August 16, 2014

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


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 speak on behalf of local and regional firms and represent those firms’ interests 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 your consideration.

GENERAL COMMENTS

TIC is supportive of the ED and is very pleased that, as part of its re-deliberations on the 2013 Preliminary Views document, the Board has addressed many of the important issues that TIC raised in its October 16, 2013 comment letter. For example, TIC appreciates that the Board concluded that a narrative description of the sensitivity of fair value measurements to changes in unobservable inputs for fair value measurements categorized in Level 3 of the fair value hierarchy should not be required and that the phrase “to procure services for the citizenry” will be deleted from the definition of an investment.

TIC’s comments on this ED address a concern regarding the requirement related to quoted prices provided by third parties, presentation of definitions within the standard, a request for additional guidance on the presentation of the sale of donated securities in the cash flow statement, requests for clarification of certain terms and concepts and a longer transition period before the required effective date.
SPECIFIC COMMENTS

Primary Comment Point—Auditing Quoted Prices Provided by Third Parties

Paragraph 52 states:

Quoted prices provided by third parties, such as pricing services or brokers, may be used if a government has determined that the quoted prices provided by those parties are developed in accordance with the provisions of this Statement.

TIC believes governments will have difficulty complying with the proposed requirement to determine whether the quoted prices provided by third parties have been developed in accordance with the provisions of this Statement. It is unclear how robust the determination needs to be and what documentation would be needed to support the determination. Although paragraph B30 provides the following guidance, TIC believes governments may be unable to gain an understanding of the inputs used by the third parties in developing the quotes:

The same considerations of market volume and orderly transactions apply, and the government should understand the inputs used by the third parties in developing the quotes.

TIC requests that the Board provide practical guidance on complying with the requirement to ensure consistent application of the final standard.

Presentation of Definitions within the Standard

TIC noticed some inconsistencies in the presentation of definitions within the text of the proposed standard. In some cases (e.g., paragraphs 8 and 24), the first time a new term is used it is shown in boldface type, defined within the paragraph and included in the Glossary. In other cases (e.g., paragraphs 9 and 26), new terms are shown in boldface type and defined only in the Glossary. TIC weighed the pros and cons of each convention. Although repetition of each definition within the text of a paragraph the first time it is used will add volume to the standard, TIC appreciated the writing style used in paragraph 8. TIC believes repetition promotes ease of use of the standard and should be used consistently in this and all future standards.

Request for Additional Guidance

Statement of Cash Flows—Presentation Issue

TIC believes the section on the application of fair value to investments should include guidance on the presentation of cash receipts from the sale of donated securities in the statement of cash flows. This has been an issue within the not-for-profit industry where diversity in practice has been noted. In 2012, the FASB issued Accounting Standards

TIC recommends that specific guidance be included in paragraph 71 of the final standard to determine whether cash receipts from the sale of donated securities would be presented as an investing, operating or a financing activity. TIC believes the guidance in ASU 2012-05 would be relevant for governmental, as well as nongovernmental, entities.

Requested Clarifications

Transaction Costs

The ED states that transaction costs are considered when determining the most advantageous market (paragraph 9) for purposes of fair value measurements, but do not enter into the calculation of the price in the principal (or most advantageous) market (paragraph 16). TIC believes many may interpret these two statements as contradictory, which may cause confusion in practice.

TIC had included this issue in its comment letter on the Preliminary Views document and is pleased that the Board has provided guidance in the Basis for Conclusions to clarify the apparent contradiction. However, TIC believes that the explanatory guidance in the Basis for Conclusions may be overlooked since this part of the standard is not included in the Codification. Because this concept is likely to be misunderstood by many preparers and practitioners, TIC recommends that relevant sentences from paragraphs B13-B14 be moved into paragraphs 9 and 16 or into the glossary term for “transaction costs.” For example, the following paragraphs could be substituted for paragraph 16:

The price used in a fair value measurement should not be adjusted for transaction costs. Transaction costs represent the incremental direct costs incurred to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability. Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to a transaction and will differ depending on how a government enters into a transaction for the asset or liability. Therefore, transaction costs relate to the current period and should be reported as an expenditure or expense in that period.

However, transaction costs should be considered to determine the most advantageous market, because the most advantageous market is the one that results in the greatest net benefit to the market participant. A market participant would take into account transaction costs in determining its most advantageous market, in order to maximize income or minimize losses.
Unobservable Inputs and Observable Market Data

The last sentence of paragraph 21 is very confusing as written:

After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, a government should ensure that those valuation techniques reflect observable market data (for example, the price for a similar asset or liability) at the measurement date.

TIC did not understand how a government could ensure that valuation techniques reflect observable market data if the valuation technique measured fair value using unobservable inputs. TIC realizes that this sentence is derived from FASB ASC paragraph 820-10-35-24C and that the Board is trying to maintain consistency with the FASB’s fair value standards. Therefore, if the Board decides not to revise the above sentence, TIC recommends adding an example of how this would be accomplished. Without such clarification, confusion in practice will result.

Definition of Blockage Factor

Paragraphs 29, 38 and B22 discuss a blockage factor, but the term is not defined either within the standard or in the glossary of the ED. Paragraph B22 includes a brief definition, but it would not be included in the GASB Codification when the proposed standard is finalized. Since the term is used multiple times within the standard, TIC recommends that an appropriate definition be included in the Glossary. TIC suggests that the some of the guidance in paragraph BC77 of FASB ASU 2012-05 be included in the definition, which states in part:

...the comments received on the IASB’s Exposure Draft indicated that respondents had different interpretations of the term blockage factor. Many respondents interpreted a blockage factor as any adjustment made because of the size of an asset or a liability. In the Boards’ view, there is a difference between size being a characteristic of the asset or liability and size being a characteristic of the reporting entity’s holding. Accordingly, the Boards clarified that a blockage factor encompasses the latter and is not relevant in a fair value measurement because a fair value measurement reflects the value of the asset or liability to a market participant for a particular unit of account and is not necessarily representative of the value of the entity’s entire holding.

Entity-Specific Synergy

Paragraph 42 refers to “an entity-specific synergy,” as follows:

In developing unobservable inputs, a government may begin with its own data, but it should adjust those data if (a) reasonably available information indicates that other market participants would use different data or (b) there is something particular to
The government that is not available to other market participants (for example, an entity-specific synergy).

TIC understands that this sentence has been excerpted from FASB ASC paragraph 820-10-35-54A and that the Board’s goal is to maintain consistency with the FASB’s fair value standards. However, TIC believes this term could mean different things to different people and should be defined or an example provided to clarify the Board’s intent.

Market Multiple Techniques

Paragraphs 23 and 48 refer to a market multiple technique. Although one example of a market multiple is provided in paragraph 23, TIC recommends adding other examples or a definition of such techniques so that constituents will be able to identify them when appropriate. TIC believes a market multiple technique will be a foreign concept for many governments and therefore more examples will be necessary.

Definition of Market Approach

The definition of “market approach” on page 25 of the ED is the same as the definition in the FASB ASC Glossary, as follows:

A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets, liabilities, or a group of assets and liabilities, such as a business.

Although certain governmental entities (such as tribal governments) can own businesses, TIC believes the Glossary definition should be revised to add examples of “a group of assets and liabilities” that would be more relevant to most state and local governments.

Clarification of Reference to the “Flows Statement”

Paragraph 71 includes the following sentence that references the “flows statement”:

...all investment income, including changes in the fair value of investments, should be recognized as revenue in the flows statement.

Paragraph 54 of GASB Statement of Financial Accounting Concepts No. 4, Elements of Financial Statements, uses the term “resource flows statement,” as follows:

The names of the elements and of financial statements used in this Concepts Statement were selected so that they would be applicable to any measurement focus and would avoid any connotations associated with their use in existing practice. For example, the term resource flows statement is used to generically refer to a statement of activities; a statement of revenues, expenditures, and changes in fund balance; a statement of revenues, expenses, and changes in net assets; or a cash flows
statement. The Board does not expect that these captions would necessarily be used in financial statements.

Since the terms “flows statement” or “resource flows statement” could apply to either a statement of activities or a cash flows statement (as well as other statements), TIC believes its use in this ED could be confusing. Since the Board did not expect that the terms would be used in financial statements, TIC recommends that the “flows statement” terminology be dropped from the ED in favor of the traditional financial statement titles. If the Board decides to retain the term, a footnote should be added to the final standard to explain the context in which it’s being used.

Observable Markets v. Observable Inputs

Paragraph 14 states:

Even if there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement should assume that a transaction takes place at that date, considered from the perspective of a market participant that controls the resource or is obligated for the liability.

TIC suggests that the term “observable market” may not be readily understood in this context. TIC also believes that the relationship between “observable inputs” and an “observable market” is unclear. TIC recommends added guidance that would explain what observable markets and observable inputs are. Such guidance should clarify what is meant by an observable component in Level 2 or Level 3 inputs.

Effective Date

If the final standard is not expected to be issued until the first quarter of 2015, TIC believes many governments will not have enough time to implement the standard before the stated effective date of “reporting periods beginning after June 15, 2015.” They will need more time just to become familiar with the standard as well as to understand and implement the new requirements. Some of the new requirements (e.g., a change in the valuation methodology for donated capital assets) will need to be applied throughout the year, not just to year-end disclosures. TIC therefore recommends that the effective date be extended to “reporting periods beginning after June 15, 2016.”

Editorial Comments

Paragraph 42, 2nd sentence

TIC believes that “those data” in the following sentence should be changed to “that data”:

In developing unobservable inputs, a government may begin with its own data, but it should adjust those data if....
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,

Scot Phillips, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees