### **EXPOSURE DRAFT**

### ***ACCOUNTING AND FINANCIAL REPORTING FOR INTANGIBLE ASSETS***

Also in December 2006, the Board issued an exposure draft of a proposed Statement that would address intangible assets. The Board notes that governments may possess a number of types of assets that can be considered as intangible, including easements, computer software, water rights, timber rights, patents and trademarks. Easements are referred to in the description of capital assets in Statement 34, and that reference created questions among constituents as to whether and when intangible assets should be considered capital assets for financial reporting purposes.

The Board also notes the absence of sufficiently specific guidance that addresses the questions raised by constituents, so that inconsistencies in financial reporting have resulted, particularly in

the areas of recognition, initial measurement and amortization. The proposed Statement would establish accounting and financial reporting requirements for intangible assets, and thereby reduce those inconsistencies, enhancing comparability among state and local governments.

### **Characteristics of intangible assets**

The ED provides the following characteristics of intangible assets (all are required to meet the definition):

- Lack of physical substance
- Nonfinancial nature
- Initial useful life extending beyond a single reporting period

Assets resulting from capital lease transactions reported by lessees are excluded from the scope of the proposed Statement. Also excluded is goodwill created through the combination of a government and another entity. The recognition and measurement provisions of the proposed Statement do not apply to other intangible assets created or acquired through the combination of a government and another entity.

### **ACCOUNTING AND FINANCIAL REPORTING – ECONOMIC RESOURCE MEASUREMENT FOCUS**

All intangible assets subject to the Statement are classified as capital assets. Accordingly, the existing authoritative guidance related to the accounting and financial reporting for capital assets, including the areas of recognition, measurement, depreciation (termed amortization for intangible assets), impairment, presentation and disclosures should be applied to intangible assets. The provisions of the remainder of the Statement are applied to intangible assets in addition to, or in lieu of, if appropriate, the existing authoritative literature for capital assets.

### **Recognition**

An intangible asset should be recognized in the statement of net assets only if it is *identifiable*, meaning that either:

- The asset is separable, i.e., capable of being separated or divided from the government and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability, or
- The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

### **Internally generated intangible assets**

Internally generated intangible assets include those that are created or produced by the government or an entity contracted by the government, and intangible assets that are acquired

from a third party, but that require more than minimal incremental effort on the part of the government to begin to achieve their expected level of service capacity.

Outlays incurred related to an internally generated intangible asset that is identifiable should be capitalized only when all of the following occur:

- Determination that an objective for the project is to create a specific internally generated intangible asset
- Determination of the nature of the service capacity that is expected to be provided by the asset upon its completion
- Demonstration of the technical or technological feasibility for completing the project so that the asset will provide its expected service capacity
- Demonstration of the current intention, ability, and presence of effort to complete or, in the case of a multi-year project, continue development of the intangible asset.

Outlays incurred prior to meeting these criteria should be expensed.

### **Internally generated computer software**

Computer software is a common type of intangible asset that is often internally generated, and may be developed in-house or by a contracted third party. It also includes commercially available software that is modified using more than minimal incremental effort before being put into operation.

The following stages are identified in creating and installing internally generated computer software:

- Preliminary project stage – activities in this stage include conceptual formulation and evaluation of alternatives, determination of the existence of the needed technology and final selection of alternatives for development.
- Application development stage – activities in this stage include design of the chosen path, including software configuration and interfaces, coding, installation to hardware, and testing, including the parallel processing phase.
- Post-implementation/operation stage – activities in this stage include training and software maintenance.

For internally generated computer software, the capitalization criteria should be considered to be met only when the activities noted in the preliminary project stage are completed and management implicitly or explicitly authorizes and commits to funding, at least currently in the case of a multi-year project, the software project. Accordingly, outlays associated with activities in the preliminary project stage should be expensed as incurred.

Once the capitalization criteria have been met, outlays related to activities in the application development stage should be capitalized. Capitalization should cease no later than the point at which the computer software is substantially complete and ready for its intended use.

A modification that increases the capacity or efficiency of computer software that is in place and operational should be considered an upgrade or improvement of such software. A modification that results in the extension of the useful life of computer software beyond its originally estimated useful life generally would be considered an upgrade or improvement only if increased capacity or efficiency is also achieved. Outlays associated with upgrades or improvements of software should be capitalized or expensed as incurred as provided above. Modifications that do not result in an upgrade or improvement of the software should be considered maintenance and expensed as incurred.

### **Specific amortization issues**

The useful life on an intangible asset that arises from contractual or other legal rights should not exceed the period to which the service capacity of the asset is limited by contractual or legal provisions. Renewal periods related to such rights may be considered in determining the useful life of the intangible asset if there is evidence that the government will seek and be able to acquire renewal without incurring outlays that are significant in relation to the level of service capacity expected to be obtained through the renewal. That evidence should consider the required consent of a third party and the satisfaction of conditions required to achieve renewal, if any.

An intangible asset should be considered to have an indefinite useful life if there are no legal, contractual, regulatory, technological or other factors that limit the useful life of the asset. Intangible assets with indefinite useful lives should not be amortized. If changes in factors and conditions result in the useful life of an intangible asset no longer being indefinite, the asset should be tested for impairment. The carrying value of the intangible asset, if any, following recognition of any impairment loss should be amortized in subsequent reporting periods over the remaining useful life of the asset. [This change is accounted for as a change in accounting estimate.]

### **Impairment indicator**

In addition to the impairment indicators provided in paragraph 9 of GASB Statement 42, a common indicator for impairment for internally generated intangible assets is developmental stoppage, such as stoppage due to technological infeasibility for development of computer software. Internally generated intangible assets impaired from development stoppage should be reported at the lower of carrying value or fair value.

## **ACCOUNTING AND FINANCIAL REPORTING – CURRENT FINANCIAL RESOURCES MEASUREMENT FOCUS**

Outlays associated with intangible assets should be reported as expenditures when incurred in financial statements prepared on the current financial resources measurement focus.

## **Effective date and transition**

The requirements of the proposed Statement would be effective for periods beginning after June 15, 2009, with earlier application encouraged. Except as noted below, the accounting changes necessary to conform to the provisions of the Statements should be applied retroactively by restating financial statements, if practical, for all periods presented. If restatement is not practical, the cumulative effect of application should be reported as a restatement of beginning net assets or fund balance, as appropriate, for the earliest period restated. In the period when the Statement is first applied, the financial statements should disclose the nature of any restatement and its effect. If prior periods are not restated, the notes should disclose the reasons therefore.

If determining the actual historical cost of intangible assets that are acquired through exchange transactions or are internally generated, or the fair value at acquisition of intangible assets acquired through nonexchange transactions, is not practical because of inadequate records, governments should report such assets based on estimated historical costs or fair value, as appropriate. For internally generated intangible assets for which, after making every reasonable effort, the government is unable to determine or estimate the historical cost, the recognition provisions of the Statement need not be applied retroactively. In this case, the financial statements for the first period in which the Statement is applied should disclose the nature of the internally generated intangible assets and the fact that they have not been recognized in the statement of net assets.

## **INVITATION TO COMMENT**

## ***FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS***

In October 2006, the GASB issued an invitation to comment (ITC) on a number of issues related to fund balance reporting.

The ITC notes that fund balance information is widely used by various groups, including bond rating agencies, taxpayer association researchers and elected legislators. However, the Board also notes that there are issues that may significantly diminish the usefulness of fund balance information:

- Actions taken to reserve or designate fund balance vary from government to government, leaving the user uncertain as to the force behind the purpose limitations imposed on a government's resources.
- Some governments transfer resources from the general fund to other governmental funds with no intention to use the resources in the receiving fund, so that the resources only reside in the receiving fund temporarily. This may mislead users regarding the amount of available resources and the purposes for which those resources can be used.
- Some governments report some fund balance as reserved, when in fact, it should be unreserved. This occurs, in part, because these governments are not aware that, to result in a reservation of fund balance, limitations on how resources can be used should be more specific than the purpose of the fund in which the resources are reported.

- Because the reporting of designations of unreserved fund balance is optional, a reporting dichotomy has evolved that undermines the comparability of information reported by governments that designate fund balance with those that do not.
- The needs of many users to identify generally available resources may not be addressed by current fund balance reporting requirements, even when current requirements are appropriately met.

The ITC describes the issues and lays out potential remedies, addressing two possible courses of action. First, it considers possible revisions to the definitions of governmental fund types that would clarify their intention. Second, it considers revisions to the definitions of the debt service and capital projects fund types. These clarifications and revisions are intended to minimize, if not eliminate, the presence of generally available resources in governmental funds other than the general fund. That would make the purposes to which resources are limited more transparent to the public, make it easier to identify resources that can be used for any purpose, and ensure that governments are more likely to report similar resources in a similar manner, increasing comparability in financial statements.

The ITC sets forth three alternative models of classifying the components of fund balance:

- Retain the current fund balance components – reserved and unreserved – and continue to base the reporting of reserved fund balance on the relationship of purpose limitations to the overall purpose of the fund, but it makes certain changes to address the issues that have been identified.
- Continue to approach distinctions in components from the perspective of the individual fund, but employ categories of fund balance that distinguish between resources that have been committed to more specific purposes within the fund they are reported in and those that can be used for any purpose consistent with the fund.
- Distinguish fund balance based in part on whether it represents restricted (as defined by Statement 34) or unrestricted resources.

The ITC also considers several other issues related to fund balance:

- Management’s intent to use resources for a particular purpose (currently accomplished by designation)
- Encumbrances associated with appropriations that lapse at year end
- The nonexpendable corpus of a permanent fund

In April 2006, the Board released a preliminary views (PV) document (as well as a “plain-language” supplement) that addresses derivative financial instruments. The plain-language supplement was used for this material, since the subject of derivatives has proved troublesome for many auditors and financial statement preparers alike.

**What is a derivative? Why do governments enter into derivative transactions?**

A derivative is a unique and often complex financial arrangement that a government may enter into with another party, typically a private financial firm. The value of a derivative or the cash it provides to a government (or requires a government to pay) is based on what happens in a separate transaction or agreement, such as an investment or bonds issued by the government. In other words, the value or cash flows *derive* from (are determined by) how the separate transaction performs or from the terms of the separate transaction or agreement.

Governments enter derivative transactions for a number of reasons:

- Investments – some governments enter derivative transactions to generate income.
- Cash flow management – including up-front payments from another party. The payment arrangements or terms of the derivative agreement provide for repayment of the up-front cash.
- Reduction of borrowing costs – governments may enter derivative agreements in connection with issuance of debt.
- Hedging – governments may enter derivative transactions to protect themselves against future changes.

**What are examples of derivatives?**

A simple example of a derivative is an *interest rate lock* - an agreement between the government and a lender that fixes the interest rate for a future borrowing. A government might enter such an agreement when it believes that interest rates may increase before it could issue the related debt.

A government that purchases significant quantities of certain commodities, such as gasoline, might enter into a derivative called a *futures contract* in order to protect itself from increases in the price of the commodity. Futures contracts are agreements to buy or sell a product for a specified price on a specific future date.

One very common derivative agreement entered into by governments is an interest rate swap. Governments enter these contracts because in some cases, issuing variable-rate debt and entering a swap agreement results in lower borrowing costs than issuing fixed-rate debt without such an agreement. The government issues the variable-rate debt, but enters into an agreement with a financial firm (often the underwriter for the debt issue) whereby the government agrees to pay the financial firm a fixed rate and receive from the financial firm a variable rate (equal to the rate

applicable to the issue). The effect of the derivative is to “fix” the government’s interest payment at the amount they agree to pay the financial firm.

Payments do not actually change hands. Only the difference between the fixed and variable rates is exchanged. If the fixed rate exceeds the variable rate, the government (which has paid the variable rate to the bondholders) pays the financial firm the difference (increasing its net cost to the fixed rate). If the variable rate exceeds the fixed rate, the government will receive the difference from the financial firm (thereby reducing its net cost to the fixed rate). This process is called *net settlement*.

Unless cash changes hands at the inception of the agreement, the derivative begins with a zero value. Subsequent changes in interest rates affect the value of the derivative. If interest rates (subsequent to issuance of the debt and execution of the swap agreement) fall, the change would be negative regarding the government; if interest rates subsequently increase, the change would favor the government.

### **Derivatives defined**

GASB defines derivatives (borrowing from the FASB) as financial instruments with two characteristics:

- The financial arrangements are leveraged, meaning that they require no initial investment, or an initial investment that is small relative to what would otherwise be required to obtain the same results
- The financial arrangements can be settled early with a cash payment or the transfer of an equivalent asset

### **Why is the GASB proposing the new standards?**

The number and dollar amount of derivative transactions affecting governments is substantial and is growing rapidly. Likewise, the complexity and variety of derivatives are also increasing. Although many governments enter derivative transactions in order to minimize an identified risk, the derivative itself may expose the government to additional risks that would otherwise not have been encountered:

- Credit risk – the risk that the firm will not honor its promise to pay the government
- Interest rate risk – the risk that changes in interest rates could reduce the value of the transaction to the government
- Termination risk – the risk that the derivative may end earlier than expected and deprive the government of the protection from risk and potentially require substantial termination payments
- Basis risk – the risk that occurs when the amounts received are determined on one index and the amounts paid are based on another
- Rollover risk – the risk that occurs when the derivative has a term different than the underlying or associated debt

- Market access risk – the risk that the government will not be able to issue debt or that doing so will become more expensive.

In order to adequately inform users of financial statements and decision makers about these risks, the GASB has considered derivatives and the associated reporting for several years.

### **What is GASB proposing?**

The GASB proposes that the fair value of derivatives be presented in the statement of net assets, and that generally changes in their fair values from year to year be reported in the statement of activities. Derivatives that represent hedging activities would be accounted for differently, depending on the effectiveness of the hedge. Changes in fair value on hedges that are effective would be deferred.

In order to apply the hedge provisions, governments would have to declare the purpose of the hedge at the time they enter the derivative transaction. The government would have to have a reasonable expectation that the hedge would be highly effective. The derivative would also have to be associated with an item that is eligible to be hedged, and that is not reported in the financial statements at fair value. The hedged item could be a single assets or liability, a group of similar assets or liabilities, or a specific expected exchange of resources in the future that exposes the government to a risk of losing cash flows or fair value. For example, variable-rate debt is eligible for a hedge transaction; investments (which are stated at fair value) are not.

Changes in fair value of a derivative that is an effective hedge would be reported in the balance sheet as deferred credits (accumulated increases in fair value) or deferred charges (accumulated decreases in fair value), rather than being reported as gains or losses in investment income. When the derivative contract terminates, the accumulated deferred credits or charges would be reported as gains or losses in investment income. If the hedging derivative remains effective and continues until its planned conclusion, the deferrals will balance out the value of the derivative until that value declines again to zero when it concludes.

If a hedging derivative terminates or loses effectiveness, the accumulated deferrals would be removed from the balance sheet and reported as gains or losses in investment income. A derivative associated with an expected future exchange of resources that is no longer probable to occur would be treated likewise.

### **How is the effectiveness of a hedge determined?**

Hedge effectiveness is determined at the time the hedge agreement is entered, and at least annually. Governments would be able to use one of three approaches to evaluate the effectiveness of the hedge:

- Consistent critical terms – if the critical terms of the derivative and the terms of the hedged item are identical (e.g., the swap agreement and the underlying debt issue start and end on the same dates and are both based on the same index), the hedge is presumed

effective. Under these circumstances, any change in the fair value or cash flows of the item being hedged is basically offset by changes in the fair value or cash flows of the hedging derivative. This method is limited to swaps. Other types of derivatives, or swaps with inconsistent critical terms, must be evaluated using another method.

- Synthetic instruments – in a derivative transaction, the hedged item and the hedging derivative may be combined to create a theoretical or “synthetic” instrument. The synthetic instruments method involves the calculation of an interest rate (or commodity rate, as appropriate) for the synthetic instrument based on the historical experience prior to entering the derivative and the actual experience to date following the start of the derivative. The synthetic rate is then compared with the fixed rate portion of the derivative.

If the synthetic rate is no less than 90 percent and no greater than 111 percent of the fixed rate as of the date of the financial statements, then the hedge is considered effective for financial reporting purposes. If the synthetic rate is outside that range, a government would examine the rates over the life of the derivative thus far. If the average synthetic rate over that period falls within the 90 to 111 percent range, then the hedge is considered effective for financial reporting purposes. However, even if the synthetic rate as of the date of the financial statements or over the life of the derivative thus far falls within the range, a government may yet determine that the hedge is not effective for financial reporting purposes because new conditions (such as changes in tax rates) make it unlikely that the hedge will remain effective going forward.

- Quantitative techniques – two quantitative techniques may be used to evaluate hedge effectiveness – the *dollar-offset* and *regression analysis*. The dollar-offset method divides changes in the fair value or cash flows of the hedged item with those of the hedging derivative, or vice versa. As long as the result of this calculation falls within a range of 80 to 125 percent, the hedge is considered effective for financial reporting purposes. Regression analysis examines the statistical relationship between changes in the fair value of the hedged item and the hedging derivative. For a derivative intended to hedge a loss of cash flows, the relationship between the changes in fair value of the hedging derivative and a “hypothetical” derivative are compared. The hypothetical derivative is a “perfect hedge” – one that has critical terms that exactly match those of the hedged item. For a hedge evaluated using regression analysis to be considered effective for financial reporting purposes, the analysis should produce:
  - An R-squared of at least .80
  - A F-statistic that indicates statistical significance at the 95 percent confidence level
  - A regression coefficient for the slope between -1.25 and -.80

## **What disclosures would be required?**

The following disclosures are proposed:

- Types of derivatives, as well as the reasons for which the transactions were entered
- Significant terms of the derivatives, including:
  - Indexes or interest rates they are based on
  - Options embedded in the derivatives
  - Starting and ending dates
  - The amount of cash that changed hands at inception
- Fair value of the derivatives at the balance sheet date and an explanation of any significant assumptions or methods used to estimate fair value
- For swap agreements or other derivatives associated with debt, the net cash flows of the derivative and the debt service requirements of the debt
- The risks to which the derivative expose the government (see the types of risk and explanations above)
- Which of the four methods were used to evaluate hedge effectiveness
- The actual critical values that resulted from the hedge effectiveness (such as the R-squared statistic for regression analysis or the synthetic interest rate)
- The amount of ineffectiveness, if any, in a derivative that is a hedge
- Other derivative activity during the year.

### **Hedge ineffectiveness**

Even if a hedge is effective for financial reporting purposes, it may be ineffective to a degree. For example, a hedge evaluated using the dollar-offset method may have a critical value of 90 percent. It is therefore effective for financial reporting purposes. However, it is not fully effective, since it does not have a critical value of 100 percent. The government would therefore have to disclose the ineffectiveness of the hedge. If the hedge is presumed effective based on consistent critical terms, no disclosure would be required.

### **Derivative activity**

Governments would also disclose derivative activity in a table summarizing the changes in derivative balances during the period covered by the financial statements. Derivatives would be aggregated by type (such as swaps, rate locks, futures, etc.) and reported in three categories – derivatives that hedge fair value, those that hedge cash flows, and those that are not hedges. The table would present fair values as of the beginning of the period, fair values of new derivatives entered into during the year, fair value of derivatives that terminated during the year, the change in fair value of derivatives during the year (referred to as “marking to market”), and the fair value at the end of the period.