March 28, 2017

MEMORANDUM

To:   Director of Research and Technical Activities
       Project No. 3-251

From: David A. Von Moll

RE:   Response to GASB Financial Reporting Model Improvements – Governmental Funds Invitation to Comment

My office reviewed the GASB Financial Reporting Model Improvements – Governmental Funds Invitation to Comment (ITC). In summary, we believe that the Near-Term Approach provides the most beneficial and effective measurement focus and basis of accounting for governmental funds. This approach allows a shorter reporting perspective that more closely equates to the budgetary cycle. The Short-Term Approach extends the reporting cycle too far into the future to be meaningful for comparison with the budgetary results, and it introduces the potential for additional inconsistencies due to the increased use of estimates and differences in estimation methodologies. The Long-Term Approach is not feasible as it provides no reasonable comparability to the budgetary statements. Additionally, the exclusion of capital related debt and capital assets greatly skews the financial statements of governmental funds for which capital activity is a significant component.

We offer the following responses to the specific questions asked 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?

Yes. The shorter time perspective allows more comparability between the budgetary operating results and the governmental fund financial statements. This comparability allows financial statement users to more readily determine whether the government has a favorable fund balance and whether there are potential liquidity issues.
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?

Yes. The budgetary statements allow financial statement users a tool to review the operating results against the adopted budget as a means to assess the government’s fiscal accountability. Additionally, these budgetary comparisons are an effective management tool to help ensure that good budgeting decisions are being made.

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?

The Virginia Comptroller’s office prefers the Near-Term Approach. This reporting approach provides the greatest comparability between the financial statements and the Commonwealth’s budgetary results. Additionally, this approach will provide the most reporting consistency among state and local governments when the specific reporting period (number of days after fiscal year end) is identified. This approach also minimizes the risk of inaccurate estimates being reported in the governmental fund financial statements. Unfortunately, this approach, as currently proposed, has the potential to provide a misleading fund balance as it does not recognize the portion of debt that is payable in the near-term.

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. (See the discussion in Chapter 3.) Which approach to the reporting of these notes provides the most valuable information? Why?

While the Virginia Comptroller’s office prefers the Near-Term Approach overall, the Short-Term Approach provides a better basis for reflecting fund balance associated with tax or revenue anticipation notes since fund balance is less likely to be artificially overstated.

2.5. Views vary on the definition of financial resources—a concept integral to all three recognition approaches. (See the discussion in paragraphs 38–40 of Chapter 2.) 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?

The Virginia Comptroller’s office believes the most valuable financial resources definition is “resources that are expected to be converted to cash or are consumable in lieu of financial resources” because financial resources should not be limited to cash. We believe that both prepayments and inventory are financial resources primarily because future resource consumption is not required to pay the expense or purchase inventory. Additionally, both prepaid items and inventory can be converted to cash through refund or sale, respectively.
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?

The Virginia Comptroller’s office would modify the Near-Term Approach to reflect a liability for payments on long-term debt that become due in the near-term. If the GASB does not wish to reflect the payments due within 60-90 days as a liability, as discussed further in our response to Question 2.7, we would expand the same-page reconciliation. These changes would reduce the possibility of presenting a misleading fund balance as of the balance sheet date.

Additionally, as we believe inventory and prepaid items should be considered financial resources, we would modify the Near-Term Approach to report these items as assets.

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?

The Virginia Comptroller’s office finds the proposed “Other long-term liabilities, including bonds payable, that are not due in the near-term” misleading if the long-term debt payments due within 60-90 days are not reflected as a liability. In this scenario, we suggest expanding this category as follows (assumes near-term is defined as 60 days after year-end):

- Other long-term liabilities, including bonds payable, that are due within 60 days after year-end
- Other long-term liabilities, including bonds payable, that are due greater than 60 days after year-end

This modification would more clearly alert the user to the imminent claims on fund balance that are excluded from the fund 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?

Existing Format. The Virginia Comptroller’s office believes the existing format with the segregation of other financial sources and uses provides a more comparable format to the budgetary statements.

3.2. Should a statement of cash flows be required for governmental funds? Why?
No. The Virginia Comptroller’s office does not believe a statement of cash flows would provide information that significantly differs from the budgetary statements. Additionally, preparing a statement of cash flows would be time-consuming and jeopardize the timely completion of the CAFR. Accordingly, there would be little benefit to providing a statement of cash flows for governmental funds.

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

The Commonwealth of Virginia operates in a decentralized environment which would require input from every state agency with a governmental fund. This level of involvement would result in many hours of compilation and auditing work to verify cash flow information obtained from agencies. Reliable, consistently classified information could not be readily obtained from the Commonwealth’s accounting system without significant modification and costs. These factors would jeopardize the timely completion of the CAFR.

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?

The Virginia Comptroller’s Office offers no suggestions for the categories as we do not believe a statement of cash flows is needed for governmental funds.

We appreciate the opportunity to provide our comments to the Governmental Accounting Standards Board. Should you have any questions or need additional information concerning our response, please contact me at 804-225-2109 or david.vonmoll@doa.virginia.gov.