

OHIO AUDITOR OF STATE KEITH FABER



From: Auditor of State's Center for Audit Excellence

To: All IPA Firms

Subject: GASB 87 / GASB 83

Date: June 28, 2021

GASB 87, *Leases* is effective for fiscal years beginning after June 15, 2021. GASB encourages earlier application. GASB 87 was originally effective for fiscal years beginning after December 15, 2019, but was postponed for eighteen months by GASB 95. In part, this GASB requires the reporting of certain lease liabilities that currently are not reported and notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements. Any contract that meets the definition of a lease in GASB 87 should be accounted for under the leases guidance, unless specifically excluded in this Statement. Therefore, governments will need to evaluate all contracts, not just those labeled as a 'lease' to determine if they meet the definition of a lease. Governments have much to do to prepare for this required reporting and identifying all contracts that meet the criteria will be very time consuming. It is critical they maintain detailed documentation to support the evaluation of all contracts so auditors can test completeness. Documentation and communication are key. Implementing GASB 87 will take a team effort. Certain elements may not be clear cut and professional judgment will be needed. Please be certain to work with the governments and the conversion companies as you audit the detail. For those governments that have not early implemented, we recommend you discuss in your entrance and exit conferences the importance of starting early on gathering and evaluating all agreements.

GASB 83, *Certain Asset Retirement Obligations* is effective for reporting periods beginning after June 15, 2019. GASB encourages earlier application. GASB 83 was originally effective for fiscal years beginning after June 15, 2018, but was extended for a year by GASB 95. This GASB addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government should recognize an ARO when the liability is incurred and reasonably estimable. Incurrence of a liability is manifested by the occurrence of both an external obligating event and an internal obligating event resulting from normal operations. ¶.9 describes external obligating events. One external obligating event is federal, state, or local laws

or regulations. For example, the EPA has confirmed to LGS that wastewater requires a decommissioning plan under certain circumstances in ORC 6111.44, while we believe this is compelling evidence, AOS Legal is currently evaluating. While there are several internal obligating events described in ¶.10, if the facility is operating then it definitely meets the criteria of an internal obligating event. Local laws or regulations, legally binding contract and issuance of a court judgment will need evaluated by each local government to determine if external obligating events exist.

Where external and internal obligating events require reporting on the financial statements, ¶.8 talks about the liability being reasonably estimable. During the 2020 compilation process for early application of the GASB, some engineers are familiar with the EPA requirements and are able to provide estimates. Some engineers have provided estimate for what they knew EPA would require, but felt certain items were unknown and were not able to provide a complete estimate. Some engineers were not familiar with the EPA requirements and were unable to provide estimates. The EPA is currently working on a fact sheet to assist in this process; however, it is not currently available. There are also a wide range in the dollar amounts reported, with some amounts seeming unrealistically high.

Based on these facts, we believe there are three acceptable approaches related specifically to the wastewater liability (state/federal laws regulations):

1. If the engineer is knowledgeable about what the EPA would require, and the local government is comfortable with the estimate, this ARO can be booked and appropriate note disclosure made for the ARO.
2. If the engineer was able to estimate what they know will need addressed, but viewed other items as not reasonably estimable, that is also acceptable. ARO note disclosures will need to be made for those items that have been estimated, and disclosure will also be needed for those item not reasonably estimable.
3. If the engineer is not able to provide an estimate, this is also acceptable, as, at this time, there can be significant uncertainty as to what the EPA will require. Also if there is an estimate from the engineer, but the local government/engineer feels there is significant uncertainty with that estimate, it can also be considered not reasonably estimable. ARO note disclosures will still be needed including the indication that amounts are not reasonably estimable.

Once the fact sheet is available, the engineers should be able to provide a reasonable estimate, which may not be available until 2021 financial statements. If a local government chooses option 3, and the EPA guidance happens to become available, the government should strive to provide estimates before the audit is issued. At this time, we do not feel the fact sheet will be available and the government to have sufficient time to develop estimates to be included in time for submission to GFOA's certificate program due June 30, 2021.

Due to the complexity of the GASB, audit adjustments made as a result of testing should not be considered a control deficiency. Governments should have supporting documentation, including opinions of legal counsel, where appropriate, as to how they reached the conclusion whether internal or external obligating events exist for any ARO and their estimates, including whether it

is reasonably estimable. When testing, auditors should refer to the guidance in AU-C Section 540, *Auditing Accounting Estimates and Related Disclosures*. In addition, refer to guidance in AU-C 500, *Audit Evidence*, when management employs or engages a specialist who may provide information to be used as audit evidence.

Questions can be directed to the Center for Audit Excellence.