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Mr. David R. Bean
Director of Research and Technical Activities
Project No. 3-17
Governmental Accounting Standards Board
401 Merritt 7
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Norwalk, CT 06856-5116

Dear Mr. Bean:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Governmental Accounting Standards Board (GASB) Exposure Draft (ED), *Government Combinations and Disposals of Government Operations,* and is pleased to offer its comments. While we generally support concepts proposed in the ED, we do have several significant comments and recommendations for the Board's consideration in the following section of this letter.

SIGNIFICANT COMMENTS AND RECOMMENDATIONS

Identifying Government Combinations – Service Continuation

Paragraph 9 of the ED states that one of the conditions for an arrangement to be considered a government combination is that it should result in the continuation of the services provided by the separate entities or their operations after the government combination has occurred. It also states that the specific provisions of an arrangement may not clearly indicate whether services will continue and that professional judgment may be required to determine if a government combination has occurred. We understand that the Board is intending for this Statement to provide a principles-based approach for identifying government combinations that is based on the notion of service continuation. However, we are concerned that without further guidance and insight from the Board on the principle of service continuation, preparer interpretations may vary widely and lead to inconsistent application.

For example, there are several scenarios in which we are unclear about whether the service continuation condition would be met, including the following:

- A combination of a privately owned business into a government when the contract terms specify financial and legal terms of the arrangement, but do not stipulate an obligation or responsibility to continue services.
- Situations where the acquiring government repurposes the asset. For example, an acquisition of a private golf course which is then repurposed to a park. The Board

should address whether the specific service previously provided would need to be continued in order for the arrangement to be included in the scope of this standard.

- Instances in which only certain functions and services are continued. For example, if a government acquires a not-for-profit entity that previously provided multiple functions would the service continuation condition be met if only a portion of the previous functions are continued?

Further, paragraph 72 of the Basis for Conclusions never clearly explains why the Board selected service continuation as the precondition for an arrangement to be considered a government combination, nor why it believes that post-acquisition decisions should affect the accounting. Such information would provide key insight to preparers and auditors when applying judgment regarding whether a government combination has occurred and would promote more consistency in practice. The Board should expand the concept in paragraph 72 to better articulate the principle and consider whether the expanded guidance should be in the Basis or the final Standard.

Treatment of Assumption of Obligations to Outside Parties as Consideration

Paragraph 100 of the ED states that in the Board's deliberations about consideration, the assumption of the liabilities of an acquired organization was discussed as a form of consideration. For purposes of this Statement, the Board concluded an assumption of liabilities does not constitute consideration provided, signifying that a government acquisition has taken place. The Board states that to conclude otherwise would result in acquisition accounting for any combination in which the liabilities assumed exceed the assets acquired. We disagree with the Board's conclusion in this area specifically as it relates to the assumption of obligations to outside parties. Instead, we believe that relief of obligations to outside parties (e.g., notes or bonds payable) provides value to an acquired organization and should be deemed consideration. We ask the Board to reconsider the conclusion described in paragraph 100 in terms of the assumption of an acquired organization's obligations to outside parties, rather than the broader concept of liabilities.

Definition of Consideration Lacking

The concept of consideration is not well defined in the ED. This is a significant issue in light of the importance of the concept as to whether a transaction is considered a merger or an acquisition. We were also confused by the discussion in paragraph 101 of the ED regarding the necessity of a quantitative measure of consideration and how or whether qualitative factors would be considered. The Board should provide a more detailed discussion of this concept in the Basis for Conclusions to improve the understanding of what should be regarded as consideration.

Considering Transactions When Legal Separation is Maintained

Paragraphs 10-11 of the ED specify that the standard applies only when merged or acquired entities cease to exist as separate legal entities. It has been our experience that acquired or merged entities sometimes retain their legal separation solely for risk management purposes. We assume that the Board's intent would be for these situations to be accounted for in accordance with GASB Statement No. 14, *The Financial Reporting Entity*

and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which differ from the guidance described in the ED. In these cases, we believe that the substance of these transactions is not significantly different from the substance of transactions defined as mergers or acquisitions in the ED where legal separation ceases. As a result, we are very concerned that the guidance in the ED will result in similar transactions being accounted for in different ways, depending on whether or not separate legal status is maintained. Further, we are concerned that governments will be able to influence the accounting for a transaction based on whether it maintains or dissolves legal separation. We understand from discussions with GASB staff that an amendment to GASB Statement Nos. 14 and 61 would be required to address this issue. Accordingly, when this Statement is finalized, we recommend the Board undertake a project to examine whether retention of legal separation of acquired or merged entities warrants different accounting and financial reporting under GASB Statement Nos. 14 and 61 and the proposed guidance for government combinations.

Clarification of New Term: Market-Based Entry Price

Paragraph 32 of the ED states that, "For purposes of this Statement, acquisition value is a market-based entry price. An entry price is assumed to be based on an orderly transaction entered into on the acquisition date. Acquisition value represents the price that would be paid for acquiring similar assets, having similar service capacity, or discharging the liabilities assumed as of the acquisition date." We question the meaning of the new term "market-based entry price" within the definition of acquisition value. The current GASB literature already references the terms "fair value" and "market value" and we are not clear how the new term relates to these terms. Instead of introducing the term "market-based entry price," we recommend the Board use an existing term, such as market value. If the Board continues the use of the term "market-based entry price," we recommend that a more thorough definition be provided to assist preparers in differentiating it from similar terms already in the literature.

Exception to the Use of Acquisition Value

Paragraph 33 of the ED provides an exception to the use of acquisition value. It requires the acquiring government to measure liabilities (and assets, if any) related to the acquiree's employment benefit arrangement using the accounting and financial reporting requirements for state and local governments that are applicable to those transactions to the extent such benefits are not terminated. Paragraph 37 states that the consideration provided by the acquiring government should be measured at the acquisition date as the sum of the values, as determined in conformity with paragraphs 32–36, of the assets remitted (generally, cash) or liabilities incurred to the former owners of the acquired entity. We are unclear in the exception being provided for in paragraph 33 whether the consideration would be measured against the net pension obligation (currently recorded as a liability) or the unfunded actuarial accrued liability (currently presented in the notes to the financial statements). We suggest the final Statement be more specific in this regard.

Consideration and Negative Net Position of an Acquiree
Paragraph 37 of the ED states that negative net position of an entity recognized in a government merger or a transfer of operations that does not include the exchange of significant consideration (a net liability assumed by the combined government) does not constitute consideration given for purposes of this Statement. We are unclear about the meaning of this sentence but assume it is trying to say that in determining whether consideration is present, negative net position is not a factor. If we are correct, we suggest the Board state more clearly that if an entity is obtained without payment for assets (or assumption of obligations to outside parties—see comment on page 2) that the combination is a merger. If we are not correct, we recommend the Board modify the sentence to more clearly articulate the Board's intent.

Accounting When Consideration Provided is Less than the Net Position Acquired
Two options are discussed in paragraphs 40-41 to address scenarios in which consideration provided is less than the net position acquired. They include: 1) eliminating the excess net position by reducing values assigned to noncurrent assets; and 2) recognizing a contribution for circumstances in which the seller intends to accept a lower price in order to provide economic benefit to the acquiring government without directly receiving equal value in exchange. It goes on to say that the provisions of an arrangement should indicate whether economic aid is intended. While we acknowledge that the second option is the more theoretically sound of the two options provided, we are concerned that basing the contribution option on the concept of intent could lead to inconsistencies in practice. Thus, adding examples of how seller intent should be considered would promote consistency in practice and help constituents understand which option should be used in which situations (for example, whether the second option would always be used when the seller intends to provide economic benefit).

Differing Levels of Disclosures
Paragraphs 54-56 of the ED discuss the various disclosure requirements. We are unclear why the required disclosures for an acquisition are different than those for a merger or transfer of assets. We also question whether the level of detail required for mergers and transfers, which appears to be far more than for acquisitions, is really needed. We recommend the Board align the disclosure requirements for all types of combinations or provide an explanation in the Basis for Conclusions to support why the Board believes more detailed disclosure is needed for certain combinations.

Clarification on Guidance Related to Recognition of Previous Acquisition Transactions
In reading the ED, we initially noted an inconsistency in paragraphs 31 and 36 of the ED in how the acquirer should account for deferred outflows of resources previously recorded by the acquiree. Paragraph 31 states, "Amounts recognized by the acquiree from previous transactions as deferred outflows of resources (or goodwill by a nongovernmental entity) for circumstances in which the consideration provided exceeded the net position acquired should not be recognized by the acquiring government." Paragraph 36 indicates that deferred outflows of resources and deferred inflows of resources should be measured at the carrying values previously reported by the acquired government, except for those that

relate to effective hedging arrangements. Upon closer review of the ED, we understood the accounting treatment for these varying situations do not conflict. We suggest the Board address how to record deferred outflows of resources and deferred inflows of resources in one section to try to clarify the appropriate treatment and avoid potential confusion. One suggestion would be to address the topic as follows:

> Deferred outflows of resources and deferred inflows of resources should be measured at the carrying values previously reported by the acquired government, except for the following two instances:
>
> a. Deferred outflows of resources (or goodwill by a nongovernmental entity) recorded by the acquiree that resulted from previous acquisitions in which the consideration provided exceeded the net position acquired. These amounts should not be recorded by the acquiring government.
> b. Deferred outflows or inflows of resources that relate to effective hedging arrangements as provided for in paragraph 20 of Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Those deferred outflows of resources and deferred inflows of resources should be adjusted to reflect the difference between the acquisition value and the carrying value of acquired hedge items. Any remaining deferred outflows of resources or deferred inflows of resources should be accounted for by the acquiring government in conformity with the provisions of paragraph 22 of Statement 53.

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The AICPA appreciates the opportunity to comment on the ED. This comment letter was prepared by members of the AICPA's State and Local Government Expert Panel 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,

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Chair
AICPA State and Local Government
Expert Panel

Mary M. Foelster
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cc: State and Local Government Expert Panel
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