American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004

November 28, 2011

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 3-23
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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), *Reporting Items Previously Recognized as Assets and Liabilities,* and is pleased to offer its comments. The stated objective of the ED is to reclassify certain items reported as assets and liabilities to deferred outflows of resources or outflows of resources or deferred inflows of resources or inflows of resources in light of definitions of these terms established in GASB Concepts Statement No. 4, *Elements of Financial Statements*.

While this letter provides our feedback on the various reclassifications proposed by the Board, we would like to reiterate concerns expressed in our prior comments on GASB Concepts Statement No. 4 and other related due process documents regarding the deferred outflows of resources and deferred inflows of resources elements. After reviewing this ED, our previous concerns are increased and center around two major themes—a lack of clarity with the underlying element definitions and the addition of needless complexity to the governmental financial reporting model. Our thoughts on both of these areas are discussed in the following paragraphs.

The lack of clarity surrounding the definitions of the deferred outflows of resources and deferred inflows of resources elements continues to be problematic when applying them to actual transactions. This is evidenced by our detailed comments in the following section of this letter where, using the same definitions that the Board established in GASB Concepts Statement No. 4, we reached different conclusions on whether certain transactions should be reclassified. In other situations, the lack of clarity in the definitions resulted in an inconsistency in the Board's own conclusions regarding whether certain reclassifications should be made. An example of this inconsistency is the Board's conclusion that debt issuance costs would be recognized immediately as an expense and yet an advance refunding would result in a deferral and amortization of cost as a component of interest expense. We challenge whether the differing result between these two transactions makes sense in light of their underlying nature. However, the Board states in paragraph 73 that it felt compelled to treat debt issuance costs in the manner proposed due to the definition of deferred outflows of resources. We also continue to believe the deferred outflows of resources and deferred inflows of resources elements and the potential inconsistencies that will exist as a result of their use will add more complexity than benefit to governmental financial reporting. Even with the limited nature of the current transactions that are being treated as deferred outflows of resources and deferred inflows of resources, our experience with financial statement preparers and users provides strong evidence that they are challenged in understanding these elements.

For all of the reasons cited above, we are again led to encourage the Board to give strong consideration to removing the deferred outflows of resources and deferred inflows of resources elements from the Board's conceptual framework. If this is not an acceptable alternative, we highly recommend that the Board attempt to further refine the definitions to achieve a better understanding and consistency surrounding when a transaction is an asset or liability versus a deferred inflow of resources or deferred outflow of resources. Finally, without regard to whether the Board accepts either of these recommended actions, we believe that the Basis for Conclusions should be expanded to better articulate and support the Board's rationale for deciding a reclassification is necessary and appropriate.

Our significant comments and recommendations are included in the following section of this letter and our other comments are in the "Other Comments and Recommendations" section below.

SIGNIFICANT COMMENTS AND RECOMMENDATIONS

Accounting for Costs/Fees Associated with Various Debt Instruments

We disagree with the ED's proposed changes in the accounting treatment for the following cost/fee components associated with various debt instruments: refundings of debt; debt issuance costs; initial direct costs of operating leases; acquisition costs related to insurance activities; loan origination fees and costs; purchase of a loan or groups of loans; and mortgage banking activities. Our strong recommendation is that the Board not move ahead with any of the proposed reclassifications in the ED for these costs/fees. Current practice for these types of transactions is generally to defer these costs/fees and amortize/recognize over the life of the debt instrument. However, the Board's approach in this ED was to generally separate out the various cost/fee components associated with debt from the underlying debt transaction itself. The result of this, in many instances, would be to recognize the costs/fees either as an outflow/inflow in the current period or as a deferred outflow of resources or deferred inflow of resources.

We disagree with the Board's approach because we believe that, for the most part, the various cost/fee components are inseparable from the debt itself. Further, we believe upfront recognition of these costs/fees as outflows/inflows of resources distorts the true cost of the debt instrument. For example, separating recognition of debt issuance costs from the interest costs results in an inconsistent treatment, especially when the debt issuance costs directly result in a more favorable interest rate. The Basis for Conclusions often cites the Board's view that the costs/fees do not benefit a future period as the reason for recommending a reclassification. However, we believe this is too narrow a view since the purpose of issuing debt is to spread costs over future periods and these costs differ from operating costs as they are directly associated with an item of longer-term focus.

Finally, we disagree with the Board's conclusion that recognizing the balance of certain items (e.g., initial debt issuance costs, direct costs of operating leases, etc.) over the life of the debt instrument is contrary to the concept of interperiod equity as defined in GASB Concepts Statement No. 4. We believe these costs/fees are integral to negotiating the terms and conditions of the various debt instruments and a key part of management's decision to incur the debt. In our view, they are an extension of the debt instrument itself and recognizing them in the period incurred would fail to properly reflect interperiod equity and would distort the operation results in the period the transaction occurs.

Challenges with Evaluating Likelihood of Third Party Actions Regarding Commitment Fees

Paragraph 23 of the ED states that fees received for a commitment to originate or purchase a loan or group of loans would typically be recorded as a liability (e.g., unearned revenue) and, if the commitment is exercised, would be recognized as revenue in the period of exercise. If the commitment expires unexercised, it would be recognized as revenue upon expiration. We support this treatment. However, we disagree with the alternative treatment in paragraph 23a of the ED which would require revenue recognition in the period the fees are received if the government's experience with similar arrangements indicates that the likelihood of the commitment being exercised is remote. We question this concept because a government has an obligation to perform until expiration of a loan commitment which is typically at the discretion of a third party. In our view, it would be difficult for government officials responsible for the performance obligation to determine the likelihood that a third party will ultimately require exercise. Further, we believe it would be inappropriate for a government to ignore its potential responsibility to perform under the term of the commitment when a third party is in control of making the decision regarding exercise of the commitment. We acknowledge that the consideration of whether the likelihood that the commitment will be exercised exists in paragraph 437a of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncement*. However, for the reasons discussed above, we recommend that the Board delete paragraph 23a in the final standard, as well as paragraph 437a of GASB Statement No. 62.

Certain Aspects of Regulated Operations Should Not be Reclassified

Paragraph 29b of the ED would reclassify 'revenue generated by current rates intended to recover costs that are expected to be incurred in the future' from its current treatment as a liability to a deferred inflow of resources. Similarly paragraph 29c would reclassify 'a gain or other reduction of net allowable costs' from its current treatment as a liability to deferred inflows of resources. We reviewed paragraphs 93-98 of the Basis for Conclusions to better understand the Board's rationale supporting the reclassification and were still not convinced that these transactions should be reclassified. This reinforces our overall concern about the lack of clarity in the element definitions and resulting differences in interpretation. In our view, and using the definitions in GASB Concepts Statement No. 4, liability treatment is most appropriate in both instances since the government has a duty to provide services over future periods which involve a sacrifice in resources. Therefore, we disagree with the proposed reclassifications and recommend that the Board delete both paragraphs 29b and 29c of the ED and maintain the current accounting as described in GASB Statement No. 62, paragraph 482.

Guidance on Order of Liquidity and Current/Noncurrent Elements Should be Moved to the Statement
Paragraph 107 of the ED describes the Board's belief that the concepts of liquidity cannot be applied to deferred outflows of resources and deferred inflows of resources. Further, paragraphs 108 and 109 of the ED describe the Board's rationale for concluding that it is not necessary for deferred outflows of resources and deferred inflows of resources to be presented to distinguish between current and long-term. While we agree with these conclusions, they are significant presentation issues that many could overlook if the guidance is only contained in the Basis for Conclusions. We recommend that the Board consider moving it to the standard section in the final standard to ensure that there is consistency in practice going forward.

OTHER COMMENTS AND RECOMMENDATIONS

GASB Should Revisit Criteria for Sales of Future Revenues in GASB Statement No. 48
As we discussed the provisions of paragraph 12 of the ED on the sales of future revenues, our conversation was dominated by practice issues practitioners currently experience with GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Asserts and Future Revenues.* We decided to take this opportunity to inform the Board about these issues. When the Board exposed GASB Statement No. 48 for comment, we expressed concerns regarding a lack of clarity regarding the criteria (specifically that of active participation in future generation of revenue) to determine whether the transaction should be treated as a sale versus collateralized borrowing treatment. Paragraphs 8 and 9 of GASB Statement No. 48 discuss the criteria necessary to treat a transaction as a sale of future revenue versus a collateralized borrowing. One of the criteria for treatment as a sale is that the transferor government does not maintain an active involvement in the future generation of the revenues. Despite the Board's efforts to clarify the distinction between active and passive involvement in the final standard, there remains confusion among preparers and inconsistent application. The lack of consistency is significant in fund financial statements prepared using the modified accrual basis of accounting, as a sale is considered a liability (or deferred inflow of resources under this ED) and a borrowing as revenue, which is often the preferred treatment by governments. We recommend that the Board consider addressing the criteria for treatment as sale or collateralized borrowing in a future amendment to GASB Statement No. 48.

Education Will be Needed on Effect of Reclassifications on Working Capital Calculations
Reclassifying certain assets and liabilities to deferred outflows of resources and deferred inflows of resources may result in unintended consequences on working capital calculations as they pertain to debt covenants. While we acknowledge the Board has no control over debt covenant measures such as working capital, we suggest that in its education efforts regarding the final standard that the Board include discussion about the potential effect of the reclassifications on working capital calculations and the need for governments to consider whether it would be necessary to renegotiate debt covenants to avoid noncompliance with the covenants in the future. The AICPA will also endeavor to educate its members on the potential impact of the reclassifications contemplated by this standard.

* * * * * * * *

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,

James C. Lanzarotta
Chair
AICPA State and Local Government
Expert Panel

Mary M. Foelster
Director
AICPA Governmental Auditing and
Accounting

cc: State and Local Government Expert Panel
Richard Paul
Dan Noll