

This document reflects the result of analyses, discussions and review by UCOP staff to date. The document is subject to change pending additional discussions with PwC; however, it represents the best information available to date.

**University of California
Governmental Accounting Standards Board (GASB) Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards.***

Issues Resolution Memo No. 56-1

Evaluation of GASB Statement No. 56 as it Relates to the UC Reporting Entities

Issued: June 16, 2009

Background

GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, incorporates into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards. This statement addresses three issues not included in the authoritative literature that establishes accounting principles:

- Related party transactions,
- Going concern considerations, and
- Subsequent events.

The presentation of principles used in the preparation of financial statements is more appropriately included in accounting and financial reporting standards rather than in the auditing literature.

This Statement does not establish new accounting standards but rather incorporates the existing guidance (to the extent appropriate in a governmental environment) into the GASB standards.

GASB Statement No. 56:

- Is effective for the University for FY 2008–2009.
- Applies to the separately audited UCRP financial statements.
- Applies to the separately audited UC Retirement Savings Plans, including the 403(b), 457(b) and PERS–VERIP plans.
- Applies to the separately audited UCRHBT financial statements.

- Applies to the campus foundations.
- Applies to the separately audited Medical Center financial statements.
- Applies to the separately audited Health and Welfare Program financial statements.

GASB Statement No. 56 may be ordered from the GASB's website at www.gasb.org. There is no Implementation Guide from the GASB for this Statement.

Define Issues

The University must determine whether the newly-issued codification of accounting and financial reporting guidance contained in the AICPA Statements on Auditing Standards related to related party transactions, going concern considerations or subsequent events changes any existing financial reporting and disclosure requirements for any of the University's financial reporting entities.

Authoritative Guidance and Approach

The authoritative guidance is presented below.

For All of the University's Financial Reporting Entities

Related Party Transactions

The University is required to disclose certain related party transactions, such as transactions with the state, campus foundations, etc. If the substance of a particular transaction is significantly different from its form because of the involvement of related parties, financial statements should recognize the substance of the transaction rather than merely its legal form.

Determining the substance of a related party transaction may pose challenges not present in assessing transactions between unrelated parties. For example, a related party relationship may result in transactions that would not take place between unrelated parties or would be subject to different terms and conditions. In such cases, the substance of the related party transaction may differ from its legal form due to the related party relationship.

Subsequent Events

Events or transactions that affect the financial statements sometimes occur subsequent to the statement of net assets date but before financial statements are issued. Some of those transactions and events (referred to as recognized events) require adjustments to the financial statements while others (referred to as nonrecognized events) may require disclosure in the notes to the financial statements.

- ***Recognized events*** consist of those events that provide additional evidence with respect to conditions that existed at the date of the statement of net assets and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used in evaluating the

conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.

Identifying recognized events that require adjustment of the financial statements calls for the exercise of professional judgment and knowledge of the facts and circumstances.

Subsequent events affecting the realization of assets such as receivables and inventories or the settlement of estimated liabilities will ordinarily require adjustment of the financial statements because such events typically represent the culmination of conditions that existed over a relatively long period of time.

- ***Nonrecognized events*** consist of those events that provide evidence with respect to conditions that did not exist at the date of the statement of net assets but arose subsequent to that date. These events should not result in adjustment of the financial statements. Some of these events, however, may be of such a nature that their disclosure is essential to a user's understanding of the financial statements.

Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the financial statements because such changes typically reflect a concurrent evaluation of new conditions.

Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, paragraph 11(h), requires a discussion in management's discussion and analysis (MD&A) of currently known facts, decisions, or conditions that are expected to have a significant effect on the government's financial position or results of operations. It may be necessary to include a discussion of subsequent events in the MD&A, depending on the facts and circumstances.

Going Concern

Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Information that may significantly contradict the going concern assumption would relate to the University's, or other of the University's legal entities, inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of its operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. Management has a responsibility to evaluate whether there is substantial doubt about the University's, or other of the University's legal entities, ability to continue as a going concern for 12 months beyond the financial statement date. Moreover, if there is information that is currently known to the University's management that may raise substantial doubt shortly thereafter (for example, within an additional three months) it also should be considered.

Indicators that there may be substantial doubt about the University's, or other of the University's legal entities, ability to continue as a going concern include:

- Negative trends—for example, recurring periods in which expenses/expenditures significantly exceed revenues, recurring unsubsidized operating losses in business-type activities, consistent working capital deficiencies, continuing negative operating cash flows from business-type activities, or adverse key financial ratios,
- Other indications of possible financial difficulties—for example, default on bonds, loans or similar agreements, proximity to debt and tax limitations, denial of usual trade credit from suppliers, restructuring of debt (other than refundings), noncompliance with statutory capital or reserve requirements, or the need to seek new sources or methods of financing or to dispose of substantial assets,
- Internal matters—for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project or program, uneconomic long-term commitments (burdensome labor contracts, for example), or the need to significantly revise operations,
- External matters—for example, legal proceedings, legislation, or similar matters that might jeopardize intergovernmental revenues and the fiscal sustainability of key University programs; loss of a critical license or patent for a business-type activity; loss of a principal customer, or supplier; or uninsured or underinsured catastrophe such as a drought, earthquake, or flood.

In all cases, the effect of the University's environment should be considered when evaluating the indicators.

If it is determined that there is substantial doubt about the University's, or other of the University's legal entities, ability to continue as a going concern, the notes to the financial statements should include disclosure of the following, as appropriate:

- Pertinent conditions and events giving rise to the assessment of substantial doubt about the University's, or other of the University's legal entities, ability to continue as a going concern for a reasonable period of time,
- The possible effects of such conditions and events,
- Management's evaluation of the significance of those conditions and events and any mitigating factors,
- Possible discontinuance of operations,
- Management's plans (including relevant prospective financial information),
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

In addition, GASB Statement No. 34, paragraph 11(h), requires a discussion in MD&A of currently known facts, decisions, or conditions that are expected to have a significant effect on the University's financial position or results of operations. It may be necessary to include a discussion of going concern issues in the MD&A, depending on the facts and circumstances.

Implementation

Prior to Statement No. 56, financial reporting guidance for related party transaction, subsequent events and going concern considerations were presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards rather than in the authoritative literature of the GASB. Statement 56 moves relevant portions of that SAS to the GASB literature without substantive changes. Because the GASB chose not to reconsider the guidance provided in the SAS, the financial reporting guidance remains unchanged in practice and there is no new effect on any of the University's financial reporting entities.

Next Steps—Required Actions

Responsibility	Required Completion Date	Action Item/Task
UCOP	May-09	Discuss with PwC.