



August 20, 2010

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 32
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

Members of the American Institute of Certified Public Accountants (AICPA) State and Local Government Expert Panel have reviewed the Governmental Accounting Standards Board (GASB) Exposure Draft (ED), *Codification of Accounting and Financial Reporting Guidance Contained in the Pre-November 30, 1989 FASB and AICPA Pronouncements* and are pleased to offer their comments. Our comments are divided into three sections as follows: 1) Responses to Questions Posed in the ED; 2) Overarching Comments and Recommendations; and 3) Comments and Recommendations by Topic.

RESPONSES TO QUESTIONS POSED IN THE ED:

1. Whether you believe specific accounting and financial reporting requirements from the FASB and AICPA pronouncements are appropriately *excluded*.

We did not identify any excluded Financial Accounting Standard Board (FASB) or AICPA pronouncements that need to be incorporated into the scope of the ED. Therefore, we believe the Board has properly excluded the FASB and AICPA pronouncement as noted in Appendix C of the ED.

2. Specific accounting and financial reporting requirements from the FASB and AICPA pronouncements that we have *included* in the proposed Statement that you believe conflict with or contradict GASB pronouncements and should, therefore, be *excluded* from the proposed Statement.

In reviewing the ED, we identified one instance where we believe the guidance included in the proposed Statement conflicts with or contradicts GASB pronouncements and should be excluded from the ED. See our detailed comments on Special and Extraordinary Items later in this letter. We also identified one section of the ED that, considering a government's reporting objectives, are too extensive and complicated for the government environment. We are suggesting that those topics be excluded from

the final Statement and that the Board consider new projects to further develop the guidance to more specifically relate to governmental entities. See our detailed comments on Sales of Real Estate later in this letter.

3. Specific accounting and financial reporting requirements from the FASB and AICPA pronouncements that we have *excluded* from the proposed Statement on the basis that the requirements rarely apply to state and local governments or the requirements conflict with or contradict GASB pronouncements that you believe should be *included* in the proposed Statement.

In reviewing the ED, there were several instances where requirements within a FASB pronouncement were excluded because they were deemed to be rare by GASB that we disagreed with. See our comments on Statement of Net Assets Classification, Special and Extraordinary Events, and Inventory later in this letter. Also, we identified one instance where guidance was excluded by the GASB due to the Board's conclusion that it conflicted with GASB pronouncements that we also disagreed with. See our comments on Costs and Initial Rental Operations of Real Estate Projects later in this letter.

OVERARCHING COMMENTS AND RECOMMENDATIONS

GASB Statement No. 20 Election. The ED would supersede GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, in its entirety. Some that reviewed the ED thought that the final Statement could be enhanced by more directly stating (in paragraphs 546 and 548 of the Basis for Conclusions) that the provisions of paragraph 7 of GASB 20 have been eliminated and clarifying that if activities or transactions that are not covered by current GASB guidance that FASB guidance may be applied as other accounting literature under GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

Terminology. This ED was drafted using FASB literature as a starting point. As a result, we noted several areas where we thought the language used in the ED had an overly strong economic resource and earnings focus. For example, see our comments in Revenue Recognition for Exchange Transactions below. In our view, this economic resource and earnings focus creates a mismatch between the ED and existing GASB literature and may confuse preparers regarding the proper application of the final Statement. We recommend an introductory section be added to the final Statement explaining this issue and how it should be considered within the context of GASB's objectives of financial reporting (e.g., how it relates to the modified accrual basis of accounting and the government's lack of an earnings motive). Such clarification is necessary to ensure an appropriate interpretation and application of the final Statement. Further, we noted terms not commonly used in GASB literature that we suggest be changed to be more consistent with GASB literature. Please see our additional detailed comments on Terminology at the end of this letter.

Accounting Changes Resulting from This Standard. There are likely to be many situations for entities that have previously chosen to adopt paragraph 7 of GASB Statement No. 20 to apply non-conflicting post-1989 FASB pronouncements that will now have to implement an accounting change as a result of the final Statement. For example, upon the effective date of the final Statement, entities that have been accounting for goodwill using FASB Statement No. 142, *Goodwill and Other Intangible Assets*, will instead have to apply the requirements of APB Opinion No. 17, *Intangible Assets*, which requires amortization of goodwill. Paragraphs 542-544 of the ED provide insight as to why the Board did not incorporate any post-1989 FASB pronouncements in the proposed Statement, but those paragraphs do not acknowledge that accounting changes will likely result upon implementation by some entities. We suggest adding discussion regarding such accounting changes to the transition guidance in paragraph 504 of the ED to help with the implementation and transition to the final Statement.

Purpose of the Statement. Paragraph 1 of the ED indicates the purpose of the proposed Statement is to “directly incorporate” FASB and AICPA standards. It is our observation that the purpose of the proposed Statement is also to modify, where necessary, the FASB and AICPA standards to adapt them to governmental entities. The Board has made a significant number of edits to adapt the FASB and AICPA standards to governmental entities. Thus, we suggest this element be added to the purpose of the Statement.

New GASB Projects or Additions to Existing Projects. In reviewing the ED, we noted a few topic areas that we believe need additional attention in order to be properly implemented. Therefore, we have made several suggestions to the Board to either adopt new projects or incorporate certain topics into current projects. See our comments later in this letter on Capitalization of Interest Cost, Revenue Recognition for Exchange Transactions, Prior Period Adjustments, Interest Costs-Imputation, Investments in Common Stock, and Leases.

COMMENTS AND RECOMMENDATIONS LISTED BY TOPIC

Capitalization of Interest Cost.

1. In reviewing the capitalization of interest costs topic in paragraphs 5-22 of the ED, we noted a gap in the guidance that we suggest the Board address. It is common for governmental funds (e.g., a capital project fund) to build an asset and then transfer it to a business-type activity. We recommend adding guidance to this section on capitalizing interest when a governmental fund is used to construct the assets. If the Board is not able to address this in the final Statement, we recommend it be addressed in a future GASB project.
2. Paragraph 8(d) regarding assets qualifying for interest capitalization states, “Assets that are donated or granted to other governments.” For clarity, we recommend changing “other governments” to “other entities.”
3. Paragraph 10 discusses assets qualifying for interest capitalization and states, “Land that is not undergoing activities necessary to get it ready for its intended use is not a qualifying asset.” We are confused about whether and when land would be a

qualifying asset because the term, “activities” as used in paragraph 10 is not clear to us for government application. We recommend the Board include a series of governmental examples to clarify how the term “activities” should be applied in a governmental environment so that there is no confusion about when interest costs can be capitalized on land assets. These examples should consider situations when land is purchased for community development and redevelopment purposes.

4. Paragraph 15 regarding the amount of interest cost to be capitalized uses the following phrase, “net of progress payment collections.” We were confused by this phrase and recommend that it be clarified.
5. Paragraph 17 discusses when the capitalization period should end. In the previous FASB standard, several examples were provided to help clarify the meaning of the paragraph. However, these examples were deleted in the ED as they were commercial in nature. We recommend adding governmental examples to the guidance to help ensure an appropriate understanding.

Revenue Recognition for Exchange Transactions.

1. We believe the guidance in paragraph 23 of the ED is both confusing and overly commercially focused. We recommend the following revision to improve the paragraph:

“Revenues from exchange transactions should generally be accounted for at the time a transaction is completed, with appropriate provision for uncollectible accounts.”

2. Paragraph 23 of the ED states, “In the absence of the circumstances referred to above or other specific guidance, such as in paragraphs 285-352, the installment method is not acceptable.” For additional clarity, we recommend creating another paragraph addressing the installment method and cost recovery methods.
3. Paragraph 23 of the ED does not address full-accrual revenue recognition versus the modified accrual recognition and how the period of availability or fund balance classification is affected. There is a divergence in current practice in accounting for exchange transactions under modified accrual accounting under the premises of paragraph 62 of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*. Thus, we believe modified accrual recognition should be addressed in the final Statement. If the Board is not able to address this in the final Statement, we recommend it be addressed in a future GASB project

Revenue Recognition when Right of Return Exists.

1. Paragraph 28 of the ED discusses factors that may impair the ability to make a reasonable estimate of the amount of future returns and paragraph 28(c) states,

“Absence of historical experience with similar types of sales of similar products, or inability to apply such experience because of changing circumstances, for example changes in the seller’s marketing policies or relationships with its customers.”

We believe the example provided in paragraph 28(c) is unlikely in a governmental environment. Therefore, we recommend ending the sentence with "...changing circumstances."

Statement of Net Assets Classification.

1. We noted in the Current Assets section of this topic that paragraph 31 of the ED had been modified from the original text of Accounting Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins*, Chapter 3A, *Current Assets and Current Liabilities*, paragraph 6, to exclude the following

"investments in securities (whether marketable or not) or advances which have been made for the purposes of control, affiliation, or other continuing business advantage."

However, we believe it would be appropriate to replace the guidance above with "investments in joint ventures," since those would generally be excluded from the concept of current assets.

Special and Extraordinary Items.

1. Paragraph 49 states, "Certain gains and losses should not be reported as special or extraordinary items because they are usual in nature or may be expected to recur as a consequence of customary and continuing operations." This language seems to take the prohibitions against certain transactions being reported as extraordinary items and further applying that prohibition to treatment as a special item. We believe this paragraph should be modified to exclude special items for a number of reasons as follows:
 - a) It appears to contradict paragraph 56 of GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, which allows reporting as a special item if the transaction meets either the infrequent test or the unusual in nature test.
 - b) Paragraph 17 of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, seems to allow a loss from abandonment of property, plant or equipment that was used in operations to be reported as a special item or extraordinary item, when appropriate. Paragraph 49(c) of the ED would contradict this as it provides an example of "Other gains or losses from sale or abandonment of property, plant or equipment used in operations.
 - c) We question whether any of the examples cited in paragraph 49 (a) through (e) (e.g., adjustments of accruals on long-term contracts) would ever be a special item.

We believe that the phrase "special or" in paragraph 49 will result in confusion and recommend deleting it from the paragraph.

2. If paragraph 49 is to remain applicable to special items, then the paragraph that follows it should be revised to state that “in rare situations, an event or transaction listed in (a) through (e), above, may occur that clearly meets one of the criteria specified in paragraph 46 and is within the control of management, and thus should be reported as a special item.” We believe this additional language would help to provide clarification.
3. In addition, paragraph 49 excludes the notion of deferred research and development costs from paragraph 23(a) of APB Opinion No. 30, *Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. On page 265 of the ED, the notes to the markup of this paragraph indicate that research and development has rare application to governments. We disagree with this conclusion because it is our experience that research and development is very common in universities. Therefore, we recommend that deferred research and development costs be added to the final Statement.

Comparative Financial Statements.

1. Paragraph 53 of the ED states, “It is necessary that prior-period figures shown for comparative purposes be, in fact, comparable with those shown for the most recent period, or that any exceptions to comparability be clearly brought out as described in paragraphs 63–89.” We believe this paragraph should be expanded to clarify that this requirement applies not only to the statement of net assets and the flows statement, but also to any prior-period figures presented within the financial report, such as in the footnote disclosures, the Management’s Discussion and Analysis, and the statistical section.

Related Parties.

1. We noted that paragraph 54 of the ED provides examples of related party transactions which were modified from paragraph 1 of FASB Statement No. 57, *Related Party Disclosures*. Paragraph 1(c) of FASB Statement No. 57 provides the example of “an enterprise and trusts for the benefit of employees, such as pension and profit sharing trusts that are managed by or under the trusteeship of the enterprise’s management.” We question why this concept was excluded from the ED and recommend that GASB reconsider this example, especially in the context of the inclusion of related organizations and jointly governed organizations currently discussed in paragraph 54 of the ED.

Prior Period Adjustments.

1. We noted that the guidance in paragraphs 58-61 of the ED on prior period adjustments does not make reference to or define the term “restatement.” We suggest that the guidance on prior period adjustments in the final Statement make reference to the appropriate authoritative literature or specifically define restatement.

2. We are unclear why the guidance in paragraph 59 to report prior period adjustments is limited to just the flows statement. Further, footnote 32 to paragraph 61 states that “the term flows statement includes the government-wide statement of activities and the proprietary fund statement of revenues, expenses and changes in fund net assets.” We question why the guidance in paragraphs 59 and 61 is limited to the flows statements and whether this guidance should instead include references to all reporting units and fund types as the guidance applies to the entire financial reporting entity. We also believe that this guidance should be expanded to address the modified accrual basis statements. If the Board is not able to add this guidance to the final Statement, it should be addressed in a separate project.

Accounting Changes and Error Corrections.

1. Paragraph 77 provides reporting requirements for all changes in accounting principle except for a change in reporting entity. This guidance is confusing because it appears to contradict the transition reporting required by most GASB standards when implemented (i.e., the restatement of financial statements for all prior periods presented). Additionally, while paragraph 64 of the ED indicates that the provisions in paragraphs 63-89, including the guidance in paragraph 77, do not apply to changes made in conformity with pronouncements issued in the past or the future, the use of “all” in the first sentence of paragraph 77 appears to contradict the exclusion made in paragraph 64 for new pronouncements.
2. Paragraph 77(a) of the ED states, “Financial statements for prior periods included for comparative purposes should be presented as previously reported.” In practice, we have not seen governmental financial statements completely report prior period financial statements “as previously reported” when there has been an accounting change. Thus, we question whether this was the Board’s intent. This should be clarified.
3. Paragraph 77(d) of the ED states, “Changes in net assets/fund net assets computed on a pro forma basis should be shown on the face of the flows statements for all periods presented as if the newly adopted accounting principle had been applied during all periods affected.” Paragraph 79 continues the requirements for pro forma reporting. In practice, we have not seen pro forma amounts for the changes shown on prior year financial statements presented. The accounting that has been used in practice has been more aligned to FASB Statement No. 154, *Accounting Changes and Error Corrections*. Further, footnote 13 of GASB Statement No. 34 adds to the confusion. That footnote states, “Changes in accounting principles addressed in APB Opinion No. 20, *Accounting Changes*, as amended, should be reported as restatements of beginning net assets/fund equity, not as a separately identified cumulative effect in the current-period statement of activities or proprietary fund statement of revenues, expenses, and changes in fund net assets.” With this footnote provision, anything other than restatement or the retrospective application used in

FASB No. 154 would not appear to make sense. Thus, we ask the Board to reconsider and clarify the pro forma requirements.

Disclosure of Accounting Policies.

1. We noted that the guidance relating to cash flows in paragraphs 6, 7, and 12 of APB Opinion No. 22, *Disclosure of Accounting Policies*, was not brought into the Codification. While we noted that the source of the cash flow guidance was a post-1989 FASB standard, we question whether the GASB's guidance will be complete without including cash flows. The GASB should address this.

Contingencies.

1. We question how the guidance related to contingencies would fit into the current GASB literature. In particular, we question how it would relate to GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*.
2. Footnote 37 to paragraph 96 of the ED states, "the term loss is used for convenience to include many decreases in net assets/fund balances that are commonly referred to as expenses/expenditures and others that are commonly referred to as losses." While we recognize that this is the wording from FASB Statement No. 5, *Accounting for Contingencies*, we believe that the distinction is confusing and ask the Board to clarify this guidance.
3. Paragraph 98(d) indicates that risk of loss from claims for delays or inadequate specifications on contracts are within the scope of the ED. We question the source for adding this element unless it was intended to re-characterize the deleted items from FASB Statement No. 5. We noted that paragraph 7 of FASB Statement No. 5 excludes employment-related costs from the scope of the Statement and suggest that this exclusion be included in paragraph 99 of the ED to clarify that employment-related costs are not within the scope of the guidance.
4. The Board should clarify in paragraph 98 or 99 whether risk of loss due to litigation should be included or excluded from this ED. While it is our understanding that pending or threatened litigation was removed from the FASB Statement No. 5 guidance included in the ED because it conflicts with GASB Statement No. 10, we were confused in that paragraph 105 of the ED provides an example of litigation.
5. Footnote 41 to paragraph 111 states, "For purposes of applying paragraphs 96-116, the term *statement of net assets* includes the government-wide statement of net assets, governmental funds balance sheet, and proprietary fund statement of fund net assets, which are required to be presented as components of the basic financial statements." We believe there would also be applicability to certain fiduciary funds such as pension and investment trust funds. Therefore, the Board should reconsider the limitations provided by this footnote.
6. Paragraph 113 of the ED discusses guarantees of indebtedness of others and the last sentence of the paragraphs describes indirect guarantees as follows, "Examples of

indirect guarantees include agreements to advance resources if a second entity's revenues, coverage of debt service, or net assets/fund balance fall below a specified minimum." FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness to Others*, from which the GASB guidance was adapted, uses the term "working capital" instead of net assets/fund balance. These are two very different concepts and we do not understand the Board's adaptation. The Board should clarify this.

Construction-Type Contracts – Long-Term.

1. Paragraph 124 states, "When the completed-contract method is used, it may be appropriate to allocate general and administrative expenses to contract costs." We noted that the ED deleted a portion of paragraph 10 of ARB No. 45, *Long-Term Construction-Type Contracts*, which provides additional context about when it may be appropriate to allocate general and administrative expenses to contract costs. To ensure consistency, we recommend that the Board either eliminate the provision in paragraph 124 or provide the necessary context regarding when it would be appropriate to allocate.
2. Paragraph 126 refers to "current" assets and liabilities classification in the statement of net assets. This appears appropriate for business-type activities. However, this guidance may not be appropriate for government-wide financial statements that do not use the classified presentation. We recommend adding the distinction between business-type activities and government-wide statements of net assets to avoid confusion.

Extinguishments of Debt.

1. Footnote 47 to paragraph 129 of the ED states, "the term *flows statement* includes the government-wide statement of activities and the proprietary fund statement of revenues, expenses, and changes in fund net assets." We are unclear why fiduciary funds are excluded unless the Board considers them to be of "rare" applicability. This should be clarified.
2. Due to the recent disruptions in the credit markets, we have encountered more situations with failed auctions where governments are refinancing and buying back their debt. It is unclear in practice whether these arrangements should fall under APB Opinion 26, *Early Extinguishment of Debt*. We encourage the Board to clarify in the basis for conclusions why the accounting treatment for these transactions was not addressed as part of the scope of this project or to incorporate existing applicable guidance from APB Opinion 26 on extinguishment into the GASB literature.

Troubled Debt Restructuring.

1. Paragraph 134 of the ED provides examples of receivables or payables involved in troubled debt restructures as accounts receivable or payable among others. Footnote 56 to paragraph 142 refers to a troubled debt restructuring of a short-term obligation. Footnote 50 limits the focus of the section to the government-wide

statement of net assets and the proprietary fund statement of net assets. We question why the guidance in footnote 50 does not extend to modified accrual since, as noted in the example, accounts receivable or payable could be reported in a governmental or fiduciary fund. Additionally, "short-term obligation" implies governmental funds could be involved.

2. Paragraph 137 of the ED provides an example which states, "a troubled debt restructuring is not involved if the fair value of cash, other assets, *or an equity interest* accepted by a creditor from a debtor in full satisfaction of its receivable at least equals the creditor's recorded investment in the receivable." We found this confusing because "an equity interest" would not be transferred by a government as the debtor. However, the government as a creditor could receive an equity interest from its debtor. This should be clarified.
3. Footnote 52 to paragraph 140 discusses a scenario where the fair value of assets is transferred or the fair value of an equity interest is granted. As noted in the previous comment, we believe that a government as a debtor would not transfer an equity interest. Therefore, we recommend that the Board reconsider the wording of this footnote.
4. Footnote 53 to paragraph 140 states, "Some factors that may be relevant in estimating the fair value of various kinds of assets are described in paragraphs 183–187 and paragraph 281." We believe that the appropriate references are to paragraphs 183, 186, and 187. We recommend that the Board review this reference and make any appropriate revision. If the Board believes that the references provided are appropriate, clarification should be provided as to how the paragraphs cited relate.
5. Paragraph 165 discusses disclosures required for a creditor about troubled debt restructuring. With regard to outstanding receivables whose terms have been modified in troubled debt restructurings, paragraph 165(a)(3) requires disclosure of the amount of interest revenue on those receivables that was included in changes to net assets for the period. This requirement should be expanded to include such revenue that had been included in fund balance because governmental funds report receivables that may be subject to restructuring.
6. The last sentence of paragraph 167 which discusses substitutions or additions of debtors indicates that the creditor should account for the restructuring based on the guidance in paragraphs 153–158. We believe that the reference should be to paragraphs 153 and 158. We recommend that the Board review this reference and make any appropriate revision. If the Board believes that the references provided are appropriate, clarification should be provided as to how the paragraphs cited relate.

Interest Costs – Imputation.

1. Paragraph 177 of the ED provides a list of exceptions to the applicability of the imputation guidance in paragraphs 176-190 of the ED. We question why the Board

added 177(f), “Low interest loans issued by governments to carry out governmental objectives” to the guidance adapted from paragraph 3 of APB Opinion 21, *Interest on Receivables and Payables*. We understand, based on the discussion in paragraph 573 of the ED, that the Board considered the impact of Q&A 7.8.7 of the *Comprehensive Implementation Guide* which discusses below-market loans. We believe that adding the factor in 177(f) goes beyond the stated intention of directly incorporating pre-1989 FASB literature as it is elevating level d guidance in the GAAP hierarchy to level a GAAP without appropriate due process. Therefore, we recommend that paragraph 177(f) should be deleted and considered by the Board in a separate project.

2. Also, we question why paragraph 177(g), which would exclude transactions between a primary government and its component units or between component units of the same reporting entity, is included in this list. The Board should clarify this exclusion to help preparers understand the Board’s rationale.

Inventory.

1. The definition of inventory in paragraph 192 of the ED does not appear to address tangible property held for installation or use in the provision of services to customers (e.g., water, gas, or power distribution). This is a common type of inventory for governmental entities. We question whether the Board’s intent was for this type of inventory to be covered in paragraph 192(c) which covers “tangible personal property that are to be currently consumed in the production of goods or services to be available for sale.” However, we were not entirely clear because of the use of the term “consumed” in paragraph 192(c). Consider, for example, inventory related to water treatment which often includes chemicals, wire, pipes, valves, and meters. We recognize that chemicals held for use in water treatment are “consumed” and covered by the definition in paragraph 192(c). However, we are not clear whether wire, pipes, valves, and meters would be considered inventory since they are not consumed. Paragraph 193 also excludes from the definition of inventory long-term assets subject to depreciation accounting, or goods that, when put into use, will be so classified. While the wire, pipes, valves, and meters in the above described scenario have long-term lives, in practice they are not typically considered long-term assets subject to depreciation accounting, or goods that, when put into use, will be so classified. The Board should clarify this or consider adapting the language from paragraph 3 of ARB No. 43, Chapter 4: *Inventory Pricing*, that was struck as a rare application to governments that states, “operating materials and supplies of certain types of companies such as oil producers are usually treated as inventory.”

Investments in Common Stock.

1. We noted that the ED excluded the definitions of terms from paragraph 3 of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. These definitions are important in understanding the application of this section and

their exclusion makes the guidance in the ED less precise than APB Opinion No. 18, which may result in more diversity in the application of the standard. For example:

- Clarification of the meaning of "earnings" would improve the proposed Statement.
 - GASB literature does not define "net earnings" or "net income" and given their importance to the proper application of the standard, we think they should be defined. Without the inclusion here, the definitions provided by FASB provide level d guidance for governments under the GAAP hierarchy. There are also implementation issues in using such definitions due to the difference in the reporting models.
2. We recognize that in paragraph 578 of the ED the Board addressed the omission of guidance from APB Opinion No. 18 that requires accounting for certain events or transactions with an investee as if it were a consolidated subsidiary due to the conflict with GASB Statement No. 14, *The Reporting Entity*. We support this omission, but suggest the Board address those proprietary funds that previously chose to adopt FASB Statement No. 142, *Goodwill and Other Intangible Assets*, using the paragraph 7 election in GASB Statement No. 20. Under FASB Statement No. 142, goodwill is not amortized. However, if the final Statement includes the requirement in paragraph 212(b) of the ED to report the difference between the cost of an investment and the amount of underlying equity in net assets of an investee as goodwill that would be amortized in a systematic and rational manner, there will be a resulting accounting change. The Board should acknowledge this in the final Statement and provide guidance for reporting the change in accounting.
 3. Paragraph 19(g) of APB Opinion No. 18 was brought into paragraph 212(f) of the ED as follows, "If financial statements of an investee are not sufficiently timely for an investor to apply the equity method currently, the government should record its share of the earnings or losses of an investee from the most recent available financial statements." We noted that APB Opinion No. 18 says "ordinarily should" while the ED says "should" and we were unclear why ordinarily was deleted. The Board should clarify its intent with this change.
 4. Paragraph 212(g) of the ED states,

"A loss in value of an investment that is other than a temporary decline should be recognized the same as a loss in value of other long-term assets. Evidence of a loss in value might include, but would not necessarily be limited to, absence of an ability to recover the carrying amount of the investment or inability of the investee to sustain an earnings capacity that would justify the carrying amount of the investment. A current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment. However, a decline in the quoted market price below the carrying amount or the existence of operating losses is not necessarily indicative of a loss in value that is other than temporary. All are factors that should be evaluated."

Since the underlying FASB literature relevant to this concept (i.e., FASB Statement No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*, and predecessor FASB statements) is not incorporated into the ED or GASB standards, we question what guidance would apply (e.g., would it be possible to apply GASB Statement No. 42?). It also might be possible to correct the gap in this guidance by striking the phrase "the same as a loss in value of other long-term assets" from the first sentence leaving the sentence to read, "A loss in value of an investment that is other than a temporary decline should be recognized." We suggest the Board either address this gap in the literature or clarify the applicable guidance for this concept.

5. Paragraph 212(k) deletes the APB Opinion No. 18 requirement to adopt the equity method by reporting the investment, results of operations (current and prior periods presented), and retained earnings of the investor by adjusting retroactively in a manner consistent with the accounting for a step-by-step acquisition of a subsidiary. We question the meaning of this change. Without better understanding what is intended, we are not able to provide further comment. We recommend that the Board consider the impact of this change and explain it in the final Statement.
6. Paragraph 212(l) of the ED states, "The carrying amount of an investment in common stock of an investee that qualifies for the equity method of accounting as described in subparagraph (k) may differ from the underlying equity in net assets of the investee. The difference should be accounted for as goodwill and amortized in a systematic and rational manner." We question this guidance in light of certain guidance in GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. Paragraph 3(a) of GASB Statement No. 51 currently scopes out goodwill created through assets acquired or created primarily for the purpose of directly obtaining income or profit. Additionally, paragraph 3(c) of GASB Statement No. 51 scopes out goodwill created through the combination of a government and another entity. With the inclusion of the guidance in paragraph 212(l) there will be a difference in accounting for goodwill based on the nature of acquisition. This is not a good outcome. We encourage the Board to address this issue in the final Statement and also to address the concept of goodwill in its entirety in the Board's Government Combinations project.

Leases.

1. We strongly encourage the Board to take on a project to reexamine lease accounting. Leases are a very common transaction for governments and have evolved considerably since the 1976 issuance of FASB Statement No. 13, *Accounting for Leases*.
2. We noted that paragraph 214 of the ED which discusses arrangements to which the standard would not apply did not incorporate license agreements for motion picture films and plays. We question why these items were deleted as higher education institutions may have such items. The Board should address why this matter was omitted.

3. Paragraph 216(d) of the ED discusses criteria for classifying leases and provides insurance and maintenance as examples of executor costs, but omits taxes as an example which was included in paragraph 7(d) of FASB Statement No. 13. We do not understand how this deletion improves the proposed Statement and ask the Board to clarify it.
4. We found the language regarding when a lease should be classified as an operating lease in paragraph 217 confusing. The second sentence of paragraph 217 states, "if the lease at inception meets any one of the four criteria in paragraph 216 and in addition meets both of the following criteria, it should be classified as a sales-type lease, a direct financing lease, a leveraged lease, or an operating lease as appropriate under paragraph 215(b)." The third sentence of paragraph 217 then states, "If the lease does not meet any of the criteria of paragraph 216 *or both of the following criteria*, the lease should be classified as an operating lease." This may cause confusion in situations where a lease fails to meet any of the criteria in paragraph 216, but meets both the criteria in paragraph 217. We believe the intent would be to classify a lease as operating in this scenario but the Board should clarify this point.
5. Paragraph 226 of the ED discusses disclosures related to leases. We recommend that the disclosures discussed in 226(a) and 226(d) be combined as they both relate to recording the leased asset.
6. We noted that paragraph 227(f) of the ED refers to direct financing leases discussed in paragraph 228. This reference appears to be in error and should be changed to paragraph 229 where direct financing leases are addressed.
7. We question whether the guidance in paragraph 242 of the ED that interest in an investee should be accounted for using the equity method would extend to interests in component units that would be reported if the proposed revisions to GASB Statements No. 14 and No. 34 are adopted. The Board should consider this in light of the recent exposure draft on the Financial Reporting Entity and clarify the related guidance in the ED.
8. We noted that in the required disclosures for sale-leaseback arrangements that the FASB Statement No. 98, *Accounting for Leases* (paragraph 18(a)) requirement to disclose the obligation for future minimum lease payments as of the date of the latest balance sheet presented in the aggregate and for each of the five succeeding fiscal years was omitted. We noted that a similar disclosure requirement in paragraph 16(a)(ii) of FASB Statement No. 13 was not carried forward because the Board determined it conflicted or contradicted paragraph 11 of GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. We recommend that the Board revise Appendix D to similarly provide the rationale for the exclusion of the requirement in paragraph 18(a) of FASB Statement No. 98.
9. We noted that the definition of "Fair Value of the Leased Property" in paragraph 274 of the ED changed the definition from FASB Statement No. 13 paragraph 5(c) to incorporate the term "willing parties" instead of "unrelated parties" in the original

standard. We do not understand the reason so we are not able to comment specifically whether we support it. We recommend that the Board provide further clarification and to address its rationale for this change.

10. In the definition of "Minimum Lease Payments" in paragraph 274 of the ED, subpart b. of the definition refers to "(1) above." We believe, after reviewing FASB Statement No. 13, that the reference should be to "(a) above."
11. The definition of "Unguaranteed Residual Value" did not carry the reference to the definition of "Estimated Residual Value of Leased Property" as in FASB Statement No. 13. The definition of "Estimated Residual Value of Leased Property" did not include the reference to the definition of "Lease Term" as in FASB Statement No. 13. The Board should provide the rationale for making this change as the various definitions need to be understood together. Readers may be confused by the lack of cross-referencing.
12. We noted that in incorporating FASB Statement No. 13, the Board modified the terminology to omit the possessive "his." Please note that in the penultimate sentence of paragraph 216(d) of the ED an instance of "his" remains.

Sales of Real Estate.

1. While sales of real estate is a frequent event for some governments (e.g., tribes) we think that the approach to revenue recognition on the sale of real estate in this section may be too extensive and complicated for the government environment considering the government's reporting objectives. Further, the applicability and infrequent occurrence of the criteria documented in paragraph 289 (b)-(d) of the ED and the related detailed paragraphs unnecessarily increase the complexity of these types of transactions. We recommend eliminating this guidance from the final Statement so that it becomes level d guidance in the GAAP hierarchy. Additionally, we recommend that the Board consider a new project on real estate transactions that specifically addresses governmental entities.
2. Paragraph 318 states, "If a buyer is not independent of the seller..." The concept of independence between some governmental entities is not always clear when considering component unit and joint venture guidance. We recommend that the Board consider this paragraph in the context of other GASB guidance and provide additional guidance regarding when entities are considered "not independent."

Costs and Initial Rental Operations of Real Estate Projects.

1. Paragraph 361 of the ED refers to the concept of "operating income (loss)." This appears appropriate for business-type activities. However, this guidance may not be appropriate for government-wide financial statements. We recommend adding the distinction between business-type activities and government-wide statements of activities.

2. Paragraph 365 of the ED states, "Real estate donated to other governmental entities...." We recommend the language to be changed to "Real estate donated to other entities...."
3. On page 464 of the ED, paragraph 13 of FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects* is deleted citing a conflict with GASB Statement No. 42. We believe that GASB Statement No. 42 does not consider abandonment and recommend that the Board reconsider this omission or clarify how GASB Statement No. 42 relates to abandonment.

Mortgage Banking Activities

1. In adapting FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*, the guidance refers only to mortgage loans and deletes references to mortgage-backed securities. For consistency, we suggest that "or security" in the third line of paragraph 459 of the ED be deleted.
2. The term "servicing" is defined in paragraph 478 of the ED. The definition deleted the notion of collecting escrow deposits for the payment of mortgagor property taxes. We do not understand this deletion because servicing includes collecting escrow deposits for the payment of taxes, not only insurance. Further, the definition in the ED includes paying taxes when due, so we are not clear why collecting for tax payments would be deleted.

Regulated Operations

1. In reading this section, beginning in paragraph 479, we were confused as to the meaning of the term "regulator." For example, does the Board intend a regulator to include the price setters? Is there a definition that can be included to clarify this?
2. Paragraph 497 of the ED uses the term "major cost" in the third sentence and we were unclear of its meaning. The Board should provide clarification.

Terminology

This comment provides additional detail regarding our comment in the section of this letter titled, "Overarching Comments and Recommendations" regarding the use of terminology in the ED not commonly used in GASB literature that we suggest be changed to be more consistent with GASB literature.

1. *Sale versus Exchange.* We believe that references to a sale transaction should be changed to an exchange transaction to governmentalize the terminology in the proposed Statement. We noted this especially in the section titled, *Revenue Recognition when Right of Return Exists*. Please see paragraphs 24, 25, 26, 27 and 28. We suggest the Board evaluate the use of "sale" and consider changing to "exchange" to be more consistent with existing GASB literature.
2. *Seller versus Government.* Paragraph 26 in the section titled, *Revenue Recognition when Right of Return Exists*, uses the word, "seller." We believe "government" would be more consistent with existing GASB literature.

3. *Sales Revenue and Costs of Sales versus Revenue and Costs Associated with the Exchange.* Paragraphs 26 and 27 in the section titled, *Revenue Recognition when Right of Return Exists*, state, “Sales revenue and cost of sales...” We believe “Revenue and costs associated with the exchange...” would be more consistent with existing GASB literature.
4. *Property Plant or Equipment versus Capital Assets.* We noted that the ED used the term “property plant or equipment” (for example, in paragraphs 49 and 54 of the ED). We recommend that this term be replaced throughout the document with “capital assets” to be more consistent with GASB literature.

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The AICPA appreciates the opportunity to comment on the ED. Due to the comprehensive nature of this ED, this comment letter was prepared by members of the AICPA’s State and Local Government Expert Panel and was not reviewed by the AICPA’s Financial Reporting Executive Committee. Therefore, this response represents only the views of individual members of the State and Local Government Expert Panel and is not an official position of the AICPA. Representatives of the State and Local Government Expert Panel would be pleased to discuss these comments with you at your convenience.

Sincerely,



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Chair
AICPA State and Local Government
Expert Panel



Mary M. Foelster
Director
AICPA Governmental Auditing and
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cc: State and Local Government Expert Panel
Dan Noll