



March 31, 2017

Mr. David R. Bean  
Director of Research and Technical Activities  
Project No. 3-251  
Governmental Accounting Standards Board  
401 Merritt 7  
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Norwalk, CT 06856-5116

Dear Mr. Bean:

Members of the American Institute of Certified Public Accountants (AICPA) State and Local Government Expert Panel have reviewed the Governmental Accounting Standards Board (GASB) Invitation to Comment (ITC), *Financial Reporting Model Improvements – Governmental Funds*, and are pleased to offer our comments. We appreciate the Board aligning the reexamination of the financial reporting model with the previous measurement focus project as this approach is consistent with our recommendations made in the earlier stages of that project.

The AICPA has long been a proponent of the government-wide financial statements and the value of the information contained in those financial statements. We have also previously questioned whether the fund financial statements are essential as part of the basic financial statements and continue to have reservations in this area. However, since all three approaches described in this ITC retain the governmental fund structure used in the existing financial reporting model, the comments in our letter are limited to responding to the various options outlined by the Board.

After considering the pros and cons of each of the recognition approaches, we support the near-term approach with certain modifications. Our support is based primarily on users' needs for information reflecting a shorter time perspective together with the information presented from a longer time perspective in the government-wide financial statements. Therefore, our responses to the questions posed in the ITC, along with our supporting rationale, are provided for the near-term approach and are included in the section below titled, "Response to Issues."

The majority of those assisting with our letter did not support the long-term approach as information with a longer time perspective is available in the government-wide financial statements, albeit on a more aggregated basis. Preparing governmental fund statements on a similar basis as the government-wide financial statements provides a singular perspective despite users' need for information on a shorter time perspective. While the proposed statement of cash flows accompanying financial statements

prepared using the long-term approach would relay information on a shorter time perspective, it would provide less utility than fund financial statements prepared on a near-term basis. However, there was a minority view that did support the long-term approach that we have described in the next section of this letter titled, “Minority View.”

Finally, with regard to the short-term approach, there was an overall consensus that it is the least suited approach to address the needs of users. We believe the short-term approach makes it difficult to understand the differences between the governmental funds and the government-wide financial statements. Given the estimations, assumptions, and subjectivity required under this approach, there will be less comparability between governments and auditing challenges will arise.

### **Minority View**

Several of our members support the long-term approach primarily because they have often observed governments utilizing their fund financial statements, rather than their government-wide financial statements, to inform significant decisions having longer term implications. Certain policy decisions at the governmental fund level, such as adequacy of the tax rates, require consideration of the long term sustainability of an individual fund. Thus, supporters of the long-term approach believe it informs decisions having longer term implications, provides informative disaggregation of amounts presented in the government-wide financial statements, and presents the best measure of interperiod equity. If the Board adopts the long-term approach, there was an overall consensus by all assisting with this letter that a statement of cash flows should be required to provide users with additional information on a shorter time perspective.

### **Response to Issues**

*2.1: Do you believe that governmental fund financial statements should continue to present information that reflects a shorter time perspective than the information presented in the government-wide financial statements and that focuses on financial, rather than economic, resources? Why?*

We believe the governmental fund financial statements should continue to present information on a shorter time perspective than the information presented in the government-wide statements and should focus on financial resources, rather than economic resources. There are different and competing needs of users of governmental financial statements and those needs can be best addressed with two different financial statement perspectives—one focused on a longer time perspective and another on a shorter time perspective. In particular, a shorter time perspective is most often cited as useful by management, regulators, and the citizenry to help assess fiscal accountability. However, the focus on a shorter time perspective is not a complete reflection of a government’s financial position and flow of resources. Therefore, we believe it is critical for the Board to continue the requirement that the government-wide statements be

prepared using the economic resources measurement focus and accrual basis of accounting.

*2.2: Do you believe that governmental fund financial statements should continue to present information that facilitates comparisons with a government's budgetary information? Why?*

We believe governments should continue to present information that facilitates comparisons with the government's budgetary information because various users are focused on whether the government has maintained accountability to its budget. For example, regulators, such as states, may be interested in the budgetary information because they impose laws that prohibit a local government from exceeding its budget. Those charged with governance use budgetary information to monitor annual financial results against the approved plan for spending. Citizens use the budgetary information to monitor how annual tax dollars are to be spent. Management uses the budget to influence and adjust plans for spending in the future. In light of these users' needs, the ability to compare financial statements to budgetary information is important.

*2.3 Which of the three recognition approaches provides the most relevant information for assessing fiscal accountability of the government? Why do you consider that information most relevant?*

Of the three recognition approaches presented in the ITC, the near-term approach provides the most relevant information for assessing fiscal accountability of the government and provides a valuable complement to the government-wide financial statements. Governments combine citizen resources (primarily taxes) in an effort to supply services, such as public safety, determined to be for the good of the community. As a result, certain users, including the citizenry and legislators, need annual information as to how the government spent the resources. Preparing governmental fund financial statements with the near-term approach provides information as to how these resources were spent in a manner that can be understood and utilized and best reflects activity for the year reported. While the near-term approach may not supply investors, creditors, or others looking for a more long-term view of the government's financial position, information needed to analyze the government's financial position is presented in the government-wide financial statements. Thus, providing different and complementary information in the governmental funds provides users with a variety of information upon which to make decisions and draw conclusions.

*2.4 Transactions related to tax anticipation notes or revenue anticipation notes are presented differently under the three recognition approaches. In the near-term approach, borrowings on and repayments of these notes would be reported as inflows of resources and outflows of resources on the statement of resource flows and in the reconciliation to the government-wide statement of net position. In the short-term and long-term approaches, outstanding balances of these notes would be reported as liabilities on the*

*balance sheet, and borrowings on and repayments of these notes would be reported in the statement of cash flows. (See the discussion in Chapter 3.) Which approach to the reporting of these notes provides the most valuable information? Why?*

While we support the near-term approach, we believe it should be revised to report outstanding balances of tax anticipation notes, revenue anticipation notes, and other similar short-term operational borrowings as liabilities on the balance sheet to provide the most valuable information. We are concerned that reporting such operational borrowings as inflows of resources rather than liabilities and repayments of these borrowings as outflows of resources has the potential to distort fund balance when the borrowing and repayment span different fiscal years. Additionally, governments may periodically or inconsistently issue such borrowings which may significantly impact fund balance at year-end. We believe that recording these borrowings as a liability will alleviate any potential artificial impact on fund balance. Thus, we recommend that the accounting for tax anticipation notes, revenue anticipation notes, and similar operational short-term borrowings continue to be consistent with the current model of modified accrual basis of accounting.

*2.5: Views vary on the definition of financial resources—a concept integral to all three recognition approaches. What definition of financial resources provides the most valuable information? Why? Do you consider prepaid items to be financial resources? Why? Do you consider inventory to be financial resources? Why?*

We believe the definition of financial resources should focus on resources that are cash or typically converted to cash which would exclude both prepaid items and inventory. For governmental funds, inventory is not typically converted to cash, but rather represents supplies to be used in subsequent periods. Likewise, prepaid items are not typically refunded or converted to cash to provide services. Consistent with our support for the near-term approach, we believe one of the important aspects of the governmental fund financial statements is to provide certain users, including the citizenry and legislators, with information on the amount of resources on hand at the end of the period which are available for subsequent year spending. As prepaid items and inventory are rarely converted to cash in a governmental fund, excluding them from the balance sheet provides the most useful information of resources available. That said, we do acknowledge that the exclusion of prepaid items could distort fund balance from one year to the next if governments make significant prepayments before the end of the year (e.g., prepaying pension contributions).

*2.6: For the recognition approach that you believe provides the most valuable information, how would you change that recognition approach to provide information that is more valuable? How would those changes make the information more valuable?*

We propose the following changes to improve the near-term approach:

Prescribe Time Period for Near-Term Approach. We recommend the Board prescribe a specific length of time following the end of the reporting period that would be considered near term. Taking this action will improve the comparability of financial statements. We believe a specific time within 60 to 90 days is appropriate.

Clarify the Concept of Normally Due. We have concerns about the concept of “normally due” as discussed in Chapter 2, paragraph 11 and footnotes 4 and 5 of the ITC. Some interpreted the concept to limit recording a liability for items like accounts payable to what the government *intends to pay* within the near term rather than what has been incurred but not yet paid. If a government has a policy decision to delay payment of liabilities, we have concerns that the wording in footnote 5, which defines “due” as “when payment is scheduled or expected to be made,” may be interpreted as requiring accrual for only those liabilities that are *expected to be paid* in the near term. We acknowledge that footnote 4 defines “normally” as circumstances for “governments in general, and not the potentially unique circumstances of a single government,” however, we are concerned there may be wide interpretation of what “governments in general” constitutes. For example, would a local government compare itself to other local governments in the immediate area, the state, or nationwide? Additionally, we question how governments would assess other governments’ policies. We believe a potentially simpler approach that would avoid the need for a comparison to other governments would be for the Board to require that liabilities for goods or services provided to the government be recorded based upon when the resulting payment is due to the vendor (i.e., either by year-end or within the near term).

Further, we noted inconsistencies in the discussion of what would be considered a liability in the near-term approach. In paragraph 11, a liability is described as “payable at period-end and normally due within the near term.” However, paragraph 13(e) gives an example of liabilities to be recorded under the near-term approach as net pension and other postemployment benefits liabilities that normally are due within the near term; it does not cite being payable at period-end as a criteria.

Finally, the Board should provide more guidance to describe what constitutes “normally due within the near term.” We were uncertain how the concept would apply to transactions like other postemployment benefits where some governments make one payment a year and others may pay on a monthly basis.

Accounting for Accrued Interest Should Align to Treatment of Debt. We suggest that accrued interest be recorded in the same manner as debt in that both should be recorded when matured.

Record Tax Anticipation Notes, Revenue Anticipation Notes, and Similar Operational Short-Term Borrowings as Liabilities. See response to question 2.4.

*2.7: Paragraph 6 of this chapter discusses a same-page reconciliation to government-wide information and the use of specific terminology to more clearly communicate that the information in governmental fund financial statements is of a shorter time perspective than information in the government-wide financial statements and focuses on financial, rather than economic, resources. Are these changes effective in communicating that the information in governmental fund financial statements is different from the information in government-wide financial statements? How could those differences be communicated more effectively?*

We support the same-page reconciliation to government-wide information. It is a clear, concise method to communicate the difference between the two statements. We also found the terminology added to the statements to reflect the shorter time perspective to be appropriate. However, we recommend the Board add a note disclosure requirement to provide a more robust discussion of the differing perspectives presented in the governmental fund versus government-wide financial statements.

*3.1: Which format for the governmental funds resource flows statement—existing format or current and long-term activity format—provides the most valuable information about governmental funds? Why do you consider the information to be more valuable?*

We did not have a consensus as to whether the existing format or current and long-term activity format provides the most valuable information about governmental funds. Instead, we offer several observations on both formats for the Board's consideration.

Existing Format: The existing format is easy to understand because it reflects the traditional flows statement format that financial statement users generally find in other financial reporting frameworks. The existing format could be improved by the Board redefining what is considered an "other financing source/use." For example, pairing debt proceeds with uses of those proceeds.

Current and Long-Term Activity Format: The current and long-term activity format makes a clearer distinction of current, capital, and debt service activities than the existing flows statement. However, we have some concerns that references to current and long-term in the near-term approach may be confusing to users. Additionally, defining current versus long-term activities, particularly for transfers may be very subjective.

*3.2: Should a statement of cash flows be required for governmental funds? Why?*

If the Board adopts the near-term approach, a statement of cash flows should not be required for governmental funds because we believe the inclusion of such a statement would not provide much additional information to that presented in the fund financial statements.

*3.3: What difficulties, if any, would arise in presenting a statement of cash flows for governmental funds?*

From the near-term perspective, presenting a statement of cash flows for governmental funds would be a time consuming exercise that ultimately results in the presentation of similar information to the resource flows statement. Therefore, we believe the costs to prepare a statement of cash flows for the near-term approach outweighs the benefits.

*3.4: Are the four classifications for the statement of cash flows from Statement 9 the most appropriate for governmental funds? If not, what classifications would be most appropriate?*

The four existing classifications are appropriate for governmental funds. We think consistency with the format of the statement of cash flows for proprietary funds is important. However, it would be helpful to clarify what types of activities are considered operating for a governmental fund.

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The AICPA appreciates the opportunity to comment on the ITC. This comment letter was prepared by members of the AICPA's State and Local Government Expert Panel and was reviewed by representatives of the Financial Reporting Executive Committee 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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Expert Panel



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