Mr. Bean;

Good day.

We are pleased to submit our comments and suggestions regarding the following questions on Governmental Accounting Standards Board (“GASB”) Financial Reporting Model Improvement—Governmental Funds—Project No. 3-25I.
The selected questions we are responding to are:

2.2.) Do you believe that governmental fund financial statements should continue to present information that facilitates comparison with a government’s budgetary information? Why?

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?

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

3. 3.) What difficulties, if any, would arise in presenting a statement of cash flows for governmental funds?
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Our suggestions per each question follow:

2.2.) Do you believe that governmental fund financial statements should continue to present information that facilitates comparison with a government’s budgetary information? Why?

Transparency for Within a Period and Across Periods Comparison
Yes and . . .

The primary matter or underlying issue of the GASB Financial Reporting Model Improvement – Governmental Funds is ‘to increase the transparency of Governmental Funds financial statement.’

There are three (3) primary stakeholders or constituency users / readers of governmental financial statements, whether at the Federal, state, or local / municipality / city levels. These three (3) constituencies are:

1.) The citizens – how well are ‘my’ tax dollars being used and leveraged to serve ‘my’ needs for governmental services and programs
2.) The Elected, Appointed, and Career governmental officials and employees – the ‘report card’ or ‘performance feedback’ as to how well and with what results the ‘current’ administration is performing or serving the needs of their constituency
3.) The Investor Community – investment profile – risk rating by the Rating Agencies, and the long-term ongoing concern of the governmental entity to continue and sustain cash flow that will meet bond payments and other invest / government funding instruments in addition to serving the community constituency needs for governmental services and programs.

These three (3) constituencies are not always in alignment although operational agreements are established – such that programs and services are funded, investors’ bond payments are made, and officials are elected for multiple terms, and the governmental payroll is met.

Each of the three (3) alternative recognition approaches provide difference insights and perspectives into a governmental financial health and wellbeing for ongoing financial responsibilities and obligations. The “three (3) alternative recognition approaches for governmental fund financial statements are: (1) near-term financial resources, (2) short-term financial resources, and (3) long-term financial resources.” Each of the three approaches has characteristic strengths and shortcomings.

The near-term financial resources approach provides insights into the governmental entity ability to meet near-term – 60 – 90 days – cash flow requirements – paying the near-term financial obligations. The near-term financial perspective is working capital.
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The short-term financial approach perspective focuses on the ‘operating budget and financial requirements’ of the governmental entity. The short-term financial view is that of: for the budget year, is there a balanced budget – ‘revenue = expenses.’ So from the short-term view, the Financial Resources Balance Sheet is balanced. The short-term financial perspective is for the period or budget cycle, the inflows and outflows of cash are balanced, or not.

The long-term financial approach perspective provides the holistic and overall ongoing concern of the governmental entity to meet the complete financial obligations. In today’s governmental operating environments some long-term financial obligations far exceed the governmental entity’s ability to meet some obligations (i.e.; pensions, and retirement health care services).

The development of an ongoing matrix, for the current year; and the past four (4) years would provide stakeholders transparency into the near-short- and long-term financial health and wellbeing of a governmental entity. This matrix structuring approach would provide insight into trends across years; and consistency of performance year to year.

As an illustration:

Near-term cash flow, may or may not align with the short-term revenue and expense for the year based on cycles of revenue / income realization. So the short-term budget may be positive for the year, there may be cash gaps in the near-term cash flow cycles. And while the short-term budget may be ‘balanced’ or positive; the long-term issues maybe negatively impacted if the government agency continues to add long-term unfunded liabilities in the forms of medical series obligations for retirees, and pension payments. This ‘kick-the-can-down-the-road’ leaves a significant and growing long-term financial liability for a next generation or administration.

Is or are the policy administration matters difficult – yes; however either the governmental entity takes difficult and painful action, or inflation and economic forces will ‘correct’ and destroy the finances for the neglectful government leadership and administration.
The development and presentation of the recommended matrix will provide: within a year; and cross years comparisons; trends across all three of the alternative recognition approaches. This trend transparence will provide for performance measuring and monitoring. As the following table or matrix illustrates that both ‘year by year’ and ‘year by alternative recognition approaches’ maybe analyzed for trends.

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<tbody>
<tr>
<td>2015 - 2016</td>
<td>“Balanced”</td>
<td>‘Balanced’ Comparison</td>
<td>Deficit – increasing - Pension and Benefits; and Debit Service [2]</td>
</tr>
<tr>
<td>Previous Year</td>
<td>‘Balanced’ Comparison</td>
<td>‘Balanced’ Comparison</td>
<td>Deficit – increasing - Pension and Benefits; and Debit Service [2]</td>
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<tr>
<td>2014 – 2015</td>
<td>‘Balanced’ Comparison</td>
<td>‘Balanced’ Comparison</td>
<td>Deficit – increasing - Pension and Benefits; and Debit Service [2]</td>
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<td>2013 - 2014</td>
<td>‘Balanced’ Comparison</td>
<td>‘Balanced’ Comparison</td>
<td>Deficit – increasing - Pension and Benefits; and Debit Service [2]</td>
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<td>2012 - 2013</td>
<td>‘Balanced’ Comparison</td>
<td>‘Balanced’ Comparison</td>
<td>Deficit – increasing - Pension and Benefits; and Debit Service [2]</td>
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<td>2011 - 2012</td>
<td>‘Balanced’ Comparison</td>
<td>‘Balanced’ Comparison</td>
<td>Deficit – increasing - Pension and Benefits; and Debit Service [2]</td>
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This suggested matrix of within years (across / horizontal analysis) and within recognition approaches (vertical analysis) provides transparency and comparative insights into the operational balance and financial health and wellbeing near- short- and long- term comparatively. This matrix comparison approach addresses the major issue of this project – “form and content of governmental fund financial statements, including their measurement focus and basis of accounting, to make them more effective, consistent, and understandable.” (GASB Project 3-25I, Page 2)

[1] Budget 2015 – 2016 and links to precious years
As an illustration of the importance of this matrix comparative approach is the recent action by Moody’s in a recent downgrading of New Jersey State bond rating; Moody’s stated – “most of the increases in spending are directed to employee pensions and health care -- Moody's said "the budget continues to rely on optimistic revenue assumptions and bolsters near-term financial stability at the expense of long-term pension health." [3]
Pension debt triggers N.J.'s 11th credit downgrade under Christie.
http://www.nj.com/politics/index.ssf/2017/03/nj_credit_downgraded_for_11th_time_under_christie.html#incart_river_home
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 Financial Reporting Model Improvements – Government Funds focuses on three recognition approaches in the middle section of the document, namely near-term, short-term, and long-term and as with everything in business and life there are pros and cons to all three approaches. In choosing the recognition approach that we believe to provide the most valuable information, we have decided on the short-term approach. Firstly, as it enables all the payable requirements which are normally due in the next operation cycle along with what resources are there to achieve these milestones to be recognized. Secondly, its set up produces a progressive system for assessing the inter-period equity over a one year operating cycle that can dictate if the government can meet its necessary compulsions. And finally, along with both the short-term assets and liabilities on the balance sheets and the defined one year operating cycle, it will appease users of the information in analyzing the financial health of the government, along with an imperative topic, the budgetary cycle.

It is hard to add to a very well thought out and defined approach that the Government Accounting Standards Board have adapted to the short-term recognition approach in the paper. That said, there are a couple of methods to use to improve the approach but more structured in a utopian business society. Starting with, should capital assets be reported under this method as financial reporting should provide information about the governments entity’s physical and nonfinancial resources that will exist well beyond the life of the current period being examined through the short-term approach. If the simplifying of the financial reporting method by introducing a dimension style for the governmental funds that has minimal differences from that of the dimension style of government wide financial statements and therefore negate any confusion that could develop between the two sets. Would the introduction of keeping certain transactions involving assets and liabilities that are not short-term but retained in the governmental fund financial statements and therefore give a better overall picture of the position of the funds as opposed to leaving them out.

As the short-term approach, as with the near-term and long-term, were put together by the Government Accounting Standard’s Board, all avenues were covered for the most part and that is why the changes suggested above, while they would have practical benefits, are probably unfeasible to be inducted into the approach as it stands.
3.2.) Should a statement of cash flows be required for governmental funds? Why?

At this moment in time cash flow statements are not done for governmental funds. To analyze whether a statement of cash flow would be beneficial and to fiscally understand the actual helpfulness of this statement, and indeed, to even further this if it should be made a requirement for government funds, then it would be first appropriate to evaluate what a cash flow statement is and relate it to governmental funds. Secondly in order to fully appreciate the benefits of a cash flow statement I shall compare it to accrual type accounting which is currently used.

Cash flow statements are defined by Ives, Patton and Patton as statements that ‘describe the causes of increases and decreases in cash from the beginning of the year to the end of the year.’ (pg 519, 2013) The changes in balance sheet accounts are broken down into operating, investing and financing activities. It deals with the ‘cash in’ and ‘cash out’ of the fund. This statement primarily presents information about the cash flows that are associated with the company/agencies chief operations. What I feel is important here is the use of ‘cash’. Real and tangible cash flow activities and a net position at the end of year is something which brings the value of an organization/agency, and in this case governmental funds, into a genuine and candid position which most people can comprehend. The term ‘cash is king’ is one that everyone is aware of and can relate to.

To put the above into context I shall now explain what accrual type accounting is and outline the value of cash flow statements compared to this. ‘Under the accrual basis of accounting, expenses are matched with the related revenues and/or are reported when the expense occurs, not when the cash is paid. The result of accrual accounting is an income statement that better measures the profitability of a company during a specific time period.’ (accountingcoach.com). There is no doubt accrual accounting is vital when it comes to governmental funds. The main difference between accrual type accounting and cash basis type accounting is timing. This is specifically when the revenue, outlays and the expenses are actually recognised. Accrual accounting is of course useful when it comes to ‘measurement focus’ and the ‘basis of accounting’ because as Ives, Patton and Patton point out ‘using the accrual basis of accounting provides the most accurate measure of the change in an organizations net assets and liabilities.’ (pg 21, 2013) Can cash flow statements enhance or bring something more to the table? I say yes.

As GASB themselves point out ‘A statement of cash flows for governmental funds may be useful for (a) assessing liquidity and solvency, (b) identifying cash flow issues, (c) providing additional information about the issuance of debt and debt service payments, (d) assessing the financial strength of a government, and (e) facilitating a trend analysis.’ (pg 24, 2016) These all seem to me to be valuable areas for levels of assessment. GASB goes on to give a reason that cash flow statements are not required and it is because ‘results of the research indicated that cash flow information at an aggregated level may be less useful than cash flow information disaggregated by fund.’ (pg 24, 2016) GASB appear to be saying that cash flow statements are not done for
governmental funds because they are too similar to resource statements for the short term. For full transparency and accountability cash flow statements should be done for all funds no matter how similar.

From researching we have also found that through the work of Hirshleifer, Kewei, and Hong Teoh who looked into these types of statements in the stock markets that ‘there is strong and robust evidence that the level of accruals is a negative cross-sectional predictor of abnormal stock returns (Sloan, 1996). The accrual anomaly has been extended and applied in numerous papers in financial economics and accounting. Furthermore, there is evidence that the other component of earnings, cash flows, is a positive cross-sectional predictor of returns (Desai, Rajgopal, and Venkatachalam, 2004; Pincus, Rajgopal, and Venkatachalam, 2007). (Journal of financial economics, 2009) This research shows us this accrual anomaly and yet another reason to proceed with cash flow statements in governmental funds given its positive indicators in previous research. In addition ‘since the cash flow component of earnings is a more positive forecaster of future earnings than the accrual component of earnings (Sloan, 1996)’ then it also makes sense to proceed with cash flow statements in this regard.
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3.3) What difficulties, if any, would arise in presenting a statement of cash flows for
governmental funds?

Cash flow is an extremely important part of financial management. It is a forecasting
system that provides information about how government entities finance its activities and meet its
cash requirements. More specifically, the statement of cash flow is really showing how much
money is being generated and is on hand. As a result, if you have a financial statement, usually
one page, sometimes it might just be a snapshot of what is the condition “now.” Cash flow would
show how the cash positions goes up and down over a period of time. We are trying to understand
how the government is financing their operations. Is government able to provide cash flow
statements out of revenues? Is the government borrowing money because their revenues collected
are not reconciled? Thus, cash flow analysis shows the stability of a business or government and
how the government is spending its money over time.

One of the difficulties that may arise in presenting the cash flow statement is that there
must be all records and information and they must know what time period they are reporting on.
Accordingly, you have to have records that accurately reflect cash flow at a given time period
because cash flow is when you are held accountable of your financial position over time and those
records are required. More specifically, this difficulty is to make sure that your accounting system
is accurate and to ensure that you have categorized all funds flowing in and out of your financial
system. Therefore, the key is that there must be a reliable accounting system that actually captures
all income and the government needs to be on top of it because the moneys are coming in and
going out all the time.

According to the chart “Illustration 9” that GASB provided, the general fund of cash flows
from operating activities is in deficit; however, the cash flows from noncapital financing activities,
which the revenue (where the moneys come from) balances the operating activities. Ultimately,
the government is not supposed to make money but not supposed to lose money as well. So
government accounting is based on budgets and “receivables” (the money that they receive), which
is predictable because the government gets the money almost the same amounts through taxes and
income budgets and it is allocated to them every year. So the goal for them at the end of the budget
cycle is to ensure that they reconcile all the different funds (which is government fund accounting).
Some of the funds may have restricted usage requiring more information to determine if there is
deficit. According to Illustration 9 chart, the general fund used by operating activities is 85 million
deficits, but the revenue was almost 97 million. The other funds such as Special Tax and Other
Governmental Funds were smaller and they had special usage.

When the presenting document would report revenues but not the money received, the
difficulty that may arise from here is that the cash flow may not be the same as revenue because it
is never current and may result in negative cash balances or late payments. This difficulty may
occur when there are no full records to reconcile the account. You have to know every transaction

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in and out, which includes all the money that came into the funds and all money paid out. If there are no records of these funds at certain times when you pay and the fund is lower than expected, you will not know where it came from. So the biggest responsibility is to make sure that all records are available.

Another difficulty is making sure the money is properly identified because people like to hide where they spend the money sometimes. Therefore, the difficulty that may arise in presenting the statement is how you account for an unanticipated cost. It might create deficits but there must still be an account for it. For example, everybody has budget for their house and there is a need for a roof repair which has to be fixed, causing a deficit for that year. Ultimately, budgets are estimated and an individual might think of a particular number to spend and at the end of the year, it could be seen how much an individual actually spends. More specifically, that is what cash flow statement shows. It reconciles how much money moves through the system.

However, another problem that may arise here is that we never know if there was any fraud in cash flow statement because the statements only shows the money that were spent and the money that came in. Assumingly, this raises another difficulty in presenting the cash flow statement that cash flow pretty much should stay the same in government and any changes would require an explanation because every year the government gets the same amount of money and if they get more it is for a special reason; therefore, the difficulty is explaining changes over time. For instance Department of Motor Vehicles receives about the same amount of money every year to run the organization and they do a cash flow to see how many licenses they sold, employees’ expenses, special projects, but for the most part the cash flow statement is going to be the same every year. Therefore, they must be able to explain any changes in the cash flow.
Summary and Recap

The integrity and transparency of financial statements and financial information is a critical underpinning to government operations and reporting. Beyond promoting accountability, improved GASB reporting increases the insights and transparency into the performance and financial operations of a governmental entity.