

American Institute of CPAs 220 Leigh Farm Road Durham, NC 27707-8110

June 15, 2012

David R. Bean, CPA
Director of Research and Technical Activities
GASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: March 7, 2012 Exposure Draft (ED) of a Proposed Statement of the Governmental Accounting Standards Board, *Government Combinations and Disposals of Government Operations* [Project No. 3-17]

Dear Mr. Bean:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to represent the views of local and regional firms on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the ED and is providing the following comments for the Board's consideration.

GENERAL COMMENTS

TIC is very supportive of this agenda topic. TIC members with governmental clients are addressing combinations of school districts and annexation of townships, as well as disposals and transfers of governmental health care operations in their practices. TIC believes authoritative guidance is needed to mitigate diversity in practice for such transactions.

TIC supports the conclusions reached in the ED, with the exception of the Board's decision to exclude the assumption of negative net position (without the exchange of additional, significant consideration) from the definition of "consideration" in a government acquisition. TIC also has provided suggestions below for including additional guidance and clarifications in the final standard.

SPECIFIC COMMENTS

Consideration—Assumption of negative net position in an acquisition

Paragraph 37 of the ED states:

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.

TIC does not support the notion that consideration can be defined differently depending on the nature of the acquisition or for the purpose of a particular standard. The term "consideration" has always included cash and non-cash forms of payment and its definition should not be changed to achieve a desired accounting outcome. If significant liabilities are incurred in a government acquisition (whether by entering into new debt or by assuming the debt of another government), TIC believes the transaction should be considered a transfer of significant consideration (paragraph 73) and be accounted for as a government acquisition, not a merger. TIC also believes that the excess consideration meets the definition of a deferred outflow or resources since the future expenditures would fulfill the purpose of realizing future economies of scale, cost reductions or efficiencies of providing services (paragraph 105). The excess consideration would not be considered an asset, as would be the case under the FASB standards for business combinations. TIC therefore recommends that the conclusion in paragraph 37 be revised to permit these transactions to be classified as acquisitions.

Requested guidance/clarifications

Transfers/Disposals of Operations to Non-Governmental Entities

Paragraph 12 of the ED states that the guidance on transfers of operations would apply only to transfers to a newly created government or a continuing government. However, TIC believes questions will arise as to the applicability of the proposed standard to transfers and disposals of operations to nongovernmental entities (such as a transfer of a waste management operation from a governmental fund to a for-profit contractor). Paragraph 51 is particularly unclear as to its applicability to nongovernmental transferees, although it implies that a transferor government must recognize the disposal gain/loss even if the transferee is a nongovernmental entity. TIC therefore requests clarification of the scope of the ED to indicate the extent to which the guidance also applies to a transfer or disposal of operations to a non-governmental entity, such as a nonprofit or a for-profit. If other standards are applicable to such transfers/disposals, the scope paragraphs of the final standard should provide cross references to the applicable sections in the GASB Codification.

Clarity of Recognition/Measurement Guidance for New Governments

The text of paragraphs 14 and 16 is almost identical, such that it is difficult to readily distinguish the purpose of the two paragraphs. TIC suggests the two paragraphs be merged or otherwise revised to clarify the applicable recognition and measurement principles for new governments.

Adjusting Carrying Values of Merging Entities Upon the Formation of a New Government

Paragraph 16 stipulates that a new government should measure its financial statement elements based on the carrying values reported in the separate financial statements of the merging entities. The ED also permits adjustments to the original carrying values of one of the merging entities to align differing accounting methods and principles. However, paragraph 18 states that carrying amounts of the merged entities should not be adjusted if the conforming change represents a change in accounting estimate.

TIC suggests the following examples be added to the final standard to provide guidance on the types of conforming issues that need to be considered when a new government is formed and to clarify the difference between changes in accounting estimates (which are accounted for prospectively) and changes in accounting principles (which are accounted for by restating amounts from prior periods):

- a. A change in the service lives of capital assets represents a change in estimate and should only affect depreciation on a prospective basis, not on a retrospective basis.
- b. In some cases, a change in estimate may be inseparable from a change in accounting principle, such as changing the assumptions underlying OPEB liabilities. Although adjusting OPEB liabilities usually involves changing the underlying assumptions (i.e., a change in accounting principles) for one of the entities to align with the other, the change represents a change in estimate brought about by a change in assumptions and would be accounted for as a change in estimate.
- c. The combining governments may follow different capitalization policies for fixed assets. For example, if one entity has as a \$1,000 capitalization threshold and the other has a \$5,000 capitalization threshold, the carrying value of capital assets may need to be revised based on the prevailing policy established for the new government. This type of change would be considered an accounting principle change and would be accounted for by restating the opening balances of the new government accordingly.

Accounting Considerations When the Merger Date Differs From the Beginning of the Continuing Government's Fiscal Year

When the separate identity of a government is terminated as a result of a continuing government merger, TIC believes financial statement users will need a proper trail to identify the break between the new and old entity. In addition, more guidance is needed for the financial statements of the continuing government since the merger is to be retroactively applied to the beginning of its fiscal period. For example, assume a charter school is merged into a public school and assume that the merger date is not the same as the beginning of the district's fiscal year. The two entities may decide prior to the merger that the continuing government will sell, rather than use, the building after the merger. Paragraph 26 of the ED states that the building would be evaluated for impairment but does not provide enough accounting guidance regarding the final financial statements for

the dissolved entity nor the presentation of the related stub period of the merged entity. Guidance is needed to address whether the building should be considered impaired as of the beginning of the fiscal period preceding the merger date or as of the date that the decision to dispose took place.

Definition of Acquisition Value in Government Acquisitions

Paragraph 32 introduces the term "acquisition value," which is defined as the price that would be paid for acquiring similar assets, having similar service capacity, or discharging the liabilities assumed in a market-based exchange as of the acquisition date. This paragraph and the related paragraph 89 do not provide sufficient guidance to distinguish between acquisition value and fair value. TIC was also uncertain how acquisition value differed from the purchase price of the acquired government. TIC suggests that additional guidance be added to further explain the concept of "acquisition value," including the notion of how significant differences between acquisition value and fair value may occur.

Paragraph 33 discusses an exception to the use of acquisition value by the acquiring government related to the acquiree's pension and postretirement assets/obligations. TIC is uncertain what specific liability or obligation should be used in lieu of acquisition value. Under current standards, the liability required to be recorded for pensions or other post-employment benefits is often a fraction of the actuarially determined liability since the amount of any pension liability recognized in the government's financial statements is based, in part, on an amortized portion of the unfunded actuarial accrued liability. Since both figures are known amounts, TIC believes this paragraph should be expanded to provide more guidance as to the specific pension liability that should be recognized in the opening balances of the acquiring government.

Paragraph 36, which discusses the measurement criteria for deferred outflows of resources and deferred inflows of resources in a government acquisition, is unclear as written. Paragraph 36 relies too heavily on references to other GASB standards, which obscures the clarity of the guidance. Moving some of the guidance from paragraph 98 to paragraph 36 may enhance the understanding of this exception to the use of acquisition value. Specific examples in the form of a table may also be helpful in understanding which types of deferred inflows and outflows are brought over at carrying value and which are not.

Disclosures re: Government Mergers and Transfers of Operations

Paragraph 55(a) requires specific financial statement elements to be recognized as of the merger date or the effective transfer date (whichever is applicable). The elements listed are relevant only to the government-wide financial statements, not the fund financial statements. The only place in the ED where this distinction is currently made is in the illustrations. TIC recommends that appropriate language be added to paragraph 55(a) to clarify its applicability and to provide consistency between the illustration and the requirements of the proposed standard.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Karen Kerber, Chair

Karen Kerber

PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees