GASB GOVERNMENTAL ACCOUNTING STANDARDS BOARD

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# 2020 REQUEST FOR RESEARCH
# Gil Crain Memorial Research Grant

Since its formation in 1984, the Governmental Accounting Standards Board (GASB) has encouraged academics and other researchers to conduct studies that would be relevant to the GASB's standards-setting activities. For 35 years, such research efforts have resulted in publishing their research in peer-reviewed journal articles, GASB research briefs, and occasionally in GASB research reports.

The GASB hopes to encourage more collaborative research efforts with academics by offering one or two research grants of up to $10,000, to be awarded by the end of June 2020.

## How Research Benefits the GASB

The setting of governmental accounting standards is a research-based activity. The technical staff of the GASB conducts extensive literature reviews (including reviewing the work of other standards setters) and studies the preparation and use of state and local government financial reports. The decision by the Board to establish standards is based on a determination, through research and due process activities, that a strong need for information exists among the users of financial statements and that the benefits of that information justify the cost incurred to generate and consume that information.

The GASB technical staff is relatively small. Therefore, the GASB seeks to leverage research efforts by encouraging the academic and research communities to conduct applied research that is relevant to the GASB's standards-setting activities.

## How Conducting Research with the GASB Can Benefit You

The GASB hopes that the Crain Grants will encourage researchers to conduct research that is beneficial to standards setting for governmental accounting and financial reporting. Researchers benefit by working with GASB staff members and by learning more about the internal workings of the standards-setting process. The GASB staff also may be able to help by introducing you to professional organizations and knowledgeable individuals and by encouraging them to participate in your research. Upon request after completion of your research, the GASB will send a letter of appreciation to your university for allowing you to participate in an important GASB research effort.

We encourage researchers who receive a grant to submit the results of their research for publication in a journal or presentation at a conference after the research results have been submitted to the GASB. Because the research that is most useful to the GASB is applied research, we realize that you may wish to consider the work that you do for the GASB as part of a larger research effort. Therefore, we generally support your gathering additional data that would be needed for publication.

Although intangible, a final reason for conducting research with the GASB is the personal satisfaction that you will receive in knowing that you have played an important role in improving governmental accounting and financial reporting standards. We encourage you to be a part of the GASB team by researching one of the topics identified in this call for proposals.

## Past Grant Award Topics

Since their establishment, Crain Grants have supported research on a variety of topics relevant to the GASB's standards-setting activities, including:

- Capital assets
- Compensated absences
- Component units
- Conduit debt
- GAAP compliance
- Going concern
- Government dissolutions
- Landfills
- Modified approach
- Nonexchange transactions
- Popular reporting
- Prior-period adjustments, accounting changes, and error corrections
- Severe financial stress
- Subsequent events
- Tax abatements
- Unrestricted net position deficits.

## Research Topics for 2020

Each year, the GASB identifies potential research grant topics that are relevant and timely in light of the GASB's current standards-setting projects and pre-agenda research activities, as well as the relative priority the Board and stakeholders place on potential standards-setting and potential reexamination topics in its technical plan. This year, the GASB is seeking proposals for research on the following topics—Capital Asset Impairment, Chapter 9 Bankruptcies, Deferrals, Derivative Instruments, Fund Balance, Present Value, and Related Party Transactions. *Applicants also may propose research on other topics they believe would be useful and relevant to the GASB.*

## Capital Asset Impairment

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* as amended, provides accounting and financial reporting guidance for identifying, measuring, recognizing, and reporting the impairment of capital assets. Statement 42 states that a capital asset generally is considered impaired if both (1) the decline in service utility of the capital asset is large in magnitude and (2) the event or change in circumstance that caused the impairment is outside the normal life cycle of the capital asset. The standards set forth how to measure the impaired capital asset and the impairment loss, depending on the nature of the impairment (for instance, physical damage or technological obsolescence). Statement 42 was issued in 2003 and has been in effect since fiscal years ending December 31, 2005, and later.

The results of research on capital asset impairment would directly inform the GASB's ongoing pre-agenda research on capital asset accounting and financial reporting. Research on capital asset impairment could consider the following issues:

- How has Statement 42 been applied in practice? What types of impairments occur most often? Is the guidance in Statement 42 sufficient for the accurate and prompt reporting of impairments?
- Do governments' notes to financial statements present the required information?
- How is the amount of asset impairment determined when there are uncertainties about one or more of the inputs to the measurement? How is the amount of asset impairment determined if it is not known whether the capital asset will continue to be used?
- Is the information that results from the reporting of capital asset impairments useful for decision making? Does it help users in assessing accountability?

## Chapter 9 Bankruptcies

Prior to the issuance of Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies,* there was no authoritative accounting and financial reporting guidance for governments filing for bankruptcy. Statement 58 was effective for periods beginning after June 15, 2009.

The Statement requires governments to remeasure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms (that is, approves) a new payment plan. Governments that have filed for bankruptcy are required to disclose information regarding, among other things, the pertinent conditions and events giving rise to the petition for bankruptcy, the expected gain, and the effects upon services.

The questions that would be addressed in this research include:

- Do the existing standards continue to appropriately capture the features of bankruptcy payment plans?
- Some debt payments in Chapter 9 bankruptcy are replaced with payments based on interest rates that increase over time, which may make it difficult to discern whether principal or interest payments, or both, have been reduced. Is new guidance needed to address these types of payment provisions?
- Should professional fees and other costs associated with the bankruptcy be reported as a special or extraordinary item?
- Subsequent to the issuance of Statement 58, the Board issued guidance on the reporting of deferred outflows of resources and deferred inflows of resources in Statement 65. Should the recognition of gains in the current period due to reduction in principal or accrued interest be reconsidered as a deferred inflow of resources?
- Have disclosures presented in conformity with the requirements of Statement 58 sufficiently met users' needs?

## Deferrals

Deferred outflows of resources and deferred inflows of resources (deferrals) are two of the five elements (along with assets, liabilities, and net position) of a statement of financial position identified in Concepts Statement No. 4, *Elements of Financial Statements*. They represent consumptions or acquisitions of net assets that are applicable to a future reporting period, respectively. Whereas outflows and inflows that occur during a period generally are related to that period and, therefore, are recognized as expense/expenditure or revenue in the resource flows statements, respectively, flows related to future periods initially are reported as deferrals in the statements of net position.

Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* requires deferrals to be reported separately from assets and liabilities in statements of financial position. Statement No. 65, *Items Previously Reported as Assets and Liabilities,* as amended, requires that certain items previously recognized as assets and liabilities henceforth be reported as deferrals or, in some cases, current-period inflows and outflows of resources. Items formerly reported as assets and liabilities that now commonly are reported as deferrals include property taxes received or receivable prior to the period for which they were levied, the difference between the reacquisition price and the net carrying amount of defeased debt in a debt refunding, and unavailable revenue in governmental funds.

In additional to the guidance in Statement 65, deferrals specifically are required to be recognized by standards addressing several types of transactions, most notably:

- Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* as amended, requires that changes in the fair value of a hedging derivative instrument should be reported as deferrals, rather than reported in investment income.

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- Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs), requires that a transferor government that receives an up-front payment in an SCA should report a deferred inflow of resources equal to the difference between the up-front payment received from the operator and any contractual obligations to the operator.
- Statement No. 68, *Accounting and Financial Reporting for Pensions,* Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68,* and *Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* require that certain sources of changes in the net pension liability and net OPEB liability initially be recognized as deferrals and introduced into expense over multiple years, such as experience gains and losses, changes in assumptions, and employer contributions made after the measurement date.
- Statement No. 87, *Leases,* requires a lessor to recognize a deferred inflow equal to its lease receivable plus any payments related to future periods that are received at or before the start of the lease term.

The questions that could be addressed in this research include:

- How often do governments report the various types of deferrals and in what amounts?
- Do governments report deferrals on the face of their statements of financial position by type or in the aggregate? If the latter, in what manner do they disclose the types of deferrals?
- What practical issues, if any, have governments and their auditors encountered in applying the reporting standards in Statement 63?
- What difficulties have governments and their auditors had in accounting for and reporting deferrals required by Statement 65 for specific transactions, if any?
- How has the ability to assess interperiod equity been affected by the introduction of deferral reporting, if at all?
- How is information about deferrals used for making decisions and assessing government accountability?
- Is the usefulness of information reported about types of deferrals affected by a government's decision to display or disclose that information?
- What other information, if any, do users need regarding deferrals?

## Derivative Instruments

Governments enter into derivative instrument transactions to manage specific risks, to make investments, and to lower the cost of borrowing. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors, and collars), swaptions, forward contracts, and futures contracts.

Statement No, 53, *Accounting and Financial Reporting for Derivative Instruments* was effective for periods beginning after June 15, 2009. The Statement requires that derivative instruments generally be reported at fair value in financial statements prepared using an economic resources measurement focus and accrual basis of accounting, with some exceptions. Changes in the fair value of derivative instruments should be reported in investment income unless the derivatives can be shown to be effectively hedging the risk of loss of cash flows or fair value of the item being hedged. If a derivative instrument is an effective hedge—meaning it substantially offsets the cash flows or changes in fair value of the hedged item—it is considered a *hedging derivative*. All other derivative instruments are considered *investment derivatives*. The changes in fair value of a hedging derivative are reported as deferrals, rather than as investment income.

Statement 53 incorporated and built upon the disclosures required by Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*. The objectives, terms, and risks of hedging derivative instruments are required disclosures. Disclosures also include a summary of derivative instrument activity that provides an indication of the location of fair value amounts reported on the financial statements.

Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions,* was issued in June 2011 to address certain circumstances of terminations of derivative transactions that occurred in the wake of the recession. The GASB is scheduled to issue another Statement before mid-2020 to provide additional exceptions to termination of hedge accounting related to the expected sunset of the London Interbank Offered Rate (LIBOR).

The questions that could be addressed include:

- Does the definition of derivative instruments adequately address the financial instruments that governments are currently entering into?
- Does the exclusion of certain derivative instruments from the scope of the standards and the exclusion of certain derivative instruments from fair value continue to be appropriate?
- Are the methods of evaluating hedge effectiveness identified in Statement 53 being applied as intended? Are the parameters for those methods set appropriately? Are there other methods that should be addressed?
- Do Statement 53's disclosures meet the needs of users?
- Is the exception to fair value for fully benefit-responsive synthetic guaranteed investment contracts still appropriate?

## Fund Balance

The GASB's pre-agenda research reexamining the financial reporting model confirmed that fund balance is among the most widely used information in the entire financial report. In 2009, Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* replaced the long-standing reserved and unreserved categories of fund balance with five classifications that identify the degree to which a government is bound by the limitations placed on the resources reported in governmental funds: nonspendable, restricted, committed, assigned, and unassigned fund balance. Those classifications should be applied consistently across fund types, which represented a change from previous standards, under which the determination of whether fund balance was reserved depended, in part, on the nature and breadth of the limitation on use compared with the overall purposes of the fund.

Statement 54 also clarified the definitions of governmental fund types. Particular attention was given to special revenue funds to address inconsistencies in practice that had developed as a result of confusion about certain aspects of the definition of that fund type. Statement 54 clarified that special revenue funds should be established only around revenue sources that are restricted or committed to specified purposes—other than debt service or capital projects—and that continue to represent a substantial portion of the inflows of the fund.

The following issues could be considered as part of research on fund balance:

- Are governments applying the standards accurately and appropriately? For instance, are the actions used by governments to commit or assign fund balance consistent with the requirements of the standards?
- Are governments reporting any stabilization arrangements outside of unassigned fund balance or in special revenue funds? If so, do those arrangements meet the requirements to be reported in that manner?
- To what extent are governments presenting the required detail within each fund balance classification on the face of the balance sheet versus in notes to financial statements? How does the choice of display versus disclosure affect the use of the information by financial statement users, if at all?
- How have the clarifications of fund type definitions affected what funds are reported by governments? What effect has there been on the usefulness of information, if any, from resources that were previously reported in a separate special revenue fund now being reported in the general fund?
- Do the required disclosures provide users with information that is valuable for making decisions and assessing government accountability?

## Present Value

Present value generally is understood to be the value of future cash flows discounted to their value in today's dollars. In Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, paragraph 97 (Basis for Conclusions), the Board noted:

> In its [Exposure Draft (ED)] and in this Statement, the Board concluded that the practice of discounting claims liabilities should be neither mandated nor prohibited because the effects of discounting in the area of claims and judgments are not yet fully understood. Board members were

> particularly concerned about discounting a liability that is a relatively "soft" estimate because it may imply a precision in the determination of the nondiscounted liability that does not exist. The majority commenting on the Board's decision to allow an option to discount agreed with this decision. However, several ED respondents urged the Board to reconsider its position, noting that it is important that the Board eliminate options in all of its standards. Others opposed discounting in any circumstances. In October 1988, the [Financial Accounting Standards Board (FASB)] added a topic on interest methods to its agenda. That topic is addressing a broad range of issues, including the use of present-value or discounted accounting measures, related measurement techniques based on interest, when and how interest methods should be used, and what rates should be used. The FASB expects to issue a neutral discussion document on the topic sometime in 1990. The GASB and its staff are monitoring this topic and will consider whatever information the topic produces. Until this work is complete, the Board believes that either mandating or prohibiting the practice as it applies to nonstructured settlements would be premature.

FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, was issued in 2000.

Present value-related issues have been raised as part of nearly every GASB Statement that contains measurement guidance. This topic is important as long as elements of financial statements are required to be reported at fair value or settlement value.

When faced with whether to provide specific guidance on how to determine the present value of a general liability (for example, in Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*), the Board has chosen not to provide specific guidance, awaiting the outcome of further research.

The primary objective of such research would be to provide the GASB with a foundation on which to conduct additional research or to consider the establishment of concepts or standards for the use of present value. The following issues could be considered:

- What are the instances in which present value is required or discussed in the literature of the GASB and other standards setters? How do the methods of measuring present value differ?
- What are the objectives of present value measurements in financial reporting?
- Within the bounds of the GASB's guidance on measuring present value, what specific methods and inputs do governments use to develop present values? To what degree does a financial statement preparer's professional judgment affect how the present value standards are applied in practice?
- What information about present value do users need governments to disclose in notes to financial statements? How do they or would they use that information?

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## Related Party Transactions

Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards,* was prompted by a request from the AICPA that the GASB and FASB incorporate into their own literature the accounting and financial reporting guidance then-residing in the AICPA's audit literature. Related party transactions were one of three topics covered by the guidance that was transferred in Statement 56.

Statement 62, paragraph 57, defines a related party as an individual or entity whose management or operating policies a government can significantly influence—or which can significantly influence the government's management or operating policies—"to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests." Related parties include a government's management and elected or appointed officials, and their immediate families, as well as the related organizations, jointly governed organizations, and joint ventures identified in Statement No. 14, *The Financial Reporting Entity,* as amended. Although transactions with related parties generally are not accounted for differently than transactions with unrelated parties, the nature of their relationship with a government may be such that one cannot presume the transactions are carried out on an arm's-length basis, as would be the case for transactions with unrelated parties.

The general requirement to disclose transactions with related parties comes from NCGA Interpretation 6, *Notes to the Financial Statements*. However, the specific disclosures are identified in paragraph 55 of Statement 62, as amended:

> 55. Financial statements should include disclosures of related party transactions, other than compensation arrangements, expense/ expenditure allowances, and other similar items in the ordinary course of operations. The disclosures should include:
>
> a. The nature of the relationship(s) involved
> b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which financial statements are presented, and such other information deemed necessary to gain an understanding of the effects of the transactions on the financial statements
> c. The dollar amounts of transactions for each of the periods for which financial statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period
> d. Amounts due from or to related parties as of the date of each statement of net position presented and, if not otherwise apparent, the terms and manner of settlement.

The following issues could be addressed in research on related parties:

- How prevalent are related party transactions for state and local governments? How significant are the dollar amounts involved in those transactions?
- What types of related party transactions do governments disclose in practice? Are the disclosure standards appropriately applied to those transactions? Do the descriptions in the disclosures appropriately capture the nature of the transactions and the related parties themselves?
- What transactions are governments including, if any, that are not with related parties, as defined in the standards? Conversely, what transactions are governments excluding that are with related parties, if any?
- Is the information disclosed about related party transactions useful for making decisions and assessing government accountability?

## Timetable for Proposing and Conducting the Research

The following table shows the critical dates for requesting research funding, conducting the research, and preparing the final research memorandum.

| Date | Activity |
|---|---|
| May 29, 2020 | Request for Funding Deadline |
| June 30, 2020 | Grant Recipient(s) Determined |
| July 31, 2020 | Grant Agreement Finalized |
| August 31, 2020 | Methodology Finalized in Consultation with GASB Staff |
| October 30, 2020 | Initial Update to GASB Staff on Progress of Research |
| January 29, 2021 | Preliminary Report to GASB Staff |
| March 31, 2021 | Draft Research Memorandum Due |
| May 31, 2021 | Final Research Memorandum Due |

## Content of the Research Memorandum

The final product from your research efforts for the GASB should be a research memorandum of publishable quality discussing your research, prepared under the guidance of the GASB. The content of the research memorandum, at a minimum, should include:

- A discussion of the background, purpose, and scope of the research
- A thorough review of relevant academic and standards-setting literature
- A thorough review of relevant analytical and methodological literature

- A thorough discussion of the research design and the appropriateness of the research method used
- A thorough discussion of the data-collection process
- A detailed analysis of research results
- A discussion of the limitations of the research
- A summary and conclusion, including a discussion of what has been learned by conducting the research.

The research memorandum should be long enough to sufficiently cover each of the aforementioned bullet points and should include tables summarizing your research results, if appropriate. The GASB anticipates that the text portion of the memorandum would be approximately 35 pages or longer (double-spaced), excluding additional pages for tables, the bibliography, and the cover page. The researcher should be available to formally present the memorandum to the Board, if requested. (An agreeable date for such a presentation can be arranged.)

The researcher is expected to provide the GASB with the raw data that was collected and used to support the results presented in the research memorandum. Although the GASB likely will not attempt to do so, it should be possible to replicate the results presented in the research memorandum with the data that you provide the GASB.

## Submitting a Request for Crain Grant Funding

If you are interested in requesting Crain Grant funding for one of the research topics, send a request for research funding to David Bean, GASB Director of Research and Technical Activities, by **May 29, 2020**. The request for research funding should be attached as a Microsoft Word document in an e-mail to drbean@gasb.org.

The request should include:

1. A description of how you believe your research on the topic will help answer the question(s)
2. A thorough description of the research design that you plan to use; that discussion should be as specific as possible and, at a minimum, include a description of the research method(s), why you believe the method is appropriate, and a description of how you expect to collect data for the research
3. A description of any limitations that you foresee regarding the validity of your research results
4. A timeline for completing the research and preparing a final report for the GASB; that timeline should meet the parameters for reporting back to the GASB, which are described above
5. Your CV or resume

6. One or two articles, reports, or papers for which you are the primary author and which demonstrate your ability to perform the research and write the memorandum.

If you have any questions regarding the content of the request for research funding, please contact Dean Mead, GASB Senior Research Manager, at (203) 956-5294 or dmmead@gasb.org.

The GASB will notify the recipients of the research grants at or soon after the end of June 2020. The maximum amount to be paid to a grant recipient is $10,000. The recipient will receive an initial $3,000 after they sign the agreement with the GASB. The agreement will explain the duties and responsibilities of the GASB and recipient and will describe the deliverables that the GASB expects from the recipient. The recipient will receive an additional $2,000 upon delivery and the GASB's acceptance of the preliminary report on the findings of the research. Upon completion of the research and the GASB's acceptance of the research memorandum, the remainder of the grant will be sent to the recipient. The grant recipient may share the grant with others who help conduct the research.