



Auditor of Public Accounts
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Audit Risk Alert

Update to *Implementing GASB Statement No. 68 for Local Government Audits Issued Under the Regulatory Basis of Accounting*

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No 27*, was effective for fiscal years beginning after June 15, 2014. GASB 68 focuses on an earnings approach for recognizing a liability on an accrual basis as pensions are earned by employees. GASB 68 also recognizes a liability for payables to a defined benefit pension plan on both the accrual basis and modified accrual basis. Most Commonwealth of Kentucky local governments have a June 30 fiscal year end date, and therefore, this standard impacted the financial statements of those governments for the fiscal year ended June 30, 2015.

Five of Kentucky's 120 counties currently have financial reporting models for fiscal courts that follow accounting principles generally accepted in the United States (U.S. GAAP). The remaining 115 counties, and all fee officials, currently follow a regulatory basis of accounting, which is defined as the basis of accounting necessary to comply with the requirements or financial reporting provisions of a regulatory agency to which the government entity is subject. The Department for Local Government (DLG) is the regulatory agency in Kentucky that dictates the financial reporting provisions for county officials.

The regulatory basis of accounting is an Other Comprehensive Basis of Accounting (OCBOA), and falls within the provision of AU-C Section 800, *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*.

On June 30, 2015, the Auditor of Public Accounts (APA) issued an Audit Risk Alert regarding implementation of GASB 68 which stated that due to the significance of pension contributions paid by local governments and reported on the regulatory basis financial statement, and also the long term nature of these required payments, the fiscal court's or fee official's proportionate share of the related pension plan liabilities and plan pension expense as defined by GASB 68 is a relevant and material disclosure for audits of fiscal courts and applicable fee officials presented under the regulatory basis of accounting. The Alert stated appropriate note disclosures should be made to disclose the fiscal court's or applicable fee official's proportionate share of the plan pension expense and the net pension liability for the plan in which it participates.

Government employers report a Net Pension Liability (NPL) on the GAAP basis Statement of Net Position as a liability to employees for pensions. Pensions are provided to employees on a deferred payment basis as part of the total compensation package offered by an employer for employee services each year. The NPL represents the government's proportionate share of the actuarial present value of projected benefit payments attributable to past periods of service, net of the pension plan's fiduciary net position.

Governments that prepare OCBOA (Cash or Regulatory basis) financial statements do not present their NPL on their financial statements and are not required to disclose their NPL in the notes. AU-C Section 730, Required Supplementary Information (AICPA, Professional Standards), defines RSI as information that a designated accounting standard setter (a body designated by the AICPA Council to establish GAAP, and limited FASB, GASB, the FASAB, and the IASB) requires to accompany an entity's basic financial statements. In GAAP financial statements, RSI is not part of the basic financial statements; however, a designated GAAP accounting standard setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Since OCBOA accounting and financial reporting standards applicable to state and local governments have not been established by GASB, any such RSI required by GASB in GAAP basis financial statements is not considered RSI that must accompany OCBOA financial statements. Therefore, in regulatory basis financial statements for state and local governments, there are no RSI requirements because there is no designated standard setter for such OCBOA frameworks. However, financial statement preparers may include such GAAP RSI in their OCBOA financial statements. In these instances, that information would be considered supplementary information that is required by law or regulation to be presented or supplementary information presented at the election of the governmental entity.

The January 2014 *County Budget Preparation and State Local Finance Officer Policy Manual*, issued by the Department for Local Government, addresses appropriate note disclosures for financial statements. Page 5 states, "In order to achieve fair presentation, the notes to the financial statement(s), whether prepared utilizing the regulatory basis or GAAP basis, should include all informative disclosures that are appropriate, including all matters that affect the financial statements' use, understanding and interpretation." It goes on to list examples of required note disclosures for financial statement(s), whether prepared on the regulatory basis or GAAP basis. The manual states, "it is important to note that GAAP disclosure requirements that are not relevant to the regulatory basis of accounting need not be considered. For instance, as noted above, Capital Assets under the GAAP basis would be reported at historical cost net of accumulated depreciation on the face of the financial statements and in the notes to the financial statements. Under the regulatory basis of accounting, Capital Assets would be reported as 'Other Information' instead of in the notes to the financial statements and only disclose the assets at historical cost."

On July 1, 2015, the AICPA issued the 2015 edition of the *AICPA Audit and Accounting Guide, State and Local Governments*, which includes a new chapter addressing accounting and auditing considerations of plans and employers under GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB 27*. Chapter 13 of this guide addresses Auditing Considerations for Single and Agent Employers. The guidance clarifies that in addition to census data testing required in audits of pension plans to test census data *maintained by the plan*, employer auditors must also perform procedures to test the census data *reported to the plan*. Auditors should be familiar with this requirement, as well as the additional audit guidance identified in Appendix B-21 and B-22 of the guide related to procedures the employer auditor must follow in order to rely on the work of the plan auditor.

The inclusion of net pension liability and pension expense in the note disclosures of OCBOA audits would require auditors for the 115 regulatory basis county fiscal courts and auditors for all applicable county fee officials to do additional procedures to verify the census data provided by the local government to the retirement plan. The APA believes that DLG's 2014 *County Budget Preparation and State Local Finance Officer Policy Manual* permits the flexibility to only disclose matters relevant to the regulatory basis of accounting, with relevant reporting requirements defined by the regulator, DLG. Given that DLG has not required reporting of the pension liability in regulatory basis audits, and because the information regarding each county's proportionate share of pension liabilities is readily available from the Kentucky Retirement System's website, the APA's updated Audit Guides will include a modification to the current financial statement disclosure labeled - "Note 8. Employee Retirement System" for regulatory basis audits to remove Part B – Net Pension Liability, and instead include a reference to the location readers can obtain the actuarial report and related proportionate share audit for the Kentucky Retirement Systems.