Mr. David R. Bean  
Director of Research and Technical Activities  
Governmental Accounting Standards Board

Re: Comment Letter on Project No. 3-40

Dear Mr. Bean,

We appreciate the opportunity to comment on Project No. 3-40 on the proposed technical bulletin related to accounting and financial reporting issues related to the COVID-19 pandemic.

Before providing our feedback, we want to acknowledge and state our appreciation for the work the Board’s members and staff have undertaken in light of the COVID-19 pandemic. The Board has been very proactive in addressing stakeholder needs and concerns during this event.

**Question 1**

We concur with the conclusion that funds provided from the federal Coronavirus Relief Fund are voluntary nonexchange transactions, subject to eligibility provisions. Although unstated within the proposed technical bulletin, it appears any transfers of cash from the recipient government to its local governments represents a pass-through grant that should continue to be reported following the general rule in GASB Codification N50.128 that the recipient government recognizes revenue and expense/expenditures and the secondary recipient would report resources received as a cash asset and corresponding liability until the eligibility requirements are met.

**Question 2**

We concur that resources from the federal Provider Relief Fund are also voluntary nonexchange transactions, subject to the eligibility provision of modified services – such as the cancellation of elective medical procedures – by healthcare entities.

**Question 3**

We concur any amendments to the CARES Act enacted after the statement of net position date, even with a retroactive effective date, are conditions that did not exist as of the period-end being reported.
**Question 4**

We concur with the general concept that a loan should be reported as a liability until an entity is legally released from the debt. We are concerned, however, about the timing of the recognition of the Paycheck Protection Program’s transactions and the negative impact to interperiod equity, as the current period’s outflows will not be matched with the related inflows.

Assuming the Board retains the loan perspective, we believe a corresponding asset arises when the eligibility requirements are met to offset the loan. Loan recipients under the Paycheck Protection Program should be able to establish, for financial reporting and audit purposes, its (1) eligible payroll costs incurred or paid during the covered period of the loan, (2) business mortgage interest payments during the covered period of the loan for lease agreements in effect prior to February 15, 2020, (3) business rent or lease payments for agreements in force prior to February 15, 2020, and (4) utility payments during the covered period if service began before February 15, 2020¹. If a recipient government is unable to establish its expenses/expenditures met these requirements, then the loan should be reported as normal. Further, we believe governments are comfortable with establishing eligibility criteria, as they are a critical part of the Board’s nonexchange transaction literature.

This asset would have intangible characteristics, representing a right to convert the loan into what is essentially a grant once the Small Business Administration processes the Paycheck Protection Program Loan Forgiveness Application. The following chart reflects the journal entries from both the exposure draft’s approach and our proposed approach.

<table>
<thead>
<tr>
<th>Accounting Period</th>
<th>Exposure Draft</th>
<th>Proposed Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Period (when the loan is made)</td>
<td>Cash Loan</td>
<td>Cash Loan</td>
</tr>
<tr>
<td></td>
<td>Wages Expense/Expenditure Cash</td>
<td>Wages Expense/Expenditure Intangible Right to Convert</td>
</tr>
<tr>
<td>Future Period (when the loan is released)</td>
<td>Loan Gain</td>
<td>Loan Intangible Right to Convert</td>
</tr>
</tbody>
</table>

We recognize this approach would appear to run afoul of the gain contingency guidance found in GASB Codification C50.167. GASB Codification C50.167 states, “Contingencies that might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realization.” (emphasis added) The Board could state this transaction represents the rare instance when the exception to the rule applies to (1) help preserve the concept of interperiod equity, (2) reflect the intent of Congress that this loan is convertible and is different from a normal loan, and (3) ensure stakeholders can readily understand the substance of the transaction entered into by the entity on the face of the financial statements.

¹ [https://www.sba.gov/sites/default/files/2020-05/3245-0407 SBA Form 3508 PPP Forgiveness Application.pdf](https://www.sba.gov/sites/default/files/2020-05/3245-0407 SBA Form 3508 PPP Forgiveness Application.pdf)
Alternatively, the Board could choose to look past the legal form of a loan and recognize the intent of Congress was to provide financial assistance through a voluntary nonexchange transaction, where failing to meet the eligibility provisions would result in the unused or misused balance of the transaction being treated as a loan. This would allow for revenue recognition when an eligible expense/expenditure is incurred, which is consistent with the Board’s guidance on recognition in GASB Codification N50.112 and subsequent contravention of eligibility requirements in GASB Codification N50.123.

Regardless of the approach taken, the Board should consider the substance of this transaction as part of its ongoing revenue recognition project to provide clear, level A guidance for this type of transaction which may occur again in the future.

**Question #5**

We concur with the nonoperating and operating revenue classifications for subsidies and treatment of uninsured individuals and COVID-19 testing, respectively.

**Question #6**

GASB Codification 2200.143 notes extraordinary items “are transactions or other events that are both unusual in nature and infrequent in occurrence.” We concur the Board’s conclusion that the COVID-19 pandemic is an example of an event which is reasonably expected to recur in the foreseeable future. While it is impossible to accuracy predict the overall length of the pandemic, it appears reasonable to conclude it is probable COVID-19 will be with us and new cases will continue to occur in the foreseeable future. As such, COVID-19 fails to meet the definition within GASB Codification 2200.146(b) for infrequency in occurrence, where the “underlying event or transaction should be of a type not reasonably expected to recur in the foreseeable future, taking into account the environment in which the government operates.”

We do not agree with the Board’s inclusion of additional dicta on whether coronavirus diseases also fail the unusual in nature criterion described in GASB Codification 2200.146(a). This section notes “the underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the government, taking into account the environment in which the government operates.”

Proximate causation through the “but for” test should be the standard for evaluating whether an event is sufficiently related to another event such that it is deemed the cause of the event. During the Board’s discussion on this issue, floods and hurricanes were used as example situations. We believe the determination of whether these types of events are extraordinary under our literature should be left to a careful analysis of the environment in which the government operates, including the geographic location as described in the following hypothetical examples debated by the Board.

1) A flood is not an extraordinary event, as it occurs due to excessive rainfall, an event that does not possess a high degree of abnormality (unusual nature) or occur infrequently (it is not reasonably expected to recur in the foreseeable future).
During the Board’s meeting, it was argued a flood could not be an extraordinary event, even in the case of an unexpected dam failure, as excessive rainfall was the cause of both events. We concur it would not be reasonable for a flood in a community in a floodplain area to use extraordinary accounting, as the proximate cause of the flood would be excessive rainfall (not unusual in nature) and would not expect to occur infrequently (as floods in floodplains would occur again). However, a dam failure upstream from a town that is protected from flooding by the dam controlling the flow of water in a nearby river is likely extraordinary. In this situation, the proximate cause of the town’s flood is the failure of the dam, an event that is unusual to the nature to the government (as the dam was in place to protect the town from flooding) and the failure of the specific dam protecting the town is infrequent and not expected to recur in the foreseeable future after the dam is reconstructed. In this case, excessive rainfall is not the proximate cause, as the dam is usually intervening by acting as a prophylactic to prevent the town’s flooding. The cause of the dam’s failure is the proximate cause of the town’s flood, which would need to be evaluated for potential extraordinary accounting treatment.

2) **A hurricane is not an extraordinary event, as even Hurricane Katrina was not extraordinary, and we should not consider the magnitude of an event in determining whether the event meets the criteria for extraordinary accounting.**

For a hypothetical city on the Florida coast, small and moderate strength hurricanes would certainly not be unusual events given its geographic location. However, category 5 hurricanes would be unusual as only three category 5 hurricanes with wind speeds in excess of 157 mph have hit the United States[2] and Florida’s building codes, especially in the central and northern parts of the state, are designed to protect against three-second wind gusts of less than 150 mph only expected to occur every 700 years[3]. If our hypothetical community was located near St. Augustine or Jacksonville, guidance provided by building codes indicates the town’s fire station only needs to sustain 130-140 mph wind gusts, as these wind speeds are only expected to occur every 700 years in this area. If this community was hit by the fourth category five hurricane to ever make landfall in the United States and the fire station was obliterated, this event would be unusual in nature (this type of hurricane as measured by its magnitude was unusual to the operating environment of the government) and infrequent in occurrence (as a hurricane of this size was not even expected to occur even every 700 years, so a second category 5 hurricane hitting this town is very, very remote). The proximate cause of the obliteration of the fire station within this hypothetical was the magnitude of the hurricane’s strength, not the hurricane itself.

Further, the Board’s discussion on this topic would seem to contradict its Q&A guidance in GASB Codification 2200.721-1, which notes “[s]ignificant damage to the community or destruction of government facilities by natural disaster (tornado, hurricane, flood, earthquake, and so forth) or terrorist act”, if the government’s geographic location indicates a weather-related natural disaster is infrequent, are extraordinary items.

---

2 https://www.usatoday.com/story/weather/2017/09/05/meteorological-monsters-only-3-category-5-hurricanes-have-ever-hit-u-s/633616001/

We recommend the Board strike its analysis of whether coronavirus diseases are unusual in nature in the final technical bulletin and focus solely on the infrequent in occurrence criterion.

Again, we appreciate the opportunity to offer our thoughts to the Board.

Sincerely,

Daniel J. Nugent

DANIEL J. NUGENT, CPA
Technical Specialist