

November 30, 2009

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 26-3
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Governmental Accounting Standards Board (GASB) Exposure Draft (ED), *Financial Instruments Omnibus*, and is pleased to offer its comments. Overall, we support the GASB's efforts to improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarifications of existing standards. However, we do have several comments and recommendations that we believe the Board should address before finalizing the standard. Our significant comments and recommendations are included in the following section of this letter and our other comments are in the "Other Comments and Recommendations" section below.

SIGNIFICANT COMMENTS AND RECOMMENDATIONS

Guidance on Display of Deferred Inflows and Outflows Needed. We are very concerned about the current lack of guidance regarding the appropriate display of deferred inflows and deferred outflows in the financial statements and strongly recommend that the Board address this matter. While we recognize this issue was not included in the scope of this ED, we are raising our concern here because GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which will be effective for June 30, 2010, year-ends, is the first pronouncement to explicitly require the presentation of these new financial statement elements.

In considering various implementation issues associated with GASB Statement No. 53, we have found that there is great uncertainty by both preparers and auditors as to how deferred inflows and deferred outflows should be displayed in the financial statements. While GASB Concepts Statement No. 4, *Elements of Financial Statements*, does not directly address display issues, it does state that these new elements are not assets or liabilities, which gives rise to the uncertainty of display. Some that are considering this question believe the appropriate display is in the asset and liability sections of the Statement of Net Assets. Such a presentation would require changes in the captions of such sections (i.e., "Assets and Deferred Outflows" and "Liabilities and Deferred Inflows"). Alternatively, others believe that deferred inflows and deferred outflows should be presented in separate sections of the Statement of Net Assets outside of the assets and liabilities sections.

Further, there is uncertainty whether deferred inflows and deferred outflows would be included in the calculation and classification of net assets in the Statement of Net Assets. Footnote 4 of GASB Concepts Statement No. 4 states that “net assets are assets netted with liabilities.” This description of net assets, along with the introduction of the deferred inflow and deferred outflow elements, could lead one to conclude that the sections of the Statement of Net Assets should be presented as follows:

- Assets;
- Liabilities;
- Net Assets (as classified based on GASB Statement No. 34, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments*);
- Deferred Inflows and Deferred Outflows;
- Net Position.

As a practical matter, this would result in deferred inflows and deferred outflows essentially being presented similarly to Other Comprehensive Income in the private sector.

Because many governments will soon be implementing GASB Statement No. 53, the display of these new financial statement elements should be discussed in authoritative literature to achieve the objectives of Concepts Statement No. 4 and to prevent diversity in practice. The Board should directly address the presentation of these new elements to promote consistency of governmental financial statements. In reviewing the current GASB technical plan, it appears as if the Board has moved the timing of consideration of this ED until mid-2010. Guidance on the display of deferred inflows and outflows is needed much sooner. Therefore, we strongly recommend that the Board take on a separate “fast-track” project to address this issue so that final guidance will be available prior to the effective date of GASB Statement No. 53.

GASB Statement No. 31 – Additional 2a-7 Like Clarifications Needed. Paragraph 4 of the ED would revise GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, to explicitly state the criterion for “2a-7 like” external investment pools in category (a) generally accepted accounting principles. While we agree that moving the definition of “2a-7 like” from the *Comprehensive Implementation Guide* to category (a) guidance will increase the visibility of the requirement, we are concerned that the proposed amendment to GASB Statement No. 31 may be too narrow. Paragraph 16 of the ED states that the concept behind the exception from fair value accounting allowed for 2a-7 like investments is that the investments are of very high credit quality and short maturity. Rule 2a-7 of the Investment Company Act of 1940 is a lengthy rule and includes requirements that go well beyond the two areas cited by the Board in paragraph 16. While we understand the Board’s logic in defining 2a-7 pools by reference to the rule rather than by incorporating its detailed provisions into the standards, we are troubled by the potential exclusion from “2a-7 like” accounting treatment for pools that use alternative rating criteria that exceed the Rule 2a-7 requirements relating to credit quality and maturity but perhaps do not meet every other detailed requirement of the rule. Therefore, we believe a much more effective approach would be for the Board to include in GASB Statement No. 31 only the Rule 2a-7 requirements that are most critical and permit the exception for pools that exceed those requirements. This would be clearer and also allow governmental external investment pools that follow alternative rating criteria that meet or

exceed the credit quality and maturity requirements of Rule 2a-7 to qualify for the fair value exception without having to adopt all of the other detailed elements of Rule 2a-7 in order to qualify for the fair value exemption.

GASB Statement No. 53 – Changes to Certain Financial Guarantee Contracts Definition May Have Unintended Consequences. We are concerned that the revisions proposed by the Board in paragraph 7 of the ED would include a broadening of the scope of GASB Statement No. 53 beyond what was intended. Specifically, paragraph 7 of the ED defines financial guarantee contracts as credit default swaps. However, there other financial guarantee contract arrangements that are not considered credit default swaps that could be scoped into GASB Statement No. 53 for the first time. For example, a higher education institution may have student loan receivables which are guaranteed by the U.S. Department of Education. In this situation, while the loan itself would not meet the definition of a derivative, the guarantee on the loan may meet the definition and therefore be subject to GASB Statement No. 53 under the proposed revision. The Board should consider whether the proposed revisions to GASB Statement No. 53 were intended to be limited to only credit default swaps. If so, the Board should discuss the rationale for narrowing the scope exception in the Basis for Conclusions. If the Board’s intent was not to restrict the scope so narrowly, the scope of the final standard should be revised to more clearly address financial guarantee contracts that would not be considered credit default swaps.

GASB Statement Nos. 25 and 43 - Unallocated Insurance Contracts. We are concerned that the amendments to GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, will not support the Board’s intention in paragraph 3 of the ED that investments in unallocated insurance contracts should be measured at fair value. Striking *unallocated insurance contracts* from GASB Statement Nos. 25 and 43 has the effect of putting them in the scope of GASB Statement No. 31. Unallocated insurance contracts would seem to be classified as “nonparticipating contracts” under paragraph 8 of GASB Statement No. 31, and therefore exempt from fair value measurement. We believe there is an inconsistency between the Board’s intent and the effect of the proposed amendments and recommend that the Board clarify this in the final standard to avoid confusion.

OTHER COMMENTS AND RECOMMENDATIONS

GASB Statement No. 40 – Disclosures of Interest Rate Risk for Bond Mutual Funds. We were initially unclear in reading paragraph 5 of the ED as to whether the amendment to paragraph 15 of GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, applies to mutual funds that hold a mix of debt and equity investments (i.e., whether those mutual funds should disclose interest rate risk information). We noted that paragraph 18 of the Basis for Conclusions addresses this by stating that an interest rate risk disclosure for mutual funds that hold a mix of debt and equity investments is not required. We recommend that for clarity purposes the Board move the final sentence in Paragraph 18 of the Basis for Conclusions to the body of the final standard.

GASB Statement No. 40 – Applicability of the Term “Bond” to External Investment Pools or Other Pooled Investments. In reviewing paragraph 5, we also questioned whether the addition of the word *bond* is meant to solely modify “mutual funds” or whether it was meant to modify the other elements in the list (i.e., bond mutual funds, *bond* external investment pools, or other pooled *bond* investments). If the addition of the word *bond* is meant to solely modify “mutual funds,” we encourage the Board to clarify whether external investment pools or other pooled investments that hold a mix of debt and equity investments would be required to disclose interest rate risk.

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The AICPA appreciates the opportunity to comment on the ED. This comment letter was prepared by members of the AICPA’s State and Local Government Expert Panel and was reviewed by representatives of the Accounting Standards Executive Committee (AcSEC) who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,



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Chair
AICPA State and Local Government
Expert Panel



Mary M. Foelster
Director
AICPA Governmental Auditing and
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cc: State and Local Government Expert Panel
Jay Hanson
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