POTENTIAL PROJECT DESCRIPTIONS

GASB

Governmental Accounting Standards Board

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Potential Projects

Accounting for Asset Retirement Obligations

Project Objective: The initial objectives of this potential research project would be (1) to research the various types of asset retirement obligations currently encountered in practice, (2) to determine whether current accounting and reporting requirements are sufficient or whether additional guidance need to be developed for such obligations. If additional guidance is determined to be needed, another objective would be to develop specific accounting and reporting standards that would enhance the transparency of and provide consistent reporting for these events.

Description of the Project Topic: Governments incur costs to retire certain assets after the service capacity of those assets has been exhausted. Retirement costs are incurred for assets as diverse as landfills and nuclear power plants.

This potential research project would identify the types of assets retirement obligations currently encountered in the government environment and attempt to quantify the significance of those events. The potential research project also would identify current and potential recognition and measurement alternatives and disclosure deficiencies.

The following issues would be considered in this project:

- What types of asset retirement obligations currently exist? How prevalent are these obligations?
- How are asset retirement obligations currently being accounted for and reported by state and local governments? How significant are the amounts associated with these obligations?
- When should asset retirement obligations be recognized?
- Does incurring an asset retirement obligation increase the service capacity of the related asset? Should this increase, if any, be recognized?
- How should this obligation be measured?
- Does the current disclosure for these obligations provide adequate information to the users of financial statements to allow them to understand their economic substance?
- Should additional financial reporting or disclosure requirements be considered?

Reasons for Considering the Addition of This Project to the Research Agenda: The most common obligations associated with the retirement of a tangible long-lived asset that are encountered by governments may be those for landfill closure and postclosure care. The guidance for recognizing and measuring those obligations is contained in GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, which was issued almost 20 years ago (1993) . Statement 18 also does not apply to the retirement of any other public sector capital assets, such as nuclear power plants or sewage treatment facilities. Although GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, would apply to a government's obligation to clean up pollution associated with non-landfill public capital assets, those standards are not specifically applicable to obligations related to the *closure* of a capital asset. Furthermore, the Statement 49 provisions would only capture pollution that has already become evident, whereas asset retirement obligations are often associated with actions to *prevent* pollution from occurring rather than remediate pollution after the fact.

In the absence of government-specific guidance, GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, allows governments to apply "other accounting literature" including FASB standards issued after November 30, 1989, which did not conflict with or contradict GASB standards. Issued in June 2001, FASB Statement No. 143, *Accounting for Asset Retirement Obligations* (now ASC 410, *Asset Retirement and Environmental Obligations*), "addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. … It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees." A legal obligation is defined as "an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel." (Summary of FASB Statement 143)

This potential project was identified in the Board's consideration of matters related to Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. Asset retirement obligations were among the topics identified by respondents to the Exposure Draft of Statement 62 as needing further guidance, but which were outside the scope of the project. The project was rankeded in the top half of potential and research projects in the two years it has been included in the GASAC's annual prioritization.

Project History: This project was added to the potential projects list in December 2010.

Accounting for Equity Interests in Component Units—Acquisitions When Legal Separation Is Maintained

Project Objective: The initial objective of this potential project would be to research whether the substance of an acquisition of an entity that remains legally separate from the acquiring government is significantly different from an acquisition in which legal separation ceases and the acquired organization becomes part of the acquirer's legal entity. If this is not significantly different, another objective would be to consider whether accounting and financial reporting guidance should be modified for acquisitions of an entity that remains legally separate.

Description of the Project Topic: Statement No. 69, *Government Combinations and Disposals of Government Operations,* provides accounting and financial reporting guidance for mergers and acquisitions of complete entities. The Statement 69 definition of *acquisition* explicitly states that an acquired entity becomes part of the acquiring government's legally separate entity. That definition does not include obtaining an equity interest in another organization that remains legally separate and will be reported as a component unit of the acquiring government. Statement No. 14, *The Financial Reporting Entity,* as amended, provides the requirements for reporting the legally separate organizations that comprise a financial reporting entity. The measurement of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources of an acquired entity that becomes part of the primary government under Statement 69 is different from measurement when an acquired entity is reported as a component unit under Statement 14, as amended.

An example may best illustrate the financial reporting implications of the issue. Assume that Government A, a business-type activity, acquires all of the assets and liabilities of Entity B, a not-for-profit organization, in an acquisition transaction. Entity B would cease to exist as a legally separate entity and would become a part of Government A's legally separate entity. That transaction would qualify as a government acquisition under the provisions of Statement 69. For this exercise, assume that Government A determines that the consideration paid exceeds the acquisition values assigned to the assets and liabilities acquired by $225,000. Government A would recognize acquisition values of the assets acquired and liabilities assumed and classify the excess of $225,000 as a deferred outflow of resources based on the requirements of Statement 69.

However, if Entity B will remain as a legally separate entity after it is acquired by Government A, the transaction falls outside the scope of Statement 69 and the financial reporting requirements are provided in Statement 14, as amended, because Government A determines that Entity B qualifies as its component unit. In this instance, based on paragraph 72 of Statement 14, as amended by Statement No. 61, *The Financial Reporting Entity: Omnibus*, Government A's equity interest in Entity B is measured by its share of the component unit's (Entity B's) net resources. There is no requirement for Entity B to remeasure its assets and liabilities at acquisition value or to allocate the acquisition price paid by Government A. Government A (the primary government) in this instance would record an expense to adjust for the difference between the carrying values of the component unit's (Entity B's) assets and liabilities and the amount of consideration paid, assuming Government A provides excess consideration as described in the preceding paragraph.

The following issue would be considered:

- Should the assets, deferred outflows of resources, liabilities, and deferred inflows of resources of a legally separate component unit for which the primary government recognizes an equity interest be measured in the same manner as those elements would be in a government acquisition under Statement 69?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Some respondents to the Exposure Draft leading to Statement 69 commented that it is not unusual for organizations to remain as legally separate entities after they are acquired. Those respondents sought clarification about whether there exists a significant difference between government combinations within the scope of Statement 69 and acquisitions when legal separation is maintained. They generally believe that the substance of the acquisition is the same in both situations. Accordingly, there is some concern that governments will be able to influence the accounting for a transaction based on whether an acquired organization maintains or relinquishes its separate legal identity.

Project History: This project will be considered for addition to the potential projects list in April 2013.

Exchange-Like Revenues

Project Objective: The initial objectives of this potential research project would be (1) to research the types of exchange-like transactions governments are currently engaging in and (2) to consider if guidance on distinguishing between transactions that are exchange-like versus exchange or nonexchange is warranted. If additional guidance is determined to be needed, another objective would be to consider providing specific accounting and financial reporting guidance for exchange-like revenues that is distinct from guidance for exchange and nonexchange transactions.

Description of the Project Topic: Current accounting and financial reporting guidance for exchange-like revenues is found in Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. The introduction of Statement 33 (paragraph 1) provides that there are two types of transactions: "(a) exchange and exchange-like transactions, in which each party receives and gives up essentially equal values, and (b) nonexchange transactions, in which a government gives (or receives) value without directly receiving (or giving) equal value in exchange." Footnote 1 provides, in part, "The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a 'pure' exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition." Examples included in the Basis for Conclusions of Statement 33 include certain fees for regulatory or professional licenses, certain tap fees, and certain developer contributions.

The Basis for Conclusions also indicates the Board's belief that "exchange-like transactions should be accounted for in the same way as 'pure' exchange transactions—that is, based on occurrence of an exchange between the reporting government and another party or parties." Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, provides that revenues, expenses, gains, losses, assets, and liabilities resulting from exchange-like transactions should be recognized similarly to exchange transactions: when the exchange takes place. Other accounting and reporting issues to be addressed include the following:

- What criteria should be established to assist in distinguishing an exchange-like revenue from an exchange or nonexchange revenue?
- Should exchange-like revenue and any related assets be recognized similarly to those resulting from exchange transactions for financial reporting purposes? If not, when should revenue and any related assets resulting from an exchange-like transaction be recognized?

Reasons for Considering the Addition of This Project to the Research Agenda: Certain transactions have characteristics of both exchange-like and nonexchange transactions and determining the appropriate treatment of a transaction can be difficult. After Statement 33 was issued, some technical inquiries were received regarding the timing of asset and revenue recognition associated with exchange-like revenues. Inquiries also were made in regard to additional guidance on how to better distinguish nonexchange and exchange-like revenues. The staff continues to monitor for issues in this area.

Project History: This project was added to the research agenda in 2002 and transferred to the potential projects list in January 2006.

Financial Performance Measurements

Project Objective: The initial objective of this potential research project would be to consider various financial performance measures, including the presentation of changes in fair values in state and local government financial statements. This project would consider presentations in the government-wide statement of activities; governmental funds statement of revenues, expenditures, and changes in fund balances; proprietary funds statement of revenues, expenses, and changes in fund net position; and statement of changes in fiduciary net position.

Description of the Project Topic: Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, indicates that changes in the fair value of investments should be included in investment income recognized as revenue in the statement of activities. These changes are not reported separately from other components of investment earnings. This requirement applies both to investments of fiduciary activities, such as investment and pension trust funds, and to a government's own investments. Existing standards do not require that accrued investment earnings (which can be viewed as related solely to the passage of time) be separately reported from other changes in fair value (which may result from other changes including interest rates or credit quality). Some view the annual required contribution for pensions, which is reported as program expense, to contain a change-in-fair-value component. Statement No. 54, *Accounting and Financial Reporting for Derivative Instruments,* requires changes in the fair values of investment derivative instruments to be reported in investment income as well. Additionally, fair value changes for other assets and liabilities may someday be reported as a result of the Board applying the expected Concepts Statement on measurement approaches.

There are many options for presenting changes in fair value in the statement of activities, including:

- As program revenue or expense
- As a separate line below general revenues, such as with special items and transfers
- A separate column, possibly added in to governmental or business-type activities.

Because issues of reporting changes in fair value are not unique to investments or derivatives, it is important to consider reporting changes in fair value from a broader perspective of fair value changes in any type of asset or liability. The following issues would be considered as a part of this project:

- Which changes in fair value should be reported separately from other transactions?
- Should changes in fair value resulting from sale or other disposal of an asset be reported differently than changes in fair value resulting from the passage of time?
    - How should fair value changes associated solely with the passage of time, such as related to accrued interest, be reported?
    - What is the effect when a change in fair value is realized through sale or settlement?
- Should changes in fair value associated with a program expense or revenue be reported differently than changes associated with a general revenue?
- How should changes in fair value be presented?
- Should the presentation of fair value changes differ depending on the type of asset (for instance, a financial asset versus a capital asset)?

In addition to changes in fair value, other issues that affect financial performance measures also would be considered in the project:

- Where in the flows statements should certain revenues and expenses/expenditures be reported?
    - Is the distinction between operating and nonoperating revenues and expenses important?
    - Should operating/nonoperating distinctions be made in flows statements other than those for the proprietary funds?
    - What revenues and expenses should be reported as operating? Nonoperating?
- Does classifying specific revenues or expenses as operating or nonoperating affect decisions made by users?

The following issues would not be considered as part of this project:

- The overall format of financial statements—Other standards setters that have begun financial performance reporting projects have considered the issue more broadly. They are considering broad changes to existing financial statement formats, such as grouping transactions by those related to business activities, financing, and other gains and losses. Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, established the format for the statement of activities; statement of revenues, expenditures, and changes in fund balances; statement of revenues, expenses, and changes in fund net assets; and statement of changes in fiduciary net assets. The basic formats of these financial statements are better considered as part of an overall review of the effectiveness of Statement 34, which is a separate potential reexamination project in the technical plan.

- Development of a key performance indicator—Other standards setters are also considering what key measure(s) should be considered the primary financial performance result. Because users of governmental financial statements traditionally have not focused on any single reported result similar to the focus on key indicators for commercial enterprises (such as earnings per share and earnings before interest, depreciation, taxes, and amortization), there does not appear to be a need to pursue development of a key performance indicator for governments.

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> A question on this topic arose during the deliberations of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. More recently, the issue arose in conjunction with the project that resulted in Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* In both instances, given the fundamental nature of the issue, the Board decided that it would be more appropriate to address this topic as its own project than as a part of either of those two Statements. In addition the fair value reporting issue, operating versus nonoperating revenue and expense issues continue to be raised to the GASB in technical inquiries. The project was ranked in the top 10 in the GASAC's project prioritization in 2012.

<u>Project History:</u> A project proposal was presented to the Board in December 2003. The Board concluded that the project should be included in the research projects category. The project was transferred to the potential projects list in January 2006.

Financial Transactions with Characteristics of Both Loans and Grants

Project Objective: The initial objectives of this potential research project would be to (1) research the types of transfers of financial resources that have characteristics of both loans and grants (for example, federal contributions to Perkins Loan programs of colleges and universities), and (2) to consider if guidance on distinguishing between transactions that have characteristics of both loans and grants is warranted. If additional guidance is determined to be needed, another objective would be to consider providing guidance regarding whether these types of transactions should be reported as exchange transactions (loan liabilities) or as nonexchange transactions in the financial statements of recipient governments.

Description of the Project Topic: This project would address transactions that are essentially permanent provisions of financial resources to governments in which the provider of the resources retains title or some other form of ownership rights to the resources. Specifically, the project would examine: (a) federal capitalization contributions to Perkins Loan programs at colleges and universities; (b) federal funds provided to states to capitalize revolving loan funds from which loans are made to local governments for the construction, renovation, or expansion of sewage treatment facilities and appurtenances; and similar programs. The project would consider the proper accounting for these transactions within the framework of existing accounting literature. Specifically, this project would consider whether these transactions should be accounted for as nonexchange transactions or as exchange (loan) transactions.

The major issue to be discussed would be whether transactions within the scope of the project fall within the scope of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. As part of this issue, the project likely would consider the following issues:

- Do the resources provided constitute financial resources as discussed in Statement 33?
- Does the federal government, or other provider, receive a direct benefit as discussed in Statement 33? If so, is the benefit commensurate with the resources provided?
- Is the “use” of a financial resource, as discussed in regard to meeting timing requirements, the same as “receiving” value, as discussed in paragraph 1 of Statement 33?
- How do these transactions differ from permanent endowments?

- Does a possibility of return of resources to the provider constitute a liability that should be reported differently than a subsequent contravention as discussed in paragraph 26 of Statement 33?

The following items would be excluded from the scope of this project:

- Accounting for provisions of financial resources that are *not* essentially permanent (for example, long-term loans)
- Accounting for permanent or long-term provisions of capital assets to which the provider retains title—for example, the provision of a federally-owned helicopter to a state for the remaining useful life of the equipment, or permanent or long-term loans of artwork to museums.

Reasons for Considering the Addition of This Project to the Research Agenda: The GASB has received several technical inquiries regarding the proper accounting for federal capitalization contributions to Perkins Loan programs at colleges and universities. Some colleges and universities believe that these contributions are nonexchange transactions and are recording them as revenue. Others point to language in the agreement with the federal government that states that the federal government retains ownership of the resources. They hold that the contribution is an exchange transaction and should be reported as a liability. The National Association of College and University Business Officers issued Emerging Issues Update 02-4, which states the following:

> Amounts received from the federal government as [federal capitalization contributions (FCC)] will ultimately be returned to the federal government if the institution ceases making loans or has excess cash. Although this event may be unlikely, these advances are ultimately refundable to the federal government and the institution is not permitted to keep them once new loan originations cease. As such, the FCC should be classified as a liability (i.e., a refundable advance).

Some question whether that guidance is appropriate given the facts and circumstances of the transaction.

The Perkins Loan amounts are material to some governments. Amounts outstanding for other revolving loan programs (for example, clean water revolving loans) are in the billions of dollars.

The project has been ranked in the top half of potential research projects in the past four GASAC annual prioritization exercises.

Project History: A project proposal was presented to the Board in December 2003. The Board concluded that the project should be included in the research agenda at that time. The project was transferred to the potential projects list in January 2006.

Impairments of Assets Other Than Capital Assets

Project Objective: The initial objectives of this potential research project would be (1) to research the types of assets other than capital assets that could be subject to impairment and (2) to determine whether existing guidance is adequate or if additional guidance on impairments for these assets is warranted. If additional guidance is determined to be needed, another objective would be to consider providing specific accounting and financial reporting guidance for impairments of assets other than capital assets.

Description of the Project Topic: Current guidance for impairment of noncapital assets is found in Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, paragraphs 8, 9 and 16; Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, paragraphs 17 and 18; and Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* paragraphs 96 and 97 regarding contingencies.

Specific issues that would be evaluated as a part of this project include the following:

- What factors or events indicate that impairment of a noncapital asset has occurred?
- What criteria should be used in determining when impairment of a noncapital asset should be recognized?
- What measurement method(s) should be applied to determine the amount of an noncapital asset's impairment?
- Should the measurement method(s) be based on incurred losses or expected losses?

Reasons for Considering the Addition of This Project to the Research Agenda: This issue arose most recently during deliberations on the Fair Measurement and Application project. Considering recent efforts on this topic by other standards setters and the potential range of assets that could be affected, the Board decided it merited its own project.

As noted above, there is reference to impairment of noncapital assets in Statements 31, 53, and 62. These Statements establish the possibility of impairment for certain noncapital assets but do not explain when impairment has occurred, how and when it should be recognized, or how impairment should be calculated.

As part of the FASB and IASB's convergence effort on Financial Instruments, the two boards have been deliberating the issue of impairment of financial assets. As a result of the financial crisis in 2008, stakeholders raised concerns about current "incurred loss" impairment models in which impairment is not recognized until incurred or probable. Initially, the Boards were jointly considering a "three-bucket" model that would apply to all debt instruments and would recognize lifetime expected credit losses based on which of three categories an instrument was classified in. In August 2012, the FASB decided to pursue an alternative approach deemed the "current expected credit loss" approach. Under this approach, impairment would still be based on lifetime expected losses but calculation would not depend on categorization of the asset into one of three categories. The FASB issued an Exposure Draft on impairment of financial instruments in December 2012. As a result of the proposed amendments, financial assets carried at amortized cost less an allowance would reflect the current estimate of the cash flows expected to be collected at the reporting date, and the income statement would reflect credit deterioration (or improvement) that has taken place during the period.

<u>Project History:</u> This project will be considered for addition to the potential projects list in April 2013.

In-Kind Contributions

Project Objective: The initial objectives of this potential research project would be (1) to identify the various types of in-kind contributions currently received by state and local governments and (2) to determine whether existing standards are sufficient or if additional guidance needs to be developed for in-kind contributions. If it were determined that additional guidance is needed, the project would consider specific accounting and financial reporting standards that would provide consistent reporting for these types of contributions.

Description of the Project Topic: The Board specifically excluded "contributed services" from the guidance in Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. Those types of services also previously had been excluded from the scope of Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*. As noted in paragraph 48 of Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, the Board chose not to address the effects of regulator-required in-kind contributions on pollution remediation obligations.

The following issues would be considered during the research stage:

- What types of donations should be considered in-kind contributions?
- Should in-kind contributions be recognized in the financial statements or disclosed in the notes to the financial statements?
- Should the recognition or disclosure guidance be applied to all in-kind contributions?
- How should in-kind contributions be measured?

Reasons for Considering the Addition of This Project to the Research Agenda: The Financial Accounting Standards Board (FASB) addressed in-kind contributions in Statement No. 116, *Accounting for Contributions Received and Contributions Made*. FASB Statement 116 provides, "Contributions of services shall be recognized if the services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Services requiring specialized skills are provided by accountants, architects, carpenters, doctors, electricians, lawyers, nurses, plumbers, teachers, and other professionals and craftsmen. Contributed services and promises to give services that do not meet the above criteria shall not be recognized."

Since the release of FASB Statement 116, the GASB has received numerous inquiries to contributed services. There is no specific guidance for in-kind contributions in the GASB's standards. With the issuance of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, the guidance in FASB Statement 116 is now considered "other accounting literature."

The project was ranked in the top half of potential and research projects in the GASAC's 2012 prioritization.

Project History: This project was added to the research agenda in 2002. The project was transferred to the potential projects list in January 2006.

Interim Financial Reporting

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the importance of quarterly or semiannual financial reporting, for instance, to users of financial statements and (2) to assess the need for specific guidance related to interim financial reports. If guidance is determined to be needed, another objective would be to consider whether specific guidance should be issued regarding interim financial reporting.

Description of the Project Topic: In the course of developing Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* the Board considered incorporating APB Opinion 28, *Interim Financial Reporting* (now ASC 270, *Interim Reporting*), but decided not to because APB Opinion 28 conflicts with or contradicts existing GASB standards.

Specifically, the Board considered the following paragraphs from NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* as amended by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments:*

> Appropriate interim budgetary reports should be prepared during the fiscal period to facilitate management control and legislative oversight of governmental fund financial operations. Such reports are important both to revenue and expenditure control processes and to facilitate timely planning and budgetary revisions. [NCGAS 1, ¶93]
>
> Financial statements and schedules are derived from the accounts and related records. Interim financial statements cover periods of less than one year (e.g., a month or quarter) and traditionally have been prepared primarily for internal use. Annual financial statements are prepared for each fiscal year to serve information needs of both internal and external users. [NCGAS 1, ¶130]
>
> Interim financial reports are comprised principally of statements that reflect current financial position at the end of a month or quarter and compare actual financial results with budgetary estimates and limitations, for the month or quarter and/or for the year to date. Interim reports typically are prepared primarily for internal use. Thus, they usually are prepared on the budgetary basis and often do not include statements reporting general capital assets or general long-term debt. Further, they may properly contain budgetary or cash flow projections and other

> information deemed pertinent to effective management control during the year. [NCGAS 1, ¶133, as amended by GASBS 34, ¶80]
>
> The key criteria by which internal interim reports are evaluated are their relevance and usefulness for purposes of management control, which include planning future operations as well as evaluating current financial status and results to date. Continual efforts should be made to assure that accounting and related interim information properly serve management control needs. Because managerial styles and perceived information needs vary widely, however, appropriate internal interim reporting is largely a matter of professional judgment rather than one to be set forth in detail here. [NCGAS 1, ¶134]

The preceding paragraphs from the GASB literature set forth general principles regarding the use of interim financial reporting by governments and the purpose of such reporting. The FASB and AICPA pronouncements that address interim financial reporting, however, provide specific guidance on the application of accounting principles and practices in financial reports prepared for periods less than one year. The Board, therefore, concluded that the prescriptive nature of the provisions in APB Opinion 28 and related pronouncements conflicts with the general principles established in NCGA Statement 1. As a result, the Board decided to exclude these FASB and AICPA provisions from incorporation into the GASB literature and that a separate project on interim financial reporting would be most appropriate.

The following issues would be considered during the research stage:

- Do interim financial reports of general purpose governments provide users with information that is valuable for making decisions and assessing accountability?
- Should specific recognition and measurement standards be developed for interim reporting?
- Should separate reporting entity standards be developed for interim reporting?
- Should guidance or guidelines be established regarding the timing of interim financial reporting?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> At present, no government-specific guidance is available for financial reporting for periods less than full fiscal years. Although interim financial reporting by general purpose governments is relatively infrequent, certain business-type activities such as public hospitals often prepare quarterly

financial reports. The project was ranked in the top 10 potential and research projects in the GASAC's 2012 prioritization.

Project History: This project was added to the potential projects list in April 2011.

Irrevocable Charitable Trusts

Project Objective: The initial objectives of this potential research project would be (1) to identify the types of irrevocable charitable trust encountered in the government environment and (2) to consider whether resources held for the exclusive benefit of governments in these irrevocable trusts meet the definition of an asset of the beneficiary governments. If additional guidance is determined to be needed, another objective would be to consider developing specific accounting and financial reporting standards.

Description of the Project Topic: An irrevocable trust is an arrangement in which contributions of resources, once made by a contributor, can no longer be accessed by that contributor. Further, the trust cannot be altered or terminated without the acquiescence of the beneficiaries of the trust.

Questions about the appropriate reporting in irrevocable trust situations occasionally come to the GASB. Discussions with practitioners and auditors suggest that practice varies. Some constituents believe that the recognition criteria in Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, are not met and recognition is not appropriate. Paragraph 22 from Statement 33 states:

> In some kinds of government-mandated and voluntary nonexchange transactions, a provider transmits cash or other assets with the stipulation (time requirement) that the resources cannot be sold, disbursed, or consumed until after a specified number of years have passed or a specific event has occurred, if ever. In the interim, the provider requires or permits the recipient to benefit from the resources—for example, by investing or exhibiting them. Examples of these transactions include permanently nonexpendable additions to endowments and other trusts; term endowments; and contributions of works of art, historical treasures, and similar assets to capitalized collections. For these kinds of transactions, the recipient should recognize revenues when the resources are received, provided that all eligibility requirements have been met. Resulting net assets (or equity or fund balance, as appropriate) should be reported as restricted for as long as the provider's purpose restrictions or time requirements remain in effect.

Other constituents do not see a substantive difference between permanent endowments received by an institution (and subsequently transferred to independent investment managers) and resources deposited directly into an irrevocable trust.

Private institutions, under the guidance of Financial Accounting Standards Board Statement No. 136, *Transfers of Assets to a Not-for Profit Organization or Charitable Trust That Raises or Holds Contributions for Others,* recognize the resources held in an irrevocable trust as assets and the contributions into the trust as revenues. Paragraph 15 of Statement 136 states:

> A specified beneficiary shall recognize its rights to the assets (financial or nonfinancial) held by a recipient organization as an asset unless the recipient organization is explicitly granted variance power. Those rights are either an interest in the net assets of the recipient organization, a beneficial interest, or a receivable. . . . If the beneficiary has an unconditional right to receive all or a portion of the specified cash flows from a charitable trust or other identifiable pool of assets, the beneficiary shall recognize that beneficial interest, measuring and subsequently remeasuring it at fair value. In all other cases, a beneficiary shall recognize its rights to the assets held by a recipient organization as a receivable and contribution revenue in accordance with the provisions of Statement 116 for unconditional promises to give.

The following issues would be considered during the research stage:

- What types of trust arrangements are in used in practice?
- Does the substance of trust arrangements currently used in practice define the resources held and govern their access and use in ways that could meet the definition of an asset and the criteria for revenue recognition?
- If the trust arrangements do not meet the definition of an asset, should the resources be disclosed in the notes to the financial statements?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Irrevocable trusts are the topic of technical inquiries about three to four times a year on average. In light of the feedback from constituents indicating that there is diversity in practice, there may be a need for clarification of the application of existing standards, at a minimum. Alternatively, it may be necessary to establish new standards that specifically address irrevocable trusts that are not consistently and accurately accounted for and reported.

<u>Project History:</u> The project was added to the potential projects list in January 2006.

Popular Reporting

Project Objective: The initial objectives of this potential research project would be (1) to update research on the types of popular reports that are being issued by governments and (2) to determine if additional guidance is warranted. If guidance is determined to be needed, another objective would be to consider developing specific guidance regarding the preparation of popular reports to the citizenry and what type of guidance should be issued.

Description of the Project Topic: Within the framework developed in Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, popular reports are considered general purpose external financial reports that are separate from general purpose external financial reports that contain the basic financial statements, notes to basic financial statements, and supporting information. This project would consider whether criteria for an effective popular report should be developed and, if so, whether the criteria should be published in the form of a special report, a standard, or some other communication.

The GASB released a research report in 1992 that focused on popular reporting. This research was designed to:

- Research the extent of financial reporting outside of the CAFR.
- Identify specific report characteristics that may enhance citizen understanding of municipal finances.
- Develop reports that may be understandable to citizens and useful in providing an overall view of municipal finances to the citizenry.

The research report found that a wide-variety of approaches to popular reporting were being used and discussed the content and presentation of the reports with preparers. The report continued to provide a prototype of what the researches believed to be a highly effective type of reporting. The following issues would be considered during the research stage:

- How prevalent is popular reporting under current practice and what forms are being used?
- Should criteria for an effective popular report be developed?
- How should the requirements be communicated?

Reasons for Considering the Addition of This Project to the Research Agenda: Governments currently prepare popular reports for use by their citizens routinely, particularly relatively larger governments. Prior research by two academics that received one of the GASB's 2011 Crain Memorial Research Grants found that 77 percent of local governments and 85 percent of state governments responding to a survey publish some type of popular financial report. The reports included budget summaries, popular annual financial reports, service efforts and accomplishments reports, financial trends reports, and state of the government annual reports.

It is apparent that little consistency exists in the types of information that are reported in popular reports or in the way the information is presented and published. Government preparers of popular reports and the users of such reports—citizens—should benefit by a well-reasoned consideration of how popular reports can be made more effective. The academics observed a disparate group of persons and departments responsible for popular report preparation across governments and a wide range of dissemination methods.

The 1992 GASB research report on popular reporting called for a further examination of the ability of users to understand and use the report's prototype as well as study alternative prototypes. The 2011 Crain Grant funded research into citizen perceptions of popular reporting, including the types of information they most want to see and how they wish to receive the information. The grantees developed a prototype popular report based on their research with citizens and prior research on best practices, and used the prototype to obtain feedback from graduate and undergraduate students in public administration and public affairs programs.

The project was in the top dozen potential and research projects in the past two years GASAC annual prioritization exercises.

Project History: This project resided on the research agenda for many years before being moved to the potential project list in January 2006.

Present Value

Project Objective: The initial objectives of this potential research project would be (1) to explore the applicability of present value measurement approaches to state and local government and (2) to consider the need to develop specific accounting and financial reporting standards describing how present value should be used in the measurement of assets and liabilities in a government's financial statements. If additional guidance is determined to be needed, another objective would be to develop specific accounting and reporting standards for these events.

Description of the Project Topic: Present value is generally understood to be the value of future cash flows discounted to their value in today's dollars. In Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, paragraph 97 (Basis for Conclusions), the Board noted:

> In its [Exposure Draft (ED)] and in this Statement, the Board concluded that the practice of discounting claims liabilities should be neither mandated nor prohibited because the effects of discounting in the area of claims and judgments are not yet fully understood. Board members were particularly concerned about discounting a liability that is a relatively "soft" estimate because it may imply a precision in the determination of the nondiscounted liability that does not exist. The majority commenting on the Board's decision to allow an option to discount agreed with this decision. However, several ED respondents urged the Board to reconsider its position, noting that it is important that the Board eliminate options in all of its standards. Others opposed discounting in any circumstances. In October 1988, the [Financial Accounting Standards Board (FASB)] added a project on interest methods to its agenda. That project is addressing a broad range of issues, including the use of present-value or discounted accounting measures, related measurement techniques based on interest, when and how interest methods should be used, and what rates should be used. The FASB expects to issue a neutral discussion document on the project sometime in 1990. The GASB and its staff are monitoring this project and will consider whatever information the project produces. Until this work is complete, the Board believes that either mandating or prohibiting the practice as it applies to nonstructured settlements would be premature.

This issue was again raised in the development of Statement No.18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, and Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations.*

The following issues would be considered:

- What are the objectives of present value measurements in financial reporting?
- What guidance should be provided for appropriate methods and inputs for the development of present values?
- For the development of present value estimates, should there be a hierarchy of inputs, such as between market-observed prices and model-based information?
- What present value disclosures are appropriate?
- What differences exist or should exist between present value and fair value?

When faced with whether to provide specific guidance on how to determine the present value of a general liability (for example, nonexchange financial guarantees), the Board has chosen not to provide specific guidance, awaiting the outcome of this potential project.

Reasons for Considering the Addition of This Project to the Research Agenda: Present value has been discussed during deliberations for the current agenda project on fair value measurement and application and nonexchange financial guarantees. The Board tentatively agreed that present value warrants its own project and that it should not be fully incorporated within the scope of the fair value project. Present value topics will only be included to the extent that they are used in a fair value measurement.

This project is important as long as elements of financial statements are required to be reported at fair value and present value is an acceptable basis for determining fair value. This project could provide useful guidance for how to determine fair values for certain assets and liabilities that may not have readily available market values—for example, investments, derivative instruments, pollution remediation obligations, and contingent liabilities. The project was ranked in the top half of potential and research projects in the past three GASAC annual prioritization exercises.

Project History: This project was formerly on the research agenda but was removed until further progress was made on related projects. The project was formally added to the potential project list in January 2006.

Preservation Method

Project Objective: The initial objective of this potential research project would be to consider whether reported changes in asset condition levels (associated with the modified approach to accounting for infrastructure assets) can be measured in monetary terms that meet the qualitative characteristics for financial reporting. If those events can be measured and additional guidance is determined to be needed, another objective would be to develop specific accounting and financial reporting standards for changes in condition levels.

Description of the Project Topic: In developing Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, the Board considered alternatives to reporting depreciation expense for infrastructure assets on the statement of activities. One such alternative was the preservation method, which proposed reporting a capital use charge based on changes in an asset's condition level in the statement of activities. At the time, the Board heard from engineers and transportation finance officers and learned that although these approaches are of great value in managing infrastructure assets, they had not developed to the point at which consistent measurement methods or scales could be used to assess condition sufficient for recognition in financial statements. The Board tabled the preservation method and did not include the option in Statement 34, due to measurement and other issues. However, at that time, GASB staff was directed to monitor developments in this area.

As part of the project's monitoring efforts, a staff member served on a project panel for the Transportation Research Board, a unit of the National Research Council of the Academy of Science. The project catalogued and analyzed the approaches taken by state departments of transportation (DOTs) to comply with the requirements of Statement 34, with an emphasis on documenting why and how the approaches were implemented. The project provided an assessment of the impact of Statement 34 on transportation finance and management of transportation assets. This research was sponsored by the National Cooperative Highway Research Program (NCHRP). A final report was issued in 2004.The staff also worked with the researchers experimenting with condition assessment methodologies. Most of the staff's work was the result of liaison efforts with the American Association of State Highway and

Transportation Officials (AASHTO), the Federal Highway Administration (FHWA), and the American Public Works Association (APWA). Because the modified approach depends on information gathered by the engineering community, innovators in this area are DOTs and engineering consulting firms.

The following issues would be considered:

- What is the prevalence of reporting infrastructure assets using the modified approach? Which networks or subsystems is it being applied to? What methods are used to assess condition? What condition levels are set?
- How are users using the information resulting from the modified approach?
- Should the modified approach be applied to capital assets other than infrastructure?
- How has state and local government usage of asset management systems that meet the criteria in Statement 34, paragraph 23, changed since the issuance of Statement 34? Has the state of the art developed to the point that consistent measurement methods and scales are in place?
- Should a change in condition of capital assets have an impact on resource flows in the statement of activities and other resource flows statements? How would it be measured?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Although the Board concluded that a preservation approach to accounting for infrastructure assets would not be included in Statement 34, as previously noted, the Board decided to continue monitoring both the development of asset management systems and the disclosures of governments that choose to use the modified approach. Available research on the use of the modified approach suggests significant variation.

An academic study of the use of the modified approach by state governments, Puerto Rico, and the District of Columbia, found that 23 governments (44 percent) use the modified approach to report some infrastructure assets, predominantly bridges and roadways.[1] Their analysis determined that the governments that chose to use the modified approach, in comparison with those that used depreciation, had infrastructure assets with a value that accounted for a greater

[1] Thomas E. Vermeer, Terry K. Patton, and Alan K. Styles, “Reporting of General Infrastructure Assets under GASB Statement No. 34,” *Accounting Horizons,* Vol. 25, No. 2, pp. 381–407.

percentage of total governmental activities assets, greater overall value of assets, larger population, and a higher percentage of principal arterial roadways rated in good and fair condition on the International Roughness Index, among other statistically significant differences.

One of the recipients of the 2011 Crain Memorial Research grant found less widespread usage of the modified approach among counties and cities. A review of the financial reports of 620 large and medium county and city governments found 37 governments (6 percent) use the modified approach. Preliminary findings suggest that counties are more likely than cities to use the modified approach, relatively larger governments are more likely to use it, and it is more likely to be used to report roads (a finding that echoes the study in the preceding paragraph). It may also be the case that governments with infrastructure assets in relatively better condition are more likely to use the modified approach (although the direction of causality is not clear—it may be that using the modified approach leads governments to keep their infrastructure in better condition).

Project History: This project was added to the research agenda in 2000. In January 2006, the Board transferred the project to the potential project list and ongoing research efforts were suspended.

Reporting Unit Presentations

Project Objective: This initial objective of this potential research project would be (1) to update research on separately-issued financial statements for reporting units that comprise less than a separate legal entity and (2) to consider whether guidance for these financial statements is warranted. If guidance is determined to be needed, another objective would be to consider establishing generally accepted accounting principles (GAAP) for separately-issued financial statements for reporting units that comprise less than a separate legal entity.

Description of Project Topic: For many years, governments have issued separate statements for funds, departments, and agencies and have characterized those statements as being in accordance with GAAP, even though there has never been a set of principles established for that particular reporting purpose. Government preparers and their auditors currently use professional judgment to apply existing standards to the extent they believe those standards are logical and appropriate in that reduced scope reporting situation. The 2005 edition of the AICPA audit guide for state and local governments addresses individual fund, departmental, and agency reporting in five paragraphs (which was not cleared by the GASB). The key point in that guidance is:

> Although GASB standards do not address the accounting and financial reporting for separately issued GAAP-based financial statements [for a department or for one or more individual funds], in meeting their reporting obligations, auditors should consider long-established practice dictating that those presentations should apply all relevant GAAP. Thus in developing an opinion on the separately issued GAAP-based financial statements [for a department or for one or more individual funds], the auditor considers whether the financial statements include all relevant GAAP financial statements, note disclosures, MD&A topics, and other RSI.

There is widespread uncertainty about the extent to which the government-wide reporting standards in Statement 34 should be applied to departmental or agency financial statements.

Issues this project would address include:

- Should an agency or department report focus on demonstrating operational accountability?
- Should guidance be developed for determining the boundaries of departments for reporting purposes? If so, what should that guidance be?

- Should the project provide guidance regarding the number and categories of funds that could be included in a fund financial report versus a departmental report? If so, what is that guidance?
- Should guidance be developed for developed for part-of-a-fund financial reports?
- Should there be agency- or department-wide financial statements to accompany the financial statements that present the funds which comprise the agency or department?
- How should specific assets, liabilities, revenues, and expenditures/expenses (including noncurrent assets and liabilities and government-wide obligations) be assigned, attributed, or allocated to a department or agency?
- By what criteria should those assignments and allocations be evaluated to ascertain whether they “fairly present?”
- Should major fund reporting requirements, internal activity eliminations, and other requirements applicable to GAAP presentations apply to fund and departmental reports?

There is currently diversity in practice with reporting unit financial statements regarding what constitutes a complete set of basic financial statements. In addition, the following issues have arisen in technical inquiries:

- Should MD&A be considered required supplementary information?
- Should component units be included in the “reporting entity” of the reporting unit (for example, should college enterprise fund statements include foundation component units)?
- How should intra-entity transactions (that is, appropriations, transfers from other funds within the primary government) be classified?
- Which notes to the financial statements and required supplement information that are normally presented for the primary government as a whole should be presented by a reporting unit?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Questions regularly come to the staff about what should be included in fund/departmental financial statements that are “required” (such as by state laws and regulations) to be reported in accordance with GAAP. In the absence of specific guidance within the GASB literature,

however, satisfactory answers cannot be provided by the staff. This issue was ranked among the top 10 research and potential projects in the past two years.

Project History: At its January 2006 meeting the Board combined this project with a separate project to reexamine Statement 14 and added them to the research agenda. However, at the January 2009 meeting, the Board concluded that the issues related to the reports that fall within the reporting units category are broader than reporting entity issues and should be addressed separately. A separate project was then added to the potential projects list in April 2009.

Potential Reexamination Projects

Accounting for Prior-Period Adjustments, Accounting Changes, and Error Corrections—Reexamination of Statement 62

Project Objective: The initial objectives of this potential research project would be (1) to study (a) the prevalence of prior-period adjustments, accounting changes, and error corrections by state and local governments, (b) the consistency with which existing guidance is applied, and (c) the effectives of that guidance, and (2) to consider the need for revisions to existing standards . If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for prior-period adjustments, accounting changes, and error corrections.

Background: Adjustments to the financial statements of prior periods are required when there is a change in accounting principle (for instance, a shift from the consumption method to the purchases method of inventory accounting, or the implementation of a new GASB Statement) or a change in a government's financial reporting entity would require. The former requires a government to adjust beginning net position or fund balance, as appropriate. The latter requires a restatement of the prior period's financial statements as if they new structure of the financial reporting entity had been in place in that period.

Guidance on accounting for prior-period adjustments, accounting changes, and error corrections has historically been based upon several sources of accounting literature, many of which are superseded. These sources include APB Opinion No. 9, *Reporting the Results of Operations, Part 1—Net Income and the Treatment of Extraordinary Items and Prior Period Adjustments*, FASB Statement No. 16, *Prior Period Adjustments,* APB Opinion No. 20, *Accounting Changes*, and FASB Interpretation No. 20, *Reporting Accounting Changes under AICPA Statements of Position an Interpretation of APB Opinion No. 20*. This disparate guidance was brought into the GASB literature by Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

Statement 62 requires disclosure of the effects of prior-period adjustments on the change in net assets of prior periods. Statement 62 also stipulates the treatment of changes in (a) accounting principle, (b) accounting estimate, and (c) the reporting entity. Lastly, Statement 62 requires that corrections of errors in previously issued financial statements should be reported as prior-period adjustments.

The questions that would be addressed in this project include:

- How prevalent are prior-period adjustments, accounting changes, and error corrections in state and local government financial statements?
- What is the nature of the prior-period adjustments, accounting changes, and error corrections that are being reported? How large are the amounts involved?
- Are users aware of the reporting of prior-period adjustments, accounting changes, and error corrections? Do users understand what they mean?
- Is information about prior-period adjustments, accounting changes, and error corrections valuable to users for making decisions and assessing accountability? How is it used?
- Statement 62 requires governments to present financial statements of prior periods as previously reported even though an accounting change has occurred. How frequently do governments include prior-period financial statements after an accounting change? Are the financial statements presented as previously reported or are they adjusted for the accounting change?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Accounting and reporting for prior-period adjustments, accounting changes, and error corrections are common topics that impact a majority of constituents. There are about 10 technical inquiries per year on these topics. Further, the various accounting literature used to develop these requirements has been in place for many years. APB Opinion 20, for instance, was issued in 1971. The FASB has reexamined some of this literature, replacing APB Opinion 20 and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, with FASB Statement No. 154, *Accounting Changes and Error Corrections*. However, because these changes were made subsequent to November 30, 1989, they were not considered for incorporation into the GASB's literature through Statement 62.

<u>Project History:</u> This project was added to the potential projects list in December 2010.

Asset Impairment: Capital Assets—Reexamination of Statement 42

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* as amended. This would include survey the application of Statement 42 in practice and (2) to consider whether revisions to that pronouncement should be developed. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for capital asset impairments.

Description of the Project Topic: Statement 42, issued in 2003, provides accounting and financial reporting guidance for identifying, measuring, recognizing, and reporting the impairment of capital assets. The technical inquiry databases contain nearly 80 technical inquiries regarding capital asset impairment during the past eight years. Many of the inquiries ask for application guidance under a specific set of circumstances. The GASB responses usually apply or interpret the guidance in the Statement to the specific situations in the inquiries, but the nature of the inquiries generally does not indicate that provisions of the Statement are unclear, inappropriate, or difficult to apply.

The following issues would be considered in this project:

- Is there a discernible pattern in the issues raised in technical inquiries that might identify a deficiency in the guidance?
- How has Statement 42 been applied in practice? What types of impairments occur most often? Is the guidance in Statement 42 sufficient for the accurate and prompt reporting of impairments?
- Do the notes to the financial statements present the required information?
- How should the amount of asset impairment be determined when there are uncertainties about either one or more of the inputs to the measurement? If it is not known whether the capital asset will continue to be used?
- Is the information that results from the reporting of capital asset impairments useful for decision making? Does it help users in assessing accountability?

Reasons for Considering the Addition of This Project to the Research Agenda: The GASB routinely reviews its existing standards to ensure that they remain relevant and up-to-date. These reviews typically take place after a pronouncement has been in effect long enough to be fully evaluated. Statement 42 was first effective for periods beginning after December 15, 2004. Even though one of the impairment indicators was modified by Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, the continued relevance of Statement 42 has not been evaluated.

Project History: This project was added to the potential reexamination project list in December 2010.

Blending Requirements for Certain Business-Type Activities—Reexamination of Statements 14 and 61

Project Objective: The initial objectives of this potential research project would be (1) to research which method of reporting component units for business-type activities would best meet financial statement user needs and (2) to consider the need for revisions to existing standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for blended component units.

Description of the Project Topic: Paragraph 8 in Statement No. 61, *The Financial Reporting Entity, Omnibus,* provides business-type activities (BTAs) with the option to consolidate their *blended* component units. Statement 61 did not affect the manner in which discretely presented component units should be reported; that is, by adding a separate column or columns adjacent to the total column for the primary government. The option to present a reporting entity total column was likewise not affected by Statement 61. That total column would essentially present the same information that would be presented if all component units were blended (consolidated).

Paragraph 26 in the Basis for Conclusions section of Statement 61 states, "Based on the research and the review of other reporting entity standards, the Board concluded that, in general, the reporting entity framework established in Statement 14 (the criteria for inclusion of component units, the display and disclosure requirements, and other provisions) continues to be appropriate and provides financial statement users with decision-useful information in a cost-effective manner."

Some respondents to the Statement 61 Exposure Draft voiced a similar interest within the context of redefining the blending principle. Paragraph 44 in the Basis for Conclusions stated the following with regard to those concerns.

> Some of the respondents expressed agreement with the current blending principle; however, others preferred a different blending principle based on control. Paragraph 123 in the Basis for Conclusions of Statement 14 states that, "only in specific situations in which a component unit is, in substance, an integral part of the primary government should a component unit be blended." Primary governments often have

> control of organizations that are not an integral part of themselves. The notion of control as the foundation for the governmental financial reporting entity was considered during deliberations leading to Statement 14 and rejected in favor of the financial accountability concept because “control” is difficult to assess in the governmental environment and likely would be inconsistently applied and ineffective. The Board has reaffirmed the Statement 14 blending principle in this Statement.

The following issue would be considered:

- Would financial statement users find component unit information more or less decision useful if that information were consolidated into a single column with a primary government that is a BTA?

Reasons for Considering the Addition of This Project to the Research Agenda: At a 2012 liaison meeting with interested parties from the Healthcare Financial Management Association (HFMA), financial reporting entity issues were discussed. During that discussion, HFMA representatives encouraged the Board to allow the optional single or multiple-column approach set forth in Statement 61 for blending component units to be applied to all component units of BTAs. Although some would view the introduction of such an option as a fundamental shift in the presentation of component units, others would view such a change as an enhancement of special-purpose entity reporting.

Project History: This project will be considered for addition to the potential reexamination project list in April 2013.

Capitalization of Interest Cost—Reexamination of Statement 62

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the continued effectiveness of the accounting and financial reporting standards for capitalization of interest cost and (2) to consider the need for improvements to those standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards that would enhance the transparent and consistent reporting of the capitalization of interest costs.

Description of the Project Topic: Accounting guidance for capitalization of interest cost historically has been based upon FASB Statement No. 34, *Capitalization of Interest Cost,* as amended, and FASB Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants*. This potential project was identified in the Board's consideration of matters related to Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

The standards incorporated by Statement 62 state that "the historical cost of acquiring an asset includes the costs necessarily incurred to bring it to the condition and location necessary for its intended use. If an asset requires a period of time in which to carry out the activities necessary to bring it to that condition and location, the interest cost incurred during that period as a result of outlays for the asset is a part of the historical cost of acquiring the asset." (Paragraph 7, footnotes omitted) Statement 62 identifies the types of assets for which interest should and should not be capitalized, describes how to determine the amount to be capitalized, the length of the period during which interest should be capitalized, and requires certain disclosures related to the capitalization of interest. As stated in paragraph 553 of the Basis for Conclusions:

> GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus,* provides that construction-period interest on assets used in the governmental activities should not be capitalized. Therefore, the Board modified the scope of the provisions from FASB Statements No. 34, *Capitalization of Interest Cost,* and No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants,* to exclude interest costs reported for governmental activities.

Some respondents to the Exposure Draft of Statement 62 took issue with the start date for interest capitalization differing for taxable and tax-exempt borrowing. Some respondents recommended that this distinction be replaced with criteria that distinguish debt that is issued as an integral part of the decision to acquire the asset from other debt.

The following issues would be considered:

- How prevalent is the capitalization of interest cost by state and local governments? How are the provisions of existing standards applied to the various types of interest-bearing borrowing by governments?
- Should the beginning of capitalization differ depending on whether a borrowing is taxable or tax exempt?
- Should the guidance for capitalization differ for governmental activities and business-type activities?
- What are the most suitable criteria for determining when capitalization should begin?
- Do the existing standards for capitalization of interest cost, in general, continue to be effective?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Although GASB Statement 62 brought the FASB guidance into the GASB's literature in 2010, the Board did not consider the effectiveness of that guidance. Existing pronouncements are considered eligible for reexamination after they have been in effect long enough to be meaningfully evaluated; this is generally 5 to 10 years after their effective date. FASB Statements 34 and 62 were issued in 1979 and 1982, respectively. GASB Statement 37 was issued in 2000. The GASB has not broadly considered whether the existing capitalization guidance continue to function appropriately in the state and local government, nor investigated if the standards are applied accurately or results in information that is useful for making decisions and assessing accountability.

<u>Project History:</u> This project was added to the potential projects list in December 2010.

Compensated Absences—Reexamination of Statement 16

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statement No. 16, *Accounting for Compensated Absences*, as amended, and (2) to consider whether additional guidance needs to be developed. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for compensated absences.

Description of the Project Topic: Compensated absences are leave time for which employees will be paid at the end of their employment, such as vacation, sick leave, and sabbatical leave. Before the issuance of Statement 16, the existing standards of accounting and financial reporting for compensated absences were established in NCGA Statement 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences*. Although the criteria for measuring the liability was the same for all fund types, differences between the measurement focuses of governmental and proprietary fund types resulted in differences in the amounts recognized in a period's operations and in how the accrued liability was displayed. Statement 16 was issued in 1992 to establish standards of accounting and reporting for compensated absences regardless of the reporting model or fund type used to report the transactions.

Compensated absences has been a fairly common topic for technical inquiries. Over 50 inquiries have been documented in the databases during the past six years. Because the searchable technical inquiry databases were created in 2002, early questions about initial implementation issues and the answers provided are not readily retrievable for review. Many of the inquiries ask for application guidance under a specific set of circumstances. Recurring or significant issues include:

- The effects of Interpretation 6 on accruals in governmental funds
- Using an internal service fund to account for compensated absences
- Conversion of accumulated amounts at termination to defined pension or other postemployment benefits

- Accounting for a compensated absences liability when the obligation is funded and payments into the fund are determined actuarially.

The staff responses to the questions in the databases usually apply or interpret the guidance in the Statement to the specific situations in the inquiries and generally do not indicate that provisions of the Statement are unclear or difficult to apply. Virtually no questions have been asked about how to measure the liability under the provisions of paragraph 8 in recent years.

The following issues would be considered in this project:

- How decision-useful has information about compensated absences been subsequent to the implementation of Statement 16?
- What method(s) do governments use to calculate the liability for compensated absences: the *termination payment method* or the *vesting method* (as described in paragraph 8 of Statement 16)?
- Should there continue to be a choice regarding how to calculate the liability? Should one method be eliminated? Should additional provisions be included to allow for recognition of a liability in a manner comparable to those for defined benefit pension and other postemployment benefit plans?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> The GASB routinely reviews its existing standards to ensure that they remain effective. These reviews typically take place after a pronouncement has been in effect long enough to be fully evaluated. Statement 16 was first effective for periods beginning after June 15, 1993. Certain provisions in the Statement have been superseded or amended by Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities,* Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements.* However, the effectiveness of Statement 16 itself has not been evaluated. It is one of the longest standing GASB pronouncements yet to be reexamined.

External research on compliance with Statement 16 was conducted with funding from the GASB's Crain research grant program. That research was completed in August 2009.

Project History: This project was added to the potential reexamination project list in December 2008.

Conduit Debt—Reexamination of Interpretation 2

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of GASB Interpretation No. 2, *Disclosure of Conduit Debt Obligations*, and (2) to consider the need for revisions to existing standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for conduit debt.

Background: Conduit debt obligations are certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing capital financing for a specific third party that is not a part of the issuer's financial reporting entity. Although conduit debt obligations bear the name of the governmental issuer, the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued.

Interpretation 2 was issued in 1995 as "interim" guidance pending the Board's conceptual framework project on financial statement elements. Paragraph 12 of Interpretation 2 explains the Board's reasoning:

> The Board concluded that issuers of conduit debt obligations should not be required to recognize a liability, but that such debt should be disclosed and quantified. The Board currently has on its agenda a conceptual framework project that will address the definition of elements of financial statements, including liabilities. Therefore, it has decided that questions relating to accounting recognition for conduit debt transactions should be reconsidered after further progress is made on that project. However, because existing disclosures of conduit debt transactions are inconsistent among issuers and often fail to adequately inform readers of these transactions' significance, the Board concluded that the standardized disclosure requirements set forth in this Interpretation will improve the level of readers' understanding of these transactions until recognition issues can be addressed. …

The project would consider the following issues:

- How decision-useful has information about conduit debt been subsequent to the implementation of this pronouncement?
- Do conduit debt obligations constitute a liability of the government issuing the debt?

- If conduit debt is a liability of the issuing governments, is the amount owed by third-party entities an asset (receivable) of the government?
- How should the primary government's financial statements reflect conduit debt issued in one of its component units on behalf of the primary government?
- If conduit debt has been defeased, how should it be reported?
- What is meant by the phrase *within the same reporting agency* (paragraph 2 of Interpretation 2)?

Reasons for Considering the Addition of This Project to the Research Agenda: The interim guidance in Interpretation 2 has remained in effect for over 15 years, in part because Concepts Statement No. 4, *Elements of Financial Statements,* was not completed until June 2007. With the definition of a liability established by Concepts Statement 4, the issue that remained unanswered in Interpretation 2 can now be considered.

More than 20 technical inquiries on conduit units have been logged in the GASB's technical inquiry databases over the past three years. The project was ranked in the top dozen potential and research projects in the past two GASAC annual prioritization exercises.

Project History: This project was originally identified in 1995 and was identified as a research project in the past. The Board reaffirmed its earlier decision to keep this project on technical plan and added it to the potential project list in January 2006. The reexamination of Interpretation 2 was added to the potential reexamination project list in December 2008.

Costs and Initial Rental Operations of Real Estate—Reexamination of Statement 62

Project Objective: The initial objective of this potential research project would be (1) to examine whether capitalization of costs associated with acquiring, developing, constructing, selling, and renting real estate projects meets the needs of financial statement users and (2) to consider the need for revisions to existing standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for those activities.

Description of the Project Topic: The guidance incorporated into the GASB literature by Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, specifically covers "accounting and reporting standards for acquisition, development, construction, selling, and rental costs associated with real estate projects," including "accounting for initial rental operations and criteria for determining when a rental project is substantially completed and held available for occupancy." (Paragraph 350) Statement 62 specifically addresses the following issues related to real estate projects: (a) preacquisition costs, (b) insurance, (c) project costs, (d) amenities, (e) incidental operations, (f) allocation of capitalized costs to components of a real estate project, (g) revisions of estimates, (h) abandonments and changes in use, (i) selling costs, (j) rental costs, and (k) costs in excess of estimated net realizable value.

The guidance in Statement 62 generally requires capitalization of costs associated with real estate projects using varying approaches depending on the type of cost and the period of the project in which it is incurred. Two examples of the guidance are:

- Project costs clearly associated with the acquisition, development, and construction of a real estate project should be capitalized. Indirect project costs that relate to several projects should be capitalized and allocated to the projects to which the costs relate. Indirect costs not clearly related to projects under development should be charged to expense as incurred.
- If costs incurred to rent real estate projects, other than initial direct costs, under operating leases are related to and their recovery is reasonably expected from future rental operations, they should be capitalized.

In contrast to the guidance in Statement 62, paragraph 18 of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, states, "Capital assets should be reported at historical cost. The cost of a capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use."

The following issues would be considered in this project:

- Are the capitalization provisions of Statement 62 applied consistently to all capital transactions?
- Should costs associated with acquiring, developing, constructing, selling, and renting real estate projects be capitalized?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> The costs and initial rental operations of real estate guidance historically has been based on FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects,* which was issued over 20 years ago. The applicable provisions of FASB Statement 67 were incorporated "as is" by Statement 62 and the Board did not evaluate its continued relevance.

<u>Project History:</u> This project was added to the potential projects list in December 2010.

Debt Refundings and Other Extinguishments of Debt—Reexamination of Statements 7, 23, and 62

Project Description: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statements No. 7, *Advance Refundings Resulting in Defeasance of Debt*, and No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities,* and relevant sections of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* and (2) to consider the need for revisions to existing standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for those events.

Description of the Project Topic: Guidance on extinguishment of debt has historically been based on APB Opinion No. 26, *Early Extinguishment of Debt,* and FASB Statement No. 76, *Extinguishment of Debt.* GASB Statements 7 and 23 were issued to specifically address certain refunding situations. The guidance incorporated into the GASB literature by Statement 62 addresses all extinguishments of debt, early or not (whereas Statements 7 and 23 deal with only one type of extinguishment of debt—early retirement through refunding). In addition to general issues related to debt extinguishment, this project also would evaluate the effectiveness the standards and consistency across the pronouncements.

Advance refundings involve the issuance of new debt and using the proceeds to repay existing outstanding debt with a higher interest rate. The GASB issued Statement 7 in response to a large volume of advance refundings by governmental entities during favorable municipal bond conditions in the mid-1980s. The Board was asked to consider the accounting for advance refundings that resulted in defeasance of debt reported in the General Long-Term Debt Account Group (GLTDAG) because then-current literature provided insufficient guidance for such transactions, including the appropriate disclosures. Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* subsequently eliminated the GLTDAG.) Similarly, Statement 23 considers refundings for proprietary funds, which had previously been guided by APB Opinion 26; however, the Board did not think that this guidance reflected the economic substance of such transactions in the government environment. The Board resolved that viewing refundings as *substitutions* of debt was more appropriate, advocating the recognition of the difference over future periods rather than immediate recognition.

The major issue to be studied in this project would be whether Statements 7 and 23 provide sufficient guidance in reporting refundings and advance refundings resulting in defeasance of debt. As part of this issue, the project would consider the following elements that have been raised through the technical inquiry process:

- How decision-useful has information about refundings been subsequent to the implementation of these pronouncements?
- What are the distinguishing indicators of a refunding versus a change in a bond's mode—the basis on which a bond's variable payment is calculated, such as an auction or a short-term index? Does restructured debt qualify as an advanced refunding?
- If the new debt issued is more than the amount needed to refund the old debt, how should the disclosure requirements of paragraph 11 of Statement 7 apply, and how should the cash flow difference in economic gain or loss be calculated?
- For purposes of the recognition period, how do call options affect what is considered the remaining life of the refunded bonds?

Extinguishment of debt would be studied on a broader and more fundamental level. Research on what constitutes an extinguishment of debt would clarify the differences in treatments between ordinary extinguishments of debt and extinguishments involving the issuance of refunding bonds.

- What constitutes an extinguishment of debt?
- What information should be reported or disclosed when debt is extinguished?
- Should the standards for specific types of debt extinguishments, such as refundings, be consistent with the general standards for debt extinguishment?
- Does the governmental environment operate in a manner such that the Board's perspective of substitution of debt still prevails?

Reasons for Considering the Addition of This Project to the Research Agenda: Statements 7 and 23 have been in effect since periods beginning after December 15, 1986, and June 15, 1994, respectively. All other extinguishments of debt were codified in Statement 62 but derive from APB Opinion 26, which has been in effect since 1973.

Neither Statement 7 nor 23 has been reexamined previously. Moreover, the guidance incorporated by Statement 62 was brought in "as is" without consideration of its effectiveness. Transactions in the municipal bond markets have grown significantly in volume and complexity over the past two to three decades since those standards became effective. Extinguishments of debt and refundings continue to be prevalent transactions among state and local governments.

Debt refundings are among the more common technical inquiry topics that the GASB responds to, with more than 75 in the past three years alone. This annual level of inquiry is comparable to that for some Statements during their initial implementation period. The project has been ranked in the top half of potential and research projects over the past three GASAC annual prioritization exercises.

Project History: The reexamination of Statements 7 and 23 was added to the potential reexamination project list in December 2008. The reexamination of the debt extinguishment provisions of Statement 62 was added to the potential projects list as a separate project in December 2010. The two projects will be considered for combination in April 2013.

Deferred Compensation Plans—Reexamination of Statement 32

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, and (2) to consider the need for revisions to existing standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for deferred compensation plans.

Description of the Project Topic: Statement 32 was developed in response to a change in the Internal Revenue Code requiring that deferred compensation plan assets be "held in trust for the exclusive benefit of participants and their beneficiaries." Statement 32 requires that a government report a plan if it has fiduciary responsibility for it. The Statement refers readers to existing guidance that establishes the fiduciary responsibility notion. However, the Basis for Conclusions suggests that fiduciary responsibility could include holding or investing the plan assets.

Statement 32 was developed with general purpose governments in mind. There is some question as to whether business-type activities that report using a single column should report deferred compensation plans, and other employee benefits plans, within the column. A separate potential reexamination project is considering the most appropriate method of reporting component units for business-type activities.

The project would consider the following issues:

- Are the requirements of Statement 32 sufficiently meeting the needs of financial statement users?
- Do the requirements produce comparable results among governments? Are governments consistent in assessing whether they have fiduciary responsibility for Section 457 plans and whether they hold the assets in a trustee capacity?
- Should the scope of Statement 32 be reexamined?

- Is further clarification needed (as some respondents to the Exposure Draft stated) for when a government is required to report its Section 457 plan (or when *any* activity meets the fiduciary criteria)?
- Is it appropriate to report such plans as expendable trust funds since (as some Exposure Draft respondents suggested) the term may misconstrued as meaning expendable for governmental purposes rather than meaning the corpus is expendable?

Reasons for Considering the Addition of This Project to the Research Agenda: Statement 32 has been in effect since periods beginning after December 31, 1998. The effectiveness of the standards has not been evaluated.

Technical inquiries regarding Statement 32 are rarely received—fewer than 10 over the past 3 years. Inquiries typically involve a discussion of whether the government has sufficient fiduciary responsibility for a deferred compensation plan to require reporting the plan. The notion of fiduciary responsibility, including presentations in financial statements of business-type activities, was at one time a part of the scope of the reexamination project that resulted in Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and 34.* However, the Board ultimately decided that the issue needed to be addressed separately from financial reporting entity and required further study and discussion. A research project intended to clarify what constitutes fiduciary responsibility in included in the technical plan.

Project History: This project was added to the potential reexamination project list in December 2008.

Escheat Property—Reexamination of Statement 21

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statement No. 21, *Accounting for Escheat Property*, and (2) to consider the need for revisions to existing standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting for escheat property.

Description of the Project Topic: An escheat is the reversion of property to a governmental entity in the absence of legal claimants or heirs. The Board addressed escheat property in response to requests from various state governments that indicated that a literal interpretation of the existing guidance could lead to extreme results. Prior to Statement 21, accounting for escheat property was governed by NCGA Interpretation No. 9, *Certain Fund Classifications and Balance Sheet Accounts*, issued in 1984. The major issue to be considered in this project would be whether the standards result in an accurate depiction in the financial statements of the nature of escheat assets and liabilities. As part of this issue, the project might consider the following issues:

- How decision-useful has information about escheat property been subsequent to the implementation of Statement 21?
- Has the nature of escheat property and the laws regarding them changed subsequent to the implementation of these standards?
- Have there been any difficulties in estimating the liabilities for the amounts ultimately expected to be reclaimed and paid to others?
- Is *probable* the appropriate threshold for recognition?
- Are the escheat property standards being applied consistently among governments?
- Is it still appropriate to account for escheat property in the governmental or proprietary funds to which the property ultimately escheats?
- Is it still appropriate to account for escheat property *held for others* in a private-purpose trust fund, an agency fund, or in the governmental or proprietary fund in which escheat property is otherwise reported, with a corresponding liability?

Reasons for Considering the Addition of This Project to the Research Agenda: The GASB routinely reviews its existing standards to ensure that they remain effective. These reviews typically take place after a pronouncement has been in effect long enough to be fully evaluated. Statement 21 has been in effect since periods beginning after June 15, 1994. Statement 21 was amended by Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus—an amendment of GASB Statements No. 21 and No. 34*, to conform to the new financial reporting model. However, the effectiveness of Statement 21 was not evaluated at that time.

The GASB has received few technical inquiries from constituents regarding the application of Statement 21 and is unaware of any pervasive issues concerning the effectiveness of the guidance on accounting for escheat property otherwise.

Project History: This project was added to the potential reexamination project list in December 2008.

Financial Reporting Model—Reexamination of Statements 34, 35, and 37

Project Description: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of the financial reporting model set forth by Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as amended, and (2) to consider the need for revisions to existing standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for the financial reporting model.

Description of the Project Topic: Statement 34 was the culmination of 15 years of research, deliberation, and due process and established the present blueprint for state and local government financial reporting—the basic financial statements, notes to the financial statements, and required supplementary information including management’s discussion and analysis (MD&A). Among its many features, Statement 34 introduced government-wide financial statements containing accrual information, which notably included the reporting of capital assets, including infrastructure, for activities previously reported only on a modified accrual basis in the governmental funds. Statement 34 also required a narrative MD&A to precede the financial statements, improved upon the budgetary comparison schedule, introduced major fund reporting in the governmental and enterprise funds, and added note disclosures related to capital asset and long-term liability activity during the reporting period.

Statement 34 was first effective for periods beginning after June 15, 2001. Most provisions of the Statement became effective in three phases, beginning with the largest governments. An additional five years were allowed for period for Phase 1 (annual revenues of $100 million or more) and Phase 2 ($10 million to $100 million) governments to retroactively apply the infrastructure reporting provisions (Phase 3 governments were allowed to report general infrastructure prospectively). Consequently, Statement 34 technically was not fully effective until 2009.

As a result of the extended implementation period, GASB-sponsored or conducted research on the effects of Statement 34 has been delayed until recently. Two research projects funded by

Crain Research Memorial Grant—one completed in 2012 and the other to be completed in 2013—will assist in the assessment of Statement 34. Further financial statement analysis will now be possible as well with full implementation; for example, ratio analysis may uncover whether Statement 34 may provide insight for detecting a municipal bankruptcy. Lastly, the full impact of Statement 34 has not felt, as standards that would more fully utilize the economic resources measurement focus (such as those covering pensions, other postemployment benefits, and fair value) are still being deliberated or not yet implemented.

The technical inquiry databases contain over 1,000 inquiries related to some aspect of Statement 34. Topics run the gamut from questions about MD&A and the relevance of government-wide reporting to inquiries about classification of transactions with fiduciary funds. Many of the inquiries ask for application guidance under a specific set of circumstances. Virtually every major provision in Statement 34 has been the subject of inquiries, but a few of the more common areas include:

- Distinguishing between program and general revenues
- Reporting direct expenses
- Determining restricted net assets
- Determining what constitutes capital-related debt
- Reporting capital assets and infrastructure
- Reporting interfund activity and eliminations.

The relatively high number of inquiries received and the fact that there are over 500 items in the Comprehensive Implementation Guide concerning Statement 34 are testimony to the breadth of its scope and the complexity of the individual provisions that comprise the entire reporting model. Those measures do not, however, indicate that the standards are in urgent need of major revision or that the provisions of the Statement generally are unclear, inappropriate, or difficult to apply. The learning curve for the Statement was quite steep and continued experience and familiarity with the reporting model (especially with regard to the Phase 3 governments) should form a basis from which to evaluate the provisions in the Statement that may warrant some level of modification in a reexamination project.

Government-Wide Financial Statements

The principal new feature introduced to the financial reporting model by Statement 34 were two accrual-based financial statements encompassing the entire financial reporting entity—the government-wide statement of net assets (now statement of net position) and statement of activities. The focus of a review of the government-wide financial statements would be to assess whether they have been effective in providing decision-useful information and supporting assessments of operational accountability. In general, this potential project would seek to assess effectiveness by identifying the importance of government-wide information to users, the purposes for which the information is used, and how these purposes differ from the uses of fund financial statements. Specific topics could include:

- The relative usefulness of government-wide financial statements
- The separation of governmental activities and business-type activities
- Capital asset reporting, including general infrastructure assets
- Net position categories
- The net (expense) revenue format of the statement of activities
- Program revenues and general revenues
- The level of detail for reporting assets, liabilities, expenses, and revenues
- Special and extraordinary items
- Related disclosures, such as capital assets and long-term liabilities.

Governmental and Proprietary Fund Financial Statements

Statement 34 introduced major fund reporting for governmental and enterprise funds. Statement 34 also required reconciliations of the fund financial statements with the government-wide statements. Information from a government’s original adopted budget was added to the budgetary comparison. In the proprietary funds, the direct method was required for reporting cash flows. In general, an evaluation of the fund reporting requirements of Statement 34 would focus on the usefulness of fund information as it is required to be reported, perhaps in comparison with alternative methods of reporting funds. Specific topics could include:

- The relative usefulness of major fund and fund-type reporting

- Whether the quantitative and qualitative criteria for identifying major funds lead to reporting of the number and types of funds that users need to see
- The value-added of including original budget information in the budgetary comparison
- Reporting of budgetary comparisons as basic financial statements versus required supplementary information
- Reconciliations of governmental funds to governmental activities, proprietary funds operating cash flows to operating income (loss), and budgetary basis to GAAP basis
- The direct method of reporting proprietary fund cash flows.

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Statement 34 is evidently the most sweeping of the GASB's standards and, as the blueprint for financial reporting, the pronouncement that cements all of the other standards together. No pronouncement is more crucial to the overall effectiveness of generally accepted accounting principles for state and local governments as a whole.

The GASB's reexamination of existing standards typically take place after a pronouncement has been in effect long enough to be fully evaluated. In practice, pronouncements are added to the potential reexamination projects list after they have been fully effective for 5 years and evaluations are generally initiated after 10 years. Most of Statement 34's requirements have been effective for more than 5 years, with the exception of retroactive infrastructure reporting; nevertheless, it will not be *fully* effective for 5 years until the second quarter of 2014. However, considering the many moving parts of Statement 34, a reexamination would likely take many years. Therefore, the time may be appropriate to begin evaluating its provisions.

A Crain Memorial Research Grant awarded in 2011 funded research on practice experience with the infrastructure reporting requirements of Statement 34, particularly regarding the use of the alternative "modified approach" to reporting infrastructure. A review of the financial reports of 620 large and medium county and city governments found 37 governments (6 percent) use the modified approach. Preliminary findings suggest that the counties reviewed are more likely than cities to use the modified approach, relatively larger governments are more likely to use it, and it is more likely to be used to report roads. It may also be the case that governments with infrastructure assets in relatively better condition are more likely to use the modified approach (although the direction of causality is not clear—it may be that using the modified approach leads governments to keep their infrastructure in better condition). Some of these findings echo an academic study of the use of the modified approach by state governments, Puerto Rico, and the District of Columbia.[2] That study found that 23 of those 52 governments (44 percent) use the modified approach to report some infrastructure assets, predominantly bridges and roadways. Their analysis determined that the governments that chose to use the modified approach, in comparison with those that used depreciation, had infrastructure assets with a value that accounted for a greater percentage of total governmental activities assets, greater overall value of assets, larger population, and a higher percentage of principal arterial roadways rated in good and fair condition on the International Roughness Index, among other statistically significant differences.

Another Crain Memorial Research Grant awarded in 2012 will fund research regarding the value of information resulting from Statement 34 to municipal bond analysts. That research is expected to be completed in summer 2013.

The project was ranked in the top 10 potential and research projects in the two years it has been included in the GASAC's annual prioritization.

Project History: This project was added to the potential reexamination project list in December 2010.

[2] Vermeer et al., *op. cit.*

Inventory—Reexamination of Statement 62

Project Objective: The initial objectives of this potential research project would be (1) to consider whether the current literature for inventory remains appropriate for the governmental environment and (2) to determine if additional guidance is warranted. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for inventory.

Description of the Project Topic: Much of the current accounting literature for inventory was intended for business-type entities; in addition, the sparse accounting literature available for governmental activities was formulated before the advent of government-wide financial statements and the utilization of the economic resources measurement focus. As such, a reexamination of accounting for inventory associated with governmental activities would gauge if the current literature remains appropriate for the governmental environment and, if not, determine if additional guidance is warranted. Inventory guidance has traditionally been based on ARB 43, *Chapter 4—Inventory Pricing*. The relevant parts of ARB 43 were incorporated into the GASB's literature by Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

The guidance incorporated by Statement 62 contains the fundamental principles of inventory accounting, such as the definition of inventory and the approaches to valuing it (for instance, lower of cost or market, LIFO, FIFO, and so on). This guidance is limited, however, to use for business-type activities (BTAs). Inventory guidance in the GASB literature for activities other than BTAs consists only of portion of paragraph 73 of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* which allows for a choice between the consumption method (expenditures are reported when inventory is used) and the purchases method (expenditures are reported when inventory is purchased).

During deliberations on Statement 62, several respondents expressed concerns regarding this issue. One noted the need for inventory guidance for governmental activities, citing the lack of literature prescribing a cost-flow assumption when employing the consumption method or holding inventory for use in the provision of services. Another respondent specifically named real estate in default as an example of inventory that would necessarily be accounted for in a governmental fund.

Notwithstanding the consideration given during those deliberations, inventory is an item normally included in governmental funds. As the GASB progresses with its conceptual framework, especially with respect to recognition, it is unknown how or if a new measurement focus and basis of accounting will alter the reporting of inventory in the funds. Furthermore, full implementation of Statement 34 being achieved in 2009, it is unknown how respondents might react to information reported in both the government-wide financial statements and governmental fund financial statements.

The following issues would be addressed in this project:

- Does the present guidance for inventory remain appropriate for both business-type activities and governmental activities?
- Should the Board provide more guidance for selecting a cost-flow assumption? How does the selection of method affect the reporting of cost of services? How have the consumption method and purchase method performed subsequent to implementation of Statement 34?
- Are there certain types of inventory other than supplies that necessitate further guidance, such as real estate in default?
- Might a change in concept or the inclusion of government-wide statements alter the perspective or treatment of inventory for governmental activities?

Reasons for Considering the Addition of This Project to the Research Agenda: ARB 43 was issued in 1953. The GASB has never evaluated the effectiveness of these standards. For practical purposes, the guidance incorporated into the GASB literature by Statement 62 was done “as is.” Furthermore, this guidance is not strictly applicable to governmental activities, nor is it clearly applicable to certain kinds of inventory held by state and local governments.

Project History: This project was added to the potential projects list in December 2010.

Landfills—Reexamination of Statement 18

Project Objective: The initial objectives of this potential research project would be (1) to reexamine the reporting requirements of Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs,* and (2) to consider the need for revisions to existing standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for landfill closure and postclosure care costs.

Description of the Project Topic: Statement 18 was prompted by the October 9, 1991, U.S. Environmental Protection Agency (EPA) rule, "Solid Waste Disposal Facility Criteria," which establishes closure requirements for all municipal solid waste landfills (MSWLFs) that receive solid waste after October 9, 1991. The EPA rule also establishes thirty-year postclosure care requirements for MSWLFs that accept solid waste after October 9, 1993. The effect of the EPA rule and similar state or local laws or regulations is to obligate MSWLF owners and operators to perform certain closing functions and postclosure monitoring and maintenance functions as a condition for the right to operate the MSWLF in the current period.

Statement 18 requires that certain MSWLF closure and postclosure care costs that result in disbursements near or after the date that the MSWLF stops accepting solid waste and during the postclosure period—such as the cost of final cover and subsequent monitoring and maintenance—should be included in the *estimated total current cost of MSWLF closure and postclosure care.* Current cost is defined as the amount that would be paid if all equipment, facilities, and services included in the estimate were acquired during the current period. In accrual-basis financial statements, a portion of the estimated total current cost of MSWLF closure and postclosure care is required to be recognized as an expense and as a liability in each period that the MSWLF accepts solid waste.

Technical inquiries regarding Statement 18 are received only sporadically and the number is small—approximately 25 over the past 3 years. The inquiries often involve the staff explaining the basic requirements of Statement 18 rather than interpreting those requirements.

The project would consider the following issues:

- Are the requirements of Statement 18 sufficiently meeting the needs of financial statement users?
- Dose the volatility inherent in the measurement requirements of Statement 18 impair the usefulness of landfill data and, if so, what alternative measurement approaches might be appropriate?
- How are governments accounting for landfills that are outside of the scope of Statement 18 (such as hazardous waste landfills)? Would it be appropriate to extend the scope of Statement 18 to those landfills?
- What other types of asset retirement obligations are governments facing? Are the reporting requirements of Statement 18 appropriate for those other obligations?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Statement 18 has been in effect since periods beginning after June 15, 1993, and has not been evaluated since. At the time that the project leading to Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, was added to the GASB agenda, the Board requested that the staff conduct research to determine whether a reexamination of the requirements of Statement 18 also should be included in that project. In particular, a concern was raised regarding fluctuations in liabilities for landfill closure and postclosure care. Accordingly, in 2002 the staff conducted research on landfill liabilities and related landfill data. The analysis found that information produced in accordance with Statement 18 can be volatile. The Board tentatively decided not to comprehensively reexamine the methodology of Statement 18. Statement 49 did not result in any changes to the requirements for landfills under Statement 18 but did establish a different approach to measuring and reporting costs and obligations than the method in Statement 18.

<u>Project History:</u> This project was added to the potential reexamination project list in December 2008.

Nonexchange Transactions—Reexamination of Statements 33 and 36

Project Objective: The initial objectives of this project would be (1) to evaluate the effectiveness of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* as amended by Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues,* and (2) to consider the need for revisions to the existing nonexchange transaction standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for nonexchange transactions.

Description of the Project Topic: In nonexchange transactions, a government gives (receives) value without receiving (giving) equal value in return. They are distinguished from exchange transactions, in which there is an equal exchange of value between a government and another party.

The GASB determined specific guidance was necessary for nonexchange transactions during the deliberations that led to Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* The Board believed that guidance was needed for the new government-wide financial statements and more consistency was desired for the existing fund statements. Statement 33 incorporated past research on measurement focus and basis of accounting, grants, state aid, and other projects, and created four categories of nonexchange transactions: (a) derived tax revenues; (b) imposed nonexchange revenues; (c) government-mandated nonexchange revenues; and (d) voluntary nonexchange revenues. Statement 33 primarily addresses the timing of recognition of nonexchange transactions and distinguishes between two types of stipulations on the use of resources (time requirements and purpose restrictions). Permanent endowments, term endowments, contributions of art, promises of donations, applicable period and proration, when claims become enforceable, reimbursements, and revenue recognition were among the most discussed topics.

Accounting for nonexchange transactions continues to be a major category of technical inquiries received by the GASB. When the Statement was first implemented, many inquiries related to (a) changes in the manner in which reimbursements (expenditure-driven grants) were recognized in governmental funds and (b) new requirements to recognize property tax receivables in periods before revenues could be recognized. Currently, inquiries typically involve explaining the provisions of Statement 33, as amended, and how they relate to specific transactions. Some inquiries relate to transactions that are excluded from the scope of Statement 33, such as donated professional services, donated use of facilities, and so forth. Over 160 inquiries have been received in the past three years alone, among the most for any pronouncements not going through its initial implementation period.

The project would consider the following issues:

- Are the requirements of Statement 33, as amended, sufficiently meeting the needs of financial statement users?
- Do the requirements result in comparable reporting among governments?
- Are reporting requirements consistent with the conceptual framework that has developed since Statement 33 was issued?
- Are requirements for reporting reimbursement grants and property taxes in governmental funds still considered to be appropriate?
- Should the scope of Statement 33 be expanded to include other nonexchange transactions, such as donated services?
- What clarifications are appropriate to address common areas of misunderstanding? How can the language in Statement 33 be revised to make its provisions easier to understand and apply?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Statement 33 was effective for periods beginning after June 15, 2000. Statement 36, which addressed issues that arose regarding the application of Statement 33, was effective at the same time. Neither has been reexamined since then. The prevalence of nonexchange transactions among state and local governments underscores the foundational importance of these standards. The continuing flow of technical inquiries on nonexchange transactions emphasizes that continuing importance and reflects the complexity of the standards. Research conducted by the staff regarding how the readability and understandability of GASB standards could be improved found that Statement 33 was widely considered the most difficult GASB pronouncement to understand.

An accounting professor is conducting research on practice experience with Statement 33 and user needs, with the GASB's support. Surveys of financial statement preparers and auditors are currently underway. A survey of users will be conducted later in 2013..

The project was ranked in the top 10 potential and research projects in the GASAC's annual prioritization for the past two years.

Project History: This project was added to the potential reexamination project list in March 2010.

Nonmonetary Transactions—Reexamination of Statement 62

Project Objective: The initial objectives of this potential research project would be (1) to consider whether the current literature for nonmonetary transactions remains appropriate for the governmental environment and (2) to determine if additional guidance is warranted. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for nonmonetary transactions.

Description of the Project Topic: Accounting for nonmonetary transactions historically has been based on APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, which was incorporated into the GASB literature by Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

The guidance incorporated by Statement 62 addresses *exchange* transactions that involve little or no monetary assets or liabilities. The basic requirement of Statement 62 is to account for the transaction using fair value. Specifically, the cost of acquiring a nonmonetary asset or liability is the fair value of the nonmonetary asset or liability surrendered to obtain it, not including any related gain or loss on the exchange. (Paragraph 274)

The GASB does not frequently receive technical inquiries related to nonmonetary transactions. As such, it is unknown whether current guidance is sufficient or transactions as such are uncommon.

The project would consider the following issues:

- Does the current guidance continue to be appropriate and reflect the governmental environment? Are references to the "earnings process" and "customers" relevant to all of the activities of state and local governments?
- Does fair value continue to be the appropriate measurement basis for nonmonetary transactions? Does the GASB's fair value measurement and application project conflict with this guidance?

Reasons for Considering the Addition of This Project to the Research Agenda: APB Opinion 29 was issued in 1973 and has since been superseded. The effectiveness of its provisions and their appropriateness for the governmental environment has never been evaluated by the GASB.

Project History: This project was added to the potential projects list in December 2010.

Note Disclosures—Statements 38 and 40

<u>Project Objective:</u> The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statements No. 38, *Certain Financial Statement Note Disclosures*, and No. 40, *Deposit and Investment Risk Disclosures,* as amended, and (2) to determine if modifications to the current guidance is warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised financial reporting standards for note disclosures.

<u>Description of the Project Topic:</u> The initial scope of Statement 38 sought to identify unnecessary and irrelevant disclosures. After focus groups, task forces, and further Board deliberation, the scope of the project expanded to also consider ways to enhance existing disclosures and add disclosures to incomplete areas. In order to not delay Statement 38, the Board removed deposit and investment risk disclosures from the project scope in order to perform adequate additional research. The deposit and investment risk disclosure project resulted in Statement 40.

Statement 38 established or amended requirements for notes to the financial statements relating to interfund balances and transfers, accounts receivable and payable, minimum debt service and lease payment requirements, descriptions of activities accounted for in major funds and internal service and fiduciary fund types, and other issues. Statement 40 amended the standards for disclosing deposit and investment risk to focus the disclosures specifically on deposits and investments that are exposed to risk. Statement 40 also required disclosure of risks facing investments, including credit risk, concentration of credit risk, interest rate risk, and foreign currency risk.

Related to these statements is the FASB's project on Disclosure Framework, which issued an Invitation to Comment with comments received on November 30, 2012; the FASB began discussion of the feedback in January 2013. The FASB's objective is to provide a framework that promotes consistent decisions about disclosures with the hope that a sharper focus on important information will usually result in less voluminous disclosures. The FASB also established the

Private Company Council (PCC), which held its inaugural meeting on December 6, 2012. The PCC expects to develop its own decision-making framework.

Note disclosures in general, and deposit and investment risks in particular, have been a fairly common area for questions in the GASB's technical inquiry databases. Nearly 50 inquiries have been documented in the past 6 years. The staff responses to the questions in the databases usually apply or interpret the guidance in the standards to the specific situations in the inquiries and generally do not indicate that provisions of the Statement are unclear, inappropriate, or difficult to apply.

The project would consider the following issues:

- Do the required disclosures meet their intended objectives and continue to be relevant, useful, and comprehensive?
- Do governments meet the disclosure requirements consistently over time? How has the ability to meet disclosure requirements been affected by subsequent requirements for notes to the financial statements contained in standards on pensions, other postemployment benefits (OPEB), derivatives, and fund balance reporting and fund type definitions?
- Would it be preferable to continue setting disclosure requirements on a Statement-by-Statement basis or, as the FASB has proposed, create framework criteria for all disclosures? Would the latter approach help to reduce repetition within disclosures and overall CAFR length?
- What unmet users needs exist that might require new note disclosures?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Statement 38 was first effective for periods beginning after June 15, 2001. Statement 40 was first effective for periods beginning after June 15, 2004. Neither pronouncement has been reexamined by the GASB.

These two Statements address a number of very important disclosure requirements and, as such, represent a fundamental component of financial reporting by state and local governments. They encompass most of the more widely applicable disclosure requirements that are not associated with a broader accounting and financial reporting topic (for instance, pensions, derivatives, asset impairment, municipal bankruptcy, and so on). Other generally applicable note disclosure requirements are found in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* such as capital asset and long-term liability activity during the reporting period. Those disclosure requirements could conceivable be reexamined as a part of this project, rather than in the separate potential reexamination project on the Statement 34 financial reporting model.

Specific note disclosure requirements continue to generate a significant number of technical inquiries each year. General concerns also are regularly express to the GASB regarding the volume of note disclosures.

Statement 40 is one of two GASB pronouncements (along with Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements)* currently under review by the Financial Accounting Foundation's Post-Implementation Review staff.

<u>Project History:</u> This project was added to the potential reexamination project list in December 2010.

Pollution Remediation Obligations—Reexamination of Statement 49

Project Objective: The initial objectives of this project would be (1) to evaluate the effectiveness of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, and (2) to determine if modifications to the current guidance is warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting financial reporting standards for pollution remediation obligations.

Aspects of scrutiny would include the scope of the Statement, measurement of the obligations, the threshold for recognition, and the extent to which Statement 49 has information that users of governmental financial statements can employ for assessing accountability and making decisions.

Description of the Project Topic: Congress passed a series of laws in the 1970s regulating the release of pollutants into the environment in response to concerns about the impact of pollution on health, welfare, and the environment. The GASB considered pollution remediation in 1991 while deliberating Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, but decided to consider a more comprehensive project later. In 1996, the AICPA issued SOP 96-1, *Environmental Remediation Liabilities*, to clarify application of FASB Statement No. 5, *Accounting for Contingencies*, to pollution remediation liabilities. However, governments were not included in the scope of SOP 96-1, and GASB research indicated that governments were not applying its guidance.

Pollution remediation was added to the GASB's agenda in 2002 when outreach revealed that some governments had significant obligations for site cleanups and faced issues applying guidance (NCGA Statement No. 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences*, and FASB Statement 5) to those obligations. The scope of the project was narrowed to pollution remediation obligations from there, after the Board decided to defer projects on other environmental issues to a later time.

Statement 49 identifies five specified obligating events that, if occurring, would lead a government to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired. The liability should be determined using the expected cash flow technique, which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amounts—the estimated mean or average.

This project would consider the following issues:

- Do the "obligating events" established by the GASB faithfully represent when a liability for a government exists? If not, should a government recognize an obligation sooner or later?
- Does the measurement technique of expected cash flow provide relevant and useful information to users of financial statements? If not, would a different measurement technique (lowest/highest figure in a range, discounted cash flows, and so on) be more appropriate?
- Is further guidance on pollution prevention obligations and other asset retirement obligations warranted? How analogous are these other related areas to pollution remediation?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> Statement 49 was first effective for periods beginning after December 15, 2007. The standards have not yet been reexamined by the GASB. The GASB continues to receive technical inquiries regarding Statement 49—more than 125 in the past three years—even after the initial wave of implementation-related questions had subsided.

<u>Project History:</u> This project will be considered for addition to the potential reexamination projects list in April 2013.

Regulated Operations—Reexamination of Statements 62 and 65

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of the accounting and financial reporting standards for regulated operations, such as rate-regulated public power utilities, and (2) to determine if additional guidance is warranted. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for regulated operations.

Description of the Project Topic: Accounting and financial reporting guidance for regulated operations historically has been based on several sources of accounting literature that include but are not limited to FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs,* and FASB Statement No. 101, *Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71.*

The project would examine the key differences between accounting for regulated operations and for other types of governmental entities and consider whether those differences (a) result in a more faithful representation of the economic substance of regulated-operations transactions and (b) lead to the provision of information that is useful for making decisions and assessing accountability. The most notable difference from general accounting guidance is that regulated-operations accounting requires a regulated entity to recognize a regulatory asset (soon to be a deferred inflow of resources) for what would normally be expenses if it is probable that future revenue will result from that cost and that the future revenue will be provided to recover previously incurred costs. Likewise, regulated entities recognize a regulatory liability (soon to be a deferred outflow of resources) if ordered by a regulator to make refunds to customers, or to give back to customers amounts related to gains or reduction in costs the regulator previously allowed the entity to capitalize and report as a regulatory asset.

Much, if not all of the accounting literature previously described has been superseded. Further, Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* supersedes provisions described in paragraph 7 of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* which entities contemplated under relegated operations have conventionally followed. However, Statement 62 does incorporate the applicable portions of FASB Statement 71 into the GASB literature. The effective date for Statement 62 is periods beginning after December 15, 2011.

Guidance on regulated operations was modified again with the issuance of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. However, the effective date for this statement is December 15, 2012, and, therefore, examination of these modifications would be premature. Statement 65 requires that the entity should recognize a deferred outflow of resources in lieu of a regulatory liability, since the resource flows would be applicable to future reporting periods.

The project would address the following issues:

- To what extent do governments with regulated operations elect to apply these standards? What factors influence their decision?
- In what amounts do governments report regulatory assets and liabilities, and in what proportion to total assets and liabilities?
- Are the requirements for reporting impairments of regulatory assets, and the related requirements of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* understood and applied consistently?
- How have governments reported instances in which accounting for regulated operations has been discontinued?
- What information about regulated operations is disclosed in the notes?
- Is information about regulated operations useful for making decisions and assessing accountability? How is it used?
- Does the practice of recording regulatory assets and liabilities (and, soon, a deferred outflow of resources) accurately portray economic reality? Do they meet the definitions of assets and liabilities in the GASB's conceptual framework? Can the regulatory environment assure the

realization of future revenues and require future payments to customers to the extent to justify the recognition of an asset or liability, respectively?

- Are the types regulatory environments researched in 1977, when the project that results in FASB Statement 71 was initiated, comparable to regulatory environments today?
- Does the *probable* threshold for this application continue to be appropriate? Is it applied consistently between governments *and* private entities?
- Should allowable costs include a “fair” return on capital or merely allow an entity to break even?

<u>Reasons for Considering the Addition of This Project to the Research Agenda:</u> FASB Statement 71 has been in place for 30 years and has not been significantly amended since it was issued in 1982. For practical reasons, the guidance incorporated into the GASB literature by Statement 62 was brought in largely “as is.” The Board therefore did not examine the effectiveness FASB Statement 71 or its appropriateness for the governmental environment, other than to confirm that it did not conflict with or contradict other GASB standards.

Instances in which the GASB literature allows for special accounting treatment are relatively rare (for example, hedge accounting for hedging derivative instruments as an exception to the basic requirement to report changes in the fair value of derivatives in investment income). It is important to regularly consider whether the circumstances that originally justified an accounting approach different from general practice continue to exist, and that the key differences in the underlying transactions or events continue to merit a separate accounting approach.

<u>Project History:</u> The project reexamining Statement 62 was added to the potential projects list in December 2010. The relevant provisions of Statement 65 will be added to the project in April 2013.

Research and Development—Reexamination of Statement 62

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of the accounting and financial reporting standards for research and development costs, including circumstances in which research and development costs are paid for by others, and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for research and development costs.

Description of the Project Topic: Research and development guidance historically has been based on FASB Statement No. 68, *Research and Development Arrangements,* which was incorporated into the GASB literature by Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

One reason the FASB issued Statement 68 was due to inconsistent practice. Additionally, the FASB sought to create a distinction between an entity performing research and development on its own and an entity that receives funds from another entity to perform research. Essentially, the scope of Statement 68 encompasses only research and development arrangements that result from exchange transactions.

The guidance incorporated by Statement 62 applies to exchange and exchange-like transactions in which a government "is a party to a research and development arrangement through which it can obtain the results of research and development funded partially or entirely by others." (Paragraph 374) Specifically, Statement 62 contains standards for identifying, measuring, and reporting a government's obligations to repay the funders in part or in full or to provide research and development for others, as well as requirements for disclosure of research and development arrangements.

This project would address the following issues:

- How prevalent is the reporting of research and development by state and local governmental entities?
- Is there consistent application of the guidance across governmental entities? Does the application by governmental entities maintain comparability with private entities?
- Should there be guidance for research and development associated with a *nonexchange* transaction? How would that guidance differ from Statement 62, if at all?
- Does the *probable* threshold for repayment of funding remain appropriate for recognition? What would the consequences be with other thresholds?

Reasons for Considering the Addition of This Project to the Research Agenda: FASB Statement 62 was issued in 1982 and has since been superseded. For practical reasons, the guidance incorporated into the GASB literature by Statement 62 was brought in largely "as is." The Board therefore did not examine the effectiveness FASB Statement 68 or its appropriateness for the governmental environment, other than to confirm that it did not conflict with or contradict other GASB standards. No consideration was given as to if and how the standards might be applicable to nonexchange transactions, which are more prevalent among governmental transactions.

There are few, if any, questions in the GASB's technical inquiry databases related to research and development accounting. The absence of government-specific guidance for research and development is a hole in the GASB's standards, but it is unclear that there is a significant need for prompt standards setting in this area.

Project History: This project was added to the potential projects list in December 2010.

Revenue Recognition: Exchange Transactions—Reexamination of Statement 62

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of the accounting and financial reporting standards for revenue recognition in exchange transactions, including when a right of return exists, and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for revenue recognition in exchange transactions.

Description of the Project Topic: Revenue recognition guidance has historically been based on FASB Statement No. 48, *Revenue Recognition When Right of Return Exists,* ARB 43, *Chapters 1A-1B—Prior Opinions,* and APB Opinion No. 10, *Omnibus Opinion—1966,* which have been superseded. The relevant guidance in those pronouncements was incorporated into the GASB's literature by GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

The essential requirement of paragraph 23 of Statement 62 is that revenues from exchange transactions should be recorded when the exchange takes place. Paragraphs 24–28 specifically address exchange transactions of business-type activities and proprietary funds in which a purchased product may be returned to the government for a refund, credit, or another product.

In 2008, the FASB and the IASB added Revenue Recognition to their agendas. The overarching change to existing guidance proposed by the Boards is that entities will switch from recognizing revenue when it is "realized and earned" to when an entity…transfers promised goods or services to the customer." The criteria for these events may or may not substantively affect the point(s) of time in which revenue is recognized. This new guidance accounts for the right of return differently as well, recognizing an asset for the rights to recover products settling the return liability. A final Accounting Standards Update is expected in the first half of 2013.

This project would examine the following issues:

- Does the guidance in FASB Statement 48, which was incorporated in Statement 62, successfully reduce diversity in accounting for revenue when the right for return exists?
- Considering that the scope of the guidance incorporated by Statement 62 applies only business-type activities and proprietary funds, should guidance be developed for governmental activities? How might that guidance differ, if at all?
- Should the guidance be amended to reflect the changes in development by the FASB and IASB?
- Do the criteria for recognizing revenue when the right of return exists remain appropriate?

Reasons for Considering the Addition of This Project to the Research Agenda: The principal sources of the revenue recognition standards incorporated by Statement 62—FASB Statement 48, ARB 43, and APB Opinion 10—were issued between 30 and 60 years ago. For practical reasons, the guidance incorporated into the GASB literature by Statement 62 was brought in largely "as is." The Board therefore did not examine the effectiveness the revenue recognition standards or their appropriateness for the governmental environment, other than to confirm that they did not conflict with or contradict other GASB standards.

The revenue recognition guidance incorporated by Statement 62 was determined not to apply to governmental activities and, therefore, the scope of the guidance is currently limited to business-type activities. The lack of exchange transaction revenue recognition standards for governmental activities is a significant shortcoming of the GASB's standards.

Technical inquiries related to the broad topic of revenue recognition are fairly common. About 125 such inquiries are documents in the GASB's technical inquiry databases for the past three years.

Project History: This project was added to the potential projects list in December 2010.

Right of Offset—Reexamination of Statement 62

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of the accounting and financial reporting standards for the right of offset and (2) to determine if modifications to the current guidance is warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for the right of offset.

Description of the Project Topic: Right of offset guidance historically has been based on APB Opinion No. 10, *Omnibus Opinion—1966*. This guidance was incorporated into the GASB's literature by Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

Offsetting involves the netting of related assets and liabilities and reporting of only the net difference as an asset or liability, rather than reporting the gross amounts for the assets and liabilities separately. Paragraph 501 of Statement 62 prohibits offsetting of assets and liabilities in the government-wide statement of net position and the proprietary funds statement of fund net position, *except where a right of offset exists.* No further guidance is provided regarding the nature of right of offset that a state or local government might hold, nor the approach to accounting for, reporting, or disclosing offset assets and liabilities.

In 1992, the FASB addressed the right of offset in Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts—an interpretation of APB Opinion No. 10 and FASB Statement No. 105*, two years after FASB Statement No. 105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, had been issued. FASB Statement 105 addressed disclosure of financial instruments with off-balance sheet risk and concentration of credit risk. FASB Interpretation 39, in general, corroborated the position of APB Opinion10, stating that offsetting "in the balance sheet is improper except where a right of setoff exists. A *right of setoff* is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor."

This project would examine the following issues:

- Do the criteria for when a right of offset exists remain appropriate for the present governmental environment?
- Does accounting when the right of offset exists provide a faithful representation of the financial position of the governmental entity?
- What information is most useful to financial statement users—offsetting amounts or gross amounts?
- What is the appropriate scope of offsetting? Should it be limited to short-term receivables and payables or extended longer term elements such as pension plan assets and pension liabilities?
- Does the right of offset affect comparability among governments? Is the economic position of one government with a right of offset significantly different from another government without a right of offset, such that the accounting each uses should be different? Might a user perceive a government with a right of offset to be in better financial health because it appears to have fewer liabilities?
- How might the standards be affected by ongoing deliberations of the FASB and IASB regarding balance sheet offsetting?

Reasons for Considering the Addition of This Project to the Research Agenda: APB Opinion 10 was issued over 40 years ago. For practical reasons, the guidance incorporated into the GASB literature by Statement 62 was brought in largely "as is." The Board therefore did not examine the effectiveness the right of offset standards or their appropriateness for the governmental environment, other than to confirm that they did not conflict with or contradict other GASB standards.

APB Opinion 10 was superseded by FASB Statement 105 and FASB Interpretation 39. However, that updated guidance was not incorporated by GASB Statement 62 because it was issued after November 30, 1989. In addition, the FASB and IASB are currently working on a Balance Sheet—Offsetting project, the objective of which is to provide guidance on the criteria that would determine when offsetting in the balance sheet is appropriate.

Project History: This project was added to the potential projects list in December 2010.

Risk Financing—Reexamination of Statements 10, 30, and 62 and Interpretation 4

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* Statement No. 30, *Risk Financing Omnibus;* paragraphs 400−432 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*; and Interpretation No. 4, *Accounting and Financial Reporting for Capitalization Contributions to Public Entity Risk Pools;* and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for the risk financing events.

Description of Project Topic: Statement 10 stems from FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*. FASB Statement 60 "extracts the specialized principles and practices from the AICPA insurance industry related Guides and Statements of Position and establishes financial accounting and reporting standards for insurance enterprises other than mutual life insurance enterprises, assessment enterprises, and fraternal benefit societies." The FASB defined an insurance transaction in the paragraph 1.

Statement 10 was issued in 1989, seven years after FASB Statement 60. GASB Statement 30 and Interpretation 4, issued in early 1996, both dealt with diversity in practice in recognition and measurement for a variety of reasons, including the omission of maintenance costs from the premium deficiency calculation and recognition of capital contributions to public entity pools.

The major issue to be discussed in this project would be whether Statements 10, 30, and 62 and Interpretation No. 4, provide sufficient accounting and financial reporting guidance for risk financing and insurance activities. The project would consider the following topics that have been raised through the technical inquiry process:

- How decision-useful has information about risk financing been subsequent to its implementation?
- What is the basis for recognizing liabilities for claims and judgments?

- What is the basis for distinguishing when or to what extent liabilities for claims and judgments of active-employee healthcare have matured, or become due and payable?
- For workers compensation programs that are reported as proprietary funds, how would credits to policyholders on their premiums due in the coming year be accounted for?
- To what degree do the standards improve accountability or the transparency of financial reporting by accurately depicting the economic substance of risk financing and insurance transactions? Did the standards lead to information that is useful for decision-makers and users of the governmental financial information?

Reasons for Considering the Addition of This Project to the Research Agenda: Statements 10 and 30 have been in effect since periods beginning after June 15, 1990, and June 15, 1996, respectively. The provisions of Interpretation 4 also have been in effect since periods beginning after June 15, 1996. None of these pronouncements has been reexamined in the intervening period. Risk financing is an occasional topic of technical inquiries, with about 30 documents during the past 3 years.

Project History: This project was added to the potential reexamination project list in December 2008.

Sales of Pledges of Receivables and Future Revenues—Reexamination of Statements 48 and 65

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, and Statement No. 65, *Items Previously Reported as Assets and Liabilities*, and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for those transactions.

Description of the Project Topic: Statement 48 was issued in 2006 to provide consistent reporting of transactions in which governments sell accumulated receivables or pledge future revenue streams to repay borrowed amounts. Statement 48 responded to inconsistency in reporting such transactions, most notably reporting as revenue the proceeds of transactions that inherently are borrowings rather than sales.

Statement 48 describes the criteria for distinguishing between the two types of transactions, one of which (sale of receivables) results in the recognition of revenue and the derecognition of the transferred receivables and the other of which (pledging of future revenues) results in the recognition of a liability to repay the proceeds received but no revenue at the time the transaction is initiated. The default presumption of Statement 48 is that such transactions constitute borrowings collateralized by the pledge of a future revenue stream, unless the transaction meets specific criteria based on "an assessment of a government's continuing involvement with the receivables or future revenues transferred. A significant aspect of that assessment is the degree to which the selling/pledging government (the transferor) retains or relinquishes (to the transferee) control over the receivables or future revenues transferred."

The FASB issued its Statement No. 166, *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140,* in 2009, three years after the GASB issued Statement 48, and utilized similar terms to the GASB, such as "surrender[ing] control," "continuing involvement," and "participating interest."

Statement 65 amended Statement 48 by requiring the proceeds of a sale of future revenue to be recognized as a deferred inflow of resources.

This project would examine the following issues:

- Was Statement 48 successful in reducing the diversity in reporting sales of pledges of receivables and future revenues?
- Did Statement 48 result in faithful representation of economic substance of transactions by distinguishing between a sale and a collateralized borrowing?
- What impact, if any, might result from the FASB's Revenue Recognition project, which shifts from a risk-and-reward perspective to a control perspective? Did Statement 48 adequately improve disclosures about pledged revenues? Did it lead to information that is useful for assessing accountability and making decisions?

The provisions of Statement 65 are not effective until periods beginning after December 15, 2012. Consequently, it is too early to assess the impact of its amendments of Statement 48. Ultimately, the project could consider issues such as whether the switch to reporting deferred inflows of resources affects the comparability of reporting across governments, and if Statement 65 appropriately reflects the concept of interperiod equity with respect to sales of receivables and pledges of future revenues.

Reasons for Considering the Addition of This Project to the Research Agenda: Statement 48 became effective for periods beginning after December 15, 2006. The standards have not been reexamined in the period since. During its initial implementation period it was the subject of numerous technical inquiries and continues to generate occasional inquiries. However, the substance of the inquiries does not suggest that there are widespread problems of interpretation of the standards or diversity in practice.

Project History: The reexamination of Statement 48 was added to the potential reexamination project list in December 2011.

Sales of Real Estate—Reexamination of Statement 62

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of the accounting and financial reporting guidance for sales of real estate, including the recognition of profit or loss on the sale of real estate, and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for sales of real estate.

Description of the Project Topic: Sales of real estate guidance traditionally has based on FASB Statement No. 66, *Accounting for Sales of Real Estate.* That guidance was incorporated into the GASB literature by Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

Present guidance distinguishes between retail land sales and other real estate, and prescribes which method of recognition to utilize given a unique set of circumstances surrounding the particular transaction. In general, the guidance incorporated by Statement 62 requires recognition of a gain associated with the sale of real estate at the time of the sale, provided the collectability of the sale price is reasonably assured and the seller is not obligated to perform significant activities after the sale. Specifically, recognition of the gain should take place only after all four of the following criteria are met:

- A sale is consummated.
- The buyer's initial and continuing investments are adequate to demonstrate a commitment to pay for the property.
- The seller's receivable is not subject to future subordination.
- The seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property. (Paragraph 286, references omitted)

Statement 62 explains the four criteria in greater detail and stipulates how to account for and report sales in which fewer than all four criteria are met.

This project would examine the following issues:

- How frequently do governments engage in sales of real estate? How are the existing standards applied to those transactions?
- Is the guidance appropriate for the governmental environment?
- Is further conceptual guidance needed before standards for the sales of real estate can be readdressed? Does the current guidance for sales of real estate align with the GASB's present conceptual framework projects?
- How might the FASB's Revenue Recognition project—and its proposed move from a "risks-and-rewards" approach to a "control" approach—affect present guidance? The FASB's Revenue Recognition project, essentially, and the GASB currently has recognition on its agenda for its conceptual framework.

Reasons for Considering the Addition of This Project to the Research Agenda: FASB Statement 62 was issued in 1982. For practical reasons, the guidance incorporated into the GASB literature by Statement 62 was brought in largely "as is." The Board therefore did not examine the effectiveness of the sales of real estate standards or their appropriateness for the governmental environment, other than to confirm that they did not conflict with or contradict other GASB standards. There are few, if any, questions in the GASB's technical inquiry databases related to this guidance.

Project History: This project was added to the potential projects list in December 2010.

Securities Lending Transactions and Reverse Repurchase Agreements—Reexamination of Statement 28 and Interpretation 3

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, and Interpretation No. 3, *Financial Reporting for Reverse Repurchase Agreements*, and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for those transactions.

Description of the Project Topic: A securities lending transaction consists of a governmental entity transferring securities to broker-dealers and other entities for collateral (usually cash, securities, or letters of credit) and simultaneously agreeing to return the collateral for the "same" securities in the future. Governmental entities seek to earn additional income from the securities, and the other entity usually needs to borrow the securities to cover a short position or to avoid failing to receive a security it purchased for delivery to a buyer.

Prior to the issuance of Statement 28, there were no governmental accounting standards addressing securities lending transactions; governments reported the underlying securities on the balance sheet but not the assets and liabilities arising from the lending transactions. During the deliberations on Statement 28, the Board observed no substantive economic difference between a government selling securities under reverse repurchase agreements and lending securities under securities lending arrangements for cash collateral. Although the Board noted differences in legal form, federal tax treatments, and differences in motivation for entering into one transaction over the other, ultimately, both transactions had the same effect on the government. As a result, in addition to governments recognizing the underlying assets on the balance sheet, governments generally should report collateral (cash received and investments made with that cash) as assets along with the resulting liability. Transaction costs should be reported gross as expenses and expenditures.

The GASB issued Interpretation 3 to reconcile several reporting differences between reverse repurchase agreements and securities lending transactions. The Board particularly believed in disclosing information about the maturity matching on reverse repurchase agreements to provide users with liquidity risk information.

In the 2009 Comprehensive Implementation Guide, a new question was added indicating that securities lending collateral should be measured using Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.*

The major issue to be considered would be whether additional guidance is needed. As part of this issue, this project would consider the following topics that have been raised through the technical inquiry process:

- How decision-useful has information about securities lending been subsequent to the implementation of these pronouncements?
- Should the investments purchased with the collateral be reported at fair value? Should the corresponding liability be the same amount as the collateral?
- In a securities lending transaction, if a trust buys and holds the securities purchased with the collateral, but the securities are in the government's name, is there custodial credit risk?
- How does Statement No. 40, *Deposit and Investment Risk Disclosures,* affect securities lending? Are investments purchased with securities lending cash collateral subject to Statement 40 risk disclosures? If so, should the value disclosed be the fair value of the new investment or of the collateral?
- Does the risk of loss referred to in paragraph 9 of Statement 28 relate to the collateral or the lent security?
- Should liabilities resulting from securities lending transactions (paragraph 6) be the same amount as collateral investments, or the amount of collateral that was taken under the agreement?

Issues associated with Interpretation 3 would be:

- Should reverse repurchase agreement reported in an internal investment pool continue to be allocated to the participating funds based on the fund's equity in the pool?
- Should the allocation of investment revenue from reverse repurchase agreements be based on the fund's equity in pool or be based on legal and contractual provisions, if applicable?

- Are the disclosures regarding reverse repurchase agreement required by this Interpretation still decision useful?

Reasons for Considering the Addition of This Project to the Research Agenda: Statement 28 and Interpretation 3 have both been in effect since periods beginning after December 15, 1995. Neither has been reexamined in the intervening period. Reverse repurchase agreements and securities lending continue to be prevalent transactions for some governmental entities and remains a regular subject of technical inquiries received by the GASB.

Project History: The reexamination of Statement 28 and Interpretation 3 was added to the potential reexamination project list in December 2008.

Statistical Section—Reexamination of Statement 44

Project Objective: The initial objectives of this project would be (1) to evaluate the effectiveness of Statement No. 44, *Economic Condition Reporting: The Statistical Section* (an amendment of NCGA Statement 1) and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised financial reporting standards for the statistical section.

Description of the Project Topic: The GASB has had a project on Economic Condition Reporting (originally titled Financial Condition) since the early years of its existence. At that time, the perception of the meaning of "financial condition" and, consequently, the scope of the project were broader than the more commonly used "financial position," but existing standards and concepts statements did not clearly distinguish between the two terms. During its deliberations that ultimately led to the issuance of Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, the Board decided that it would be useful to define the terminology more precisely.

The Board eventually settled on the term "economic condition," which was used in the National Council on Governmental Accounting's (NCGA) 1981 Research Report,[3] with a meaning similar to the GASB definition in paragraph 34 of Concepts Statement No. 1, *Objectives of Financial Reporting*. In that paragraph, financial condition is referred to as a government's "financial position and its ability to continue to provide services and meet its obligations as they come due." The definition of economic condition was subsequently developed and revised as the Board proceeded through the development of Concepts Statement 3 and Statement 44, and its present project on financial projections. In December 2011, the Board proposed the following definition in its Preliminary Views, *Economic Condition Reporting: Financial Projections:*

> Economic condition is a composite of a government's financial position, fiscal capacity, and service capacity.
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> a. Financial position is the status of a government's assets, deferred outflows, liabilities, deferred inflows, and net position, as of a point in time.

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[3] Allan R. Drebin, James L. Chan, and Lorna C. Ferguson. NCGA Research Report, *Objectives of Accounting and Financial Reporting for Governmental Units: A Research Study*. 1981.

b. Fiscal capacity is the government’s ability and willingness to meet its financial obligations as they come due on an ongoing basis.
c. Service capacity is the government’s ability and willingness to meet its commitments to provide services on an ongoing basis.

Statement 44 was intended to improve the information provided in the statistical section, the standards for which had not been amended since 1979, in order to better equip users to evaluate a government’s economic condition. In that vein, Statement 44 incorporated information newly reported due to Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, most notably accrual-basis government-wide information. Statement 44 also reflected significant changes in government finance that had taken place over the prior 25 years, such as the diversification of revenue streams and debt instruments.

The Board chose to limit the scope of Statement 44 to considering the 5 types of information already included in the statistical section—financial trends, revenue capacity, debt capacity, economic and demographic, and operating. Based on NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, the statistical section is one of three required parts of a comprehensive annual financial report (CAFR) and is presented as unaudited supplementary information (SI) following the financial section. Governments that do not prepare a full CAFR are not required to prepare a statistical section. The Board decided not to include within the scope of the project the question of the appropriate communication method for statistical section schedules.

Statement 44 was issued in 2004 and a freestanding Implementation Guide to Statement 44 was published in 2005.

This project would examine the following issues:

- Was Statement 44 successful in leading to information that places the basic financial statements, notes to the basic financial statements, and RSI in historical, economic, or operational context? How do users employ this information to evaluate economic condition?
- Are the overarching objectives listed in Statement 44 still appropriate for the governmental environment? Are they meeting the needs of users?

- Do the five types of information identified by Statement 44 comprehensively address the various aspects of economic condition? Is there other information that should be reported among those five types? Are there other types of information that should be included in the statistical section?
- In light of the guidance included in Concepts Statement 3, what communication method is most appropriate for the statistical section—basic financial statements, notes to basic financial statements, RSI, or SI? Rather than considering the statistical section in its entirety, are particular required schedules suitable to communication via different methods?

Reasons for Considering the Addition of This Project to the Research Agenda: Statement 44 was effective for periods beginning after June 15, 2005. The requirements for the financial trends schedules were amended by Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* However, the effectiveness of Statement 44 has not yet been evaluated. Statement 44 continues to be the subject of occasional technical inquiries throughout the year—about 20 over the past 3 years.

Project History: The reexamination of Statement 44 was added to the potential reexamination project list in December 2011.

Termination Benefits—Reexamination of Statement 47

Project Objective: The initial objectives of this potential research project would be (1) to evaluate the effectiveness of Statement No. 47*, Accounting for Termination Benefits*, and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for termination benefits.

Description of the Project Topic: Termination benefits are provided (a) to hasten an employee's voluntary termination of services, sometimes referred to as early-retirement incentives, and (b) to terminated employees as a result of involuntary terminations, such as layoffs. Examples of benefits commonly provided as incentives for voluntary terminations include cash payments, enhancements to defined benefit pension or other postemployment benefit (OPEB) formulas, and healthcare coverage when none otherwise would be provided. Examples of benefits provided for involuntary terminations include severance pay, continued access to health insurance through the employer's group insurance plan, career counseling, and outplacement services.

Statement 47 requires that, in financial statements prepared on the accrual basis of accounting, employers should recognize a liability and expense for *voluntary* termination benefits when the offer is accepted and the amount can be estimated. A liability and expense for *involuntary* termination benefits should be recognized when a plan of termination has been approved by those with the authority to commit the government to the plan, the plan has been communicated to the employees, and the amount can be estimated.

Healthcare-related termination benefits that are provided as the result of a large-scale, age-related program should be measured at their discounted present values based on projected total claims costs (or age-adjusted premiums approximating claims costs) for terminated employees, with consideration given to the expected future healthcare cost trend rate. Employers that provide other healthcare-related termination benefits are permitted, but not required, to measure the cost of termination benefits based on projected claims costs for terminated employees. That is, in this circumstance, the cost of termination benefits may be based on unadjusted premiums.

The cost of non-healthcare-related termination benefits for which the benefit terms establish an obligation to pay specific amounts on fixed or determinable dates should be measured at the discounted present value of expected future benefit payments (including an assumption regarding changes in future cost levels during the periods covered by the employer's commitment to provide the benefits). If, however, the benefit terms do not establish an obligation to pay specific amounts on fixed or determinable dates, the cost of non-healthcare-related benefits should be calculated as either (a) the discounted present value of expected future benefit payments or (b) the undiscounted total of estimated future benefit payments at current cost levels.

As an exception to these general recognition and measurement requirements, the effects of a termination benefit on an employer's obligations for defined benefit pension or other postemployment benefits should be accounted for and reported under the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* as amended, or Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* as applicable.

This project would consider (a) how termination benefits accounting fits into the overall area of compensation accounting and (b) if the measurement method is conceptually sound and comparable to other areas of postemployment benefits.

This project will examine the following issues:

- Is Statement 47 successful in providing users with information that can be used for making decisions and assessing accountability?
- Do the allowable measurement methods result in a faithful representation of the termination benefits transaction? Are the recognition criteria still appropriate?
- Are "expected future benefit payments" an appropriate measurement? Would "most likely payments" or "the minimum in a range of payments" be more appropriate?
- Is the estimated yield, over the period of time the benefits are to be provided, on the investments that are expected to be used to finance the payments of the benefits an appropriate choice of rate with which to discount the payments? Should it be consistent and comparable to the new pensions standards or current OPEB standards?

- Are there other areas of compensation for which there is no guidance that the GASB should seek to address in order to provide comprehensive guidance for compensation?

Reasons for Considering the Addition of This Project to the Research Agenda: Statement 47 was issued in June 2005 with an effective date for periods beginning after June 15, 2005 (except for termination benefits provided through an existing other postemployment benefits plan, which were to be implemented simultaneously with the implementation of Statement 45). Statement 47 has not been reexamined in the interim.

Termination benefits continue to be a regular transaction among state and local governments. The financial pressures of the recession that began in 2008 may have increased the likelihood that governments will consider termination benefits as one method of reining in costs. The GASB has received about 30 technical inquiries on termination benefits in the last three years.

Project History: The reexamination of Statement 47 was added to the potential reexamination project list in December 2011.

Troubled Debt Restructurings—Reexamination of Statement 62

Project Objective: The initial objective of this potential research project would be (1) to evaluate the effectiveness of the accounting and financial reporting standards for troubled debt restructurings and (2) to determine if modifications to the current guidance are warranted. If modifications to the current guidance are determined to be needed, another objective would be to consider the development of revised accounting and financial reporting standards for troubled debt restructurings.

Description of the Project Topic: Accounting for troubled debt restructuring has historically been based accounting literature provided by FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings.* That guidance was incorporated into the GASB's literature by Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. Municipal bankruptcy is not covered within the scope of the troubled debt restructuring standards; that guidance is found in GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*.

The FASB issued Statement 15 in 1977 in response to a substantial increase in debtors unable to meet their obligations on outstanding debt because of financial difficulties with "many of the most publicized troubled debt restructurings [involving] debtors that are real estate companies or real estate investment trusts." The FASB addressed the topic due to the lack of guidance in authoritative literature at the time.

Statement 62 defines a troubled debt restructuring as a restructuring in which "the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider." (Paragraph 129) In other words, the creditor has agreed or been ordered by law or a court to accept an amount less than it is owed by the debtor or a payment schedule other than originally agreed upon. "[M]any troubled debt restructurings involve modifying terms to reduce or defer cash payments required of the debtor in the near future to help the debtor attempt to improve its financial condition and eventually be able to pay the creditor. Or, for example, the creditor may accept cash, other assets, or an equity interest in the debtor in satisfaction of the debt though the value received is less than the amount of the debt because the creditor concludes that step will maximize recovery of its investment." (Paragraph 129)

Statement 62 provides accounting and financial reporting guidance both for governments that are creditors or debtors. The guidance differs depending on the type of restructuring, including transfer of assets in full settlement, modification of terms, or combinations of the two.

This project would examine the following issues:

- What is the most appropriate method of measurement for troubled debt restructurings?
- If there is a substitution of debtors, is there truly a substantive economic event that warrants recognition?
- Is there an economically substantive difference between a troubled debt restructuring and the plan that arises out of a municipal bankruptcy that justifies a different accounting treatment?

Reasons for Considering the Addition of This Project to the Research Agenda: FASB Statement 15 was issued 25 years ago. For practical reasons, the guidance incorporated into the GASB literature by Statement 62 was brought in largely "as is." The Board therefore did not examine the effectiveness of the troubled debt restructuring standards or their appropriateness for the governmental environment, other than to confirm that they did not conflict with or contradict other GASB standards.

The project was ranked in the top 15 potential and research projects in the GASAC's annual prioritization for each of the two years it has been included.

Project History: This project was added to the potential projects list in December 2010.