

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*

Purpose: To advise state agencies, universities, community colleges, and clerks of superior court about the financial disclosures required for year 2000 issues and their impact on financial audits conducted by the Office of the State Auditor.

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

Background: As noted in the GASB Technical Bulletin, 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. 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. These problems have a potential for causing a disruption to some governmental operations and may temporarily increase the cost of those operations.

GASB through this Technical Bulletin has established that certain disclosures about year 2000 are necessary. In reaching this conclusion, GASB notes that financial reporting should assist financial statement 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. The year 2000 problem affects many of the computer systems and other electronic equipment necessary for the continued and uninterrupted operations of a government.

The following disclosures about year 2000 issues are required in the financial statements:

1. Any significant amount of resources committed and contracted at the end of the government's reporting period to make computer systems and other electronic equipment year 2000 compliant.
2. A general description of the year 2000 issue, including a description of the stages of work in process or completed as of the end of the government's reporting period, and a description of the additional stages of work necessary for making computer systems and other electronic equipment year 2000 compliant.

The Technical Bulletin provides the following stages that are necessary to implement a year 2000 compliant system.

- 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.

In response to the Technical Bulletin, the American Institute of Certified Public Accountants (AICPA) issued *The AICPA Illustrative Reporting Guidance on Year 2000 Disclosures Made Under GASB Technical Bulletin 98-1* on October 22, 1998. Through this guidance, the AICPA raises its concerns that the required Technical Bulletin disclosures are neither assertable by management nor verifiable by auditors. The AICPA advises auditors to be very cautious about being associated with the disclosures required by the Technical Bulletin. "Because of the unprecedented nature of the year 2000 issue, its effects and the success of the related remediation efforts will not be fully determinable until the year 2000 and thereafter. Accordingly sufficient audit evidence may not exist to support the required Technical Bulletin disclosures. Therefore, auditors may need to consider issuing qualified opinions (scope limitations) with respect to such disclosures."

Implementation:

The Office of the State Auditor is required by General Statutes to conduct its audits in accordance with generally accepted auditing standards and has discussed auditing concerns regarding the year 2000 disclosures required by GASB. Accordingly, the State Auditor's opinion on all financial audits subject to GASB pronouncements will include a qualification (attachment) consistent with the AICPA reporting guidance. This qualification will continue for future fiscal years and thereafter, as long as the disclosure is required; however, the qualification will not cause an audit finding.

The 1998 pro forma financial statements have been revised to incorporate the disclosures required by this Technical Bulletin (attachment). While the Year 2000 Issues note will be qualified in the auditor's opinion, the disclosures should be presented in the financial statements as required by the Technical Bulletin. Failure to provide the

required disclosures could result in a more serious auditor qualification and audit finding in the audit report.

Questions: If you have any questions relative to this audit advisory, contact the audit 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 98-1
Pro Forma Disclosures for Year 2000 Issues
Pro Forma Scope Limitation Paragraph

Internet Access: This advisory (including the attachments) are available on the internet at the following address:

www.osa.state.nc.us/presrel/AA4.pdf

If you experience problems with internet access to these files, please contact our Information Resource Management Division for assistance.

GASB Technical Bulletin No. 98-1

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October 1998

Title:

Disclosures about Year 2000 Issues

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*

Background

1. The year 2000 issue is the result of shortcomings in many electronic data-processing systems and other equipment that may adversely affect operations in the year 1999 and beyond. For many years, programmers eliminated the first two digits from a year when writing programs. For example, programmers would designate January 1, 1965 as "01/01/65" instead of "01/01/1965." On January 1, 2000 at 12:00:01 a.m., the internal clock in computers and other equipment will roll over from "12/31/99" to "01/01/00." Unfortunately, many programs (if not corrected) will not be able to distinguish between the year 2000 and the year 1900. This may cause the programs to process data inaccurately or to stop processing data altogether. Another factor that may cause problems in programs is the leap-year calculation. Some programs are unable to detect the year 2000 as a leap year.
2. Problems affecting a wide range of governmental activities will likely result if computers and other electronic equipment that are dependent upon date-sensitive coding are not corrected. These problems have the potential for causing a disruption to some government operations and may temporarily increase the cost of those operations.

Question

3. What type of disclosures should be presented in the financial statements about compliance with year 2000 issues for a government's internal computer systems and other electronic equipment?

Response

4. 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.

5. The year 2000 problem affects many of the computer systems and other electronic equipment necessary for the continued and uninterrupted operations of a government. The effects of the year 2000 problem extend beyond systems that produce financial information. It encompasses all computer systems and any equipment that is dependent on microchip technology. This includes computer systems and other equipment that are a part of the entity's operational activities. A significant commitment of resources may be required to make year 2000 compliance changes or updates to computer systems and other equipment.
6. Governments should disclose any significant amount of resources committed—contracted amounts at the end of the government's reporting period—to make computer systems and other electronic equipment year 2000-compliant.
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 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. 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 following stages have been identified as necessary to implement a year 2000-compliant system¹.

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 for year 2000 compliance or, through a risk analysis, identify only mission-critical systems and equipment—systems and equipment critical to conducting operations—to check for compliance.

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 make the systems or processes year 2000-compliant, and the required system 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.

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

Effective Date

8. The provisions of this Technical Bulletin are effective for financial statements on which the auditor's report is dated after October 31, 1998. The provisions terminate for financial statements for periods ending after December 31, 1999 unless systems and other equipment are not year 2000-compliant as of the balance sheet date. Earlier application is encouraged.

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

9. 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 98-1

TECHNICAL BULLETINS EFFECTIVE AFTER MARCH 15, 1992

Disclosures about Year 2000 Issues

.602 This paragraph provides Technical Bulletin guidance on disclosures about year 2000 computer issues.

Question

[GASBTB 98-1, ¶3]

Response

[GASBTB 98-1, ¶4-¶7]

Proforma Disclosures for Year 2000 Issues

University Financial Statements:

Note X Year 2000 Issues - 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 University makes the following disclosures about Year 2000 issues.

Description of Year 2000 Issues and the Stages of Work Necessary to Make Systems Compliant - The University 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 university should make appropriate adjustments to the description as necessary to explain its management of the Y2K issue.]

The University [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 University’s operations. The University 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 University’s year 2000 remedation work for its mission critical systems and electronic equipment are 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 university 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 University is or will be Year 2000 ready, that the University's remediation efforts will be successful in whole or in part, or that parties with whom the University does business will be year 2000 ready.

Outstanding Contractual Commitments Related to Year 2000 Efforts – The University's contractual commitments outstanding at June 30, 1998, related to Year 2000 remediation efforts was [\$34,000].

Proforma Disclosures for Year 2000 Issues

Community College Financial Statements:

Note X Year 2000 Issues - 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 College makes the following disclosures about Year 2000 issues.

Description of Year 2000 Issues and the Stages of Work Necessary to Make Systems Compliant - The College's mission critical electronic data processing systems and equipment are provided by the North Carolina Community College System, but the systems can be modified by the College. The North Carolina Community College System is responsible for remediating the core operations of these systems and the College is responsible for modifications it has made to the systems.

(If the College has other systems not provided by NCCCS and has established a Year 2000 Project Team to manage the remediation of those systems, complete the following)

The College has other systems not provided by the North Carolina Community College System and 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 College having a Year 2000 project team should make appropriate adjustments to the description as necessary to explain its management of the Y2K issue.]

The College and the North Carolina Community College System *[have completed or is in the process of completing]* an inventory of the College's electronic data processing systems and other electronic equipment that may be affected by the Year 2000 issue and that are necessary to conducting the College's operations. The College and the North Carolina Community College System are 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 College's and the North Carolina Community College System's year 2000 remediation work for its mission critical systems and electronic equipment are 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
General Ledger, Accounts Payable, Payroll and Human Resources, Student Accounts Receivable and Cash Receipts, Purchasing, Student Admission, Student Financial Aid, Curriculum Student Registration, Continuing Education Registration, Equipment Inventory, Literacy Application that Accesses Continuing Education Records for Tracking Students,	C	C	C	P
Communications Systems	C	C	P	A
Library & Academic Resource Systems	C	P	P	A
LAN & Distributive Network Systems	P	P	P	A

[The table above is an example only. Each college 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 College is or will be Year 2000 ready, that the College's and the North Carolina Community College System's remediation efforts will be successful in whole or in part, or that parties with whom the College does business will be year 2000 ready.

Outstanding Contractual Commitments Related to Year 2000 Efforts – The College's contractual commitments outstanding at June 30, 1998, related to Year 2000 remediation efforts was [*\$34,000*].

Proforma Disclosures for Year 2000 Issues

Clerk of Superior Court Financial Statements:

Note X Year 2000 Issues - 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 Clerk makes the following disclosures about Year 2000 issues.

Description of Year 2000 Issues and the Stages of Work Necessary to Make Systems Compliant – The Clerk’s electronic data processing system and equipment is provided by the North Carolina Administrative Office of the Courts (AOC). AOC is responsible for remediating the system and equipment, and is solely responsible for any associated cost. AOC is subjecting the Clerk’s systems (the Financial Management System and others as identified by AOC) 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 AOC’s year 2000 remediation work for the Clerk’s mission critical systems and electronic equipment are 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 Management System	C	C	C	P
Other Systems (<i>describe</i>)	C	P	P	A
LAN & Distributive Network Systems	P	P	P	A

[The table above is an example only. Each clerk 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 Clerk is or will be Year 2000 ready, that the AOC’s remediation efforts will be successful in whole or in part, or that parties with whom the Clerk does business will be year 2000 ready.

Outstanding Contractual Commitments Related to Year 2000 Efforts – AOC is responsible for the cost related to Year 2000 remediation efforts.

Sample "Scope Limitation" Opinion

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

Board of Trustees

*1

*2, North Carolina

We have audited the accompanying Balance Sheet of the *1, a component unit of the State of North Carolina, as of June 30, 199x and the related Statement of Changes in Fund Equity and Statement of Current Funds Revenues, Expenditures, and Other Changes for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Governmental Accounting Standards Board Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*, requires disclosure of certain matters regarding the year 2000 issue. *1 has included such disclosures in Note X. 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 the year 2000 and thereafter. Accordingly, insufficient audit evidence exists to support *1's disclosures with respect to the year 2000 issue made in Note X. Further, we do not provide assurance that *1 is or will be year 2000 ready, that *1's year 2000 remediation efforts will be successful in whole or in part, or that parties with which *1 does business will be year 2000 ready.

In our opinion, **except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding year 2000 disclosures,** the general-purpose financial referred to above present fairly, in all material respects, the financial position of *1 as of June 30, 199x, and the changes in fund equity and the current funds revenues, expenditures, and other changes for the year then ended in conformity with generally accepted accounting principles.

[If applicable, add paragraph on implementation of GASB 31/32 and change in method of accounting for securities lending transactions.]

In accordance with *Government Auditing Standards*, we have also issued reports dated *3 on our consideration of the University's internal control structure and its compliance with laws and regulations.

Ralph Campbell, Jr.
State Auditor

*3

As required for disclosure by G.S. §143-170.1, 375 copies of this public document were printed at a cost of \$67.50, or 18¢ per copy.