March 31, 2017

Mr. David R. Bean  
Director of Research and Technical Activities  
Project No. 3-251  
Governmental Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk CT 06856-5116

Dear Mr. Bean;

We are writing to you on behalf of the Vermont League of Cities and Towns (VLCT) in response to the Governmental Accounting Standards Board’s (GASB) Invitation to Comment (ITC) on Financial Reporting Model Improvements – Governmental Funds. VLCT is a nonprofit, nonpartisan organization that serves Vermont’s municipal officials. All 246 organized cities and towns are eligible for full municipal membership, while other political subdivisions (villages, special districts, etc.) are entitled to associate membership. One of the many service areas that we provide to members is our Municipal Assistance Center (MAC), which among other consulting services, provides financial consulting services to our members.

The Invitation to Comment was issued to obtain feedback on potential changes to the existing financial reporting model. Our response will start with our understanding of what the objectives of financial reporting for governmental funds should be and how we think the current model could be improved, and will follow with our comments on the various items included in the ITC.

VLCT has long been a proponent of two elements of the current financial reporting model in particular – that the integrity of fund accounting needs to be preserved, and that the integrity of the current financial resources measurement focus and the modified accrual basis of accounting must be preserved. The reason that we feel strongly about these two elements is that governments have a responsibility to demonstrate fiscal accountability; that is that governments demonstrate that they have complied with public decisions regarding the raising and spending of public moneys in the short term (generally considered to be one budgetary cycle).

In order to demonstrate fiscal accountability, the primary focus is on the statement of resource flows (statement of revenues, expenditures and changes in fund balances). Governments need to ensure that they have included all of the expenditures that were incurred during the fiscal period as well as all of the revenues that will be used to pay those expenditures. One of the issues that needs to be addressed is that reporting does not stop on the last day of the fiscal year. For example, invoices and statements for expenses that were incurred during the fiscal year will likely not be received and paid until after the
last day. Similarly, governments may be entitled to revenues to reimburse grant expenses, but it is likely that the reimbursement requests will not be processed and received until after the last day.

To address these issues, we currently use the current financial resources measurement focus (to address what type of information is reported) and modified accrual basis of accounting (to address when changes are recognized). Generally, revenues are recognized in the accounting period in which they become available and measurable, and expenditures are recognized when the related fund liability is incurred, with certain modifications.

When it comes to applying these concepts the standards for recognizing revenues are pretty clear and understandable. The general application of revenue recognition concepts is that revenue is recognized in governmental funds as soon as the government obtains a claim to those resources, but only to the extent that the resources will be received soon enough to be used to liquidate the liabilities of the current period. Governments generally tend to use a sixty day period to determine the availability period. In addition, the specific applications to various exchange and non-exchange type revenues are pretty clearly spelled out. Applying these recognition concepts results in more accurate information about revenues that were raised during the year, and is consistent with the concepts of demonstrating fiscal accountability.

It should be noted that the concepts for recognizing revenues do not apply to the concepts of recognizing the related asset. When a revenue is earned, the entire amount of the related receivable is recorded as an asset. When applying the concepts of availability to revenue recognition, those amounts that are unavailable are recorded as unavailable revenues as a deferred inflow of resources. We feel that this manner of presentation provides valuable information as it informs the reader of the total amount of the asset, not just the amount that is available.

One of the inconsistencies of the current financial reporting model is applying the concepts to expenditure recognition. Generally, the regular rules for expenditure recognition are the same as those for expense recognition (accrual basis) unless a modification has been applied in the financial reporting standards. There are two problems with this approach. The first is the inconsistency with the concept of revenue recognition in that there is no related provision concerning whether the liability will be paid using revenues of the current period. This results in recording expenditures that will be liquidated using revenues of a future period. A second problem is the inconsistency of applying some of the exceptions to the basic rule.

We believe that if changes are made to the existing expenditure recognition concepts to make them more consistent with existing revenue recognition concepts, it would result in a vastly improved reporting model that would demonstrate that a government is demonstrating fiscal accountability.

The first change to make the two concepts more consistent would be to recognize expenditures as soon as they are incurred, but only to the extent that payment of those expenditures would be made using available revenues raised in the current period. Conceptually, this could be done using the same approach for revenue recognition – record the total amount of the expenditure that has been incurred as a liability, and record the amount that will not be liquidated using available revenues as a deferred outflow.
We also should note that in advocating for reporting receivables and payables in gross amounts, we are not advocating for any change in excluding long-term assets (such as long-term receivables or capital assets) and long-term liabilities (such as pension liabilities or bonded debt) in the fund financial statements.

The second change to make the concepts more consistent would be to remove many of the exceptions to the basic rule. All current revenues that are available are recognized, and all current expenditures that will be liquidated using those revenues should also be recognized.

The Board also expresses concern that the users of government financial statements do not understand that the fund financial statements represent a shorter-term time perspective than the government-wide financial statements, and we agree that we have found that to be the case as well. However, we do not agree that the misunderstanding is the fault of the current financial reporting model, nor will that be resolved by moving to a reporting model that reflects a longer-term approach. Rather, we believe the resolution would be to improve the financial statement presentation and/or improve the required disclosures.

We believe that requiring the additional disclosures needed to improve that understanding be displayed on the face of the financial statements would result in an overly cumbersome and difficult to read financial statements. We would prefer that reporting model should be more specific about the information that should be included in the notes to financial statement to provide that understanding, and make a specific reference to the notes on the face of the financial statements.

The Board has proposed three alternative financial reporting models, near-term financial resources, short-term financial resources, and long-term financial resources. As the names imply, the recognition period under each alternative would be from 60-90 days for the near-term, one operating cycle (generally one-year for most governments) for short-term, and all financial resources for the long-term (the items excluded under this model would be capital assets and related debt).

It is our opinion that the longer the recognition period that is used for reporting resource inflows and outflows (revenues and expenditures), the further away you become from demonstrating that the government has complied with the spending decisions of the public, and that they have demonstrated fiscal accountability. For that reason, as well as others, we do not agree with either the short-term model or the long-term model.

The near-term financial resources model addresses many of the issues that are problematic with the current model, without straying from the overall objectives of fiscal accountability. It standardizes the time period for recognizing both spending and resources available for spending. Assets include all resources that are receivable at period-end and normally due to convert to cash within the near term, and liabilities include those payables at period-end and normally due within the near term. It also continues to exclude long-term assets and long-term liabilities from being recognized. Inflows of resources include amounts that are available for spending, and outflows of resources include payments made shortly after period-end. Finally, it provides for deferred outflows of resources for outflows of resources that are inherently related to future spending, and for deferred inflows of resources for inflows of resources that are going to be used to fund future spending.
If you have any questions regarding our position, please do not hesitate to contact us.

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