



April 26, 2018

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 4-6I
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 (SLGEP) have reviewed the Governmental Accounting Standards Board (GASB) Invitation to Comment (ITC), *Revenue and Expense Recognition*, and are pleased to offer our comments. Our comments also reflect the views of the AICPA Health Care Expert Panel (HCEP) who assisted with the development of this response.

We appreciate the Board taking on this project and support the Board's intention to create a comprehensive model for revenue and expense recognition. After reading and discussing the options presented in the ITC, we support the alternative model presented in Chapter 4, "Alternative Models" which is further described in the next section of this letter.

Overall Position

We believe that the alternative model described in Chapter 4 is the best approach for revenue and expense recognition because governmental funding intuitively falls into the exchange and nonexchange categories. There are fundamental differences between transactions designed to exchange goods and services of relatively equal value from the one-sided nature of nonexchange transactions. Therefore, we support providing distinct guidance for exchange and nonexchange transactions as a first step in the recognition process. Replacing the current recognition approach for revenues and expenses classified as exchange transactions with a performance obligation recognition approach is appealing for various reasons including the fact that it will increase the alignment with other standard setters' recognition approaches for exchange transactions. In particular, this alignment for exchange transactions was very important to our HCEP members due to its similarity to the model that will soon be used by private sector health care entities under the jurisdiction of the Financial Accounting Standards Board (FASB). While we believe modifications are needed to address current practice challenges with GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, we support leveraging the existing guidance

for nonexchange transactions within a future recognition model. See our response to Question 4.1 below for our additional thoughts on the Chapter 4 alternative model.

Chapter 2—Exchange/Nonexchange Model

The exchange/nonexchange model would classify revenue and expense transactions based on whether a transaction is considered exchange or nonexchange. If the transaction is an exchange, revenue or expense would be recognized based on an earnings recognition approach. If the transaction is a nonexchange, revenue or expense would be recognized based on the provisions of Statement 33, as amended.

2.1. Do you believe the exchange/nonexchange model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?

In our view, the classification of transactions as exchange/nonexchange is appropriate as discussed in our support for the alternative model. However, our primary concern with the exchange/nonexchange model relates to the earnings recognition for exchange transactions and the fact that GASB would be taking an approach to further develop exchange transaction guidance that would substantially differ from other standard setters. Taking an approach for exchange transactions that is consistent with other standard setters (that is, a performance obligation model) is particularly important for governments that have private sector counterparts where investors and analysts are often focused on evaluating revenue metrics.

Chapter 3—Performance Obligation/No Performance Obligation Model

The performance obligation/no performance obligation model would classify revenue and expense transactions on the basis of whether a binding agreement contains one or more performance obligations. If the transaction contains a performance obligation, revenue or expense would be recognized following the performance obligation recognition approach. If the transaction does not contain a performance obligation, revenue or expense would be based on the provisions of Statement 33, as amended.

3.1. Do you believe the performance obligation/no performance obligation model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?

As stated earlier, our strong preference is for the alternative model. With regard to the performance/no performance obligation model, it does have several positive attributes that may be viewed by some as providing a suitable basis for classifying transactions and recognizing revenue and expense. For example, this model would entail a single principle-based model which may provide simplicity in understanding. It would also increase the focus of performance obligations in the financial statements, which some users may find more meaningful.

However, we believe the challenges associated with this model overcome these positives. First, the application of this model to existing nonexchange transactions, which are predominant in governments, is a burden that would outweigh the benefit of conceptual consistency. As compared with current requirements, this model would require much more significant analysis of individual agreements and transactions, which may also require further bifurcation depending upon the specific provisions of each agreement (for example, state shared revenues and certain other revenues that can currently be considered simply nonexchange.) This will be a challenge for many governments and lead to inconsistency in application.

Second, this model introduces additional complexity in analyzing transactions currently classified as nonexchange transactions which is not ideal. We understand the intent of the Board is to categorize imposed and derived nonexchange revenues as transactions with no performance obligation, thus recognition for such transactions would continue to be under GASB Statement No. 33. However, government mandated nonexchange and voluntary nonexchange transactions will need to be analyzed based on specific facts and circumstances to determine whether there is a performance obligation. This determination will be primarily based on the existence of a specific beneficiary. We believe this factor alone should not drive differences in revenue recognition for these categories of transactions. Grant arrangements (voluntary nonexchange transactions) may be classified as having a performance obligation if the grant cites a specific beneficiary or as having no performance obligation if the grant benefits the general public. Conceptually, we do not believe there should be two different accounting treatments for very similar types of transactions. Furthermore, distinguishing when a transaction benefits “the government” or “a group of beneficiaries” versus “the general public” is a judgmental determination which could result in differences in practice. Thus, we recommend the Board develop a more definitive definition or notion of specific beneficiary if it proceeds with this approach to promote consistency in understanding and application.

Additionally, our HCEP members are very concerned about applying this model to governmental health care entities because the industry has a system based largely on third-party payers. Therefore, there is a potential for health care revenue transactions to be treated as grants (third-party payer purchasing services on behalf of patients) which is inconsistent with the substance of the transaction.

Chapter 4—Alternative Models

Other alternative revenue and expense recognition models could be suitable for governments.

4.1. Do you believe that the alternative model presented as an example in Chapter 4 could provide a suitable basis for classifying transactions and recognizing revenue and expense? If so, what are the potential benefits and challenges of that model?

As discussed previously, we believe that the alternative model provides the most appropriate basis for classifying transactions and recognizing revenue and expense and represents the model the majority of our members favored. One of the main reasons for our support relates to the fact that

nonexchange transactions comprise the majority of governments' revenues. Although improvements are needed to GASB Statement No. 33, we strongly support the continued classification of nonexchange transactions in the government environment. Additionally, the application of an initial exchange/nonexchange decision achieves simplicity and consistency with existing guidance. On the exchange transaction side, applying the performance obligation notion addresses the gap in existing standards while increasing alignment to other standard setters. While we acknowledge there may be challenges in distinguishing between exchange and nonexchange transactions, these can be overcome with the development of additional guidance, similar to that which FASB is currently considering. If this model is adopted, we encourage the Board to develop additional guidance to address issues encountered in making the exchange/nonexchange determination. Such guidance should include the proper characterization of grants as voluntary nonexchange or exchange transactions and distinguishing between conditional and unconditional contributions.

While one of the advantages of this approach is convergence with other standard setters in applying the performance obligation model to exchange transaction, we noted that the definition of performance obligation in the ITC differs slightly from other standard setters' definitions. If this model is adopted, we suggest the Board align the definition and recognition criteria to other standard setters' guidance unless there are compelling reasons to diverge.

4.2. The models distinguish transactions on the basis of (a) exchange or nonexchange or (b) a performance obligation or no performance obligation. Do you believe there is another alternative for distinguishing revenue and expense transactions? If so, please describe that alternative and explain why you believe it would be suitable.

We do not have other alternatives to present at this time.

Other Comments Relevant to Health Care Entities

Evaluating Binding Agreement Versus Contract. The HCEP has spent the last several years analyzing how health care revenue transactions fit within the type of performance obligation model articulated in the ITC. Certain characteristics of the hospital industry and the nature of health care services initially appeared to pose challenges to application of the model. For example, services are not often voluntarily requested, the provision of services (treatment) is often complete before determining the payment source, and services are often provided to patients who may be unable (or in some cases, unwilling) to pay. The most challenging aspects are evaluating whether a binding agreement/contract exists and determining the amount of consideration expected. The HCEP resolved these difficulties by building out concepts of "implied price concessions" and portfolios of similar contracts. It is possible that these concepts could be useful as the Board further considers the performance obligation model to the broader notion of all governments. If the staff or Board would be interested in learning more about the approaches developed, representatives of the HCEP would be happy to have further discussions.

Additional Considerations Regarding Bundling. As this project progresses, we suggest the Board consider additional factors to consider when determining whether to bundle performance obligations. Chapter 3 of the ITC indicates that goods and services should be bundled if they are

not separately identifiable or they do not provide benefit on their own. However, we believe there are scenarios where it would make sense for separately identifiable goods and services that are capable of providing benefit on their own to be bundled. Consider a knee replacement example provided by our HCEP members to support this point. Within the larger process of a knee replacement there are separately identifiable goods or services that benefit the patient individually (for example, prescription drugs) and are part of the single performance obligation (that is, the knee replacement). In this scenario, it would seem bundling would be most appropriate even though separately identifiable goods and services provide benefit on their own.

Maintain and Expand Graphics. We found the graphics included in the ITC to illustrate the various models very helpful. Thus, we encourage the Board to maintain these graphics in future due process documents, as well as expand upon them.

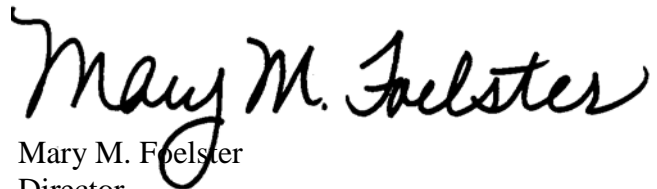
* * * * *

The AICPA appreciates the opportunity to comment on the ITC. This comment letter was prepared by members of the AICPA's SLGEP with input from the AICPA's HCEP and was reviewed by representatives of the Financial Reporting Executive Committee who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,



Heather S. Acker
Chair
AICPA State and Local Government
Expert Panel



Mary M. Foelster
Director
AICPA Governmental Auditing and
Accounting

cc: State and Local Government Expert Panel
James Dolinar
Dan Noll