

SPECIAL EDITION

Quill

NEWSLETTER

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Since the issuance of GASB Statement No. 34 and related statements, the Governmental Accounting Standards Board (GASB) has been busy. The Municipal Department at RKO thought it was a good time to update our clients on recently issued statements that are effective for 2005 or later years that may have an impact on your future financial statements as well as updates and reminders on other developments in the governmental arena. Since most of the statements summarized below are not effective until later years, the biggest impact to your financial statements will be GASB Statement No. 40 related to cash and investment disclosures. We will obviously provide assistance in implementing these changes. We will soon be updating our website to include sample disclosures. www.rko-cpas.com

Deposit and Investment Risk Disclosures (GASB 40 – effective for all years ending June 30, 2005 or later)

By Kathy Tyson

GASB 40 updates our custodial credit risk footnote disclosure and adds a number of other risks which were not addressed by GASB 3, such as credit risk, concentration of risk, interest rate risk and foreign currency risk.

Prior to GASB 40, disclosure requirements dealt with what we will now be referring to as *custodial credit risk*. This is the risk that, in the event a financial institution fails, a government is unable to recover the value of its deposits, investments or collateral securities in the possession of the institution.

The good news under the revised custodial credit risk disclosure requirement, is that it will now only be necessary to disclose those situations that formally fell into category 3. Category 3 covered deposits that were uncollateralized, collateralized with securities held by the financial institution, or collateralized by securities held by the financial institutions trust department or agent, but not in the government's name. For investments, category 3 is defined as investments held by a counterparty and not in the entity's name, or held by the counterparty's trust department or agent and not in the entity's name.

The new areas of risk that require disclosure are as follows:

Credit risk: The possibility that the issuer/counterparty to an investment will be unable to fulfill its obligations. Credit risk requires disclosure of credit quality ratings as set by nationally recognized statistical rating organizations (NRSROs), including Moody's investor services, Fitch ratings, Standard and Poors, Dominion Bond rating services, and AM Best Company, Inc.

Concentration of Credit risk: The inability to recover the value of deposits, investments, or collateral securities in the possession of an outside party caused by a lack of diversification (investments acquired from a single user). This disclosure is required for investments in a single issuer that represent 5% or more of total investments, excluding investments issued or explicitly guaranteed by the U.S. government, mutual funds, external investment pools, and other pooled investments. If required, the disclosure should include the issuer and the amount.

Interest Rate risk: The possibility that an interest rate change could adversely affect an investment's fair value. This requirement of GASB 40 appears to be the most daunting. This is because the GASB has given five different acceptable methods for disclosing this risk. We think the most commonly used methods will be the *specific identification method* (may be used for small entities with few investments), or the *weighted average maturity method* (groups and applies a weight based on dollar size).

Foreign Currency risk: The possibility that changes in exchange rates between the U.S. dollar and foreign currencies could adversely affect a deposit/investment's fair value. When this risk applies, disclosure is required of the investment type, foreign currency denomination, and value in U.S. dollars.

In addition to the new requirements listed above, GASB 40 also requires disclosure of any "formal" investment policy relating to each risk that applies to the entity's investments. When no policy has been adopted, that fact should be disclosed.

GASB Statement No. 42

Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries

By Casey Leonard

GASB Statement #34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, requires the recording of depreciation on capital assets (with the exception of inexhaustible assets and those accounted for using the modified approach). Excluding depreciation, GASB Statement #34 does not address the reduction in a capital assets value. In November 2003, GASB Statement #42 was issued to establish accounting and reporting standards for impairment of capital assets. Per Statement #42, asset impairment is defined as a “significant, unexpected decline in the service utility of a capital asset.” Common indicators of impairment include the following:

1. Evidence of physical damage
2. Enactment or approval of laws or regulations or other changes in environmental factors
3. Technological development or evidence of obsolescence
4. A change in the manner or expected duration of use of a capital asset
5. Construction stoppage

The Statement describes three separate measurement methods for impairment losses on capital assets that will continue to be used by the government. They are as follows:

1. Restoration cost approach – Under this approach, generally used for impairment of capital assets with physical damage, the amount of impairment is based on the estimated cost to restore the utility of the asset.
2. Service units approach – This approach devalues the asset based on the historical cost of the service utility of the asset that cannot be used due to the impairment event or change in circumstances. This method is most often used for impairments resulting from enactment or approval of laws or regulations or other changes in environmental factors or technological development or obsolescence.
3. Deflated depreciation replacement cost – Under this approach, the cost of the service currently being provided by the capital asset is quantified and converted to historical cost.

Impairment due to a change in manner or duration of use should be measured by using the service units approach or deflated depreciation replacement cost.

Impaired capital assets that will no longer be used by the government or impaired from construction stoppage should be reported at the lower of carrying value or fair value.

GASB Statement #42 also addresses insurance recoveries, stating that insurance associated with events or changes in circumstances resulting in impairment of a capital asset should be netted with the impairment loss.

The requirements of Statement #42 are effective for years beginning after December 31, 2004, with earlier application encouraged.

GASB Statement No. 43

Financial Reporting for Post Employment Benefit Plans other than Pension Plans

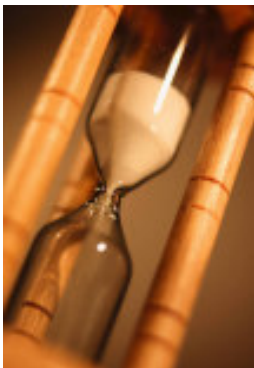
By Greg Chabot

The objective of this Statement is to establish uniform standards of financial reporting by state and local governmental entities for other post employment benefit plans (OPEB). The Statement addresses both defined benefit OPEB plans in which the terms of the plan specify benefits to be provided after separation from employment, and defined contribution plans which provide an individual account for each plan member and specify how contributions to the accounts are to be determined.

The Statement also applies to certain multiple-employer OPEB plans, but does not apply to assets that an employer earmarks for OPEB purposes within its governmental or proprietary funds as either designated fund balances, net assets, or to assets that an employer transfers to, and accumulates in, a separate governmental or proprietary fund for that purpose.

Termination offers and benefits, including transferring unused sick leave to an account to be used for payment of post employment benefits, are generally excluded from the scope of this Statement.

A related Statement, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions*, established standards for accounting and financial reporting of OPEB costs and obligations by state and local governmental employers that offer OPEB.



Since OPEB is a form of employee compensation, it should be recognized as an expense as those benefits are earned by employees. OPEB is defined as post employment benefits other than pension benefits, including post employment health care benefits and other types of post employment benefits (such as life insurance), if provided separately from a pension plan. The Statement applies to all state and local governments that have OPEB that are administered as trusts or equivalent arrangements, through which assets are accumulated and benefits are paid as they come due in accordance with an agreement between the employer and plan members or their beneficiaries, and in which

- a) Employer contributions to the plan are irrevocable.
- b) Plan assets are dedicated to providing benefits to their retirees and their beneficiaries in accordance with the terms of the plan.
- c) Plan assets are legally protected from creditors of the employer or the plan administrator.

The financial report of a defined benefit OPEB that meets this criteria should include two financial statements and two schedules of historical trend information, reported as required supplementary information (RSI) as follows:

Statements:

- A **Statement of Plan Net Assets** on the accrual basis that reports assets, liabilities, and net assets.
- A **Statement of Changes in Plan Net Assets** that reports additions to, deductions from, and net increase (decrease) for the year in plan net assets.

RSI:

- **Schedule of Funding Progress** that includes historical trend information about the actuarially determined funded status of the plan.
- **Schedule of Employer Contributions** that includes historical trend information about the annual required contributions and actual contributions made.

Additionally, notes to the financial statements should be included, whether the financial statements are presented in a stand-alone financial report, or in the financial report of an employer (as an employee benefit trust fund). If the financial statements of the plan are presented in both the employer's report and a publicly available stand-alone financial report that complies with this Statement, the employer may limit its plan disclosures and disclose information about how to obtain the stand-alone plan financial report. Required note disclosures include:

- Plan description
- Summary of significant accounting policies
- Information about contributions and reserves
- Funded status and funding progress of the plan

For financial reporting purposes, an actuarial valuation should be performed at least every two years for plans with 200 or more participants, and at least every three years for plans with fewer than 200 participants. The actuarial present value of total projected benefits should include all benefits to be provided by the plan at the time of each valuation. Defined benefit plans with fewer than 100 plan members may elect to use an alternative measurement method permitted by the Statement, which permits simplification of certain assumptions and which does not require actuarial valuations.

For OPEB plans that are not administered as trusts or equivalent arrangements and not meeting the requirements outlined above, the employer should report the fund as an agency fund. Defined contribution plans that provide OPEB should apply the reporting requirements for fiduciary funds generally.

Similar to GASB Statement 34, this Statement is effective depending on the government's total annual revenues in the first fiscal year ending after June 15, 1999 as follows:

- Phase 1 – revenues of \$100 million or more – periods beginning after December 15, 2005
- Phase 2 – revenues \$10 to \$100 million – periods beginning after December 15, 2006
- Phase 3 – revenues under \$10 million – periods beginning after December 15, 2007

Any prior periods that are presented in the year of implementation should be restated.



GASB Statement No. 44
Economic Condition Reporting: The Statistical Section

By Greg Chabot

This Statement updates and expands the statistical information included in the government's Comprehensive Annual Financial Report to provide users with better contextual information with which to assess a government's financial health. GASB 44 replaces the 15 statistical tables that were required to be presented as part of the comprehensive annual financial report (CAFR). It applies only to governments that present a statistical section with their basic financial statements. GASB 44 establishes five broad categories of information that should be presented and outlines the objectives of each category. The five sections are:

- Financial trends – focuses on how the government's financial position has changed over time
- Revenue capacity – assists users in understanding and assessing the government's ability to generate its "most significant own source revenue"
- Debt capacity – intended to help users understand a government's debt burden and its ability to issue new debt
- Demographic and economic – gives users context for understanding the trend information presented in all the other schedules
- Operating – gives users context to help them assess economic condition

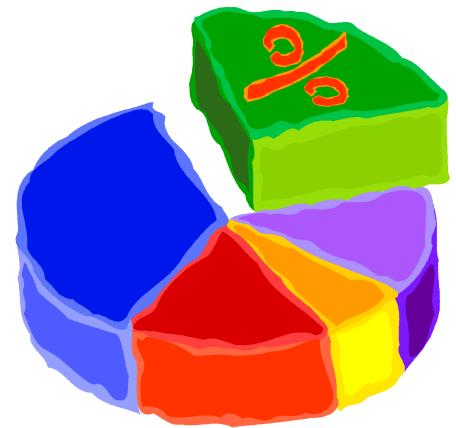
Financial Trend Information:

Required:

- Schedule 1 – Net Assets by Component – last 10 fiscal years
- Schedule 2 – Changes in Net Assets – last 10 years
- Schedule 3 – Fund Balances – Government Funds – last 10 years
- Schedule 4 – Changes in Fund Balances – last 10 years

Optional:

- Program Revenues by Function/Program – last 10 years
- Tax Revenues by Service – Governmental Funds – last 10 years



Reserve Capacity:

Required:

- Schedule 5 – Assessed Value to Actual Value of Taxable Property – last 10 years (optional formats)
- Schedule 6 – Direct and Overlapping Property Tax Rates – last 10 years (optional formats)
- Schedule 7 – Principal Property Tax Payers – current year and nine years ago
- Schedule 8 – Property Tax Levies and Collections – last 10 years

Optional:

- Schedule 5A – Taxable Sales by Category – last 10 years
- Schedule 6A – Direct and Overlapping Sales Tax Rates

Debt Capacity:

Required:

- Schedule 9 – Ratios of Outstanding Debt by Type – last 10 years (optional formats)
- Schedule 10 – Ratios of General Bonded Debt Outstanding – last 10 years (optional formats)
- Schedule 11 – Direct and Overlapping Governmental Activities Debt
- Schedule 12 – Legal Debt Management – last 10 years (optional formats)
- Schedule 13 – Pledged Revenue Coverage – last 10 years

Demographic & Economic:

- Schedule 14 – Demographic and Economic Statistics – last 10 calendar years
- Schedule 15 – Principal Employees – Current year and nine years ago

Operating Information:

Required:

- Schedule 16 – Full time equivalent town/city government employees by function/program – last 10 years
- Schedule 17 – Operating Indicators by Function/Program – last 10 years
- Schedule 18 – Capital Assets Statistics by Function/Program - last 10 years

This Statement is effective for reporting periods beginning after June 15, 2005. GASB does not require any schedule to be presented retroactively. For schedules that present data derived from the government-wide statements, governments are encouraged to retroactively report data from the date they adopted GASB 34. For other schedules, governments are encouraged to restate prior year data to conform to the new requirements.

GASB Statement No. 45***Accounting and Financial Reporting by Employers for Post Employment Benefits other than Pensions***

By Greg Chabot

This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures, related liabilities and assets, note disclosures, and required supplementary information (RSI) in the financial reports of state and local governmental employers.

The cost of OPEB, like the cost of pension benefits, should be expensed in the period the employee earns the compensation rather than when the benefits are paid. Currently most OPEB plans are financed on a pay-as-you-go basis. This Statement requires an accrual basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and requires disclosure of information about actuarial accrued liabilities and funding status of the plan. The annual OPEB cost is equal to the employer's annual required contribution to the plan (ARC) adjusted for past under or over contributions. The Statement identifies the frequency of the required actuarial valuations (similar to the requirements of Statement 43) as well as the actuarial methods and assumptions that are acceptable for financial reporting purposes.

The employer's net OPEB obligation is defined as the difference between annual OPEB cost and the employer's contributions to a plan. Retroactive application of the measurement requirements is not required. In other words, the beginning net OPEB obligation will be zero at transition. Sole and agent employers should recognize the annual OPEB expense and the net OPEB obligation (liability) in the government-wide financial statements, and in the financial statements of proprietary funds and fiduciary funds from which OPEB contributions are made. OPEB expenditures should be measured on the modified accrual basis in the governmental funds financial statements.

The notes to the financial statements should disclose descriptive information about each defined benefit plan in which they participate, including the funding policy followed, information about contributions made in comparison to the ARC, and the funded status of the plan based on the latest actuarial valuation, as well as significant methods and assumptions used. Additionally, a schedule of funding progress should be presented as RSI.

Employers participating in cost-sharing multiple employer plans that are administered as trusts or equivalent arrangements are required to recognize OPEB expense/expenditures for their contractually required contributions to the plan if the following conditions are met:

- Employer contributions to the plan are irrevocable.
- Plan assets are dedicated to providing benefits to their retirees and their beneficiaries in accordance with the terms of the plan.
- Plan assets are legally protected from creditors of the employer or the plan administrator.

This Statement's effective date depends on the government's total annual revenues in the first fiscal year ending after June 15, 1999 as follows:

Phase 1 – revenues of \$100 million or more – periods beginning after December 15, 2006

Phase 2 – revenues \$10 to \$100 million – periods beginning after December 15, 2007

Phase 3 – revenues under \$10 million – periods beginning after December 15, 2008

Earlier application is encouraged.



GASB Technical Bulletin 2004-2
Recognition of Pension and Other Post Employment Benefit Expenditures/Expenses and Liabilities
by Cost-Sharing Employers

By Greg Chabot

This Technical Bulletin, which was issued in December 2004, is limited to employers participating in cost sharing pension or OPEB plans. The Technical Bulletin clarifies certain questions that arose in interpreting Statement 45. The clarifications include the following:

- 1) Contractually required contributions refer to the contributions assessed by a cost-sharing pension or OPEB plan to the participating employers for the periods to which the contractual requirement relates, based on the funding policy. For sole and agent employers it is the annual required contribution (ARC).
- 2) Contractually required contributions from employers to cost-sharing pension and OPEB plans are attributable to the periods of time for which the contributions are assessed by the plan.
- 3) In the governmental fund financial statements, prepared on the modified accrual basis of accounting, a cost sharing employer should recognize:
 - Pension or OPEB expenditures equal to the amounts contributed during the period as contractually required contributions, and any additional unpaid contractually required contributions for one or more pay periods within that period.
 - A fund liability for the unpaid, contractually required contributions.
- 4) On the accrual basis, cost-sharing employers should recognize the contractually required contributions for the financial reporting period and a liability for any of those contributions that remain unpaid at the end of the period.

GASB Statement No. 46
Net Assets Restricted by Enabling Legislation

By Hank Farrah

This Statement is effective for periods beginning after June 15, 2005. Earlier application is encouraged. GASB 34 requires net assets to be reported in three categories in both the government-wide and enterprise fund financial statements. The three categories are:

- Invested in capital assets, net of related debt
- Restricted
- Unrestricted

Restricted net assets result from three types of restrictions:

- By external bodies or persons, such as creditors or grantors or the laws or regulations of other governments
- By constitutional provisions
- By enabling legislation

Enabling legislation is defined in GASB 34 as the legislation that allows the government to assess, levy, charge or otherwise require payments from outsiders that includes “a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.” GASB 46 provides guidance on determining when enabling legislation is legally enforceable. Enabling legislation is considered legally enforceable if an external party (such as a citizen or public interest group) can compel the government to use the resources only for the purposes specified by the enabling legislation. In certain instances this may require an opinion from legal counsel. GASB 46 requires governments to disclose in the notes to their financial statements the amount of restricted net assets that are restricted by enabling legislation. From a practical standpoint, enabling legislation is typically encountered only in larger governments such as states and counties.

New and revised recommended practices approved by the GFOA Executive Board:

The Executive Board has recently approved the following recommended practices.

- Establishment of Strategic Plans (new)
- Evaluating the Use of Pension Obligation Bonds (revised)
- Use of Cash Flow Forecasts in Operations (new)
- Procurement of Banking Services (revised)
- Electronic Commerce and Cash Management (revised)
- Auditor Association with Financial Statements Included in Offering Statements or Posted on Websites (new)

All of these newly approved recommended practices are available at GFOA.org.

In March the GFOA Executive Board approved a recommended practice that opposes attempts by some audit firms to require their prior approval before audited financial statements may be included in offering statements or posted on a government's website. A government owns the audited financial statements and should feel free to use them in any appropriate manner. More and more of our clients now request their financial statements in PDF format so that they can be posted on their websites. RKO's only limitation is that our audit opinion not be associated with an incomplete set of financial statements. For example, some of our clients put selected statements or exhibits in the annual town report or on the website, but do not include the footnote disclosures with them. In those instances, we request that our opinion be replaced with a statement from management that the statements or exhibits were excerpted from the financial statements and perhaps indicate where the complete set of financial statements can be obtained. In accordance with the recommended practice, future audit contracts will clarify that you are free to post your audited financial statements on your website.

New fair labor standards on overtime

Workers earning less than \$23,660 are automatically entitled to overtime compensation. Those earning between \$23,660 and \$100,000 must also meet a "duties test", meaning they must meet certain definitions of an executive, administrative, or professional employee in order to be exempt from overtime compensation. New regulations also amend the "disciplinary suspension rule". Employers can now suspend employees for certain misconduct without pay in full-day increments, rather than full-week increments, without affecting the employees' exempt status. Additionally, the regulations require that first responders, regardless of rank or pay level, who perform rescue, fire prevention, or police or fire investigative work will be nonexempt employees and eligible for overtime compensation. For more information visit the "Fairplay" section of the DOL's website at <http://www.dol.gov>.

Continuing disclosure reporting

The Securities and Exchange Commission, under Rule 15c2-12 (the "Rule"), currently requires issuers of municipal bonds issued after July 3, 1995 to provide certain financial information and operating data by no later than 270 days after the end of each fiscal year, and/or to provide notices of the occurrence of certain enumerated events, if material.

Exceptions are provided for issues that (a) have final maturities of 18 months or less, (b) qualified for "limited offering", or (c) are issued in an original amount of less than \$1 million.

Limitations to the rule are available for issuers that have a consolidated amount of debt that is less than \$10 million.

Issuers not qualifying for an exemption or limitation have two filing requirements:

- 1) Issuers must provide to each nationally recognized municipal securities information repository (NRMSIR) and the appropriate state information depository for the State of Maine (SID), if any, financial information and operating data relating to the issuer for the preceding fiscal year of the type presented in the Official Statement prepared in connection with the last sale of its bonds (i.e. audited financial report or CAFR).
- 2) The issuer must also provide, in a timely manner, to each NRMSIR or the Municipal Securities Rulemaking Board and the SID, if any, notice of the occurrence of any of the following events with respect to the bonds, if material:
 - Principal and interest payment delinquencies
 - Non-payment related defaults
 - Unscheduled draws on debt service reserves reflecting financial difficulties
 - Unscheduled draws on credit enhancements reflecting financial difficulties
 - Substitution of credit or liquidity providers, or their failure to perform
 - Adverse tax opinions or events affecting the tax-exempt status of the bonds
 - Modifications to the rights of securities holders
 - Bond calls
 - Defeasances
 - The release, substitution, or sale of property securing repayments of the bonds
 - Rating changes

Many issuers are now filing electronically.

This information was obtained from Joe Cuetara, Senior Vice President Banking and Advisory Group at Moors & Cabot, Inc. For more information and/or to obtain the contact information for the NRMSIRs contact RKO or contact Joe Cuetara at 617-314-0258 or jcuetara@moorscabot.com.



The Social Security Protection Act of 2004 and Its Effect on Employers and Employees of State and Local Governments

By Chris Stevenson

The Social Security Protection Act of 2004 was signed into law last March by the President, amending the Social Security Act Internal Revenue Code of 1986. Among its many provisions, the new legislation places requirements on employers who hire employees not covered by social security after January 1, 2005 and limits social security for workers, or spouses, who also receive a pension benefit based on their work, or their spouse's work, in a job not covered by Social Security.

To comply with the new law, employers, such as state and local governments, who hire workers not covered by social security after January 1, 2005 should supply Form SSA-1945 (available at www.socialsecurity.gov/form1945/SSA-1945.pdf) to the employee for his/her review and signature and then submit a signed copy of the form to the pension-paying agency. Form SSA-1945 will inform the employee of two provisions, of the Social Security Protection Act of 2004, The Government Pension Offset and The Windfall Elimination Provision that could potentially affect the amount of social security benefits the employee receives in addition to other pension benefits.

The Government Pension Offset

The Government Pension Offset targets those who receive a pension from federal, state, or local government work where they did not pay Social Security taxes and also receive spouse's, widow's, or widower's Social Security benefits. Under the new provision the spouse's, widow's, or widower's Social Security benefit is reduced by 2/3 of the beneficiaries other governmental pension. An example listed on Social Security Online (www.socialsecurity.gov) illustrates a situation in which an individual receives a \$600 monthly civil service pension and \$500 monthly spousal benefit from Social Security. Under The Government Pension Offset provision, the beneficiary will now receive \$100 monthly from Social Security (original \$500/month reduced by \$400 or 2/3 the original \$600 monthly civil service pension) instead of the full \$500/month spouse's benefit.

The U.S. Social Security Administration explains the provision as a means to standardize spouse, widow, and widower benefits among those workers of governmental agencies with those of private business. To illustrate its rationale, The U.S. Social Security Administration cites the example of a retiree who receives \$800/month based on her calculated Social Security benefit and is otherwise eligible to receive a \$500/month spousal benefit under her husband's policy. Under long standing law relating to Social Security, the retiree does not receive her \$500/month spouse's benefit from Social Security. Before The Social Security Act of 2004, however, the same retiree would have received the full \$500/month spouse's benefit had she received an \$800/month government pension as opposed to \$800/month Social Security benefit.

The U.S. Social Security Administration does cite several instances where a worker may retain eligibility to receive both spouse, widow, or widower Social Security benefits and other governmental pensions. Generally spousal social security benefits will not be reduced if a worker:

- Is receiving a governmental pension that is not based on earnings;
- Is a state or local employee whose government pension is based on a job where they were paying Social Security taxes on the last day of employment and their last day was before July 1, 2004 or during the last five years of employment and their last day of employment was July 1, 2004, or later;
- Is a federal employee, including Civil Service, who pays Social Security taxes on their earnings;
- Is a federal employee who elected to switch from the Civil Service Retirement System to the Federal Employees Retirement System on or before June 30, 1988;
- Received or was eligible to receive a government pension before December 1982 and met all the requirements for Social Security spouse's benefits in effect in January 1977; or
- Received or was eligible to receive a federal state or local government pension before July 1, 1983, and was receiving one-half support from their spouse.

The Windfall Elimination Provision

Think you're in the clear because you paid into Social Security for enough years, before taking a government agency job, to qualify for both Social Security and your government pension? The Windfall Elimination Provision of the Social Security Protection Act of 2004 lowers Social Security benefits for individuals qualifying for Social Security and government pensions based on their employment history. In these instances a modified formula is used to calculate their benefit amount, resulting in a lower Social Security benefit. On their website, as a result of The Windfall Elimination Provision, the U.S. Social Security Administration lists that the maximum monthly reduction in Social Security benefits for someone age 62 in 2005 is \$313.50 per month. The reduction amounts will be indexed annually for inflation.

For more information on the new legislation visit www.socialsecurity.gov, or call 1-800-772-1213.

GASB issues new Comprehensive Implementation Guide

The GASB recently issued its Comprehensive Implementation Guide – 2004 that incorporates the individual GASB implementation guides on GASB Statement Nos. 3,9,10,14,25,26,27,31,34, and 40. It includes all GASB standards through GASB No. 40 (Deposit and Investment Risk Disclosure), GASB Interpretation No. 6 (measurement of certain liabilities) and Technical Bulletin 2004-1 (Tobacco Settlement).

The GASB plans to issue two new Implementation Guides in 2005 – one on Other Post Employment Benefits and another on the Statistical Section.

2005 Blue Book issued by GFOA

The 2005 edition of the Governmental Accounting, Auditing, and Financial Reporting: Using the GASB 34 Model (GAAFR), commonly referred to as the Blue Book, can now be ordered at www.estoregfoa.org. The new Blue Book covers all pronouncements through GASB Statement No. 45, which addresses other post employment benefits. For those not familiar with the Blue Book, it is written by Stephen Gauthier, GFOA's director of technical services, and provides a comprehensive guide to governmental accounting. We recommend that you consider purchasing this excellent technical reference guide if you do not already have one. The new GAAFR comes with a CD-ROM that contains all 19 chapters. The CD-ROM does not include the sample comprehensive annual financial report. The GAAFR sells for \$119.00 for GFOA members and \$169.00 for non-members.



In addition to the CD-ROM, other revisions and updates to the 2005 GAAFR include:

- New material related to GASB 39 through 45
- New material based on GASB's 2004 Comprehensive Implementation Guide, including the Implementation Guide to GASB Statement 40 on investment disclosures
- A new section that specifically addresses school district issues

Arbitrage Compliance Planning

By Casey Leonard

In the municipal finance world, arbitrage is defined as the excess profit earned from the investment of tax-exempt bond proceeds in higher yielding taxable securities. The Internal Revenue Code and arbitrage rebate regulations issued by the IRS require rebate of excess investment earnings on tax-exempt debt proceeds to the federal government, if the yield on those earnings exceeds the effective yield on tax-exempt debt issued. With careful planning, arbitrage rebate can be avoided. Following are the more common exceptions to rebate:

- 1) Small issuer exception—Applies to governmental entities with general taxing powers that issue less than \$5 million of tax-exempt debt during a calendar year (\$10 million for public school construction financings issued after January 1, 1998).
- 2) Six month expenditure exception – All gross proceeds and earnings must be spent within six months.
- 3) Eighteen month expenditure exception – All gross proceeds and earnings must be spent within eighteen months, as follows:
 - Within six months – 10%
 - Within twelve months – 60%
 - Within eighteen months – 100%
- 4) Twenty-four month construction exception – Seventy-five percent of the available construction proceeds must be for construction expenditures and spent within twenty-four months, as follows:
 - Within six months – 10%
 - Within twelve months – 45%
 - Within eighteen months – 75%
 - Within twenty-four months – 100%



LD-1, An Overview

By Hank Farrah and Casey Leonard

Spending limitations

The spending limitations of LD-1 focus attention on the year-to-year growth of the property tax commitment that relates to municipal spending. There are three steps necessary to calculate a municipalities property tax levy limit. They include calculating the core municipal commitment, calculating the growth limitation factor or percentage of allowable growth to core commitment, and adjustment by net new state funds.

To calculate the core municipal commitment, which is the starting point in fiscal year 2006 and only includes municipal spending, the total property tax commitment is taken and reduced by the following:

- a) Total funds raised and appropriated for schools
- b) Total county assessment
- c) All TIF payments and special tax district payments
- d) Overlay

The core municipal commitment is only calculated in the first year. Each succeeding year begins with the previous year's levy limit as a starting point, not the actual commitment.

The next step is to calculate the growth limitation factor. This is a blended percentage of average real TPI (total personal income) and the property growth factor. The average real TPI is the average real growth in total personal income (less the effect of inflation) and is calculated by the State. This percentage cannot exceed 2.75% if the State Tax Assessor has determined that the State and local tax burden ranks in the highest 1/3 of all states. If the State ranks in the middle 1/3 of all states, the growth limitation factor is the average real personal income growth, plus forecasted inflation, plus the property growth factor. The property growth factor is the measure of new real value that has come into the municipality as a percentage of the municipality's total taxable value (usually measured by the tax commitment for the most recent tax year, less abatements and supplementals). New value is due to property becoming subject to taxation for the first time, property taxed as a separate parcel for the first time, or improvements or expansion of property. The allowable growth factor, which is the sum of the average real TPI and the municipality's property growth factor plus one, is multiplied by the core municipal commitment to determine the allowable growth value.

The last step in determining the property tax levy limit is to adjust the allowable growth value by net new State funding. New State funding included in the adjustment are municipal revenue sharing, local road assistance, and general assistance, and exclude tax related reimbursements (homestead, tree growth, veterans', etc.) and specific purpose grants. The adjustment is calculated by subtracting the difference in current-year State funding by prior-year State funding, and multiplying the value by one plus the growth limitation factor (as calculated above). This balance is then subtracted by the allowable growth to calculate the property tax levy limit. The levy limit can be adjusted down when there are increases in State funding, but is never adjusted up when there are decreases in State funding.

Per LD-1, a municipality may exceed the tax levy limit if certain extraordinary circumstances are met, and must be approved by

a summary article that specifically identifies the intent to exceed the property tax levy limit. Extraordinary circumstances include:

- a) Catastrophic events (natural disasters, terrorism, fire, etc.)
- b) Unfunded or under funded state or federal mandates
- c) Citizens' initiatives or other referenda
- d) Court orders or decrees
- e) Loss of state or federal funding

LD-1 also allows the municipality to *increase* the property tax levy limit without justification or demonstration of "extraordinary circumstances". *Increasing* the new property tax commitment overrides the formula and creates a new property tax levy limit that will be used as base for the following year calculation. This is not the case if the limit is *exceeded*, under which scenario; the levy limit as originally calculated is used as the base in the following year.

Unless prohibited by the municipalities' charter, voters have the right to initiate by petition a referendum vote on the question of exceeding or increasing the property tax levy limit that has been approved by the council.

The municipalities' authority to add overlay has not changed, even if it adopts a budget that goes to the limit allowed by the growth factor formula. Overlay can be applied even if it exceeds the formula limit.

Any property tax revenues collected by a municipality in any fiscal year in excess of its property tax levy limit, as determined by a final audited accounting, must be transferred to a property tax relief fund and used to reduce property tax levies in subsequent fiscal years.

School Funding

LD-1 established a four-year phase in of education funding for the State to provide 55% of the cost of K-12 education based on a new funding model called Essential Programs and Services (EPS). Major components of the EPS budgeting model are:

- Base pupil amount that is calculated separately for each school unit based largely on modeled staffing levels
- Weighted pupil count for categories of students determined to be more costly to educate (i.e. limited English, economically disadvantaged)
- Program cost components calculated separately from the base per pupil rate, but also factoring in student count (i.e. special ed., transportation)
- Targeted funds (i.e. technology costs, assessment costs)

Any proposed school budget that exceeds the FY 06 100% EPS allocation, which will be located on the Department of Education website for each school unit, must be adopted by special procedure. These budgets over 100% EPS must be approved by voters in an "additional local appropriation" article worded specifically, and adopted by written ballot vote. This applies to all SAD's, CSD's, school boards, and town and city councils with school budget authority. If council approves a budget over 100% EPS, the petition and referendum process is available to the voters. This process is also available to the voters when a school budget in excess of 100% EPS is presented to the council, and the council elects not to exceed the 100%. Voters can force the council to adopt the budget that is in excess.

Homestead Exemption

Changes were made to the Homestead Exemption under LD-1. All properties, regardless of value, will now receive a \$13,000 exemption. The State has reduced the reimbursement of lost tax revenues to municipalities to 50%, which is the minimum under the State constitution. The unreimbursed \$6,500 should not be included in the total municipal valuation upon which the tax commitment is levied. The effective date for this change is September 15, 2005, but has an established retroactive date of April 1, 2005.

Circuit Breaker Program

The circuit breaker program provides property tax relief benefits directly to Maine residents. LD-1 has changed the old income-limitation system with a new benefit-based system. The benefit base, which is the maximum amount of any property tax bill the State will recognize for the purpose of calculating eligibility, is \$4,000 for multi-member households and \$3,000 for single member households. For renters, 20% of their annual rental obligation is presumed to be their property tax bill. If an applicant's total property taxes paid (up to benefit base limits) exceed 4% of their income, they will receive a "part one" refund, which is one half of the excess. If an applicants total property taxes paid (up to benefit base limits) exceed 8% of their income, they will receive a "part two" refund, which is the entire excess over 8% up to the maximum benefit. The maximum benefit is \$2,000.

CALCULATING MUNICIPAL SPENDING LIMITATION

Core Municipal Commitment Calculation

Total commitment	3,000,000
Less: School commitment	1,750,000
County assessment	150,000
TIF payments	75,000
Overlay	<u>25,000</u>
Core Municipal Commitment	<u>1,000,000</u>

Property Growth Factor Calculation

New property taxed for first time	<u>3,000,000</u>
Total taxable value of municipality	100,000,000
Property Growth Factor	3.00%

Growth Limitation Factor Calculation

Avg. Real TPI (provided by State)	2.50%
Property Growth Factor	3.00%
Growth Limitation Factor	<u>5.50%</u>

Required Deduction for New State Funding Calculation

Actual State revenue from prior year	400,000
Multiplied by Growth Limitation Factor	<u>1.055</u>
Total adjusted	422,000

Actual State revenue from current year	425,000
Net difference	<u>3,000</u>

Property Tax Levy Limit Calculation

Core Municipal Commitment	1,000,000
Growth Limitation Factor	<u>1.055</u>
Allowable Growth Subtotal	1,055,000
Less New State Funding	<u>3,000</u>
Property Tax Levy Limit	<u>1,052,000</u>



Congratulations to the following RKO Clients who were Awarded a Certificate of Achievement for Excellence in Financial Reporting by GFOA for their most recent CAFR:

- City of Auburn
- City of Bangor
- Town of Brunswick
- Town of Cumberland
- Town of Falmouth
- Town of Gorham
- City of Lewiston
- City of Portland
- Portland Water District
- City of Saco



Congratulations to the City of Saco for being awarded the GFOA Distinguished Budget Presentation Award for its FY2004 budget.

RKO Joins Government Audit Quality Center

RKO has recently joined the AICPA's Government Audit Quality Center which is a web-based hub for practitioners committed to excellence. We are one of only two Maine firms to join the Center.

RKO to Sponsor New England GFOA Conference

RKO will be sponsoring the Friday night reception at this year's annual conference September 22-25 at the Colony Hotel in Kennebunkport. We hope to see you there.

New Faces

We are pleased to announce that Anne Jameson has accepted a position with us starting July 5th. Anne received her MBA from Thomas College and has three years experience with the State Department of Audit; she was responsible for auditing the DHS program. She also worked several years with the Maine Revenue Service as a revenue agent and tax examiner. She will come on board as an in-charge accountant.

Peter Hall has recently joined the firm as a supervisor in the municipal and non profit departments. Peter is a graduate of Amherst College with a degree in Economics (Magna cum Laude, Phi Beta Kappa) and has also studied at the University of Southern Maine as well as the Harvard Graduate School of Business Administration Executive Education Program. He has served several local not-for-profit organizations in various capacities, including as director and treasurer, and is presently serving in a volunteer capacity in municipal government. He is a Certified Public Accountant, and holds membership in the Maine Society of Certified Public Accountants and the American Institute of Certified Public Accountants. He has 14 years experience in private and public accounting, most recently focusing on not-for-profit and municipal auditing. He and his wife reside in Standish with their two-year old son. Peter is an avid competitive sailor, and has completed numerous offshore and ocean yacht races, including the Newport to Bermuda Race.

Single Audit Employee Certification

Beginning in fiscal year 2004, employees whose positions are 100% funded by selected federal programs, such as Title 1A or Local Entitlement, must attest to the extent of their involvement in these programs. Specifically, the A-133 Compliance Supplement states that, "An employee whose compensation is funded solely from a Single Cost Objective must furnish a semi-annual certification that he/she has been engaged solely in activities supported by the applicable source in accordance with OMB Circular A-87, Attachment B paragraph 11.h.3". At RKO, we recommend the LEA develop a simple certification form listing the employees name, title, and applicable grant. We also recommend that the form is signed semi-annually by the employee and his/her supervisor. For a complete list of the grants covered, please visit:

http://www.whitehouse.gov/omb/circulars/a133_compliance/04/ed.pdf

RUNYON KERSTEEN OUELLETTE
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