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# Welcome!

## MN Government Training Academy 2023





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# Upcoming GASB Pronouncements and their impact on your organization



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# Learning Objectives



Outline the new accounting standards affecting state and local government accounting and reporting



Discuss how to prepare for the new: Public-Private and Public-Public Partnership standard



Get familiar with new accounting standards that have been issued but are not yet effective







# GASB 94: Public-Private, Public-Public Partnerships and Availability Payment Arrangements

# Objectives of GASB 94

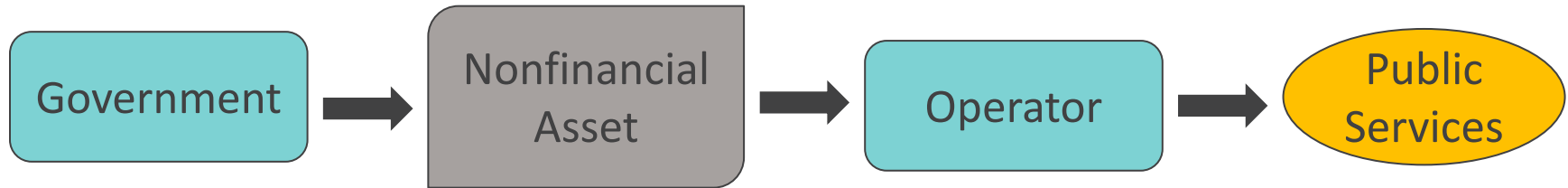
- Guidance on Public-Private and Public-Public Partnerships (PPP) arrangements and Availability Payment Arrangements (APA)
- Guidance for types of PPP's not within GASB 87 and not a service concession arrangement (SCA)
- Supersedes GASB 60, *Accounting and Financial Reporting for Service Concession Arrangements*

# Effective Date

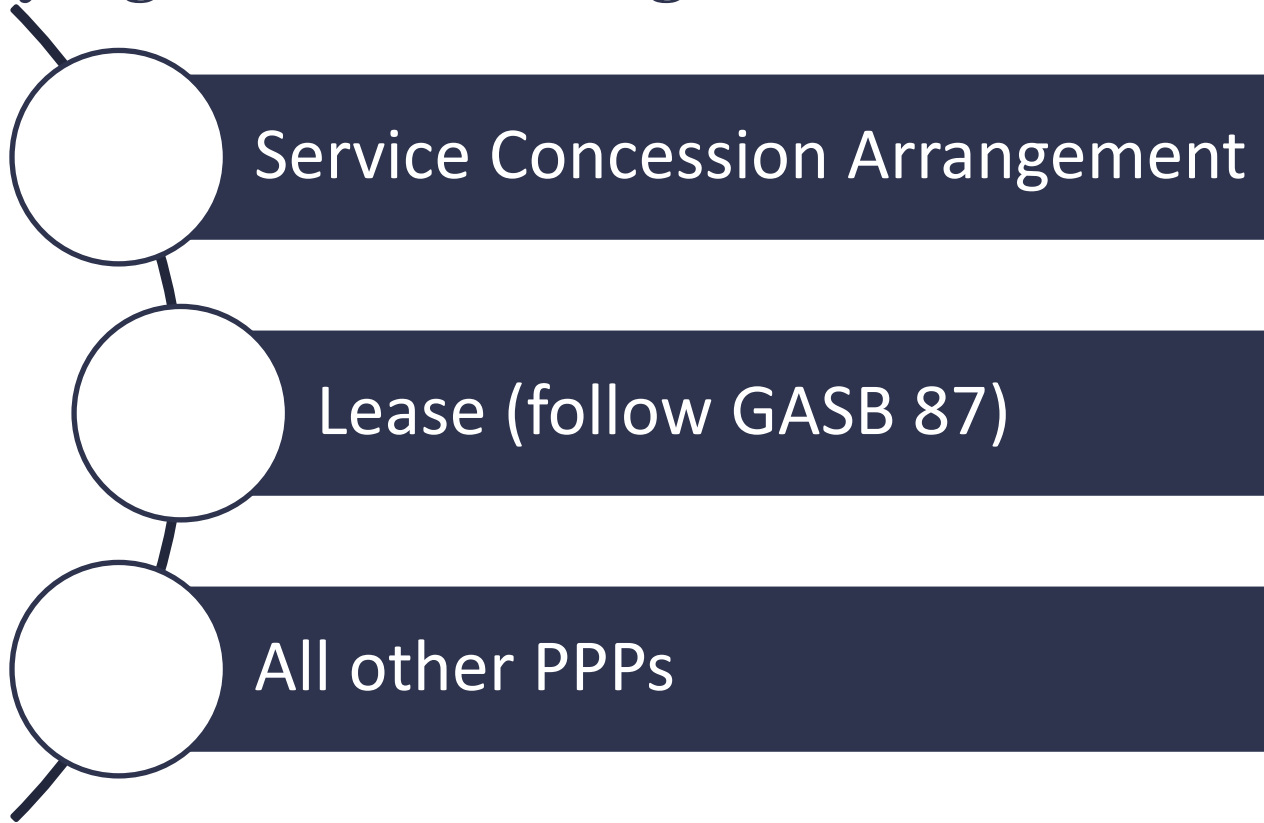
- Fiscal years beginning after June 15, 2022 (06/30/2023 and 12/31/23)
- Earlier application encouraged

# Definition of PPP

- Arrangement in which a government (the transferor) contracts with an operator to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital assets for a period of time in an exchange or an exchange-like transaction



# Identifying the PPP Arrangement



# Identifying the PPP Arrangement

- Service Concession Arrangement (SCA) - Arrangement between a transferor and an operator if all the following criteria are met:
  - Transferor conveys to the operator the right and related obligation to provide public services through the use and operation of an underlying PPP asset in exchange for significant consideration
  - The operator collects and is compensated by fees from third parties
  - The transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom services are provided to, and the prices or rates that are charged
  - The transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the term



# Identifying the PPP Arrangement

- PPP meets the definition of a lease - apply guidance in GASB 87 if all of the following criteria are met:

Existing assets of the transferor are the **only** underlying PPP assets

Improvements are not required to be made by the operator to those existing assets as part of the PPP arrangement

The PPP does not meet the definition of an SCA

# Identifying the PPP Arrangement

- All other PPP arrangements
  - Some provisions applicable to an SCA do not apply
  - Similar accounting to GASB 87

# Definition of Availability Payment Arrangements - APA

- An APA is an arrangement in which a government compensates an operator for activities that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction
  - Payments by the government are based entirely on the asset's availability for use rather than on tolls, fees, etc.
  - Availability for use may be based on specified criteria – physical condition of the asset, construction milestones, achievement of certain availability measures
  - Government procures the asset for service rather than receiving compensation to allow another entity to provide public services
  - The operator receives compensation from the government entirely based on availability to perform and not the actual performance

# Availability Payment Arrangements-APA

- An APA may contain multiple components
- Each component should be recognized as a separate arrangement
- Example – a government enters into an agreement with an operator to design, construct, finance, operate and maintain a public toll road in exchange for
  - Fixed payments meant to provide compensation for the design, construction, financing, operation and maintenance of the toll road
  - Variable payments to the operator based on whether measures related to availability have been met



# PPP Example

- Government enters into an arrangement with a developer for a period of 50 years
- Developer/operator will finance demolition of existing structure and construction of new structure
- New structure includes housing and dining facilities which the developer will operate, including setting rates
- Compensation to the developer will be exclusively from customers
- Arrangement is considered a PPP but not an SCA as the developer has control over rates that may be charged



# SCA Example

- Government enters into an arrangement with a private entity to operate their toll-collecting function on government's roadways for a period of 50 years
- Operator provides an up-front payment of \$3 billion
- Operator has the right to operate the toll collection (at government determined rates) and receive and retain all revenues during the arrangement period
- Arrangement is considered a PPP as well as an SCA as the government sets rates for the tolls





# APA Example

- Government enters into an arrangement with a developer to design, build and finance construction of a bridge. The developer will also collect tolls for the bridge and remit to government for a period of 40 years
- Government pays developer \$20 million at project commencement, \$20 million and completion, and \$5 million annually throughout the arrangement
- Government will pay developer \$200,000 per month for collecting tolls
- Government is compensating the developer for operating the toll by paying \$200,000 per month, whereas under the SCA example revenues collected were retained by the operator as compensation

# Common Assets Under PPP or APA Arrangements

- Infrastructure
- Hospitals
- Student services for colleges or universities
- Sports facilities
- Recreational facilities
- Jails/prisons
- Wastewater treatment plans
- Museums



# Accounting for PPPs - Transferor

- The underlying PPP asset is an existing asset of the transferor
- Transferor continues to report the underlying asset at carrying value
- Continue to apply other accounting and financial reporting requirements (depreciation, impairment, etc.)
- At commencement of the arrangement
  - Record a receivable at present value for installment payments to be received
  - Payments received at or prior to from the operator
  - Recognize a deferred inflow of resources
- Recognize any improvements to the underlying assets as an asset and deferred inflow – do not depreciate if asset is returned to the operator



# Accounting for PPPs - Transferor

- The underlying PPP asset is a new asset purchased or constructed by the operator
- At term commencement the transferor should record:
  - Underlying asset at the acquisition value when placed in service
  - Receivable for installment payments to be received at net present value
  - Recognize a deferred inflow of resources
- Apply other accounting and financial reporting requirements (depreciation, impairment, etc.)
- Do not depreciate if asset is returned to the operator



# Accounting for PPPs - Operator

- The underlying PPP asset is an existing asset of the transferor
- Operator recognizes an intangible right-to-use asset as the sum of the following:
  - The amount of initial measurement of the liability for installment payments
  - PPP payments made to the transferor at or before commencement of the PPP term
  - The cost of the purchased or constructed asset
  - The cost of improvements to an existing underlying asset
  - Initial direct costs that are ancillary charges necessary to place the asset into service
- A liability for the present value of installment payments over the PPP
- Treatment is the same when the underlying asset in the PPP is a new asset purchased or constructed by the operator as long as it is an SCA



# Accounting for PPPs - Transferor

- The underlying PPP asset is a new asset purchased or constructed by the operator – PPP is not an SCA
- At term commencement the transferor should record:
  - Receivable for the underlying asset based on the carrying value at the expected date of the asset to the transferor from the operator
  - Receivable at present value for installment payments to be received
  - Deferred inflow of resources





# Accounting for PPPs - Operator

- The underlying PPP asset is a new asset purchased or constructed by the operator – PPP is not an SCA
- At term commencement the transferor should record:
  - Underlying asset when it is place in service until transferred to the transferor
  - Liability for the underlying asset based on the carrying value at the expected date of the asset to the transferor from the operator
  - Liability for installment payments to be made
  - Deferred outflow of resources for the PPP asset to be transferred

# Accounting for PPPs - Transferor

- Total deferred inflow will include:
  - The amount of the initial measurement of the receivable for installment payments
  - PPP payments received at or prior to commencement of the PPP term
  - The amount of the initial measurement of assets constructed or purchased by the operator
  - The amount of the initial measurement for improvements made by the operator
  - The amount of the initial measurement of a receivable for an underlying PPP asset constructed or purchased by the operator (if not an SCA)



# Determining the Value of Installment Payments

- The Present Value of Installment Payments includes the following (for transferor and operator):
  - Fixed payments
  - Variable payments that depend on an index or a rate, initially using the index or rate as of the commencement date of the PPP term
  - Variable payments that are fixed in substance
    - Exclude payments based on future performance of operator, usage of the underlying asset or variable factors other than an index or rate
  - Residual value guarantee payments that are fixed in substance

# Determining the Value of Installment Payments

- Additional elements of installment payments for the operator:
  - Payments for penalties for terminating the PPP, if the PPP term reflects the operator exercising 1) an option to terminate the PPP or 2) a fiscal funding or cancellation clause
  - Any other payments to the transferor associated with the PPP that are reasonably certain of being required

# Identifying the Contract Term

- The term of the arrangement includes all of the following:
  - The period during which an operator has a non-cancellable right to use the underlying asset
  - Includes periods covered by the transferor's or operator's option to extend the PPP if reasonably certain the option will be exercised
  - Includes periods covered by the transferor's or operator's option to terminate the PPP if reasonably certain the option will not be exercised

# Recording Installment Payments

- Installment payments made should be recorded appropriately reflect a reduction a liability and amortization of the discount calculated on the initial liability
- Amortization of the discount should be recorded as an outflow of resources (such as interest expense)



# Future Recognition of Assets and Deferred Amounts

- An operator should amortize a right-to-use asset in a systematic and rational matter over the shorter of the PPP term or the useful life of the PPP asset
- Amortization should be reported as an outflow of resources such as amortization expense
- Deferred outflows of resources should be subsequently recognized as an outflow of resources in a systematic and rational manner over the remaining PPP term
- Deferred inflows of resources should be subsequently recognized as an inflow of resources in a systematic and rational manner over the remaining PPP term

# Re-Measuring the Value of Installment Payments

- Re-measure at subsequent financial reporting dates if one or more of the following changes has occurred before the reporting date, and the changes are expected to significantly affect the liability:
  - Change in PPP term
  - Change in interest rate the transferor charges the operator
  - A contingency on which variable payments are based is resolved

# Re-Measuring the Value of Installment Payments

- Additional events for consideration by the operator:
  - There is a likelihood the residual value guarantee has changed from reasonably certain to not reasonably certain
  - There is a change in the estimated amount for payments already included in the measurement of the liability for PPP payments



# Termination of PPP - Transferor

- Recognize a gain or loss for the reduction of deferred inflows of resources including the sum of the following:
  - Reduction of carrying value of any remaining receivable for installment payments
  - Termination penalties paid to or received from the operator
  - Amounts paid to the operator for underlying PPP asset



# Termination of PPP - Operator

- Recognize a gain or loss for sum of the following:
  - Reduction of carrying value of any remaining liability for installment payments
  - Reduction of the carrying value of the right-to-use asset related to the liability for installment payments
  - Reduction of carrying value of right-to-use asset transferred to transferor
  - Termination penalties paid to or received from the transferor
  - Amounts received from transferor to acquire right-to-use asset



# Re-Measuring the Value of Installment Payments

- Additional events for consideration by the operator:
  - There is a likelihood the residual value guarantee has changed from reasonably certain to not reasonably certain
  - There is a change in the estimated amount for payments already included in the measurement of the liability for PPP payments



# Other PPP Considerations

- Modification to a PPP should be treated as a separate PPP if both of the following conditions are present:
  - The modification gives the operator and additional underlying PPP asset that was not included in the original arrangement
  - The increase in PPP payments for the additional underlying PPP asset does not appear to be unreasonable based on terms of the amended PPP arrangement and professional judgement

# Other PPP Considerations

- Modifications not treated as a separate PPP
  - Transferors should adjust deferred inflows of resources for changes in the re-measurement of receivables for installments or underlying assets.
  - To the extent the change relates to payments for the current period the change should be recognized as an inflow or outflow of resources
  - If the modification results from a debt refinancing in which the perceived economic advantage is passed through to the operator, the transferor should adjust the receivable for installment payments receivable. Any adjustment to a deferred outflow or inflow should be recognized over the remaining life of the old debt or new debt, whichever is shorter.





# Other PPP Considerations

- Modifications not treated as a separate PPP
  - Operators should adjust the underlying asset by the difference between the initially recorded and re-measured liability
  - If the change reduces the carrying value of the right-to-use asset to zero, any remaining amount should be recognized as a gain
  - If the modification results from a debt refinancing including defeasance of debt, the operator should adjust the liability for installment payments to the present value of future PPP payments. The resulting different should be reported as a deferred inflow of resources which should be recognized as an inflow of resources over a systematic and rational manner.

# Re-Measuring the Value of Installment Payments

- Additional events for consideration by the operator:
  - There is a likelihood the residual value guarantee has changed from reasonably certain to not reasonably certain
  - There is a change in the estimated amount for payments already included in the measurement of the liability for PPP payments





# GASB 91: Conduit Debt Obligations

# GASB 91: Conduit Debt Obligations

- Effective for periods beginning after December 15, 2021 (06/30/2023 and 12/31/23)
- Eliminates the existing option for issuers to report conduit debt as liabilities
- Additional commitments to support debt service payments may be recorded as liabilities
- Disclosures for issuers:
  - Type of commitments
  - Description of each type
  - Aggregate outstanding principal balance





# GASB 92: Omnibus 2020

# GASB 92: Omnibus 2020 (12/31/2022)

- Effective dates vary:
  - Requirements related to intra-entity transfers of assets are effective for fiscal years beginning after June 15, 2021
  - Requirements related to application of Statement 84 to postemployment benefit arrangements and nonrecurring fair value measurements are effective for periods beginning after June 15, 2021
  - Requirements related to the measurement of liabilities associated with AROs in a government acquisition are effective for periods beginning after June 15, 2021

# GASB 92: Omnibus 2020 (Continued)

- Intra-entity transfers of assets – clarifies how to report a transfer of capital or financial assets between a governmental employer (or non-employer contributing entity) and a defined benefit pension or OPEB plan if there are any differences between the carrying value of assets transferred and amount paid by the plan
- Applicability of Statement 84 to Postemployment Benefit Arrangements – notes that a government that reports a fiduciary activity for OPEB plans that are not administered through trusts must apply certain provisions of statement 84 to liability recognition and financial statement presentation
- Exception to acquisition value in a government acquisition – addresses the measurement of liabilities related to the acquired entity's ARO



# GASB 93: Replacement of Interbank Offered Rates



# GASB 93: Replacement of Interbank Offered Rates

- Effective for periods beginning after June 15, 2020 (hedge fund accounting) and for periods beginning after June 15, 2021 (lease modifications)
- The London Interbank Offered Rate, or LIBOR, which is included in some variable rate payment agreements, no longer exists
- Statement 53 requires the termination of hedge fund accounting if a critical term, such as the variable rate, is amended
- Statement 87 considers the replacement of a rate to determine variable payments as a lease modification, requiring remeasurement
- This standard addresses hedge fund accounting and provides an exception to the lease modification guidance





# GASB 97: Certain Component Unit Criteria, and Accounting and Financial Reporting for IRS Code Section 457 Deferred Comp Plans

# GASB 97: Accounting and Financial reporting for Internal Revenue Code Section 457 Deferred Comp Plans

- Section related to governing boards is effective immediately, section related to 457 plans for periods beginning after June 15, 2021 (12/31/22)
- The absence of a governing board is treated the same as the appointment of a voting majority for CU determination
- 457 plans should be classified as either a pension plan or another employee benefit plan
- GASB 84 should then be applied to determine whether a fiduciary activity
- If considered a pension plan, all pension accounting and reporting requirements apply





# GASB 98: The Annual Comprehensive Financial Report

# GASB 98: The Annual Comprehensive Financial Report

- Effective for periods ending after December 15, 2021 (12/31/22 (earlier application encouraged))
- Replaces the Comprehensive Annual Financial Report with Annual Comprehensive Financial Report or ACFR
- Commonwealth implemented in prior year



# GASB 99: Omnibus 2022

# GASB 99: Omnibus 2022

- Effective dates vary:
  - Requirements related to extension of the use of LIBOR, accounting for SNAP distributions, disclosure of nonmonetary transactions, pledges of future revenues by pledging governments, clarifications to GASBS 34, 53, and 63 – EFFECTIVE UPON ISSUANCE
  - Requirements related to leases, PPPs, and SBITDAs - EFFECTIVE FOR FISCAL YEARS BEGINNING AFTER 6/15/22 (06/30/2023 and 12/31/23)
  - Requirements related to financial guarantees and the classification and reporting of derivative instruments within the scope Of GASB 53 - EFFECTIVE FOR FISCAL YEARS BEGINNING AFTER 6/15/23 (06/30/2024 and 12/31/24)



# GASB 99: Omnibus 2022 (Continued)

- GASB 87 – Clarification of unconditional/conditional termination options, reclassification of short-term leases, other items
- SBITDAs – Clarification of subscription terms, short term SBITDAs,
- SNAP – Clarification of applicability of GASB 33 to SNAP distributions for state governments
- Various terminology updates





# GASB Implementation Guide No, 2021-1

# GASB Implementation Guide No, 2021-1, Question 5.1

- Effective for periods beginning after June 15, 2023 (06/30/2024 and 12/31/24)
- Q – Should a government's capitalization policy be applied only to individual assets, or can it be applied to a group of assets acquired together?
- A – 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.



# GASB 100: Accounting Changes and Error Corrections

# GASB 100: Accounting Changes and Error Corrections – an Amendment of GASB Statement No. 62

- Effective date is fiscal years beginning after June 15, 2023 (06/30/2024 and 12/31/24)
- Classifies accounting changes as:
  - Changes in accounting principles
  - Changes in accounting estimates
  - Changes to or within the financial reporting entity

# GASB 100: Accounting Changes and Error Corrections – an Amendment of GASB Statement No. 62 (Continued)

- Change in Accounting Principle:
  - Change from one generally accepted accounting principle to another
    - Only when new accounting principle is preferable considering qualitative characteristics of understandability, reliability, relevance, timeliness or comparability.
  - Implementation of new accounting pronouncement
  - Reported retroactively by restating beginning net position
  - Additional note disclosures are applicable

# GASB 100: Accounting Changes and Error Corrections – an Amendment of GASB Statement No. 62 (Continued)

- Change in Accounting Estimate:
  - Estimates are amounts subject to measurement uncertainty
  - Should be justified on basis that newly adopted measurement methodology is preferable to the previous methodology used
    - Basis for determination – understandability, reliability, relevance, timeliness, consistency and comparability
  - Reported prospectively by recognizing the change in accounting estimate in the reporting period in which change occurs
  - Additional note disclosures are applicable



# GASB 100: Accounting Changes and Error Corrections – an Amendment of GASB Statement No. 62 (Continued)

- Changes to or within the Financial Reporting Entity include:
  - Addition or removal of a fund that results from the movement of continuing operations within the primary government
  - A change in a fund's presentation as major or nonmajor
  - Addition or removal of a component unit
  - Change of presentation of component unit as blended or discretely presented
  - Beginning net position/fund balance should be adjusted for the effect of the change at the beginning of the reporting period
  - Additional note disclosures are applicable

# GASB 100: Accounting Changes and Error Corrections – an Amendment of GASB Statement No. 62 (Continued)

- Correction of an Error:
  - Mathematical mistake
  - Mistake in application of accounting principle
  - Oversight or misuse of facts that existed at time of financial statements were issued
    - Facts that could reasonably be expected to have been obtained and considered about conditions that existed as of the financial statement date
  - Reported retroactively by restating beginning net position
  - Additional note disclosures are applicable





# GASB 101: Compensated Absences

# GASB 101: Compensated Absences

- Defines three general criteria for recognizing a liability for unused leave balances:
  - The leave is attributable to services already rendered
  - The leave accumulates
  - The leave is more likely than not to be used for time off or otherwise paid or settled
- Some types of leave, such a parental leave, military leave and jury duty are not recognized until leave commences
  - Effective for fiscal years beginning after December 15, 2023
    - (06/30/2024 and 12/31/24)





# Upcoming GASB Projects

# Upcoming GASB Projects

- Financial Reporting Model
- Revenue and Expense Recognition
- Going Concern
- Classification of nonfinancial assets
- 2023 Implementation Guidance
- Risk and Uncertainties disclosure



# Thank You!



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# Economic and Market Update

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# Learning Objectives

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

- Discuss the current economic situation in the U.S.



# Agenda

- Economic Update
- Interest Rates
- Inflation/  $R^*$ cession?



# Economic Update

# What Happened In 2022?

## STOCK AND BOND RETURNS

### Worst year for bonds and 7th worst for stocks

#### Worst years for U.S. Bonds

Since 1926, total return for each period

Year	Return	Next 12 months
2022	-13.0	?
1994	-2.9	18.5
1931	-2.3	8.8
2013	-2.0	6.0
2021	-1.5	-13.0
1958	-1.3	-0.4
1999	-0.8	11.6
1969	-0.7	16.9
1955	-0.7	-0.4
1956	-0.4	7.8
Avg.	-2.6	6.2

#### 7<sup>th</sup> worst ever year for U.S. Stocks

Since 1926, total return for each period

Year	Return	Next 12 months
1931	-43.3	-8.2
2008	-37.0	26.5
1937	-35.0	31.1
1974	-26.5	37.2
1930	-24.9	-43.3
2002	-22.1	28.7
2022	-18.1	?
1973	-14.7	-26.5
2001	-11.9	-22.1
1941	-11.6	20.3
Avg.	-24.5	4.9

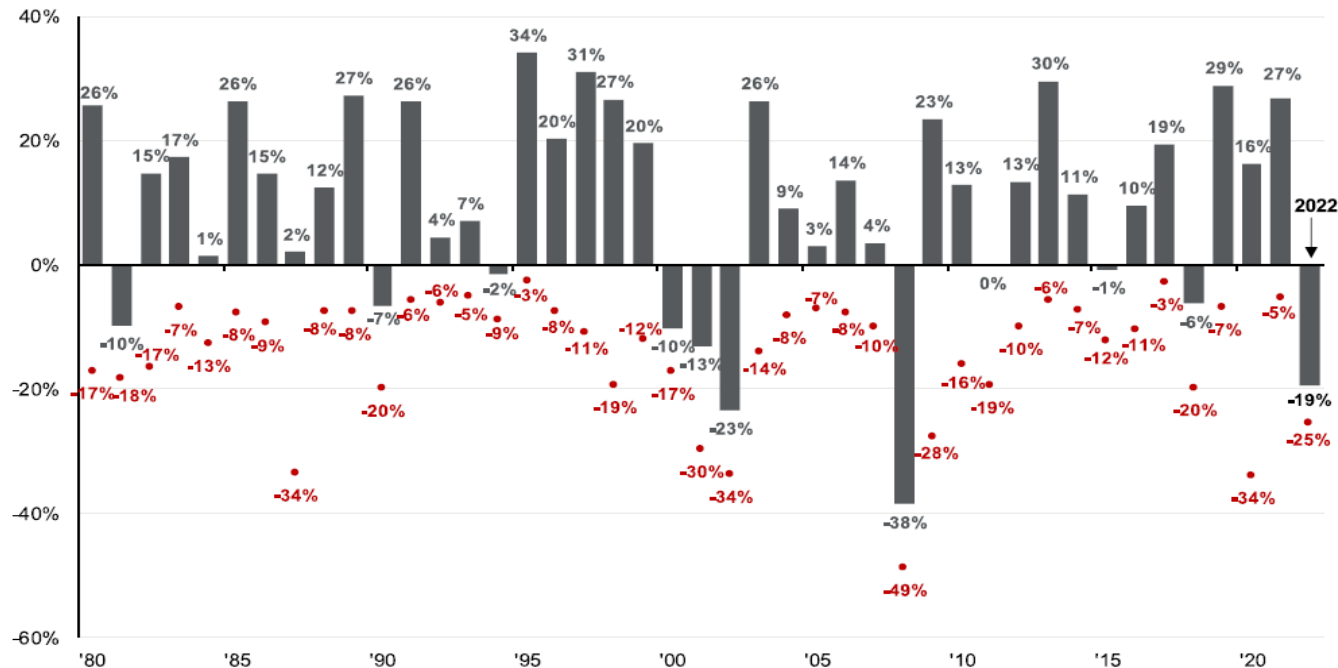
Source: Morningstar as of 12/31/22. U.S. bonds represented by the IASBBI US Gov IT Index from 1/1/26 to 1/3/89 and the Bloomberg U.S. Agg Bond TR Index from 1/3/89 to 12/31/22. U.S. stocks are represented by the S&P 500 Index from 3/4/57 to 12/31/22 and the IASBBI U.S. Lrg Stock Tr USD Index from 1/1/26 to 3/4/57, unmanaged indexes that are generally considered representative of the U.S. stock market during each given time period. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.



# Intra-Year Stock Declines

## S&P intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.3%, annual returns were positive in 32 of 43 years



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2022, over which time period the average annual return was 8.7%.

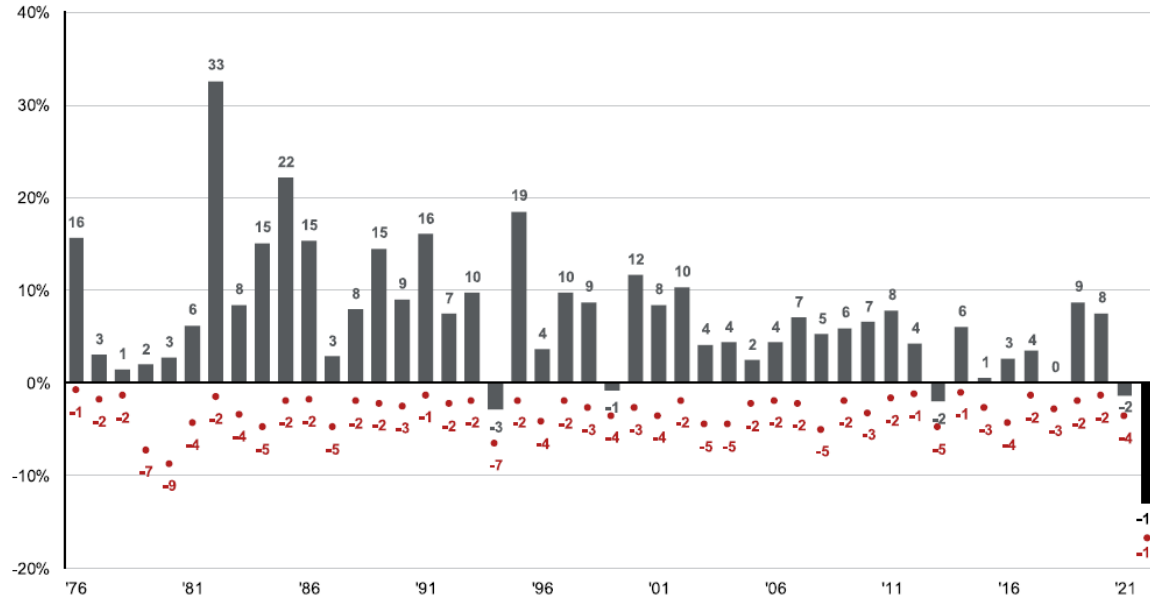
Guide to the Markets – U.S. Data are as of December 31, 2022.



# Intra-Year Bond Declines

## Bloomberg U.S. Aggregate intra-year declines vs. calendar year returns

Despite average intra-year drops of 3.3%, annual returns positive in 42 of 47 years



Source: Bloomberg, FactSet, J.P. Morgan Asset Management.

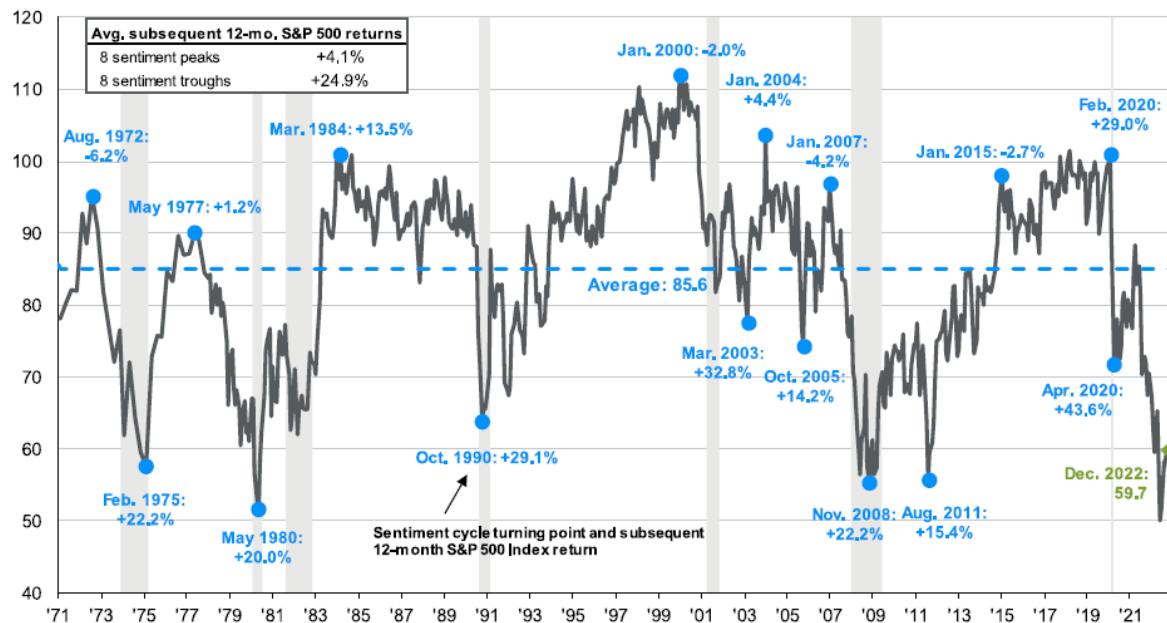
Returns are based on total return. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1976 to 2022, over which time period the average annual return was 6.6%. Returns from 1976 to 1989 are calculated on a monthly basis; daily data are used afterwards.

Guide to the Markets - U.S. Data are as of December 31, 2022.



# Consumer Confidence & The Stock Market

Consumer Sentiment Index and subsequent 12-month S&P 500 returns



Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management.

Peak is defined as the highest index value before a series of lower lows, while a trough is defined as the lowest index value before a series of higher highs. Subsequent 12-month S&P 500 returns are price returns only, which excludes dividends. Past performance is not a reliable indicator of current and future results.

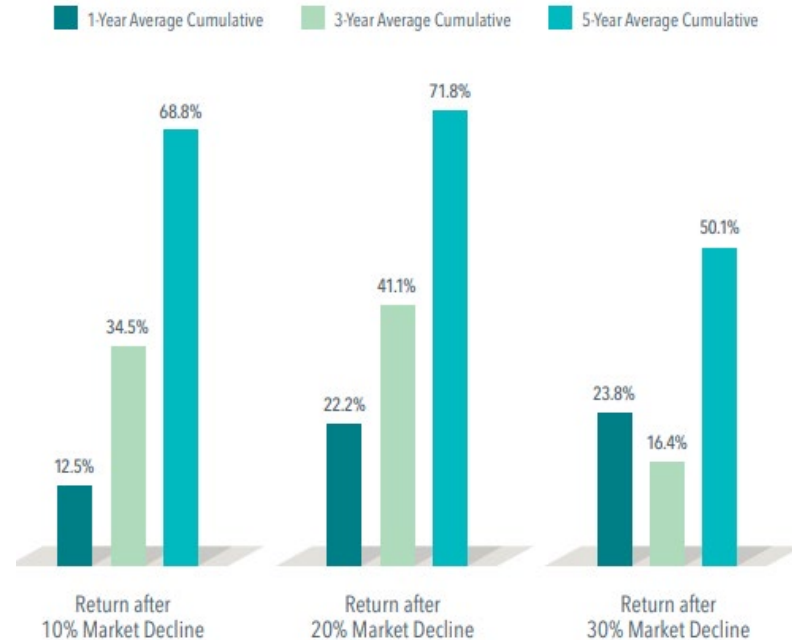
Guide to the Markets – U.S. Data are as of December 31, 2022.



# US Stock Returns Following Large Declines

FAMA/FRENCH TOTAL US MARKET RESEARCH INDEX RETURNS

July 1, 1926–December 31, 2021



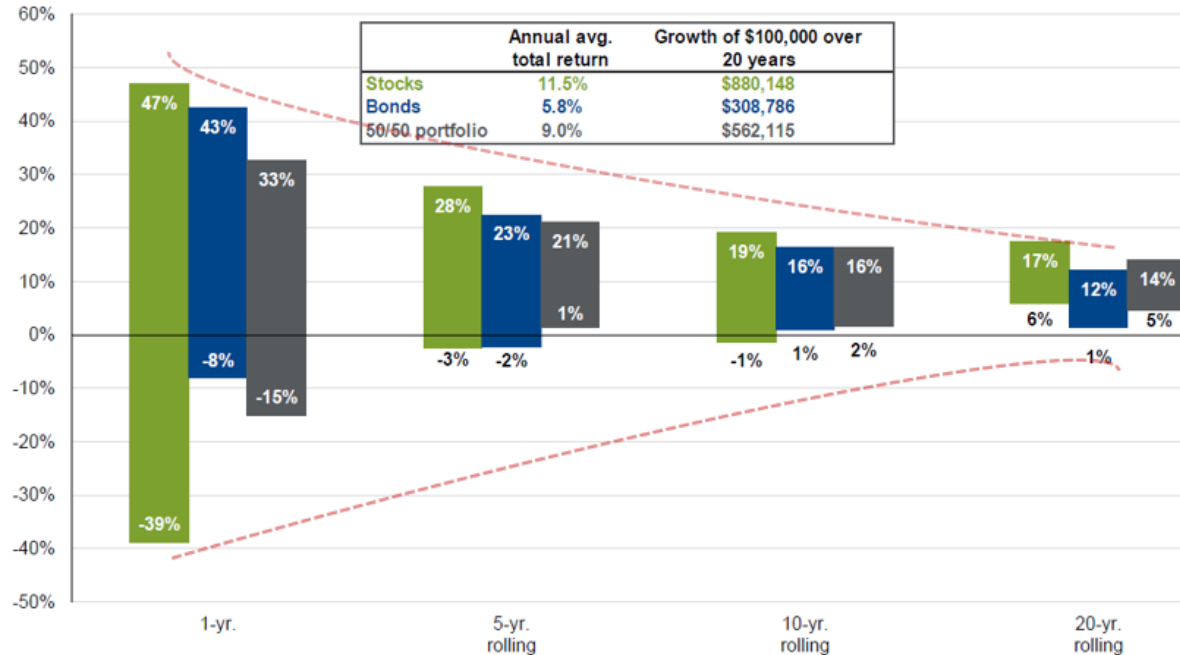
FAMA/FRENCH TOTAL US MARKET RESEARCH INDEX: 1926-present: Fama/French Total US Market Research Factor + One-Month US Treasury Bills. Source: Ken French website.



# Time & Volatility of Returns

## Range of stock, bond and blended total returns

Annual total returns, 1950 - 2021



Source: Bloomberg, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management.





# Asset Class Returns 2008-2022

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2008 - 2022	
Fixed Income	EM Equity	REITs	REITs	REITs	Small Cap	REITs	REITs	Small Cap	EM Equity	Cash	Large Cap	Small Cap	REITs	Comdty.	Large Cap	REITs
5.2%	79.0%	27.9%	8.3%	19.7%	38.8%	28.0%	2.8%	21.3%	37.8%	1.8%	31.5%	20.0%	41.3%	16.1%	8.8%	23.4%
Cash	High Yield	Small Cap	Fixed Income	High Yield	Large Cap	Large Cap	Large Cap	High Yield	DM Equity	Fixed Income	REITs	EM Equity	Large Cap	Cash	Small Cap	Small Cap
1.8%	59.4%	26.9%	7.8%	19.6%	32.4%	13.7%	1.4%	14.3%	25.6%	0.0%	28.7%	18.7%	28.7%	1.5%	7.2%	23.2%
Asset Alloc.	DM Equity	EM Equity	High Yield	EM Equity	DM Equity	Fixed Income	Fixed Income	Large Cap	Large Cap	REITs	Small Cap	Large Cap	Comdty.	High Yield	REITs	EM Equity
-25.4%	32.5%	19.2%	3.1%	18.6%	23.3%	6.0%	0.5%	12.0%	21.8%	-4.0%	25.5%	18.4%	27.1%	-12.7%	6.6%	23.0%
High Yield	REITs	Comdty.	Large Cap	DM Equity	Asset Alloc.	Asset Alloc.	Cash	Comdty.	Small Cap	High Yield	DM Equity	Asset Alloc.	Small Cap	Fixed Income	Asset Alloc.	Comdty.
-26.9%	28.0%	16.8%	2.1%	17.9%	14.9%	5.2%	0.0%	11.8%	14.6%	-4.1%	22.7%	10.6%	14.8%	-13.0%	6.1%	20.2%
Small Cap	Small Cap	Large Cap	Cash	Small Cap	High Yield	Small Cap	DM Equity	EM Equity	Asset Alloc.	Large Cap	Asset Alloc.	DM Equity	Asset Alloc.	Asset Alloc.	High Yield	DM Equity
-33.8%	27.2%	15.1%	0.1%	16.3%	7.3%	4.9%	-0.4%	11.6%	14.6%	-4.4%	19.5%	8.3%	13.5%	-13.9%	5.4%	20.0%
Comdty.	Large Cap	High Yield	Asset Alloc.	Large Cap	REITs	Cash	Asset Alloc.	REITs	High Yield	Asset Alloc.	EM Equity	Fixed Income	DM Equity	DM Equity	Fixed Income	Large Cap
-35.6%	16.5%	14.8%	-0.7%	16.0%	2.9%	0.0%	-2.0%	8.6%	10.4%	-5.8%	18.9%	7.5%	11.8%	-14.0%	2.7%	17.7%
Large Cap	Asset Alloc.	Asset Alloc.	Small Cap	Asset Alloc.	Cash	High Yield	High Yield	Asset Alloc.	REITs	Small Cap	High Yield	High Yield	High Yield	Large Cap	DM Equity	High Yield
-37.0%	25.0%	13.3%	-4.2%	12.2%	0.0%	0.0%	-2.7%	8.3%	8.7%	-11.0%	12.6%	7.0%	1.0%	-18.1%	2.3%	13.0%
REITs	Comdty.	DM Equity	DM Equity	Fixed Income	Fixed Income	EM Equity	Small Cap	Fixed Income	Fixed Income	Comdty.	Fixed Income	Cash	Cash	EM Equity	EM Equity	Asset Alloc.
-37.7%	18.9%	8.2%	-11.7%	4.2%	-2.0%	-1.8%	-4.4%	2.6%	3.5%	-11.2%	8.7%	0.5%	0.0%	-19.7%	1.0%	12.4%
DM Equity	Fixed Income	Fixed Income	Comdty.	Cash	EM Equity	DM Equity	EM Equity	DM Equity	Comdty.	DM Equity	Comdty.	Comdty.	Fixed Income	Small Cap	Cash	Fixed Income
-43.1%	5.9%	6.5%	-13.3%	0.1%	-2.3%	-4.5%	-14.6%	1.5%	1.7%	-13.4%	7.7%	-3.1%	-1.5%	-20.4%	0.6%	4.2%
EM Equity	Cash	Cash	EM Equity	Comdty.	Comdty.	Comdty.	Comdty.	Cash	Cash	EM Equity	Cash	REITs	EM Equity	REITs	Comdty.	Cash
-53.2%	0.1%	0.1%	-18.2%	-1.1%	-9.5%	-17.0%	-24.7%	0.3%	0.8%	-14.2%	2.2%	-5.1%	-2.2%	-24.9%	-2.6%	0.4%

Source: Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management

Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Bloomberg Global HY Index, Fixed Income: Bloomberg US Aggregate, REITs: NAREIT Equity REIT Index, Cash: Bloomberg 1-3m Treasury. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg US Aggregate, 5% in the Bloomberg 1-3m Treasury, 5% in the Bloomberg Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period from 12/31/2007 to 12/31/2022. Please see disclosure page at end for index definitions. All data represents total return for stated period. The "Asset Allocation" portfolio is for illustrative purposes only. Past performance is not indicative of future returns.

Guide to the Markets - U.S. Data are as of December 31, 2022.



# Diversification Does Not Always Feel So Good...

## A diversified portfolio can work even though it never feels good

Last 20+ years

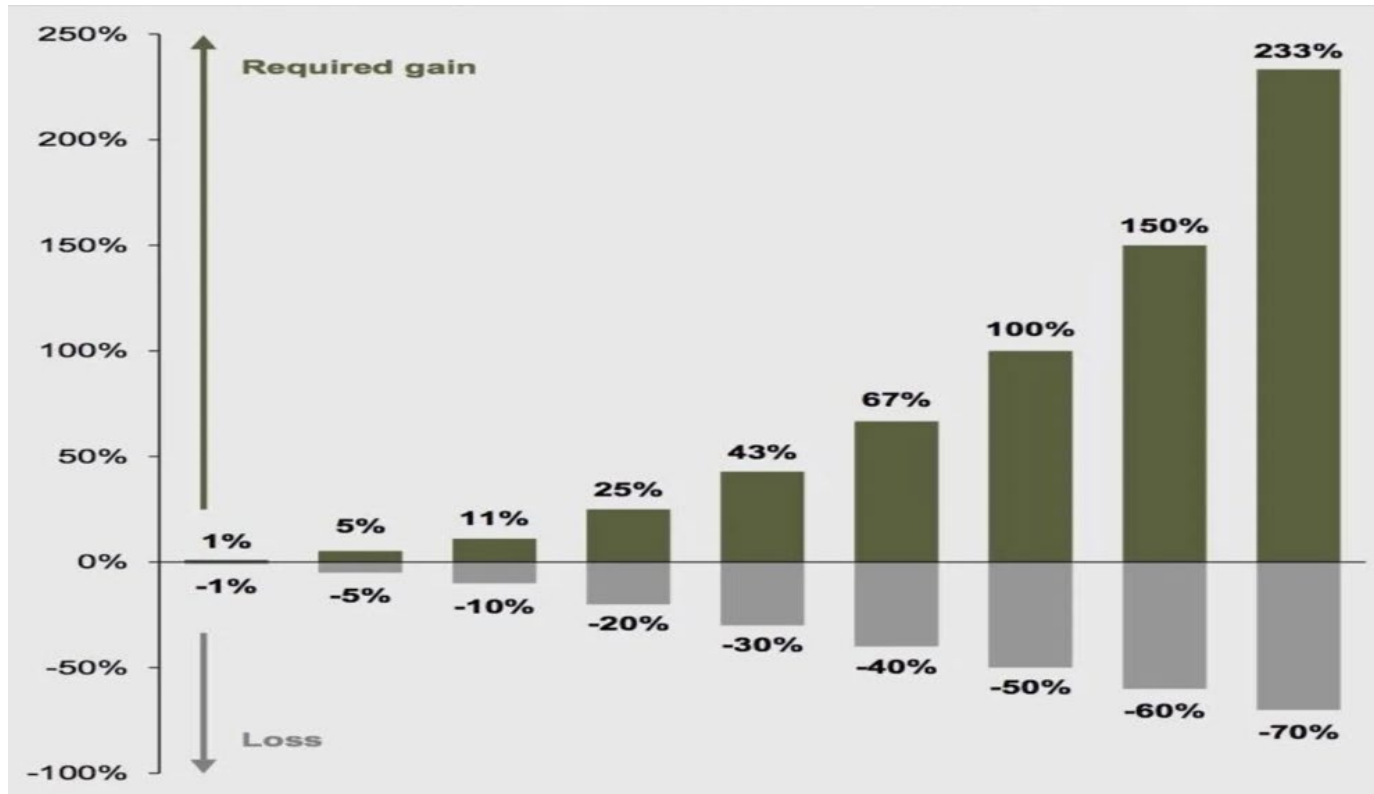
25% U.S. large stocks, 19% U.S. mid cap stocks, 7% international stocks, 5% U.S. small cap stocks, 4% emerging market stocks, 25% U.S. bonds, 15% high yield bonds

Years	S&P 500	Diversified Portfolio	
2000–2002*	-40.1%	-15.7%	🙄 "I lost money"
2003–2007	82.9%	87.1%	😊 "Diversification worked"
2008	-37.0%	-26.6%	🙄 "I lost money"
2009–2019	351.0%	219.7%	😞 "I didn't make as much"
Q1 2020†	-30.4%	-23.1%	🙄 "I lost money"
Q2 2020-2021†	119.0%	66.6%	😞 "I didn't make as much"
2022	-18.1%	-15.5%	🙄 "I lost money"
<b>Total Return</b>	<b>288.6%</b>	<b>301.6%</b>	😊 "Diversification can work even when it feels like its losing"
<b>Gr \$100K</b>	<b>\$388,610</b>	<b>\$401,550</b>	

Source: Morningstar as of 12/31/22. \*Performance is from 9/1/00 to 12/31/02. †Performance is from 1/1/20 to 3/23/20. ‡Performance is from 3/24/20 to 12/31/21. Diversified Portfolio is represented by 25% S&P 500 Index, 19% Russell Mid Cap Index, 7% MSCI EAFE Index, 5% Russell 2000 Index, 4% FTSE Emerging Stock Index, 25% Bloomberg US Aggregate Bond Index, 15% Bloomberg US Corporate High Yield Index. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.



# Mathematics of Loss – Breaking Even



For illustration purposes only – does not reflect any specific investment or index.



# Timing the Market

## Even bad market timing trumps inertia



Buys at lowest  
price every year

Buys  
Jan. 1

Buys 1<sup>st</sup>  
of every  
month

Buys at highest  
price every year

Stays in money  
market (cash)

**\$2,000 invested annually** in a hypothetical portfolio that tracks the S&P 500® Index from 2001-2020. The individual who never bought stocks in the example invested in a hypothetical portfolio that tracks the Ibbotson U.S. 30-day Treasury Bill Index. **Past performance is no guarantee of future results.**

Source: [Does Market Timing Work? | Charles Schwab](#)



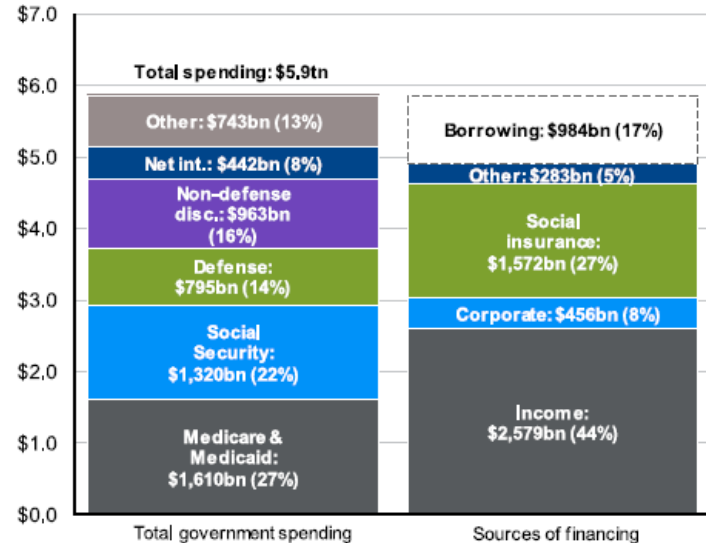


# Interest Rates

# Federal Finances

## The 2023 federal budget

CBO Baseline forecast, USD trillions



## CBO's Baseline economic assumptions

	2023	'24-'25	'26-'27	'28-'32
Real GDP growth	3.0%	1.6%	1.5%	1.7%
10-year Treasury	2.8%	3.1%	3.5%	3.8%
Headline inflation (CPI)	3.6%	2.4%	2.3%	2.4%
Unemployment	3.6%	3.7%	4.1%	4.5%

Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department.

Estimates are based on the Congressional Budget Office (CBO) May 2022 Update to the Budget and Economic Outlook. Data for fiscal year 2022 is from the CBO's Monthly Budget Review. Other spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Note: Years shown are fiscal years. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

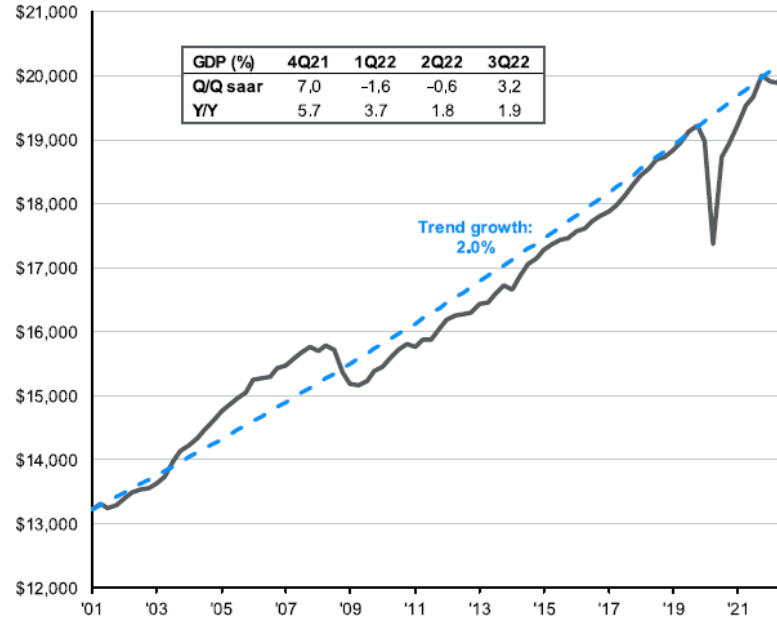
Guide to the Markets - U.S. Data are as of December 31, 2022.



# Economic Growth & GDP Composition

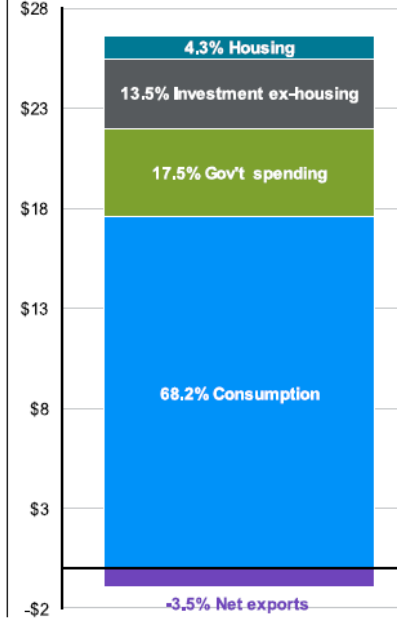
## Real GDP

Billions of chained (2012) dollars, seasonally adjusted at annual rates



## Components of GDP

3Q22 nominal GDP, USD trillions

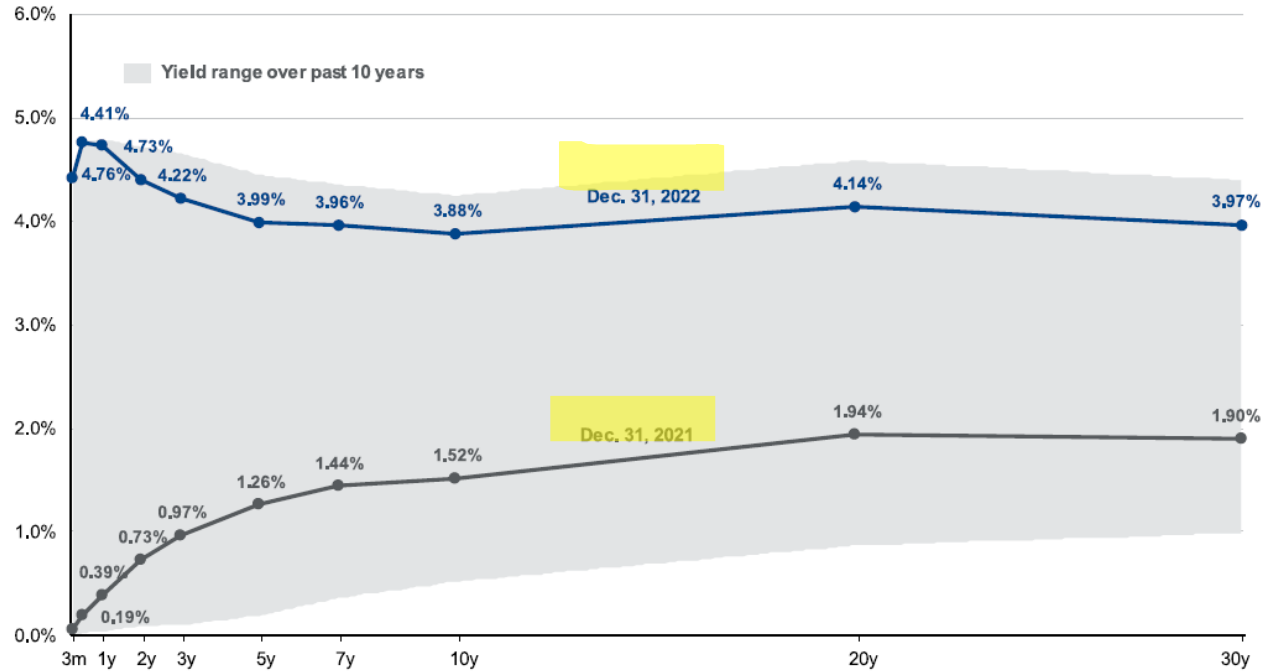


Source: BEA, FactSet, J.P. Morgan Asset Management. Values may not sum to 100% due to rounding. Trend growth is measured as the average annual growth rate from business cycle peak 1Q01 to business cycle peak 4Q19. Guide to the Markets – U.S. Data are as of December 31, 2022.



# Yield Curve

U.S. Treasury yield curve



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.  
Guide to the Markets – U.S. Data are as of December 31, 2022.

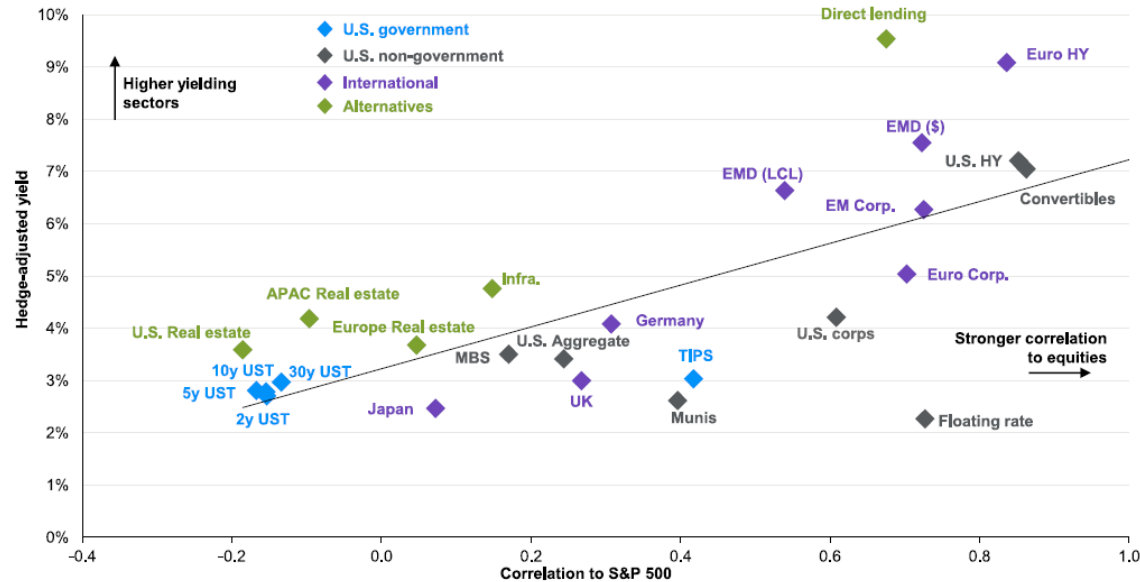




# Correlations of Stocks and Higher Yielding Sectors

## Equity market correlations and yields

Hedge-adjusted yield, last 12 months, 10-year correlations, quarterly



Source: Bloomberg, Gilberto-Levy, NCREIF, MSCI, FactSet, ICE, J.P. Morgan Asset Management. \*CML is commercial mortgage loans. Fixed income shown above are represented by Bloomberg indices except for EMD and ABS - U.S. Aggregate; MBS: U.S. Aggregate Securitized - MBS; U.S. corporates: U.S. Corporates; Munis: Municipal Bond; U.S. HY: Corporate High Yield; TIPS: Treasury Inflation-Protected Securities (TIPS); Floating Rate: U.S. Floating Rate; Convertibles: U.S. Convertibles Composite; ABS: J.P. Morgan ABS Index; EMD (\$): J.P. Morgan EMBIG Diversified Index; EMD (LCL): J.P. Morgan GBI EM Global Diversified Index; EM Corp.: J.P. Morgan CEMBI Broad Diversified Index; Euro Corp.: Euro Aggregate Corporate Index; Euro HY: Pan-European High Yield Index; U.S. Real Estate: NCREIF Property Index - GDCE - Europe Real Estate; Market weighted avg. of MSCI Global Property Fund Indices - U.K. & Cont. Europe: APAC Real Estate; MSCI Global Property Index - Asia-Pacific; Global Infra: MSCI Global Quarterly Infrastructure Asset Index (equal weighted blend); U.S. Direct Lending: Cliffwater Direct Lending Index; Timber: NCREIF Timberland Property Index (U.S.); Transport returns and yield are derived from a J.P. Morgan Asset Management index; CML - Senior: Gilberto-Levy Commercial Mortgage Performance Aggregate Index. Convertibles yield is based on the U.S. portion of the Bloomberg Global Convertibles. Country yields are represented by the global aggregate for each country. Yield and return information based on bellwethers for Treasury securities. U.S. Real Estate yield is calculated using the MSCI Global Property Fund Index - North America. Correlations are based on quarterly return over the past 10 years through 9/30/2022. All non-alternative yields are as of 11/30/2022. Alt yields are as of 9/30/2022. Quarterly return correlations and yields for Infrastructure are as of 6/30/2022. Guide to the Markets - U.S. Data are as of December 31, 2022.



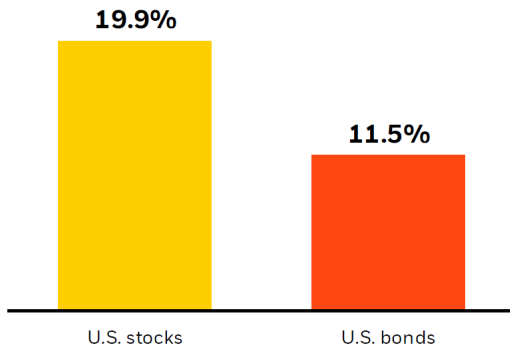
# What May Come Next?

## FEDERAL RESERVE RAISING RATES

### Returns following the last interest rate hike

The Federal Reserve raising rates for the last time in a cycle and U.S. stock and bond performance

**Average U.S. stock and bond performance 12 months following the last Fed hike**  
(2/4/94 – 12/31/22)



**Specific periods of higher interest rates**  
(2/4/94 – 12/31/22)

Last Federal Reserve rate increase	U.S. Stocks	U.S. Bonds
	Next 12 months	Next 12 months
2/1/95	38.7%	17.0%
3/25/97	35.0%	11.5%
5/16/00	-13.0%	13.8%
6/29/06	22.8%	6.4%
12/20/18	16.1%	8.8%
Average	19.9%	11.5%

Source: Morningstar as of 12/31/21. U.S. stocks are represented by the S&P 500 Index. U.S. bonds are represented by the Bloomberg US Agg Bond TR Index. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.



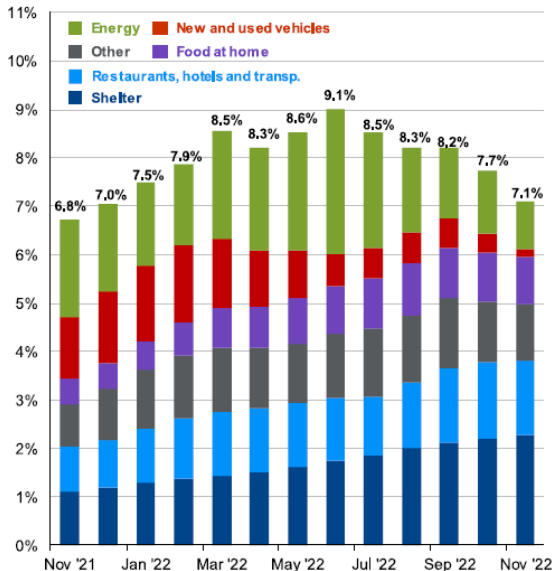


# Inflation/R\*cession

# Drivers of Inflation & Expectations

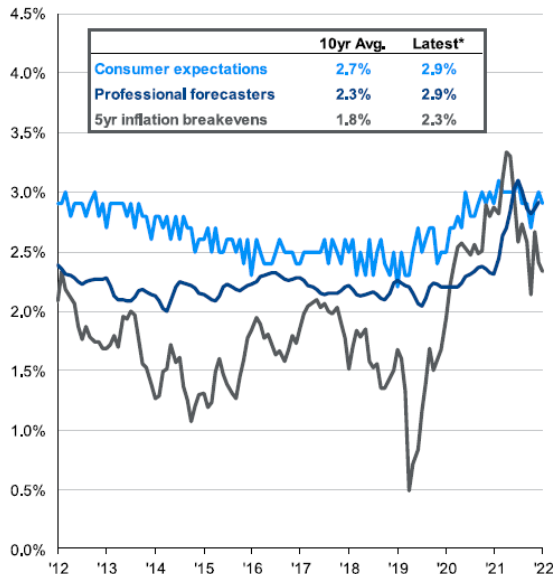
## Contributors to headline inflation

Contribution to y/y % change in CPI, not seasonally adjusted



## Inflation expectations, next 5 years

% change vs. prior year, non-seasonally adjusted



Source: Bureau of Labor Statistics, FactSet, Federal Reserve Bank of Philadelphia, University of Michigan, J.P. Morgan Asset Management. Contributions mirror the BLS methodology on Table 7 of the CPI report. Values may not sum to headline CPI figures due to rounding and underlying calculations. "Shelter" includes owner's equivalent rent and rent of primary residence. "Other" primarily reflects household furnishings, apparel, education and communication services, medical care services and other personal services. \*Reflects the latest daily 5yr/5yr breakevens, preliminary or final Consumer Sentiment survey, and the quarterly Survey of Professional Forecasters interpolated to a monthly series. The Survey of Professional Forecasters reflects the median estimate by professional forecasters of average CPI inflation over the next 5 years. The series has been adjusted by J.P. Morgan Asset Management to exclude realized inflation readings within the forecast window.  
Guide to the Markets – U.S. Data are as of December 31, 2022.



# 5-Year Inflation Break Even



As of 2/9/2023



# Unemployment Rate

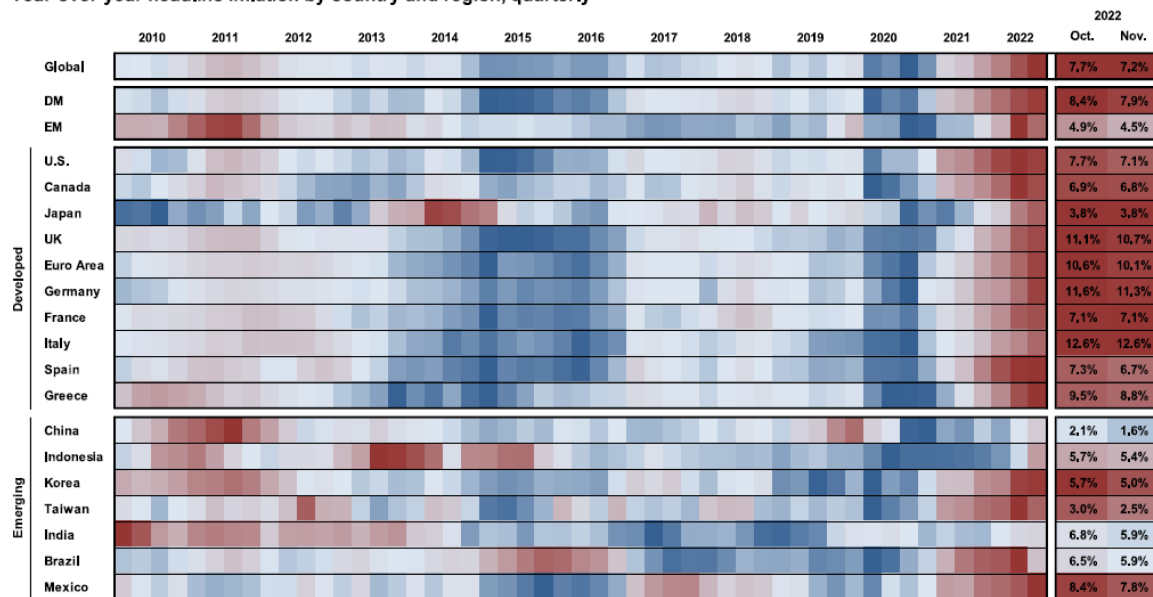


As of 2/9/2023



# Global Inflation

Year-over-year headline inflation by country and region, quarterly



Source: Bank of Mexico, DGBAS, Eurostat, FactSet, Federal Reserve, Goskomstat of Russia, IBGE, India Ministry of Statistics & Programme Implementation, Japan Ministry of Internal Affairs & Communications, Korean National Statistical Office, Melbourne Institute, National Bureau of Statistics China, Statistics Canada, Statistics Indonesia, UK Office for National Statistics (ONS), J.P. Morgan Asset Management. Heatmap is based on quarterly averages, with the exception of the two most recent figures, which are single month readings. Colors determined by percentiles of inflation values over the time period shown. Deep blue = lowest value, light blue = median, deep red = highest value. DM and EM represent developed markets and emerging markets, respectively.  
 Guide to the Markets – U.S. Data are as of December 31, 2022.



# Market Expectations On Federal Funds Rate

MEETING PROBABILITIES								
MEETING DATE	400-425	425-450	450-475	475-500	500-525	525-550	550-575	575-600
3/22/2023	0.0%	0.0%	0.0%	90.8%	9.2%	0.0%	0.0%	0.0%
5/3/2023	0.0%	0.0%	0.0%	19.9%	72.9%	7.2%	0.0%	0.0%
6/14/2023	0.0%	0.0%	0.0%	10.8%	48.6%	37.3%	3.3%	0.0%
7/26/2023	0.0%	0.0%	0.0%	9.6%	44.4%	38.5%	7.1%	0.4%
9/20/2023	0.0%	0.0%	1.4%	14.8%	43.5%	33.8%	6.1%	0.3%
11/1/2023	0.0%	0.4%	5.0%	22.5%	40.9%	26.4%	4.5%	0.2%
12/13/2023	0.3%	3.5%	16.8%	34.9%	31.2%	11.7%	1.6%	0.1%

Source: [CME FedWatch Tool - CME Group](#)

As of 2/10/2023

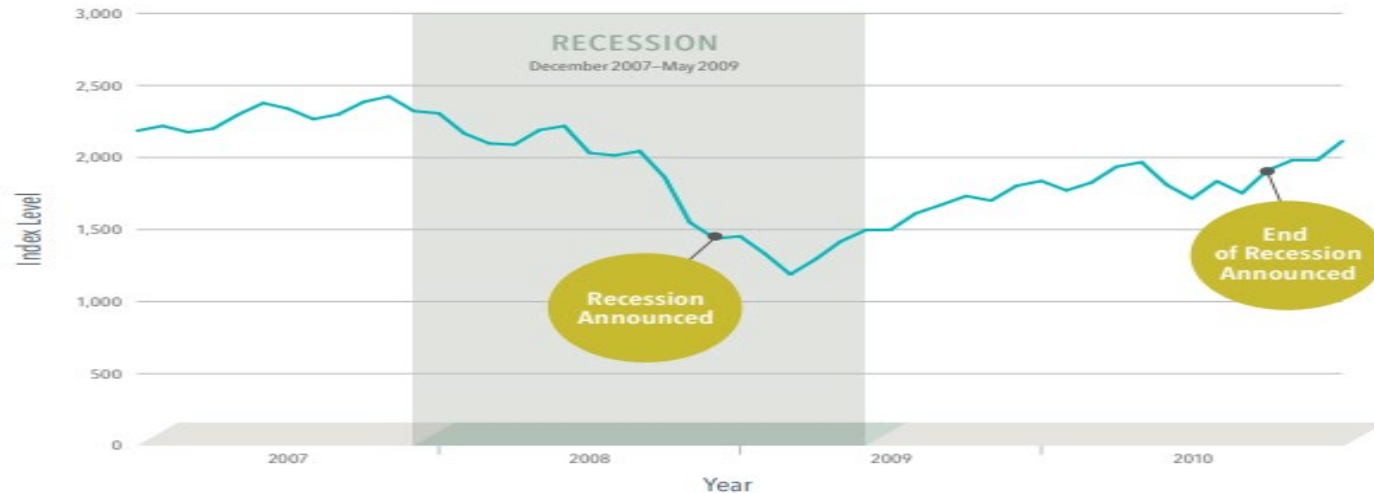




# Darkness Before The Dawn

## US RECESSION AND STOCK PERFORMANCE DURING THE GLOBAL FINANCIAL CRISIS<sup>1</sup>

S&P 500 Index, January 2007–December 2010



1. Start and end dates of US recessions, along with announcement dates, are from the National Bureau of Economic Research (NBER).  
[nber.org/research/data/us-business-cycle-expansions-and-contractions](http://nber.org/research/data/us-business-cycle-expansions-and-contractions) and  
[nber.org/research/business-cycle-dating/business-cycle-dating-committee-announcements](http://nber.org/research/business-cycle-dating/business-cycle-dating-committee-announcements)
2. Decline based on the S&P 500 Index's price difference between the actual start of the recession in December 2007 and the official "in recession" announcement 12 months later.



# Takeaways For 2023

- Difficult to time the market – staying invested is the best course.
- Higher interest rates hurt investors last year –now help cash savers and bond income.
- Consumer Spending (~70% of GDP) remains strong.
- Recession is possible (i.e., slowing GDP growth) – Do not abandon long term investment strategy.

Thank you!



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## 15 –Minute Break



*We'll get you there.*

CPAs | CONSULTANTS | WEALTH ADVISORS

# Ethical Challenges in Business Decisions:

Creating an Environment of Ethical Awareness to Prevent Fraud

# Learning Objectives

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

- Identify common fraud schemes and how ethics and integrity are possible in today's world
- Identify and differentiate the principles and key concepts of personal ethics and business ethics
- Recognize the need for ethics in business to help mitigate risks to the organization
- Describe case examples of ethical violations that lead to fraud
- Identify and describe the attributes of a highly ethical organization



# Ethics Concepts

# Personal Ethics - Values

- What are your personal values?
  - Simply: The things that are important to you in life.
- It should be easy to live by your “values,” right?
  - NOT ALWAYS! Why?

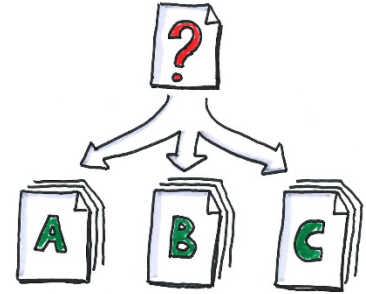


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# Personal Ethics - Values

Personal ethics can change over time – depending on what is most important to you. Or can change from situation to situation, based on how you perceive your “role” in each situation.



Role Morality - Feeling you have permission to make ethical decisions that may harm others in ways that would be wrong if it weren't for the role you're playing. But because you're acting on behalf of someone else's best interests, you view your actions as permissible.

# Personal Ethics - Values

- Ethics means different things to different people.
- What has helped you define your personal ethics?
  - Faith?
  - Spirituality?
  - Upbringing?
  - Family?
  - Moral code of conduct?
  - Laws and civil rights?
  - Academia?



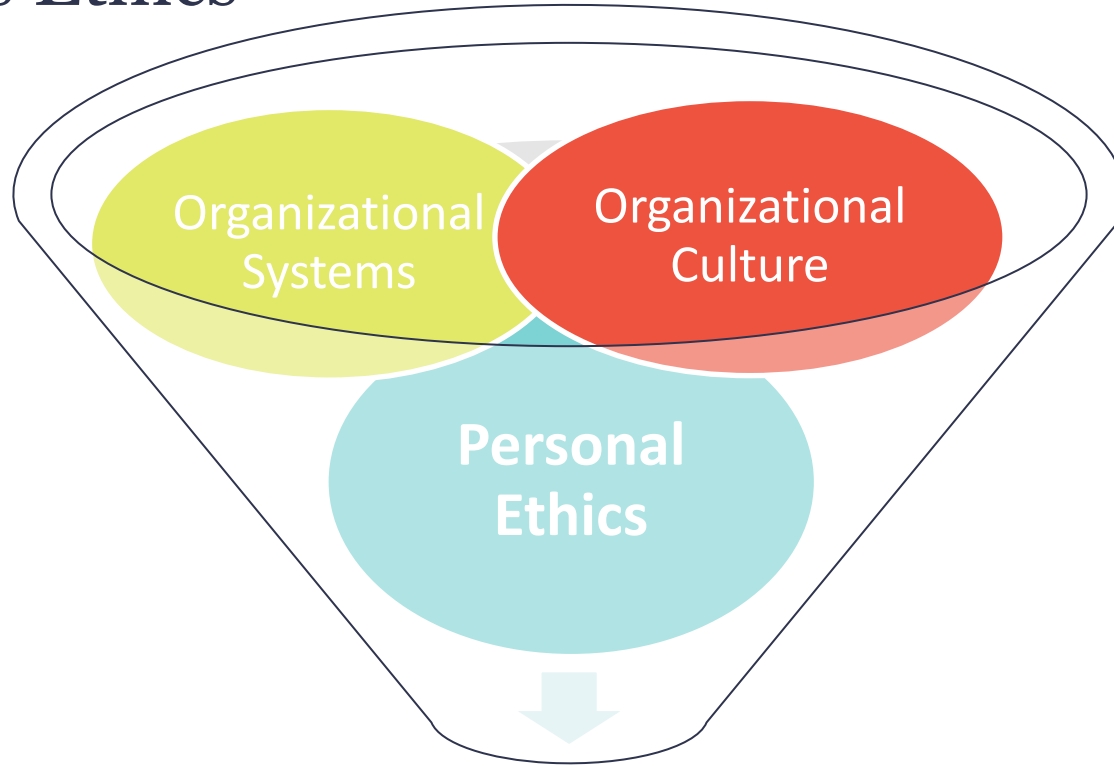
# Ethical Leaders Start at Home





# How Are My Personal Ethics Relevant to My Job?

# Business Ethics



Are the decisions made by an organization ethical?

# Let's Hear from You...

In your opinion, which of these has the most impact on whether a company is ethical?

- A. Organizational systems
- B. Organizational culture
- C. Personal ethics of employees

# Principles of Ethics in Business

Honesty

Integrity

Loyalty

Fairness

Concern/Respect for others

Courage



# Practicing Ethics – Inside & Outside the Workplace

## Honesty

- Returning extra change/driving the speed limit
- Not withholding information from employees

## Integrity

- Keeping promises to your kids over work commitments
- Don't accept praise for or steal others' ideas/work

## Loyalty

- Sticking up for a friend who is the subject of gossip
- Recognize others for their accomplishments



# Practicing Ethics – Inside & Outside the Workplace

## Fairness

- Don't take sides in family disputes
- Hold all team members accountable

## Respect

- Practice active listening
- Welcome and encourage diversity

## Courage

- Speak up when you see someone being mistreated
- Speak up when you see unethical or inappropriate behavior

# Why Is Ethics Important in Business?

- A. It helps employees make good decisions and in turn leads to happier, more satisfied employees.
- B. It reduces liability.
- C. It ensures high-quality customer service.
- D. All of the above.



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And most importantly, it keeps everyone off the front pages!

# Moral Muteness

Moral Muteness is:

1. Not speaking up when witnessing unethical behavior
2. The unwillingness to discuss ethics
3. Discussing practices/decisions in a way that obscures your moral position and ethical beliefs (Bird & Walters, 1989)

What causes moral muteness?

***Discussions of ethics can be threatening to harmony, efficiency, or power.***

# Ethical Fading



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- An erosion of the **ethical** standards of a business in which employees become used to engaging in or condoning bad behavior.
- Ethical Fading – The inability to see that a situation requires an ethical judgement.



# Ethical Challenges in Government

# Ethical Challenges Turned Fraud...

Charging non-grant costs to federal/state contracts

Abuses of credit cards  
– meals; travel; etc.

Staff benefiting personally from organization assets

Awarding grant funds to family or friends

Awarding vendor contract to family or friend

Allowing employees to pad their timesheets to compensate for “value”

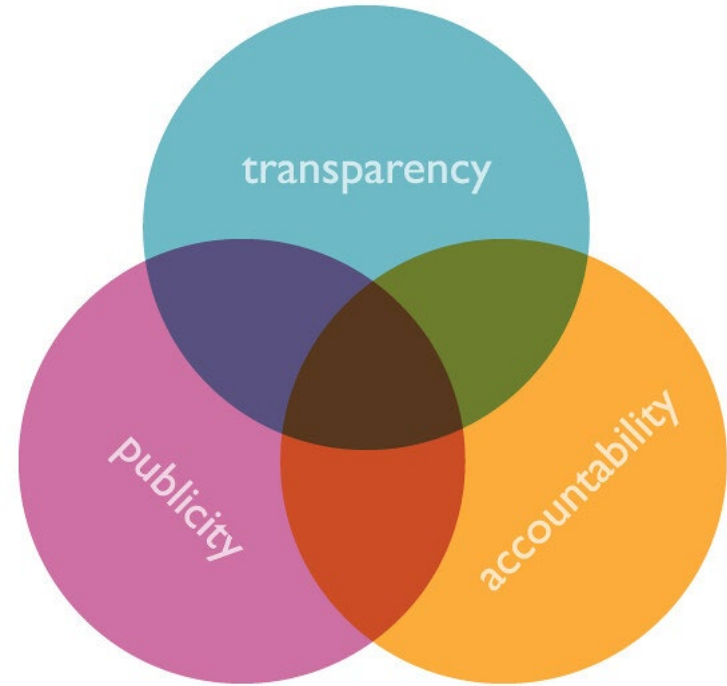
# Qualities of Ethical Leaders



# Ethical Challenges in Government

The importance of:

- Perception – What is more important, reality or perception?
- How is transparency achieved?



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# Ethics and the Law

- Do unethical decisions always involve illegal behavior? **NO!**





## Case Study #1

# Case Study #1 – City Enterprise Fund

- City that operates a service business as an enterprise fund
- City contracted with an Operator to run the business and report to the City Finance Director
- Bartering and double-dipping schemes
- CLA's scope was a 5-year period, the entirety of the Operator's contract
- Operator was engaged as an independent contractor, not an employee of the City
  - Had long been associated with the City's service business through their role prior to Operator
  - No known financial or other issues but appeared to desire recognition



# Case Study #1 – City Enterprise Fund

Operator paid themselves in excess of the contracted stipend amounts and made personal purchases with City funds (including reimbursements).

Operator set up vendor accounts that were billed to the City, but only used those vendors for personal purchases.

## Schemes

Operator added several unauthorized lines to the legitimate cell phone plan that was being reimbursed by the City.

Operator bartered with individuals and other businesses using City assets and only benefiting the Operator personally.

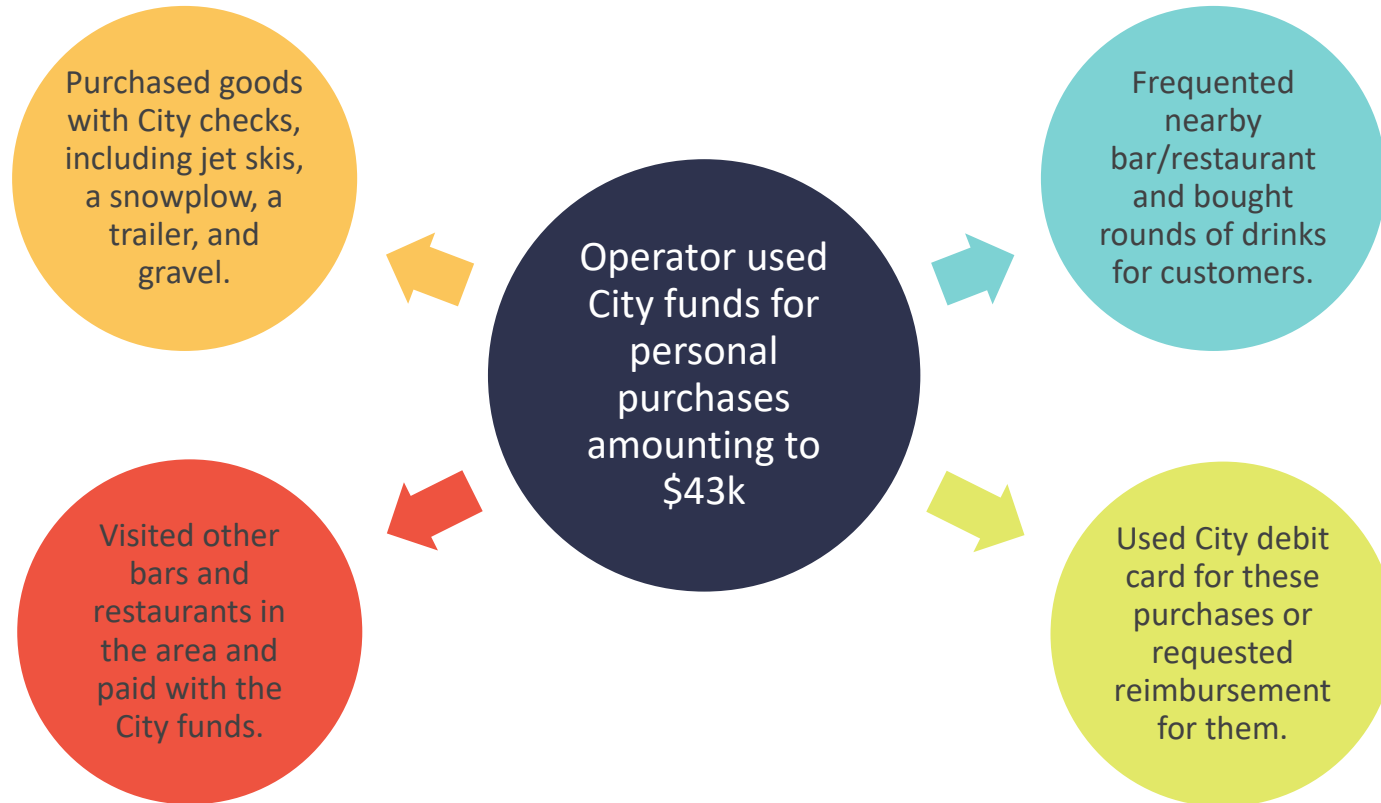


# Case Study #1 – City Enterprise Fund

Operator paid themselves \$59k in excess stipends

- Entitled to stipends as part of their contract:
  - \$8,000 per year for personal vehicle usage
  - \$6,000 per year for health insurance
  - Unspecified amount for cell phone (specified only for Operator)
- Excess amounts received by Operator:
  - Vehicle loan payments
  - Vehicle maintenance and upgrades
  - Vehicle fuel

# Case Study #1 – City Enterprise Fund



# Case Study #1 – City Enterprise Fund

- Operator set up unauthorized vendor accounts and used them for personal services amounting to \$45k
  - Operator opened accounts at multiple fuel vendors
  - Only one fuel vendor was used for legitimate City fuel purchases
  - Other vendors were used by the Operator for their personal vehicle only

# Case Study #1 – City Enterprise Fund

- Operator added unauthorized phone lines to the City-reimbursed cell phone plan, costing the City \$14k
  - Entitled to reimbursement for their own cell phone and any lines needed for operations, including at the office or for the employees
  - Admitted to police that they put two of their kids on the cell phone plan
  - CLA identified a total of 12 phone lines in service at one point or another during the Operator's contract period

Lines Authorized (2)

Lines Paid (12)





# Case Study #1 – City Enterprise Fund

Operator bartered with individuals and businesses using City assets and benefited personally, costing the City \$51k in lost revenue.

- Operator gave away City services for free or at a discounted rate in exchange for goods or services for themselves
  - Offered space on City land for cash rent paid directly to the Operator, without authorization from the City
  - Offered credit on City services in exchange for service work on Operator's vehicle
- Operator used City funds to purchase a snowplow, then received compensation from a business for plowing their parking lot

# Case Study #1 – City Enterprise Fund

*How did this happen?*

Operator had full access to the bank account

Operator had full access to the accounting records

Operator was the sole person communicating with the City Finance Office regarding the Enterprise Fund

Operator forged documents when reporting to the City

# Case Study #1 – City Enterprise Fund

## Conclusions

Total loss of approx. \$212k:

- \$59k – excess stipends
- \$43k – personal purchases
- \$45k – unauthorized vendor accounts
- \$14k – unauthorized phone lines
- \$51k – lost revenue due to bartering

The Operator's contract  
with the City was  
terminated.

The Operator was  
arrested by local police.



# Attributes of a Highly Ethical Organization

# Attributes of a Highly Ethical Organization

1. Person or office dedicated to anti-fraud, ethics, and compliance
2. Lead by example (“tone at the top”)
  - a. Highest level management promote an environment of high ethics and integrity
  - b. Governance holds top level executive accountable
3. Encourage transparency and accountability
  - a. Review, oversight, monitoring
4. Well developed anti-fraud and ethics policy
  - a. Documented in writing and communicated to employees
  - b. Read and acknowledged by all employees
  - c. Communicate during hiring; carefully screen job applicants
5. Well developed and updated written policies and procedures

# Attributes of a Highly Ethical Organization

6. Regular technical training of employees on policies, procedures, applicable laws, ethics, fraud awareness, etc.
7. Strong compliance/internal audit programs
  - a. Internal, outsourced, or combination
  - b. Prioritized and communicated
  - c. Access to Governance
8. Establish a fraud and ethics hotline
  - a. Provide for anonymity
  - b. Maintain confidentiality
  - c. Incorporate whistleblower protections; protect employees that come forward
9. Reinforce good behavior; don't reinforce bad behavior
  - a. Follow through with reports of misconduct and promote effective internal controls
  - b. Encourages people to come forward

Thank you!



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# Cyber Risks and IT Internal Control Strategies



# Learning Objectives

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

- Outline current IT security risks impacting local governments

# Cyber Security Services at CLA

- Information Security offered as specialized service offering for over 25 years
- Penetration Testing and Vulnerability Assessment
  - Black Box, Red Team, and Collaborative Assessments
- IT/Cyber security risk assessments
- IT audit and compliance (HIPAA, GLBA/FFIEC, NIST, CMMC, CIS, etc.)
- PCI-DSS Readiness and Compliance Assessments (PCI-DSS)
- Incident response and forensics
- Independent security consulting
- Internal audit support



C:\whoami  
> moth\_man

- “Professional Student”
- Science Teacher / Self Taught Computer Guy
- IT Consultant - Project Manager → IT Staff/Help Desk → Hacker
- Assistant Scout Master (Boy Scouts)
- Boys Scouts Motto: Be Prepared

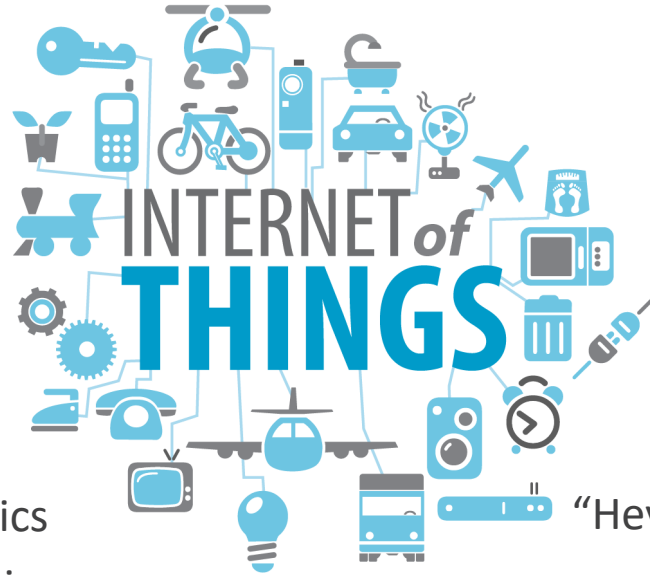




# The Current Threat Landscape

# Raise Your Hand if You Work for a Tech Company

- Security Cameras
- Motion Sensors
- Logistics Tracking
- Print Vendors
- Smart TV Displays
- Temperature and Humidity
- Digital Assistance
- Cloud Applications & Analytics
- Bio-Medical Care & Monitoring
- “Presence”



Security cameras  
Garage door  
Home thermostat  
Cable TV remote  
Smart TV  
Sleep number bed  
Roomba  
“Hey Siri, what’s my balance?”  
Apple Watch or FitBit  
“Presence”



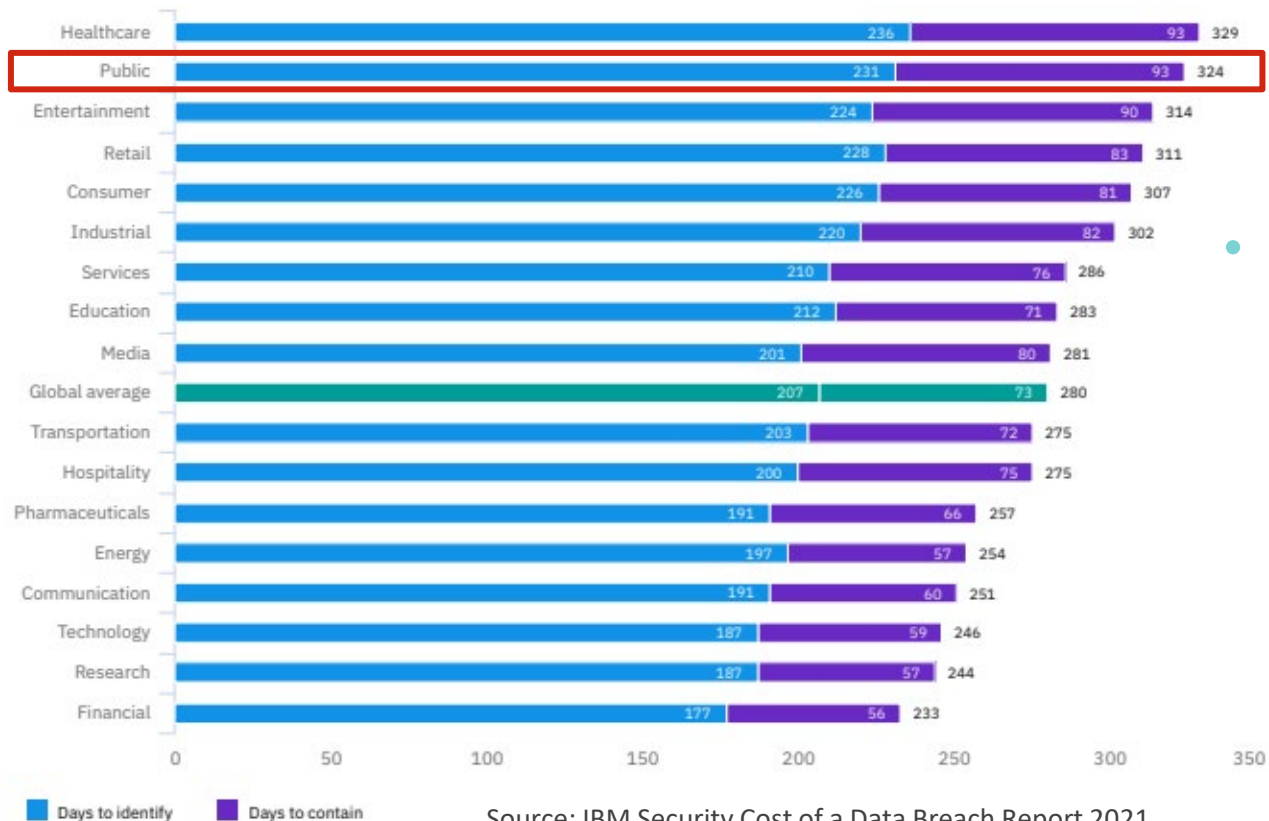
# Cybercrime and Black-Market Economies

- Black market economy to support cyber fraud
  - Business models and specialization
  - Underground Marketplace (The Dark Web)
- Most common cyber fraud scenarios we see affecting our clients
  - Theft of information
  - Credit card information
  - EPHI, PII, PFI, account profiles, etc.
  - Log-in Credentials
  - Ransomware and interference w/ operations
- To the Hackers, we all look the same...

They will hit you with any or all of the following:

1. Email Spear Phishing Attacks
2. Password Guessing and Business Email Account Takeovers
3. Payment and Funds Disbursement Transfer Fraud
4. Ransomware
5. Extortion to avoid breach disclosure

# Average Days to Identify and Contain a Data Breach



- Global average is 280 days
  - 207 days to identify a breach
  - 73 days to contain the attack

Source: IBM Security Cost of a Data Breach Report 2021



# Behind the Statistics

- Hackers can do a lot in AND to your network in 231 days
  - Learn everything about your institution
  - Find your crown jewels and take them
  - Disable backups and security systems
  - Create numerous back doors
- Public portrayal of ransomware creates a false sense of security
  - Ransomware is usually coupled with other acts – Ransomware is simply the most visible part of the attack – it is usually “the last act”
  - Current ransomware attacks are coupled with data exfiltration
  - Resuming operations is just the first step
  - Legal and business ramifications of a data breach can persist



Average cost  
\$4.35M







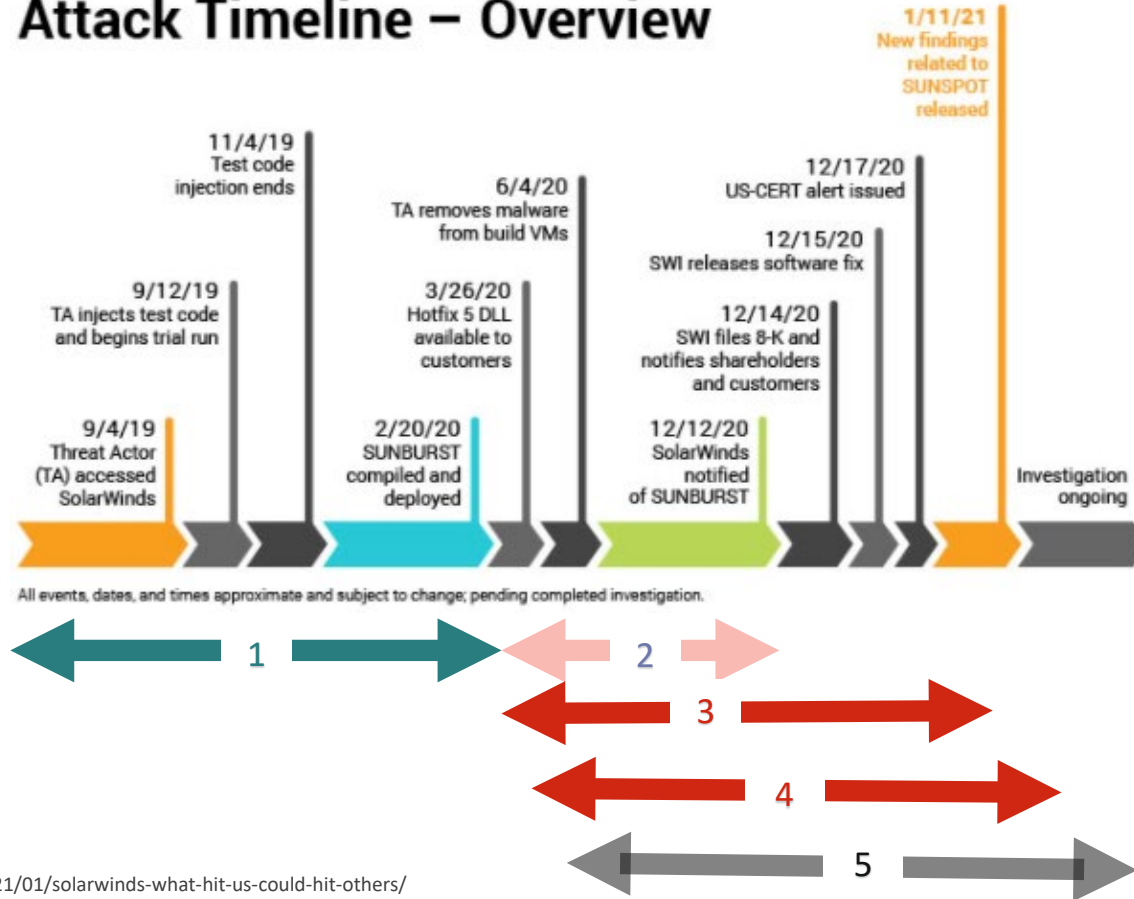
# Attacking the Supply Chain Enterprise Software

SolarWinds Orion and MS Exchange

# Timeline of Events

Krebs On Security

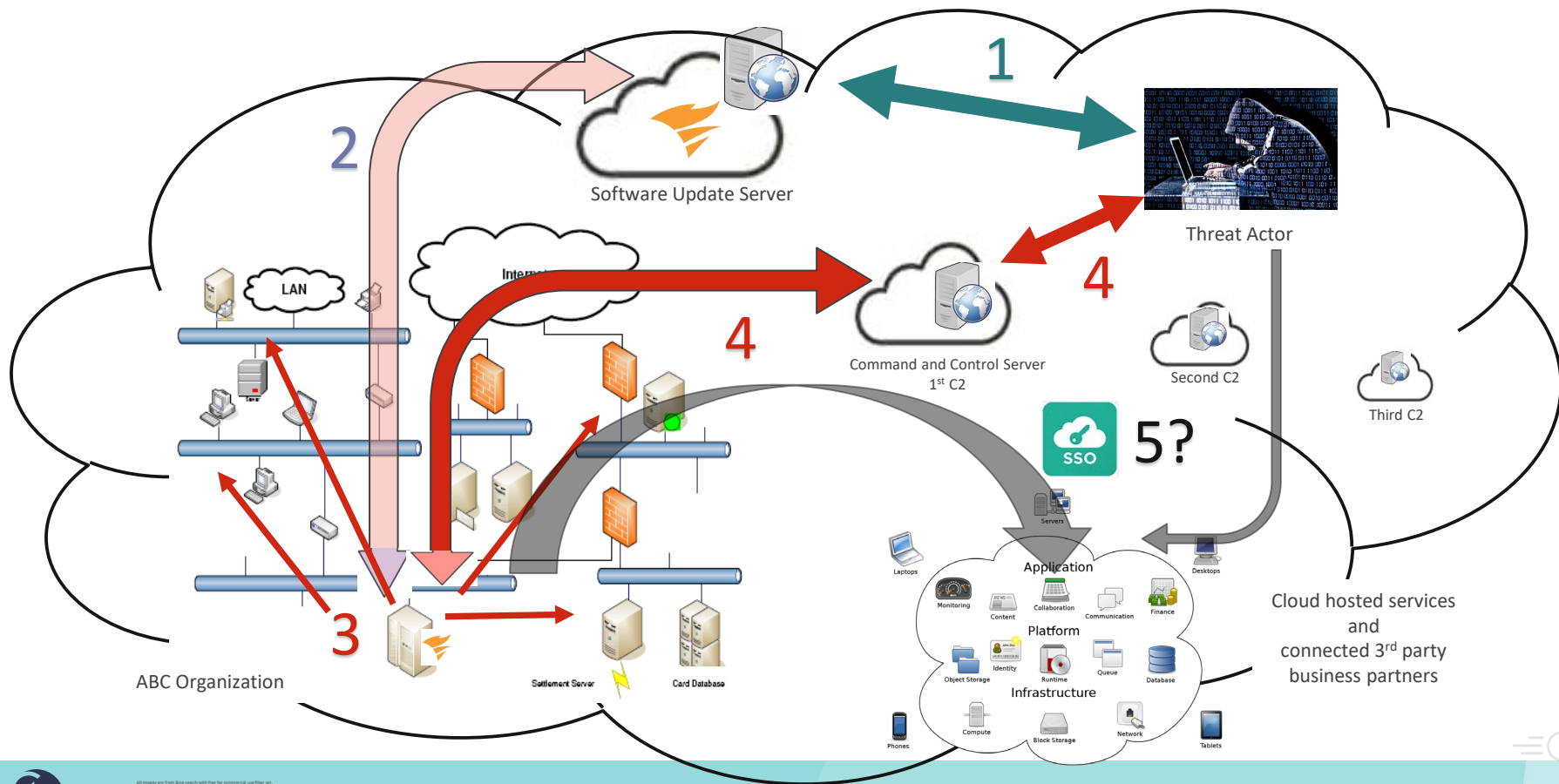
## Attack Timeline – Overview



<https://krebsonsecurity.com/2021/01/solarwinds-what-hit-us-could-hit-others/>



# Picture in Your Mind's Eye – SolarWinds Orion Compromise



All images are from Bing search with free for commercial use filter set.

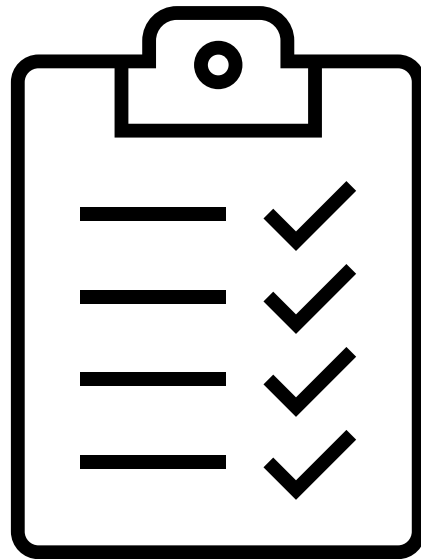
# Take-Aways and To-Dos (i.e., On the Fly IR)

1. Do we use SolarWinds Orion?
  - If **NO** → Go to 6
  - If YES → What version?
2. Is our version the affected version (see SW advisory)?
  - If **NO** → Go to 6
  - If YES → Continue
3. Have we created a timeline of potential exposure?
4. What logs do we have and how far back in time do they go?
5. What Indicators of Compromise (IOC's) have we searched for?
  - What resources/references have we used to identify known and potential IOC's?
  - Use 3 and 4 to search for IOC's
6. Do we have any third-party service providers with trusted access?
  - Who has remote access into our environment?
  - Who do we push our data out to?
  - Are there any persistent open connections to or from third parties?
7. Repeat 1-5 for those identified in 6



# Take-Aways and To-Dos (i.e., IR)

- “Know What Normal Looks like”
  - Easy to say... challenging to execute
  - Server communication to the outside
  - DNS logs
- In-house threat hunting for IOC's
  - In-house changes
  - Privileged accounts and service accounts
    - Critical files and system settings
- Threat hunting in cloud Infrastructure
  - Mandiant Azure AD Investigator
  - CISA Sparrow
  - MS Azure Security Compass



# Microsoft Exchange

- Exchange
  - Installed on-premise
  - Installed on corporate servers
  - Exchange servers have privileged access in network
- Exchange Online
  - Hosted by Microsoft in Microsoft's cloud
  - Organizations don't have to manage server, only application
- Exploitable vulnerabilities in Exchange on-prem
- MS Office 365 is NOT secure by default



# Software Vendor/Supply Chain Risk Management

- All software products have bugs/vulnerabilities
- Key questions:
  - What does this software application have access to?
  - What user account/privileges are given to it?
  - What is the software vendor doing to provide us a level of comfort that they have done their due diligence?
  - What do we need to do for our due diligence?
  - What impact does this software have on the institution...
    - If it is hacked/breached?
    - If it is down for... 2 hours? 2 days? 2 weeks? 2 months?



# The Supply Chain Exposing Us Embedded / Open-source Software

Log4j and Other Imbedded Software Components



# Software Vendor/Supply Chain Risk Management

- Recent Significant Issues:

- Common software components with exploitable vulnerabilities.

- Recent examples include:

- **“Log4j”** Java vulnerabilities...
- **Pkexec** - CVE-2021-4034 (PwnKit)
- **Python** – CVE-2007-4559
  - September 2022
  - 15-Year-Old Python Flaw Slithers into software worldwide
  - An unpatched flaw in more than 350,000 unique open-source repositories leaves software applications vulnerable to exploit

Google:  
Log4j vulnerabilities



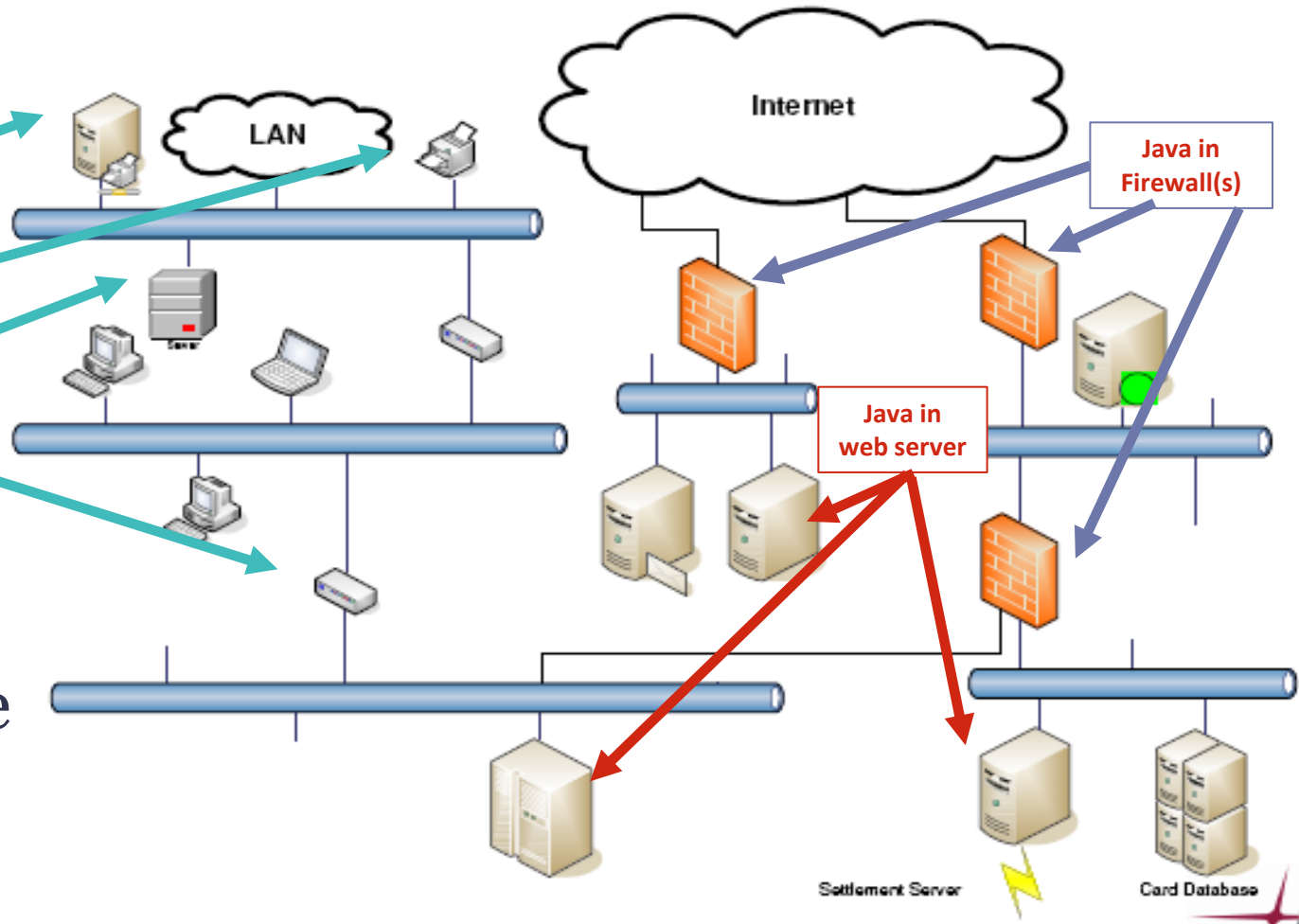
Java in  
Multifunction  
device

Java in  
Printer

Linux appliance

Where else?

# Java Software and Log4j



# Software Vendor/Supply Chain Risk Management

- Inventory
- Controlled use of Administrative Access
- Secure Standard Builds
- Vulnerability Management
- Logging, Monitoring and Alerting
- Vulnerable API Interfaces and Web Services



# Email Spear Phishing

The Root Cause For More Than 85% of Breaches

# Spear Phishing

The image shows a screenshot of an email client window titled "Your Bill Is Now Available - Message (HTML)". The email is from "Account@votfy@verizonwireless.com" and is addressed to several recipients. The subject is "Your Bill Is Now Available". The email body features the Verizon logo and a red banner that reads "IMPORTANT ACCOUNT INFORMATION FROM VERIZON WIRELESS." Below this, the text states: "Your current bill for your account is now available online in My Verizon." and "Total Balance Due: \$2335.58". A red circle highlights the "Total Balance Due: \$2335.58" text. Another red circle highlights a link that says "> View and Pay Your Bill" with a tooltip that displays the URL "http://dancingdivaswear.com/robyn/index.html" and the text "Click to follow link". A third red circle highlights a link that says "> Enroll in Auto Pay". A red callout box on the right side of the email contains the text: "Your current bill for your account is now available online in My Verizon" and "Total Balance Due: \$2335.58". Another red callout box on the right side of the email contains the text: "Keep in mind that payments and/or adjustments made to your account after your bill was generated will not be reflected in the amount shown above." and "> View and Pay Your Bill" with a tooltip that displays the URL "http://dancingdivaswear.com/robyn/index.html" and the text "Click to follow link".

From: Account@votfy@verizonwireless.com  
To: Rogers, Ted; Romes, Randall J.; Ruivo, Roy; Olsen, Craig W.; Olson, Cathy L.; Boston Confirmations; Orlando Confirmations;  
Cc: Sicilia, Teresa  
Subject: Your Bill Is Now Available

Sent: Wed 8/14/2013 10:29 AM

**verizon**

**IMPORTANT ACCOUNT INFORMATION FROM VERIZON WIRELESS.**

Your current bill for your account is now available online in My Verizon.

Total Balance Due: \$2335.58

Keep in mind that payments and/or adjustments made to your account after your bill was generated will not be reflected in the amount shown above.

> [View and Pay Your Bill](http://dancingdivaswear.com/robyn/index.html)  
Want to simplify your bill payment process?  
Click to follow link

> [Enroll in Auto Pay](#)

Thank you for choosing Verizon Wireless.

Verizon. America's Largest 4G LTE Network. [Learn More](#)

© 2013 Verizon Wireless  
Verizon Wireless | One Verizon Way | Mail Code: 180WVB | Basking Ridge, NJ 07920

**Your current bill for your account is now available online in My Verizon**

Total Balance Due: \$2335.58

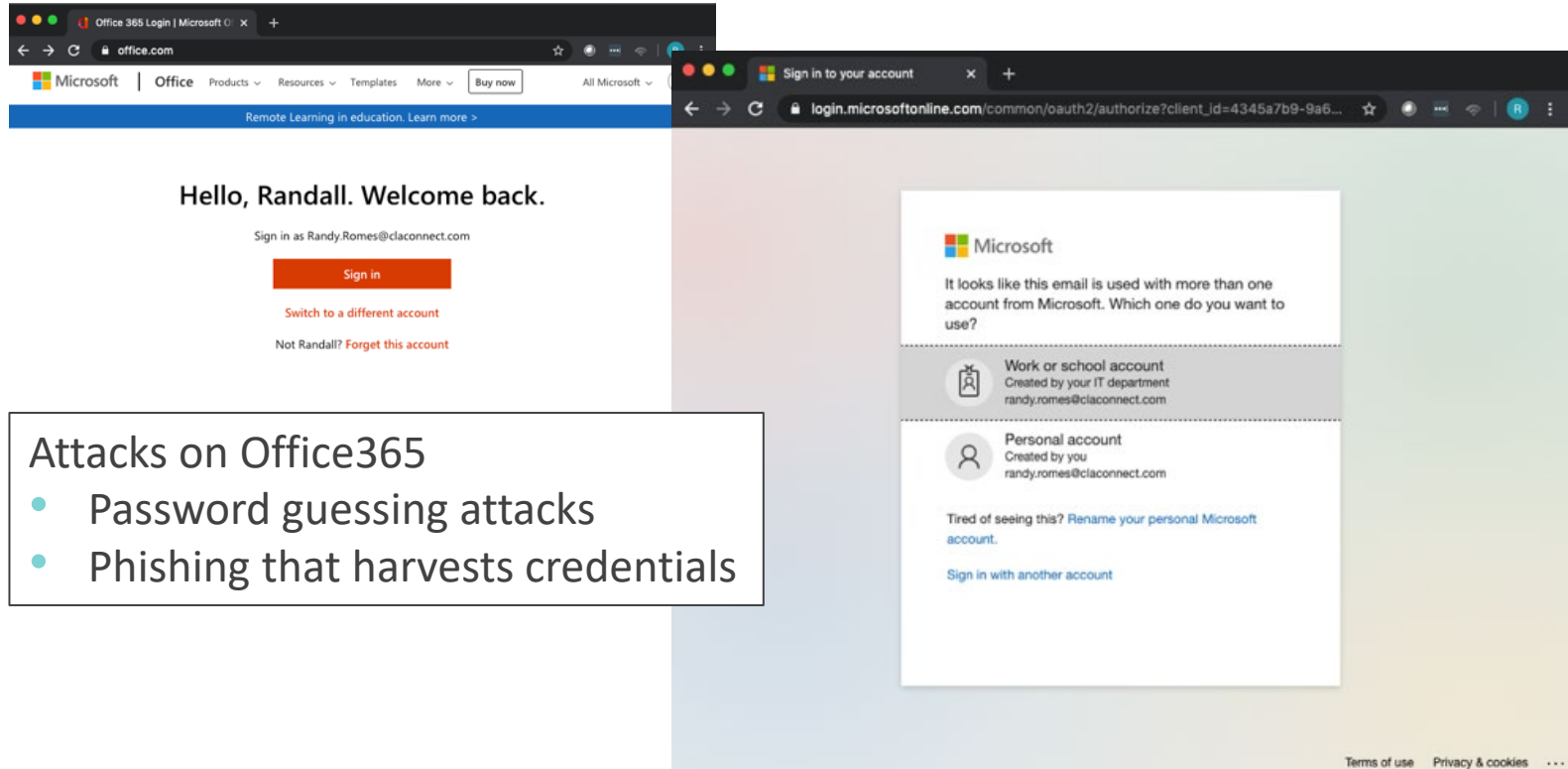
Keep in mind that payments and/or adjustments made to your account after your bill was generated will not be reflected in the amount shown above.

> [View and Pay Your Bill](http://dancingdivaswear.com/robyn/index.html)  
Want to simplify your bill payment process?  
Click to follow link

> [Enroll in Auto Pay](#)



# Credential Harvesting and Password Guessing:



Office 365 Login | Microsoft

office.com

Microsoft | Office Products Resources Templates More Buy now All Microsoft

Remote Learning in education. Learn more >

Hello, Randall. Welcome back.

Sign in as Randy.Romes@claconnect.com

Sign in

Switch to a different account

Not Randall? Forget this account

Microsoft

It looks like this email is used with more than one account from Microsoft. Which one do you want to use?

Work or school account  
Created by your IT department  
randy.romes@claconnect.com

Personal account  
Created by you  
randy.romes@claconnect.com

Tired of seeing this? Rename your personal Microsoft account.

Sign in with another account

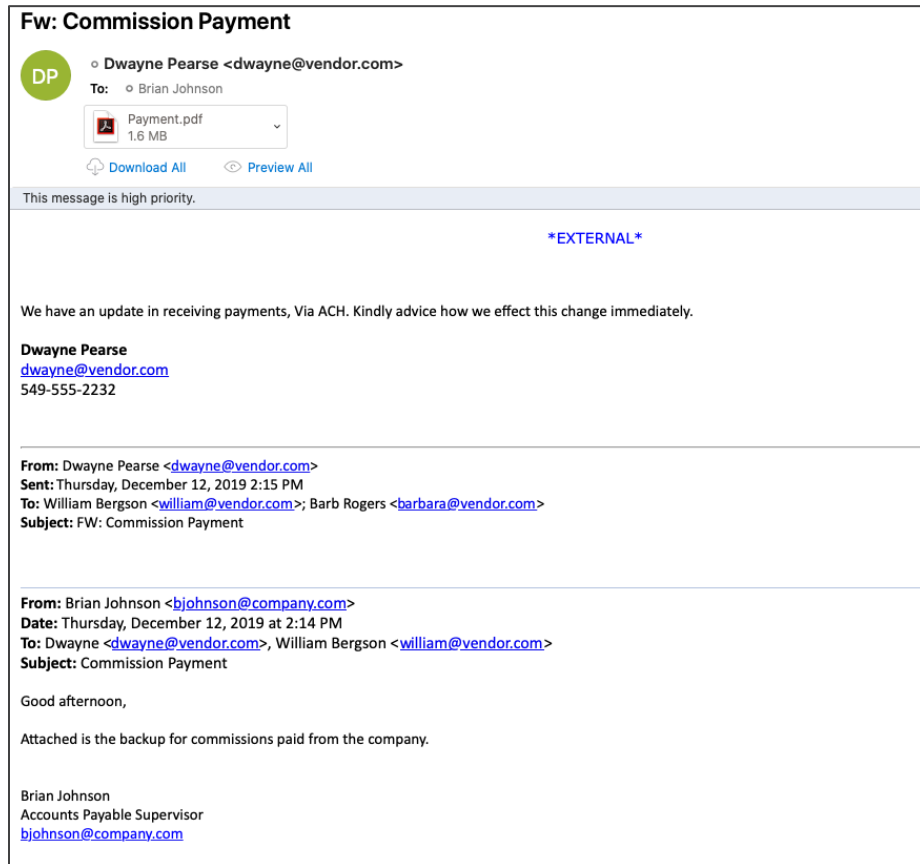
Terms of use Privacy & cookies ...

## Attacks on Office365

- Password guessing attacks
- Phishing that harvests credentials

# Business Email Compromise

- Fraudsters impersonate employees, service providers, or vendors via email in an attempt to...
  - EXAMPLE
  - Finance person phished
  - ...gift cards...
  - IT staff “investigated...”
  - IT staff “shut it down”
  - We are good (right?)



# Business Email Compromise - Examples

- Finance person's email account is compromised....
  - Finance person phished
  - ...gift cards...
  - IT staff "investigated..."
  - IT staff "shut it down"
  - We are good (right?)
- IT Administrator is phished
  - Email
  - Office 365 administrator tenant





# Does Your Organization Already Use a Phishing Service?

- “We already use \_\_\_\_\_”
  - “IT tests our people every \_\_\_\_\_”
  - “Click through rate is \_\_\_\_\_”
  - “Failures are required to take training...”
  - “We report results to the board quarterly...”
- These services are best categorized as training and training effectiveness measurement tools.
- They are NOT penetration testing...
- **There is a “so what factor” that you may be missing...**





# Interference With Operations & Extortion

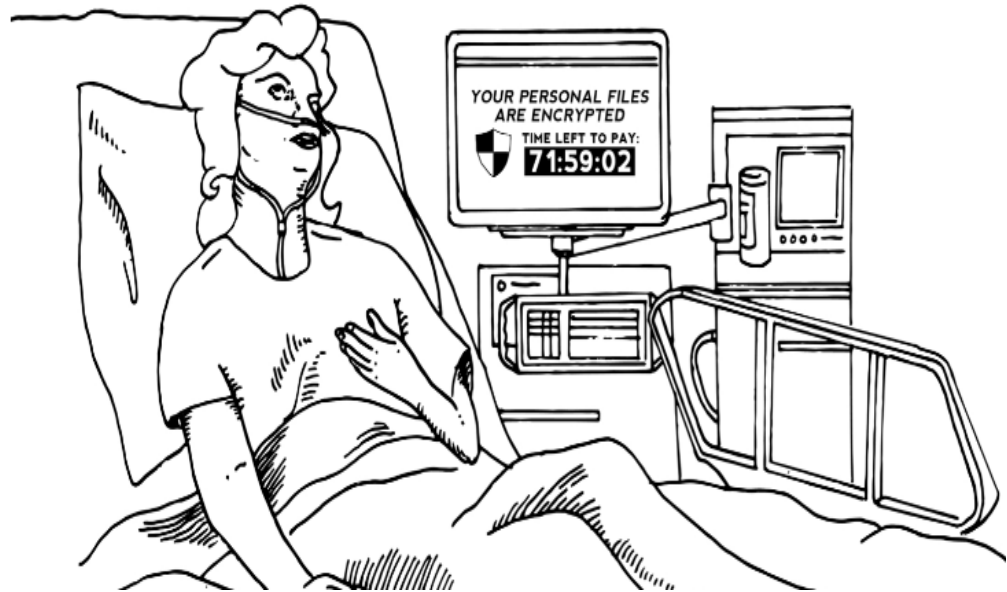
Ransomware is not going away...

# Ransomware

- Ransomware bursts on the scene more than eight years ago...

## Hospital ransomware: A chilling wake-up call

Hollywood Presbyterian was forced to pay up, just like everyone else.



# Ransomware Attacks Continue to Evolve

- Earliest versions attack consumer availability
- 2<sup>nd</sup> generation attacked business availability & confidentiality
- Newest versions
  - Successful against all operating systems
  - Include Internet banking trojans (Zeus Sphinx Trojan)
  - Search for and encrypt back ups first
  - **FINISH with threat of data disclosure (DR is not enough...)**
- **If you have not tested your susceptibility to Ransomware...???**
- **If you have not tested your recovery capabilities, from bare metal up...???**



**Ransomware**



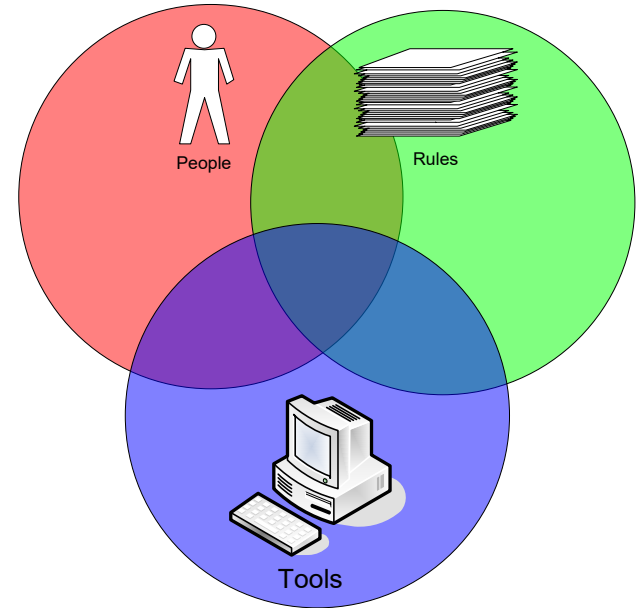


# Standards Based Operations

“People, Rules, and Tools”

# Policies and Standards

- Security is not a product
- People, Rules and Tools
  - What do we expect to occur?
  - How do we conduct business?
  - Who is responsible for what?
- Standards based operations from a governance or compliance framework:
  - HIPAA, GLBA, (State Laws?) ----- Regulatory
  - PCI – DSS, CMMC ----- Contractual
  - CIS Critical Controls, NIST ----- Operational standards



# Standards Based IT and Cyber Operations



V7

## Basic

- 1 Inventory and Control of Hardware Assets
- 2 Inventory and Control of Software Assets
- 3 Continuous Vulnerability Management
- 4 Controlled Use of Administrative Privileges
- 5 Secure Configuration for Hardware and Software on Mobile Devices, Laptops, Workstations and Servers
- 6 Maintenance, Monitoring and Analysis of Audit Logs

## Foundational

- 7 Email and Web Browser Protections
- 8 Malware Defenses
- 9 Limitation and Control of Network Ports, Protocols, and Services
- 10 Data Recovery Capabilities
- 11 Secure Configuration for Network Devices, such as Firewalls, Routers and Switches
- 12 Boundary Defense
- 13 Data Protection
- 14 Controlled Access Based on the Need to Know
- 15 Wireless Access Control
- 16 Account Monitoring and Control

## Organizational

- 17 Implement a Security Awareness and Training Program
- 18 Application Software Security
- 19 Incident Response and Management
- 20 Penetration Tests and Red Team Exercises

<https://www.cisecurity.org/controls/>



cisecurity.org/cis-benchmarks/

# CIS Benchmarks™

With our global community of cybersecurity experts, we've developed CIS Benchmarks: more than 100 configuration guidelines across 25+ vendor product families to safeguard systems against today's evolving cyber threats.

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[Overview of CIS Benchmarks and CIS-CAT Demo](#) [Register for the Webinar](#) [CIS Benchmarks FAQ](#) [Access all Benchmarks →](#)

Thu, Nov 4, at 1:30pm EDT  
Tue, Nov 16, at 11:00am EDT

## CIS Benchmarks

Checklists and How-to guides for just about everything

- Operating Systems
- Server Software
- Network Devices
- Cloud Implementations
- Etc.

Currently showing ALL Technologies. Use the buttons above to filter the list.

Operating Systems	Server Software	Cloud Providers	Mobile Devices	Network Devices	Desktop Software	Multi Function Print Devi...
Cloud Providers	<b>Alibaba Cloud</b> Expand to see related content ↓	<a href="#">Download CIS Benchmark →</a>				
Operating Systems	<b>Aliyun Linux</b> Expand to see related content ↓	<a href="#">Download CIS Benchmark →</a> Build Kit also available				
Operating Systems	<b>Amazon Linux</b> Expand to see related content ↓	<a href="#">Download CIS Benchmark →</a> CIS Hardened Image and Build Kit also available				
Cloud Providers	<b>Amazon Web Services</b> Expand to see related content ↓	<a href="#">Download CIS Benchmark →</a>				
Server Software	<b>Apache Cassandra</b> Expand to see related content ↓	<a href="#">Download CIS Benchmark →</a>				
	Database Server					





# Secure Office 365

- NOT fully secure by default.
- Needs to be secured:
  - Enable/Turn On security features
  - Harden (email) security
  - Fine tune logging, monitoring and alerting
  - Enforce retention periods
- Security configurations need to be periodically assessed.

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Microsoft 365

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- > Get started
- > Overview of the Microsoft 365 admin center
- > Manage users, groups, and passwords
- > Manage email and calendars
- > Manage domains
- > Manage your data and compliance
- > Manage subscriptions and billing
- > Secure your organization
  - Top 10 ways to secure your data
  - Multi-factor authentication for Microsoft 365
  - Set up multi-factor authentication
  - Manage and monitor priority accounts
  - Enable Modern Authentication for Office 2013
  - Pre-requisites for data protection
  - Security features
  - Increase threat protection
  - Threats detected by Microsoft Defender Antivirus
  - Review detected threats and take action
  - Set up compliance features
  - Secure score
  - A guide to GDPR compliance
- > Manage devices and app data
- > Work with customers
- Troubleshoot
- Contact support
- Navigation menu
- Download PDF

## Top 10 ways to secure Microsoft 365 for business plans

10/05/2021 • 14 minutes to read • 10

If you are a small or medium-size organization using one of Microsoft's business plans and your type of organization is targeted by cyber criminals and hackers, use the guidance in this article to increase the security of your organization. This guidance helps your organization achieve the goals described in the Harvard Kennedy School Cybersecurity Campaign Handbook<sup>1</sup>.

Microsoft recommends that you complete the tasks listed in the following table that apply to your service plan.

Number	Task	Microsoft 365 Business Standard	Microsoft 365 Business Premium
1	Set up multi-factor authentication	✓	✓
2	Train your users	✓	✓
3	Use dedicated admin accounts	✓	✓
4	Raise the level of protection against malware in mail	✓	✓
5	Protect against ransomware	✓	✓
6	Stop auto-forwarding for email	✓	✓
7	Use Office Message Encryption		✓
8	Protect your email from phishing attacks		✓
9	Protect against malicious attachments and files with Safe Attachments		✓
10	Protect against phishing attacks with Safe Links		✓

Is this page helpful?

Yes No

In this article

- 1: Set up multi-factor authentication
- 2: Train your users
- 3: Use dedicated admin accounts
- 4: Raise the level of protection against malware in mail
- 5: Protect against ransomware
- 6: Stop auto-forwarding for email
- 7: Use Office Message Encryption
- 8: Protect your email from phishing attacks
- 9: Protect against malicious attachments and files with Safe Attachments
- 10: Protect against phishing attacks with Safe Links

Related content

# Operational Discipline

- Disciplined change management
- Consistent exception control and documentation
  - Should include risk evaluation and acceptance of risk
  - Risk mitigation strategies
  - Expiration and re-analysis of risk acceptance

# Passwords

- Old Rules (NIST – 2005?)
  - Length (8+ characters)
  - Complexity (Aa4@)
  - Forced expiration (every\_\_\_\_\_)
- New Guidance (NIST – 2018?)
  - Looooooooong Passwords
  - No expiration
  - Especially important for administrative accounts (CIS 4)

Password Audit	Total
Number of passwords audited	855
Passwords cracked	794
Passwords that were all letters	63
Passwords that were all numbers	5
Passwords that were an English word	20
Passwords that were a word with numbers appended to it	200
Passwords that were the same as the username	6
Passwords that do not meet Windows complexity	584



# Password Strategies:

- Multi-factor authentication on ALL external systems
- Password management tools
- **Pass Phrases – Loooooong natural language**
  - *Password21* <----- **Unforgiveable!**
  - *Summer21* <----- *Terrible*
  - *N\*78fm/1* <----- *Painful*
  - *Wallet Painting lamp* <--- **GOOD**
  - *The Packers always beat the Bears!* ← **BEST**
- Audit your passwords



# Disaster Recovery & Business Continuity

- Inventory of assets and results of risk assessment are crucial
  - Hardware and software
  - Critical data elements (“the crown jewels”)
    - Data Retention policies and standards
    - Where is the data (if we know where it is, we know where to apply controls)
  - Critical business processes
- Business impact analysis with definition of recovery point objectives
  - This is another name for a specialized type of risk assessment
  - Defines priority for restoration
- Disaster Recovery is periodically practiced
  - Need to make sure it works the way you expect



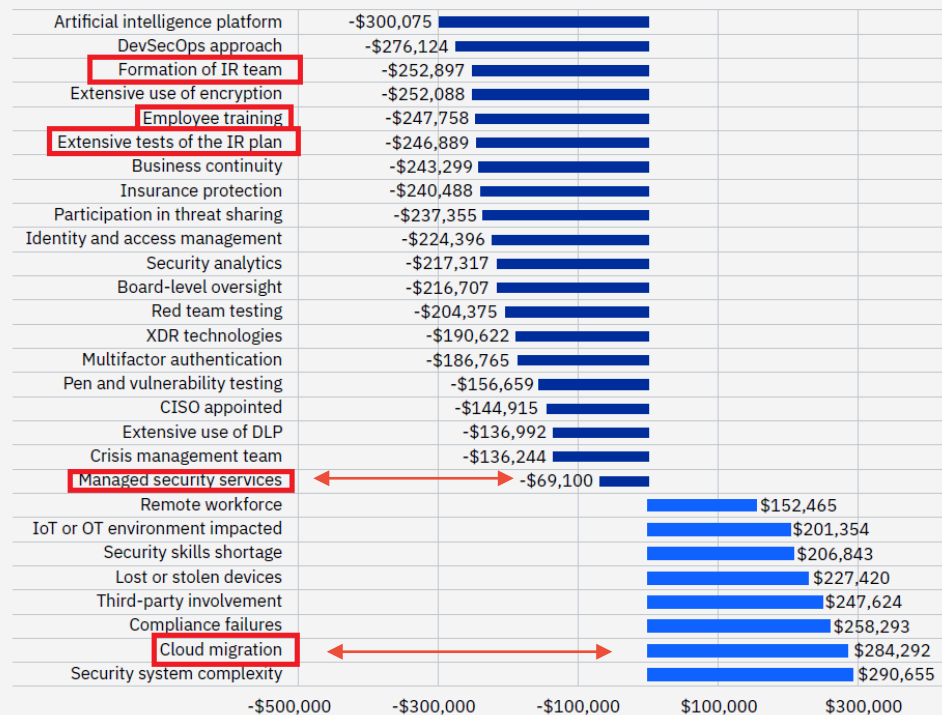
# Practice the Plan

- Tabletop exercises- simulations where participants walk through the incident and response procedures
- Two types of tabletop exercises
  - Technical
  - Management
  - Both types should be conducted annually
- Spear phishing tests and other social engineering tests
- Red Team penetration testing



# Incident Response Preparedness- Cost Savings

Impact of key factors on the average total cost of a data breach



The impact of 28 factors on the average cost of a data breach

\$4.35 Million – The average cost of a data breach in the US



Measured in USD

Source: IBM Security Cost of a Data Breach Report 2022





# Boy Scouts Motto: Be Prepared...

Prepare

Operate

Test

- Standards Based Operations and Exception Management
  - *Daily Operational DNA*
- Regular/periodic risk assessment:
  - *Daily Business as Usual*
- Monitor and fine tune:
  - *Continuous improvement*
- **Practice and Test**
  - Audit your operations controls (against a framework)
  - Review Office 365 (O365) security (periodically)
  - Schedule IR Tabletop and Disaster Recovery exercises
  - Test new systems and after significant change
  - *PROVE IT*





Thank you!



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## 45 - Minute Lunch Break



*We'll get you there.*

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# Federal Procurement Under Uniform Guidance

# Learning Objectives

- *At the end of the session, you will be able to:*
  - Identify common auditing findings related to procurement under the Uniform Guidance
  - Recognize the importance of grant compliance
  - Recognize administrative requirements for procurement
  - Identify grants management best practices



# Important of Grant Compliance

# Pros and Cons of Receiving Federal Grants

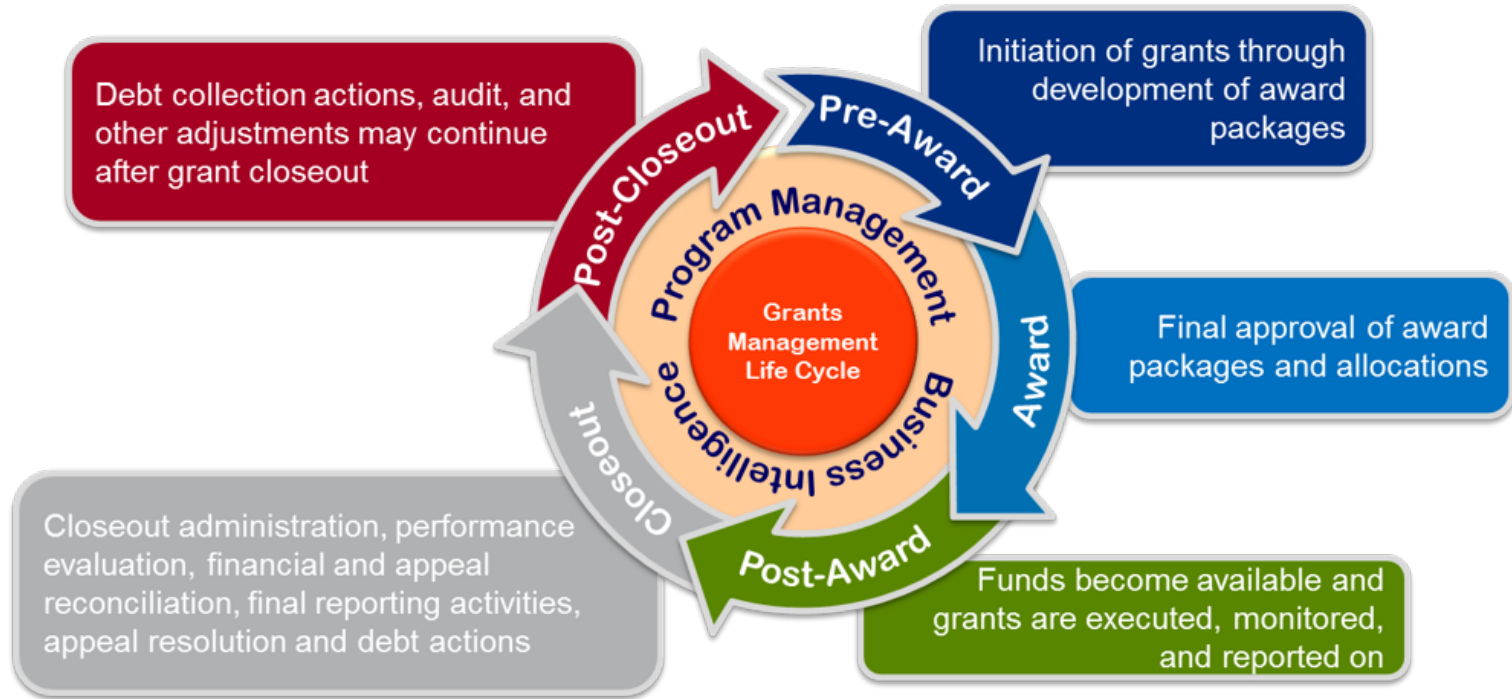


Additional funding for programs that support mission of organization



Administrative work, procurement regulations, record keeping, reporting, audits

# Grant Lifecycle



# What Is a Grant Compliance Program?

Ensuring that terms and conditions of grants are being met/followed:

- Budgets
- Reporting
- Procurement



Cornerstone of proper grants management



# Effective Grant Compliance

Effective grant compliance relies on having:

An in-depth  
understanding  
of the grant  
requirements

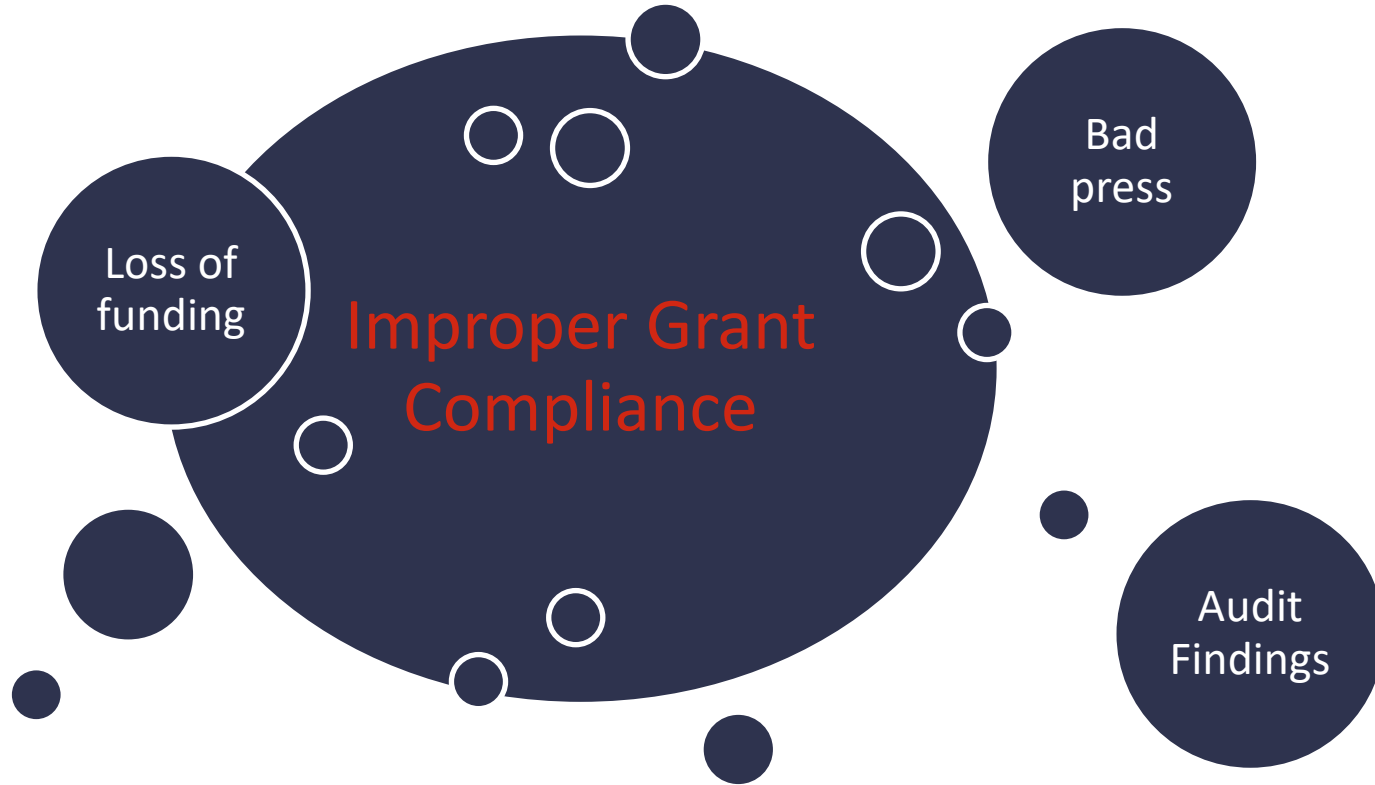
Proper  
policies and  
procedures in  
place

Strong  
internal  
controls

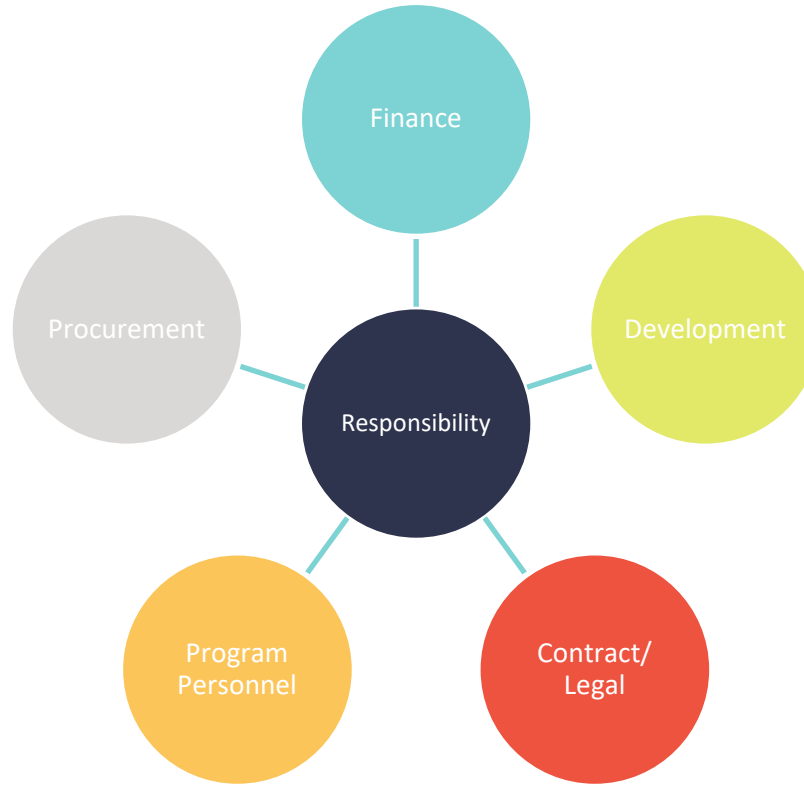
Resources and  
personnel



# Why Is Grant Compliance Important?










# Grant Compliance Responsibility





# Procurement Requirements

# Applicability of Subpart D (Admin Requirements)

Title 2 / Subtitle A / Chapter II / Part 200 / Subpart B			<a href="#">Previous</a> / <a href="#">Next</a> / <a href="#">Top</a>	
 Table of Contents  Details  Print/PDF  Display Options  Subscribe <hr/>  Timeline  Go to Date  Compare	 Expand Table	The following portions of this Part	Are applicable to the following types of Federal Awards and Fixed-Price Contracts and Subcontracts (except as noted in <a href="#">paragraphs (d) and (e)</a> of this section):	Are NOT applicable to the following types of Federal Awards and Fixed-Price Contracts and Subcontracts:
		Subparts C-D, except for <a href="#">§§ 200.203</a> Requirement to provide public notice of Federal financial assistance programs, 200.303 Internal controls, 200.331-333 Subrecipient Monitoring and Management	- Grant Agreements and cooperative agreements	- Agreements for loans, loan guarantees, interest subsidies and insurance. - Procurement contracts awarded by Federal Agencies under the Federal Acquisition Regulation and subcontracts under those contracts.



# Must vs. Should

When the Uniform  
Guidance References:

MUST = Requirement

SHOULD = Best Practice,  
Suggestion,  
Recommendation

# What Do Uniform Guidance Procurement Requirements Apply To?

- Goods and services charged to (or used for match for)
  - ✗ Non-Federal program
  - ✗ Indirect cost pool
  - ✓ Federal award

Source: COFAR FAQ .320-5

# Procurement (200.318-327)

## Uniform Guidance Provisions:

- **§200.318 General procurement standards.**
- **§200.319 Competition.**
- **§200.320 Methods of procurement to be followed.**
- **§200.321 Contracting with small and minority businesses, women's business enterprises, and labor surplus area firms.**
- **§200.322 Domestic preferences for procurements.**
- **§200.323 Procurement of recovered materials..**
- **§200.324 Contract cost and price**
- **§200.325 Federal awarding agency or pass-through entity review.**
- **§200.326 Bonding requirements.**
- **§200.327 Contract provisions.**





# I – Procurement Procedures §200.318(A)

- Must have and use documented procurement procedures:
  - Consistent with state, local, and tribal laws and regulations and the standards of this section, for the acquisition of property or services required under a Federal award or subaward.
  - The non-Federal entity's documented procurement procedures must conform to the procurement standards identified in [§§ 200.317](#) through [200.327](#).

# Procurement (200.318(B))

Entities must maintain oversight to ensure that contractors perform in accordance with the

terms

conditions

and specifications

of their contracts or purchase orders

# Individual Conflict of Interest (200.318(C)(1))

Need to have documented policy stating that:

No

-employee,

-officer,

-member of governing board

-or agent, advisor, consultant, attorney, accountant or  
shareholder

may participate in the selection, award, or  
administration of a contract supported by a Federal  
award if he or she has a real or apparent conflict of  
interest.



# Conflict of Interest – Interested Parties

- This also includes immediate family and other persons directly connected to the interested party by law or through a business arrangement.

# Individual Conflict of Interest

A financial interest may include:

Employment

Stock  
ownership

A creditor or  
debtor  
relationship

Or prospective  
employment with  
the organization  
selected or to be  
selected for the  
contract or  
subaward

# Procurement (200.318)

Organizational conflicts of interest means that because of relationships with:

- a parent company,

- affiliate,

- or subsidiary organization,

the non-Federal entity is unable or appears to be unable to be impartial in conducting a procurement action involving a related organization

# I – Procurement Procedures §200.318(D)



Procedures must avoid acquisition of unnecessary or duplicative items.

Consideration should be given to consolidating or breaking out procurements to obtain a more economical purchase.

Where appropriate, an analysis should be made of lease versus purchase alternatives, and any other appropriate analysis to determine the most economical approach.

# I – Procurement §200.318(H)

Organizations must award contracts only to responsible contractors:

Contractors must possess the ability to perform successfully under the terms and conditions of a proposed procurement.

Consideration will be given to such matters as contractor integrity, compliance with public policy, record of past performance, and financial and technical resources.



# Suspension and Debarment

Checks for contracts over \$25,000 should be made on the EPLS site – ([www.sam.gov](http://www.sam.gov))



Or add in the clause in the procurement contract



Keep documentation



Best practice recommendation is to do this on every procurement with federal funds!



# Procurement Records (200.318(I))

For ALL procurements:

- Detail history of the procurement [different for each procurement method]
- Rationale for method of procurement
- Selection of contract type
- Contractor selection or rejection
- Basis for contract price



# Competition (200.319)

All procurement transactions must be conducted in a manner providing full and open competition consistent with the standards of this section.

In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, or invitations for bids or requests for proposals must be excluded from competing for such procurements.

# Competition (200.319)

Some of the situations considered to be restrictive of competition include but are not limited to:

- (1) Placing unreasonable requirements on firms in order for them to qualify to do business;
- (2) Requiring unnecessary experience and excessive bonding;
- (3) Noncompetitive pricing practices between firms or between affiliated companies;
- (4) Noncompetitive contracts to consultants that are on retainer contracts;
- (5) Organizational conflicts of interest;
- (6) Specifying only a “brand name” product instead of allowing “an equal” product to be offered and describing the performance or other relevant requirements of the procurement; and
- (7) Any arbitrary action in the procurement process.

# Competition (200.319)

Must have  
*written*  
procedures for  
procurement  
transactions.

# Competition (200.319)

These procedures must ensure that all solicitations:

Incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured.

The description may include a statement of the qualitative nature of the material, product or service to be procured and, when necessary, must set forth those minimum essential characteristics and standards to which it must conform if it is to satisfy its intended use.



# Competition (200.319)

These procedures must ensure that  
all solicitations:

When it is impractical or uneconomical to make a clear and accurate description of the technical requirements, a “brand name or equivalent” description may be used as a means to define the performance or other salient requirements of procurement.

Identify all requirements which the offerors must fulfill and all other factors to be used in evaluating bids or proposals.

# Competition (200.319)

If prequalified lists are used, organizations must ensure that all lists are current and include enough qualified sources to ensure maximum open and free competition

Must not preclude potential bidders from qualifying during the solicitation period

Have a regularly scheduled review and update of lists



# Procurement

- Uniform Guidance allows for 5 acceptable procurement methodologies

# §200.320 Methods of Procurement

Method	Dollar Threshold
Micro-purchase	Not to exceed micro-purchase threshold (\$0 - \$10,000)
Small purchase procedure	Greater than micro-purchase, not to exceed the Simplified Acquisition Threshold (\$10,001 - \$249,999)
Sealed bid	Greater than the Simplified Acquisition Threshold (\$250,000 and greater)
Competitive proposal	Greater than the Simplified Acquisition Threshold (\$250,000 and greater)
Noncompetitive proposal (Sole Source)	Greater than micro-purchase threshold (\$10,000 and greater)



# §200.320(a) Micro-Purchases

## Characteristics

- Acquisitions that, in aggregate, do not exceed micro-purchase threshold
- Micro-purchase threshold set by Federal Acquisition Regulation (FAR) at 48 CFR, Subpart 2.1
  - Subject to change
  - Currently \$10,000

## Requirements and Documentation

- No quotes required if price is reasonable
- Distribute equitably among qualified suppliers
- **Must** document:
  - Evidence the price was considered reasonable
  - If documented procedures note that the reviewer/approver is to look at price reasonableness along with allowability, that would satisfy this documentation

# §200.320(B) Small Purchases

## Characteristics

- Acquisitions more than micro-purchases but not greater than simplified acquisition threshold
- Simplified Acquisition Threshold set by FAR at 48 CFR, Subpart 2.1
  - Subject to change
  - Currently \$250,000

## Requirements and Documentation

- Price or rate quotations **must** be obtained from adequate number of sources (at least 2)
- Can be informal – phone call or web search
- All quotations, including phone calls, web searches, etc., **must** be documented and kept on file
- Price does not need to be deciding factor but all quotes need to be kept in procurement records

# §200.320(C) Sealed Bids

## Characteristics

- Procurements more than simplified acquisition threshold
- The following should be present:
  - A complete, adequate, and realistic specification or description is available
  - Two or more bidders are willing and able to compete
- Procurement lends itself to a firm fixed price contract and the selection can be made principally on basis of price

## Requirements and Documentation

- Bids **must** be solicited from an adequate number of known suppliers, providing sufficient response time
- Local and tribal governments **must** be publicly advertised bids
- Invitation for bids **must** define the items or services in order for bidders to properly respond
- All bids will be opened at time and place prescribed in invitation – local and tribal governments **must** be opened publicly
- Firm fixed price contract made in writing to the lowest responsive and responsible bidder
- Any or all bids may be rejected if there is a sound documented reason

# §200.320(D) Competitive Proposals

## Characteristics

- Procurements more than simplified acquisition threshold
- Normally conducted with more than one source submitting an offer
- Either a fixed price or cost-reimbursement type contract is awarded
- Generally used when conditions not appropriate for sealed bids

## Requirements and Documentation

- **Must** be publicized and identify all evaluation factors and their relative importance.
- **Must** be solicited from an adequate number of qualified sources
- **Must** have a written method for conducting technical evaluations of the proposals and selecting recipients
- Contracts **must** be awarded to the responsible firm whose proposal is most advantageous to the program, with price and other factors considered

# §200.320(F) Noncompetitive Procurements

## Characteristics

- Procurement through the solicitation of a proposal from only one source
- May be used only when:
  - The item is available only from a single source
  - The public exigency or emergency will not permit a delay resulting from competitive solicitation
  - Federal awarding agency or pass-through entity expressly authorizes its use in response to a written request
  - After solicitation of a number of sources competition is determined inadequate

## Requirements and Documentation

- Justification of the use of sole source needs to be documented
- Document any research on availability from multiple sources
- Retain documentation of authorization
- Document any initial solicitations from multiple sources which are concluded to be inadequate, and document why

# Contracting with Small and Minority Businesses, Women's Business Enterprises, and Labor Surplus Area Firms.(200.321)

The non-Federal entity must take all necessary affirmative steps to assure that minority businesses, women's business enterprises, and labor surplus area firms are used when possible.



# Contracting (200.321)

## Affirmative steps must include:

- Placing qualified small and minority businesses and women's business enterprises on solicitation lists;
- Assuring that small and minority businesses, and women's business enterprises are solicited whenever they are potential sources;
- Dividing total requirements, when economically feasible, into smaller tasks or quantities to permit maximum participation by small and minority businesses, and women's business enterprises;
- Using the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Minority Business Development Agency of the Department of Commerce; and
- Requiring the prime contractor, if subcontracts are to be let, to take affirmative steps

# §200.321

## Small Business Enterprises:

- Website: <http://dsbs.sba.gov>
- Search based on specific NAICS codes (<http://www.naics.com/search/>)

## Minority Business Enterprises and Women's Business Enterprises:

- Website: <http://www.sba8a.com/>
- Search based on Industry code and/or state location

## Labor Surplus Area Firms:

- Website: <https://www.doleta.gov/programs/lisa.cfm>
- Note that this list is updated on an annual basis and therefore look under “related links” box to find latest list issued by DOL

## §200.322 Domestic Preferences for Procurements

- As appropriate and to the extent consistent with law, the non-Federal entity should, to the **greatest extent practicable** under a Federal award, provide a preference for the purchase, acquisition, or use of goods, products, or materials produced in the United States (including but not limited to iron, aluminum, steel, cement, and other manufactured products).
- The requirements of this section must be included in all subawards including all contracts and purchase orders for work or products under this award.



# Cost or Price Analysis (200.324)

Non-Federal entity must perform a cost or price analysis in connection with every procurement action in excess of the Simplified Acquisition Threshold (\$250,00) including contract modifications.

**Price analysis** strategy identifies the best price, which requires performing a marketplace competition comparison.

**Cost analysis**, a more complex process, is a in-depth assessment of the direct and indirect costs leading to the final price of the product or service. Need to get breakdown of cost from vendor.

## §200.324 Contract Cost and Price

(b) The non-Federal entity **must** negotiate profit as a separate element of the price for each contract in which there is no price competition and, in all cases, where cost analysis is performed.

# §200.323 Contract Cost and Price

To establish a fair and reasonable profit, consideration must be given to:

- the complexity of the work to be performed
- the risk borne by the contractor, the contractor's investment
- the amount of subcontracting
- the quality of its record of past performance
- industry profit rates in the surrounding geographical area for similar work



# Subrecipient vs. Vendor

# Subrecipient Monitoring (200.330-332)



Subaward is for the purpose of carrying out a portion of a federal award and creates a federal assistance relationship



Subrecipient: determines eligibility, has performance measured in relation to objectives of program, has responsibility for programmatic decision making; and uses the Federal funds to carry out a program for a public purpose



# Subrecipient Monitoring

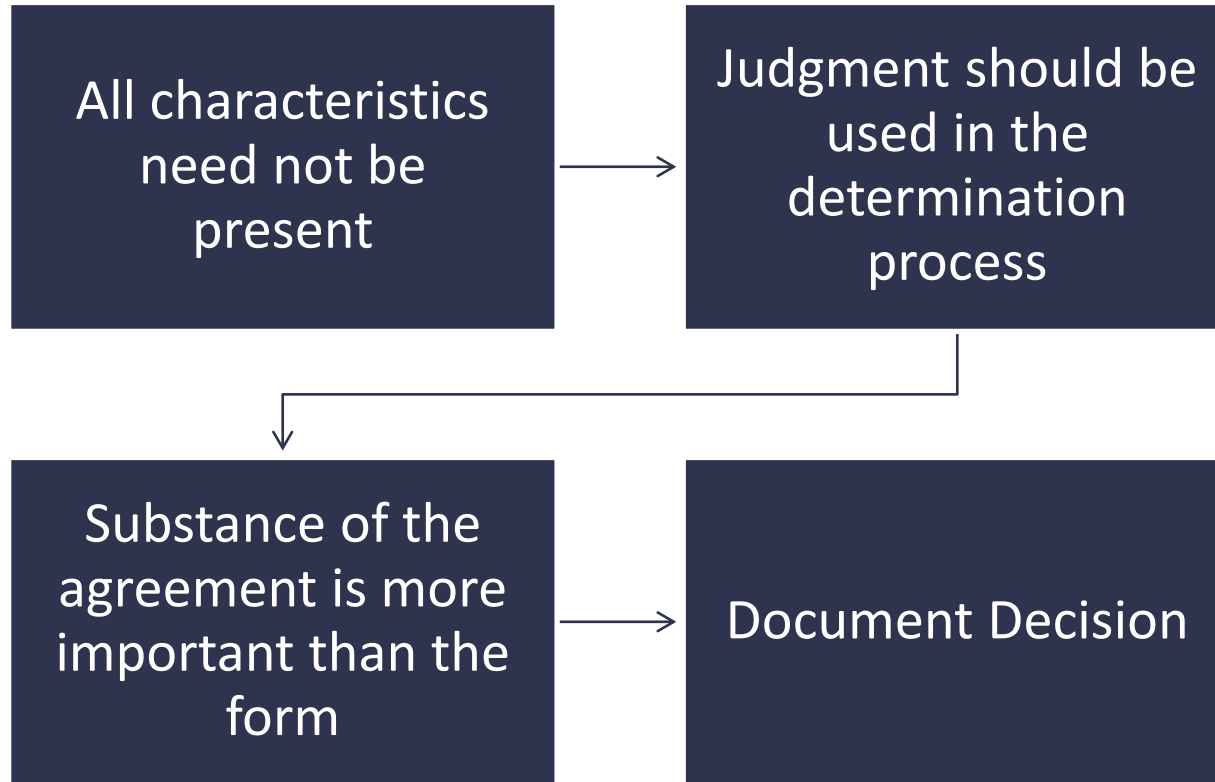


Contract is for the purpose of obtaining goods and services for the non-federal entity's own use and creates a procurement relationship



Contractor: Provides the goods and services normally, provides similar goods or services to many different purchasers; provides goods or services for the benefit of the pass-through entity

# Subrecipient/Contractor Determination





# Grants Management Best Practices

# Grants Compliance

Read through  
grant  
agreement for  
terms and  
conditions

Read through  
Uniform Grant  
Guidance &  
Compliance  
Supplement

Obtain Proper  
Training



# Policy Review and Revisions



Document compliance requirements



Document proper internal controls over compliance

# Checklists

Develop checklists for all aspects of the grant process, such as:

Procurement

Grant application process

Preparation for the single audit

Subrecipient risk assessment and monitoring


Submission of financial and program reports

Grant close-out




# Policy Review and Revisions

Designate key individual or team to monitor your policies over federal programs.



Regularly review policies for compliance and educate employees on changes to policies. Encourage open dialogue regarding questions and decision making.



Make sure policies are easily accessible for all employees involved and they know that they are responsible for reviewing these.



# Thank You!



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# GASB 87 Practical Application

# Learning Objectives

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

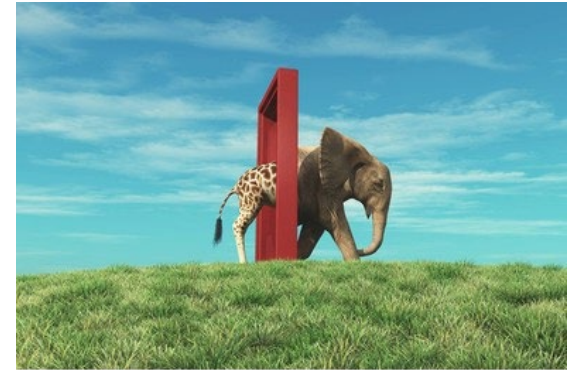
- Identify guidance related to GASB 87 – Leases and GASB 96 – what are the impacts of these Standards on their financial statements and the users of the financial statements
- Identify how to take the necessary steps to implement the new standard
- Identify implementation best practices
- Identify what qualifies as a lease under GASB 87
- Recognize what your auditor will need to audit your GASB 87 work
- Identify how to ready yourself for GASB 96 - SBITA

# Implementation Date for GASB 87 – NOW!



# Biggest Changes

- Operating leases are removed from lease classification; all leases are financings of the right-to-use an underlying asset
- Lessors will mirror lessees and recognize a lease receivable and corresponding deferred inflow of resources, while continuing to report the asset underlying the lease (distinctions of Sales-type, Direct-financing and Operating leases are removed)
- Lessor lease revenue recognized from amortizing the deferred inflow of resources
- Increased financial statement disclosures
- Concept of contracts that transfer ownership
- NOTE:
  - Ability to amortize the lease assets as a group rather than individually



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# Practical Application - Implementation

- For leases that were reported as operating leases prior to the implementation of Statement 87, should a government determine what the lease asset would have been on the date of implementation if it initially had been recognized and amortized in prior periods as a lease under the provisions of Statement 87?
- No. Paragraph 94 of Statement 87 states that leases should be measured using the facts and circumstances that existed at the beginning of the period of implementation. The government is not required to estimate what the lease asset would have been if it initially had been recognized and amortized in prior periods as a lease under the provisions of Statement 87. The lease liability should be measured using the remaining lease term and discount rate as of the beginning of the earliest period restated. The right-to-use asset should be measured based on the lease liability at that date and no restatement of beginning net position would be required because the lease asset and the lease liability would be the same.
- Implementation Guide 2019-3, Leases



# Financial Statement Impact (Lessee)– Financing & Short-Term Lease

Longer-term  
leases

Short-Term  
Lease

Statement of Net Position	Statement of Activities	Statement of Cash Flows
<ul style="list-style-type: none"> <li>Intangible Right-to-Use Asset (subject to GASB 42 impairment guidance)</li> <li>Lease Liability</li> </ul>	<ul style="list-style-type: none"> <li>Amortization expense</li> <li>Interest expense</li> <li>Payments first allocated to accrued interest liability and then to lease liability</li> </ul>	<ul style="list-style-type: none"> <li>Interest &amp; Lease Principal = Capital &amp; Related Financing</li> </ul>
<p>N/A</p> <p>(unless payments are made in advance or subsequent to the reporting period)</p>	<ul style="list-style-type: none"> <li>Lease expense</li> <li>Based on payment provisions of the contract</li> <li>Not straight-lined for rent holiday</li> </ul>	<ul style="list-style-type: none"> <li>Operating</li> </ul>

Similar to former Operating Lease treatment under GASB 13





# Accounting for Leases – Where do I start?

Completeness of the lease population

# Inventory of Potential Leases

- Remember that a contract could be a lease even if the word lease never appears in the contract!
- Is lease origination and accounting centralized or decentralized?
  - Different departments may need to provide input – procurement, legal, etc.
- Compare draft lease schedule to prior year capital lease and operating lease disclosure information for consistency – This is a good starting point.
- Review the accounts payable subledger or a listing of disbursements by vendor to identify any apparent recurring payments.
  - Perform data analytics to identify any payments that might have been missed.
- Review general ledger detail for expenditure accounts where lease payments were recorded prior to GASB 87 implementation.
- Review governance minutes and approved budgets



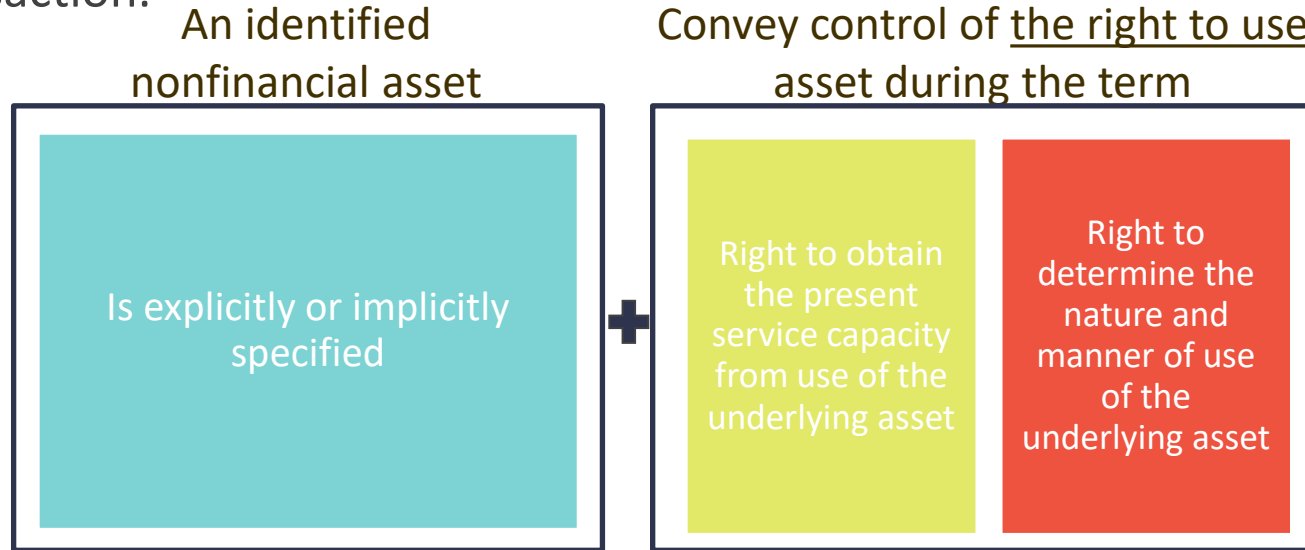


# What Should be Included in the Lease Population?

- Determine which contracts meet the definition of a lease under GASB 87
- Review lease contracts for multiple components, such as multiple asset components and service components
- Certain contracts that can be excluded
  - Software licensing contracts (GASB 96)
  - Service concession arrangements (GASB 60/94)
  - Contracts relating to biological assets, intangible assets, licensing contracts, inventory, or supply contracts
  - Contracts financed with outstanding conduit debt (GASB 91)
- Documentation of the work around pulling the lease population is key for the audit

# Definition of a Lease

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



# Practical Application – Is There an Exchange Transaction?

- Example - A government leases land, which has a market rent of \$100,000 per year, for \$1 per year. Should the government apply the guidance in Statement 87 to that transaction?
- No. The government is not receiving equal or essentially equal value for what it is giving up. GASB 87 would not apply in this example.
- *Implementation Guide 2019-3, Leases*

# Practical Application – Present Service Capacity

- A developer builds and leases a building to a government. The government is required to make payments during the three-year construction period. The government does not have access to the building until a certificate of occupancy is issued at the end of the construction period. When does the lease term begin?
- The lease term commences when the lessee gains physical possession of the asset or attains access to use the underlying asset. Payments made before commencement of the lease term should be reported as prepayments. At the commencement of the lease term, the prepayments should be reclassified as part of the initial measurement of the lease asset.
- *Implementation Guide 2019-3, Leases*



# Practical Application – Interrupted Access

- A lessee does not need to have uninterrupted access to an underlying asset for the arrangement to be considered a lease.
- A government should assess whether it has (a) the right to obtain the present service capacity from use of the underlying asset and (b) the right to determine the nature and manner of use of the underlying asset “as specified in the contract”. If the contract specifies that the government has control of those rights during three days of each week, the control criterion is met.
  - As an example, a government enters a three-year contract for the right to use a piece of equipment. Because the government only needs the equipment on a seasonal basis, the contract states that the government only has the right to use the equipment from January through March for each of those three years. Based on the contract, the government has control of the right to use the equipment during those three months each year and does not have an option to extend the right to use the equipment. In this example, the maximum possible term is nine months.
- *Implementation Guide 2019-3, Leases*



# Practical Application – Right to Determine Nature and Manner of Use

- What if the contract required the lessee to allow others to use the asset if they were not using it?
- If the lessee is not able to prevent others from using the asset during the period specified in the contract, they do not have the right to determine the nature and manner of use. The contract would not meet the definition of a lease in GASB 87.
- *Implementation Guide 2019-3, Leases*

# Bargain Purchase Options

When does the asset transfer ownership:

Per GASBS No. 87, paragraph 19 "a contract that (a) transfers ownership of the underlying asset to the lessee by the end of the contract and (b) does not contain termination options, but that may contain a fiscal funding or cancellation clause that is not reasonably certain of being exercised, should be reported as a financed purchase of the underlying asset by the lessee or sale of the asset by the lessor."



Per paragraph B14 of GASB Statement No. 87 (Basis for Conclusions), "the presence of a bargain purchase option in a lease contract is not equivalent to a provision that transfers ownership of the underlying asset." For that reason, a lease that contains any purchase option, including a bargain purchase option, should not be treated as a financed purchase or sale until that option is exercised.

# Categories of Leases



## Short-Term Leases

Maximum lease term is 12 months or less, including options to extend, regardless of probability of being exercised.

Recognize expense (lessee) and revenue (lessor) based on contract provisions, as due

NOT INCLUDED IN LEASE SCHEDULE



## Contracts that Transfer Ownership

Term typically longer than 12 months  
Recognize a sale of the underlying asset (gain or loss)

NOT INCLUDED IN LEASE SCHEDULE



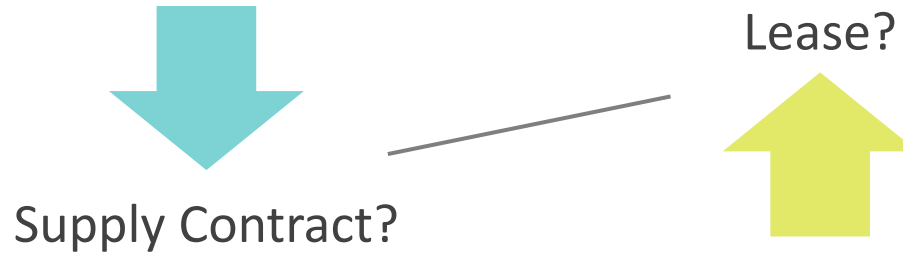
## Long-term Leases – INCLUDED IN THE LEASE POPULATION

Longer than 12 months





# Supply Contract vs. Lease



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## Supply Contracts

Contracts that are intended to result in the purchase or sale of a *commodity* used in the normal course of operations.


---

Normally do not convey the right to use the underlying asset.


**But wait....BEWARE OF THE EMBEDDED LEASE!!**

# Example: Supply Contract


To obtain access to additional power during the warmest months of the year, Entity A enters into a contract with a Company B for electricity from March through October for three years.



Entity A makes fixed payments to obtain exclusive rights to the present service capacity and to determine the nature and manner of use of the turbine used to generate the electricity.



In addition, the government makes variable payments that are based on actual usage and output.



Does this contract include a lease?



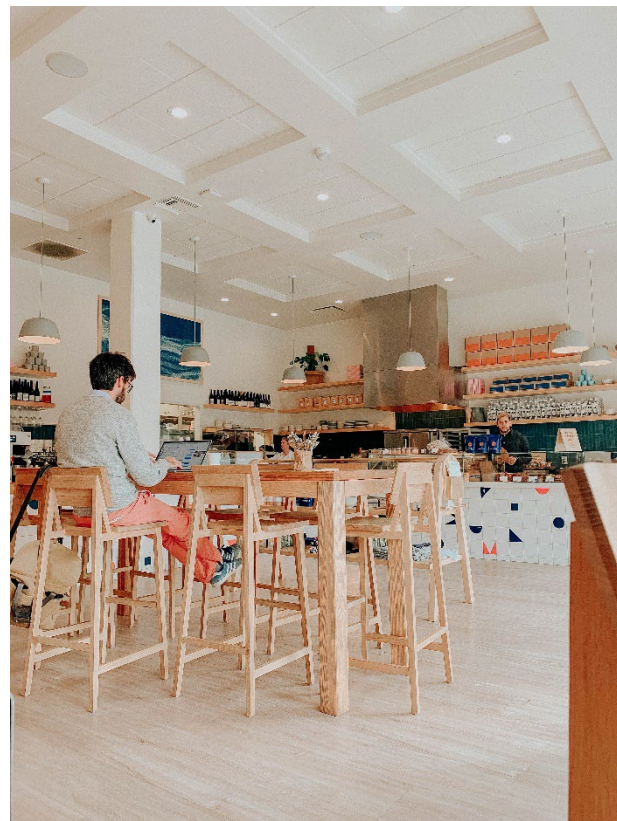
# Answer: Supply Contract

- Yes!
- While the Board stated that GASB 87 does not apply to supply contracts, this contract conveys control of the right to use the underlying asset (implicit asset = turbine) as specified in the contract for a period of time in addition to the right to the output generated by the underlying asset.
- The portion of the contract that requires fixed payments pertains to the full control of the asset (assumed to be a turbine) and meets the definition of a lease.
- *Implementation Guide 2019-3, Leases*



# Other Examples of Embedded Leases in Service Contracts

- Cafeteria
- Service contracts
- Water coolers
- Cell phone antennae
- Transportation or construction arrangements



# Separating Lease and Non-lease Components

Separate lease components from non-lease components (e.g., copy machine plus toner cartridges)



Services are non-lease components (e.g., maintenance, CAM, utilities)



Allocate the contract price based on 'reasonable' individual component prices



Maximize the use of observable information in estimates, if individual prices are not available or unreasonable



**Only** if estimating individual prices is **not practical**, may multiple component contracts be accounted for as a single lease unit

GASB: 'inconvenient' does not fall under 'not practical'!





# Measuring Leases – What steps do I Take?

Accuracy of the lease schedule

# Key Calculation Information to Document

- Lease commencement date (date of ownership of leased asset)
- Understanding of underlying asset (type, estimated useful life, etc)
- General description of lease (for footnote disclosure)
- Lease term
  - It's critical that this determined correctly!
  - Must document conclusions concerning how the lease term was determined, since judgment may be involved
- Payment information – frequency/timing of payments, variable payments
  - Since this is calculated using PV, frequency will impact the balance, leases need to be calculated specifically to how the contract is written
- Interest rate
  - Must document conclusions concerning how the interest rate was determined, since judgment may be involved



# Lease Term

- The lease term is the period during which a lessee has a noncancelable right to use an underlying asset, plus the following periods, if applicable:
- Keep in mind, these must be reasonably certain (of being/not being) exercised, based on all relevant factors...
  - Periods covered by a lessee's option to extend the lease
  - Periods covered by a lessee's option to terminate the lease
  - Periods covered by a lessor's option to extend the lease
  - Periods covered by a lessor's option to terminate the lease





# Practical Application – Cancellable Periods



Periods for which both the lessee and the lessor have an option to terminate the lease without permission from the other party shall be excluded from the lease term as cancellable periods.



The presence of cancellation penalties does not affect this conclusion.



*Implementation Guide 2019-3, Leases*



# Calculation of Lease Asset and Liability

- Included in calculation of present value for lease asset and lease liability:
- Variable Payment that is “fixed in substance”
  - Example: Copier lease with a minimum of 1,000 pages at \$0.05 per copy are included in the payment each month would be included as "fixed in substance" payment of \$50 each month.
- Variable Payment based on an index or rate (like CPI)
  - Future lease payments are assumed to increase as if the index rate remains the same as the current rate through the entire lease term
- Fixed Payments
- Excluded in calculation of present value for lease asset and lease liability:
- Variable Payment based on performance
  - Required to disclose the terms of the variable payment in the footnote
  - Example: Copier lease with an additional payment per copy used
  - Example: Fee based on number of antenna's with no base fee



# Initial Direct Costs

Costs to originate a lease incurred in transactions with independent third parties that:

Result directly from and are essential to acquiring that lease and

Would not have been incurred had that leasing transaction not occurred

Certain costs directly related to specified activities performed by the lessor for that lease.

Examples:

Evaluating the prospective lessee's financial condition

Evaluating and recording guarantees, collateral, and other security arrangements

Preparing & processing lease documents

Negotiating lease terms

Closing the transactions





# Lessee – Full Accrual Journal Entries

Governmental and Business-Type Activities, Proprietary Funds

# First Year's Journal Entries

1

Debit to Right-of-use Asset and Credit to Lease Liability for present value of lease payments at commencement

2

Debit to amortization expense and credit to accumulated amortization

3

For payments, Debit to Lease Liability and Interest Expense, and Credit to Cash based on amortization schedule

# Subsequent Entries

Credit to Cash and Debit to Lease Liability and Interest Expense based on amortization schedule

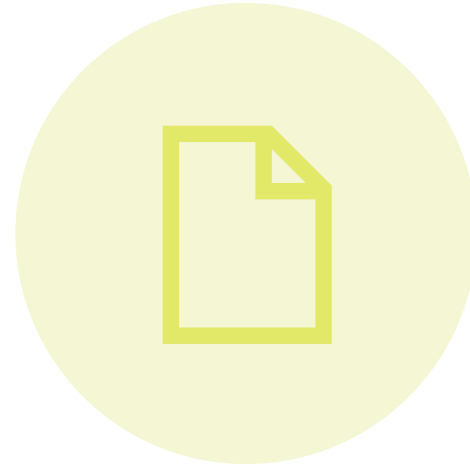


Debit to Amortization Expense and Credit to Accumulated Amortization on right of Use Asset in systematic and rational manner

# Statement of Cash Flows



Cash flows included in capital  
and related financing section



Inflow for a lessor and  
outflow for a lessee



# Lessee – Modified Accrual Journal Entries

Governmental Funds



# First Year's Journal Entries

## Transaction

- Debit to Expenditure and Credit to Other Financing Source for present value of lease payments

## Transaction

- For payments, Debit to Lease Principal and Interest Expense, and Credit to Cash based on amortization schedule.


## Impact

- Impact to both governmental fund and budgetary statements

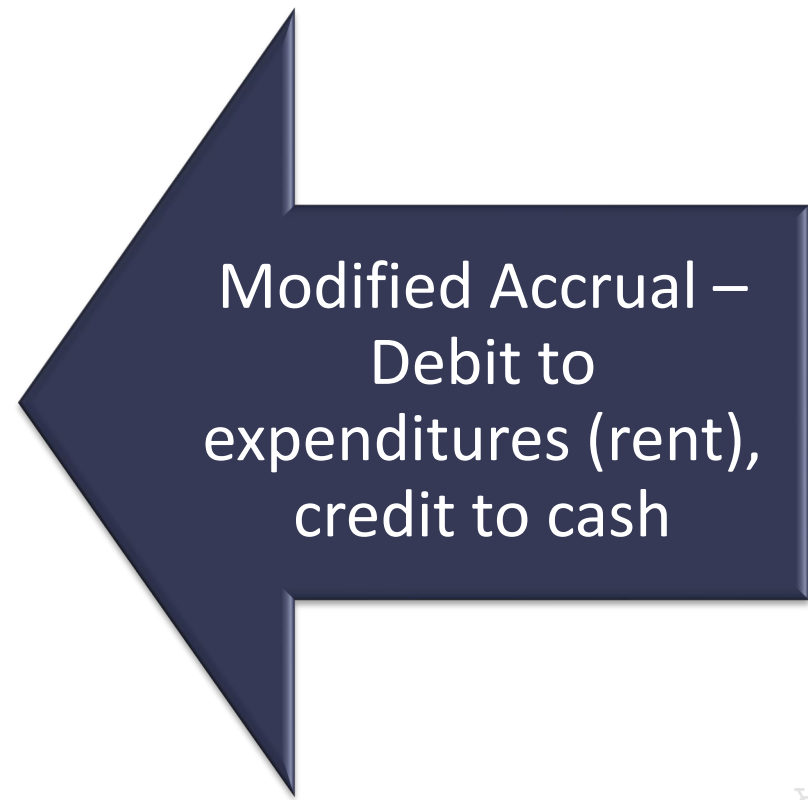


## Lessee – Short Term Leases

# Monthly Journal Entries



Full Accrual – Debit  
to rent expense,  
credit to cash



Modified Accrual –  
Debit to  
expenditures (rent),  
credit to cash



# Lessor Entries

# Lessor Entries

Debit to Lease Receivable and Credit to Deferred Inflow of Resources for present value of lease at commencement



Do NOT derecognize underlying asset



Consider lease incentives and any prepayments



No difference between full and modified accrual



# Lessor Entries

Debit to Cash and Credit to Lease Receivable and Interest Revenue based on amortization schedule



Debit to Deferred Inflow of Resources and Credit to Lease Revenue in systematic and rational manner



No difference between full and modified accrual



# Financial Statement Examples

## Lessee Footnotes

# Statement of Net Position

- Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Position
- Assets
  - Cash and Investments
  - Cash Held by Fiscal Agent
  - Receivables:
    - Property Taxes
    - Other Governments
    - Other
  - Prepaid Items
  - Net OPEB Asset
  - Inventories
  - Due from Other Funds
  - Capital Assets:
    - Land
    - Construction in Progress
    - Other Capital Assets, Net of Depreciation/Amortization
      - Total Assets
- Governmental funds report capital outlays as expenditures. However, in the statement of activities, assets are capitalized and the cost is allocated over their estimated useful lives and reported as depreciation/amortization expense. The amount by which depreciation/amortization capital outlay in the current period is:
  - Capital Outlays
  - Depreciation/Amortization Expense
  - Capital Asset Dispositions
- Capital assets used in governmental funds are not financial resources and therefore, are not reported in the funds. Those assets consist of:
  - Land
  - Right-to-Use Assets, Net of Accumulated Amortization
  - Land Improvements, Net of Accumulated Depreciation
  - Buildings and Improvements, Net of Accumulated Depreciation
  - Equipment, Net of Accumulated Depreciation



# Notes to the Financial Statements

## K. Leases

The District determines if an arrangement is a lease at inception. Leases are included in right-to-use assets and lease liabilities in the statement of net position.

Right-to-use assets represent the District's control of the right to use an underlying capital asset for the lease term, as specified in the contract, in an exchange or exchange-like transaction. Right-to-use assets are recognized at the commencement date based on the initial measurement of the lease liability, plus any payments made to the lessor at or before the commencement of the lease term and certain direct costs. Right-to-use assets are amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset.

Lease liabilities represent the District's obligation to make lease payments arising from the lease. Lease liabilities are recognized at the commencement date based on the present value of expected lease payments over the lease term, less any lease incentives. Interest expense is recognized ratably over the contract term.

The lease term may include options to extend or to terminate the lease when it is reasonably certain that the District will exercise that option.

The District has recognized payments for short-term leases with a lease term of 12 months or less as expenses are incurred, and these leases are not included as lease liabilities or right-to-use assets on the statement of net position.

The District accounts for contracts containing both lease and nonlease components as separate contracts when possible. In cases where the contract does not provide separate price information for lease and nonlease components, and it is impractical to estimate the price of such components, the District treats the components as a single lease unit.



# Notes to the Financial Statements – First Year

- FYI: Need to disclose useful life of the right-to-use assets in Note 1

## **U. Adoption of New Accounting Standards**

In June 2017, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 87, *Leases*. This standard requires the recognition of certain lease asset and liabilities for leases that were previously classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this standard, a lessee is required to recognize a lease liability and an Right-to-use asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources.

The District adopted the requirements of the guidance effective July 1, 2021, and has applied the provisions of this standard to the beginning of the period of adoption.

# Capital Asset Note

Capital asset activity for the year ended June 30, 2022, was as follows:

	Beginning Balance <u>As Restated</u>	<u>Increases</u>	<u>Decreases</u>	Ending Balance
Governmental Activities:				
Capital Assets, Not Being Depreciated:				
Land	\$ 128,350	\$ -	\$ -	\$ 128,350
Capital Assets, Being Depreciated/Amortized:				
Right-to-Use Assets	* 16,330	-	-	16,330
Land Improvements	306,288	-	-	306,288
Buildings	15,286,113	18,951	-	15,305,064
Equipment	699,060	51,337	-	750,397
Total Capital Assets, Being Depreciated/Amortized	16,307,791	70,288	-	16,378,079
Accumulated Depreciation/ Amortization for:				
Right-to-Use Assets	-	(4,557)	-	(4,557)
Land Improvements	(170,960)	(9,582)	-	(180,542)
Buildings and Improvements	(7,151,647)	(315,796)	-	(7,467,443)
Equipment	(466,711)	(42,795)	-	(509,506)
Total Accumulated Depreciation/Amortization	(7,789,318)	(372,730)	-	(8,162,048)
Total Capital Assets, Being Depreciated/Amortized, Net	8,518,473	(302,442)	-	8,216,031
Governmental Activities Capital Assets, Net	<u>\$ 8,646,823</u>	<u>\$ (302,442)</u>	<u>\$ -</u>	<u>\$ 8,344,381</u>

\* The beginning balance of capital assets was restated to record right-to-use assets due to the implementation of GASB Statement No. 87.



# Long-Term Debt Note

- Lease Liability – GASB 87 leases
- Finance Purchase Agreements – Contracts that transfer ownership

Components of long-term debt are as follows:

Description of Issue	Issue Date	Net Interest Rate	Original Issue	Final Maturity	Principal Outstanding	
					Total	Due Within One Year
Series 2017A Facilities Maintenance	5/18/2017	1.40-2.65%	260,000	2/1/2027	\$ 150,000	\$ 30,000
Lease Liability					12,032	4,410
Finance Purchase Agreements					60,471	10,225
Severance Benefits Payable					150,578	-
Compensated Absences Payable					35,010	928
Total					<u>\$ 408,091</u>	<u>\$ 45,563</u>



# Long-Term Debt Note

## B. Minimum Debt Payments

Minimum annual principal and interest payments required to retire long-term debt are as follows:

Year Ending June 30	General Obligation Bonds Payable		Finance Purchase Agreements Payable		Lease Liability	
	Principal	Interest	Principal	Interest	Principal	Interest
2023	\$ 30,000	\$ 20,145	\$ 10,225	\$ 1,538	\$ 4,410	\$ 250
2024	30,000	3,525	4,849	384	4,526	134
2025	30,000	2,910	3,129	-	2,127	48
2026	30,000	2,250	3,238	-	969	5
2027	30,000	1,545	3,350	-	-	-
2028-2032	-	795	14,609	-	-	-
2033-2037	-	-	17,615	-	-	-
2038-2042	-	-	3,456	-	-	-
Total	\$ 150,000	\$ 31,170	\$ 60,471	\$ 1,922	\$ 12,032	\$ 437

## C. Changes in Long-Term Debt

	June 30, 2021 As Restated	Net Additions	Retirements	June 30, 2022	Due Within One Year
Bonds Payable	\$ 715,000	\$ -	\$ 565,000	\$ 150,000	\$ 30,000
Bond Premium	26,448	-	26,448	-	-
Lease Liability	* 16,330	-	4,298	12,032	4,410
Finance Purchase Agreements	* 70,598	-	10,127	60,471	10,225
Severance Benefits Payable	252,103	-	101,525	150,578	-
Compensated Absences	69,051	36,950	70,991	35,010	928
Total	\$ 1,149,530	\$ 36,950	\$ 778,389	\$ 408,091	\$ 45,563

\* The beginning balance of debt was restated due to the implementation of GASB Statement No. 87.



# Long-Term Debt Note

## 8. Lease Liabilities

On February 15, 2008, the District entered into a 20-year lease with Artspace Brainerd Limited Partnership in the amount of \$718,553, bearing interest at 5.15% to finance the acquisition of additional gymnasium space. Lease terms call for a \$250,000 down payment and monthly lease payments of \$3,115 commencing April 1, 2008.

On July 5, 2017, the District entered into a six-year lease agreement with TCF Equipment Finance in the amount of \$153,109, bearing interest at 4.876% to finance mowing equipment. Repayment of the lease will occur with a \$28,665 down payment and annual lease payments of \$28,665 commencing July 5, 2018.

On May 9, 2019, the District entered into a four-year lease- agreement with Apple Financial Services, in the amount of \$145,980, with an imputed interest rate of 0.89% and actual interest rate of 0.00%, to finance I-Pads for the District. Repayment of the lease will incur in four annual installments of \$36,495, commencing July 1, 2019.



# Long-Term Debt Note

## 9. Finance Purchase Agreements

On March 13, 2014, the District entered into a finance-purchase agreement with Capital One Funding, LLC in the amount of \$3,020,702, bearing interest at 3.87% to finance capital projects. Repayment of the agreement will occur in 30 semi-annual installments of \$133,011 commencing August 8, 2014. The proceeds were used to finance improvements made to the lower-site activity fields.

On May 19, 2015, the District entered into a 15-year finance purchase agreement with Kinetic Leasing in the amount of \$1,835,000, bearing interest at 2.87% to finance the Riverside addition. Repayment of the agreement will occur with \$75,075 payments occurring twice a year starting August 1, 2015. The proceeds were used to finance the addition to the Riverside School Building.



# Financial Statement Examples

## Lessor Footnotes



# Statement of Net Position

- Assets

- Cash and Investments
- Receivables:
  - Property Taxes
  - Other Governments
  - Other
  - Lease Receivable
- Prepaid Items
- Net OPEB Asset
- Inventory
- Capital Assets:
  - Land
  - Construction in Progress
  - Other Capital Assets, Net of Depreciation/Amortization
    - Total Assets

- Deferred Inflows or Resources

- Pension Related
- OPEB Related
- Property Taxes Levied for Subsequent Year
- Lease Receivable
  - Total Deferred Inflows of Resources

# Fund Level Balance Sheet

- Assets

- Cash and Investments
- Receivables:
  - Current Property Taxes
  - Delinquent Property Taxes
  - Due from Other MN School Districts
  - Due from MN Department of Education
  - Due from Federal Through MN
    - Department of Education
  - Due from Other Governmental Units
  - Lease Receivable
  - Other Receivables
- Prepaid Items
- Inventory
- Total Assets

- Liabilities

- Salaries Payable
- Accounts and Contracts Payable
- Due to Other Governmental Units
- Unearned Revenue
  - Total Liabilities

- Deferred Inflows of Resources

- Property Taxes Levies for Subsequent Year
- Unavailable Revenue – Delinquent Taxes
- Lease Receivable
  - Total Deferred Inflows of Resources

# Footnotes

## NOTE 5 LONG-TERM LEASE RECEIVABLES

The District, acting as lessor, leases buses to a company to transport the District's students under long-term, non-cancelable lease agreements. The lease expires in fiscal year 2024. During the year ended June 30, 2022, the District recognized \$131,974 and \$18,026 in lease revenue and interest revenue respectively, pursuant this contract.

## NOTE 5 LONG-TERM LEASE RECEIVABLES (CONTINUED)

Total future minimum lease payments to be received under the lease agreement are as follows:

<u>Year Ending June 30,</u>	<u>School Buses</u>	
	<u>Principal</u>	<u>Interest</u>
2023	\$ 138,798	\$ 11,202
2024	145,975	4,025
2025	12,500	-
Total	<u>\$ 297,273</u>	<u>\$ 15,227</u>

Changes in the lease receivable for the year is as follows:

	<u>June 30, 2021 as Restated</u>	<u>Additions</u>	<u>Retirements</u>	<u>June 30, 2022</u>
School Buses	<u>\$ 429,247</u>	<u>\$ -</u>	<u>\$ (131,974)</u>	<u>\$ 297,273</u>





# What to provide to your Auditor

# Audit Support



Have all lease agreements available if requested



Excel spreadsheet of inventory of leases



Description of the purpose of each lease



Total value of leased assets and related accumulated amortization. This should be segregated by major categories of assets



Principal and interest requirements to maturity, presented separately, for the lease liability



# Audit Support

- The amount of outflows of resources [expenses] recognized in the reporting period for 1) variable payments and 2) other payments such as residual value guarantees or terminations penalties, not previously included in the measurement of the lease liability
- Commitments under leases before the commencement of the lease term
- It is also important to make sure that you have booked the necessary entries in your funds
- All leases assessed, whether or not they qualify under GASB 87



# Audit Support

- Discount rate
  - Lessees
    - Interest rate charged by lessor, which may be an implicit rate
    - The lessee's incremental borrowing rate
  - Lessors – rate it charges the lessee
  - Discount rates should only be reassessed in the following instances:
    - Lessee - upon a change in the lease term or a change in determination as to whether the lessee is reasonably certain to exercise a purchase option
    - Lessor – upon a change in lease term or a change in interest rate charged to the lessee



# GASB 96 SBITA



# GASB 96 Subscription-Based Information Technology Agreements

GASB 96 does **NOT** apply for:

....the right to use another party's combination of IT software and tangible capital assets that meets the definition of a lease in Statement No. 87, Leases, in which the software component is insignificant when compared to the cost of the underlying tangible capital asset

.....Governments that provide the right to use their IT software and associated tangible capital assets to other entities through SBITAs

.....Contracts that meet the definition of a public-private and public-public partnership in paragraph 5 of Statement No. 94, Public-Private and Public-Public Partnerships and Availability Payment Arrangements

.....Licensing arrangements that provide a perpetual license to governments to use a vendor's computer software, which are subject to Statement No. 51, Accounting and Financial Reporting for Intangible Assets, as amended.

# GASB 96 - More on Licensing Arrangements

Not Excluded if for a Set Period

GASB 96 does not apply for licensing arrangements that provide a perpetual license to governments to use a vendor's computer software, which are subject to Statement No. 51, Accounting and Financial Reporting for Intangible Assets, as amended.

Why

Perpetual licensing agreements are indefinite, whereas SBITAs are for a finite period.

Excluded When Perpetual

If the license agreement was for a set period, that was not perpetual, then GASB 96 would apply.

# GASB 96 Subscription-Based Information Technology Agreements

From GASB 96 Basis for Conclusion:

“The Board believes that because the key characteristics of a SBITA resemble those of a lease, the most appropriate and efficient approach to developing guidance for SBITAs is to incorporate into the SBITA standards all relevant guidance from Statement 87, as amended. Statement 87, as amended, was based on the foundational principle that leases are financings, and the Board believes that SBITA transactions also meet this principle.”

# Definitions



A SBITA is defined as a contract that conveys control of the right to use another entity's information technology (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.



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



# Determining whether a contract conveys control

To determine whether a contract conveys control of the right to use the underlying IT assets, a government should assess whether it has both:

The right to obtain the present service capacity from use of the underlying IT assets as specified in the contract

The right to determine the nature and manner of use of the underlying IT assets as specified in the contract.



SAME AS GASB 87 - Leases



# Term of the Agreement



## Lease Term

GASB 87, Paragraphs 12-15 defines and provides criteria for determining the term of the lease.



## Subscription Term

GASB 96. Paragraphs 9-12 define and provide criteria for determining the term of the SBITA.

# Short-Term Agreements

GASB 87, Paragraph 16 defines a short-term lease.



GASB 96, Paragraph 13 defines a short-term SBITA.



GASB 87 addresses short term leases from both the Lessee and Lessor side. GASB 96 only deals with SBITAs that a government enters into. It does not address SBITAs where the government is the “Lessor”

# Outlays Other Than Subscription Payments



Preliminary Project Stage



Initial Implementation Stage



Operational and Additional  
Implementation Stage

Subsequent implementation  
outlays





# Recognition and Measurement

At the commencement of the subscription term, a government should recognize a subscription liability and a subscription asset. (excludes short-term SBITAs).

The commencement of the subscription term occurs when the initial implementation stage is completed at which time the government has obtained control of the right to use the underlying IT assets, and, therefore, the subscription asset is placed into service.

# Other Considerations

Impairment

Incentives provided by a SBITA vendor

Contracts with multiple components

Contract combinations

Modifications and terminations



# Prepaid SBITA's



If you prepaid the "entire" SBITA you would not have a corresponding liability.



If you prepay portions of it, that will eventually be capitalized with the RTU asset, you'd put those amounts in a prepaid account and then add them to the value of the RTU asset when it's placed into service.



Same treatment you would do if you prepaid an entire lease. You wouldn't show a liability because it's been paid. You'd only show the RTU asset



For SBITAs, the majority of the "prepaid" costs will be to get the asset ready to use. If they are not capitalizable you'd just expense the costs. If they are capitalizable, you'd put them in the prepaid asset account (almost like a CIP type account). When the asset is ready to be placed into service, the RTU asset would be valued at the PV of the subscription payments PLUS any capitalizable costs in the prepaid account.



# Notes to the Financial Statements



Disclosure requirements follow requirements relating to leases



Subscription asset

Presented net of amortization  
Separate from other capital assets



Subscription Liability

Not considered debt for purposes of GASB 88 disclosure requirements



Thank you!



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# Preparing for a Successful Audit, Common Audit Recommendations, & Common Audit Adjustments



# Preparing for a Successful Audit

# Objectives



Recognize what an audit is and define responsibility.



Recall best practices for planning and preparing for an audit.



Identify common pitfalls.





# What Is an Audit?

- An audit is the process of examining and verifying management's assertions that their financials are materially correct.
- Auditors choose what to test based on risk inherent to transactions or control risk created by control processes that do not adequately address the items that can go wrong with a particular balance.

# Who Is Doing What?

- Management is responsible for ensuring that their financial statements are in compliance with GAAP (Generally Accepted Accounting Principles).
- Auditors are responsible for verifying and testing to ensure that the financial statements are in compliance with GAAP.

# Team Process



The Audit is not just for the finance department, it is the entire organization's financial statement audit.



Communication is key!



# Point Person

- Designate a point person to make sure all tasks are complete, and the organization is “audit ready”.
- Provides a central point of communication and coordination for the audit preparation and execution.
- Multiple people are typically working together to gather everything but having one person take ownership of how the audit flows is key for a smooth audit.

# Point Person Responsibilities:

- Will divide out the audit request list.
- Assign who will oversee each area.
- Assign when the item will be due back to the point person.
- Set up a meeting with the assigned people.
- Hand out the list with the assigned person and a due date by each item.
- Monitor completion of assignments.
- Review completed assignments to ensure they are accurate.
- Communicate schedule restrictions to the auditors.
- Work with the audit in-charge to establish progress and audit update meetings (Client needs and preferences vary for this).

# Audit Requests

- Utilize to track audit preparedness.

Have all of it done  
prior to scheduled  
timeframes, not  
after.

Do the hard stuff  
first.

Stick to the list.

Due dates.

Review before  
sending.

# Communication and Transfer of Audit Documentation

- Electronic files add efficiency to the audit process. Discuss format with lead auditor.
- Electronic files should be editable and use formulas where applicable.
- File names should be clear as to what the item is. (Not the number assigned by the scanner).
- Information should be reviewed by the audit point person prior to being sent to the audit team.



# Auditor Access to Your Systems

- Can be an efficient way for auditors to view items for invoices, contracts, payroll, and other types of support documentation.
- Auditors will request what we need ahead of time, and client should verify ahead of fieldwork that the auditors will have access to all information requested through system access, or it should be pulled ahead of time and provided to the auditor.
  - This is faster than auditors looking for it in the system, not finding it, then requesting it and waiting for it to be pulled by client's teams.





# Housekeeping

- Plan to accommodate audit team.
  - Reserve conference room or area for them to work together.
  - Internet availability.
  - Access badges as needed.
  - Work schedule.
  - Tour & introduction to key personnel.
  - Adjust schedule to be available for auditor inquiries during scheduled fieldworks and preliminary fieldworks.

# Common Audit Prep Pit Falls



Accounts not reconciled – All necessary year end adjustments should be recorded. Check last years audit adjustments.



Not addressing prior year audit issues.



Surprising your auditor with unusual or complex transactions.



Planning to complete audit schedules while auditors are onsite.



Incomplete confirmations – Not signed by the appropriate signer, incomplete/incorrect accounts, not sent by auditors (Please don't mail them out).



# Audit Preparation Best Practices

- Cash reconciliations – Check after all year end adjustments are posted to ensure that total cash still ties to your cash reconciliations.
- Transfers in = transfers out.
- Interfund payables & receivables in balance.
- Verify no adjustments were made to fund balance.
- Fund balance should agree to prior year audited balance.

# Audit Preparation Best Practices (Continued)

- Investments
  - Ensure to have an investment schedule and include all required elements to prepare the footnotes:
    - Purchase date.
    - Maturity date.
    - Investment rating.
    - Investment type/name/CUSIP (when available).
    - Banking institution where the investment is held.
    - Year end value of each investment. (Fair market value when applicable).
    - Reconcile investment revenue and show how it is allocated.

# Audit Preparation Best Practices (Continued)

## Proper accounting for federal and state grants.

Grant administrator has knowledge of all grants.

Revenues are not commingled.

Monitor federal spending – If over \$750,000 (and that is not typical for your organization) contact your auditor you have.

Summarize each revenue account and identify where it should be reported in both the intergovernmental revenue schedule and schedule of federal expenditures.

Ensure you understand if grants should be recorded as current year revenue, unearned revenues, or as deferred inflows of resources. If your unsure, we can help contact your auditor. Also ensure that you have properly restricted any fund balance for recognized grants with restrictions.

# Audit Preparation Best Practices (Continued)

- Revenue cutoff:
  - Review subsequent transactions for proper coding.
  - Contact departments for outstanding items.
- Capital assets:
  - Reconcile often to reduce year end burden.
  - Tie beginning balances to prior year audited balances.
  - Evaluate construction in progress (CIP).
  - Review accruals for items impacting CIP.
  - Ensure when CIP is transferred it is clear what exactly is coming from CIP and going into other types of additions versus being an addition that didn't run through CIP during the year.
  - Ensure retainage is not booked both as retainage payable and as accounts payable.
  - Capital outlay reconciliation (completeness) and utilize other departments (deletions).



# Audit Preparation Best Practices (Continued)

- Debt preparation:
  - Prepare a debt summary with beginning, additions, payments, and ending balances.
  - Calculate accrued interest related to debt for the year and show that calculation.
  - Ensure all premiums and discounts on long-term debt are amortized utilizing the effective interest rate method.
  - Run debt entries past auditors if your unsure how to initially book them on the fund level. The underwriter's discount is an expense similar to issuance fees.

# Audit Preparation Best Practices (Continued)

- Ensure to provide a listing of payables and receivables and not batch totals so that its by vendor, payment, and shows where items were recorded and the applicable fund.
- OPEB studies done in just after fiscal year end, when applicable.
- OPEB updates in off-years.
- Compensated absences schedules done early.
- GASB 87 - Leases (FY 2022 Audits) & 96 – SBITA (FY 2023 Audits)
  - Don't wait! Start early. Complete prior to final fieldwork for the audit.
  - When unsure on where to start, we can help!



# Audit Conclusions

## Exit conference:

- Discussion of audit observations/findings.
- Timing of audit report issuance.
- Open items and resolutions.

## Internal conclusions:

- Draft management responses to audit results.
- Perform post audit evaluation.
- Discuss efficiencies with the audit team for next year.



# In Conclusion...



Prepare, Prepare, Prepare!



A successful audit is a combination of preparedness on the client's part and planning on the auditor's part.





# Common Audit Recommendations & Common Audit Adjustments

# Debt Entries

- Ensure that all of the debt is accounted for based on the issuance document and not based solely on the amount of cash received. Underwriters' discounts should be expensed, as part of issuance costs.
- Reconciled to ensure principal payments and interest payments in the general ledger tie to the debt roll forward amounts of principal and interest paid.
- Enterprise funds should ensure to reduce the debt amounts versus posting principal payments as expenses.

# Commonly Missed Adjustments (Miscellaneous)

- Ensure that retainage payable is booked along with contracts payable, however, ensure it is not double booked as part of contracts or accounts payable as well.
- Book interest receivable from year end bank statements.
- Period of availability adjustments for deferred inflows of resources for receivables received within or after the period of availability.

# Unreconciled Balances

- Look over all of your assets, deferred outflows, liabilities, deferred inflows, fund balance classifications, revenues, and expenditures.
  - If you can't confidently be asked what makes up that account and provide something other than General Ledger Detail, its likely an account that has not been reconciled to anything and that creates audit risk and often times leads to adjustments.

# Key Control Processes Are not Documented

- Document the control activities within the organization.
- It doesn't have to be a physical signature and date, although that works.
- Someone should be able to determine who performed the control and when and it should be documented in a way that is not easily manipulated by another individual when possible.
  - Locked cells on spreadsheets.
  - Electronic signatures.
  - Program approvals with an audit trail.

# Access Issues

- Someone has full access to a full transaction process.
  - Example 1: Someone can add/edit vendors, enter invoices, and process payments.
  - Example 2: Someone can add/edit employees in payroll, process payroll, and process payments.
  - Example 3: Someone can initiate and execute any sort of cash payment or transfer without the involvement of another person.
    - Try to avoid these situations, they create audit risk, are not proper ways to segregate duties, and they provide the opportunity for fraud to occur.
    - In smaller organizations sometimes this is difficult or not reasonable to do.



# Minnesota Legal Compliance Items



Prompt payment of claims  
(35 days typically if board  
meets monthly).



IC-134 forms prior to final  
payment. Ensure they are on  
file prior to final payment for  
applicable contracts.



Insufficient collateral.



Subcontractor language in  
contracts.

# Thank You!



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