

Martin Ives
47 Lexington Drive
Croton-on-Hudson, NY 10520
(914) 271-9041
martives@verizon.net

September 6, 2011

Director of Research and Technical Activities, Project 3-20

Dear Dave:

These are my comments on GASB PV *Recognition of Elements in Financial Statements and Measurement Approaches*. I am commenting only on the portion of the PV that deals with the near-term financial resources measurement focus (NTFR). I totally disagree with the Board's position on this matter and agree instead with the Alternative View. Here are my reasons:

1. The PV fails to state clearly the purpose of the NFTR approach. I agree with par. 13 of the Alternative View that the PV does not provide a clear statement of what the NFTR approach is intended to communicate. Chapter 2, par. 5 of the PV states that the objective of NFTR is to assist users in *evaluating financial results* by presenting information about the sources and uses of financial resources. Although that sounds good, implementing NFTR creates a strong potential for presenting *incorrect* financial results (just like CFR) because it fails to record significant expenditures arising from current operating events. Chapter 2, par. 4 of the PV states that NFTR provides information useful in assessing near-term liquidity, but it excludes significant *long-term* liabilities arising from current operating transactions that have near-term and intermediate-term financial implications.

2. The NTFR approach fails to deal with the most significant problem – Pensions and OPEB. The net effect of the PV is to tweak the existing current financial resources measurement focus (CFR), without coming to grips with the single most significant problem created by CFR – the failure to recognize the effect of sustained underfunding of pensions and OPEB on annual expenditures and liabilities. Recent studies (e.g., those performed by the Pew Center) show that many state and local governments have been underfunding their pension obligations year after year and that most governments always underfund their OPEB obligations. In fact, two small governments (the latest being Central Falls, RI) have recently defaulted on their pension obligations. The CFR measurement focus allows the severe expenditure and liability underfunding to go unreported in the fund financial statements and I find no evidence in the PV that NTFR will do anything to change it.

3. The NTFR approach automatically adopts the fundamentally flawed CFR foundation. I believe the PV misses a key point when it states that CFR lacks a cohesive, conceptual foundation (page 2, par. 8). The underlying concept of CFR is rooted in

GASB COD Sec. 1500.103, which declares that all unmatured debt of governmental-type funds (including compensated absences, judgments and claims, pensions, etc.) is general long-term debt, rather than fund debt. That approach to recognition and reasurement denies the existence (within governmental funds) of expenditures and related liabilities that are applicable to a period, but that will not be paid either during the period or shortly thereafter. From an accounting perspective, I regard that notion as utter nonsense. Unless you think cash (or near-cash) basis accounting always produces reliable operating results, I do not see how one can develop a meaningful recognition and measurement approach around it. But the NFTR approach espoused in the PV *adopts this underlying notion without specifically saying so and without dealing with the problems created by it.* Therefore, the foundation upon which the NFTR model is built is no more conceptually sound than CFR. As noted in par. 18 of the Alternative View, NFTR can conceal, rather than expose, manipulative budgetary practices.

4. The GASB makes an egregious error in failing to acknowledge that CFR (and therefore NFTR) is a budget-based model. The Board states (Chapter 4, par. 4. of the PV) that “budgetary practices...should not determine recognition and measurement concepts for financial statements using the NFTR measurement focus.” In my opinion, the only way one can make any sense out of the theory underlying NCGA Statement 1 is to recognize that NCGA Statement 1 is budget-driven. I acknowledge that there is no uniformity among governments in preparing budgets, and I readily acknowledge that the NCGA and the GASB added some accounting discipline in order to improve CFR and the modified accrual basis of accounting. *But the key modifications to the accrual basis of accounting are budget-driven.* How else can you explain (a) the measurable and available notion regarding revenues and (b) the treatment of significant expenditures and liabilities applicable to a period but that will not be paid in the period or shortly thereafter as if they were not fund expenditures and liabilities?

NFTR adds a bit more discipline to CFR and modified accrual accounting, but it still permits existence of the key modifications to accrual basis of accounting. By doing this and simultaneously saying that budgetary practices should not determine accounting measurements under NFTR, the Board is creating its own accounting monstrosity. I believe that, if the Board were given a blank sheet of paper and had never seen CFR, it might have created a cash flows statement, but would not have created NFTR.

5. The implications of the term “normally payable at year-end” are not clear. I believe the term “normally” first appeared in governmental accounting literature in the basis for conclusions supporting NCGA Statement No. 4. NCGA Statement No. 4 dealt with two issues – compensated absences and judgments and claims. Ron Points and I co-authored Statement 4 and, as I recollect, our conclusions regarding the accrual were based on an attempt to apply the term “related *current liabilities*,” as used in NCGA Statement No. 1, par. 18, to those two issues. I believe NCGA staff came up with the term “normally,” and although there may have been some grumbling among NCGA members, I don’t recall any extensive debate over it. Chapter 2, par. 5, of the PV uses the term “normally,” stating that “liabilities include those normally payable at period-end and due within the near term.” But what does “normally payable” mean – normally payable by most governments or normally payable by the government preparing the financial

statements? If it means the former (which I believe it does), and if most governments “normally” finance pensions so as to maintain a funded ratio of 80% to 100%, will NTFR require an accrual by governments that fail to achieve that ratio? And will the GASB require no accrual for OPEB because most governments finance OPEB pay-as-you-go? Or will the GASB say that “normally payable” doesn’t apply to pensions and OPEB?

6. The notion of assets is not entirely clear to me. In Chapter 2, par. 5, the PV says that, in order to achieve symmetry, “Assets include resources that are normally receivable at period end and due to convert to cash within the near-term (as well as cash and other financial resources that are available to be converted to cash within the near-term).” I tried to apply that phrase to property taxes receivable and am having difficulty with it. For example, do assets include property taxes receivable that are likely to wind up in foreclosure, but may not convert to cash in say, three or four years? Should those receivables not be classified as assets because they are not due to convert to cash or should they be classified as assets because, technically, they are “*available* to be converted to cash in the near-term”?

Concluding Observation: For governments that adopt prudent budgetary and financial policies (wherein budgets are balanced both in form and in substance), CFR and the modified accrual basis of accounting may produce operating results not materially different from ER and the accrual basis of accounting. Unfortunately, however, there are many governments that are accumulating significant net asset deficiencies because they adopt budgets that are balanced in form, but not in substance. For those governments, NTFR provides no improvement whatever over the CFR model because its underpinnings are based on the same flawed concepts that underlie CFR.

The Board has several alternatives. It can do what it should have done many years ago – discard CFR and modified accrual accounting entirely. Or, it can make some major improvements, as suggested in par. 17 of the Alternative View. Or, it can tinker with it by, for example, ensuring consistent application of measurable and available. But the one thing the Board should not do is cloak the same flawed model with different terminology in a formal concepts statement.

Sincerely,

Martin Ives