ACCOUNTING AND AUDITING UPDATE

Ehlers Conference

PRESENTED BY:

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Malloy Montague Karnowski Radosevich & Co., P.A.

OBJECTIVES:

- Entity-wide Impact of COVID-19
- Legal Compliance Update
- Single Audit Update
- SAS 134-141 Update
- GASB #84 Fiduciary Funds – as amended by GASB #97
- GASB #87 Leases – as amended by GASB #95
- GASB #89 – as amended by GASB #95
- GASB #91 Conduit Debt – as amended by GASB #95
- GASB #96 SBITAs
- GASB #98 The Annual Comprehensive Financial Report
- Other Noteworthy Items

IMPACT OF COVID-19

- **Internal Control Considerations**
  - Document and approve changes at the appropriate level of management
  - Consider operating effectiveness
  - Assessment of review-type controls
  - Inability of individuals to perform duties due to absences
  - Lack of information from offices may affect effectiveness of controls
  - Identify appropriately designed controls to compensate for lack of information

IMPACT OF COVID-19

- Policy Considerations
  - Consider policies for approval of requests for funds received by e-mail (check requests, wiring funds, changes to payroll, and updating of system settings)
  - Changes in approval processes that are not currently using an on-line approval process
  - Consider segregation of duties over bank transactions
  - Consider grant submission deadlines and requests for extensions
  - Plan for processing payroll and related approvals including any changes to the internal controls over the processing of payroll and related approvals
  - Approval of payroll tax related payments

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LEGAL COMPLIANCE UPDATE

Summary of Significant Changes to Minnesota Legal Compliance Audit Guide

DEPOSITORIES OF PUBLIC FUNDS

In the Depositories of Public Funds and Public Investment section, the following question was added:

"If the School used a sweep account, did the timing of the sweep take place so that all amounts on deposit at the end of the banking day were protected by deposit insurance, bond or pledged collateral?"

LEGAL COMPLIANCE MANUAL

RETAINAGE REQUIREMENTS

- Minn. Stat. § 15.72 and § 541.051, subd. 1(a)
  - For a contract for public improvement, a public contracting agency may withhold up 5% of any progress payment as retainage to ensure satisfactory performance. You must release the retainage no more than 60 days after *substantial completion*.
  - "Substantial completion" – Defined
    - the date when construction is sufficiently completed so that the owner can occupy or use the improvement for the intended purpose.
    - the date when construction-related activity and ongoing inspections are no longer required.

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RETAINAGE REQUIREMENTS: AN EXCEPTION

- Minn. Stat. § 15.72. and § 541.051, subd. 1(a)
  - The public contracting agency is permitted to continue to withhold the following two amounts even after the 60-day period
    1. up to 250 % of the cost to correct or complete work known at the time of substantial completion, <u>and</u>
    2. the greater of $500 or 1% of the value of the contract pending submission of final paperwork.
  - The first amount must be released within 60 days of work completion. The second must be released within 60 days of submission of final paperwork.

SINGLE AUDIT UPDATE

CARES	CRRSA	ARP
• 03/27/20 • CRF, ESF, PPP, PRF, add'l $ for existing programs • $2+ Trillion • MN $1.87billion	• 12/27/20 • ESF – add'l ESSER and GEER $, EANS • $81.9 billion to ESF • MN $140M in ESSER	• 03/11/21 • ESF, CSLFRF • $1.9 Trillion • $122.7 billion in ESSER III • MN $4+ billion in CSLFRF and ESSER III

CARES ACT, CRRSA ACT, AND ARP ACT

AN OVERVIEW AND DISTINCTION BETWEEN THE 3 DIFFERENT ACTS

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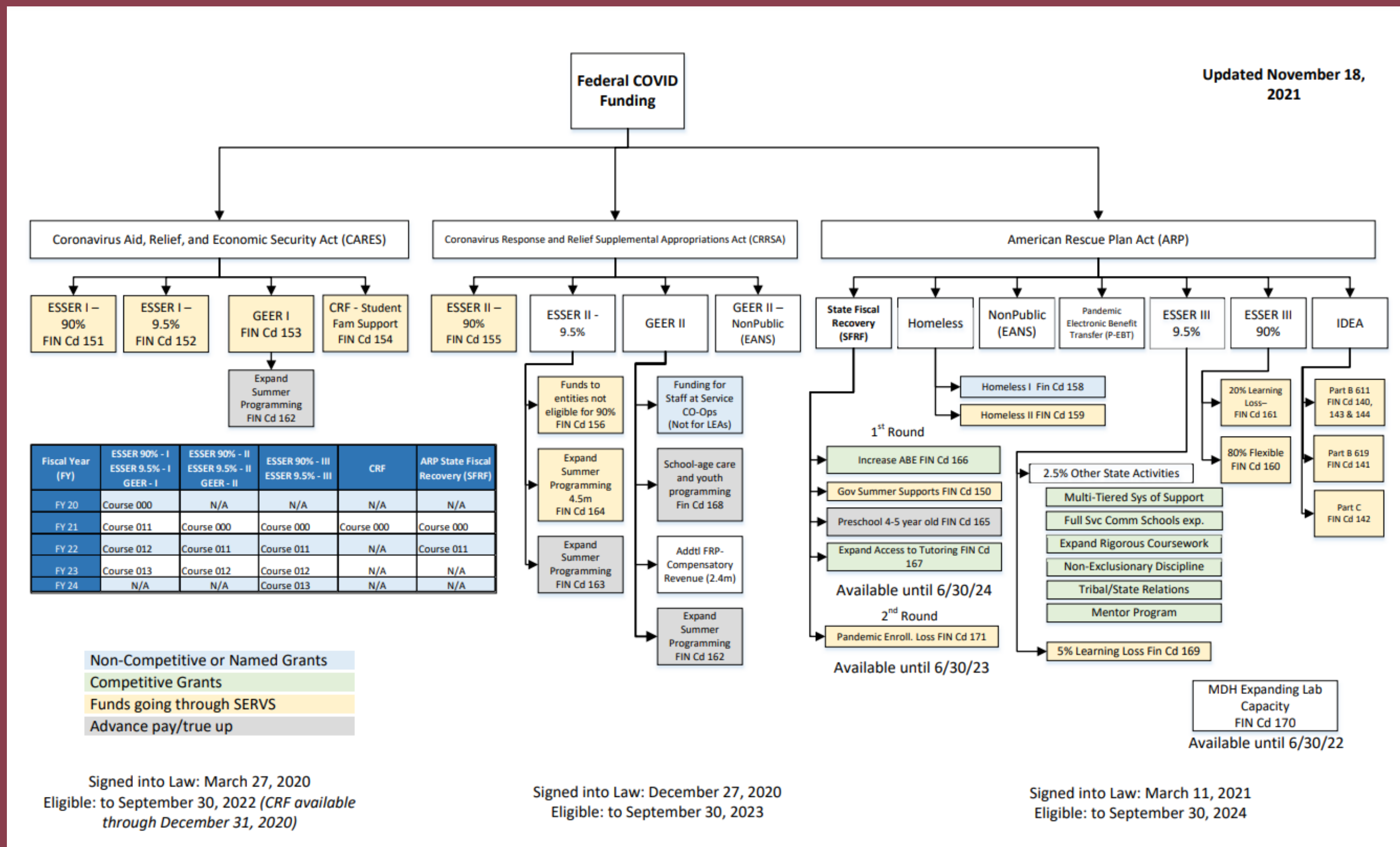
GET SOME PERSPECTIVE

A COMPARISON OF ARP ESSER TO PY TOTAL SEFA

District/Charter	2020 SEFA	ARP ESSER 90%
Charter School A	$ 869,122	$ 1,232,795
Charter School B	Below $750,000	$ 1,286,395
Charter School C	$ 1,326,897	$ 3,205,266
School District A	$ 4,977,005	$ 5,688,524
School District B	$ 15,891,612	$ 23,555,598
School District C	$ 24,460,978	$ 30,676,070
School District D	$ 76,665,001	$ 206,862,473

MDE FEDERAL FLOW CHART

REFER TO MDE WEBSITE FOR MOST RECENT VERSION



Fiscal Year (FY)	ESSER 90% - I ESSER 9.5% - I GEER - I	ESSER 90% - II ESSER 9.5% - II GEER - II	ESSER 90% - III ESSER 9.5% - III	CRF	ARP State Fiscal Recovery (SFRF)
FY 20	Course 000	N/A	N/A	N/A	N/A
FY 21	Course 011	Course 000	Course 000	Course 000	Course 000
FY 22	Course 012	Course 011	Course 011	N/A	Course 011
FY 23	Course 013	Course 012	Course 012	N/A	N/A
FY 24	N/A	N/A	Course 013	N/A	N/A

https://education.mn.gov/MDE/dse/health/covid19/cares/

ALN 84.425	CARES	CRRSA	ARP
ESSER 90%	151	155	160, 161
ESSER 9.5%	152	156 163, 164	169
GEER	153 162	157 162, 168	
Home-less			158, 159

IDEA 84.027/84.173/84.181	140-144
CSLFRF 21.027	150, 165-167,171
ELC Reopen Schools 93.323	170

UFARS Finance Coding

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SCRUTINIZE

FIN 499 AND FIN 699

TO VERIFY ASSISTANCE

LISTING NUMBERS (CFDA #'S)

OF GRANTS

ESSER I, ESSER II, AND ARP ESSER

COMPARE AND CONTRAST

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ESSER I

- Legislation – CARES Act, Sec. 18003 of Division B
- POA – 03/13/20 - **09/30/22**
- Reporting - Fins 151 and 152
- General Uses – preventing, preparing for, and responding to COVID-19
- Same allowable purposes as ESSER II and ARP ESSER
- Earmarking – equitable services to non-pubs
- MOE – N/A – for states only
- MOEq – N/A

ESSER II

- Legislation – Section 313 of the CRRSA Act
- POA – 03/13/20 - **09/30/23**
- Reporting - Fins 155, 156, 163, and 164
- General Uses – preventing, preparing for, and responding to COVID-19
- Same allowable purposes as ESSER II and ARP ESSER
- Earmarking – NONE
- MOE – N/A – for states only
- MOEq – N/A

ARP-ESSER

- Legislation – Section 2001 of the ARP Act
- POA – 03/13/20 - **09/30/24**
- Reporting - Fins 158-161, and more to come
- General Uses – preventing, preparing for, and responding to COVID-19
- Same allowable purposes as ESSER II and ARP ESSER
- Earmarking – 20% learning loss (Fin 161)
- MOE – N/A – for states only
- MOEq – **Applicable** FY22 &23

MAINTENANCE OF EQUITY

WHAT IS IT AND WHEN DOES IT APPLY?

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MOEquity – new fiscal equity requirements in **ARP ESSER** to ensure:

- District doesn't disproportionately reduce State and local per-pupil funding in high-poverty schools.
- District doesn't disproportionately reduce the number of FTE per-pupil in high-poverty schools
- Applicable in FY 2022 and 2023 for ALL Districts/charters that received ARP ESSER funding (fins 160/161)
- Must meet both the fiscal and staffing equity
- MDE required first survey reporting due March 18th, 2022

MAINTENANCE OF EQUITY

EXEMPTIONS

MOEquity – exempt if you meet one of the following:

- LEA operates a single school for all grades
- LEA has total enrollment less than 1,000 students
- LEA serves all students within each grade span with a single school
- LEA can demonstrate an exceptional or uncontrollable circumstance – (ie – the pandemic's impact to enrollment)
    - Must be able to certify that there was no aggregate reduction in combined State and local per-pupil funding in FY22 and FY23
    - Must be approved by the Department of Education

MAINTENANCE OF EQUITY

CALCULATION CONSIDERATIONS

- Determination of “high poverty” schools
  - Use any measure of poverty under section 1113(a)(5) of ESEA
  - Typically uses free-reduced count
  - Districtwide or by grade span
  - Equals the highest quartile (top 25%) identified as “high-poverty”
- Calculation of FTE’s
  - Include instructional and non-instructional
  - If time is split between more than one school – include proportional FTE for each school
- Refer to Department of Education guidance
  - https://oese.ed.gov/files/2021/12/Maintenance-of-Equity-updated-FAQs_12.29.21_Final.pdf

MAINTENANCE OF EQUITY

DETERMINING FISCAL EQUITY

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Calculation of Fiscal Equity

- Includes:
  - All sources of State and local funds available for current expenditures for free public education
  - General Fund
- Excludes:
  - Federally funded expenditures
  - Private donations
  - Dedicated funds for capital outlay and debt service
- Consistency is key

GEER I AND GEER II

COMPARE AND CONTRAST

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CARES Act – GEER I

- Legislation - Sec 18002 Division B
- POA – 03/13/20 - **09/30/22**
- Reporting - Fins 153 and 162
- General Uses – preventing, preparing for, and responding to COVID – 19
- Specified Uses – Technology and summer programming
- Earmarking – equitable services to non-publics
- MOE – N/A – for states only

CRRSA Act – GEER II

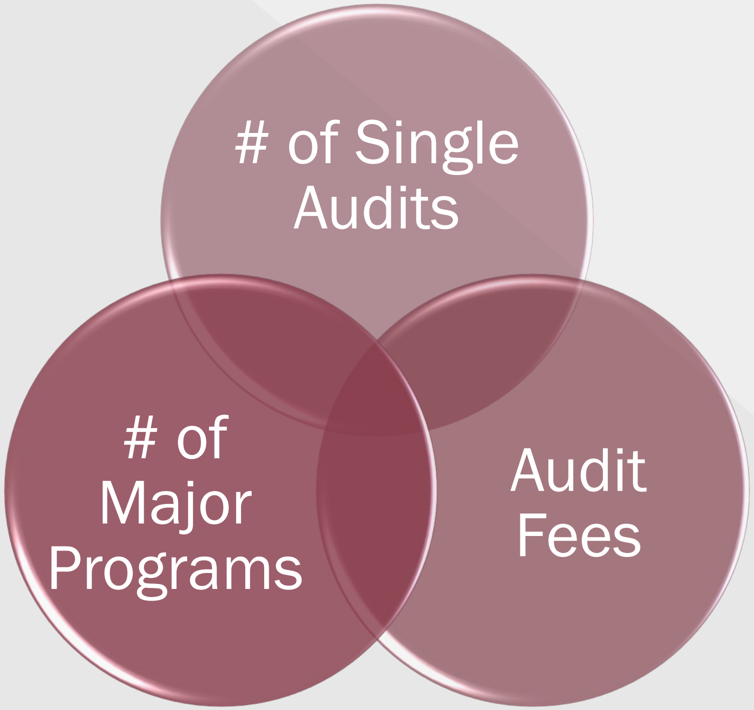
- Legislation - Section 312 of CRRSA
- POA – 03/13/20 - **09/30/23**
- Reporting - Fins 157, 162, and 168
- General Uses – SAME as GEER I
- Specified Uses – Additional compensatory revenue, summer programming, school-age care and youth programming
- Earmarking – N/A – now have EANS
- MOE – N/A - same as GEER I

COVID IMPACT ON THE SEFA

- Expect significant $ increases from FY21 SEFA
- Moving Type A and B program thresholds
  - Type A = 3% of total SEFA or $750K, whichever is larger
  - Type B (big B) = 25% of Type A Threshold
- Identify COVID awards on the face of SEFA

COVID IMPACT ON SINGLE AUDIT

SIGNIFICANT INCREASES IN THE SEFA
=
SIGINIFICANT INCREASES IN:



SINGLE AUDIT SUMMARY

AND ACTION ITEMS

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Lots of new grants + Lots of new $ + Lots of new Fin Codes = Lots of confusion

- Identify ALN for each grant/award
- Gather your grant agreements and terms of awards
- ??'s - Reach out to pass thru-entities or your auditors NOW
- Documentation, documentation, documentation

GOVERNMENT ACCOUNTING STANDARDS BOARD(GASB)

Update on Standards Issued by GASB

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AUDITING STANDARDS

- The American Institute of CPAs (AICPA) Auditing Standards Board has recently issued Statements on Auditing Standards (SAS's).
  - The standards, SAS Nos. 134-140, were postponed for one year and are now effective for audits of fiscal 2022 financial statements.
  - Some of the standards substantially change the auditor's report and also cover other matters.
  - These standards also change the required communication of audit risk assessment to the governing body as part of the audit planning process.

GASB #97

Update portions of GASB #84 on Fiduciary Funds

GASB #84

AS MODIFIED BY GASB #97

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GASB #97 – Component Unit Criteria and Accounting for IRS Code 457 Deferred Compensation Plans

- Defined Contribution Plans involved in this GASB include:
  - Defined contribution plans, 457 plans, 403b plans, 401(a) plans, Heath Savings Accounts, Health Reimbursement Accounts, Flexible Spending Plans, and other similar plans with employer contributions.
- A School District should be able to answer the following questions related to these plans:
  - Do these plans have separate trust agreements and/or employee benefit plan agreements that would distinguish them as being legally separate from the school district?
  - Can the District impose its will on these plans by significantly influencing the program, projects, activities, or level of service performed by these plans?
  - Can the District modify rates being charged, overrule plan decisions, and/or appoint or dismiss employee benefit plan management personnel?

GASB #84

AS MODIFIED BY GASB #97

Defined contribution plans are considered to be a Fiduciary Fund of the District if all 3 of the following are true:

1. District controls the assets

   The District ***controls the assets*** of an activity if:

   a) The District holds the assets

   b) District has ability to direct the use, exchange, or employment of the assets in a manner that provides benefits to the specified or intended recipients

2. Assets are **NOT** either derived solely from own-source revenue (revenue generated by the District itself) or revenue from grants.

GASB #84

AS MODIFIED BY GASB #97

Defined contribution plans are considered to be a Fiduciary Fund of the District if <u>all</u> of the following are true (continued):

3. Assets associated with the activity have 1 or more of the following characteristics:

The assets are:

a) administered through a trust committed to providing benefits to recipients,
b) the government is not a beneficiary of the trust, <u>and</u>
c) the assets are protected from the government's creditors

The assets are for the benefit of individuals and the District doesn't have administrative involvement including:

a) Monitors recipients for compliance with program–specific requirements
b) Determines eligible recipients (including directly by the government or by a resource provider)
c) Has the ability to exercise discretion in how the funds are allocated

GASB #87 - LEASES

GASB Statement #87 on Leases improves existing standards on lease accounting and financial reporting

Effective for the year ended June 30, 2022

(as amended by GASB #95)

LEASES

PRIOR CLASSIFICATION OF LEASES

- Prior Lessee Classification of Leases includes two primary classification of leases
  - Capital leases (meet <u>one</u> of four criteria)
    1. Transfer of ownership at conclusion
    2. Bargain purchase option
    3. Lease term ≥ 75% of economic life of asset
    4. PV of future minimum lease payments ≥ 90% of FMV
  - Operating leases (all other leases)

LEASES

NEW DEFINITION OF A LEASE

- A contract that conveys **control** of the **right to use** another entity's nonfinancial asset (the underlying asset) as specified by the contract for a period of time in an exchange or exchange-like transaction
- Control requires <u>both</u> of the following:
  - Right to obtain the present service capacity from use of the underlying asset, <u>and</u>
  - Right to determine the nature and manner of use of the underlying asset
- Control applied to the **right-to-use** lease asset (a capital asset) "specified in the contract"

LEASES

IMPACT OF THIS STANDARD

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- Lessee Accounting
  - Recognize an intangible right-to-use lease asset and lease liability for future payment
- Lessor Accounting
  - Recognize a lease receivable for right to receive payments and a deferred inflow of resources
  - Do not de-recognize underlying asset
- No classification of leases into operating/capital or other categories
- Underlying assumption that leases are *debt* financings

LEASES

IMPACT OF THIS STANDARD (CONTINUED)

- Exceptions (lessors and lessees):
  - Short-term leases (12 months or less)
  - Short-term leases calculations include options to extend
  - Recognize revenue and expenditures based on payment provisions
- Standardized lessor and lessee disclosures in financial reports
- UFARS coding has been revised to provide guidance for lease accounting
  - See MDE memo dated June 2021

LEASES

IMPLEMENTATION ISSUES

- Use of lease facts and circumstances that existed at the beginning of the implementation period (July 1, 2021)
- Lease term includes periods covered by options
  - Start with noncancelable period
  - Extend lease term, if reasonably certain of being exercised
  - Terminate lease, if reasonable certain of not being exercised
  - Excludes “cancellable periods” if both parties can terminate lease (month-to-month leases)
  - Fiscal funding cancellation clauses ignored unless reasonable certain of being exercised

LEASES

IMPLEMENTATION ISSUES (CONTINUED)

- Lease liability includes:
  - Fixed and variable payments
  - Residual value of guaranteed payments
  - Purchase options
  - Penalties for terminating
  - Lease incentives
  - Other payments reasonably certain of being made
- Identifying the interest rate charged
  - Stated lease rate
  - Lessor determined rate implicit in the lease can be estimated
  - Prevailing rates for similar debt instruments
  - Lessor’s own incremental borrowing rate
  - Published market rates for similar debt instruments

LEASES

IMPLEMENTATION ISSUES (CONTINUED)

- Conveyance of control
  - A contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified by the contract for a period of time in an exchange or exchange-like transaction
  - Leases with terms that do not represent market conditions are not conserved leases ($1 lease term)
  - Examples – Buildings. Land, Equipment, Cell Phone Towers, Antenna Placement
  - Control requires <u>both</u> of the following:
    1. The right to obtain present service capacity for the use of the underlying asset
    2. The right to determine the nature and manner of use of the underlying asset
  - Does not require uninterrupted control (can be for part-time use)

LEASES

IMPLEMENTATION ISSUES (CONTINUED)

- Transfer of Ownership
  - If a contract transfers ownership of the underlying asset at end of the contract and doesn't contain termination options, this type of contract is not a lease and is considered a financed purchase
- Contracts with Multiple Components
  - Separate contracts into lease and non-lease components
  - IT contracts
  - Service plans
  - Differing lease terms
  - Differing major asset classes
- Remeasure Lease Liability
  - Changes occur that significantly affect liability measurement
  - Lease term, change in the interest rate, change in stream of payments
- Consider Materiality

LEASES

ACCOUNTING GUIDANCE – LESSEE AT EXECUTION OF LEASE

Fund Based Entries

- Record capital outlay (Dr)
  - Fixed payments over lease term
  - Variable payments based index/rate in effect at that date (CPI) or fixed by contract
- Record other financing source (Cr)

Government-Wide Entries

- Record intangible asset (Dr)
  - Represents right to use an asset for a period of time
  - Measured at the amount of the lease liability
  - Amortized over the lease term
- Record liability for present value of future payments (Cr)
- Offset these entries against fund based entries

LEASES

ACCOUNTING GUIDANCE – LESSEE PAYMENTS MADE

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Fund Based Entries

- Code payments to lease principal (Dr)
- Code payments to lease interest (Dr)
- Cash (Cr)

Government-Wide Entries

- Offset lease principal payments against lease liability (Dr)
- Record amortization expense of leased assets (Dr)
    - Amortization equals the shorter of the useful life of the asset or the lease term

LEASES

ACCOUNTING GUIDANCE – LESSOR FUND BASED ENTRIES

Lessor– Execution of Lease

- Record lease receivable for future lease payments (Dr)
  - Equal to present value of lease payments expected to be received during the lease term
- Record deferred inflow of resources for future lease payments (Cr)

Lessor – Payments Received

- Depreciate leased asset normally
- Reduce lease receivable lease payments (Cr)
- Record interest revenue on lease payments (Cr)
- Recognize revenue from amortization of deferred inflow of resources over the lease term in a systematic manner

LEASES

FINANCIAL STATEMENT DISCLOSURES - LESSEE

- Description of lease
- Total amount of leased asset and related accumulated depreciation
- Amount of leased assets by major class including related accumulated amortization disclosed separately from other capital assets
- Amount of outflow of resources recognized
- Current year expense for any payments not included in original liability
- Principal and interest requirements to maturity
- Commitments under leases that have not begun

LEASES

FINANCIAL STATEMENT DISCLOSURES - LESSOR

- Description of lease
- Total amount of deferred inflows of resources
- Amount of inflow of resources recognized
- Existence of terms for lessee to terminate payments
- Any debt used for financing leased asset
- Maturity analysis of all future lease payments in lease receivable

GASB #89

Accounting for Interest Costs Incurred Before the End of Construction Period

Effective for the year ended June 30, 2022

(as amended by GASB #95)

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GASB #89

- This Statement requires that interest cost incurred before the end of a construction period be **recognized as an expense** in the period in which the cost is incurred for financial statements prepared using the accrual basis.
- Interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.
- For modified accrual financial statements interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

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GASB #91 – CONDUIT DEBT

Effective for the year ended June 30, 2022 (as amended by GASB #95)

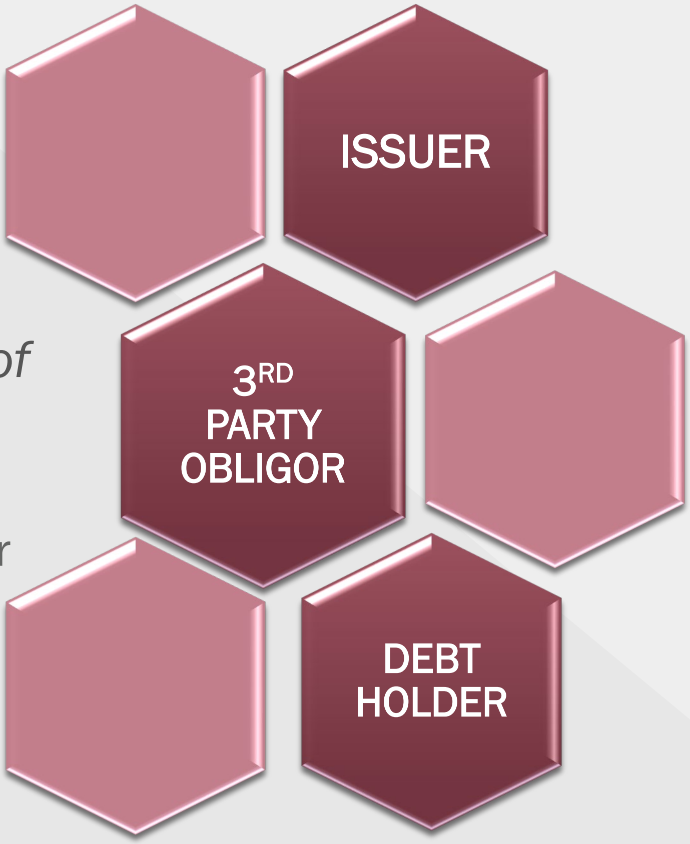
CONDUIT DEBT

DEFINED

CONDUIT DEBT

A debt instrument issued in the name of a local government but is for the benefit of a third party that is primarily liable for repayment and has ***all*** *of the following characteristics:*

- 3 parties involved: issuer, 3^{rd} party obligor, debt holder
- Issuer and 3^{rd} party are separate entities
- 3^{rd} party ultimately receives the debt proceeds
- 3^{rd} party is primarily obligated to pay debt service
- Issuer's commitment on debt service payments is limited



CONDUIT DEBT

ACCOUNTING AND REPORTING

- Issuer does not recognize liability and expense unless more than likely they will support debt service
- Issuer has the following disclosure requirements:
  - Brief description of debt issuance
  - Description of the commitment
  - The aggregate outstanding principal amount of all conduit debt obligations outstanding at the end of the reporting period

GASB #96 – SUBSCRIPTION-BASED INFORMATION TECHNOLOGY ARRANGEMENTS (SBITA)

Improves existing standards on accounting and financial reporting for SBITA's

Effective for the year ended June 30, 2023
(Earlier application is encouraged)

SBITA'S

DEFINED

- *A contract that conveys control of the right to use another party's (a SBITA vendor'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*
- Subscription Term Includes:
  - The period the government has a noncancellable right to use the underlying IT asset
  - Periods covered by an option to extend (if reasonably certain the government will extend the option)

SBITA'S

EXEMPTIONS

- Short-term SBITA's
  - Maximum possible term of 12-months
  - Includes options to renew, regardless of their probability of being exercised
- Excludes arrangements that provide a perpetual license to use software (considered a purchase)
- Excludes contracts with combination of a tangible capital assets and an insignificant software component

SBITA'S

ACCOUNTING APPLICATION

- Recognize a right-to-use subscription asset – an intangible asset
- Recognize a subscription liability
- Recognize liability at the commencement of the subscription term, which is when the subscription asset was placed in service.
- Recognize the subscription liability at the present value of subscription payments made during the term of the agreement
- Subscription payments should be discounted using the interest rate the SBITA vendor charges the government or the government's incremental borrowing rate

SBITA'S

FINANCIAL REPORTING

- Disclose descriptive information about the SBITA's
- Amount of subscription and accumulated amortization
- Principal and interest requirements for the subscription liability
- Other essential information
- Accounting standard based on GASB 87 for leases

SBITA'S
IMPLEMENTATION ISSUES

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- Considered a financing arrangement (debt) of a right-to-use assets
- Assets and liabilities recognized and measured using facts and circumstances that existed at the beginning of the fiscal year
- Governments are permitted, but not required, to include the capitalizable outlays associated with the initial implementation stage incurred prior to the implementation date.
- Report an entire multiple-component contract as a single SBITA.
- Does not apply to Governments that provide right to use software to other entities

GASB #98 – THE ANNUAL COMPREHENSIVE FINANCIAL REPORT (ACFR)

Effective for the year ended June 30, 2022

REPORT NAME

- The Statement establishes the term Annual Comprehensive Financial Report and its acronym (ACFR).
    - Replaces Comprehensive Annual Financial Report and its acronym
- Developed in response to concerns raised by stakeholders that the common pronunciation of the acronym for comprehensive annual financial report sounds like a profoundly objectionable racial slur in South Africa
- Many organizations, including AICPA, removing the acronym from all publications and other documents

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OTHER NOTEWORTHY ITEMS

Effective for the year ended June 30, 2022

FINANCIAL REPORTING

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- GASB Implementation Guide 2021-1

Question 5.1 – A government should capitalize assets whose individual acquisition costs are less than the threshold for an individual asset if those assets in the aggregate are significant. Examples include computers and classroom furniture

- *Certificate Programs*
    - Application will include need to include calculation of net investment in capital assets.
    - Consider including in notes to basic financial statements.

CONTACT INFORMATION

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