



February 14, 2019

Mr. David R. Bean
Director of Research and Technical Activities
Project Nos. 3-20 and 3-25
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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) Preliminary Views (PV), *Financial Reporting Model Improvements* (Model PV) and *Recognition of Elements of Financial Statements* (Elements PV), and are pleased to offer our comments on both documents.

We appreciate the Board's responsiveness to our March 31, 2017, comment letter on the related Invitation to Comment (ITC) on governmental fund improvements. We continue to believe the governmental fund financial statements should 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. We acknowledge that there are likely significant costs to governments in implementing an eventual standard and encourage the Board to consider the costs and benefits from revising the fund financial statements. Assuming the Board continues with a conceptual underpinning to the fund financial statements, we support the Board's proposed short-term financial resources measurement focus.

Our comments are based on our general understanding of the proposed model concepts as described in both PVs. We encourage the Board to provide more substantive detail on the various aspects of the model in the Exposure Drafts. This detail is needed to help clarify how the Board will treat specific transactions as either short-term or long-term which is essential for purposes of comprehending the resulting financial reporting impact of the proposed model changes.

The remainder of this letter provides our detailed comments which are presented in categories similar to those in the PVs. We also provided examples of transactions

discussed by our members during our evaluation of the PVs for the Board to consider in its continued deliberations.

RECOGNITION CONCEPTS & APPLICATION FOR GOVERNMENTAL FUNDS

Support Short-Term Financial Resources Measurement Focus

A measurement focus that incorporates elements of financial statements arising from short-term transactions and other events as they occur and elements of financial statements arising from long-term transactions and other events when payments are due.

We support the definition of the short-term financial resources measurement focus (short-term focus) in paragraph 2 of Chapter 2 of the Elements PV because it presents logical accounting as to when and where transactions are recorded in governmental funds. While our response to the ITC supported the near-term approach with certain modifications, we believe the PV's short-term focus represents a combination of the more favorable aspects of the near-term and short-term models proposed in the ITC.

We also support the approach to include inventory, prepaid items, and tax and revenue anticipation notes as financial resources. While our response to the ITC recommended that inventory and prepaid items be excluded from the definition of financial resources because they are rarely converted to cash, given the longer time horizon of the short-term focus, we are now able to support the inclusion of inventory and prepaid items as financial resources.

Support the Recognition of Short-Term or Long-Term Transactions Based on the Notion of Normally Due

We support the recognition concepts proposed in Chapter 2 of the Elements PV. Paragraph 6 of Chapter 2 of the Elements PV presents a definition of short-term and long-term transactions as follows:

Short-term: Items that arise from short-term transactions and other events would be those that normally are due to convert to or generate cash or require the use of cash entirely within one year from the inception of the transaction or other event.

Long-Term: Items that arise from long-term transactions and other events would be those that normally are due to convert to or generate cash or require the use of cash in periods that extend beyond one year from the inception of the transaction or other event.

These definitions are rooted in the concept of "normally" as defined in paragraph 9 of Chapter 2 of the Elements PV to refer to circumstances of governments in general, not the potentially unique circumstances of a single government or type of government.

We considered these definitions and the “normally” concept at length and compared them to the Alternative Views. We ultimately decided to support the definitions above from a conceptual basis, including the concept of normally, as we believe they will provide more consistent accounting and an ability to better compare financial statements across governments. Our rationale for opposing the Alternative Views is in our later comment.

While we agree conceptually with the definitions of short-term and long-term transactions, we have reservations as to how the various classes of transactions will be defined (broadly versus in detail), and about how preparers and auditors will determine how “governments in general” would account for a certain transaction. The Board will need to provide specific guidance in both areas in the Exposure Drafts to provide a more in depth understanding of the proposed model and for there to be consistent application of the definitions in practice. In addition, we would also ask that the Board address the treatment of out of character transactions in the next due process documents (i.e., those with time horizons that may be very different than what is defined for “governments in general”). The following provides our additional feedback on certain aspects of the above definitions for the Board’s consideration.

Classes of Transactions

An underpinning concept of the short-term model is that transactions will be categorized as either short-term or long-term. Paragraph 8 of Chapter 2 of the Elements PV indicates that this determination would be made for an entire class of transactions (e.g., issuance of long-term debt) rather than individually. We identified challenges with a very broad application of this concept which led us to question how broadly or how detailed these classes will be defined within the standard going forward. As stated earlier, we encourage the Board to include guidance on how these classes of transactions will be defined in the Exposure Drafts to give better context and definition to the model.

We understand the Board’s goal is to define classes of transactions as broadly as possible. While we agree with that approach for certain transactions (e.g., issuance of long-term debt), we foresee certain other transactions as being more complicated to define broadly. Therefore, it is critical for the Board to define subcategories of certain transaction classes based on their specific characteristics. For illustration purposes, consider prepaid assets. If the Board were to consider all prepaid assets as short-term (as illustrated in Example 4 of Appendix C in the Model PV), we believe that would be too broad and not reflective of the underlying characteristics of all prepaid transactions. We believe prepaid assets will require multiple subsets of transactions to be defined, such as classifying prepaid bond insurance as long-term given it is often prepaid for a

30-year term. Another category of transactions that the Board should address using subcategories is special assessments. While they often operate as long-term transactions (as illustrated in Example 6 of Appendix C in the Model PV), they can also be structured as short-term transactions (e.g., service-type assessments). We have provided additional examples for the GASB to consider as it deliberates the next phase of this project in the “Transactions to Consider” section of our letter.

Governments in General

Another underpinning of the short-term model is that “normally” refers to circumstances of governments in general, not the potentially unique circumstances of a single government or type of government. We agree that evaluating the circumstances of governments in general promotes comparability across governments and simplifies reporting and auditing by taking judgment out of recognition for many transactions.

However, the Board should clarify what is intended as normal for “governments in general” for transactions that are not defined by the standard. While we understand it is the Board’s intent that there be one standard of normal, versus a definition tailored to geographical locations, the PVs were not clear on this point. For example, without further specificity a local government could define normal by looking at other local governments in the immediate area, the state, or nationwide; and each comparison could derive different accounting based on the government’s determination of “normal.” We suggest the Board clarify this point to promote consistent understanding and application.

Further, the Board should provide more robust guidance or a framework to evaluate “governments in general” for transactions not specifically identified or defined by the Board as short-term or long-term. We are concerned that governments and auditors without a national perspective may struggle to classify a unique transaction as either short-term or long-term for governments in general. For example, auditors focused on school districts in one state may not be knowledgeable of practices in other governmental sectors and other states. In this case, differing interpretations of “normal” could lead to inconsistent interpretations of “governments in general” by preparers, regulators, and auditors.

Out of Character Transactions

While we support the concept of governments in general to promote consistency, we have concerns that for some outlier transactions, determining the classification of a transaction as either short-term or long-term in relation to governments in general could be misleading. If the timeframe for a specific transaction of an individual

government is significantly different than that categorized by the Board or for governments in general, we believe the standard should allow the government an ability to diverge from “normal” to better represent the specific unusual circumstance of that government. Specific guidance should be provided by the Board on when divergence is appropriate.

Oppose Alternative Views

We do not support the alternative views in Chapter 4 of the Elements PV and Chapter 7 of the Model PV which present the following definition of short-term transactions.

Financial assets that represent cash or are expected to be converted to cash within one year from the date of the financial statements. Include the portion of all financial liabilities that mature or is otherwise expected to be paid in cash within one year from the date of the financial statements.

While we appreciate that the alternative views focus on individual governments rather than governments in general, doing so erodes comparability between governments. Further, the alternative views present similar problems to those inherent with the ITC’s short-term focus.

Our biggest concern with the alternative views is including liabilities in the short-term measurement focus that have typically only been reported in the government-wide statements. The alternative views could also cause confusion on which long-term liabilities are included as we understand the intent is to exclude pension and OPEB liabilities, but to include other long-term liabilities (e.g., compensated absences). Further, estimating balance sheet items due within the current operating cycle would be very subjective for certain transactions where the payment date is not specified.

PRESENTATION of GOVERNMENTAL FUND FINANCIAL STATEMENTS

Support the Current and Noncurrent (Long-Term) Activity Format

We support the current/noncurrent activity format for the governmental fund financial statements as it provides a clearer distinction of current, capital, and debt service activities. However, we encourage the Board to provide more guidance on defining current versus noncurrent as it relates to transfers to promote consistent application. Additionally, if the noncurrent activities are limited to debt and capital, the Board should consider using the caption “Debt and Capital Activities” instead of noncurrent or long-term to ensure clarity.

Specific Terminology

The illustrative financial statements included in Appendix D of the Model PV repeatedly use “short-term” which we believe is overly redundant without providing any real benefit to the reader. We agree with titling the balance sheet and resource flows statements using “short-term financial resources,” however, it should be removed elsewhere to avoid long and repetitive captions.

PRESENTATION OF PROPRIETARY FUND FINANCIAL STATEMENTS

Nonoperating Revenues and Expenses Should be Further Clarified

We support the self-sustaining or subsidized approach for proprietary fund financial statements. However, we are very concerned about the description of nonoperating revenues in paragraph 3 of Chapter 4 of the Model PV to include “subsidies received and provided” given the lack of clarity around subsidies. Subsidy is defined in paragraph 7 of Chapter 4 of the Model PV as:

Resources provided by another party or fund to keep rates lower than otherwise would be necessary to support the level of goods and services to be provided.

How this definition is interpreted in practice will greatly impact reporting. Health care entities, higher education institutions and other business-type activities often have principal activities that are supported by various forms of supplemental payments, including grants, and it is unclear how the definition of subsidy will impact reporting. Illustration 5 in Appendix D of the Model PV displays grants in both the “Operating Revenues” and “Noncapital Subsidies” sections. The Board should provide additional guidance to define subsidies to ensure an appropriate understanding of the rationale for this presentation.

We anticipate crossover with the Board’s Revenue and Expense Recognition project in terms of how exchange and nonexchange transactions are defined and how subsidies would play into the revenue recognition concepts. We highly encourage the Board to present its thoughts on subsidies in the next due process document on the Revenue and Expense Recognition project to provide readers with a comprehensive understanding.

We also suggest additional guidance be included to address the appropriate classification of transfers in the self-sustaining or subsidized approach. Illustration 5 does not present transfers so we were unclear whether noncapital subsidies were intended to be solely from external sources or if interfund transfers could also be included.

Support Subtotal for Operating Income (Loss) and Noncapital Subsidies

We support the subtotals for operating income (loss) and noncapital subsidies as they illustrate the sustainability of proprietary funds.

Support Proprietary Funds Statement of Cash Flows.

We support the presentation of a statement of cash flows in proprietary funds. Such reporting is beneficial to explain to those charged with governance (i.e., elected leaders) and provides an additional statement to compare operations to other proprietary funds. We do not support the Alternative Views position for a government-wide statement of cash flows in Chapter 7 of the Model PV.

BUDGETARY COMPARISON INFORMATION

Support Budgetary Comparison Information as Required Supplementary Information

We strongly support a single method of communication for budgetary comparison information. We also support reporting it as required supplementary information as we believe the budgetary comparison information is essential for placing the basic financial statements and notes in an appropriate operational context.

Oppose Presentation of Variances between the Original and Final Budget Amounts

We disagree with the proposed presentation of variances between the original and final budget amounts as it adds unnecessary complexity without a commensurate benefit. Management's discussion and analysis currently requires explanation of significant variances for the general fund which we believe sufficiently addresses the need to alert the reader of major budgetary changes.

COMMUNICATION OF MAJOR COMPONENT UNIT INFORMATION

Support Major Component Unit Information as Financial Statements

We support the presentation of major component units in the basic financial statements as a combining financial statement after the fund financial statements if it is not feasible to present major component unit financial statements in the reporting entity's statement of net position and statement of activities. We also support eliminating the option to present such information in the notes to the financial statements as we rarely see this option utilized.

GOVERNMENT-WIDE EXPENSES BY NATURAL CLASSIFICATION

Oppose Schedule Government-Wide Expenses by Natural Classification

We disagree with the proposed schedule of government-wide expenses by natural classification because it is not an improvement and is inconsistent with the Board's efforts to simplify reporting. For governments that do not currently track their expenses in this manner, the preparation of this schedule would require significant effort to capture the information; especially the classification of expenses other than personnel. While the comparison of personnel and non-personnel costs could be helpful, any further classifications of non-personnel expenses would introduce inconsistencies.

HIERARCHY FOR ELEMENTS OF FINANCIAL STATEMENTS

Support Hierarchy for Elements of Financial Statements

We support the hierarchy for elements of financial statements as presented in paragraph 15 of Chapter 1 of the Elements PV.

TRANSACTIONS TO CONSIDER

As we evaluated and discussed the Model PV, we identified circumstances where we believe more clarity is needed or where we foresee implementation challenges depending upon how the final standard may be written. Thus, we have provided them below for the Board's consideration in future deliberations.

Classes of Transactions

Grants Related to a Period

Based on the discussion in paragraph 23c of Chapter 2 of Model PV, we question what is meant by a "grant relating to a period." The PV seems to assume that grants are short-term. As many grants could be longer term, especially those related to capital and long-term projects, the Board should provide a delineation in the standard that allows for the determination of grants as either short-term or long-term, depending upon the circumstances.

To illustrate complexities with grants, consider a state grant program awarded to local governments for infrastructure improvements. Upon successful completion of the project, the local government can draw the grant funds from the state. Based on our understanding of the short-term definition in paragraph 6 of Chapter 2 of the Elements PV, we believe the local government would recognize grant revenue and a receivable when the project is complete. However, if the state is 18 months behind in processing the grant closeout payment, should the local government still report the receivable and

revenue? Alternatively, if the local government does not submit the grant reimbursement paperwork for 18 months, is it appropriate for the local government to recognize revenue and a receivable at project completion?

Claims Payable

The timing of payments related to claims payable can also vary widely (e.g., 12 months or 10 years). Thus, this is another category of transactions that could be split between short-term and long-term. While we acknowledge that the footnote to Example 12 in Appendix C of the Model PV cites the determination of short-term versus long-term based on the specific transaction which seems appropriate, citing a specific transaction contradicts the treatment of this determination by class of transaction.

Prepaid Assets

See our comments on page 3 of our letter. We believe prepaid assets should be broken down into subcategories to reflect the underlying characteristics of the type of prepaid transactions.

Special Assessments

See our comments on page 3 of our letter. We believe special assessments should be broken down into subcategories to reflect the underlying characteristics of the type of transaction.

Other Transactions to Consider

Noncurrent Transactions Other than Debt or Capital

The categories of net flows of short-term financial resources for noncurrent activities presented in Illustration 4 in Appendix D in the Model PV includes transfers, debt service and capital outlay. We are unclear whether and how net flows of other noncurrent activities would be displayed in this model and aligned (or not) with the government-wide presentations and recommend the Board further address other noncurrent assets in the Exposure Draft. For example, the Board could provide an illustration of how the flows and asset related to land purchased for redevelopment (assuming neither a capital asset nor an investment) would be displayed to help improve understanding of the treatment of other noncurrent transactions.

On-Behalf Payments for Pensions or Other Postemployment Benefits

Examples 15 and 16 in Appendix C of the Model PV discuss pensions and OPEB but do not consider on-behalf payments. We are unclear how, under the short-term model, on-behalf payments would be reported.

Clarify Advances

We were unclear how advances would be reported under the model. We believe that interfund receivables are intended to capture advances, but this should be clarified in the Exposure Draft.

Advance Receipts/Payments in Long-Term Transactions

We question the appropriate accounting for advance receipts and advance payments related to long-term transactions. For example, we are unclear whether an advance receipt related to a long-term special assessment should be a credit to an inflow of resources or to a deferred inflow of resources. Similarly, we are unclear whether an advance payment on a long-term transaction should be a debit to an outflow of resources or to a deferred outflow of resources.

Two examples we discussed are as follows:

- Treatment of a government's advance funding of debt principal when remitted to an escrow fund which is later remitted at the due date to bondholders.
- Treatment of a government's advance funding of debt principal when remitted directly to the debt holder (e.g., a private placement).

Additional guidance within the Exposure Draft on these types of transactions would be helpful.

Issuance of Debt for Others

We suggest the Board address the treatment of debt issued for others. Based on what is presented in the PV, we assume the proceeds from the debt would be an inflow in the noncurrent activities section of the resource flows statement and the remittance to the other party as an outflow in the current activities section of the resource flows statement. However, additional guidance confirming this treatment would be helpful.

* * * * *

Mr. David Bean
February 14, 2019
Page 11

The AICPA appreciates the opportunity to comment on these PVs. 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,



Heather S. Acker
Chair
AICPA State and Local Government
Expert Panel



Mary M. Foelster
Director
AICPA Governmental Auditing and
Accounting

cc: State and Local Government Expert Panel
 James Dolinar
 Dan Noll