NORTH CAROLINA
DEPARTMENT OF STATE TREASURER

STATE TREASURER OF NORTH CAROLINA
DALE R. FOLWELL, CPA

STATE AND LOCAL GOVERNMENT FINANCE DIVISION

LGC UPDATE

Spring NCGFOA Conference

March 1, 2023

Sharon Edmundson

Agenda

- News from SLGFD
- Senate Bill 265 (Bond Info Transparency and LGC Toolkit II)
- Audit Review Update
- Alternative Reporting Project
- Opioid Funding Settlement
- ARPA
- GASB Statement 96 – SBITA, and GASB 101 – Compensated Absences

News from SLGFD

Arrivals and Job Changes:

- Becky Garland, currently the finance officer in Graham Co, is joining us as a member of the COACH team to work in western NC
- Carolyn Heden is joining us as a financial analyst in the State Debt Management section
- Bill Irwin has joined us as a program manager
- Melissa Cardinali and Natalie Rountree have permanently joined the staff as members of the COACH team
- Eric Faust was promoted to Assistant Director in Fiscal Management
- Currently have 11 openings

News from SLGFD

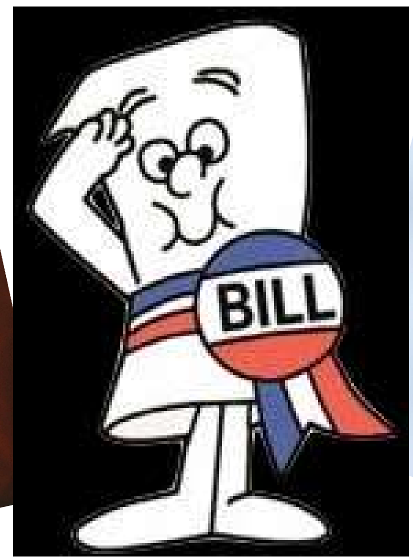
Departures:

- Manasa Cooper left the Department in August 2022
- Terri Morris left the Department in August 2022
- Joe Futima left the Department in September 2022
- Darrus Cofield left the Department in January 2023
- Marian Griffis has left the Department in February 2023
- Susan McCullen has retired from the Department as of the end of February

News from SLGFD

- Treasurer's Conference will be virtual again this year
  - 8:30 – 1:00 on June 15th, 20th, and 22nd
  - No agenda at this time
- Auditor's Training also will be virtual
  - May 17th from 8:00 to 3:00
  - No agenda at this time
- Please contact us with topics for either or both!

LEGISLATIVE UPDATE – SPECIFIC TO LOCAL GOVERNMENT FINANCE



Recent Legislation Impacting Local Finance

SL 2022-53 (S265 - Bond Info Transparency / LGC Toolkit II)

- Modifies Article 4 of Chapter 159 (Local Government Bond Act)
- Creates new requirements for finance officer to disclose and file with the LGC estimates of interest to be paid on the bonds, increase in property tax necessary to service the debt, amount of two-thirds bonds available (new 159-155.1)

Recent Legislation Impacting Local Finance

SL 2022-53 (S265 - Bond Info Transparency / LGC Toolkit II)

- Creates a new finding required for the LGC to approve an application under this section:

  > "That the assumptions used by the finance officer of the unit in preparing the statement of estimated interest…are reasonable" (modification to 159-52(b))

- LGC has adopted a safe harbor policy on reasonableness; can access here: Applying for Debt | NC Treasurer

- Modifies requirements for bond orders (modifications to 159-56 and 159-58)

- Effective for all bond orders introduced on or after October 1, 2022.

Recent Legislation Impacting Local Finance

SL 2022-53 (S265/Bond Info Transparency / LGC Toolkit II)

- Notification to LGC required if a new unit subject to Local Government Budget and Fiscal Control Act is created (modification to 159-7).

Recent Legislation Impacting Local Finance

SL 2022-53 (S265/Bond Info Transparency / LGC Toolkit II)

- Finance Officer bond requirements modified
  - Increased from minimum of $50,000 to minimum of $50,000 or 10% of annually budgeted funds, with a **cap amount for the bond** of $1 million.
  - Annually budgeted funds = $500,000, bond required is $50,000
  - Annually budgeted funds = $2,000,000, bond required is $200,000
  - Annually budgeted funds of $10 million or more, bond is $1 million

Recent Legislation Impacting Local Finance

SL 2022-53 (S265/Bond Info Transparency / LGC Toolkit II)

Memo 2023-06 reviews requirements

- Effective on next renewal on January 1, 2023, or later
- "Annually budgeted funds" is the total of the appropriations in all annually budgeted "accounting" funds (General Fund, Water Sewer Fund, etc.) at the time the budget is adopted

Recent Legislation Impacting Local Finance

SL 2022-53 (S265/Bond Info Transparency / LGC Toolkit II)

Connor Crews, faculty at SOG, has issued

Local Finance Bulletin #62 (Impending Changes to Bonding Requirements for Finance Officers: Prepare Now for January 1, 2023, and Beyond)

- Statute requires a “faithful performance bond” and not just a “surety bond”
- Also requires bond be on the person, not the position

Recent Legislation Impacting Local Finance

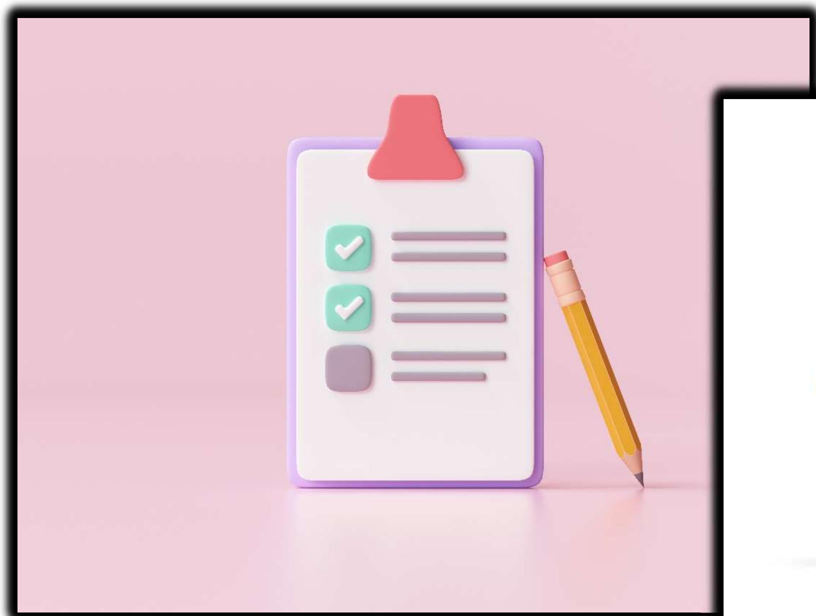
SL 2022-53 (S265/Bond Info Transparency / LGC Toolkit II)

- Persons unable to secure bonds cannot serve as finance officer or specific positions related to public funds and inventories (modification to 159-29)

Recent Legislation Impacting Local Finance

SL 2022-53 (S265/Bond Info Transparency / LGC Toolkit II)

- New lower limits for LGC approval for contracts for UAL units (modification to 159-148)
  - Contracts that extend for three or more years (five or more years for other units)
  - Contracts that obligate the unit to at least $50,000 (generally $500,000 for other units)
  - Does not change statutory language that a contract must meet all of four defined criteria to require LGC approval
  - Effective for contracts entered into on or after October 1, 2022.



AUDIT STATUS UPDATE AND OTHER AUDIT-RELATED NEWS

Audit Review Update:

- As of February 24, 2023, we had received 820 of 1,100 audits for our review vs. 878 as of February 24, 2022. Missing includes
  - 22 counties
  - 131 municipalities
- We are lagging about 5% behind 2021 audits.
- 76 units lost their auditors between 2021 and 2022 when **nine** CPA firms got out of the governmental auditing business in NC.
- We anticipated increased delays in 2022 audits.

ALTERNATIVE REPORTING PROJECT

Review of Annual Reporting Requirements

1

Improve readability of Statements for Citizens and local governments

- Simplify financial statements
- Simplify accounting basis

2

Increase Internal Control work done in units

3

Improve timeliness of audits

4

Increase interest in the CPA community to perform local government work

Overview of Annual Reporting Project

Multi-year project

Would require legislative approval

Overview of Annual Reporting Project - Research Phase

	✓
Other States with emphasis on AAA States – surveys, meetings, official statements, State agencies in other states, municipal organizations in other states	✓
Bond Counsels	✓
Major underwriters in State – how do they use the current statements	✓
Federal & State agencies – How they use current statements	✓
NCCPA Board	✓
NC League of Municipalities and County Commissioners Association	✓
NCACPA	✓
Other Experts in this area (Lee Carter and Greg Allison)	✓
Finance Officers from local governments	

✓ Indicates that we are in discussions with these organizations

Overview of Annual Reporting Project

- The output from the research phase was presented to the State Treasurer and State Auditor and they have asked us to continue into the next phase of research.
- We will develop with input from the previous mentioned organizations
  - Annual reporting options
  - Who will be eligible for this option
- We will be sending out information this month on how we plan to obtain input from local government finance officers and the audit community

OPIOID SETTLEMENT FUNDS

Opioid Settlement Funds (OSF)

- OSF Funds must be used to provide opioid-related expenditures, such as treatment, recovery, harm reduction and other life-saving programs and services incurred after the date the government signed the MOA.
- Any expenditures that are inconsistent with the MOA may be recovered by the Attorney General. Budgets or resolutions for opioid expenditures that don't comply with the MOA are required to be redone before the government can expend settlement funds.
- Template for resolutions are on NCACC website HERE.
- GA made change to NCGS 159-13.2 adding "other grant or settlement funds" but needs to do more, so LGC staff have requested Settlement Fund Special Revenue fund as a new Section 159-13.2 (a)(3).
- Use an interest earned allocation that is consistent with MOA.

Opioid Settlement Funds (OSF)

- Carolina County illustrative statements were updated in 2022 for the financial reporting required for OSF.
  - Use a multi-year fund Special Revenue Fund, moneys are unearned revenue until spent on qualifying expenditure(s) under resolution approved by DOJ.
- Expenditures of settlement funds will be subject to NC Local Government Budget and Fiscal Control Act and the State Single Audit. See Memo 2023-03 for auditing and compliance guidance.
- Reporting through NC Statewide Opioid Dashboard is completed through the NC DOJ's website on the **C**ommunity **O**pioid **R**esources Engine for North Carolina (CORE-NC).
- Complete information on the NCACC website is located here.

ARPA


FEDERAL RESERVE NOTE
MG 53264757 G
ML 66734471 N
ML 62814486 L

ARPA – The Gift That Keeps on Giving

- Continue to recommend strongly that units use a Special Revenue Fund (SRF) with a Grant Project ordinance for reporting and budgeting, respectively.
- Either spend funds directly out of SRF or transfer to another fund, typically General or Water/Sewer.
- Grants meet the GASB 33 definition of a government-mandated, non-exchange transaction.
- Restricted asset and unearned revenue until all eligibility requirements have been met.

ARPA – The Gift That Keeps on Giving

What does it mean to “meet all eligibility requirements”?

- When both the obligation and expenditure requirements are met
  - May be in different fiscal years
  - Must be **obligated** by 12/31/24 – orders placed, sub-awards made, transaction requires payment at some point.
  - Must be **expended** by 12/31/26 – payment is made, check is cut.

Any funds not obligated or expended by 12/31/26 must be returned to the US Treasury.

ARPA – The Gift That Keeps on Giving

Where do you recognize revenue?

- Can only be recognized one time, in one fund.

Scenario 1 – dollars recorded in SRF; dollars spent directly out of SRF

- Initially record as restricted cash and unearned revenue
- Once obligation and expenditure requirements are met, reclass unearned revenue to grant revenue.

ARPA – The Gift That Keeps on Giving

Scenario 2 – Using money to reimburse qualifying expenditures that have already been incurred.

- Money recorded in SRF as restricted cash and unearned revenue
- Transfer funds to General Fund and/or Utility Fund as purposes of expenditures are determined.
- Recognize revenue in SRF, and record transfer from the SRF to the receiving fund.
- DO NOT recognize revenue again in receiving fund. Receiving fund has a transfer in from SRF.

ARPA – The Gift That Keeps on Giving

Scenario 3 – Using ARPA dollars for qualified expenditures that have not yet been obligated or incurred

- Same as Scenario 2 except that transfers should occur as the use(s) of the money has been determined and when the dollars will be properly procured AND expended by the recipient fund in that same fiscal year.
- Transfers should match up with expenditures.
- Recognize revenue in SRF as transfers out occur to recipient fund.

ARPA – The Gift That Keeps on Giving

Scenario 4 – Using ARPA dollars to fund multi-year enterprise capital project.

- Still receive dollars in SRF, record as restricted assets and unearned revenue.
- Once a fiscal year, determine how much you have spent in the capital project that is for qualified purposes, and has been obligated and expended, and transfer that amount from the SRF to the capital project; recognize revenue for that same amount in SRF.
- Again, no revenue recognition in the receiving fund. Recipient Fund will report a transfer in.

ARPA – The Gift That Keeps on Giving

- If, at the end of a fiscal year, there are dollars that have been transferred out of the SRF into another fund but have not yet been obligated and expended on qualified items, transfer dollars back to the SRF by fiscal year end for reporting.

- Purpose of transfer back to SRF is to report all unearned ARPA amounts in one fund at the end of the year.

GAAP UPDATE


GASB
GOVERNMENTAL
ACCOUNTING
STANDARDS BOARD


GASB
ORIGINAL PRONOUNCEMENTS
GASB
ORIGINAL PRONOUNCEMENTS
GASB
GASB
FINANCIAL REPORTING STANDARDS

Materiality – A Reminder:

The provisions of this Statement need not be applied to immaterial items.

Lease Materiality:

- Consider both the capitalization threshold and the lease liability when determining the significance (materiality).
- The lease liability may be significant for a given lease, but not the capitalization threshold. In this case, lease accounting would need to be followed.
- The capitalization limit may be significant for a given lease, but not the lease liability. In this case, lease accounting would need to be followed.
- Ref: Government Finance Review, December 2021

GASB 96 - What is a SBITA?

- "A contract that conveys control of the right to use another party's (a SBITA vendor'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"
- The software is an intangible asset that you are procuring the right to use for an expected period of time as defined in your contract
- Does not include contracts that meet the definition of a public-public or public-private partnership (GASB 94)
- Does not include licensing arrangements that provide a **perpetual** license to use a vendor's software (GASB 51)

Similar to GASB 87 (but not the same)

- Contracts that meet the definition of a lease where the software component is “insignificant when compared to the cost of the underlying tangible capital asset” should use GASB 87
- Unlike GASB 87, a SBITA will not have previously recognized capital assets to worry about
- Under GASB 96, implementation costs normally associated with a leased asset can be capitalized as part of the initial subscription asset (ie. Rolling over data or testing costs)

Implementation

- GASB 96 was released in May of 2020 and goes into effect for fiscal years beginning after June 15 of 2022 (this fiscal year)
- Reviewing all software arrangements currently used to determine which ones meet the preceding definition will require coordination between all departments
- The effects of this statement must be applied retroactively by restating financial statements for all years presented in your audited financial statements
- Units that present more than 1 year in their audited statements will need to apply the effects of this statement to both years presented

Subscription Term

- Includes the period of time that the unit has a noncancellable right to use the intangible IT asset
- Periods when the government and/or the vendor can extend the subscription without requiring consent of the other party (if reasonably certain the option will be exercised) should be included
- Periods when the government and/or the vendor can terminate the subscription without requiring consent of the other party (if reasonably certain the option will not be exercised) should also be included

Subscription Term (continued)

- Month-to-month terms after the noncancellable period where either party can terminate should not be included
- Short-term SBITAs with a maximum term of 12 months (including any option to extend) should be expensed
- The subscription term begins when the SBITA is officially placed into service

Outlays Other Than Subscription Payments

Training costs should always be expensed. Other costs will be categorized into 3 stages.

- The preliminary project stage would include costs incurred prior to negotiating a contract such as evaluating vendor options or technological needs and should be expensed as incurred
- The initial implementation stage would include costs associated with putting the subscription asset into service such as installation or testing of the asset and should be included in the initial calculation of the subscription asset
- The operation and additional implementation stage would include costs related to subsequent activities such as maintenance. These should generally be expensed as incurred

Example

The City of Dogwood has entered into a subscription-based IT arrangement for new accounting software. The term of the subscription is 5 years and will require an annual payment of \$10,000, paid on July 1st of each year. The discount rate is 3%. During the initial implementation stage, The City incurred \$2,500 in data migration costs.

In governmental funds (current financial resources measurement focus), the unit will initially need to recognize an outflow and other financing source. Remember to also make any necessary budget amendments to avoid over-expenditures that may result in a finding in your audit.

	Debit	Credit	
Capital outlay	$49,671		Present value of payments plus implementation costs
Other Financing Source		$47,171	Present value of total subscription payments
Cash		2,500	Implementation costs

Subsequent subscription payments will be recognized (and budgeted) like debt service payments made on long-term debt. Note that the interest expenditure will be 0 for the initial payment made at the beginning of the arrangement.

	Debit	Credit	
Debt Service Expend. - Principal	10,000		Principal reduction
Debt Service Expend. - Interest	0		Outstanding principal balance multiplied by the interest rate
Cash		10,000	Subscription Payment

Adjusting entries will need to be made to convert governmental fund numbers to the government-wide statements. The unit will essentially need to 'undo' and 'redo' the initial recognition and the subscription payments as well as recognize amortization of the subscription asset.

Other Financing Source	47,171		"Undo" above entry
Subscription Asset	49,671		PV of payments plus implementation costs
Capital Outlay		49,671	"Undo" above entry
Subscription Liability		47,171	PV of total subscription payments
Interest Expense	0		Outstanding principal balance multiplied by the interest rate
Subscription Liability	10,000		Reduction to initial liability (equal to principal reduction)
Debt Service Expend. – Principal		10,000	"Undo" above entry
Debt Service Expend. – Interest		0	"Undo" above entry
Amortization Expense	9,934		Initial subscription asset value/ subscription term
Accumulated Amortization		9,934	Initial subscription asset value/

Don't forget to recognize the interest at year end for 364 out of 365 days using the outstanding principal balance remaining on the contract and the interest rate .

Interest expense	1,112	
Accrued interest		1,112

The unit will also need to record a description of the arrangements that will include at least the following information.

- a general description of the SBITAs, including any terms, conditions, or variable payment information (if applicable)
- the total amount of subscription assets, and the related accumulated amortization which should be shown separately from other capital assets
- the amount of any payments related to the SBITAs incurred during the year that are not included in the initial liability
- principal and interest requirements for each of the next five years and in five-year increments thereafter
- any other payments not included in the subscription liability such as impairments or commitments related to the SBITA before the commencement of the SBITA term

At the beginning of the subscription term, the unit will recognize a subscription asset and a subscription liability in an enterprise fund (economic resources measurement focus). The subscription liability should include fixed and variable payments and any penalties or incentives expected to be realized. This may include termination clauses or incentives offered by the vendor. If the discount rate needed to calculate the present value of the subscription payments is not implicitly stated in the contract, an estimated incremental borrowing rate can be used.

Subscription Asset	$49,671		⟵ PV of payments plus implementation costs
Subscription Liability		$47,171	⟵ Present value of total subscription payments
Cash		2,500	⟵ Implementation costs

The subscription asset will then be amortized over the term of the arrangement.

Amortization Expense	9,934		Initial subscription asset value/ subscription term
Subscription Liability	10,000		Subscription payment principal
Accumulated Amortization		9,934	Initial subscription asset value/ subscription term
Cash		10,000	Subscription payment

Interest expense should be accrued at the end of each year and can be calculated by multiplying the outstanding principal balance remaining on the contract by the interest rate. In our example, this will be for 364 out of 365 days.

Interest expense	1,112	
Accrued interest		1,112

Other Considerations

- The statement may not apply to arrangements deemed immaterial which will vary by unit
- Units will need to use professional judgment regarding both the subscription asset and liability when considering materiality
- The subscription liability should be remeasured in subsequent years if there is a change in the term, payments or the interest rate charged by the vendor
- Payments or implementation costs made prior to the contract should be recorded as a prepaid asset which would be reclassified to the initial measurement recorded at the start of the subscription term

Guidance

We will be releasing a memo and an implementation worksheet similar to the previously released GASB 87 templates in the near future to help you implement the changes described in this statement. These and other helpful memos can be found on our website at:

https://www.nctreasurer.com/state-and-local-government-finance-division/local-government-commission/memo-document

NC Budgetary Impact of GASB Statements 87 and 96:

- Modified accrual statements:
  - Recognize a capital outlay expenditure and other financing source at the time agreement is entered into. Budget this entry.
  - Subsequent subscription payments should be recognized as debt service payments as currently done. Budget this entry.
- Government-wide and enterprise fund full accrual statements:
  - Adjusting entries between modified accrual to full accrual will need to be developed.
  - Reconciling items between modified and full accrual statements in audited financial statements.

GASB 101: Background:

- GASB Statement No. 101 was issued in June 2022 and replaces GASB Statement No. 16 (issued November 1992).

- Statement No. 101 was issued to:
  - Redefine compensated absences recognition and measurement.
  - Create uniformity in determining liability and reporting the liability.
  - Update reporting guidance to be consistent with other newly issued GASB statements.
  - Address certain types of leave that were not addressed in Statement No. 16.

Compensated Absence Defined…

A compensated absence is leave which an employee may receive: (1) Cash payments when leave is used for time off; (2) Other cash payments such as a payment for unused leave upon termination of employment; (3) Noncash settlements such as a conversion to defined benefit post-employment benefits.

Compensated absences may include vacation pay, sick leave, paid time off (PTO), parental leave, bereavement leave, and certain types of sabbatical leave. Compensated absences do not have a payment schedule and could occur during employment or upon termination of employment.

When are Compensated Absences Considered a Liability?

- **Leave has Not been used:**
  - Leave accumulates;
  - Leave is based on services rendered; and
  - Leave is more likely to be paid than not to be used for time off or to be paid (More than likely than not is more than 50%).

Examples may include compensatory time (comp time), vacation leave, sick leave, paid time off (PTO).

When are Compensated Absences Considered a Liability?

- **Leave Has Been Used (but not yet settled through cash or non-cash means):**
  - Employees are able to take as needed without specific limits (known also as unlimited leave)
  - Holiday leave that is taken on a specific date but not at the discretion of the employee (i.e., council approved holiday schedule).

  Other types of leave that are not recognized until the leave begins are parental, military, and jury duty, holiday leave (when leave is taken on a specific date not at the discretion of the employees) and sabbatical leave (in which the employee is required to perform duties of a different nature).

- **Exceptions** - Leave that is more likely than not to be settled through conversion to defined benefit post-employment benefits should **not** be recognized as a liability for compensated absences. Leave that fails to meet the more likely than not criteria would not be recognized as a liability (i.e., leave forfeitures)

What Does “More Likely than Not” Actually Mean?

“More likely than not” is defined as mote than 50% and may include the following considerations:

(1) the unit's employment policies related to compensated absences;

(2) Whether the leave that has been earned is or will become eligible for use or payment in the future;

(3) Historical information about use, payment, or forfeiture of compensation;

(4) Information known to unit that would indicate historical data may not be representative of future trends or patterns;

(5) Forfeited amounts; or

(6) Amounts satisfied through defined benefit postemployment benefits.

Other Information necessary for “more likely than not…”

- Employee name
- Employee pay rate as of 6/30 (If rate changed during the year, then rate should be reflected for hours paid)
- Accumulated hours for each compensated absence
- Salary-related payments
- Is the compensated absence paid at termination? If yes, is it based on percentage, number of hours, dollar amount?
- Years of employment (vested, not vested)

NC Budgetary Impact of GASB 101:

- GASB 101 does **not** impact the governmental fund financials or the budgets for proprietary funds, which use the modified accrual basis of accounting to measure the current financial resources. There is NO impact on fund balance in governmental funds.

- In governmental funds and in budgets for enterprise funds, recognize compensated absences as they are expected to be liquidated with expendable available financial resources. No change from current practice clarified in GASB Interpretation No. 6.

- GASB 101 currently impacts the government – wide and the proprietary fund full accrual financial statements only.

Preparing for Statement No. 101

To implement changes in accounting and reporting of compensated absences, units will need to address several key issues, such as:

- Educating the governing board and management on pending changes.
- Identifying all categories of compensated absences your unit offers employees, how they meet the new guidance for compensated absences, determine when they are paid out (some, none or all may be paid at termination of employment), and use new guidance to determine calculations necessary for reporting.
- Determining if reporting software can perform the necessary calculations to account for and report based on the new guidelines.
- Identifying any business processes that may need to be revised to account for new calculations for compensated absence liabilities.
- Creating/revising policies as necessary to comply with new guidance.

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