
NO. 25-19 | OCTOBER 3, 2011

Governmental Accounting Standards Series

EXPOSURE DRAFT

Proposed Statement of the Governmental Accounting Standards Board

Technical Corrections

an amendment of GASB Statements No. 10 and No. 62

This Exposure Draft of a proposed Statement of Governmental Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 25-19

Comment Deadline: December 16, 2011



Governmental Accounting Standards Board
of the Financial Accounting Foundation

TECHNICAL CORRECTIONS REQUEST FOR WRITTEN COMMENTS

Deadline for submitting written comments: December 16, 2011

Requirements for written comments. Comments should be addressed to the Director of Research and Technical Activities, Project No. 25-19, and emailed to director@gasb.org or mailed to the address below.

OTHER INFORMATION

Public hearing. The Board has not scheduled a public hearing on the issues addressed in this Exposure Draft.

Public files. Written comments will become part of the Board's public file and will be available for inspection at the Board's offices. Copies of those materials may be obtained for a specified charge. The GASB will make all comments publicly available by posting them to the Projects portion of its website.

Orders. Any individual or organization may obtain one copy of this Exposure Draft on request without charge until December 16, 2011, by writing or phoning the GASB Order Department. For information on prices for additional copies and copies requested after December 16, please contact the Order Department. The Exposure Draft also may be downloaded from the GASB's website at www.gasb.org.

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Notice to Recipients of This Exposure Draft

The Governmental Accounting Standards Board (GASB) is responsible for developing standards of state and local governmental accounting and financial reporting and other accounting and financial reporting communications that will (1) result in useful information for users of financial reports and (2) guide and educate the public, including issuers, auditors, and users of those financial reports.

The due process procedures that we follow before issuing our standards and other communications are designed to encourage broad public participation in the standards-setting process. As part of that due process, we are issuing this Exposure Draft setting forth a proposed Statement that would (1) modify requirements for the accounting and financial reporting of risk financing activities in Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, and (2) modify requirements for the accounting and reporting pertaining to certain operating leases and to a purchased loan or group of loans in Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

We invite your comments on all matters in this proposed Statement. Because this proposed Statement may be modified before it is issued as a final Statement, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe we should consider.

All responses are distributed to the Board and to staff members assigned to this project, and all comments are considered during the Board's deliberations leading to a final Statement. When the Board is satisfied that all alternatives have been adequately considered and modifications, if any, have been made, a vote is taken on the Statement. A majority vote is required for adoption.

Summary

The objective of this proposed Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two recent pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

This proposed Statement would amend Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. As a result, governments would base their decisions about fund type classification on the nature of the activity to be reported, as required in Statement 54.

This proposed Statement also would amend Statement 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis and (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans. These changes would eliminate any uncertainty regarding the application of Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively.

The provisions of this proposed Statement would be effective for periods ending after June 15, 2012. Earlier application would be encouraged.

How the Changes in This Proposed Statement Would Improve Financial Reporting

The requirements of this proposed Statement would resolve conflicting accounting and financial reporting guidance that could affect the consistency of financial reporting and therefore avoid diminishing the usefulness of the financial reports.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 2 discusses the applicability of this Statement.

Proposed Statement of the Governmental Accounting Standards Board

Technical Corrections

an amendment of GASB Statements No. 10 and No. 62

October 3, 2011

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October 3, 2011

INTRODUCTION

1. The objective of this Statement is to improve accounting and financial reporting by a governmental entity by resolving conflicting guidance that resulted from the issuance of two recent pronouncements. Since the release of these Statements, questions have arisen concerning differences between the provisions in Statements No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, and No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, regarding the reporting of risk financing activities, and Statements No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, regarding the reporting of certain operating lease transactions and the reporting of the acquisition of a loan or a group of loans.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

2. This Statement deletes Statement 10, paragraph 63, and Statement 62, paragraph 222. It also amends Statement 62, paragraphs 227 and 442. This Statement applies to accounting and financial reporting by state and local governmental entities, including public entity risk pools.

Amendments to Statement 10—Use of Special Revenue Funds to Report Risk Financing Activities

3. Paragraph 63 of Statement 10 requires that an entity's risk financing activities be accounted for in either the general fund or an internal service fund, if a single fund is used. That paragraph is deleted in its entirety, with the exception of footnote 12, to remove the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. Footnote 12 is retained to clarify the reference to an internal service fund in paragraph 65 of Statement 10.

Amendments to Statement 62—Operating Leases

4. Paragraphs 222 and 227(b) of Statement 62 include specific guidance on accounting for operating lease payments that vary from a straight-line basis. Those provisions are deleted to remove the specific guidance that does not allow the use of the fair value method that is permitted in paragraph 6(b) of Statement 13 for operating lease payments that vary from a straight-line basis.

Amendments to Statement 62—Purchase of a Loan or Group of Loans

5. Paragraph 442 of Statement 62 includes specific guidance on accounting for the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans. The purchase of a loan or group of loans should be reported at its purchase price. Paragraph 442 of Statement 62 is amended to delete the last three sentences and retain the first sentence as follows:

The initial investment in a purchased loan or group of loans should include the amount paid to the seller plus any fees paid or less any fees received.

EFFECTIVE DATE AND TRANSITION

6. The provisions of this Statement are effective for periods ending after June 15, 2012. Early application is encouraged. In the first period that this Statement is applied, changes made to comply with this Statement should be treated as an adjustment of prior periods, and financial statements presented for the periods affected should be restated. If restatement of the financial statements for prior periods is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning net assets (or fund equity or fund balance, as appropriate) for the earliest period restated (generally the current period). In the first period that this Statement is applied, the financial statements should disclose the nature of the restatement and its effect.

<p>The provisions of this Statement need not be applied to immaterial items.</p>

Appendix A

BACKGROUND

7. Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, issued in November 1989, establishes accounting and financial reporting guidance for risk financing and insurance-related activities of state and local governmental entities. The guidance provided in paragraph 63 of Statement 10 requires that if a single fund is used to account for an entity's risk financing activities, that fund should be either the general fund or an internal service fund.

8. Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, issued in February 2009, enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The definition of a special revenue fund provided in paragraphs 30 and 31 of Statement 54 would allow for certain risk financing activities to be reported in a special revenue fund; however, specific guidance provided in paragraph 63 of Statement 10 was not superseded.

9. Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, issued in May 1990, establishes accounting and financial reporting guidance for governments that enter into operating leases with scheduled rent increases. The guidance provided in paragraphs 6(a) and 6(b) of Statement 13 allows the lessor government to recognize operating lease payments on either a straight-line basis over the lease term or based on the estimated fair value of the rental.

10. Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, issued in September 2006, establishes accounting and financial reporting guidance for governments that exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments. The guidance provided in paragraph 13 of Statement 48 requires that the transferee government recognize the receivables acquired at the purchase price.

11. Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, issued in December 2010, incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989, provided that such guidance does not conflict with or contradict GASB pronouncements. The guidance on reporting operating lease payments that originated from FASB Statement No. 13, *Accounting for Leases*, issued in November 1976, and the guidance on reporting the purchase of a loan or group of loans that originated from FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*,

issued in December 1986, was incorporated into the GASB authoritative literature with the issuance of Statement 62.

12. Statement 62 provides specific guidance on accounting for (a) operating lease payments that vary from a straight-line basis and (b) the difference between the initial investment (purchase price) and the principal amount (face value) of a purchased loan or group of loans (a receivable). That specific guidance conflicts with the requirements in paragraph 6(b) of Statement 13 and paragraph 13 of Statement 48, respectively.

13. In June 2011, the risk financing reporting issue was introduced to the Governmental Accounting Standards Advisory Council (GASAC). The GASAC members recognized the reporting issues associated with this item and the need to address it.

14. At its August 2011 meeting, the Board considered GASAC members' input and the potential adverse effect on the consistency of financial reporting posed by the conflicting guidance. A project on technical corrections was then added to the current agenda.

Appendix B

BASIS FOR CONCLUSIONS

15. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

Scope and Applicability of This Statement

16. Questions raised through technical inquiries received by the GASB highlighted conflicting accounting and financial reporting guidance issues. Given the nature of the current authoritative guidance, these issues cannot be resolved through an Interpretation, Technical Bulletin, or question and answer in the *Comprehensive Implementation Guide*. Accordingly, the scope of this project was established to develop a Statement amending Statements 10 and 62. This Statement resolves the conflicting accounting and financial reporting guidance that resulted from the issuance of Statements 54 and 62.

Amendments to Statement 10—Use of Special Revenue Funds to Report Risk Financing Activities

17. The Board recognizes that a single fund that meets the special revenue fund criteria in Statement 54 could be used to account for an entity's risk financing activities. For example, some state statutes authorize their local governments to assess a dedicated tax levy for tort liabilities, which would constitute a restricted revenue that could serve as the foundation for a special revenue fund. This dedicated tax levy is an example of a constraint placed on the use of resources that is externally imposed by laws or regulations of other governments (state statute). As a result, the Board concluded that it is not appropriate to limit single fund type reporting of risk financing activities to the general fund and the internal service fund type, as is currently required in the guidance provided in Statement 10.

18. The Board considered three alternatives that would address the conflicting guidance within Statements 10 and 54: (a) amending Statement 10, paragraph 63, to specifically include the special revenue fund type as a potential alternative to report an entity's risk financing activities; (b) amending Statement 10 by deleting paragraph 63 to remove the single fund type reporting of risk financing activities limitation to the general fund and the internal service fund type; and (c) amending Statement 54 to specifically recognize the provision in Statement 10, paragraph 63.

19. The Board believes that it generally is not appropriate to prescribe which governmental fund type should be used in standards addressing specific individual activities or transactions, such as risk financing (Alternative (a)). Rather, the Board concluded that the governmental fund type definitions provided in Statement 54, generally, should be used as the basis for making these fund type determinations.

20. The Board also concluded that there is no compelling reason to prohibit the use of a special revenue fund to account for risk financing activities (Alternative (c)). Paragraph 119 of the Basis for Conclusions of Statement 10 discusses the perceived benefit of being able to easily review and evaluate the risk financing function when all related activities are isolated in one dedicated fund. However, risk financing activities generally are not presented as a single line in the financial statements of the general fund. Therefore, in practice, the goal of presenting risk financing information in the general fund that is easily reviewed and evaluated usually cannot be achieved. The Board noted that risk financing activities that meet the definition of a special revenue fund generally would provide information that could be easily reviewed and evaluated if those activities were presented in a separate special revenue fund.

21. For the aforementioned reasons, the Board concluded that it was most appropriate to remove the guidance creating the implied prohibition against using a special revenue fund to account for an entity's risk financing activities (Alternative (b)). As a result, governments should base their fund type decision on the nature of the activity to be reported. The current fund type definitions would limit that decision to an internal service fund, the general fund, or a qualifying special revenue fund for risk financing activities.

Amendments to Statement 62—Operating Leases

22. Statement 13 provides that when the payment requirements of an operating lease with scheduled rent increases include a rental payment in one or more years that is artificially low when viewed in the context of earlier or later payment requirements (rent reduction or "rent holiday"), payments received from the operating lease should be accounted for based on either (a) the estimated fair value of the rental payments or (b) a straight-line basis over the lease term. In these cases, part of the scheduled increased rental payments compensates the lessor for not receiving fair rental payments in the early periods of the operating lease. Consequently, part of the later rental payments should be considered as payment of the principal of the financing and part as interest. (Similar rent reductions in the middle or later periods of the operating lease may also be a method of financing and should be accounted for similarly.) Certain rent reductions or rent holidays may be inducements designed to provide an incentive for the lessee to enter into an operating lease, and these lower rental payments are not based on economic factors relating to the property. In these cases, Statement 13 provided that the accounting should not be based on the contract terms. Although the Board initially preferred using fair value to account for operating leases in this situation, it was persuaded by respondents to the Exposure Draft on Statement 13 to allow the straight-line alternative in addition to the estimated fair value of the rental payments. Therefore, Statement 13 included a provision that a straight-line recognition approach should be available as a practical and cost-beneficial alternative to the fair value method in those limited situations.

23. The Board considered two alternatives to address the differences in the guidance within Statements 13 and 62: (a) amending Statement 62 to exclude the guidance that differs from Statement 13 and (b) amending Statement 13 to be consistent with Statement 62. The Board believes that professional judgment should be used to determine whether rental payments are based on economic factors relating to the property or, instead, are an

inducement to attract the lessee. Statement 13 provides for both measurement approaches addressed in paragraphs 222 and 227(b) of Statement 62—paragraph 5(b) in Statement 13 addresses payments that are more representative of the time pattern of use, and paragraph 6(a) provides the straight-line alternative. The Board is not aware of any compelling reason why the fair value option in paragraph 6(b) of Statement 13 also should not be available. Therefore, the Board concluded that it would be more appropriate to amend Statement 62, which does not allow for recognition based on the fair value of the rental payments.

Amendments to Statement 62—Purchase of a Loan or a Group of Loans

24. The Board believes that transactions involving certain financial instruments (accounts receivable and loans receivable) should be accounted for in a similar manner. While loans generally have stated interest rates and receivables do not, the Board found no compelling reasons why the acquisition of such financial assets should be reported differently. The conflict in guidance arose in September 2006 with the issuance of Statement 48, which differed from the pre-November 30, 1989 FASB guidance (FASB Statement 91).

25. The Board considered two alternatives to address the conflicting guidance within Statements 48 and 62: (a) amending Statement 62 to exclude the conflicting guidance and (b) amending Statement 48 to be consistent with Statement 62. The Board concluded that the purchase of a loan or groups of loans should be reported at its acquisition cost because that is the government's initial investment. Therefore, the Board concluded that it would be more appropriate to amend Statement 62.

26. The Board notes that as a result of a proposed Statement, *Reporting Items Previously Recognized as Assets and Liabilities*, the guidance for the recognition of fees associated with the purchase of a loan or group of loans in paragraph 442 of Statement 62 is currently proposed to be amended. The amendment of the fee guidance, if approved as a Statement, would be incorporated into the final standard associated with that project.

Effective Date

27. The provisions of this Statement are effective for periods ending after June 15, 2012. The effective date is considered appropriate because of the conflicting guidance that currently exists. The Board believes that it is important to remove the inconsistencies in the authoritative literature in a timely manner in order to avoid adverse effects on the consistency of financial reporting.

Appendix C

CODIFICATION INSTRUCTIONS

28. The sections that follow update the June 30, 2011, *Codification of Governmental Accounting and Financial Reporting Standards*, for the effects of this Statement. Only the paragraph number of this Statement is listed if the paragraph will be cited in full in the Codification.

* * *

CLAIMS AND JUDGMENTS

SECTION C50

Sources: [Add the following:] GASB Statement XX

.124 [Delete the third sentence; move footnote 8 to the end of paragraph .127.] [GASBS 10, ¶63, as amended by GASBS 34, ¶6; GASBS 34, ¶92 and ¶107; GASBI 6, ¶14; GASBS XX, ¶3]

* * *

LEASES

SECTION L20

Sources: [Add the following:] GASB Statement XX

.121 [Delete paragraph and renumber subsequent paragraphs.]

.123 [Move paragraph, including footnote, to existing paragraph .134 and renumber subsequent paragraphs.]

.133 [Delete subsection (b) of existing paragraph .133 and renumber subsequent subsections.] [GASBS 62, ¶227, as amended by GASBS XX, ¶4]

* * *

LENDING ACTIVITIES

SECTION L30

Sources: [Add the following:] GASB Statement XX

.113 [Delete the second, third, and fourth sentence.] [GASBS 62, ¶442, as amended by GASBS XX, ¶5]

* * *

PUBLIC ENTITY RISK POOLS

SECTION Po20

Sources: [Add the following:] GASB Statement XX

.145 [GASBS 10, ¶45, as amended by GASBS 62, ¶431–¶451 and GASBS XX, ¶5]

* * *