

1 NEW DEVELOPMENTS

Introduction	1	Application of Fair Value to Assets and Liabilities	5
Recently Issued GASB Statements and Their Effective Dates	1	Elements of Financial Statements – Recognition and Measurement Approaches	6
Exposure Drafts	2	Recognition of Elements of Financial Statements	7
Exposure Draft of Proposed Concepts Statement – <i>Measurement of Elements of Financial Statements</i>	2	Measurement Approaches	8
Preliminary Views	3	GASB Project Plan	10
Fair Value Measurement and Application	3	Summary	11
Fair Value Measurements	3		

INTRODUCTION

The 2014 Governmental GAAP Guide incorporates all of the pronouncements issued by the Governmental Accounting Standards Board (GASB) through October 2013. This chapter is designed to keep the reader up to date on all pronouncements recently issued by the GASB and their effective dates, as well as to report on the Exposure Drafts, Preliminary Views, and Invitations to Comment for proposed new statements or interpretations that are currently outstanding. This chapter also includes relevant information on the GASB's Technical Agenda for the upcoming year to give readers information as to potential areas for future GASB requirements.

RECENTLY ISSUED GASB STATEMENTS AND THEIR EFFECTIVE DATES

	<u>GASB Statement</u>	<u>Effective Date</u>	<u>Where in this book</u>
62	<i>Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements</i>	Periods beginning after December 15, 2011	Chapter 2
63	<i>Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position</i>	Periods beginning after December 15, 2011	Chapter 9
64	<i>Derivative Instruments: Application of Hedge Accounting Termination Provisions—An Amendment of GASB Statement No. 53</i>	Periods beginning after June 15, 2011	Chapter 13

65	<i>Items Previously Reported as Assets and Liabilities</i>	Periods beginning after December 15, 2012	Chapter 9
66	<i>Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62</i>	Periods beginning after December 15, 2012	Chapters 2 and 21
67	<i>Financial Reporting for Pensions Plans—An Amendment of GASB Statement No. 25</i>	Periods beginning after June 15, 2013	Chapter 22
68	<i>Accounting and Financial Reporting for Pensions—An Amendment of GASB Statement No. 27</i>	Periods beginning after June 15, 2014	Chapter 17
69	<i>Government Combinations and Disposals of Government Operations</i>	Periods beginning after December 15, 2013	Chapter 11
70	<i>Accounting and Financial Reporting for Nonexchange Financial Guarantees</i>	Periods beginning after June 15, 2013	Chapter 15

The GASB has a number of Exposure Drafts and Preliminary Views that it has issued which will affect future accounting and financial reporting requirements when final standards are developed. The following provides a brief synopsis of what is being covered by each Exposure Draft and Preliminary Views document. Readers should always be aware that the GASB often modifies proposal stage literature based upon its continuing deliberations and consideration of comments that it receives on each Exposure Draft and Preliminary Views Document.

EXPOSURE DRAFTS

Exposure Draft of Proposed Concepts Statement – *Measurement of Elements of Financial Statements*

This proposed Concepts Statement addresses both measurement approaches and measurement attributes for elements of financial statements. It is the first outgrowth of a related Preliminary Views Document discussed later in this chapter. As described in the proposed Concepts Statement, a measurement approach determines whether an asset or liability presented in a financial statement should be (1) reported at an amount that reflects a value at the date that the asset was acquired or the liability was incurred or (2) remeasured and reported at an amount that reflects a value at the date of the financial statements. A measurement attribute is the feature or characteristic of the asset or liability that is measured.

This proposed Concepts Statement establishes the two measurement approaches that would be used in financial statements, as follows:

- ***Initial-Transaction-Date-Based Measurement (Initial Amount)***—The transaction price or amount assigned when an asset was acquired or a liability was incurred, including subsequent modifications to that price or amount, such as through depreciation or impairment.

- **Current-Financial-Statement-Date-Based Measurement (Remeasured Amount)**—The amount assigned when an asset or liability is remeasured as of the financial statement date.

This proposed Concepts Statement also establishes the four measurement attributes that would be used in financial statements, as follows:

- **Historical cost** is the price paid to acquire an asset or the amount received pursuant to the incurrence of a liability in an actual exchange transaction.
- **Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- **Replacement cost** is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the measurement date.
- **Settlement amount** is the amount at which an asset could be realized or a liability could be liquidated with the counterparty, other than in an active market.

NOTE: Concepts Statements themselves do not change existing GAAP, rather they form a basis on which the GASB will likely issue a new statement, which will then change existing GAAP. Essentially, it represents a re-examination of the accounting basis (historical cost or fair value) of the various components of the financial statements.

PRELIMINARY VIEWS

Fair Value Measurement and Application

In June 2013 the GASB issued a Preliminary Views document entitled *Fair Value Measurement and Application*. This Preliminary Views document would bring many of the accounting and disclosure requirements related to fair value that are currently required by the Financial Accounting Standards Board (FASB) for the types of entities that follow its accounting standards for financial statement preparation.

The Preliminary Views document favors the adoption of an exit price method for determining fair value. The fair value of an asset or liability would be defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The objective of a fair value measurement would be to estimate the exit price of assets and liabilities using observable or unobservable inputs.

Fair Value Measurements

In determining an appropriate fair value measurement, the characteristics of the asset or liability would be taken into account, such as the condition and location of an asset. Markets also would be considered. In a fair value measurement, the sale of an asset or the

transfer of a liability would be expected to take place in the principal market or, in the absence of a principal market, in the most advantageous market to which a government has access. In addition, the Preliminary Views document holds that transaction costs, such as commissions, do not meet the definition of an asset and, therefore, should be recognized when incurred.

The Preliminary Views document notes that certain market conditions may make quoted prices less reliable for fair value measurement. If fair value measurement is required and there has been a significant decrease in the volume or level of activity for an asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices would be needed. Similarly, if evidence indicates that a transaction is not orderly, a government would place little, if any, weight (compared with other indications of fair value) on that transaction price.

The Preliminary Views document provides that valuation techniques used to estimate the fair value of an asset or liability should be appropriate in the circumstances. The objective of using a valuation technique would be to estimate the price at which an orderly sale of an asset or transfer of a liability would take place between market participants, at the measurement date, under current market conditions. Valuation techniques should maximize the use of observable inputs and minimize the use of unobservable inputs. In other words, the most objective of fair value measurements available is the one that should be used to report the fair value of an asset or a liability.

Valuation approaches included in the Preliminary Views document include market, cost, and income approaches. The market approach uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities, or a group of assets and liabilities. The cost approach reflects the amount that would be required currently to replace the service capacity of an asset. The income approach converts future amounts (for example, cash flows or income and expenses) to a single discounted amount. When the income approach is used, the fair value measurement would reflect current market expectations about those future amounts.

To increase consistency and comparability in fair value measurements and related disclosures, the Preliminary Views document would establish a fair value hierarchy that would categorize the inputs to valuation techniques used to measure fair value into three levels (Level 1, 2, or 3). The highest priority would be given to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs would be other than quoted prices that are observable for the asset or liability, either directly or indirectly. Quoted prices obtained from third parties, such as pricing services or brokers, would be allowed if a government has determined that the quoted prices provided by those parties are developed in accordance with the preliminary views described in this document.

NOTE: The above discussion is very similar to the FASB requirements relating to fair value, including the discussion of the three levels of objectivity in determining fair value. An additional result of specifying the three levels noted above is extensive disclosure requirements as to the categorization of financial statement amounts measured at fair value into one of the three categories.

If fair value measurements were applied to nonfinancial assets, those assets would be valued based on their highest and best use, which would take into account the best use of the asset that is physically possible, legally permissible, and financially feasible.

A government would be permitted, as a practical expedient, to estimate the fair value of an investment that does not have a readily determinable fair value using the net asset value per share (or its equivalent) of the investment. This expedient would be available if the net asset value per share of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles for investment companies as of the government's measurement date.

NOTE: This practical expedient is meant for investment funds where net asset value per share is not available on an open market, which would generally be the case for hedge funds or funds that are only available to members of a common trust fund. It would not apply to mutual funds that are offered to the public each day at their published net asset value, as these mutual funds would be categorized in Level 1.

Fair value also may apply to certain liabilities. The Preliminary Views document used the example of an interest rate swap that is in a liability position to a government. The fair value of such a liability would be the price to transfer it to a market participant at the measurement date. The liability would be assumed to remain outstanding, requiring the assuming market participant to fulfill the obligation. Additionally, the fair value measurement would take into account the effect of nonperformance risk, which includes a government's own credit risk and any other factors that might influence the likelihood that the obligation would or would not be fulfilled.

Application of Fair Value to Assets and Liabilities

The Preliminary Views document provides that investments generally should be measured at fair value and also contains an extensive discussion of what types of assets should be considered "investments". An investment is defined as a security or other asset that a government holds primarily for the purpose of income or profit, and the present service capacity of which is based solely on its ability to generate cash, to be sold to generate cash, or to procure services for the citizenry.

Certain investments would be excluded from measurement at fair value and would continue to be measured according to existing GASB literature. This would include investments in 2a7-like external investment pools, investments in money market instruments with remaining maturity at time of purchase of one year or less, investments in

certain life insurance policies, investments in common stock that are eligible for the equity method, and investments in nonparticipating interest-earning investment contracts.

An additional item addressed by the Preliminary View document is the measurement requirements for donated capital assets. It provides that donated capital assets which are currently measured at fair value would be measured using acquisition value. Acquisition value would represent the price that would be paid for acquiring similar assets having similar service capacity as of the acquisition date. Acquisition value would replace fair value measurements for donated works of art, historical treasures, and similar assets; capital assets received in a service concession arrangement; and nonmonetary assets acquired in an exchange when the value of the asset received is used to measure the cost of the asset acquired.

Elements of Financial Statements – Recognition and Measurement Approaches

In June 2011 the GASB issued a Preliminary Views document entitled *Recognition of Elements of Financial Statements and Measurement Approaches*. This PV document would result in the issuance of a GASB Concepts Statements related to recognition of elements of financial statements and measurement approaches.

NOTE: Before the reader decides that this is only a Preliminary Views document and that it will “only” lead to a Concepts Statement and takes the potential impact lightly, be advised that the concepts being addressed are the basis of accounting and the measurement focus as they are applied to financial statements, which could ultimately have a profound impact on both fund and government-wide financial reporting, particularly for governmental funds, where the modified accrual basis and current financial resources measurement focus are under particular scrutiny. The GASB has actually split this project into (at least) two components. The measurement of elements of financial statements aspect resulted in an Exposure Draft of a Concepts Statement described above. The second component as to recognition will likely result in an additional Concepts Statement where the anticipated impact on the modified accrual basis of accounting is likely to be included.

The PV document presents the Board’s preliminary views on recognition of elements of financial statements and measurement approaches. The PV document states that recognition concepts encompass two aspects of state and local government financial statements. The measurement focus of a specific financial statement determines *what* items should be reported as elements of that financial statement. The related basis of accounting determines *when* those items should be reported. A measurement approach is a broad concept focusing on whether an asset or liability presented in a financial statement should be reported at an amount that reflects the value when the asset was acquired or the liability incurred or whether the asset or liability should be remeasured and reported at an amount that reflects the value at the date of the financial statements.

Recognition of Elements of Financial Statements

The PV document proposes a recognition framework for both the economic resources measurement focus and the near-term financial resources measurement focus. One component of this framework is that an item, on a conceptual basis, should be recognized, and therefore reported as an element of financial statements prepared using the economic resources measurement focus, if the item both meets the definition of an element and is measurable with a sufficient degree of reliability.

Because of various inconsistencies in the current financial resources measurement focus model, the framework being proposed would include a component that, on a conceptual basis, would replace that model with the near-term financial resources measurement focus, which recognizes balances from a near-term perspective and flows of financial resources for the reporting period. Near term refers to the period subsequent to the end of the reporting period during which financial resources at period-end can be converted to cash to satisfy obligations for spending for the reporting period. Consistent with the objective of developing a conceptually sound model, the near-term financial resources measurement focus is based on a symmetrical concept: assets include resources that are normally *receivable at period end and due* to convert to cash within the near term (as well as cash and financial resources that are available to be converted to cash within the near term) and liabilities include those normally *payable at period-end and due* within the near term.

Consistent with the concept of interperiod equity, another component of this proposed framework would include proposed concepts related to the recognition of deferred outflows of resources or deferred inflows of resources in financial statements prepared using the economic resources measurement focus when the following types of transactions occur:

- Outflows of resources that do not meet the definition of an asset and are inherently related to services that the government will provide in future periods.
- Inflows of resources that do not meet the definition of a liability and can only be used in the future.
- Inflows of resources related to items that were not previously recognized as assets in the financial statements (future resources).
- Outflows of resources and inflows of resources related to changes in the fair value of recognized assets and liabilities when the item is related to an outflow of resources or inflow of resources that will occur in the future.

The PV's proposed framework includes a component that, on a conceptual basis, would include recognizing deferred outflows of resources or deferred inflows of resources in financial statements prepared using the near-term financial resources measurement focus when the following transactions occur:

- Outflows of resources that do not meet the definition of an asset and are inherently related to future spending.
- Inflows of resources that do not meet the definition of a liability and can only be used for spending in the future.

Measurement Approaches

The PV document also proposed a framework for when each of two primary measurement approaches, on a conceptual basis, should be used. These views are discussed in the Exposure Draft of a Concepts Statement described earlier in this chapter.

NOTE: As mentioned above, the impacts of a Concepts Statement that could result from this PV in its present form would conceivably affect many future GASB statements that would have to incorporate the concepts included in a Concepts Statement that might ultimately result from this PV. Given the broad range of areas—replacing the current financial resources measurement focus with the near-term financial resources measurement focus to examining what balance sheet items are better reported at cost or fair value, this is a project that preparers, users, and auditors of governmental financial statements need to carefully monitor.

In March 2012 the GASB issued a Preliminary Views Document titled *Economic Condition Reporting: Financial Projects*.

The GASB believes that decision makers need information with which to assess a government's *economic condition*—its financial position, fiscal capacity, and service capacity. Fiscal sustainability is the forward-looking aspect of economic condition. Fiscal sustainability is defined as a government's ability and willingness to generate inflows of resources necessary to honor current service commitments and to meet financial obligations as they come due, without transferring financial obligations to future periods that do not result in commensurate benefits.

The Preliminary Views document lists five components of information that are necessary to assist users in assessing a governmental entity's fiscal sustainability:

- Projections of the total cash inflows and major individual cash inflows, in dollars and as a percentage of total cash inflows, with explanations of the known causes of fluctuations in cash inflows.
- Projections of the total cash outflows and major individual cash outflows, in dollars and as a percentage of total cash outflows, with explanations of the known causes of fluctuations in cash outflows.
- Projections of the total financial obligations and major individual financial obligations, including bonds, pensions, other postemployment benefits, and long-term contracts, with explanations of the known causes of fluctuations in financial obligations.
- Projections of annual debt service payments (principal and interest).
- Narrative discussion of the major intergovernmental service interdependencies that exist and the nature of those service interdependencies.

The Preliminary Views document provides that financial projections would be (1) based on current policy, (2) informed by historical information, and (3) adjusted for known events and conditions that affect the projection periods. Current policy includes policy changes that have been formally adopted by the end of the reporting period but that will not be effective until future periods. Inflows and outflows would be projected on a cash basis of accounting, and financial obligations would be projected on an accrual basis of accounting.

The assumptions employed in making projections would be based on relevant historical information, as well as events and conditions that have occurred and affect the projection periods. The assumptions would be (1) consistent with each other (where appropriate) and with the information used as the basis for the assumptions and (2) comprehensive by considering significant trends, events, and conditions. Disclosure of assumptions would be required. Further, annual financial projections would be made for a minimum of five individual years beyond the reporting period for the purpose of external reporting.

The Preliminary Views document provides that all of the components of fiscal sustainability information are believed to be essential for placing the basic financial statements and notes to the basic financial statements in an operational or economic context and therefore would be required and communicated as required supplementary information (RSI). All governmental entities would be required to report the components of fiscal sustainability information.

The components of fiscal sustainability information would be reported for the primary government, including both governmental activities and business-type activities with net subtotals (inflows less outflows) for the general fund, other governmental activities, total governmental activities, total business-type activities, and a net total for the entire primary government. Notes to RSI would be necessary in instances when one or more activities may significantly affect (positively or negatively) the fiscal sustainability of the primary government.

In addition, an individual cash inflow, cash outflow, and financial obligation of a governmental or business-type activity would be separately projected if it is considered major, meaning it represents at least 10% of total cash inflows, total cash outflows, or total financial obligations, respectively, for all activities of that type in any of the projection periods reported. All cash outlays for capital and capital-related cash inflows from bond proceeds, capital grants, or other sources restricted or committed to capital outlays would be considered major and reported separately. Any other cash inflow, cash outflow, or financial obligation may be reported as major if the government believes that information is particularly important to users when making an assessment of the primary government's economic condition, including fiscal sustainability. Determining which intergovernmental service interdependencies are major is a matter of professional judgment.

The Preliminary Views document notes that projections based on current policy do not represent a forecast or a prediction of the most likely outcome. Financial projections may be based upon assumptions regarding changes in social, economic, and demographic events and conditions that are inherently subject to uncertainties. Therefore, a cautionary notice would precede the displayed financial projections and related narrative discussions advising readers that actual results may vary from the financial projections reported.

OBSERVATION: This Preliminary Views document has received quite a bit of push-back from government financial statement preparers. The main objection is that the requirements for preparing the projections cannot assume that the government will make changes that will impact its future cash receipts or disbursements. This is in contrast to how governments actually budget, which takes such changes into consideration.

GASB PROJECT PLAN

The GASB has a number of important projects on its agenda that will likely affect governmental accounting and financial reporting in the future. Some of the more significant projects are as follows.

Postemployment Benefits Other Than Pensions (OPEBs). Having recently issued major new standards for plan and employer accounting for pensions, the GASB will turn its attention to address how and if the changes related to pension accounting should be applied to employers' accounting for OPEB benefits.

Fiduciary Responsibilities. This is a project to assess whether additional guidance should be developed regarding the application of the fiduciary responsibility criterion in deciding whether and how governments should report fiduciary activities in their financial reports.

GAAP Hierarchy. This project would consider possible modifications to the GAAP hierarchy, as set forth in Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. It would reexamine the hierarchy levels to assess whether the standards setting process and the governmental financial reporting environment have sufficiently evolved since the establishment of the original hierarchy by the AICPA in 1992 to warrant reconsideration or reconfiguration of certain aspects of the structure.

Lease Accounting. This project would reexamine issues associated with lease accounting, considering improvements to existing guidance. The research project would provide a basis for the GASB to consider whether operating leases meet the definitions of assets or liabilities.

Tax Abatement Disclosures. This research project would address the potential need for additional disclosures for governments that have granted tax abatements and subsidies.

Financial Reporting Model. This research project would take a fresh look at the basic financial reporting model required by GASBS 34, as amended, to determine if it is working effectively and whether any changes to the model need to be made.

SUMMARY

The GASB, as always, maintains an active agenda, and the accounting and financial reporting standards for governments are consistently evolving. Financial statement preparers need to keep an eye on emerging new GASB pronouncements to ensure that they have adequate time to plan for their implementation, as well as to inform financial statement users about their potential impacts.

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