

2017 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 more than 30 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 \$5,000 research grants, to be awarded by the end of June 2017.

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 information can be provided at what is believed to be a reasonable cost.

The GASB technical staff is relatively small. Therefore, the GASB seeks to leverage research efforts by encouraging the academic community 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 knowledgeable professionals and by encouraging them to participate in your research. Upon completion of your research, the GASB intends to mail 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 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.

Research Topics for 2017

The GASB is seeking proposals for research on the following topics—Related Party Transactions, Subsequent Events, Present Value, Public-Private Partnerships, Interfund Transactions, Chapter 9 Bankruptcies, Derivative Instruments, and Distributed Water Management Programs.

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 No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, 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 would be addressed:

- How prevalent are related party transactions for state and local governments? How significant are the dollar amounts involved in these transactions?
- What types of related party transactions do governments disclose in practice? Are the disclosure standards appropriately applied to these 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?

Subsequent Events

Subsequent events were another of the three topics covered by the guidance that was transferred in Statement 56. Subsequent events occur after the end of the fiscal year but before the financial statements are issued. There are two kinds of subsequent events. *Recognized* subsequent events relate to conditions that existed as of the date of the financial statements and, therefore, may require a government to adjust amounts already recognized. *Unrecognized* subsequent events involve conditions that were not in place as of the date of the financial statements. Because the conditions affected by the subsequent event took place after the fiscal year, the impact of the subsequent event is not reflected in the financial statements and, therefore, may need to be disclosed. It also may be necessary to mention unrecognized subsequent events in the section of management's discussion and analysis related to currently known facts, decision, or conditions.

The general requirement to disclose subsequent events is found in NCGA Interpretation 6. However, neither Interpretation 6 nor Statement 56 specifies what information should be disclosed about unrecognized subsequent events.

The following issues would be addressed:

- How prevalent are subsequent event disclosures by state and local governments? What types of subsequent events do governments disclose in practice?
- What issues do governments and auditors have, if any, in applying the standards?
- What information are governments disclosing about subsequent events? Is the information useful for making decisions and assessing government accountability?
- What information do users need about subsequent events that they are not currently receiving? How would they use that information?

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 this research.

The primary objective of this 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 would be considered:

- What are the instances in which present value is required or discussed in the literature of the GASB and other standards setters?
- What are the objectives of present value measurements in financial reporting?
- When would the application of a present value be appropriate?
- What guidance should be provided for appropriate methods and inputs for the development of present values?
- What present value disclosures are appropriate?

Public-Private Partnerships

Service concession arrangements (SCA) are a subset of a broader group of transactions generally referred to as public-private partnerships (PPP). Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, defines an SCA as an arrangement between a transferor (a government) and an operator (a governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a “facility”) in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties. Statement 60 is applicable only to transactions that meet this definition, not to all PPPs. Statement 60 was effective starting with periods beginning after December 15, 2011.

The following issues would be considered:

- Do the existing standards continue to appropriately capture the economic substance of SCAs?
- Are governments appropriately applying the recognition and disclosure requirements of Statement 60?
- Have disclosures presented in conformity with the requirements of Statement 60 sufficiently met user needs?
- What transactions, if any, fall outside the scope of both Statement 60 and the forthcoming standards on leases? What is the nature of these transactions?

Interfund Transactions

Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, makes a clear distinction between interfund transfers and interfund loans. Paragraph 112 states that amounts provided by one fund to another with the expectation of repayment should be reported as interfund loans, with an interfund receivable in the lender fund and an interfund payable in the borrower fund. However, the paragraph clarifies that if repayment is not expected within a reasonable time, the transaction should be reclassified as a transfer and the receivables and payables eliminated. All other interfund resource flows without an equivalent return flow of resources or requirement for repayment should be reported as interfund transfers.

Statement No. 38, *Certain Financial Statement Note Disclosures*, requires disclosure of greater detail of interfund balances and interfund transfers beneath the aggregated amounts on the face of the financial statements. Governments also are required to disclose the purposes of interfund balances and transfers, amounts of interfund balances not expected to be repaid within a year, and the purposes of transfers that do not occur on a routine basis or are inconsistent with the activities of the fund making the transfer. NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, as amended by Statement 38, requires disclosure of violations of finance-related legal and contractual provisions, as well as actions taken to resolve them, which could be applicable to some of those nonroutine or inconsistent interfund transfers. All of these disclosures are among those included in the ongoing GASB pre-agenda research reexamining note disclosure requirements.

The questions that would be addressed in this research include:

- Are governments appropriately applying the existing standards distinguishing between interfund loans and transfers? What types of interfund transactions, if any, are not being appropriately reported?
- Have governments known to have made transfers that violate legal or contractual provisions disclosed the violations appropriately?
- How are governments reporting transactions in which temporarily available cash is loaned from one fund to another (for example, to allow the other fund to invest the cash short-term to generate income for the other fund’s purpose, before returning the cash to the lender fund)?
- How do users view the distinction between interfund loans and transfers? What information do they need regarding these transactions?

Chapter 9 Bankruptcies

Prior to the issuance of Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, in December 2009, 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?

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 issued in June 2008 and 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—based on the methods for assessing hedge effectiveness described in Statement 53, 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 deferred outflows of resources or deferred inflows of resources, 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 questions that would 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 these 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?
- Have there been changes in the economic environment such that the Statement 64 exception to Statement 53's termination of hedges guidance is no longer appropriate? Should the exception be expanded or continued?

Distributed Water Management Programs

Distributed water management broadly refers to planning, design, and water management activities, both centralized (performed by the water utility) and decentralized (performed by customers and others external to the utility). Programs involving decentralized activities often take the form of a utility providing incentives to install water-saving devices such as water-efficient appliances, low-water-use landscaping, and greywater reuse systems. In some cases, the incentives cover the entire cost of installation. Some utilities pay for the incentives using existing resources and others finance them by issuing long-term debt.

The relevant standards are apparent for (1) construction of new capital assets by a utility as part of these programs and (2) upgrades to a utility's existing capital assets. However, it may be unclear what standards should be applied to transactions that involve incurring costs for decentralized activities, particularly those that involve borrowing. Issues also arise regarding the application of regulatory accounting under the provisions of Statement 62, as amended by Statement 65.

The questions that would be addressed in this research include:

- Are utilities accounting for and reporting these transactions in conformity with existing standards? If not, what accounting and reporting practices are they following?
- What types of decentralized activities, if any, might result in the reporting of capital assets?
- Under what circumstances would it be appropriate for a utility to report a regulatory asset related to these transactions?
- What specific user information needs exist with respect to these transactions?

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.

<u>Date</u>	<u>Activity</u>
May 31, 2017	Request for Funding Due
June 30, 2017	Grant Recipient(s) Determined
August 31, 2017	Methodology Finalized in Consultation with GASB Staff
October 31, 2017	Initial Update to GASB Staff on Progress of Research
January 31, 2018	Preliminary Report to GASB Staff
April 30, 2018	Draft Research Memorandum Due
May 31, 2018	Final Research Memorandum Due

Content of the Research Memorandum

The final product from your research efforts for the GASB on either of the two topics 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 31, 2017**. 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:

- A description of how you believe your research on the topic will help answer the question(s)
- A thorough description of the research design that you plan to use; this 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
- A description of any limitations that you foresee regarding the validity of your research results
- A timeline for completing the research and preparing a final report for the GASB; this timeline should meet the parameters for reporting back to the GASB, which are described above
- Your CV or resume
- One or two articles or reports 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 by the end of June 2017. The recipients will receive an initial \$2,500 soon after they sign a contract with the GASB. The contract will explain the duties and responsibilities of the GASB and researcher and will describe the deliverables that the GASB expects from the researcher. Upon

completion of the research and the GASB's acceptance of the research memorandum, the remainder of the grant will be sent to the researcher. The maximum amount to be paid to a grant recipient is \$5,000. The grant recipient may share the grant with others who help conduct the research.