



We'll get you there.

CPAs | CONSULTANTS | WEALTH ADVISORS

Accounting Complexities and Review

October 10, 2024



The information herein has been provided by CliftonLarsonAllen LLP for general information purposes only. The presentation and related materials, if any, do not implicate any client, advisory, fiduciary, or professional relationship between you and CliftonLarsonAllen LLP and neither CliftonLarsonAllen LLP nor any other person or entity is, in connection with the presentation and/or materials, engaged in rendering auditing, accounting, tax, legal, medical, investment, advisory, consulting, or any other professional service or advice. Neither the presentation nor the materials, if any, should be considered a substitute for your independent investigation and your sound technical business judgment. You or your entity, if applicable, should consult with a professional advisor familiar with your particular factual situation for advice or service concerning any specific matters.

CliftonLarsonAllen LLP is not licensed to practice law, nor does it practice law. The presentation and materials, if any, are for general guidance purposes and not a substitute for compliance obligations. The presentation and/or materials may not be applicable to, or suitable for, your specific circumstances or needs, and may require consultation with counsel, consultants, or advisors if any action is to be contemplated. You should contact your CliftonLarsonAllen LLP or other professional prior to taking any action based upon the information in the presentation or materials provided. CliftonLarsonAllen LLP assumes no obligation to inform you of any changes in laws or other factors that could affect the information contained herein.

Learning Objectives

At the end of this session, you will be able to:

01

Recognize certain accounting complexities in governmental accounting

02

Identify the proper usage and disclosures required for various transactions

03

Discuss unusual activity related to intra/interfund activities



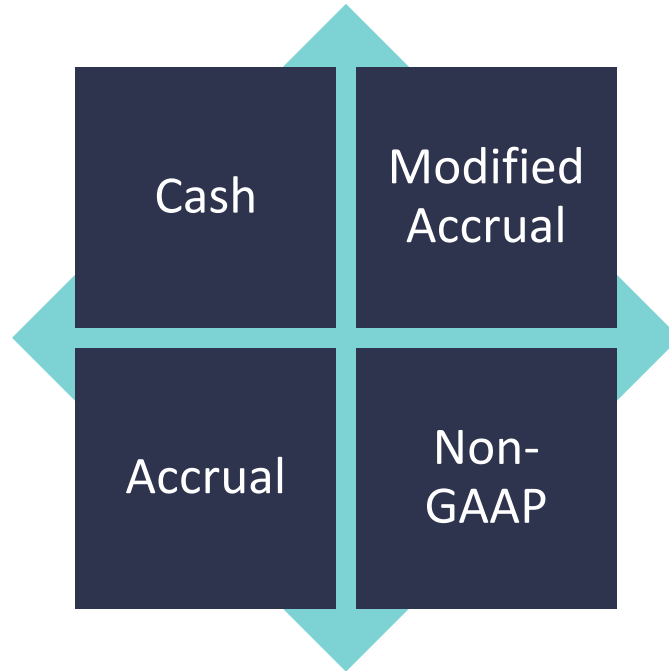
Component Entities

- Economic substance over legal form
 - Parent/Subsidiary = primary government/component unit
 - Primary government (PG)
 - Special purpose government
 - Separate legal status
 - Separately elected governing body
 - Fiscal independence
 - Identifying component units
 - Legally separate organization
 - Financial accountability
 - Fiscal dependence



Types of Transaction and Basis of Accounting

Complexity increases as basis change





Cash Basis

Easiest to quantify and record

All transactions based on cash (investments) changing hands

No estimates or judgements

Cash in and cash out

Shortfalls

- Easy to manipulate by not paying your bills or delaying recording receipts



Modified Accrual Basis

- Cash basis with some accrual and revenue recognition adjustments
- More difficult than cash, but not the most difficult
- Issues to consider
- Investment fair value
- Allowances for receivables
- Certain accruals and payables
 - Accounts payable
 - Compensated absences
 - Retainage
 - Most can be a by-product of full accrual transactions



Modified Accrual Basis

- Revenue recognition – susceptible to accrual
 - Deferred inflows
- Period of availability – 60, 90, 120 days
- Capital outlay
- Debt service
- Other financing sources and uses
 - Proceeds (long-term debt, leases, subscription-based information agreements)
 - Advance refunding
 - Transfers



Accrual Basis

- Revenues are recognized when earned and liabilities are recorded as incurred
 - Builds on modified accrual
 - No susceptibility to accrual for revenues
 - All accruals recorded – short and long-term
 - Long-Term Assets
 - Capital Assets



Accrual Basis

Long-term liabilities

Certain accruals
(e.g., interest
expense)

Debt

Net pension
liability

Net OPEB liability

Leases

Subscription-based
information
arrangements

Pollution
remediation

Escheated
property



Accounting Issues – Investments

Investment fair value

Level within the fair value hierarchy determines complexity in determining fair value

- As level increases, so does the amount of estimation of value

Alternative Investments

- Understand how they are valued
- Question the experts
- Check for reasonableness

Foreign denominated investments add another layer of uncertainty because of currency conversion



Accounting Issues – Investments

Disclosure requirements

- GASB 72 valuation methodologies
- Future commitments
- Disclosure of valuation methodologies



Accounting Issues – Receivables

- Accounts Receivable – Allowance and unavailability
 - Understand the population and desired results
 - Understand the basis for the calculations
 - Is the methodology sound?
 - Is it representative of the population?
 - Are we overlooking trends?
 - Look at relationships (e.g., taxpayer), not just individual amounts?
 - Question large changes in either direction
 - Is there a flaw in the methodology?
 - Bad data?



Accounting Issues – Capital Assets

Capitalization policy

- Understand the level at which items are capitalized
- Set up accounting systems to capture such items

Conversion of CIP to depreciable item

- Review CIP at least at year end to identify completed projects

Depreciation calculation

- Depreciable lives
- Depreciation methods



Accounting Issues – Capital Assets

Internally developed software costs

- Increase in functionality of the software
- Increases in efficiencies
- Extension of useful life
- Set up accounting systems to capture such items

Three stages

- Preliminary
- Development
- Post implementation

Costs related to activity in the development should be capitalized, preliminary and post implementation costs should be expensed as incurred



Accounting Issues

Certain accruals

Unused vacation/compensated absences

- Easy calculation
- Hard to determine the current portion
- Remove pension contributions

Interest payable

- Easy calculation
- Principle times interest rate, prorated over period of time

Termination benefits

- Incentive to retire early
- Amounts to be provided in the future, gets recorded at time of acceptance



Accounting Issues – Debt

Receive cash, repay according to a predetermined schedule

Complications

- Premiums/discounts at issuance
 - Amortize over the life of the debt as interest adjustment
 - Utilize interest method or approximate interest method
- Refundings
 - Recognize a gain or loss on the transaction
 - Calculation is tricky
 - Amortize over the shorter of the life of the new debt or remaining actual life of the old
 - Disclosures are more complicated



Accounting Issues – Leases

Two transactions

- Borrowing of money
- Purchase of asset

Proper recording on the face of the operating statement of governmental funds

- Recognition criteria
- Other financing source – Proceeds
- Capital outlay

Note disclosure is different from bond or loan



Accounting Issues – Pension and OPEB

- Net Pension/OPEB liability
 - Actuarial-based
 - Understand the assumptions used
 - Review them for reasonableness and propriety
 - Know the standards to determine what is acceptable
 - Method
 - Discount rate
 - Amortization method



Accounting Issues – Pension and OPEB

- Know the standards
- Be willing to question things you don't understand
 - Deferred Inflows and outflows
 - Grouping - netting only allowed for return expectations
 - Amortization
 - Allocations of Liability, deferred outflows and deferred inflows
 - Verify methodology
 - Determine consistency



Accounting Issues – Pension and OPEB

- Special funding situations
 - Legal responsibility to contribute directly to plan
 - Contribution not dependent on events unrelated to pensions
 - Non-employer entity is the only entity required to pay



Accounting Issues – Self Insurance

- Commonwealth acting as an insurance entity/company
- Incurred but not reported (IBNR) Liability
- Actuarially calculated
 - Understanding of calculation and assumptions used
 - Big driver is claims experience
 - Look for outliers in data
- Understand disclosures



Accounting Issues – Pollution Remediation

Be able to identify triggering events

- Awareness
- Responsibility
- Reasonable estimate

Obtain estimates

- How derived?
- Who determined?
- Review methodology for appropriateness and consistency



Accounting Issues – Claims and Judgements

Obtain information from “experts” (attorney)

Determine likelihood of outcome based on professional opinion

Attorney’s help in assessing -

- Remote (nothing to be said)
- Possible (footnote it)
- Probable (book it)

Review estimated range of losses

Determine estimate of liability based on the above factors



Accounting Issues – Net Investment in Capital Assets

Capital asset (net of depreciation)
plus capital-related deferred outflows
less capital-related borrowing and deferred inflows

- Adjustments for unspent bond proceeds
- Retainages and accounts payable



Accounting Issues – Fund Balance

- Long-term amount of loans and notes receivables (unless proceeds are restricted, committed or assigned)
- Reconciling restricted from fund statements to government wide statements
- Stabilization arrangements
- Negative and positive fund balance amounts



Special Topic – Opioids Settlement

- Distributors and J&J
- Teva to pay up to \$3.34 billion over 13 years and to provide either \$1.20 billion of its generic version of the drug Narcan over 10 years or \$240 million of cash in lieu of product, as each state may elect
- Allergan to pay up to \$2.02 billion over 7 years
- CVS to pay up to \$4.90 billion over 10 years
- Walgreens to pay up to \$5.52 billion over 15 years
- Walmart to pay up to \$2.74 billion in 2023, and all payments to be made within 6 years



Participation

Distributors

J&J

CVS

Walgreens

Walmart

Allergan

Teva



Key Discussions and Accounting Issues

When do we recognize the settlement?

- Discussion of the dates.

What amount do we recognize?

- Governmentwide – full accrual
- Governmental funds – modified accrual
 - Exchange transaction (settlement)
 - Nonexchange transaction (abatement)



Key Dates

Note: Notice of the 2022 National Opioid Settlements has already been provided to all eligible states, and there has been sufficient state-level participation to proceed to the second phase of these settlements. Key dates for the second phase of these settlements are set forth below.

TEVA	ALLERGAN	WALGREENS	WALMART	CVS
January 25, 2023 Notice to subdivisions to begin rolling out	January 25, 2023 Notice to subdivisions to begin rolling out	January 25, 2023 Notice to subdivisions to begin rolling out	January 25, 2023 Notice to subdivisions to begin rolling out	January 25, 2023 Notice to subdivisions to begin rolling out
April 18, 2023 "Initial Participation Date" - Deadline to submit participation forms	April 18, 2023 "Initial Participation Date" - Deadline to submit participation forms	April 18, 2023 "Initial Participation Date" - Deadline to submit participation forms	April 18, 2023 "Threshold Subdivision Participation Date" - Deadline to submit participation forms	April 18, 2023 "Initial Subdivision Participation Date" - Deadline to submit participation forms
		May 2, 2023 Deadline for Settling States to inform Walgreens whether they agree to proceed with the settlement		May 2, 2023 Deadline for Settling States on the Enforcement Committee to determine whether to proceed with the settlement
May 18, 2023 "Reference Date" - Deadline for Teva to decide whether to proceed with the settlement	May 18, 2023 "Reference Date" - Deadline for Allergan to decide whether to proceed with the settlement	May 18, 2023 "Reference Date" - Deadline for Walgreens to decide whether to proceed with the settlement		May 18, 2023 "Reference Date" - Deadline for CVS to decide whether to proceed with the settlement
July 17, 2023 "Effective Date" of settlement [60 days after Reference Date]	July 17, 2023 "Effective Date" of settlement [60 days after Reference Date]	July 17, 2023 "Effective Date" of settlement [60 days after Reference Date]; Date of first payment by Walgreens	June 2, 2023 "Effective Date" of settlement [assuming certain "Subdivision Participation Thresholds" are achieved]	June 2, 2023 "Effective Date" of settlement [15 days after Reference Date]
August 16, 2023 Date of First Payment by Teva	August 16, 2023 Date of First Payment by Allergan	August 16, 2023 First payment transferred from Settlement Fund Escrow Fund to Settlement Fund	July 15, 2023 Date of first payment by Walmart	June 30, 2023 Date of First Payment by CVS
Payments to subdivisions on a rolling basis	Payments to subdivisions on a rolling basis	Payments to subdivisions on a rolling basis	Payments to subdivisions on a rolling basis	Payments to subdivisions on a rolling basis



Recognition in Governmental Funds

- If a government can recognize a receivable in the statement of net position, it may be able to recognize a long-term receivable in the balance sheet
- Revenue would be recognized only to the extent it is *available*
 - Revenue recognition is limited to payments received during the year or within the period of availability after fiscal year end
- The unavailable portion is a deferred inflow



Recognition in Government Wide

- If a government can recognize a receivable in the statement of net position, it may be able to recognize a long-term receivable in the balance sheet
- Revenue would be recognized, and net position would be restricted for opioid settlement purposes
- Should the receivable be adjusted for the time-value of money? Good question. Waiting to verify





GASB 96, Subscription-Based Information Technology Arrangements



GASB 96 – Subscription-Based Information Technology Arrangements



Subscription-Based Information Technology Arrangements (SBITA) – defined as a contract that conveys control of the right to use another party’s IT software for a specified period of time



SBITA is accounted for as a right to use subscription asset and a corresponding subscription liability



GASB 96 is very similar in concept to GASB 87 for leases

GASB 87/GASB 96 Side by Side

SBITDA

- A contract that conveys control of the right to use another party's IT software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction.

Lease

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



What Does GASB 96 **Not** Cover?

SBITA agreements less than 12 months

Contracts that solely provide IT support services

Perpetual licensing agreements

Internally-generated software

Insignificant software components of GASB 87 lease assets



Recognition and Measurement of a SBITA



- Once a SBITA is identified, governments recognize a subscription asset and liability at the commencement of the subscription term of the SBITA
 - This occurs once the government obtains control of the right to use the underlying IT asset

Recognition and Measurement of a SBITA

- The subscription term is the period that the government has the noncancellable right to use the underlying IT assets, plus the following periods, if applicable:
 - Periods covered by a government's extension option if it is reasonably certain that the government will exercise that option
 - Periods covered by a government's termination option if it is reasonably certain that the government will not exercise that option
 - Periods covered by a vendor's extension option if it is reasonably certain that the SBITA vendor will exercise that option
 - Periods covered by a vendor's termination option if it is reasonably certain that the vendor will not exercise that option



Subscription Liability

Present value of the total subscription payments expected to be made to the vendor during the subscription term

Discount future payments by the interest rate the vendor charges the government which may be the implicit rate in the SBITA

- If the implicit rate is not readily available, an estimated incremental borrowing rate can be utilized



Subscription Liability – Payments Included

- Fixed payments
- Variable payments based on an index or rate – measured using the index or rate as of the commencement of the subscription term
- Variable payments that are fixed in substance
 - Termination penalties – if the subscription term reflects the government exercising either an option to terminate the agreement or a fiscal funding or cancellation clause
 - Incentives receivable from vendor
 - Any other payments government is reasonably certain will be paid



Subscription Liability



In subsequent periods, the government will accrue interest on the remaining subscription liability at the applicable discount rate



The subscription payments will be allocated first to the accrued interest, and then to reduce the outstanding subscription liability

Subscription Asset

- The subscription asset is measured as the initial value of the subscription liability plus:
 - Payments made to the vendor at the commencement of the subscription term
 - Minus any vendor incentives received at the commencement of the subscription term
 - Capitalizable initial implementation costs



Subscription Asset

- The government will amortize the subscription asset in a systematic and rational manner over the shorter of the subscription term or the useful life of the underlying IT asset
- Amortization of the subscription asset begins at the commencement of the subscription term, and is reported as an outflow of resources by the governmental entity



Other Potential Outlays

- In addition to subscription payments, there can be cash outlays for other activities associated with SBITAs. The type and timing of the activity dictates the accounting treatment of these cash outlays. Other activities associated with SBITAs are grouped into three stages:
 - Preliminary Project State
 - Initial Implementation Stage
 - Operation and Additional Implementation Stage



Implementation Stages

Stages	Activities	Capitalize
Preliminary project stage	<ul style="list-style-type: none"> • Conceptual formulation and evaluation of alternatives • Determination of the existence of needed technology • Final selection of alternatives for SBITA 	No Expense as incurred
Initial implementation stage	<ul style="list-style-type: none"> • Design of chosen path, including configuration • Coding • Installation • Testing • Minimum data conversion needed to make underlying assets operational 	Yes, if incurred after: <ul style="list-style-type: none"> • Completion of preliminary project stage • Funding for at least the first year of the SBITA has been approved
Operation and additional implementation stage	<ul style="list-style-type: none"> • Application testing • Data conversion (other than that above) • Software maintenance 	No Expense as incurred Implementation of additional modules with new functionality may qualify as improvements



Challenges

Volume

Educating departments

Completeness of
Population

Software contracts are
more complex
(terminology)



Re-emerging Complexity and Issues

- *GASB No. 33, Accounting and Financial Reporting for Nonexchange Transactions*
 - *Specifically, period of availability and revenue recognition*
- *GASB No. 54, Fund Balance Reporting and Governmental Fund Type Definition*
 - *Specifically, fund usages and classification of fund balance*



Type of Nonexchange Transactions

Types of Nonexchange Transactions:

1. Derived Tax Revenues: Income and sales taxes.
2. Imposed Nonexchange Revenues: Property taxes, fines.
3. Government-Mandated Nonexchange Transactions: Federal programs requiring state implementation.
4. Voluntary Nonexchange Transactions: Grants, donations.



Period of Availability

- Under GASB Statement No. 33, the “period of availability” refers to the timeframe within which revenue must be collected to be considered available for use in the current period. Specifically, revenue is considered available if it is collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.
- Argument: Full accrual’s matching principle is a fundamental accounting concept that dictates that expenses should be recognized in the same accounting period as the revenues they help generate. This principle ensures that financial statements reflect the true economic activity of a business by matching related revenues and expenses within the same period.



Funds and Fund Balance Classification

- Special revenue funds
 - **Special Revenue Funds:** Used to account for specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects
- Classification of Fund Balance
 1. **Non-spendable:** Resources that cannot be spent (e.g., inventories).
 2. **Restricted:** Resources constrained by external parties or legislation.
 3. **Committed:** Resources constrained by formal government action.
 4. **Assigned:** Resources intended for specific purposes but not formally committed.
 5. **Unassigned:** Residual resources available for any purpose, primarily in the general fund



Questions



Sean Walker, CPA, CFE, CGFM, CGMS

Principal

sean.walker@CLAconnect.com



CLAconnect.com



CPAs | CONSULTANTS | WEALTH ADVISORS

©2024 CliftonLarsonAllen LLP. CLA (CliftonLarsonAllen LLP) is an independent network member of CLA Global. See [CLAglobal.com/disclaimer](https://www.claglobal.com/disclaimer). Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor.