University of California
Governmental Accounting Standards Board (GASB) Statement No. 65,
Items Previously Reported as Assets and Liabilities

Issues Resolution Memo No. 65-1

Evaluation of GASB Statement No. 65 as it Relates to the UC Reporting Entities
Issued: December __, 2013

Background

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, was adopted by the University effective July 1, 2013. This statement addresses accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities, and recognizes, in the Statement of Revenue, Expenses, and Changes in Net Position (SRECNP) as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

The statement changes the accounting for the following types of transactions

1. Refunding of debt
2. Debt issuance costs
3. Certain non-exchange transactions
4. Leases
5. Sales of Future Revenues

Definitions

Assets	Resources with present service capacity that the government presently controls.
Liabilities	Present obligations to sacrifice resources that the government has little or no discretion to avoid.
Deferred outflow of resources	Consumption of net assets by the government that is applicable to a future reporting period.
Deferred inflow of resources	Acquisition of net assets by the government that is applicable to a future reporting period.
Government-mandated nonexchange transactions	Occurs when a government at one level provides resources to a government at another level and requires the recipient to use the resources for a specific purpose (for example, federal programs that state or local governments are mandated to perform).

Imposed nonexchange revenues	Result from assessments imposed on nongovernmental entities, including individuals, other than assessments on exchange transactions (for example, property taxes and fines).
Voluntary nonexchange transactions	Results from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties. Examples of voluntary nonexchange transactions include certain grants, certain entitlements, and donations by nongovernmental entities, including individuals (private donations). Both parties to a voluntary nonexchange transaction may be governments (including the federal government, as a provider), or one party may be a nongovernmental entity, including an individual. Frequently, the provider establishes purpose restrictions and eligibility requirements. In many cases, the provider may require the return of the resources if the purpose restrictions or eligibility requirements are contravened after recognition of the transaction. The principal characteristics of voluntary nonexchange transactions are (1) they are not imposed on the provider or the recipient and (2) fulfillment of eligibility requirements is essential for a transaction (other than the provision of cash or other assets in advance) to occur.

Effective Date

The requirements of this Statement are effective for the University for the period beginning July 1, 2013 and are required to be applied retroactively for all periods presented in the annual financial statements of the University of California and its Medical Centers.

Define Issue

The University must determine whether GASB Statements No. 65 changes any existing financial reporting and disclosure requirements for any of the University's financial reporting entities.

Authoritative Guidance

Refunding of Debt
This statement changes the financial reporting for current refundings and advance refundings resulting in the defeasance of debt. For current refundings and advance refundings resulting in defeasance of debt reported by the University, the difference between the reacquisition price and the net carrying amount of the old debt should be reported as a deferred outflow of resources or a deferred inflow of resources and recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

In summary, this statement changed the placement of the difference on the Statement of Net Position. Prior to the issuance of this statement, the difference was accounted for and included as a component of Long Term Debt on the Statement of Net Position whereas; under this statement, the difference is reported as either a deferred outflow of resources or a deferred inflow of resources. Manner in which the deferred item is recognized on the Statement of Revenues, Expenses and Changes in Net Position did not change from the guidance issued prior to this statement.

Debt Issuance Costs
Debt issuance costs include all costs incurred to issue long-term debt (i.e. general revenue bonds, pooled medical center bonds, etc.), including but not limited to insurance costs (net of rebates from the old debt, if any), financing costs (e.g. rating agency fees), and other related costs (e.g. printing, legal, administrative, etc.).

Debt issuance costs, except any portion related to prepaid insurance costs, should be recognized as an expense in the period incurred. Prepaid insurance costs should be reported as an asset and recognized as an expense in a systematic and rational manner over the duration of the related debt.

Nonexchange Transactions
This statement establishes guidance for the following two types of nonexchange transactions;

1. Imposed Nonexchange Revenue Transactions

   Deferred inflows of resources should be reported when resources associated with imposed nonexchange revenue transactions are received or reported as a receivable before the period when resources are required to be used or when use is first permitted for all imposed nonexchange revenues in which the enabling legislation includes time requirements.

   The University believes this is a rare occurrence for the University and any Campus that believes such a transaction exists should consult with UCOP.

2. Government-mandated nonexchange transactions and Voluntary nonexchange transactions

   The University receives grants and contract revenue from governmental and private sources. Providers of resources in government-mandated or voluntary nonexchange transactions such as research grants frequently establish eligibility requirements.

   Revenue recognition (e.g. contracts and grant revenue) should not be delayed pending completion of purely routine requirements, such as the filing of claims for allowable costs under a reimbursement program or the filing of progress reports with the provider.

   Resources received before time requirements are met but after all other eligibility requirements have been met, should be reported as a deferred inflow of resources by the recipient (the University). Resources received in advance that do not meet the non-time related eligibility requirements meet the definition of a liability and should be reported as a liability of the University as such.

	Eligibility Requirements Met	Accounting Treatment
Recipient of resources (i.e. recipient of expenditure driven grant program)	Eligibility requirements met, excluding time requirements	Deferred inflow of resources
Recipient of resources (i.e. recipient of expenditure driven grant program)	Eligibility requirements not met, excluding time requirements	Unearned revenue included as a component of liabilities
Provider of resources (i.e.	Eligibility requirements	Deferred outflow of

provider of expenditure driven grant program)	met, excluding time requirements	resources
Provider of resources (i.e. provider of expenditure driven grant program)	Eligibility requirements not met, excluding time requirements	Other asset included as a component of assets

Leases

Initial direct costs of operating leases should be expensed as incurred.

Further, with regards to sale-leaseback[1] transactions, the gain or loss on the sale[2] of property that is accompanies by a leaseback of all or any part of the property for all or part of its remaining economic life should be recorded as a deferred inflow of resources or a deferred outflow of resources, respectively, and recognized in a systematic and rational manner as follows;

Type of Lease	**Manner of recognition**
Capital Lease	Over the lease term in proportion to the recognition of the leased asset.
Operating Lease	In proportion to the related gross rental charged to expense/expenditure over the lease term.

Certain exceptions apply to lease-back transactions as follows;

a. The seller-lessee relinquishes the right to substantially all of the remaining use of the property sold (retaining only a minor portion of such use), in which case the sale and the leaseback should be accounted for as separate transactions based on their respective terms. However, if the amount of rentals called for by the lease is unreasonable under market conditions at the inception of the lease, an appropriate amount should be deferred or accrued, by adjusting the gain or loss on the sale, and amortized as specified in the introduction of this paragraph to adjust those rentals to a reasonable amount.
b. The seller-lessee retains more than a minor part but less than substantially all of the use of the property through the leaseback and realizes a gain on the sale in excess of (1) the

[1] Sale-leaseback transactions involve the sale of property by the owner and a lease of the property back to the seller.
[2] Gain or loss on the sale is used to refer to the gain or loss that would be recognized on the sale if there were no leaseback.

present value of the minimum lease payments over the lease term, if the leaseback is classified as an operating lease, or (2) the recorded amount of the leased asset, if the leaseback is classified as a capital lease. In that case, the gain on the sale in excess of either the present value of the minimum lease payments or the recorded amount of the leased asset, whichever is appropriate, should be recognized at the date of the sale. For purposes of applying this provision, the present value of the minimum lease payments for an operating lease should be computed using the interest rate that would be used to apply the 90 percent recovery criterion.

c. The fair value of the property at the time of the transaction is less than its undepreciated cost, in which case a loss should be recognized immediately up to the amount of the difference between undepreciated cost and fair value

Sales of future revenues
GASB 65, paragraph 11 states that GASB statement 48 provies accounting and financial reporting guidance for transactions that meet the criteria to be recognized as sales, in which a government receives proceeds in exchange for the right to cash flows from specific future revenues. Further, such proceeds received should be reported as a deferred inflow of resources except in instances where recognition in the period of sale as appropriate as discussed in GASB 48 paragraph 14.

Revenue Recognition in Governmental Funds
Revenue and other governmental fund financial resources should be recognized in the accounting period in which they become both measurable and available. When an asset is recorded but the revenue is not available, the government should report a deferred inflow of resources until such time as the revenue becomes available (i.e. deferred revenue should be reported as a deferred inflow instead of a liability).

Use of the Term Deferred
The use of the term *deferred* should be limited to items reported as deferred outflows of resources or deferred inflows of resources.

Implementation

Refunding of Debt
The University will remove the following AGC codes so that they may no longer be used going forward and will repurpose for use as deferred inflows of resources and deferred outflows of resources.

AGC Account Name	AGC Code

CL-Long-Term Debt-Revenue Bonds-Deferred Financing Cost	114611
CL-LTD-Rev Bonds-Non Cap Fin-Deferred Financing Cost	112611
CL-Long-Term Debt-COP-Deferred Financing Cost	114621
CL-Long-Term Debt-3rd Party Debt-Deferred Financing Cost	114614
NL-LTD-Revenue Bonds-Deferred Financing Costs	115411
NL-LTD-Rev Bonds-Non Cap Fin-Def Financing Costs	112411
NL-LTD-Certificates of Participation-Deferred Financing Costs	115421
NL-LTD-3rd Party Debt-Deferred Financing Costs	115414

All balances included in the above should be reclassified to the following AGC Codes for fiscal year 2013/2014 for all campuses with balances within their respective general ledgers. Once zeroed out the above accounts will be closed.

AGC Account Name	AGC Code
Deferred Inflows-Deferred Financing Costs – Capital related debt financing	114620
Deferred Inflows-Deferred Financing Costs – Noncapital related debt financing	114621
Deferred Outflows-Deferred Financing Costs – Capital related debt financing	115620
Deferred Outflows-Deferred Financing Costs – Noncapital related debt financing	115621

Debt Issuance Costs

The University will remove the following AGC codes so that they may no longer be used going forward and will expense any balances within the accounts during fiscal year June 30, 2014.

AGC Codes to be discontinued: 100840, 110840, 112840, 101960, 111960, 112960

The University will analyze the balance of the asset accounts as of June 30, 2012 and 2013 in order to determine the cumulative effect of the change in accounting as of July 1, 2012, the earliest reported period in the June 30, 2014 and 2013 University and Medical Center financial statements. The University does not believe the financial statements of its related retirement plans will be effected by the change in accounting principle.

Nonexchange Transactions

As of June 30, 2013 and 2012, respectively, the University had deferred revenue of $586,413,000 and $511,002,000 related to Contracts and Grants. As the recipient of resources from governmental and private sources, each Campus will need to evaluate all deferred revenue included in the below AGC codes and determine if all of the eligibility requirements have been met, excluding time requirements, to determine how much, for each respective Campus, should be reclassified as a deferred inflow of resources on the Statements of Net Position. The results of each Campuses analysis for the years ended June 30, 2013 and 2012 should be reported to UCOP by June 15, 2014. If all of the eligibility requirements have been met, excluding time requirements, see below for the account to be used.

For unearned revenue related to grants received in advance and meeting eligibility requirements (time requirements excluded), a deferred inflow of resources should be recorded to the following AGC code.

AGC Account Name	Current	Unexpended Plant
Deferred Inflows-Deferred Revenue-Grants Received in Advance, Eligibility Requirements Met Excluding Time Requirements	164810	104810

The following codes will remain classified as unearned revenue (in the liabilities category) in CFR.

	Current	Unexpended Plant
Unearned Revenue-General	164310	
Unearned Revenue-Auxiliary Enterprises	164320	
Unearned Revenue-Medical Center	164340	
Unearned Revenue-Grants Received in Advance of Meeting Eligibility Requirements	164330	104330
Unearned Revenue-OPEB-DOE-LBNL	164370	
NL-Unearned Revenue-UCRP-DOE	165585	

The following codes will be retired and no longer be used.

	Current	Unexpended Plant	Retirement of Indebt.	Loan
Unearned Revenue-General		104310 **	114310 **	
CL-Deferred Revenues-Grants and Contracts				144330
CL-Deferred Revenues-Sale of Future Revenues	164350			144350
CL-Deferred Revenues-Sale of Future Revenues-Earned	164360			144360
NL-Deferred Revenue-Sale of Future Revenues	165580			145580
NL-Deferred Revenue-OPEB-DOE-LBNL	165590			

** The balances included within these fund group codes are used exclusively to record premiums received from the issuance of SPWB bonds by the State. Historically the deferred liability has been recognized into revenue in the Statements of Revenue, Expenses, and Changes in Net Position over the life of the related capital lease obligations; however, during fiscal year 2013/2014, all SPWB bonds were refinanced into general obligation bonds in the name of the University of California. All amounts included in these deferred revenue AGCs will be written off as a result of the refinancing transaction and thus, the codes will be retired subsequent to recording the write-off. UCOP will provide journal entries to the Campuses with balances.

Leases
The gain/loss on sale-leaseback transactions should be recorded to the below AGC codes. Deferred losses should be accounted for as deferred outflows of resources and deferred gains as deferred inflows of resources.

AGC Account Name	Current	Investment in Plant
Deferred Outflows-Gain/Loss on sale-leaseback – Capital Lease		121625
Deferred Outflows-Gain/Loss on sale-leaseback – Operating Lease	161625	
Deferred Inflows-Gain/Loss on sale-leaseback – Capital Lease		124625
Deferred Inflows-Gain/Loss on sale-leaseback – Operating Lease	164625	

Sales of future revenues
The University reviewed MOP loan sales and considered if sales of future revenue applied to such transactions. Because the MOP loan sales are a transaction in which the University receives or is entitled to proceeds in exchange for the future cash flows from existing receivables, GASB 48, paragraph 6 is the prevailing guidance in which the transaction is reported as a sale if the University's continuing involvement with the related receivable is effectively terminated. As a result, deferring revenue recognition is not allowed as the transaction meets the definition for revenue recognition under GASB 48.

No other transactions were identified in which the University sells the right to future cash flows.

Frequently Asked Questions

1. Q- If a report is a requirement for payment, i.e. payment contingent upon receipt of progress report from the Primary Investigator (PI), would this be considered a routine

requirement and allow for revenue recognition or would this be considered a situation in which an eligibility requirement was not met? If so should the amount received be considered a liability or a deferred inflow of resources?

A- If we have received funds in advance of filing a report, the GASB board believes that revenue recognition should not be delayed to the extent that all other eligibility requirements have been met, fulfilling the University's performance obligation or promise to its customer. Recognition of assets and revenues should not be delayed pending completion of purely routine requirements such as the filing of claims for allowance costs under a reimbursement program (paragraph 20c of Statement 33) or the filing of progress reports with the provider. – *Footnote 4, Paragraph 10 of GASB 65.* **Neither a liability or a deferred flow of resources should be reported.**

2. Q- In a clinical trial where there is a mix between time requirements, reporting requirements and patient service requirements based on visits and treatments, how would one determine which amount could be recognized as revenue; which amount would be a deferred inflow; and which amount would be liability?

A- The above is dependent on the individual facts and circumstances of each clinical trial agreement and the degree to which the University has met the requirements. If the University has not met all of the patient service requirements of the agreement, any funds received in advance of meeting the requirements must be deferred as a liability in the University's Statement of Net Position.

If however, all of the patient service requirements have been met, but the time requirements have not been met, then any **amounts received in advance should be classified as deferred inflows of resources**.

B- If all of the patient service and time requirements have been met, even if the reporting requirements have not been met, recognition of assets and revenues should not be delayed pending completion of purely routine requirements such as the filing of claims for allowance costs under a reimbursement program (paragraph 20c of Statement 33) or the filing of progress reports with the provider. – *Footnote 4, Paragraph 10 of GASB 65.* **Under this scenario, neither a liability or a deferred flow of resources should be reported.**

3. Q- The grantee gave us the entire amount of the award up front. The only requirement is that annual progress and financial reports are submitted. Under the new GASB rules, would this be considered revenue at time of payment?

   A- If the grant agreement has terms within the contract requiring the University to pay back unspent grant proceeds, then the University is only allowed to recognize revenue to the extent of expenditures. Any unspent advances have not met the performance requirements of the contract and should be deferred as a liability. To the extent that no such clause is included, unless there are time requirements, **professional judgment should be exercised in determining how much of the advance should be recognized as revenue during the period and how much should be deferred as a liability.**

4. Q- We receive money from an agency that gave us a lump sum payment in years one and two but changed to reimbursement payments for the remaining three years. During the time period in which we received the lump sum, there were required annual reports. We did not spend all of the lump sum funds prior to the switch to reimbursements. This change happens during the period where we are required to go back and restate under the new GASB rules. What portion of this would be actual revenue? How would we treat that remaining balance at the switch in payment methodologies?

   A- At the time of the change, even if there are time requirements associated with the grant agreement, the University should record a liability related to unspent advances associated with the lump sum payments received in year one and two classified as a liability to the University as of the end of year two's fiscal year because the University has not met the performance requirements associated with the unspent amounts. In year three of the contract, the unspent grant proceeds should be recognized into revenue to the extent expenses are incurred and not included in any reimbursement requests made in year three of the agreement. Absent any time requirements, the University should follow **normal procedures in recognizing revenue and receivables associated with the reimbursement driven grant programs**.

Next Steps—Required Actions

The Campuses should analyze all balances included in deferred financing costs on their respective general ledgers for the codes that will be retired and make the necessary reclassifications in their respective journal entries prior to the June 30, 2014 year-end close.

Further, the campuses should evaluate all deferred revenue liabilities related to contracts and grants as of June 30, 2012 and 2013, applying the above guidance and report the results to UCOP. For amounts deferred as of June 30, 2014, the Campuses should perform an analysis during the year-end close process. A step will be added to the fiscal close schedule published by UCOP for the fiscal year ended June 30, 2014.