



January 30, 2017

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Project: 3-25I

Dear Mr. Bean:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Government Accounting Standards Board (GASB) on its December 7, 2016 Invitation to Comment (ITC) entitled *Financial Reporting Model Improvements – Governmental Funds*. The FMSB is comprised of 23 members (list attached) with accounting and auditing backgrounds in federal, state and local government, as well as academia and public accounting. The FMSB reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

We also desire to testify on the ITC during the May 11, 2017 hearing in Burlingame, California.

The FMSB strived to achieve consensus on the provisions of the ITC. Similarly, to what is discussed in Appendix B to the ITC, the FMSB is comprised of different groups of stakeholders including users, auditors and preparers. Each has their own perspective. Years from now, if the financial reporting model project has a 'true north' of striving to satisfy each of those perspectives, no group will be totally satisfied. We believe that the Board does not want to see years of wasted effort trying to achieve perfection for each group. We encourage the Board, as part of this process, to focus on reducing the complexity of the financial statements while providing adequate and efficient, not exhaustive, information for internal and external perspectives. Two perspectives have emerged in our group:

- 1) For the users / auditors, the governmental funds are not as useful for decision-making for elements beyond the budget and compliance with budgetary law and need to be improved or presented as either required supplementary or supplementary information, or in a contemporaneously issued, audited separate document, audited using the applicable financial reporting framework.
- 2) For the preparers, budgetary compliance is a key legal focus and from an operational standpoint, given the scarcity of resources currently and for the foreseeable future, preparing the financial statements needs to be simplified.

Should the fund structure be retained in its current form, the user community and audit community on the FMSB overall thought the approach offered by the long-term financial resources approach allows the best opportunity to streamline the financial reporting process as the perspective differences between the funds and the government-wide statements are largely eliminated. Only the capital asset and capital-related debt transactions are reconciling items. However, the FMSB does not have any legislative or similar governance members who assuredly have a different perspective.

The preparers and the auditors of smaller governments desired the near-term approach due to its consistency with budgetary transactions and mirrors how management and governance officials make fiscal decisions, perceived ease of transition and the ability to present financial statements without the need for a statement of cash flows for governmental funds.

The value judgments and relevancy judgments in questions 2.6 and 2.3, respectively are based on norms that are current or in hindsight. The accounting, financial reporting, accountability and assurance world is in the process of enormous change due to technology and demographics. The updated model is projected to be implemented 5 to 7 years from now. If we look at the environment 5 to 7 years ago, cloud computing and smartphone applications were in their infancy as we only had the I-phone 3, but the original I-phone was still the top seller. IBM Watson was under development. The GASB needs to envision what practices and procedures will be 5 to 7 years from now, not just continue the norms of today. The Board must envision accounting and financial reporting with transactions built off of Blockchain, with financial reporting and assurance being performed through robotics and artificial intelligence. Because of this, today's assurance will transform to consultative practice very quickly. GASB must seize this opportunity to take the step back and instead of looking back and tweaking, look forward and revolutionize. If we are catering primarily to the decision-makers of today, they will be retired by the time the model is implemented.

Specifically, to the questions in the ITC:

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?

A. We believe a short-term focus is necessary for many stakeholders. However, the current financial resources measurement focus and basis of accounting has fundamental flaws. It is inherently inconsistent in the presentation of liabilities and the ability of similar governments to be comparable. They present incomplete information in the balance sheets. The fund balances are easily manipulated by legislative action. Some on our Board rightfully believe that the primary users of the governmental fund financial statements are the governments themselves. Any other changes to them makes the fund financial statements harder to understand. They are relevant for day-to-day operations. But this leads to problems as it continues to emphasize short term decision making within the governmental entities. Others on our Board believe that a different reporting model for governmental funds and proprietary funds does not make sense. It makes it harder to audit and for external users to the government, which we identified as bondholders, public interest resource groups, analysts and rating agencies need a longer-term perspective. Therefore, the long-term approach, or presenting the fund statements as either Required Supplementary (RSI) or Supplementary Information (SI) is preferable to this group due to the presentation of the entirety of financial liabilities.

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?

A. We believe budgetary comparisons are critical for compliance with legally established budgetary acts. However, the concept of a budgetary comparison is flawed as:

- 1) Budgets change annually or biennially hindering trend analysis,
- 2) Budgets are for more than operating purposes as capital budgets may be legally established and frequently may be for longer than one or two years and
- 3) They are only applicable to the reporting entity and are not comparable even for adjoining governments.

Therefore, the utility beyond the governments themselves is greatly diminished. We believe budgetary comparisons are best presented as required supplementary information and are measured based on the applicable statutory provisions (and in accordance with GAAP in very few cases). The most important aspects of comparison should be presentation of whether the budgetary act was violated, with an emphasis on note disclosure of the reasons why significant violations occurred.

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?

- A. At the outset, we believed the question had a fundamental flaw. “Fiscal accountability” is noted by the GASB staff as reflecting a shorter time perspective than that conveyed by the information in the government-wide financial statements and focuses on financial, rather than economic resources. Therefore, consideration of the long-term approach is hampered by this alignment toward fiscal accountability.

The users and auditors on our Board tended to agree on the long-term approach presenting more relevant meaningful information, addressing accountability for decisions made by current members of governance that may affect future stakeholders. In essence, many decisions made by legislative bodies have uncalculated long-term effects. By excluding elements in the near-term approach and short-term approach, we believed accountability is actually diminished. Unfortunately, the long-term approach also has its drawbacks – simply, those same legislative bodies will not understand what is presented in conjunction with the approach without a significant, consistent, education effort. The users and auditors in our group believe the long-term approach provides the most transparency, if funds are to be presented. Unfortunately, again, it is hard to align many unstructured liabilities to individual funds. This may result in most long-term liabilities recorded by the General Fund and Debt Service Funds.

For the preparers and small-government auditors in our group, the near-term approach was preferred as it aligned fiscal accountability to the budgetary act and to the definition offered in footnote 1. Therefore, if relevancy is decided by the legislative body, then the near-term approach is the only choice.

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 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. Which approach to the reporting of these notes provides the most valuable information? Why?

- A. Of the many questions in the ITC, this may have among the simplest of answers and an answer we agreed on as a group. We believe that tax anticipation notes and revenue anticipation notes are liabilities to the government if they are outstanding at a reporting period end. At the issuance of the notes, the receipt of proceeds increases cash but also increases a liability. Yes, they do provide resources, but they must be repaid with current or future resources. This is one of the major inconsistencies that should be solved by any change to the current reporting model.

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?*

- A. Of the non-financial items currently presented in governmental fund balance sheets, prepaid items and inventory are rarely material, except for insurance entities and transportation-related entities which may buy consumables such as asphalt, concrete, road salt and fuel. As a group, we focused on financial resources being just that – financial resources including cash and investments. Should the governmental funds focus solely on financial resources, they should only focus on cash and investments. Unfortunately, some governments include prepaid items as budgetary activity. Depending upon the Board's conclusions, these governments may have to change if the funds are to align to budgetary activity.

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?*

- A. Where question 2.3 focused on relevancy, this question focuses on value. As previously said in various ways, none of the approaches will be ideal to all users. We all have different value judgments. Unfortunately, revisiting the concepts in the thirty-year-old Statement No. 1, Objectives of Financial Reporting are outside the scope of the majority of this project. But the question cannot be answered as to value without first understanding what value we are comparing to. As can easily be seen in the current model, preparers, users and auditors all have different frames of reference and as evidence has shown throughout our group's deliberations, all have different points of view as to which recognition approach provides the most valuable information. Some value the budget as the most important aspect. In that respect, if the budget was prepared on a cash basis, than cash basis governmental fund statements have the most value. But by only valuing the budget, any other information is discounted even though decisions made using budgetary values may have long-term impacts. For the users and auditors, the long-term approach is most valuable as it contains the least reconciliation to the government-wide statements, if the governmental fund financial statements are to be presented at all. As a group, we could not decide which of the three approaches provided the most valuable information. As we mentioned above, we believe that if the Board decides to make the financial statements more complex than today in order to provide the most valuable information for all users, then this whole process will be for naught. As Aesop wrote – “he who pleases everybody, pleases nobody.”

2.7. *Paragraph 6 of Chapter 2 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?*

- A. Attempting to present the reconciliations on the same page as the fund financial statements is noble by the Board. We believe that if the reconciliation is to be carried forward, this is beneficial to the readers and we would encourage the GASB to continue to strive to make this happen and streamline the information presented. A number of our members had concerns that the one page presented would cause a smaller font size which is not efficient for the reader. One of our Board members was reviewing a fund County's General Fund statement for this past year. An expenditure line had \$8 in a fund where total expenditures were nearly \$200 million. There is too much detail presented by many

preparers in some fund statements. Of course, to some of us, the more effective approach would be to eliminate the reconciliations altogether.

We would also like to caution the Board and GASB staff about the use of terminology above each of the Statements. Some have called this terminology a ‘disclaimer.’ The word disclaim has very important audit implications. It also indicates to some users that the utility of the statements is diminished as they do not present the entirety of information. If the utility is diminished, then is the essentiality standard of the Board met? If information is missing, then by definition, the statements may not be auditable. This is why the alternative of presenting the governmental funds as required supplementary information, supplementary information or as a contemporaneously issued document may address this issue. Within the supplementary information, an introductory page could describe the basis of accounting and budgetary activity and an ending page could reconcile the activity to the governmental activities.

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?

A. Most of our group believe the format of the governmental funds resource flow statement should be consistent with the government-wide and proprietary statements. Accordingly, they have suggested using the conventional operating and non-operating format of the proprietary fund statements. If this cannot be accomplished, others believe the separation between current and long-term activity gives that presentation method a slight edge and provides consistency in treating highlighting capital asset and long-term debt transactions.

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

A. The users and auditors of our group support either a statement of cash flows for each major governmental funds or one government-wide statement of cash flows, of course excluding fiduciary activities. The users and auditors believe users need both full-accrual and cash flow information about governments and that fund level reporting should be in alignment with government-wide reporting and their support of the long-term approach. In essence, preparers are wary of a statement of cash flows for governmental funds, even though they understand that the current model of the Statement of Revenues, Expenditures and Changes in Fund Balances is not very different from a Statement of Cash Flows if the accruals are removed and the titles and subtotals of the statement are changed. Should a Statement of Cash Flows be presented, we further suggest it be presented in the aggregate or only for major funds. This is due to the prevalence of internal investment pools. If an internal pooling of cash or investments are used, individual funds do not have individual bank or investment accounts. Therefore, to require statements of cash flows for individual funds will trigger a further reconciliation between the cash balance for accounting purposes in the aggregate of all funds in the internal pool and the balances of the bank or investment accounts in the notes to the financial statements or on the face of the statements of cash flows.

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

A. Although we cannot provide specific examples, we are concerned there will be many governments whose accounting software will not easily accommodate a cash flows statement for governmental funds. Additional outreach may be necessary to determine the ease of implementing a cash flows statement by preparers. The addition of a financial statement will add to financial statement and audit complexity, cost and potential time to prepare. Should a statement of cash flows be required

for individual funds, there should be enough lead time for any software changes and education to occur. Many question whether the cost incurred in the designing, coding, testing and implementation of the provisions will be less than the benefit of having a cash flow statement.

3.4. Are the four classifications for the statement of cash flows from Statement No. 9, Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting, the most appropriate for governmental funds? If not, what classifications would be most appropriate?

- A. If the Statement of Cash Flows is to be presented for governmental funds, we suggest that the noncapital financing category may be the least useful. Taxation would likely be the biggest element presented in the noncapital financing category and for governmental funds, taxation should be operating cash flow. Therefore, there should be a collapsing to three categories – operating, capital and related financing and investing. Noncash transactions and the reconciliation should still be presented.

In summation, we agree with the Board that a conceptually consistent basis for governmental funds within GAAP should be established and we applaud the Board's efforts to do so. We have included some of our members' thoughts beyond the questions as an appendix to this letter.

We appreciate the opportunity to comment on this document and will be pleased to discuss this letter with you at your convenience. If there are any questions regarding the comments in this letter, please contact me at (208)383-4756 or Lmiller@eidebailly.com

Sincerely,



Lealan Miller, CGFM, CPA
Chair- AGA Financial Management Standards Board

cc: Doug Glenn, CPA
AGA National President

Association of Government Accountants
Financial Management Standards Board

July 2016 – June 2017

Lealan Miller, Chair
Eric Baltas
Eric S. Berman
Robert L. Childree
Vanessa Davis
Scott DeViney
Richard Fontenrose
Melanie L. Geesaman
Stephen Gilbride
J. Dwight Hadley
David C. Horn
Albert A. Hrabak
Drummond Kahn
Simcha Kuritzky
Craig M. Murray, Vice Chair
Suesan R. Patton
Harriet Richardson
Eric Scheetz
Kenneth Smith
Roger Von Elm
Sheila Weinberg
Brittney Williams
Stephen Wills

Ann M. Ebberts, Chief Executive Officer, (Ex-Officio Member) AGA
Susan Fritzlen, Staff Liaison, AGA

Appendix – Additional Suggestions by Members of the FMSB with Regard to the ITC

I. A User's Perspective

After reading the summary (page vii) I am not clear on why the Board is deliberating these issues. The summary proves evidence that the governmental funds statements should be changed immediately. The summary highlights:

- 1. "However, the governmental fund financial statements may not clearly communicate to all users of financial statements that the information presented is limited to a shorter time perspective and that information necessary for demonstrating operational accountability (a longer time perspective and a focus on economic resources) is not presented."*
- 2. "Some users continue to rely solely on the information in governmental fund financial statements to inform decisions that have longer term implications."*
- 3. The governmental fund statement, "lack a conceptual foundation."*
- 4. "Third, because of the lack of a conceptual foundation, it is challenging to establish guidance for reporting more complex transactions, such as derivative instruments and service concession arrangements."*

II. An Auditor's Perspective

The current reporting model is singularly complex. The basic financial statements are a mix of different basis of accounting (full accrual, modified accrual, cash and budgetary); different vantage points (fund level and government-wide, each with different treatments of component units, internal service funds and fiduciary funds) and different classification structures for revenues (by both source and program/function) and expenses (by character, by program/function and by a mix of both).

We believe this complexity undermines the goal of public accountability, objectives of financial reporting and characteristics of financial reporting – in particular for legislative and citizen users. Overall, we are in favor of changes that (a) reduce the complexity of the reporting model, (b) create more alignment within the reporting model, and/or (c) create more alignment of the state and local government reporting-model with those generally accepted for other types of organizations.

To this end, we encourage consideration of further simplifications, such as:

- A traditional format for the government-wide Statement of Activities, consistent with current proprietary fund statements.*
- A basis of accounting and presentation format for governmental funds that is consistent with that used for government-wide and proprietary fund statements. This either could be full accrual statements or limited to cash flow statements if full accrual statements are deemed unnecessary at the fund level for governmental funds.*
- Choosing whether to provide shorter-term information consistently across the reporting model through budget-to-actual statements, cash flow statements or a near-term basis of accounting, rather than all three.*
- Choosing to report shorter-term information at either the government-wide level or the fund level, rather than both.*
- Choosing whether details should be provided as major fund reporting, combining fund reporting or segment reporting, rather than all three.*
- Moving fund level statements to combining statements presented as required supplementary information. Audit requirements for required supplementary information in AU-C 730 include comparing the information for consistency with the basic financial statements. We believe this can be*

appropriate given that fund level statements are merely break-outs of the government-wide, similar to segment information.

- *Management's Discussion and Analysis should only be required for CAFRs and be combined with transmittal letter (NCGAS 1 par 138) and financial trend information (GASB 44 par 8) requirements.*

Since the direct method for presenting the statement of cash flows is required, the additional requirement to present the reconciliation to operating income (that is, the indirect method) should be eliminated.