STATE OF LOUISIANA

Appendices to the
Annual Fiscal Reports

FY 2021
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DEPOSITS WITH FINANCIAL INSTITUTIONS AND INVESTMENTS

I. Purpose:

The Deposits with Financial Institutions and Investments Note provides the required disclosures about the governmental entities’ deposits with financial institutions and investments. The disclosures required for deposits and investments as of the fiscal year ended date provides information on the credit risk of deposits and the fair market value, credit risk, and interest rate risk of investments and are designed to provide users of the financial statements information about the potential for losses associated with the deposits and investments.

II. Comparison of amounts disclosed per requirements in the Note to amounts shown on the Statement of Net Position (if required as part of AFR packet):

- Because the statement of net position (SNP) reports cash and cash equivalents and investments and the Note discloses deposits and investments, the amounts of cash and investments on the SNP will not be classified exactly the way they would be classified in the Note.
- “Deposits with Financial Institutions” and “Investments” in the Note may be reported on the SNP using titles or line items that are different than those in the Note, or they may be combinations of titles or line items. For instance, “Deposits” in the Note may come from several line items on the SNP such as “Cash in Bank” and “Certificates of Deposits (CDs)”, or even “Investments” (See section III below that gives further guidance on what should be considered “Deposits” in the Note).
- Line items on the SNP may include amounts that would be deposits in the Note, and may also include amounts that would be investments in the Note. Cash and cash equivalents line items on the SNP may include amounts that are not deposited in bank accounts and therefore would NOT be reported in the Note. Imprest funds and petty cash NOT on deposit in bank accounts outside the STO and cash on hand (cash physically on hand at the agency at June 30th) should NOT be included in this Note.
- Each line item on the SNP that involves cash or investments, including any restricted cash and/or investments, needs to be analyzed to determine what is included in the item and how it should be disclosed in the Note.
- OSRAP has revisited its guidance on how to report certificate of deposits (CDs) that mature within 3 months or less of the purchase date. Formerly, these were reported as cash equivalents. However, now these CDs should be reported as investments on the SNP. Non-negotiable CDs should be reported as deposits in the note disclosures and negotiable CDs should be reported as investments in the note disclosures.

III. Deposits with Financial Institutions:

- Beginning with the June 30, 2016 fiscal year end, agencies will ONLY report the book balance of deposits with financial institutions in the Deposits with Financial Institutions and Investments Note. The book balance should be reported on the SNP, not in the Note.
- Generally, this section of the Note disclosure refers to the various examples of “Deposits with Financial Institutions”. The term “cash and cash equivalents” is used in reference to GASB Statement 9 that affects presentation for the SNP and statement of cash flows, NOT the Note disclosures as required by GASB Statement 3, 40 & 72. “Deposits with Financial Institutions” include deposit accounts in banks, savings and loan associations, and credit unions. They can be demand, savings,
time accounts, including negotiable order of withdrawal (NOW) accounts, non-negotiable CDs, and money market demand accounts. As stated previously, deposits for the Note may be a combination of SNP line items or titles and should be the bank balance of these items.

- **Do not include** any cash on deposit with the STO, petty cash not in a bank account, or cash on hand in the Note. **The book balance of these cash items should be reported on the SNP.**

- In addition to regular checking and saving accounts the following financial instruments should also be reported as deposits:

  1. **Nonnegotiable Certificate of Deposit** – Nonnegotiable CDs are time deposits that are placed by depositors directly with financial institutions and generally are subject to a penalty if redeemed before maturity. These are treated as deposits for GASB 3 note disclosures and investments on the SNP and Statement of Cash Flows. The bank balance should be reported under “Nonnegotiable CD’s” in the Note.

  2. **Money Market Demand Account** – Financial institution “money market” accounts are simply deposit accounts that pay interest at a rate set to make the accounts competitive with money market mutual funds. **They should be treated like any other deposit account for GASB 3 note disclosures and reported under “Money Market Demand Accounts” in the Note.**

  3. **Bank Investment Contract (BIC)** – A BIC is a general obligation instrument issued by a bank, typically to a pension plan that provides for a guaranteed return on principal over a specified period. Since these are issued by a bank, they are treated as deposits for GASB 3 note disclosures. **The bank balance should be reported under “Nonnegotiable CD’s” in the Note.**

  4. **Negotiable Order of Withdrawal (NOW)** – Checking accounts that earn interest and may require at least seven days written notice of a withdrawal.

- **Custodial Credit Risk** – GASB 3 as amended by GASB 40 requires disclosure of bank balances that are considered to be exposed to custodial credit risk. Custodial credit risk is the risk that, in the event of the failure of the depository financial institution, a government will not be able to recover deposits or collateral securities that are in the possession of an outside party. **Bank deposits that are fully insured are not exposed to custodial credit risk.**

  1. **Insured (Insurance)** – deposits are insured by federal deposit insurance (FDIC), state deposit insurance, multiple financial institution collateral pools that insure public deposits, and even commercial insurance (if scope of coverage would be substantially the same as FDIC). For deposits with in-state banks, governments receive up to $250,000 FDIC insurance for the combined amount in all time deposits and savings accounts and an additional $250,000 for the combined amount in all interest and noninterest-bearing demand deposit accounts. **Deposits up to the $250,000 threshold are fully insured and require no additional disclosure.**

  2. **Collateral** – Security pledged by a financial institution to a government entity for its deposits.
3. **Uninsured and Uncollateralized** – Deposits in excess of $250,000 that are not covered by additional depositor’s insurance or collateralized by securities pledged by the financial institution.
   
   Example: an agency has deposits of $100,000 in a non-interest bearing checking account, $200,000 in a money market demand account, and a $150,000 nonnegotiable CD. The non-interest bearing checking account and the money market demand account are both demand accounts covered by $250,000 of combined FDIC insurance. The nonnegotiable CD is a time deposit and is therefore covered by an additional $250,000 of FDIC insurance. If no additional insurance or collateral is provided by the financial institution, the agency would report $50,000 as uninsured and uncollateralized deposits for total demand deposits in excess of the $250,000 FDIC insurance.

4. **Uninsured and Collateralized with Securities Held by the Pledging Institution** – Includes deposits in excess of $250,000 that are not covered by additional depositor’s insurance, but are collateralized with securities held by the pledging institution and **NOT** in the agency’s (depositor’s) name.

5. **Uninsured and Collateralized with Securities Held by the Pledging Institution’s Trust Department or Agent, but not in the agency’s name** – include deposits in excess of $250,000 that are not covered by additional depositor’s insurance, but are collateralized with securities held by the pledging institution’s trust department or agent and the securities are **NOT** in the agency’s (depositor’s) name.

   **Note:** The only difference between (4) and (5) is how the collateralized securities are held. Agency deposits under (5) are exposed to greater custodial credit risk because the agency’s access to the collateral and its liquidation rights may not be clear, in the event of default by the institution, since the securities are not held by the pledging institution and are not registered in the agency’s name.

**IV. Investments:**

For reporting purposes, an investment is a security or other asset that is held primarily for the purpose of income or profit and has present service capacity based solely on its ability to generate cash or to be sold to generate cash. The disclosures required for investments provides information on the fair market value (FMV) or cost (where applicable), custodial credit risk, credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. **Due to materiality, agencies (excluding STO and the pension systems) are not required to report concentration of credit risk or foreign currency risk in their AFR.**

Beginning with the June 30, 2016 fiscal year end all investments (exceptions noted in the standard) should be stated at FMV, which as defined by GASB Statement No. 72, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Some investments such as, negotiable certificates of deposit, are exempt from fair value reporting and should be reported using a cost-based measure.
Appendix A

Types of Investments

Below is a comprehensive list of the most common investments along with a brief explanation of each. Note: All new and changed requirements for fiscal year 2016 are in bold.

- Negotiable Certificates of Deposit - Securities with a minimum face value of $100,000, but are normally sold in $1 million units and can be traded in the secondary market. They appeal to institutions interested in low-risk investments with a high degree of liquidity. Because of their high liquidity, negotiable CD’s are money market investments that are subject to different valuation reporting requirements contingent upon their original maturity. See the matrix below for reporting requirements.

- Repurchase Agreement/Reverse Repurchase Agreement – A repurchase agreement is an agreement in which a governmental entity (buyer-lender) transfers cash to a broker-dealer or financial institution (seller-borrower): the broker-dealer or financial institution transfers securities to the entity and promises to repay the cash plus interest in exchange for a) the same securities, or for b) different securities. Include under this category, overnight repos, term repos, open repos, and tri-party repos. A reverse repurchase agreement is an agreement in which a governmental entity (buyer-lender) transfers securities to a broker-dealer or financial institution (seller-borrower): the broker-dealer or financial institution promises to resell the securities back to the governmental entity (buyer-lender) on a specified date at an agreed upon rate. Repurchase/reverse repurchase agreements are usually done on an overnight basis and provides incremental income an alternative to liquidating a portfolio.

- U.S. Government Obligations – Investments issued directly by and backed by the full faith and credit of the U.S. Government. Generally these investments are not exposed to custodial credit risk because they are backed by the full faith of the U.S. Government. Examples include treasury bills, treasury notes and treasury bonds. Note: Although not issued directly by the U.S. Government, investments in Fannie Mae and Freddie Mac now carry backed by the full faith and credit of the U.S. Government. Investments in Fannie Mae and Freddie Mac should be reported as U.S. Government Obligations in the Note. Because of their high liquidity, U.S. Government Obligations are money market investments that are subject to different valuation reporting requirements contingent upon their original maturity. See the matrix below for reporting requirements.

- U.S. Agency Obligations – Fixed-income securities that are issued by U.S. government-sponsored entities (GSEs). Because of their special GSE status, the market doesn’t demand as high of an interest rate as it would from an equivalent private sector issuer because of the perception that the government would step in to back the securities in the case of default. However, the U.S. government does not actually back these debt issues. Although they are U.S. Agency Obligations, Fannie Mae and Freddie Mac should not be reported as U.S. Agency Obligations because they are now backed by the full faith and credit of the U.S. Government and therefore should be reported as U.S. Government Obligations. Because of their high liquidity, negotiable CD’s are money market investments that are subject to different valuation reporting requirements contingent upon their original maturity. See the matrix below for reporting requirements.

- Equity Securities – An equity security represents ownership interest held by shareholders in a corporation, such as a stock. The most common equity investments are common and preferred stock, but all forms of equity, including private equity, should be included in this category. Private equity investments, though not as common, are investments in private companies such
as limited partnerships and venture capital that are not actively traded on the public exchange.

- **Mortgages** - Mortgage-backed securities (MBS) and collateralized mortgage obligations (CMO) are asset backed securities that use mortgage-backed securities as collateral. MBS’s and CMO’s are created when a financial institution, such as Fannie Mae, purchases mortgages from the banks that issue the mortgages, then the financial institution packages the mortgages and resells them into the secondary market where investors purchase them to earn current income in a relatively safe investment. **These investments should be reported according to the type of financial institution issuing the investment. Most investments within this category are issued by Fannie Mae, Freddie Mac, or one of the other GSE’s and should be reported as U.S. Government Securities or U.S. Agency Obligations.**

- **Corporate Bonds** – bond issued by a corporation in order to raise financing for a variety of reasons such as to ongoing operations, M&A, or to expand business. The term is usually applied to longer-term debt instruments, with maturity of at least one year.

- **Municipal Bonds** - Municipal bonds are debt obligations issued by public entities that use the loans to fund public projects such as the construction of schools, hospitals, and highways.

- **Closed-end Mutual Fund** – The investment company sells shares of its stock to investors and it invests on the shareholders’ behalf in a diversified portfolio of securities. A closed-end mutual fund has a constant number of shares, the value depends on the market supply and demand for the shares rather than directly on the value of the portfolio, the fund does issue certificates, and the securities are traded on a stock exchange.

- **Open-end Mutual Funds** – The investment company sells shares of its stock to investors and it invests on the shareholders’ behalf in a diversified portfolio of securities. In contrast to a closed-end mutual fund, the open-end mutual fund creates new shares to meet investor demand, the value depends directly on the value of the portfolio, and the fund does not issue certificates but sends out periodic statements showing account activity. These investments are not evidenced by securities that exist in physical or book entry form.

- **Commercial Paper** – An unsecured promissory note that is typically sold by a corporation, has a fixed maturity of 1 to 270 days, and is usually sold at a discount from face value. **See the matrix below for reporting requirements.**

- **Banker’s Acceptance** – A banker's acceptance (BA) is a short-term debt instrument issued by a firm that is guaranteed by a commercial bank. Banker's acceptances are issued by firms as part of a commercial transaction. These instruments are similar to T-Bills and are frequently used in money market funds. Banker's acceptances are traded at a discount from face value on the secondary market, which can be an advantage because the banker's acceptance does not need to be held until maturity. **See the matrix below for reporting requirements.**

- **External Investment Pools** - An arrangement that commingles (pools) the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio; one or more of the participants is not part of the sponsor's reporting entity. An external investment pool can be sponsored by an individual government, jointly by more than one government, or by a nongovernmental entity. An investment pool that is sponsored by an individual state or local
government is an external investment pool if it includes participation by a legally separate entity that is not part of the same reporting entity as the sponsoring government. If a government-sponsored pool includes only the primary government and its component units, it is an internal investment pool and not an external investment pool.

- Other – It is not appropriate to present material amounts of investments as “Other”, unless the Note disclosure describes the composition of the “Other” category. The following are examples of other investments:
  a. Guaranteed Investment Contracts - insurance contracts that guarantee the owner principal repayment and a fixed or floating interest rate for a predetermined period of time.
  b. Investments Held in Private Foundations
  c. Other Bonds – Examples include foreign government bonds, bond issue trustee accounts, bond index funds, foreign bonds, private placement bonds, and Yankee bonds.
  d. Any other unique investment not listed above or not included in another category type.

**Determining the Value of Investments**

In March of 2015, the Governmental Accounting Standards Board (GASB) released Statement No. 72 *Fair Value Measurement and Application*, which would generally require governmental entities to measure investments at fair value. Prior to GASB Statement No. 72, GASB Statement No. 31 established valuation reporting requirements for investments in interest-earning investment contracts, external investment pools, mutual funds, debt securities, and equity securities for all governmental entities except defined benefit pension plans and deferred compensation plans. GASB Statement No. 31 is still applicable, but has been amended to include the fair value reporting requirements established in GASB Statement No. 72.

**Per GASB Statement No. 72, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement technique aimed at maximizing the use of relevant observable valuation inputs and minimizing the use of unobservable valuation inputs.**

**A. Investments Not Valued at Fair Market Value**

While GASB Statement No. 72 requires investments to be measured at fair value, the standard provides for a few exceptions that were and may continue to be accounted for using other valuation methods as prescribed in the applicable GASB standards issued prior to GASB No. 72. The following is a comprehensive listing of investments that do not require fair value reporting as well as the required valuation method:

- Nonparticipating interest-earning investment contracts (non-negotiable CD’s) - should be measured using a cost-based measure as provided in paragraph 8 of Statement 31.
- Unallocated insurance contracts - should be reported as interest-earning investment contracts according to the provisions of paragraph 8 of Statement 31, and paragraph 4 of Statement No. 59, Financial Instruments Omnibus.
Money market investments and participating interest-earning investment contracts (negotiable CD’s) – short term, highly liquid debt instruments including negotiable CD’s, commercial paper, banker’s acceptances, US Government Securities, and US Agency Obligations that have a remaining maturity at the time of purchase of 12 months or less and are held by governments other than external investment pools should be measured at amortized cost as provided in paragraph 9 of Statement 31.

Investments held by 2a7-like external investment pools - measured at amortized cost as provided in paragraph 16 of Statement 31.

Fully Benefit-Responsive Synthetic guaranteed investment contracts - should be measured at contract value as provided in paragraph 67 of Statement 53.

Investments in 2a7-like external investment pools - should be measured at the net asset value (NAV) per share (or its equivalent) determined by the pool as provided in paragraph 5 of Statement 59.

Life insurance contracts - should be measured at cash surrender value.

B. Fair Market Value

For all other investments not included in the list above, valuation approaches and techniques should be used to determine fair value. Per GASB Statement No. 72, governments should use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. These techniques should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. Per Statement No. 72, governments should use valuation techniques consistent with one or more of the following three approaches:

- **Market approach** - The market approach to measuring fair value uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities, or groups of assets and liabilities. Using quoted market prices is a technique that is most consistent with the market approach. Additional examples include the use of the market multiples technique and the matrix pricing technique.

- **Cost Approach** - The cost approach to measuring fair value reflects the amount that would be required currently to replace the present service capacity of an asset. From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence can be physical, functional (technological), or economic (external).

- **Income Approach** - The income approach to measuring fair value converts future amounts (for example, cash flows or revenues and expenses) to a single current amount (such as would be determined by using the discounted present value technique). When the income approach is used, the fair value measurement reflects current market expectations about those future amounts. Valuation techniques consistent with the income approach include (a) the present value technique, (b) the option pricing model technique, such
as the Black–Scholes–Merton formula, and (c) the multiperiod excess earnings technique.

C. **Fair Value Hierarchy & Valuation Techniques**

**Valuation Techniques**

**What is a Valuation Technique?**

A valuation technique is a specific method or combination of methods used to determine the fair value of an investment. Government should use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs. A government should use valuation techniques consistent with one or more of three approaches to measuring fair value as defined above and should apply the techniques consistently from period to period.

**Are Governments Allowed to Change Valuation Techniques?**

Governments are allowed to change valuation techniques as well as changing how those techniques are applied when multiple techniques are used to value a single investment. For example, change in the weighting of individual valuation techniques when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique.

A change in valuation technique is appropriate if the change results in a measurement that is equally or more representative of fair value under the current circumstances. A few examples of what may facilitate a need for a change include, newly developed markets, new information, prior inputs no longer available, and changing marking conditions.

Whenever a change in valuation technique is made, the following should be disclosed in the “Change of Valuation Techniques” section of the Investment Note:

- Type of Investment – should correspond to the investment listing in the fair market value hierarchy table. Each type of investment should be listed separately
- Current Year Valuation Technique – describe the valuation technique used in the current fiscal year
- Prior Year Valuation Technique – describe the valuation technique used in the prior fiscal year
- Reason for the change – what new circumstances occurred facilitating a need for a change

**Fair Market Value Hierarchy**

Beginning with the June 30, 2016 fiscal year end, all investments stated a fair market value must ranked according to the fair value hierarchy established by GASB Statement No. 72. The fair value hierarchy prioritizes or ranks the valuation inputs used to measure fair value into three categories – Level 1, Level 2 and Level 3 inputs – considering the relative reliability of the inputs.
What are Valuation Inputs?

The assumptions that market participants would use when pricing an asset or liability, including assumptions about risk, such as the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) or the risk inherent in the inputs to the valuation technique. Inputs can be observable or unobservable.

- **Observable inputs** are developed using market data, such as publicly available information about actual events or transactions, and which reflect the assumptions that market participants would use when pricing an asset or liability.

- **Unobservable inputs** are inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing an asset or liability.

Governments should maximize the use of observable inputs and minimize the use of unobservable inputs when assessing fair value through valuation techniques.

What is the Fair Value Hierarchy?

The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels. Each investment required to be valued at fair value, per GASB Statement No. 72, must be ranked according to the provisions in the standard as defined below:

- **Level 1 - Quoted Prices in Active Markets for Identical Assets** – Level 1 inputs are the 1st valuation assumptions in the hierarchy. The value of investments in this category are derived from quoted or unadjusted prices of identical investments traded in active markets and accessible at the measurement date. Active or observable markets include exchange markets, dealer markets, brokered markets, and principal to principal markets.
  - **Level 1 inputs are the most reliable.**
  - **No additional valuation technique disclosures are required for level 1 investments because the only technique that can be used is quoted or unadjusted prices in active markets for identical assets.**
  - **If adjustments to the quoted prices are necessary, the investments should be ranked as level 2 or level 3 NOT level 1.**

- **Level 2 - Significant Other Observable Inputs** – Level 2 inputs are the 2nd valuation assumptions in the hierarchy. These inputs are derived from or corroborated by observable market data through correlation or by means other than identical investments on the active market. Level 2 inputs include: (1) Quoted prices for similar investments in active markets, (2) Quoted prices for identical or similar investments in inactive markets, (3) Inputs other than quoted prices (e.g. interest rates and observable yield curves, implied volatilities, and credit spreads), and (4) Market-corroborated inputs. **Disclose the specific valuation technique used in addition to the hierarchy level for each investment.**

- **Level 3 inputs – Significant Unobservable Inputs** are the 3rd valuation assumptions in the hierarchy. Level 3 inputs can include historical prices, nonbinding quotes that cannot be corroborated by observable market data, and financial forecasts developed using the government’s own data. **Level 3 inputs should only be used when relevant level 1 and...**
level 2 inputs are not available. Disclose the specific valuation technique used in addition to the hierarchy level for each investment.

Additional Valuation Technique Disclosures

GASB Statement No. 72 requires governments disclose the specific valuation technique used to value all of its investment stated at fair value. Level 1 investments, which used quoted market prices, **do not** require additional disclosure because any adjustments to the quoted market price will drop the investments ranking to 2 or 3.

Specific valuation technique disclosure is required for all investments ranked as level 2 or level 3. Examples of specific valuation techniques include:

- Expected cash flow technique - the probability-weighted average (that is, mean of the distribution) of possible future cash flows.
- Market multiples technique - technique that relies on the use of multiples or ratios as an expression of market price relative to a key statistic, such as earnings, book value, or cash flows.
- Matrix pricing technique - used to value securities based on their relationship to benchmark quoted prices.
- Multi-period excess earnings technique - based on prospective financial information (for example, revenues, expenses, or cash flows) associated with a collection of assets. The initial amount is reduced for the contributions of supporting assets, with the residual amount being the excess earnings associated with the asset being valued.
- Option pricing model technique - used to value an option contract that is based on the critical terms of the contract and implied volatility.
- Present value technique - used to link future amounts (cash flows or values) to a present amount by employing a discount rate (an application of the income approach).

V. Risk Disclosures for Deposits and Investments:

Deposits and investments are subject to several types of risks, mainly credit risk, market risk, interest rate risk, and foreign currency risk.

- **Credit risk** – defined as the risk that a counterparty to an investment transaction will not fulfill its obligations and can be associated with the issuer of securities, with a financial institution holding deposits, or with a party holding investment or collateral securities.
- **Concentration of credit risk** – defined as the risk of loss attributed to the magnitude of a government’s investment in a single issuer.
- **Interest rate risk** – defined as the risk that changes in interest rates will adversely affect the fair value of an investment.
- **Foreign currency risk** – defined as the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.
Appendix A

A. Custodial Credit Risk Disclosures for Deposits

Following GASB Statement 3, deposits were classified into three categories of custodial credit risk depending on whether they were insured or collateralized, and who holds the collateral and how the collateral is held.

1. Collateral – Securities pledged by the financial institution for the purpose of securing the governmental entity’s deposits.
2. Collateralized – When the entity’s deposits are secured with securities pledged by the financial institution holding the deposits.

GASB Statement 40 amended GASB Statement 3 to eliminate the requirement to disclose all deposits by the three categories of risk. GASB Statement 40 requires only the disclosure of deposits that are considered to be exposed to custodial credit risk. An entity’s deposits are exposed to custodial credit risk if the deposit balances are 1) uninsured and uncollateralized, 2) uninsured and collateralized with securities held by the pledging financial institution, or 3) uninsured and collateralized with securities held by the pledging financial institution’s trust department or agent, but not in the entity’s name.

Government’s bank deposits are exposed to custodial credit risk if any of the three situations occurs:

- Deposits exceed FDIC insurance and pledged securities;
- Pledged securities are held by the government’s bank; and/or
- Pledged securities are held by the government’s bank’s trust department or their agent, but not in the name of the government.

B. Custodial Credit Risk Disclosures for Investments

Following GASB Statement 3, investments (listed by type) were either classified into three categories (depending on whether they are insured or registered and who holds the securities and how they are held), or listed as non-categorized investments.

GASB Statement 40 amended GASB Statement 3 to eliminate the requirement to disclose all investments by the three categories of risk. GASB Statement 40 requires only the separate disclosure of investments that are considered to be exposed to custodial credit risk. However, the total reported amount and fair value columns still must be reported for total investments regardless of exposure to custodial credit risk. Those investments exposed to custodial credit risk are reported by type in one of two separate columns depending upon whether they are held by a counterparty, or held by a counterparty’s trust department or agent not in the entity’s name.

Investment securities exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either:
1. The counterparty or
2. The counterparty’s trust department or agent but not in the government’s name.

C. Additional Risk Disclosures for Required by GASB Statement 40:

Credit Risk - Disclose the credit risk of debt investments by credit quality ratings as described by rating agencies as of the fiscal year end, including the rating agency used. All debt investments regardless of type can be aggregated by credit quality rating (if any are un-rated, disclose that amount). Examples of un-rated debt
investments include U.S. Treasury Notes, external investment pools, or investments held by foundations. The preparer may need to contact their investment advisor for complete information relating to debt investments and their credit quality ratings.

Debt securities issued by a federal government-sponsored enterprise (GSE) and held by a state or local government as an investment are subject to credit risk. GSEs are independent organizations sponsored by the federal government. Examples include the Federal Farm Credit Banks, the Federal Home Loan Bank System, and Student Loan Marketing Association (SLMA). The liabilities of the GSE are not backed by the full faith and credit of the federal government.

In November 2008, Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) were taken into conservatorship by the U.S. Government (government). The government entered into a Senior Preferred Stock Purchase Agreement with each of these entities which ensures that each enterprise maintains a positive net worth, which means they are currently backed by the full faith and credit of the federal government. As with U.S. Treasury Notes, a credit quality rating may not be available, but the amount of the investment should be disclosed. For more information on these agreements refer to the Federal Housing Finance Agency [http://www.fhfa.gov/Default.aspx?Page=33](http://www.fhfa.gov/Default.aspx?Page=33).

**Interest Rate Risk** - Interest rate risk is the risk that changes in interest rates may reduce or increase the market value of a debt instrument. Interest rate risk is only applicable to debt investments. Interest rate risk should be listed by the investment type, fair value, and maturity in years. The preparer may need to contact their investment advisor for complete information relating to the related maturities of these investments.

**Highly Sensitive Investments** - The fair value and terms of any debt investments that are highly sensitive to changes in interest rates due to the terms (e.g. coupon multipliers, reset dates, embedded options, etc.) of the investments should be disclosed. Examples of debt investments that are highly sensitive to changes in interest rates include asset-backed securities such as mortgage pass-through securities issued by FNMA, Government National Mortgage Association (GNMA), and FHLMC.

### INVESTMENTS MATRIX

<table>
<thead>
<tr>
<th>INVESTMENT TYPE</th>
<th>Fair Market Value Hierarchy</th>
<th>Valuation Techniques (Only Required for Level 2 and Level 3 FMV Hierarchy)</th>
<th>Custodial Credit Risk</th>
<th>Credit Risk</th>
<th>Interest Rate Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiable CD &lt; 12 Months to Maturity at Purchase Date</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Negotiable CD &gt; 12 Months to Maturity at Purchase Date</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Commercial Paper &lt; 12 Months to Maturity at Purchase Date</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Commercial Paper &gt; 12 Months to Maturity at Purchase Date</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Fair Market Value Hierarchy</td>
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<td></td>
</tr>
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<td>---------------------------------------------------------------</td>
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<td></td>
</tr>
<tr>
<td>Banker's Acceptance &lt; 12 Months to Maturity at Purchase Date</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Banker's Acceptance &gt; 12 Months to Maturity at Purchase Date</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
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<tr>
<td>Repurchase Agreements backed by US Government Obligations, Fannie Mae, and/or Freddie Mac</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
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</tr>
<tr>
<td>Repurchase Agreements backed by Securities other than US Government Obligations, Fannie Mae, and/or Freddie Mac Only</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>US Government Obligations (including Fannie Mae &amp; Freddie Mac) &lt; 12 Months to Maturity at Purchase Date</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>US Government Obligations (including Fannie Mae &amp; Freddie Mac) &gt; 12 Months to Maturity at Purchase Date</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>US Agency Obligations &lt; 12 Months to Maturity at Purchase Date</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
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</tr>
<tr>
<td>US Agency Obligations &gt; 12 Months to Maturity at Purchase Date</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Municipal Bonds</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Closed-End Mutual Fund</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Open-End Mutual Funds Exclusively Invested in Fixed Income Securities</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Open-End Mutual Funds Not Exclusively Invested in Fixed Income Securities</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>External Investment Pools Exclusively Invested in Fixed Income Securities</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>External Investment Pools Not Exclusively Invested in Fixed Income Securities</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Equity Securities (including Common Stock, Preferred Stock &amp; Private Equity)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
</tbody>
</table>
VI. Securities as Applied to Credit Risk of Deposits and Investments:

Securities defined – a transferable financial instrument that evidences ownership or creditorship. Securities can be in either paper or book-entry form.

1. Examples of securities that are often held by or pledged to (as collateral) governmental entities include:
   a. treasury bills, treasury notes, treasury bonds
   b. federal agency obligations
   c. corporate debt instruments (including commercial paper)
   d. corporate equity instruments
   e. negotiable CDs (key word here is negotiable)
   f. bankers’ acceptances
   g. shares of closed-end mutual funds (key word here is closed-end)
   h. shares of unit investment trusts

2. Instruments or investments that are not securities include:
   a. investments made directly with another party (such as limited partnerships)
   b. real estate
   c. direct investments in mortgages and other loans
   d. investments in open-ended mutual funds (keyword here is open-ended)
   e. pools managed by other governments
   f. annuity contracts

VII. Derivative Instruments

What is a derivative?
A derivative instrument is a complex financial instrument or other contract that has all three of the following characteristics:
   a. It has (1) one or more reference rates and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required.
   b. It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
   c. Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

A derivative instrument that is embedded in a financial instrument or contract should be evaluated in accordance with the hybrid instrument guidance in paragraphs 63-66 of GASB Statement No. 53. Fully benefit-responsive Synthetic Guaranteed Investment Contracts (SGICs) should be measured and reported in accordance with the guidance in paragraphs 67 and 79 of GASB Statement No. 53, respectively.

What financial instruments are excluded from the scope of GASB Statement No. 53?
   a. Normal purchases and normal sales contracts
   b. Insurance contracts
   c. Certain financial guarantee contracts
   d. Certain contracts that are not exchange-traded
e. Loan commitments

**How should derivative instruments be recognized and measured on the financial statements?**

Derivative instruments should be reported on the statement of net position and measured at fair value. Fair value should be measured by the market price if there is an active market for the derivative instrument. If a market price is not available, a forecast of expected cash flows may be used, provided that the expected cash flows are discounted. Formula-based methods and mathematical methods are acceptable. Fair values of options may be based on an option pricing model, such as the Black-Scholes-Merton model. That model considers probabilities, volatilities, time, settlement prices, and other variables. Fair values developed by pricing services are acceptable, provided that those values are developed using the methods described in this paragraph.

Potential hedging derivative instruments must be evaluated for effectiveness to determine whether it is an investment derivative instrument or a hedging derivative instrument.

Changes in the fair value of hedging derivative instruments are reported as either deferred inflows or deferred outflows in the statement of net position.

Changes in the fair value of investment derivative instruments should be reported within investment revenue on the statement of revenues, expenses and changes in fund net position.

An embedded derivative instrument that is a component of a hybrid instrument should be recognized and measured in accordance with this Statement. An embedded derivative instrument that is a component of a hybrid instrument may also be a hedging derivative if it meets the requirements of this Statement. The companion instrument should be recognized and measured in accordance with the reporting requirements that are applicable to that companion instrument – such as the financial reporting requirements for a debt instrument, a lease, or an insurance contract.

Costs associated with on-behalf payments included in derivative instrument payments should be reported as expenditures or expenses consistent with the manner in which those payments would have been reported if the government had made the payment directly.

**What are the methods for evaluating effectiveness and what does it mean to be effective and/or ineffective?**

Potential hedging derivative instruments should be evaluated for effectiveness as of the end of each reporting period using a method described in paragraphs 36-62 of GASB Statement No. 53. The extent to which these methods are required to be applied in the evaluation of effectiveness is as follows:

a. **Evaluation of effectiveness in the first reporting period.** If a potential hedging derivative instrument is first evaluated using the consistent critical terms method and does not meet the criteria for effectiveness of that method, at least one quantitative method also should be applied before concluding that the potential hedging derivative instrument is ineffective. If a potential hedging derivative instrument is first evaluated using a quantitative method and does not meet the criteria for effectiveness of that method, a government may, but is not required to, apply another quantitative method(s) before concluding that the potential hedging derivative instrument is ineffective. If it is determined that a potential hedging derivative instrument is ineffective in the first reporting period, evaluation of effectiveness in subsequent reporting periods should not be performed for financial reporting purposes.
b. **Evaluation of effectiveness in subsequent reporting periods.** All potential hedging derivative instruments that were determined to be hedging derivative instruments in the prior reporting period should be re-evaluated as of the end of the current reporting period using the method that was applied in the prior reporting period. If that method is applied and the hedging derivative instrument no longer meets the criteria for effectiveness of that method, a government may, but is not required to, apply another method(s) before concluding that the hedging derivative instrument is no longer effective.

The methods for evaluating effectiveness discussed in GASB Statement No. 53 include the following:

a. **Consistent Critical Terms Method** – evaluates effectiveness by qualitative consideration of the critical terms of the hedgeable item and the potential hedging derivative instrument

b. **Synthetic Instrument Method** – this quantitative method evaluates effectiveness by combining the hedgeable item and the potential hedging derivative instrument to simulate a third synthetic instrument

c. **Dollar-Offset Method** – this quantitative method evaluates effectiveness by comparing the changes in expected cash flows or fair values of the potential hedging derivative instrument with the changes in expected cash flows or fair values of the hedgeable item

d. **Regression Analysis Method** – this quantitative method evaluates effectiveness by considering the statistical relationship between the cash flows or fair values of the potential hedging derivative instrument and the hedgeable item

e. **Other Quantitative Methods** – a government may use a quantitative method to evaluate effectiveness not specifically identified in GASB Statement No. 53 if the method meets all of the following criteria:
   i. Through identification and analysis of critical terms, the method demonstrates that the changes in cash flows or fair values of the potential hedging derivative instrument substantially offset the changes in cash flows or fair values of the hedgeable item
   ii. Replicable evaluation of effectiveness are generated that are sufficiently complete and documented such that different evaluators using the same method and assumptions would reach substantially similar results
   iii. Substantive characteristics of the hedgeable item and the potential hedging derivative instrument that could affect cash flows or fair values are considered

If the potential hedging instrument is deemed to be effective, it is a hedged derivative instrument; otherwise, it is an investment derivative instrument.

**What financial statement note disclosures should be presented for derivative instruments?**

A. Governments should provide a summary of their derivative instrument activity during the reporting period and balances at the end of the reporting period. The information disclosed should be organized by governmental activities, business-type activities, and fiduciary funds. The information should then be divided into the following categories – hedging derivative instruments (distinguishing between fair value hedges and cash flow hedges) and investment derivative instruments. Within each category, derivative instruments should be aggregated by type (for example, receive-fixed swaps, pay-fixed swaps, swaptions, rate caps, basis swaps, or futures contracts).
Information presented in the summary should include:

a. Notional amount
b. Changes in fair value during the reporting period and the classification in the financial statements where those fair values are reported
c. Fair values as of the end of the reporting period and the classification in the financial statements where those fair values are reported (if derivative instrument fair values are based on other than quoted market prices, the methods and significant assumptions used to estimate those fair values should be disclosed)
d. Fair values of derivative instruments reclassified from a hedging derivative instrument to an investment derivative instrument, along with disclosure of the deferral amount that was reported within investment revenue upon reclassification

B. Governments should disclose contingent features that are included in derivative instruments held at the end of the reporting period, such as a government’s obligation to post collateral if the credit quality of the government’s hedgeable item declines. For derivative instruments with contingent features reported as of the end of the reporting period, disclosure should include:
   a. The existence and nature of contingent features and the circumstances in which the features could be triggered
   b. The aggregate fair value of derivative instruments that contain those features
   c. The aggregate fair value of assets that would be required to be posted as collateral or transferred in accordance with the provisions related to the triggering of the contingent liabilities
   d. The amount, if any, that has been posted as collateral by the government as of the end of the reporting period.

C. If a government reports a hybrid instrument, disclosures of the companion instrument should be consistent with disclosures required of similar transactions, for example, disclosures for debt instruments. In that case, the existence of an embedded derivative with the companion instrument should be indicated in the disclosures of the companion instrument. For example, if a government has entered into a hybrid instrument that consists of a borrowing for financial reporting purposes and an interest rate swap, the government’s disclosure should indicate the existence of the interest rate swap within the debt disclosure.

Derivative instruments often are stand-alone instruments, such as futures contracts. A derivative instrument also may accompany a companion instrument such as a debt instrument, a lease, an insurance contract, or a sale or purchase contract. An embedded derivative instrument may be a call option in a bond, a cap, or floor in a sale or purchase contract, or an interest rate swap in a debt instrument. Alternatively, some derivative instruments may include investing or borrowing transaction. These instruments may give rise to a hybrid instrument, which consists of a derivative instrument and a companion instrument.

A hybrid instrument exists when the instrument meets all of the following criteria:

a. The companion instrument is not measured on the statement of net position at fair value.
b. A separate instrument with the same terms as the derivative instrument would meet the definition of a derivative instrument.
c. The economic characteristics and risks of the derivative instrument are not closely related to the economic characteristics and risks of the companion instrument.
D. Governments that report a synthetic guaranteed investment contract (SGIC) that is fully benefit-responsive should disclose the following information in the notes to the financial statement as of the end of the reporting period:

a. A description of the nature or the SGIC
b. The SGIC’s fair value (including separate disclosure of the fair value of the wrap contract and the fair value of the corresponding underlying investments).

Fully benefit-responsive SGIC, the combination of the underlying investments and the wrap contract, should be reported at contract value. An SGIC is fully benefit-responsive if all of the following criteria are met:

a. The SGIC prohibits the government from assigning or selling the contract or its proceeds to another party without consent of the issuer.
b. Prospective interest crediting rate adjustments are provided to plan participants and the government on a designated pool of investments by a financially responsible third party. Those adjustments provide assurance that probable future rate adjustments that would result in an interest crediting rate of less than zero is remote. The pool of investments in total meets both of the following criteria:
   i. Is of high credit quality such that the possibility of credit loss is remote
   ii. May be prepaid or otherwise settled in such a way that the government and plan participants would recover contract value.
c. The terms of the SGIC require all permitted participant-initiated transactions with the government to occur at contract value with no conditions, limits, or restrictions. Permitted participant-initiated transactions are those transactions allowed by the government, such as withdrawals for benefits, loans, or transfers to other investment choices.
d. Some events may limit a government’s ability to transact with participants at contract value. Examples are premature termination of contracts, layoffs, plan terminations, bankruptcies, and early retirement incentives. The probability of such an event occurring within one year of the date of the financial statements is remote.
e. The government allows participants reasonable access to their investments. The following conditions do not affect the benefit responsiveness of an SGIC:

   i. In plans with a single investment choice, restrictions on access to assets by active participants are consistent with the objective of the plan (for example, retirement benefits).

   ii. Participants’ access to their account balances is limited to certain specified times during the plan year (for example, semiannually or quarterly) to control the administrative costs of the plan.

   iii. Administrative provisions that place short-term restrictions (for example, three or six months) on transfers to competing fixed-income investment options to limit arbitrage among those investment options (that is, equity wash provisions).

If plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, participants would not have reasonable access to their investments.

The following should be disclosed for hedging derivative instruments:
a. **Objectives** - The government should disclose its objectives for entering into the instruments, the context needed to understand those objectives, its strategies for achieving those objectives, and the types of derivatives instruments entered into.

b. **Terms** - The government should disclose the significant terms of the transaction, including:
   i. Notional, face, or contract amount
   ii. Reference rates, such as indexes or interest rates
   iii. Embedded Options, such as caps, floors, or collars
   iv. The date when the hedging derivative instrument was entered into and the scheduled maturity/termination date
   vi. The amount of cash paid or received when the derivative was entered into

c. **Risks** - The government should disclose, when applicable, its exposure to the following risks that could give rise to financial loss. Risk disclosures are limited to hedging derivative instruments that are reported as of the end of the reporting period. Disclosures required by this paragraph may contain information that is also required by other paragraphs. However, these disclosures should be presented in the context of a hedging derivative instrument’s risk.

   i. **Credit risk** is the risk that a counterparty will not fulfill its obligations. If a hedging derivative instrument exposes a government to credit risk, the government should disclose that exposure as credit risk and also disclose the following information:

      (1) The credit quality ratings of counterparties as described by nationally recognized statistical rating organizations—rating agencies—as of the date of the end of the reporting period. If a credit risk disclosure is required and the counterparty is not rated, the disclosure should indicate that fact.

      (2) The maximum amount of loss due to credit risk, based on the fair value of the hedging derivative instrument as of the date of the reporting period, that the government would incur if the counterparties to the hedging derivative instrument failed to perform according to the terms of the contract, without respect to any collateral or other security, or netting arrangement.

      (3) Information about the policy of requiring collateral or other security to support hedging derivative instruments subject to credit risk, a summary description and the aggregate amount of the collateral or other security that reduces credit risk exposure, and the information about the government’s access to that collateral or other security.

      (4) Information about the policy of entering into any master netting arrangements, including a summary description and the aggregate amount of liabilities included in those arrangements, to mitigate credit risk.

      (5) The aggregate fair value of hedging derivative instruments in asset (positive) positions net of collateral posted by the counterparty and the effect of master netting arrangements.
(6) Significant concentrations of net exposure to credit risk (gross credit risk reduced by collateral, other security, and setoff) with individual counterparties and groups of counterparties. A concentration of credit risk exposure to an individual counterparty may not require disclosure if its existence is apparent from the disclosures required by other parts of this paragraph.

ii. **Interest rate risk** is the risk that changes in interest rates will adversely affect the fair values of a government’s financial instruments or a government’s cash flows. If a hedging derivative instrument increases a government’s exposure to interest rate risk, the government should disclose that increased exposure as interest rate risk and also the hedging derivative instrument’s terms that increase such a risk. The determination of whether a hedging derivative instrument increases interest rate risk should be made after considering, for example, the effects of the hedging derivative instrument and any hedged debt.

iii. **Basis risk** is the risk that arises when variable rates or prices of a hedging derivative instrument and a hedged item are based on different reference rates. If a hedging derivative instrument exposes a government to basis risk, the government should disclose that exposure as basis risk and should also disclose the hedging derivative instrument’s terms and payment terms of the hedged item that creates the basis risk.

iv. **Termination risk** is the risk that a hedging derivative instrument’s unscheduled end will affect a government’s asset/liability strategy or will present the government with potentially significant unscheduled termination payments to the counterparty. If a hedging derivative instrument exposes a government to termination risk, the government should disclose that exposure as termination risk and also the following information, as applicable:

1. Any termination events that have occurred.
2. Dates that the hedging derivative instrument may be terminated.
3. Out-of-the-ordinary termination events contained in contractual documents, such as “additional termination events” contained in the Schedule to the International Swap Dealers Association Master Agreement.

v. **Rollover risk** is the risk that a hedging derivative instrument associated with a hedgeable item does not extend to the maturity of that hedgeable item. When the hedging derivative instrument terminates, the hedgeable item will no longer have the benefit of the hedging derivative instrument. If a hedging derivative instrument exposes a government to rollover risk, the government should disclose that exposure as rollover risk and should also disclose the maturity of the hedging derivative instrument and the maturity of the hedged item.

vi. **Market-access risk** is the risk that a government will not be able to enter credit markets or that credit will become more costly. If the hedging derivative instrument creates market-access risk, the government should disclose that exposure as market-access risk.

vii. **Foreign currency risk** is the risk that changes in exchange rates will adversely affect the cash flows or fair value of a transaction. If a hedging derivative instrument exposes a government
to foreign currency risk, the government should disclose the U.S. dollar balance of the
hedging derivative instrument, organized by currency denomination and by type of derivative
instrument.

d. **Hedged debt** – If the hedged item is a debt obligation, governments should disclose the hedging
derivative instrument’s net cash flow based on the requirements established by Statement No. 38,
*Certain Financial Statement Note Disclosures*, paragraphs 10 and 11.

e. **Other quantitative method of evaluating effectiveness** – If effectiveness is evaluated by
application of a quantitative method not specifically identified in this Statement, governments
should disclose the following information:

i. The identity and characteristics of the method used
ii. The range of critical terms the method tolerates
iii. The actual critical terms of the hedge

The following should be disclosed for investment derivative instruments:

a. **Risks** – The government should disclose, when applicable, its exposure to the following risks that
could give rise to financial loss. Risk disclosures are limited to investment derivative instruments that
are reported as of the end of the reporting period. Disclosures required by this paragraph may contain
information that is also required by other paragraphs. However, these disclosures should be presented
in the context of an investment derivative instrument’s risk.

i. **Credit risk** is the risk that a counterparty will not fulfill its obligations. If an investment
derivative instrument exposes a government to credit risk, the government should disclose
that exposure as credit risk and that disclosure should be consistent with the requirements
stated above.

ii. **Interest rate risk** is the risk that changes in interest rates will adversely affect the fair values
of a government’s financial instruments or a government’s cash flows. If an investment
derivative instrument exposes a government to interest rate risk, the government should
disclose that exposure consistent with the disclosures required by Statement 40, paragraphs
14 and 15. Further, an investment derivative instrument that is an interest rate swap is an
additional example of an investment that has a fair value that is highly sensitive to interest
rate changes as discussed in Statement 40, paragraph 16. The fair value, notional amount,
reference rate, and embedded options should be disclosed.

iii. **Foreign currency risk** is the risk that changes in exchange rates will adversely affect the
cash flows or fair value of a transaction. If an investment derivative instrument exposes a
government to foreign currency risk, the government should disclose that exposure
consistent with the disclosures required by Statement 40, paragraph 17.

**When should hedge accounting cease to be applied?**

Hedge accounting should cease to be applied upon the occurrence of one of the following termination events:
1. The hedging derivative instrument is no longer effective as determined by applying the criteria stated in a prior question.
2. The likelihood that a hedged expected transaction will occur is no longer probable.
3. The hedged asset or liability, such as a hedged bond, is sold or retired but not reported as a current refunding or advanced refunding resulting in a defeasance of debt.
4. The hedging derivative instrument is terminated.
5. A current refunding or advanced refunding resulting in the defeasance of the hedged debt is executed.
6. The hedged expected transaction occurs, such as the purchase of an energy commodity or the sale of bonds.

If a termination event described in #1 through #4 above occurs, the balance in the deferral account should be reported on the flow of resources statement within the investment revenue classification. If reported separately within investment revenue, the removal of the balance in the deferral account should be captioned increase (decrease) upon hedge termination. Once the termination event has occurred, hedge accounting should not be reapplied to that hedging relationship. A derivative instrument from a terminated hedge, however, may be employed as a hedging derivative instrument in a new hedge, provided that the derivative instrument meets the criteria as described in a previous question.

If the termination event is the current refunding or advanced refunding resulting in the defeasance of the hedged debt, #5 above, the balance of the deferral account should be included in the net carrying amount of the old debt for purposes of calculating the difference between that amount and the reacquisition price of the old debt in accordance with paragraphs 4 and 5 of Statement 23. This approach should be applied regardless of whether the hedging derivative instrument is terminated, notwithstanding paragraph 23. The calculation of the difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding and the economic gain or loss resulting from the transaction, as required by paragraph 11 of Statement 7, should include the effects of a hedging derivative instrument.

If the termination event is the occurrence of the hedged expected transaction, #6 above, the disposition of the deferral balance depends on whether the hedged expected transaction results in a financial instrument or a commodity.

a. If the expected transaction results in a financial instrument, the accounting treatment depends on whether the government is re-exposed to the hedged risk.
   1. If the government is re-exposed to the hedged risk, the balance of the deferral account should be recognized on the flow of resources statement within the investment revenue classification.
   2. If the government is not re-exposed to the hedged risk, the balance in the deferral account should be reported on the flow of resources statement consistent with the hedged item. For example, a government hedges its exposure to interest rate risk associated with the expected issuance of fixed-rate debt using a hedging derivative instrument, an interest rate lock. The interest rate lock terminates on the date of the expected issuance of debt. If the fixed-rate bonds are issued and the interest rate lock is terminated, the government is no longer exposed to interest rate risk. In this case, the deferral account should be amortized in a systematic and rational manner over the life of the debt as an adjustment of interest expense.
The decision as to whether a termination event re-exposes a government to a hedged risk should be based on specific facts and circumstances. If, for example, the interest rate lock in the earlier example is terminated shortly before fixed-rate bonds are issued, the government should consider whether during that interim period, the government’s exposure to interest rate risk was significant. In the interim time period or the re-exposure to the identified financial risk is significant, the amount in the deferral account should be removed by recognizing that balance in the flow of resources statement.

b. If the expected transaction results in a commodity, the balance of the deferral account should be removed by reporting the balance as an adjustment to the actual transaction. For example, if the expected transaction is a hedge of market risk associated with the purchase of electricity and the purchase occurs, the balance of the deferral account related to the hedging derivative instrument should be removed by reporting the balance as an adjustment to the cost of energy.
GASB 42 establishes accounting and financial reporting standards for impairment of capital assets and for insurance recoveries. Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. GASB 42, paragraph 9 outlines five (5) common “indicators of impairment.” They are:

1. Evidence of physical damage, such as for a building damaged by fire or flood, when the level of damage is such that restoration efforts are needed to restore service utility.
2. Enactment or approval of laws or regulations or other changes in environmental factors, such as new earthquake standards that a facility does not meet, and cannot be modified to meet.
3. Technological development or evidence of obsolescence, such as that related to a major piece of diagnostic or research equipment.
4. A change in the manner or expected duration of use of a capital asset, such as closure of a building prior to the end of its useful life.
5. Construction stoppage, such as stoppage of construction as a result of a lack of funding.

Damaged assets can be separated into the following categories:

- assets that will not be returned to service
- assets temporarily out of service due to needed repairs, restoration, or recertification
- assets remaining in service but needing repair
- assets damaged that will continue to be used but will not be repaired

Category 1 assets that are destroyed or so badly damaged that it is not cost effective to restore them are considered to be 100% impaired, and the impairment loss will be equal to the carrying value of the asset at the beginning of the year of the impairment event. The impairment loss for category 1 assets that are not completely destroyed, will no longer be used, and will not be restored will equal the difference between the carrying value at the beginning of the year of the impairment event and the fair value after the impairment event. If the assets are going to be restored (category 2 and 3), then they need to be evaluated for impairment per GASB 42.

For assets impaired by physical damage, the restoration cost approach should be used to calculate the impairment loss. Under this approach, the amount of the impairment loss is derived from the estimated costs to restore the utility of the capital asset. According to the standard, an asset is not considered impaired unless its decline in service utility is significant; therefore, OSRAP has established impairment thresholds for assets impaired by physical damage. In order for an asset to be considered impaired by physical damage, the restoration cost (estimated restoration cost if the asset is not fully restored) of the impaired asset must be equal to or greater than the following:

Infrastructure – Greater of $3 million or 20% of the capitalized cost of the infrastructure segment or asset
Building – Greater of $100,000 or 20% of the capitalized cost of the building
Movable Property – Greater of $20,000 or 20% of the capitalized cost of the asset

Infrastructure – The magnitude in the decline in service utility will be considered significant if the (estimated) restoration cost exceeds the greater of $3 million or 20% of the capitalized cost of the impaired asset or segment.

Buildings – For buildings impaired by physical damage, the restoration cost threshold is equal to the greater of the capitalization threshold, $100,000, or 20% of the capitalized cost of the building. If the cost to restore the building is lower than the capitalization threshold or 20 percent of the capitalized cost of the impaired building (whichever is higher), we will not consider the “magnitude in the decline in service utility is significant”
component of the impairment test to be met. If, however, the building’s restoration costs are equal to or greater than the capitalization threshold or equal to or greater than 20 percent of the capitalized costs of the impaired building (whichever is higher), and the building’s decline in service utility is “unexpected”, we will conclude that the asset has met the impairment test criteria, and is impaired. Note: According to the provisions of GASB 42, an asset is impaired when there is a “significant” and “unexpected” decline in the service utility of a capital asset.

Movable property – For movable property impaired by physical damage, the restoration cost threshold is equal to $20,000, or 20 percent of the capitalized cost of the movable property. If the cost to restore the property is lower than $20,000 or 20% of the capitalized cost of the impaired property (whichever is higher), we will not consider the “magnitude in the decline in service utility is significant” component of the impairment test to be met. If the cost to restore the movable property is equal to or greater than the impairment threshold, $20,000, or 20 percent of the capitalized cost of the impaired movable property (whichever is greater), and the movable property’s decline in service utility is unexpected, we will conclude that the asset has met the impairment test criteria, and is impaired according to the provisions of GASB 42.

Category 4 assets do not meet the impairment threshold test because the magnitude in the decline in service utility component of the impairment test would not be met, and no impairment loss will be calculated for these assets.

For assets impaired by enactment or approval of laws or regulations or other changes in environmental factors, technological development or evidence of obsolescence, or a change in the manner or expected duration of use, use the examples provided in GASB 42 for guidance in calculating the impairment loss. The thresholds developed by OSRAP for estimated restoration cost discussed above do not apply to these assets. Report capital assets impaired by construction stoppage at the lower of carrying value or fair value.

An insurance recovery associated with events or changes in circumstances resulting in impairment of a capital asset should be netted with the impairment loss when the recovery and the loss occur in the same year. Restoration or replacement of the capital asset using the insurance recovery should be reported as a separate transaction. Insurance recoveries should be disclosed if not apparent from the face of the financial statements.

GASB 42 requires that the carrying amount of impaired capital assets that are idle at year-end be disclosed in the notes, regardless of whether the impairment is permanent or temporary. However, an impairment loss does not have to be calculated for a temporarily impaired asset. If management has to take action to reverse an impairment, such as restoration of a capital asset with physical damage, then the impairment should be considered permanent. In certain circumstances, temporary impairments could be associated with enactment or approval of laws or regulations or other changes in environmental factors, changes in technology or obsolescence, changes in manner or duration of use, or construction stoppage.
CAPITAL ASSETS

I. NON-DEPRECIABLE CAPITAL ASSETS:

A. LAND

- **Land** - an inexhaustible asset with an unlimited useful life and therefore is **not** depreciated.

- **Non Depreciable Land improvements** - betterments, improvements, and site preparations that ready land for its intended use. These improvements are inexhaustible and are not depreciated.

B. CONSTRUCTION IN PROGRESS – records the cost of construction work, which is not yet completed (typically, applied to capital budget items). A Construction in Progress item is not depreciated until the asset is placed in service. Upon completion, a Construction in Progress item is reclassified, and the reclassified asset is capitalized and depreciated.

II. DEPRECIABLE CAPITAL ASSETS

A. BUILDINGS

- **Buildings** - permanent structures erected above ground, together with fixtures attached to and forming a permanent part of the building, for the purpose of sheltering persons or personal property. The cost of buildings include all labor, materials, and professional services required to construct the building, and any other costs to prepare the building for its intended use.

- **Building improvements** – major repairs, renovations, or additions to a building that increase the future service potential of the building and benefit future periods. The buildings and the improvements become one and are inseparable.

- **Depreciable land improvements** - improvements made to land that have determinable estimated useful lives and deteriorate with use or the passage of time. These improvements are built or installed to enhance or facilitate the use of the land for a particular purpose. Depreciable land improvements differ from non-depreciable land improvements and land as the life of a depreciable land improvement is determinable.

- **Leasehold Improvements** – improvements made by the lessee to leased property such as land and buildings. The lessee has the right to use such facilities and improvements during the life of the lease, but the improvements made to the property would revert to the lessor at the expiration of the lease. For this reason, the useful life of the leasehold improvement cannot be longer than the remaining lease term.

B. MACHINERY & EQUIPMENT (MOVABLE PROPERTY)

- **Machinery & Equipment** - capital assets that are not fixed or stationary in nature. Machinery and Equipment consist of those assets that are not land, land improvements, buildings, building improvements, or infrastructure.
• **Capitalized Collections (Historical Treasures & Works of Art)** – items which are considered inexhaustible and held for public exhibition, educational purposes, or research in enhancement of public service instead of financial gain.

**NOTE:** Generally, collections of historical treasures & works of art will be considered inexhaustible, and would therefore not be depreciated. However, if a collection was **capitalized as of June 30, 1999, the collection, as well as additions to the collections, must continue to be capitalized.** However, if the collection was **not capitalized as of June 30, 1999**, do not capitalize the collection.

**C. INFRASTRUCTURE** – long-lived capital assets associated with governmental activities that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets.

**D. INTANGIBLES** – intangible asset should be recognized only if it is identifiable, capable of being separated and sold, transferred, or licensed. Land use rights that do not include ownership of the underlying property should be valued and reported as an intangible asset.

**NOTE:** The ending balance (gross) of capital assets per the capital assets note must agree to the capital assets (by type of asset) listed on the SNP.

**III. DEPRECIATION AND AMORTIZATION**

The following capital asset categories should be depreciated and record accumulated depreciation:
- Buildings
- Machinery and Equipment
- Infrastructure
- Intangible Assets – record amortization

**Straight Line Depreciation Method**

a. The straight-line depreciation method is used to calculate the depreciation on all depreciable capital assets. The same amount of depreciation is deducted each year over the useful life of the property.

- To calculate depreciation and or amortization:
  - Determine the cost and estimated useful life of the asset. It is assumed that capital assets will have no salvage value.
  - Divide the cost by the number of years in the useful life. This gives you the yearly depreciation deduction. This amount will remain the same throughout the time the property is depreciation. (Cost/number of years of useful life = depreciation)
  - A full year of depreciation should be calculated in the year an asset is placed into service regardless of the actual date the asset was placed into service.
  - In the year of disposal, any remaining depreciation will be taken if the asset is not fully depreciated at the time of disposal.

b. Accumulated depreciation is the total depreciation for a capital asset that has been charged to expense since an asset was acquired and made available for use.

c. Accumulated amortization is the total amortization for Intangible Assets that has been charged to expense since the assets was acquired and made available for use.
NOTE:
- The accumulated depreciation – ending balance per the capital assets note must agree to accumulated depreciation (by type of asset) listed on the SNP.
- Accumulated depreciation – additions and amortization – additions per the capital assets note must agree to the corresponding line on the SRECNP. The sum of accumulated depreciation additions and amortization additions must agree to the depreciation/amortization listed on the SCF.

CAPITALIZATION THRESHOLD AND ASSET USEFUL LIFE

Listed below are examples of each asset type, capitalization threshold and the corresponding useful life for each.

<table>
<thead>
<tr>
<th>ASSET TYPE</th>
<th>CAPITALIZATION THRESHOLD</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>LAND</td>
<td>N/A – Capitalize all</td>
<td>N/A</td>
</tr>
<tr>
<td>NON-DEPRECIABLE LAND IMPROVEMENTS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excavation</td>
<td>N/A – Capitalize all</td>
<td>N/A</td>
</tr>
<tr>
<td>Filing</td>
<td>N/A – Capitalize all</td>
<td>N/A</td>
</tr>
<tr>
<td>Grading</td>
<td>N/A – Capitalize all</td>
<td>N/A</td>
</tr>
<tr>
<td>Demolition of Existing Buildings</td>
<td>N/A – Capitalize all</td>
<td>N/A</td>
</tr>
<tr>
<td>Removal or relocation of other property (i.e. telephone or power lines)</td>
<td>N/A – Capitalize all</td>
<td>N/A</td>
</tr>
<tr>
<td>MACHINERY &amp; EQUIPMENT/ MOVABLE PROPERTY</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical Equipment</td>
<td>$5,000</td>
<td>Varies</td>
</tr>
<tr>
<td>Automobiles</td>
<td>$5,000</td>
<td>5 years</td>
</tr>
<tr>
<td>High Mileage Automobiles</td>
<td>$5,000</td>
<td>3 years</td>
</tr>
<tr>
<td>Heavy General Purpose Trucks</td>
<td>$5,000</td>
<td>6 years</td>
</tr>
<tr>
<td>Light General Purpose Trucks (&lt; 13,000 lbs.)</td>
<td>$5,000</td>
<td>5 years</td>
</tr>
<tr>
<td>Buses</td>
<td>$5,000</td>
<td>9 years</td>
</tr>
<tr>
<td>ASSET TYPE</td>
<td>CAPITALIZATION THRESHOLD</td>
<td>USEFUL LIFE</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>--------------------------</td>
<td>-------------</td>
</tr>
<tr>
<td>Airplanes</td>
<td>$5,000</td>
<td>6 years</td>
</tr>
<tr>
<td>Over-the-road tractor units</td>
<td>$5,000</td>
<td>4 years</td>
</tr>
<tr>
<td>Trailers &amp; Trailer Mounted Containers</td>
<td>$5,000</td>
<td>6 years</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>$5,000</td>
<td>6 years</td>
</tr>
<tr>
<td>Office Furniture &amp; Fixtures</td>
<td>$5,000</td>
<td>10 years</td>
</tr>
<tr>
<td>Telephone Station Equipment</td>
<td>$5,000</td>
<td>10 years</td>
</tr>
<tr>
<td>Telephone Central Office Equipment</td>
<td>$5,000</td>
<td>18 years</td>
</tr>
<tr>
<td>Radio &amp; TV Broadcasting Equipment</td>
<td>$5,000</td>
<td>6 years</td>
</tr>
<tr>
<td>Printing &amp; Publishing Equipment</td>
<td>$5,000</td>
<td>10 years</td>
</tr>
<tr>
<td>Construction Equipment (backhoe, trucks, dozers, larger tractor)</td>
<td>$5,000</td>
<td>6 years</td>
</tr>
<tr>
<td>Agricultural Assets (grain bins, agricultural machinery &amp; equipment, etc.)</td>
<td>$5,000</td>
<td>10 years</td>
</tr>
<tr>
<td>Hogs - Breeding</td>
<td>$5,000</td>
<td>3 years</td>
</tr>
<tr>
<td>Sheep &amp; Goats - Breeding</td>
<td>$5,000</td>
<td>5 years</td>
</tr>
<tr>
<td>Dairy Cattle - Breeding</td>
<td>$5,000</td>
<td>7 years</td>
</tr>
<tr>
<td>Horses – Breeding or Work</td>
<td>$5,000</td>
<td>10 years</td>
</tr>
<tr>
<td>Horses – Not Breeding or Work</td>
<td>$5,000</td>
<td>12 years</td>
</tr>
<tr>
<td>Recreation Assets – Fee for Services (bowling alleys, billiards, pool halls, concert halls, etc.)</td>
<td>$5,000</td>
<td>10 years</td>
</tr>
<tr>
<td>Research &amp; Experimentation Assets</td>
<td>$5,000</td>
<td>10 years</td>
</tr>
<tr>
<td><strong>BUILDINGS &amp; IMPROVEMENTS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings</td>
<td>$100,000</td>
<td>40 years</td>
</tr>
</tbody>
</table>
### ASSET TYPE CAPITALIZATION THRESHOLD

<table>
<thead>
<tr>
<th>ASSET TYPE</th>
<th>CAPITAL THRESHOLD</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Farm Buildings (barns, garages, warehouses)</td>
<td>$100,000</td>
<td>25 years</td>
</tr>
<tr>
<td>• Single Purpose Agricultural Structures</td>
<td>$100,000</td>
<td>15 years</td>
</tr>
<tr>
<td>• Service Station Buildings</td>
<td>$100,000</td>
<td>20 years</td>
</tr>
</tbody>
</table>

### BUILDING IMPROVEMENTS

<table>
<thead>
<tr>
<th>ASSET TYPE</th>
<th>CAPITAL THRESHOLD</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Major repairs</td>
<td>$100,000</td>
<td>40 years</td>
</tr>
<tr>
<td>• Additions (i.e. HVAC System, new wiring, etc.)</td>
<td>$100,000</td>
<td>40 years</td>
</tr>
<tr>
<td>• Renovations</td>
<td>$100,000</td>
<td>40 years</td>
</tr>
</tbody>
</table>

### DEPRECIABLE LAND IMPROVEMENTS

<table>
<thead>
<tr>
<th>ASSET TYPE</th>
<th>CAPITAL THRESHOLD</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Walking paths and trails</td>
<td>$100,000</td>
<td>20 years</td>
</tr>
<tr>
<td>• Fences and gates</td>
<td>$100,000</td>
<td>20 years</td>
</tr>
<tr>
<td>• Landscaping</td>
<td>$100,000</td>
<td>20 years</td>
</tr>
<tr>
<td>• Sprinkler systems</td>
<td>$100,000</td>
<td>20 years</td>
</tr>
<tr>
<td>• Fountains</td>
<td>$100,000</td>
<td>20 years</td>
</tr>
<tr>
<td>• Beaches</td>
<td>$100,000</td>
<td>20 years</td>
</tr>
</tbody>
</table>

### LEASEHOLD IMPROVEMENTS

<table>
<thead>
<tr>
<th>ASSET TYPE</th>
<th>CAPITAL THRESHOLD</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Land Improvements (depreciable land improvement on leased land)</td>
<td>$100,000</td>
<td>Lesser of 20 years or remaining lease term</td>
</tr>
<tr>
<td>• Building Improvement (building or structures built on leased land)</td>
<td>$100,000</td>
<td>Lesser of 40 years or remaining lease term</td>
</tr>
</tbody>
</table>

### INFRASTRUCTURE

<table>
<thead>
<tr>
<th>ASSET TYPE</th>
<th>CAPITAL THRESHOLD</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Interstates</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
</tbody>
</table>
### ASSET TYPE CAPITALIZATION THRESHOLD

<table>
<thead>
<tr>
<th>ASSET TYPE</th>
<th>CAPITALIZATION THRESHOLD</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highways</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Roads</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Boat docks</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Curbs, gutters</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Tunnels</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Sidewalks</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Drainage Systems</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Canals</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Dams</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Levees</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Water and Sewer Systems</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Lighting Systems</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Bridges</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Piers</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Wharfs</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
<tr>
<td>Airport Runways</td>
<td>$3,000,000</td>
<td>40 years</td>
</tr>
</tbody>
</table>

### INTANGIBLES

<table>
<thead>
<tr>
<th>INTANGIBLES</th>
<th>CAPITALIZATION THRESHOLD</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patents</td>
<td>$100,000</td>
<td>17 years or actual life</td>
</tr>
<tr>
<td>Timber Rights</td>
<td>$100,000</td>
<td>40 years or contract life</td>
</tr>
<tr>
<td>Copyrights</td>
<td>$100,000</td>
<td>100 years</td>
</tr>
<tr>
<td>Trademarks</td>
<td>$100,000</td>
<td>40 years or contract life</td>
</tr>
<tr>
<td>Mineral Rights</td>
<td>$100,000</td>
<td>40 years or contract life</td>
</tr>
<tr>
<td>Water Rights</td>
<td>$100,000</td>
<td>40 years or contract life</td>
</tr>
<tr>
<td>ASSET TYPE</td>
<td>CAPITALIZATION THRESHOLD</td>
<td>USEFUL LIFE</td>
</tr>
<tr>
<td>-------------------------</td>
<td>--------------------------</td>
<td>-------------</td>
</tr>
<tr>
<td>• Software</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internally Developed:</td>
<td>Less than $10 million</td>
<td>7 years</td>
</tr>
<tr>
<td></td>
<td>Greater than $10 million</td>
<td>10 years</td>
</tr>
<tr>
<td>Purchased or Licensed</td>
<td>$1,000,000</td>
<td>3 years</td>
</tr>
<tr>
<td>Software</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
OTHER POST EMPLOYMENT BENEFITS (OPEB)

GASB Statement 75 establishes standards for accounting and financial reporting for defined benefit OPEB other than pensions including liabilities, deferred outflows of resources, deferred inflows of resources, expense/expenditures, note disclosures, and required supplementary information (RSI) in the financial reports of state and local governmental employers. It identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

Projections of benefit payments are based on claims costs and the benefit terms and legal agreements existing at the measurement date. The effects of projected salary changes and service credits are considered. Projected benefit payments are required to be discounted to their actuarial present value using the single rate that reflects a tax-exempt, high-quality municipal bond rate to the extent that the conditions for use of the long-term expected rate of return are not met. The actuarial present value of projected benefit payments must be attributed to periods of employee service using the entry age actuarial cost method with each period’s service cost determined as a level percentage of pay. The actuarial present value is required to be attributed to each employee individually, from the first period in which the employee provides service under the benefit terms, through the period in which the employee exits active service.

The OPEB expense and deferred outflows of resources and deferred inflows of resources related to OPEB that are required to be reported primarily result from changes in the components of the OPEB liability. Most changes in the OPEB liability are included in OPEB expense in the period of change. For example, changes in the total OPEB liability resulting from current-period service cost, interest on the total OPEB liability, and changes of benefit terms are required to be included in OPEB expense immediately.

When the OPEB liability is determined based on an actuarial valuation, the effects of certain other changes in OPEB liability are required to be included in OPEB expense over the current and future periods. The effects on total OPEB liability of (1) changes of economic and demographic assumptions or of other inputs and (2) differences between expected and actual experience are required to be included in OPEB expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with benefits through the plan beginning in the current period.

Changes in the OPEB liability that have not been included in OPEB expense are required to be reported as deferred outflows of resources or deferred inflows of resources related to OPEB. Employer benefit payments subsequent to the measurement date of the OPEB liability are required to be reported as deferred outflows of resources. For GASB 75 purposes, benefit payments are defined as the employer health and life insurance premiums paid for retirees. The Deferred outflows related to OPEB on each entity’s current year financial statements should equal the total of deferred outflows shown on the OPEB schedule provided by OSRAP, plus the amount of the current year OPEB benefit payments made subsequent to the measurement date.

TOTAL OPEB LIABILITY

The components of the journal entry used to record the liability are provided on OSRAP’s website at http://www.doa.la.gov/Pages/OSRAP/afrpackets.aspx. Select “GASB 75 – 20CY OGB OPEB Liability and Related Amounts”. You must use the amounts provided by OSRAP. Entities with a December year-end should also use the same valuation report. (OGB OPEB Actuarial Valuation Report as of July 1, 20PY to be used for FY ending June 30, 20CY). A new account line was added in fiscal year 2019 to record the current portion of the OPEB liability. There are four accounts affected by the journal entry; a general explanation of each follows:
Deferred Outflows Related to OPEB

The balance of this account line on the statement of net position must equal the amount of deferred outflows related to OPEB on the Schedule of Employer OPEB Amounts on OSRAP’s website for the fiscal year ending June 30, 20CY plus the employer benefit payments made subsequent to the measurement date (i.e., employer’s payment of retiree health and life insurance premiums made during the current fiscal year). Entities with a calendar year-end should only report six months of employer benefit payments made subsequent to the measurement date as deferred outflows. For example, a 12/31/17 calendar year-end entity with a 6/30/17 measurement date would report employer benefit payments made from 7/1/17 to 12/31/17 as deferred outflows related to OPEB.

The following are examples of journal entries that may be necessary to change the balance in the account - deferred outflows related to OPEB:

1. The reduction of the account balance for the employer’s portion of FY 20PY OPEB benefit payments. The journal entry to reverse this transaction is as follows:
   DR Total OPEB Liability
   CR Deferred Outflows Related to OPEB

2. The addition to the account balance for each new element of Deferred Outflows in FY 20CY. The journal entry to record these elements are as follows:
   DR Deferred Outflows related to OPEB
   CR Total OPEB Liability

3. The reduction to the account balance for amortization of each element of Deferred Outflows for prior years and the current year. The journal entry to record amortization of Deferred Outflows is as follows:
   DR OPEB Expense
   CR Deferred Outflows related to OPEB

4. The addition to the account balance for the employer’s portion of FY 20CY OPEB benefit payments as delineated below. The journal entry to record these elements are as follows:
   DR Deferred Outflows related to OPEB
   CR The account that was debited when the employer OPEB Benefit Payments were made for FY 20CY

Deferred Inflows Related to OPEB

The balance of this account line on the statement of net position must equal the amount of deferred inflows related to OPEB on the Schedule of Employer of OPEB Amounts on OSRAP’s website for the fiscal year ending June 30, 20CY. The following are examples of journal entries that may be necessary to change the balance in the account - deferred inflows related to OPEB:

1. The addition to the account balance for each new element of Deferred Inflows in FY 20CY. The journal entry to record these elements are as follows:
   DR Total OPEB Liability
Appendix D

CR Deferred Inflows related to OPEB

2. The reduction to the account balance for amortization of each element of Deferred Inflows for prior years and the current year. The journal entry to record amortization of Deferred Inflows is as follows:

\[
\text{DR Deferred Inflows Related to OPEB} \quad \text{CR OPEB Expense}
\]

Potential elements of deferred outflows and deferred inflows related to OPEB for your agency are as follows:

a) Differences between expected and actual experience with regard to economic or demographic assumptions
b) Changes to assumptions about future economic or demographic factors or other inputs
c) Changes in employer’s proportionate share of OPEB liability
d) Differences between benefit payments (employer retiree health and life insurance premiums) allocated by proportionate share and actual benefit payments

The GASB 75 section, “OPEB Provided through OPEB Plans That Are Not Administered through Trusts That Meet the Criteria in Paragraph 4” (paragraphs 21, 22, 143-202, and 222 of GASB 75) applies to the OGB OPEB Plan since it does not have a funded trust. In accordance with GASB Statement 75, all amortization periods are equal to the average of the expected remaining service lives of all employees that are provided with OPEB through the OPEB plan (active and inactive employees) determined as of the beginning of the measurement period.

Note Disclosure Requirements

According to GASB 75, paragraph 143, governments issuing stand-alone financial statements should apply the requirements of GASB 75, paragraphs 172-192 to report its participation in the OPEB plan. Below are the applicable paragraphs from GASB 75 that list the note disclosure requirements. The OGB Health Plan is considered a multiple employer plan and it does not have a special funding situation. The paragraph numbers from GASB 75 are displayed for easy reference.

143. The requirements of paragraphs 144–223, as applicable, should be applied separately to OPEB provided through separate defined benefit OPEB plans, other than insured plans, that are not administered through trusts that meet the criteria in paragraph 4. If a primary government and its component units provide OPEB through the same OPEB plan, in the reporting entity’s financial report, the requirements of paragraphs 162–171 of this Statement for note disclosures and required supplementary information should be applied. In that circumstance, in stand-alone financial statements, each government should apply the requirements of paragraphs 172–192 to account for and report its participation in the OPEB plan.

Notes to financial statements

185. The total (aggregate for all OPEB, regardless of the type of OPEB plans through which the OPEB is provided and whether the OPEB plans are administered through trusts that meet the criteria in paragraph 4 of this Statement) of the government’s OPEB liabilities, net OPEB assets, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense/expenditures for the period associated with defined
benefit OPEB liabilities to employees, as applicable, should be disclosed if the total amounts are not otherwise identifiable from information presented in the financial statements.

186. The information in paragraphs 187–189 should be disclosed for benefits provided through each defined benefit OPEB plan in which the government participates. Disclosures related to more than one OPEB plan should be combined in a manner that avoids unnecessary duplication.

**OPEB Plan Description**

187. The following information should be disclosed about the OPEB plan through which benefits are provided:

a. The name of the OPEB plan, identification of the entity that administers the OPEB plan, and identification of the OPEB plan as a single-employer or multiple-employer defined benefit OPEB plan.

b. A brief description of the benefit terms, including (1) the classes of employees covered; (2) the types of benefits; (3) the key elements of the OPEB formulas; (4) the terms or policies, if any, with respect to automatic postemployment benefit changes, including automatic COLAs, ad hoc postemployment benefit changes, including ad hoc COLAs, and the sharing of benefit-related costs with inactive employees; and (5) the authority under which benefit terms are established or may be amended. If the OPEB plan is closed to new entrants, that fact should be disclosed.

c. The fact that there are no assets accumulated in a trust that meets the criteria in paragraph 4. If OPEB is provided through an OPEB plan that is administered through a trust and that trust does not meet the criteria in paragraph 4, each criterion in paragraph 4 that the trust does not meet should be disclosed.

d. Identification of the authority under which requirements for the government and nonemployer contributing entities to pay OPEB as the benefits come due are established or may be amended. Also, the amount paid by the governmental nonemployer contributing entity for OPEB as the benefits came due during the reporting period, if not otherwise disclosed.

**Additional Information**

188. Significant assumptions and other inputs used to measure the collective total OPEB liability, including assumptions about inflation, healthcare cost trend rates, salary changes, ad hoc postemployment benefit changes (including ad hoc COLAs), and the sharing of benefit-related costs with inactive employees, should be disclosed, as applicable. With regard to the sharing of benefit-related costs, if projections are based on an established pattern of practice, that fact should be disclosed. With regard to mortality assumptions, the source of the assumptions (for example, the published tables on which the assumption is based or that the assumptions are based on a study of the experience of the covered group) should be disclosed. The dates of experience studies on which significant assumptions are based also should be disclosed. For all significant assumptions, if different rates are assumed for different periods, information should be disclosed about what rates are applied to the different periods of the measurement. With regard to the discount rate, the rate applied in the measurement and the source of that rate should be disclosed. In addition, if the alternative measurement method is used to measure the collective total OPEB liability, the source of or basis for all significant assumptions selected in conformity with paragraph 225 should be disclosed.

189. Measures of the government’s proportionate share of the collective total OPEB liability calculated using each of the following rates should be disclosed:

a. If applicable, a healthcare cost trend rate that is 1-percentage-point higher than the assumed healthcare cost trend rate and a healthcare cost trend rate that is 1-percentage-point lower than the assumed healthcare cost trend rate
A discount rate that is 1-percentage-point higher than that required by paragraph 155, and a discount rate that is 1-percentage-point lower than that required by paragraph 155.

190. The following **additional information** should be disclosed, if applicable:

a. The government’s proportionate share (amount) of the collective total OPEB liability, and, if the government has a special funding situation, (1) the portion of the nonemployer contributing entities’ total proportionate share (amount) of the collective total OPEB liability that is associated with the government and (2) the total of the government’s proportionate share (amount) of the collective total OPEB liability and the portion of the nonemployer contributing entities’ total proportionate share of the collective total OPEB liability that is associated with the government.

b. The government’s proportion (percentage) of the collective total OPEB liability, the basis on which its proportion was determined, and the change in its proportion since the prior measurement date.

c. The measurement date of the collective total OPEB liability; the date of the actuarial valuation or alternative measurement method calculation on which the collective total OPEB liability is based; and, if applicable, the fact that update procedures were used to roll forward the collective total OPEB liability to the measurement date. If the alternative measurement method permitted by this Statement is used to measure the collective total OPEB liability, the fact that this alternative method was used in place of an actuarial valuation also should be disclosed.

d. A brief description of changes of assumptions or other inputs that affected measurement of the collective total OPEB liability since the prior measurement date.

e. A brief description of changes of benefit terms that affected measurement of the collective total OPEB liability since the prior measurement date.

f. A brief description of the nature of changes between the measurement date of the collective total OPEB liability and the government’s reporting date that are expected to have a significant effect on the government’s proportionate share of the collective total OPEB liability, and the amount of the expected resultant change in the government’s proportionate share of the collective total OPEB liability, if known.

g. The amount of expense recognized by the government in the reporting period.

h. The government’s balances of deferred outflows of resources and deferred inflows of resources related to OPEB, classified as follows, if applicable:

1. Differences between expected and actual experience in the measurement of the collective total OPEB liability

2. Changes of assumptions or other inputs

3. Changes in the government’s proportion (paragraph 178) and differences between (a) the amounts paid by the government for OPEB as the benefits came due and (b) the government’s proportionate share of the total of certain payments by all entities that make benefit payments (paragraph 179)

4. Amounts associated with transactions subsequent to the measurement date of the collective total OPEB liability.

i. A schedule presenting the following:

1. For each of the subsequent five years, and in the aggregate thereafter, the net amount of the government’s balances of deferred outflows of resources and deferred inflows of resources in subparagraph (h) that will be recognized in the government’s expense

2. The amount of the government’s balance of deferred outflows of resources in subparagraph (h) that will be included as a reduction of the collective total OPEB liability.
j. The amount of revenue recognized for the support provided by nonemployer contributing entities (see paragraphs 182 and 183), if any.

**Required supplementary information**

191. A 10-year schedule with the information identified in subparagraphs (a) and (b), as applicable, should be presented in required supplementary information. Information should be presented separately for each defined benefit OPEB plan in which the government participates. The information should be determined as of the measurement date of the collective total OPEB liability.

a. If the government does not have a special funding situation:
   1. The government’s proportion (percentage) of the collective total OPEB liability
   2. The government’s proportionate share (amount) of the collective total OPEB liability
   3. The government’s covered-employee payroll
   4. The government’s proportionate share (amount) of the collective total OPEB liability as a percentage of the government’s covered-employee payroll

b. If the government has a special funding situation:
   1. The government’s proportion (percentage) of the collective total OPEB liability
   2. The government’s proportionate share (amount) of the collective total OPEB liability
   3. The portion of the nonemployer contributing entities’ total proportionate share (amount) of the collective total OPEB liability that is associated with the government
   4. The total of (2) and (3)
   5. The government’s covered-employee payroll
   6. The government’s proportionate share (amount) of the collective total OPEB liability as a percentage of the government’s covered-employee payroll.

**Notes to the Required Schedule**

192. The following information should be presented as notes to the schedule required by paragraph 191a or paragraph 191b:

a. The fact that there are no assets accumulated in a trust that meets the criteria in paragraph 4 to pay related benefits.

b. Information about factors that significantly affect trends in the amounts reported—for example, changes of benefit terms, changes in the size or composition of the population covered by the benefit terms, or the use of different assumptions. (The amounts presented for prior years should not be restated for the effects of changes—for example, changes of benefit terms or changes of assumptions—that occurred subsequent to the measurement date of that information).
Future Revenues Reported as a Sale

A transaction in which an agency/entity receives proceeds in exchange for cash flows from specific future revenues should be reported as a sale if the agency/entity’s continuing involvement with those revenues meets all of the following criteria:

a. The agency/entity does not maintain an active involvement in the future generation of those revenues.

b. The transferee’s ability to subsequently sell or pledge the future cash flows is not significantly limited by constraints imposed by the agency/entity either in the transfer agreement or through other means.

c. The cash resulting from collection of the future revenues has been isolated from the agency/entity. Generally, banking arrangements should eliminate access by the agency/entity to the cash generated by collecting the future revenues. Access is eliminated when the revenues are received directly by the transferee or are deposited directly into a custodial account maintained for the benefit of the transferee. However, if the agency/entity is required to remain as the recipient, (1) the cash payments to the transferee should be made only from the resources generated by the specific revenue or receivable rather than from the agency/entity own resources and (2) the cash collected should be remitted to the transferee without significant delay.

d. The contract, agreement, or other arrangement between the original resource provider and the agency/entity does not prohibit the transfer or assignment of those resources.

e. The sale agreement is not cancelable by either party, including cancellation through payment of a lump sum or transfer of other assets or rights.

The agency/entity may cease active involvement in the generation of specific revenues yet remain involved with those revenues in some manner. *Active involvement generally requires a substantive action or performance by the government.* Agency/entity should determine whether the primary or fundamental activity or process that generates the specific revenue requires continuing active involvement. The criteria for active involvement in the future generation of revenues include the following:

a. The agency/entity produces or provides the goods or services that are exchanged for the revenues.

b. The agency/entity levies or assesses taxes, fees, or charges and can directly influence the revenue base or the rate(s) applied to that base to generate the revenues.

c. The agency/entity is required to submit applications for grants or contributions from other governments, organizations, or individuals to obtain the revenues.

d. The agency/entity is required to meet grant or contribution performance provisions to qualify for those revenues.
The agency/entity may remain associated with the specific revenues in ways that do not constitute the primary or fundamental activity that generates the revenues and thus would be considered to have a passive involvement in the generation of those revenues. Activities that would be considered passive involvement include the following:

a. Holding title to revenue-producing assets (leases, rents, or royalty income)

b. Owning a contractual right to a stream of future revenues (tobacco settlement revenues)


d. Agreeing to refrain from specified acts or transactions (agreeing to noncompetition restrictions)

If the criteria required for sale reporting are not met (as described above and in GASB Statement No. 48, paragraphs 6 through 9) a transaction should be reported as a collateralized borrowing.
COOPERATIVE ENDEAVOR AGREEMENTS

LRS 33:9022 defines cooperative endeavors as any form of economic development assistance between and among the state of Louisiana, its local governmental subdivisions, political corporations, public benefit corporations, the United States government or its agencies, or any public or private association, corporation, or individual. The term cooperative endeavor includes cooperative financing, cooperative development, or any form of cooperative economic development activity. The state of Louisiana has entered into cooperative endeavor agreements with certain entities aimed at developing the economy of the state.

The net liability for fiscal year ending June 30, 20CY, is reported according to funding source, as follows:

- State General Fund
- Self-generated revenue
- Statutorily dedicated revenue
- General obligation bonds
- Federal funds
- Interagency transfers
- Other funds/combination

NOTE: Amounts in excess of contract limits cannot be used to reduce the outstanding contract balance at June 30, 20CY. For example, if a contract specifies a percentage of usage for each month (25%) and usage exceeds that percentage (75%), you cannot claim actual usage that exceeds contract requirements (50%).

NOTE: In order to compute the ending balances by funding source, you should begin with your prior year balances at June 30, 20PY. These amounts will be increased by amounts for new contracts and amendments and decreased for payments as well as for liquidations.

INSTRUCTIONS:

- No Coop Schedule in AFR portal – Use Schedule 16 (Coop worksheet prior to AFR portal) to report your agency’s cooperative endeavors
- No Coop Schedule in AFR portal (if applicable) – Submit an electronic version via e-mail to katherine.porche@la.gov
- Do not include encumbrances
- Report only the cooperative endeavors that you are obligated to pay
- **DO NOT REPORT** – if your agency is the recipient of the cooperative endeavor
- Payments made during the 45 day close (13th period) are included in the “Paid-Inception” amount
- Liquidation amounts are included in the “Paid-Inception” amount
- The seven (7) funding source column amounts must equal “Net Liability at June 30” column
The “Paid-Inception” plus “Net Liability” columns must equal “Original Amount of Coop” column.

**TYPE OF APPROPRIATIONS:**
- Multi-year appropriation – a contract with an annual obligation of a fixed amount over a number of years
- One-time appropriation – a contract that has an one-time obligation but any remaining amount can and does roll over into the next year or thereafter
- Other appropriation – a contract with an obligation that does not fall under multi-year or one-time appropriation. Attach a brief description of the obligation.

**AGENCIES - using LaGov-SRM:**
Most cooperative endeavor contracts are coded with a document type of “COP” in LaGov-SRM; however, there are some that are considered cooperative endeavors, but are coded with other document types. Examples of document types are:
- Contracts that fall under delegated authority (AGY or IAT)
- Facility Planning and Control contracts (CEA)
- Certain federal government contracts (OTH or GOV)
- Contracts designated as such by legislative auditors (AGY or IAT)
- Work Incumbent programs (WIP)

The Office of Technology Services (OTS) has developed a Business Objects report that may be useful for the data compilation of the Schedule 16 – Cooperative Endeavors required by OSRAP. This report will identify all the PPCS numbers that have the LaGov Serv Type listed above. You will have to review this report to determine which of these PPCS numbers are validate for the current fiscal year.
CASH FLOWS STATEMENT

The following information is from the Governmental Accounting Standards Board’s (GASB) Comprehensive Implementation Guide and provides guidance on reporting cash flows for proprietary funds.

Operating Activities – General

Nature of a fund’s “operations”:
The primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an entity during a period. The most useful presentation is to provide information about capital and related financing, noncapital financing, and investing activities, as well as cash flows from operating activities. The categories are defined from a functional perspective. Although the operating activities category also is defined, it serves as the residual category. Therefore, cash flow transactions should be evaluated first according to the definitions of capital and related financing, noncapital financing, and investing activities before being included in the operating activities category.

The operating activities category of the statement of cash flows is not intended to be a cash-basis operating statement. The format prescribed is intended to complement the accrual-basis financial statements. In addition, the presentation is not intended to imply that one category is more desirable than any other category. Therefore, there should be no predilection or preference for classifying cash flows in the operating activities category or any other category.

All items reported as part of operating income be included in the operating activities:

Classification of a transaction for operating statement purposes should not dictate its classification in the statement of cash flows. The transaction should be evaluated first according to the definitions of the capital and related financing, noncapital financing, and investing activities categories.

Cash flows from operating activities generally are the cash effects of transactions and other events that enter into the determination of operating income. Most nonoperating income items are classified in other than the operating activities category. The reconciliation of operating income to cash flows from operating activities would have fewer reconciling items if the operating activities category were highly correlated to operating income. However, the operating activities category includes all transactions and other events that are not defined as capital and related financing, noncapital financing, or investing activities. Therefore, operating income should not be considered a criterion for classifying cash flows.

If a transaction is included in operating income and its resulting cash flow meets the definition of a category other than operating activities, the item should be presented as a reconciling item in the reconciliation of operating income to net cash flow from operating activities. For example, if a finance authority reports interest income as a component of operating income, the cash received from interest income should be presented in the investing activities category. The reconciliation of operating income to net cash flow from operating activities should begin with reported operating income, and the interest income amount should be deducted as a reconciling adjustment to operating income, similar to depreciation.
Presentation of Individual Line Items

Level of Detail:
In reporting cash flows from operating activities, seven classes of information serve as a minimum level of required detail:

1. Cash receipts from customers
2. Cash receipts from interfund services provided
3. Other operating cash receipts, if any
4. Cash payments to other suppliers of goods or services
5. Cash payments to employees for services
6. Cash payments for interfund services used, including payments “in lieu of taxes” that are payment for, and reasonably equivalent in value to, services provided or received
7. Other operating cash payments, if any.

In all cases, further detail should be provided if the information would be useful.

Gross cash flow information generally is required. Therefore, related transactions should not be netted. For example, bond proceeds should be reported separately from capital purchases made with the proceeds. In addition, separating the principal and interest portions of debt service payments is considered useful.

Payroll taxes and employee-related costs, such as fringe benefits
Group cash payments for payroll taxes and fringe benefits with “cash payments to employees,” even though the cash is not paid directly to the employees. Payroll taxes and fringe benefits are paid on behalf of employees and are an integral part of employment costs.

Purchases by internal service fund
An internal service fund should report its purchases for supplies from vendors separately from purchases from funds of the primary government. Interfund services provided and used should be presented separately from other operating transactions. The intent is to highlight interfund activity.

Receipts by enterprise fund from state entity and local government participants
A state governmental enterprise (such as a workers’ compensation fund) that has receipts from within the state’s entity and also from local government participants, should distinguish from customers inside and outside the entity. Interfund services provided and used should be presented separately from other operating transactions. However, there is no requirement to separate the cash flows with discretely presented component units from cash flows with external parties.

Debt Service interest payments
All interest payments associated with “capital debt” should be presented in the capital and related financing activities category as “cash payments to lenders and other creditors for interest.” The presentation of cash payments for interest should not be affected by the transaction’s presentation on the operating statement or the statement of net position/balance sheet. The fact that the amount of the cash flow is capitalized does not change the fact that the cash was paid to a lender for interest.

Rent/Royalty income
The characteristics of the rent-generating asset should be examined in order to classify rent income as an operating activity or some other activity. The definition of the investing activities category does not specifically address the possibility of an investment’s being a tangible capital asset such as land; however, the list of investments described is not intended to be all-encompassing. If the land or other capital asset generating the rent is being
held as an investment (because it is being held for appreciation or it is being held temporarily for resale), then rent should be classified as an investing activity. Reporting the rent-generating asset on the statement of net position/balance sheet as an investment rather than a capital asset is evidence that the cash flows should be classified as investing activities.

If, however, the land or capital asset is being managed solely as a rent-generating operation, the cash inflows from rent should be classified with operating activities. Royalty income should be evaluated in the same manner.

**Miscellaneous income and expense**

Miscellaneous cash flows should be included in the operating activities category even if the income or the expense is considered a nonoperating income item. The operating activities category is not limited to the cash flows resulting from operating income items. Unless the cash flows specifically meet the definition of the noncapital financing, capital and related financing, or investing activities category, they should be presented in the residual category – operating activities. If nonoperating income items, such as miscellaneous income or expense, are included in the operating activities category, an adjustment should be made to operating income in the reconciliation of operating income to net cash flow from operating activities.

**Investment earnings**

Gains and losses on investments should not be presented in the statement of cash flows. Rather, proceeds from the sale of the investments (including gains and net of losses) should be reported as a cash inflow in the investing activities category. Investment earnings are sometimes included in operating income. However, they should be classified in the investing activities category. The statement of cash flows is not intended to replicate, on a cash basis, the operating statement.

**Interfund transfers**

The cash portion of an interfund transfer out should be presented in the noncapital financing activities category. A governmental enterprise fund receiving a transfer to be used for the specific purpose of defraying the cost of acquiring, constructing, or improving capital assets, however, should classify the cash inflow as a capital and related financing activity.

**Investments, Cash, and Cash Equivalents**

**Cash equivalents**

A cash equivalent is limited to investments with an original maturity of three months or less. The definition of cash equivalents refers to short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

**Original maturity**

Original maturity is based on the date the investment is purchased. If, on the purchase date, a qualifying investment will mature in three months or less, it is a cash equivalent. The evaluation should be made only once, as of the purchase date.

**Investments and cash equivalents**

If an instrument is treated as a cash equivalent, its conversion to or from cash or another cash equivalent would not be reported on the statement of cash flows. The transaction is analogous to the transfer of cash between two checking accounts. If, on the other hand, an instrument is treated as an investment, its conversion to or from cash or a cash equivalent should be reported in the investing activities category of the statement of cash flows, and the cash flows usually should be presented gross.
Identifying a Cash Flow

Cash flow
Sometimes there may be a question as to whether a cash transaction has occurred. It may be confusing to identify a cash flow in a banking environment. Generally, cash flows only if it changes hands; that is, ownership of cash legally changes. In an internal exchange transaction conducted totally within a bank, a cash transaction occurs only if a debit or credit is made to a governmental enterprise’s bank account. For example, a service charge or interest income is considered to be a cash transaction on the date the bank posts the amount to the account. After that date, the interest amount is available for withdrawal or the amount posted for the service charge is no longer available for withdrawal. Another example is a loan granted by a bank. If the loan proceeds are credited to the borrower’s bank account, a cash flow occurred. If the bank remitted the proceeds directly to the vendor, a noncash financing activity occurred.

Bond issuance costs and underwriter fees
If bond issuance costs and underwriter fees were deducted from bond proceeds, the governmental enterprise experiences only one cash flow. The net amount of bond proceeds actually received should be presented as a cash inflow in the appropriate category (either capital and related financing or noncapital financing, depending on the purpose of the borrowing).

On the other hand, if a governmental enterprise receives the proceeds from the sale of bonds and pays bond issuance costs and underwriter fees separately, the following cash flows should be presented: The total amount of bond proceeds should be presented as a cash inflow in the appropriate category (either capital and related financing or noncapital financing, depending on the purpose of the borrowing). The costs and fees that are paid from the governmental enterprise’s cash or cash equivalents should be presented as cash outflows in the same category.

Roll over of certificate of deposit
If a certificate of deposit that does not meet the definition of a cash equivalent automatically rolls over at maturity, there is no cash flow. There is no cash flow unless there is a deposit to or withdrawal from cash or a cash equivalent. Therefore, a rollover does not affect the statement of cash flows. The certificate of deposit is merely converted from one investment instrument to another.

Noncash Investing, Capital, and Financing Activities

Required disclosure
Information about all investing, capital, and financing activities of a governmental enterprise during a period that affect recognized assets or liabilities but do not result in cash receipts or cash payments in the period should be reported. Disclosure of noncash information is required if a transaction meets all of these three characteristics:

1. Some transactions are part cash and part noncash. Only the cash portion should be presented in the statement of cash flows. The noncash portion should be evaluated further.

2. Noncash assets and liabilities should be analyzed. Changes in the balance of a noncash asset or liability that are not attributable to cash transactions should be considered noncash transactions. For example, when an enterprise enters into a capital lease for a building, a noncash transaction occurred because a capital lease obligation and the building were recorded in the statement of net position. The inception of an operating lease, on the other hand, requires no disclosure because there is no balance sheet effect.
A noncash transaction should be disclosed only when it (had it been a cash transaction) meets the definition of the investing, capital and related financing, or noncapital financing activities category. For example, a capital lease transaction meets the definition of a capital and related financing activity. However, an account receivable balance removed in exchange for the forgiveness of an account payable is an operating activity and is not required to be disclosed.
PENSIONS
(GASB Statements No. 67 & 68)

GASB Statement No. 67, effective for fiscal years beginning after June 30, 2013, replaces the requirements of GASB Statement 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements, hereafter jointly referred to as trusts, that meet certain criteria. The Statement enhances the note disclosures and RSI for both defined benefit and defined contribution pension plans as well as requiring the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules.

GASB Statement 68, effective for fiscal years beginning after June 30, 2014, replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Statement 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information (RSI).

Pension Liability
The components of the journal entry used to record the liability are provided on OSRAP’s website at [http://www.doa.la.gov/Pages/osrap/afrpackets.aspx](http://www.doa.la.gov/Pages/osrap/afrpackets.aspx). Select “Pension amounts as of July 1, 20PY to be used for fiscal year ending June 30, 20CY.” You must use the amounts provided by OSRAP. Entities with a December year-end should also use the same valuation report (Pension amounts as of July 1, 20PY to be used for fiscal year ending June 30, 20CY). There are four accounts affected by the journal entry; a general explanation of each follows:

**Deferred Outflows Related to Pensions**
The balance of this account line on the statement of net position must equal the amount of deferred outflows related to pensions on the Schedule of Employer of Pension Amounts on OSRAP’s website for the fiscal year ending June 30, 20CY plus the employer pension contributions made subsequent to the measurement date (i.e., employer pension contributions made during the current fiscal year). Entities with a calendar year end should only defer 6 month of contributions. For example, a 12/31/15 calendar year-end entity with a 6/30/15 measurement date would defer employer pension contributions made from 7/1/15 to 12/31/15.

The following are examples of journal entries that may be necessary to change the balance in the account - deferred outflows related to pensions:

5. The reduction of the account balance for the employer’s portion of FY 20PY pension contributions. The journal entry to reverse this transaction is as follows:

   DR Net Pension Liability
   CR Deferred Outflows related to pensions

6. The addition to the account balance for each new element of Deferred Outflows in FY 20CY. The journal entry to record these elements are as follows:

   DR Deferred Outflows related to pensions
   CR Net Pension Liability
7. The reduction to the account balance for amortization of each element of Deferred Outflows for prior years and the current year. The journal entry to record amortization of Deferred Outflows is as follows:

   DR Pension Expense
   CR Deferred Outflows related to pensions

8. The addition to the account balance for the employer’s portion of FY 20CY pension contributions as delineated below. The journal entry to record these elements are as follows:

   DR Deferred Outflows related to pensions
   CR The account that was debited when the employer pension contributions were made for FY 20CY

**Deferred Inflows related to Pensions**

The balance of this account line on the statement of net position must equal the amount of deferred inflows related to pensions on the Schedule of Employer of Pension Amounts on OSRAP’s website for the fiscal year ending June 30, 20CY. The following are examples of journal entries that may be necessary to change the balance in the account - deferred inflows related to pensions:

1. The addition to the account balance for each new element of Deferred Inflows in FY 20CY. The journal entry to record these elements are as follows:

   DR Net Pension Liability
   CR Deferred Inflows related to pensions

2. The reduction to the account balance for amortization of each element of Deferred Inflows for prior years and the current year. The journal entry to record amortization of Deferred Inflows is as follows:

   DR Deferred Inflows related to pensions
   CR Pension Expense

Potential elements of deferred outflows and deferred inflows related to pensions for your agency are as follows:

   e) Differences between expected and actual experience with regard to economic or demographic assumptions
   f) Changes to assumptions about future economic or demographic factors or other inputs
   g) Differences between projected and actual earnings on pension plan investments
   h) Changes in employer’s proportionate share of net pension liability
   i) Differences between employer contributions and employer’s proportionate share of total contributions

In accordance with GASB Statement 68, all amortization periods are equal to the average of the expected remaining service lives of all employees that are provided with pensions through the pension plan (active and inactive employees) determined as of the beginning of the measurement period, except the amortization of the difference between projected and actual investment returns which are to be amortized over a closed 5-year period.
In March of 2016, GASB issued Statement No. 82 *Pension Issues* effective for reporting periods beginning after June 15, 2016. The Statement amended the definition of covered payroll as provided in Statements No. 67 and 68, defined as the payroll on which contributions to a pension plan are based, and ratios that use that measure. Based on the new definition, covered payroll **no longer includes** the following non-pensionable pay:

- Overtime
- Fringe benefits (such as a car allowance or housing allowance added to the gross wages of an employee)
- Per diem paid to board members if the person participates in the pension system
- Pay of Deferred Retirement Option Program (DROP) employees
- Pay of employees subject to Social Security tax prior to the employee becoming a State pension plan participant
- Total annual pay of an employee who was covered by two different pension plans (the plan on which we are requesting information and another) in the same year;
- Payout of annual leave upon termination; and
- On-call pay.

When reporting the employer contributions, report the contributions made for each system for the period on an accrual basis. For example, if you pay retirement contributions for June 20CY in July 20CY and a retirement contribution payment was made in July 20PY for FY 20PY, then the payment made in July 20CY should be included and the payment made in July 20PY would be excluded in calculating the FY 20CY retirement contributions. Also, if a refund of contributions from a system relating to the prior year is received, consider that amount as a reduction to employer contributions in the year the cash is received.
ITEMS PREVIOUSLY REPORTED AS ASSETS AND LIABILITIES

In March, 2012 GASB issued Statement No. 65, Items Previously Reported as Assets and Liabilities. The objective of GASB 65 is to properly classify certain items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources based on the definitions of those elements in Concepts Statement No. 4, Elements of Financial Statements.

Deferred Inflows of Resources and Deferred Outflows of Resources

The items now required to be reported as deferred inflows of resources and deferred outflows of resources include, but are not limited to, the following:

Refunding of Debt - Bonds
For current refundings and advance refundings resulting in defeasance of debt reported by governmental activities, business-type activities, and proprietary funds, the difference between the reacquisition price and the net carrying amount of the old debt should be reported as a deferred outflow of resources (debts) or a deferred inflow of resources (credits) and expensed as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Refunding of Debt – Change in Provisions of a Lease
If a change in the provisions of a lease results from a refunding by the lessor, including an advance refunding, in which (a) the perceived economic advantages of the refunding are passed through to the lessee and (b) the revised agreement is classified as a capital lease by the lessee, then the lessee should adjust the lease obligation to the present value of the future minimum lease payments under the revised lease. The difference should be reported as a deferred outflow of resources or a deferred inflow of resources and expensed as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Government Mandated Non-Exchange Transactions and Voluntary Non-Exchange Transactions
Grants and other resources (including fines and penalties) transmitted before time requirements are met, but after all other eligibility requirements have been met, should be reported as a deferred outflow of resources by the provider and a deferred inflow of resources by the recipient.

Below outlines how government-mandated and voluntary nonexchange transactions that involve resources received or provided in advance of meeting eligibility requirements should be reported versus those that are received or provided in advance of meeting timing requirements.

Resources received/provided in advance of:

- Eligibility requirements (other than time):
  - Recipient reports as liability – unearned revenue
  - Provider reports as asset – advances

- Time requirements:
  - Recipient reports deferred inflow of resources
  - Provider reports deferred outflow of resources
Sale of Future Revenue
In a sale of future revenues, the transferor government should report the proceeds as a deferred inflow of resources in both the government-wide and fund financial statements except for instances wherein recognition as revenue in the period of sale is appropriate. See GASB statement 48 for additional information.

Intra-Entity Transfers of Future Revenues
In an intra-entity transfer of future revenues, the transferee government should report the amount paid as a deferred outflow of resources to be recognized over the duration of the sale agreement. The transferor government should report the amount received from the intra-entity sale as a deferred inflow of resources in its government-wide and fund financial statements and recognize the amount as revenue over the duration of the sale agreement.

Sale-Leaseback Transactions
The gain or loss on the sale of property that is accompanied by a leaseback of all or any part of the property for all or part of its remaining economic life should be recorded as a deferred inflow (gain) of resources or a deferred outflow of resources (loss) and recognized over the lease term.

Lending Activities - Loan Origination Fees and Costs
Points received by a lender in relation to a loan origination should be reported as a deferred inflow of resources and recognized as revenue in a systematic and rational manner over the duration of the loan.

Mortgage Banking Activities - Loan Origination Fees and Costs
Points received by a lender in relation to a loan held for investment should be reported as a deferred inflow of resources and recognized as revenue in a systematic and rational manner over the duration of the loan. If the loan is held for sale, origination fees, including any portion related to points, and direct loan origination costs should be recorded as a deferred inflow (origination fees, including related points) of resources and a deferred outflow (direct loan origination costs) of resources, respectively, until the related loan is sold. Prior to the sale of the loans, the fees paid to permanent investors should be recorded as a deferred outflow of resources until the sale of the loan occurs.

Revenue Recognition in Governmental Funds
When an asset is recorded in governmental fund financial statements but the revenue is not available, the government should report a deferred inflow of resources until such time as the revenue becomes available.

Balances that Remain Assets or Liabilities:

Some balances that remain assets:
- Grants paid in advance of meeting eligibility requirements (other than timing)
- Prepayments
- Rights to future revenues acquired from outside the reporting entity

Some balances that remain liabilities:
- Derived tax revenue received in advance
- Grants received in advance of meeting eligibility requirement (other than timing)
- Resources received in advance of an exchange transaction
- Premium revenues (risk pools)
Additional Changes due to GASB 65

When an asset is recorded in governmental fund financial statements but the revenue is not available, the government should report a deferred inflow of resources until such time as the revenue becomes available.

GASB Statement no. 65 also prohibits the use of the term “deferred” for any financial statement item other than deferred inflows of resources and deferred outflows of resources. As a result, terms such as “deferred revenue” should not be used in the financial statements.

Accounting changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practical, for all periods presented. If restatement is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning net position or fund balance, as appropriate, for the earliest period restated.

In addition, GASB Statement No. 65 provides that certain items previously recognized as assets and amortized into expense should now be expensed in the period incurred. These items include:

Debt Issuance Costs
With the exception of prepaid insurance costs, costs related to the issuance of debt will no longer be recorded as a deferred charge and amortized over the life of the debt; they should instead be recognized as an expense in the period incurred. These include, but are not limited to, legal costs, costs of printing, insurance costs and various fees such as rating agency fees, trustee fees and administrative fees. Prepaid insurance costs should be reported as an asset and amortized to expense in a systematic and rational manner over the life of the related.

Acquisition Costs Related to Insurance Activities
Acquisition costs are those costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts. Commissions and other costs (for example, salaries of certain employees involved in the underwriting and policy issue functions, and medical and inspection fees) that are primarily related to insurance contracts issued or renewed during the period in which the costs are incurred should be considered acquisition costs. These acquisition costs should be recognized as an expense in the period incurred.
GASB 77 – TAX ABATEMENT DISCLOSURES

In August 2015, GASB issued Statement No. 77 (GASB 77), Tax Abatement Disclosures, which establishes financial reporting standards for tax abatement agreements entered into by state and local governments. The Statement requires disclosure of tax abatement information about (1) a reporting government’s own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government’s tax revenues. Tax abatements are widely used by state and local governments to encourage economic development. GASB 77 focuses on the amount of tax revenue that is not collected as a result of tax abatement agreements, and is aimed at informing the public about how these tax abatements affect governments. GASB 77 is effective for periods beginning after December 15, 2015, which would include fiscal years ending 12/31/16, 6/30/17, and 9/30/17.

Tax Abatements as defined in GASB 77 for financial reporting purposes include all of the following three elements. This statement does not apply to tax abatements that do not include all three required elements.

1. An identifiable agreement between one or more governments.
   - The agreement should include a promise by the government to reduce the individual’s or entity’s taxes and a promise from the individual or entity to perform a certain beneficial action.
   - The agreement may or may not be a written agreement, and it may or may not be legally enforceable.
   - The agreement precedes the reduction of taxes and the fulfillment by the individual or entity of the promise to perform the beneficial action.

2. A reduction of a government’s tax revenues which would otherwise be entitled.
   - There are a variety of mechanisms employed to reduce taxes covered by the agreements. For example, a recipient of a tax abatement receives a tax bill—most often for property taxes—that already is net of the abated amount. Sometimes property tax abatements involve a reduction of the taxable assessed value of property or a rebate of tax payments made by a taxpayer but, most commonly, they are a direct reduction in the tax obligation. The actual reduction of some types of tax revenues, such as corporate income and sales tax revenues, takes place later in the fiscal year because the amount owed is not known until then.

3. Contribution to economic development or benefits the governments or the citizens of those governments.
   - Economic development programs are designed to achieve goals such as:
     - increasing the property or other tax base
     - revitalizing local economies
     - retaining or attracting jobs, companies in particular industries, or a specific company
     - increasing the number of persons employed by existing employers
   - Other purposes that benefit a government or its citizens, such as:
     - historical preservation
environmental incentives
brownfield cleanup
housing construction

The most important element of tax abatements is the existence of an agreement between the government and an individual or entity. Tax abatements as defined by GASB 77, result from an identifiable agreement between a government and a specific individual or entity. Tax abatement agreements consist of at least two components—a promise by the government to reduce the individual’s or entity’s taxes and a promise from the individual or entity to subsequently perform a certain beneficial action. The agreement precedes the reduction of taxes and the fulfillment by the individual or entity of the promise to act. The terms of the agreement, including performance contingencies, timing of the tax reduction (the reduction can occur before, during, or after the entity performs its commitments) and the transferable nature of some reductions (credits) do not impact the fact that an agreement was formed and are not relevant to the definition of an agreement. The agreement may or may not be in writing and the agreements may not be legally enforceable.

A variety of titles or labels are used to identify tax reduction programs including exemptions, deductions, credits, rebates, and abatements. These labels are used interchangeably to describe similar and different transactions. GASB 77 does not include or exclude any specifically titled transaction or program in order to avoid including transactions that do not meet the definition of a tax abatement or excluding those that do. A **transaction’s substance, not its form or title, is a key factor in determining whether the transaction meets the definition of a tax abatement for the purposes of GASB 77.**

Disclosure should commence in the period in which a tax abatement agreement is entered into and continue until the tax abatement agreement expires. Governments that are legally prohibited from disclosing specific information required by this Statement may omit that information, however certain information must be disclosed relating to the prohibitions.

Per GASB 77, disclosures information may be provided individually or may be aggregated. OSRAP will report tax abatements in the aggregate organized by major tax abatement program rather than disclose information for individual tax abatement agreements within those programs. Agencies should **report information for tax abatements that are administered by your department only. To prevent duplicate reporting, do not report information for tax abatement programs that are administered by other agencies, such as the Department of Revenue.**

Tax abatement agreements entered into by a reporting government’s discretely presented component units should be disclosed as if entered into by the reporting government if the information is essential for a fair presentation or if not essential, disclose as if entered into by another government.
POLLUTION REMEDIATION OBLIGATIONS (Governmental Funds)

GASB issued Statement 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which requires reporting a liability in financial statements for pollution remediation obligations, effective for the State of Louisiana is fiscal year ending June 30, 2009, and includes entities with a fiscal year end date of/or after December 31, 2008.

Pollution remediation obligations (PRO) are defined as “obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups.” Examples of obligations provided in GASB 49 include the obligation to perform pollution remediation as part of a Brownfield redevelopment effort, remediating a leaking underground storage tank, water pollution from an abandoned waste dump, an Environmental Protection Agency (EPA) identified Superfund site, asbestos removal whether voluntary remediation or imminent threat, and legal action. PRO also include external government oversight and enforcement related activities such as that performed by an environmental regulatory authority dealing with the site and chargeable to the government; operation and maintenance including required monitoring of the remediation effort (post-remediation monitoring); pre-cleanup activities such as site assessments and investigations, feasibility studies or designing remediation plans; and cleanup activities such as neutralizing, containing, pollutant disposal, and site restoration.

The scope of GASB 49 excludes the following types of obligations.

1. Landfill closure and postclosure obligations within the scope of GASB Statement 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*.

2. Other future pollution remediation activities required upon the retirement of an asset during the periods preceding the retirement such as nuclear power plant decommissioning. Statement 49 does not apply to these activities at the time of retirement if obligating events are met and a liability has not been previously recorded.

3. Recognition of asset impairments or liability recognition for unpaid claims by insurance activities.

4. Pollution prevention or control obligations with respect to current operations such as obligations to install smokestack scrubbers, effluent treatment, or use of environment-friendly products, such as low sodium road salts; or to fines, penalties, toxic torts, product and process (workplace) safety programs; litigation support involved with potential recoveries.

5. Accounting for nonexchange transactions, such as grants applied for and received through the EPA for Brownfield redevelopments.

The GASB has identified the following benchmarks for evaluating when a component of the liability becomes reasonably estimable: receipt of an administrative order; participation as a responsible party or PRP in a site assessment or investigation; at the completion of a corrective measures feasibility study; issuance of an authorization to proceed; and at remediation design and implementation stages.
If any one of five specified events occurs, it would indicate that the government should determine if it is required to report a pollution remediation obligation (liability) in its financial statements. The five obligating events are:

1. A pollution-caused imminent danger to the public health or welfare;
2. A violation of a pollution prevention-related permit or license;
3. The government has been or will be named by a regulator as a responsible party or potentially responsible party (PRP) for remediation or cost sharing;
4. The government has been compelled to participate in remediation because of legal action or possible legal action; or
5. The government has commenced or legally obligated itself to commence pollution remediation.

Components of pollution remediation outlays can include, among other things, legal fees, testing polluted site(s), feasibility studies, operational plans, and post-cleanup monitoring. Once a government has prior experience in pollution clean-up, data should be readily available to develop meaningful estimates of the liability at the time an obligating event occurs. When a site is initially identified, a disclosure should be made with all of the relevant facts. As the various benchmarks (identified above) occur, meaningful estimates will have to be developed and revised annually for changes in costs, inflation, and experience.

The US Environmental Protection Agency (EPA) defines a Brownfield as “…a property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant.” Superfund sites are those to which the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) as amended by the Superfund Amendments and Reauthorization Act of 1986 (SARA) apply. These acts provide the EPA with broad authority to order liable parties to remediate polluted sites or use Superfund money to remediate them and then seek to recover its costs and additional damages.

Outlays for pollution remediation obligations should be recognized as liabilities if goods and services used for pollution remediation activities are liquidated with expendable available financial resources (modified accrual accounting). However, pollution remediation outlays should be capitalized in the government-wide or proprietary fund statements when goods and services are acquired for any of the following circumstances: (1) to prepare property in anticipation of a sale, (2) to prepare property for use when the property was acquired with known or suspected pollution that was expected to be remediated, (3) to perform pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment, or (4) to acquire property, plant, and equipment that have a future alternative use other than remediation efforts.

Pollution remediation liabilities must be measured based on the pollution remediation outlays expected to be incurred to settle these liabilities. The liability must be based on “reasonable and supportable” assumptions of future events that may affect the eventual settlement of the liability, and should be measured and reported at current value. The current value of the liability should
be based on applicable federal, state, or local laws or regulations that have been approved, regardless of their effective date and the technology expected to be used for the cleanup.

Pollution remediation liabilities should be measured using the “expected cash flow” technique that measures PRO based on ‘current value’ of outlays expected to be incurred. This is a measurement technique that involves assigning probabilities to each of the potential outlays and calculating their weighted average. For example, assume the government estimates the following probabilities and potential payments to complete pollution remediation at a particular site.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Potential Payment (a)</th>
<th>Probability (b)</th>
<th>Accrual Amount (a) X (b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1,000,000</td>
<td>10%</td>
<td>100,000</td>
</tr>
<tr>
<td>2</td>
<td>2,000,000</td>
<td>60%</td>
<td>1,200,000</td>
</tr>
<tr>
<td>3</td>
<td>3,000,000</td>
<td>30%</td>
<td>900,000</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>2,200,000</td>
</tr>
</tbody>
</table>

In its entity-wide (full accrual) financial statements, the government would accrue a liability of $2.2 million and disclose in its notes the nature and source of the pollution remediation obligations, the amount of the estimated liability (if not apparent in the financial statements), the methods and assumptions used, potential changes in the liability, and estimated recoveries.

A government’s pollution remediation liability should include all remediation work the government expects to perform, including work performed for other responsible parties or PRPs, even if the government is not required to perform the work. Recoveries the government expects to receive from those other parties, as well as insurance recoveries expected from policies indemnifying it for its PRO, should reduce the expense. Unrealized/unrealizable recoveries should reduce the liability; realized/realizable recoveries should be recognized separately as recovery assets.

In periods following the completion of all pollution remediation work, if recoveries become expected when no pollution remediation liability remains, those recoveries should be recorded as revenues and cash or accounts receivable when they become realized or realizable.

As with pollution remediation liabilities, recoveries expected from other responsible parties. PRPs and insurers should be measured based on their current value and use of the expected cash flow technique. Guidance is provided in paragraphs 21 and 22 of GASB Statement 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, to determine when insurance recoveries are realized/realizable. Insurance recoveries are usually realizable when the insurer admits or acknowledges coverage, and can take place before covered outlays are made.
INSTRUCTIONS:

The worksheet is provided in the AFR to assist in completing the required note disclosure and in determining the agency’s pollution remediation activities, current year expenses, adjustments to pollution remediation obligations, the amount of the year end liability, and amounts paid during the 13th period. The instructions are as follows:

1. Enter agency/department name.
2. Project Name Description – Enter description of project
3. Project Number – Enter project number assigned by FP&C, DEQ, DNR, DOTD, or other number assigned to identify project.
4. Trigger Year the project begun – this is not necessarily the year remediation began. It is the year the pollution was identified, and include the time involved to develop remediation plan and the actual remediation process.
5. PY Ending Balance – used to report those projects that were included/added in the previous fiscal year and had an outstanding balance at the end of the year.
6. Additions – Projects not previously reported – report any additions not reported in previous fiscal years (prior year restatement).
7. Additions - Increases – report increases in the estimated remediation cost whether from expanding the scope of the project to contracting for a specific service.
8. Decreases (including accruals) – record total expenditures related to the project made during the fiscal year including those made in the 13th period
9. Decreases (other adjustments) – record activities that decrease the estimated remediation liability that are not expenditures.
   - For Example: Amounts included in original estimate were overstated and actual was less than what recorded. The scope of the project is not as extensive as originally estimated, etc.
10. CY Ending Balance – the amount of liability that is still outstanding as of the end of the fiscal year.
11. Percent Complete – indicate the percentage of project completion.
12. Current Portion of Long-term Debt – this amount represents the portion of the ending liability that are due and payable within the next 12 months.
13. Non-Current Portion of Long-term Debt – this amount represents the portion of the ending liability that are not due and payable within the next 12 months.
14. Realizable Recoveries – identify amounts that have been or will be received from other sources such as other responsible parties or insurance recovery to help cover the cost of the remediation. This amount is disclosed in the note but will not be subtracted from the liability.
15. 13th Period Expenditures – record amounts expended on pollution remediation projects during the 13th period accounting period.
16. Notes – provide reference and explanations such as awaiting court decision.