

TO: State Agency Department Heads and Chief Fiscal Officers
University Chancellors, Administrators and Fiscal Officers
Community College Presidents, Administrators and Fiscal Officers
Clerks of Superior Court

FROM: **Ralph Campbell, Jr.**
N.C. State Auditor

SUBJECT: *Year 2000 Financial Reporting Disclosure Issues – an amendment to Audit Advisory No. 4*

Purpose: To advise state agencies, universities, community colleges, and clerks of superior court about the revised financial reporting disclosures and their impact on the financial audits conducted by the Office of the State Auditor.

Accounting Pronouncement: Governmental Accounting Standards Board (GASB) Technical Bulletin 99-1, *Disclosures about Year 2000 Issues – an amendment of Technical Bulletin 98-1*, effective immediately for financial statements on which the auditor's report is dated after October 31, 1998.

Background: GASB issued in October 1998 Technical Bulletin 98-1 which established that certain disclosures about year 2000 issues are necessary and should be reported in the notes to the financial statements. As noted in Technical Bulletin 98-1, the year 2000 issues are the result of shortcomings in many electronic data processing systems and other equipment that may adversely affect a government's operations as early as fiscal year 1999.

In response to Technical Bulletin 98-1, the Office of the State Auditor issued Audit Advisory No. 4, *Year 2000 Financial Reporting Disclosure Issues*. In addition to describing the disclosure requirements, Audit Advisory No. 4 explained the impact of Technical Bulletin 98-1 on our audit process and reports. It concluded that the reports issued by the Office of the State Auditor would include a qualification regarding the year 2000 disclosures, consistent with guidance issued by the American Institute of Certified Public Accountants (AICPA).

The reporting requirements and audit responsibilities resulting from Technical Bulletin 98-1 were quite controversial. Consequently, GASB issued in March 1999 Technical Bulletin 99-1 to amend the disclosure requirements of

Technical Bulletin 98-1. Technical Bulletin 99-1 provided an option to disclose year 2000 issues as Required Supplementary Information (RSI).

In response to Technical Bulletin 99-1, the AICPA issued Guidance *on Year 2000 Disclosures Made Pursuant to GASB TB 99-1*. This guidance provides that previous guidance issued pursuant to GASB Technical Bulletin 98-1 is applicable if disclosures are not presented as RSI. Furthermore, it provides that an auditor may determine that he or she is not able to evaluate an entity's year 2000 disclosures using the disclosure criteria specified by Technical Bulletin 99-1. In this situation, the guidance provides that the auditor may indicate in an explanatory paragraph that procedures required by professional standards were not completed because of such reason.

Implementation:

The Office of the State Auditor will work with its auditees, subject to GASB requirements, to report year 2000 disclosures as RSI. The Office of the State Auditor will also implement Technical Bulletin 99-1 by reissuing fiscal 1998 reports which included year 2000 disclosures in the notes to the financial statements. Reporting year 2000 disclosures as RSI will allow us to remove the scope qualification included in our previously issued reports and to avoid the qualification in future reports

The Office of the State Auditor will include in its reports a separate explanatory paragraph stating that the Office of the State Auditor was unable to apply to the RSI certain procedures prescribed by professional (AICPA) standards. The Office of the State Auditor has determined that it is unable to evaluate an auditee's year 2000 disclosures using the disclosure criteria specified by TB 99-1. This situation is analogous to the Office of the State Auditor's previous determination on year 2000 disclosures reported in the notes to the financial statements: it is caused because reasonable criteria for the measurement of the information have not been established.

Questions:

If you have any questions relative to this audit advisory, contact the manager responsible for your audit at:

**Office of the State Auditor
300 N. Salisbury Street
Raleigh, NC 27603-5903
Phone: (919) 733-3217
Fax: (919) 733-8443**

Attachments:

GASB Technical Bulletin 99-1
Pro Form Required Supplementary Information
Pro Forma Explanatory Paragraph

Internet Access:

This advisory (including the attachments) is available on the Internet at the following address:

www.osa.state.nc.us/pressrel/AA5.pdf

If you experience problems with Internet access to these files, please contact our Information Resource Management Division at (919) 733-3217 for assistance.

GASB Technical Bulletin

Title:

Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1

References:

NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*

NCGA Interpretation 6, *Notes to the Financial Statements Disclosure*

GASB Concepts Statement No. 1, *Objectives of Financial Reporting*

GASB Technical Bulletin No. 98-1, *Disclosures about Year 2000 Issues*

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
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401 MERRITT 7, P.O. BOX 5116, NORWALK, CT 06856-5116

Background

1. GASB Technical Bulletin (TB) No. 98-1, paragraph 4, refers to notes to the financial statements as the appropriate place to disclose year 2000 issues. Paragraph 7 of that TB states that a government's year 2000 disclosures "should include a description of the stages of work in process or completed as of the end of the government's reporting period to make computer systems and other electronic equipment critical to conducting operations year 2000-compliant. The additional stages of work necessary for making computer systems and other electronic equipment year 2000-compliant should also be disclosed. . . ."

Question 1

2. Does GASB TB 98-1 require governments to make an assertion that they will be year 2000-compliant with regard to their computer systems and other electronic equipment?

Response

3. No. Technical Bulletin 98-1 requires disclosure of the stages of work in process or completed as of the end of the government's reporting period to address year 2000 issues for computer systems and other electronic equipment. Paragraphs 6 and 7 of the TB are amended as follows:

6. Governments should disclose any significant amount of resources committed-contracted amounts at the end of the government's reporting period-to address year 2000 issues for computer systems and other electronic equipment.

7. Governments should disclose a general description of the year 2000 issue as it relates to their organization. This disclosure should include a description of the stages of work in process or completed as of the end of the government's reporting period to address year 2000 issues for computer systems and other electronic equipment critical to conducting operations. If computer systems and other electronic equipment critical to operations are in the same stage of work, the description of these systems and equipment may be combined for this disclosure. The disclosure should indicate, however, that the completion of these stages is not a guarantee that systems and equipment will be year 2000-compliant. The following stages have been identified as necessary to address the year 2000 issue.¹

¹ Adapted from U.S. Securities and Exchange Commission, *Division of Market Regulation Year 2000 ("Y2K") Work Program* (January 1998).

Awareness Stage—Encompasses establishing a budget and project plan (for example, a timeline or chart noting major tasks and due dates) for dealing with the year 2000 issue.

Assessment Stage—When the organization begins the actual process of identifying all of its systems (preparing an inventory) and individual components of the systems. An organization may decide to review all system components or, through a risk analysis, identify only mission-critical systems and equipment—systems and equipment critical to conducting operations.

Remediation Stage—When the organization actually makes changes to systems and equipment. This stage deals primarily with the technical issues of converting existing systems, or switching to compliant systems. During this stage, decisions are made on how to address year 2000 system or equipment issues, and the required changes are made.

Validation/Testing Stage—When the organization validates and tests the changes made during the conversion process. The development of test data and test scripts, the running of test scripts, and the review of test results are crucial for this stage of the conversion process to be successful. If the testing results show anomalies, the tested area needs to be corrected and retested.

Question 2

4. Would it be appropriate to make the disclosures required by TB 98-1 in required supplementary information rather than in the notes to the financial statements?

Response

5. Yes. Disclosures of year 2000 issues should be made either in the notes to the financial statements or in required supplementary information following the notes. TB 98-1, paragraph 4, is amended as follows:

In accordance with NCGA Statement 1, paragraph 158, and NCGA Interpretation 6, paragraphs 5 and 6, notes to the financial statements should disclose material items whose omission would cause the financial statements to be misleading. Furthermore, in accordance with NCGA Interpretation 6, paragraph 4, entities are required to disclose significant commitments in the notes to the financial statements. Disclosure of year 2000 issues is consistent with the objectives of financial reporting in GASB Concepts Statement 1, paragraph 79, which states that financial reporting should assist users in assessing the level of services that can be provided by the government and its ability to meet its obligations as they become due. GASB Concepts Statement 1 makes clear that financial reporting can occur outside of basic financial statements and related note disclosures. Required supplementary information is a means of communicating information outside of basic financial statements. Therefore, disclosures of year 2000 issues should be made either in the notes to the financial statements or as required supplementary information following note disclosures. The disclosures should include the same items of information that are required in paragraphs 6 and 7, as amended, whether the information is disclosed in notes to the financial statements or as required supplementary information.

Effective Date and Transition

6. The provisions of this Technical Bulletin are effective immediately. Retroactive application is allowed. The provisions terminate for financial statements for periods ending after December 31, 1999 unless mission-critical systems and other equipment are not operating because of the year 2000 issue as of the balance sheet date.

The Governmental Accounting Standards Board has authorized its staff to prepare GASB Technical Bulletins to provide timely guidance on certain financial accounting and reporting problems, in accordance with the procedures described in Technical Bulletin No. 84-1, *Purpose and Scope of GASB Technical Bulletins and Procedures for Issuance*. The provisions of Technical Bulletins need not be applied to immaterial items.

The GASB has reviewed this Technical Bulletin and a majority of its members do not object to its issuance.

Appendix

CODIFICATION INSTRUCTIONS

7. The section that follows updates the June 30, 1998 *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Technical Bulletin. Only the paragraph number is listed if the paragraph will be cited in full in the Codification.

* * *

NOTES TO THE FINANCIAL STATEMENTS

SECTION 2300

Sources: [Add the following:] GASB Technical Bulletin 99-1

TECHNICAL BULLETINS EFFECTIVE AFTER MARCH 15, 1992

Disclosures about Year 2000 Issues

.603 This paragraph provides Technical Bulletin guidance on disclosures about year 2000 computer and other electronic equipment issues.

Question 1

[GASBTB 99-1, ¶2]

Response

[GASBTB 99-1, ¶3]

Question 2

[GASBTB 99-1, ¶4]

Response

[GASBTB 99-1, ¶5]

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PRO FORMA REQUIRED SUPPLEMENTARY INFORMATION
YEAR 2000 ISSUES
JUNE 30, 199X

Governmental Accounting Standards Board Technical Bulletin 98-1 (TB 98-1), *Disclosures about Year 2000 Issues*, dated October 1998, states in part that (a) the year 2000 issue is the result of shortcomings in many electronic data processing systems and other equipment that may adversely affect a government's operations as early as fiscal year 1999, and (b) problems affecting a wide range of government activities will likely result if computers and other electronic equipment that are dependent upon date-sensitive coding are not corrected. TB 98-1 further states that these problems have a potential for causing a disruption to some government operations and may temporarily increase the cost of those operations. In accordance with the requirements of TB 98-1, the ABC Government makes the following disclosures about year 2000 issues.

Description of Year 2000 Issues and the Stages of Work Necessary to Make Systems Compliant - The ABC Government has recognized the urgency in dealing with the year 2000 dilemma and established a year 2000 Project Team (project team) during fiscal year [1996]. The project team's roles and responsibilities include: conducting awareness sessions with department/technical contacts; determining the business impact of system failures; identifying date sensitive systems, electronic equipment, and equipment with embedded chips; determining contingency plans; determining source of funds; determining conversion approaches and schedules; analyzing third-party compliance; working with application analysts and programmers to test acceptance and production readiness, convert applications and equipment, and test applications; and work with a special year 2000 test resource team to perform quality assurance reviews.

[The description above is an example only. Each ABC Government should make appropriate adjustments to the description as necessary to explain its management of the Y2K issue.]

The ABC Government [*has completed or is in the process of completing*] an inventory of its electronic data processing systems and other electronic equipment that may be affected by the year 2000 issue and that are necessary to conducting the ABC Government's operations. The ABC Government is subjecting those systems and equipment to the following stages of work to address year 2000 issues:

- Awareness Stage – Establishing a budget and project plan for dealing with the year 2000 issue.
- Assessment Stage – Identifying the systems and components for which year 2000 compliance work is needed.
- Remediation Stage – Making changes to systems and equipment.
- Validation/Testing Stage – Validating and testing the changes that were made during the remediation stage.

The ABC Government's year 2000 remediation work for its mission critical systems and electronic equipment is in the following stages of work as of June 30, 1998. (A – needs to be addressed, P – in process, C – completed)

Description of Mission Critical System	Awareness Stage	Assessment Stage	Remediation Stage	Validation/ Testing Stage
Financial Records, Contract Billing Systems, Student Financial Aid, Student Loans, Human Resource Systems	C	C	C	P
Student Admissions, Student Records, Student Billing Systems, Student Housing, Payroll, Specialized Clinical Systems	C	C	C	C
Data Storage Systems (including research databases), Co-generation & Electric Distribution Systems	C	C	P	P
Communication Systems, Library & Academic Resource Systems	C	P	P	A
LAN & Distributive Network Systems	P	P	P	A

[The table above is an example only. Each ABC Government should make appropriate adjustments to the table as necessary to identify its mission critical systems and the stages of work for those systems. Systems in the same stage of work should be listed together.]

Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until year 2000 and thereafter. As a result of this uncertainty, management cannot assure that the ABC Government is or will be year 2000 ready, that the ABC Government's remediation efforts will be successful in whole or in part, or that parties with whom the ABC Government does business will be year 2000 ready. Consequently, the completion of these stages is not a guarantee that systems and equipment will be year 2000 compliant.

Outstanding Contractual Commitments Related to Year 2000 Efforts - The ABC Government's contractual commitments outstanding at June 30, 1998, related to year 2000 remediation efforts was *[\$AMOUNT]*.

[OR]

Outstanding Contractual Commitments Related to Year 2000 Efforts - The ABC Government had no contractual commitments outstanding at June 30, 1998, related to year 2000 remediation efforts.

Independent Auditor's Report
Pro Forma Explanatory Paragraph

The required supplementary information on year 2000 issues listed in the table of contents is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because we could not evaluate the information using the criteria in Governmental Accounting Standards Board Technical Bulletin 98-1, *Disclosures About Year 2000 Issues*, as amended. In addition, we do not provide assurance that the ABC Government is or will become year 2000 compliant, that the ABC Government's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the ABC Government does business are or will become year 2000 compliant.