March 31, 2017

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

Thank you for the opportunity to present the Governmental Issues Committee of the Colorado Society of Certified Public Accountant’s views on the Governmental Accounting Standards Board (GASB) Invitation to Comment (ITC), Financial Reporting Model Improvements-Governmental Funds. The Governmental Issues Committee formed a subcommittee to discuss this ITC. Members of this subcommittee included auditors in public practice, representatives from the Colorado Office of the State Auditor and the Colorado Department of Education, and a professor from Colorado State University. We then brought it to the Governmental Issues Committee as a whole.

**GENERAL COMMENTS**

Our comments are shaped by defining the users of the financial information, which we considered to be governing bodies, management, and the citizens of the government, and the environment we operate in and the impact of past pronouncements on Colorado local governments. There are several issues that relate to local government reporting in Colorado.

The committee understands there are certain problems, as enumerated in this Invitation to Comment, in the current reporting model. However, the committee believes that an approach of correcting these individual problems as opposed to an overhaul of the financial reporting system might make more sense.
State of Colorado Financial Reporting

Under the State of Colorado audit law every government with revenues or expenditures in excess of $100,000, must provide information on the basis of generally accepted accounting principles (GAAP). If they have revenues or expenditures in excess of $750,000 they must issue audited GAAP financial statements. Larger governments have the resources for implementing these complex pronouncements, however, smaller governments struggle. In addition, what is considered immaterial for a larger government requires additional scrutiny for smaller governments. An example of that is a single operating lease maybe immaterial for a large government, but is material for a smaller government.

The committee does understand that larger governments offering multiple services to its citizens might have different reporting needs. These governments will typically have pension issues which might also be driven by union negotiation. We also typically find that these governments, in order to meet financial shortfalls, will continue to refinance debt. In these circumstances, the long term full accrual approach for these governments might be relevant to ensure there is focus on long term strategies rather than short term. Even for large governments the committee believes that budget reporting on the modified accrual basis is necessary.

Budgeting

We whole heartily agree with paragraph 12 of the Invitation to Comment. For most governments, the budget tends to drive most decisions. In some cases, the audited financial statements are primarily used to determine how valid beginning budgeted fund balances are. After performing an audit, one of the questions we answer is how close audited ending fund balance is to the fund balance used for budget purposes. State of Colorado statute requires that the financial statements demonstration compliance with budget statutes. For this reason and because budgets are so important for financial accountability, a large number of governments present budget to actual statements for all funds in their financial statements.
The budget perspective is also important due to who are the users of financial statements. We believe that Board members, who are members of the public, usually without financial training in governmental accounting, understand the budget. Financial statements which mirror their understanding of governmental accounting would be the more useful to governing bodies.

Another, and perhaps the most important, user of the financial statements are the citizens of government. Citizens are the ultimate stakeholders of the government. Citizen’s questions usually begin with the budget. Assurance that the budget is reported appropriately and the financial management of the government is measured accurately is one primary purpose of the audit.

The question for both users of the financial statements is what was the budget and how did the year-end results compare to the budget.

*The Pension Liability Effect*

The majority of the individuals on the subcommittee are in public practice. The addition of the pension liability to the government wide statements has caused a large number of governmental boards, for which we collectively provide services, to either dismiss the government wide statements or ignore the pension liability on those statements.

First, for employers in plans, such as PERS, the Board has no ability to set either the contribution rates or the retirement benefits. As a result, it is a number which has a very limited impact on budgeting or the day to day operations of the government.

In addition, the size and nature of this liability make its current inclusion in the government wide financial statements untenable. For example, for the year ended June 30, 2016, the largest school district in the state recorded a defined benefit pension liability of approximately $1.59 billion and now has negative net assets of $835 million.
Answers to Selected Specific Questions

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.

All members of the subcommittee preferred either the near-term or short-term approach. No one was in favor of the long-term approach.

All members of the subcommittee agreed that the perspective that mirrored the budget was the best perspective.

As noted above, fund reporting which includes the pension liability may render those statements or portions of those statements unusable from a governing boards or managements point of view.

Finally, there is also on the subcommittee some sentiment for making the least changes possible. That sentiment carried over to the committee as a whole.

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 governing board approves the budget and management is to use the budget to financially administer the local government. The measure of an administration is a comparison of the budget to actual results. Also, as noted above, one of the functions of the audits, especially of smaller governments, is that the audit is used to prove the reasonableness of amounts shown in future budgets.
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 subcommittee favored the approach that most closely matched the budget for the reasons described above. Subcommittee members favored either the near-term or short-term approach.

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 of resources 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?

The subcommittee favors the current approach to reporting debt. We understand the concept of reporting the current portion of debt in funds, attempting to mirror what occurs in commercial reporting. However, the subcommittee’s belief that fund reporting should align with the budget meaning only current year debt activity should be reported.

In addition, future debt service payments will be funded with future revenues. In the cases of certain bonded debt revenue streams, in the form of property taxes, are already established to pay that debt. It is not really a cost of the current period.

2.5. Views vary on the definition of financial resources—a concept integral to all three recognition approaches. 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 subcommittee differed on whether to report inventory and were unable to reach a consensus. Some members of the subcommittee believe that inventory is an asset which benefits a future
period. Other members believe there is no value to inventory or inventory amounts are immaterial to the financial statements. Some members expressed that certain types of public works’ inventory is a multi-year resource. While other members believe that inventory balances maybe used to manipulate fund balance.

One member expressed the concern that financial reporting of prepaid and inventory transactions should mirror what occurs for federal grant reporting to eliminate timing differences between expenditures reported to the grantor agencies and amounts reported in a government’s general ledger.

Members also expressed that not reporting inventory and prepaid in Near-Term approach was a trade-off. They would like to see inventory and prepaid items continue to be reported in fund financial statements, however, it is more important to them that the near-term approach be adopted, then continue to report inventory and prepaid items.

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 make the information more valuable?

As noted above, for those members who liked the short-term approach believe that there should be no reporting of next year’s debt obligations. Again, the emphasis is on mirroring the activity in the budget.

Also, the estimate of compensated absences to be paid in the next year is not a number that can be computed with any reliability. Some guidance on what this number means would be helpful. We have seen this number as a percentage of the liability reported many different ways. Is this number what will be paid to terminating employees in the next year? Is this number the amount that will be used in the next year? As the liability replenishes itself, is there any usefulness in reporting the amount that will be used during the following period?

One of the issues with the short-term and near-term approaches, which is noted in current practice, is reporting of grant revenues. The available criteria sometimes results in expenditures
in one period and revenues in a subsequent period. As a result, fund balance is sometimes artificially understated. We have seen other instances, in which grant receivables, most notably related to Federal Emergency Management Agency (FEMA) funds, where a portion of the funds will not be reimbursed until the completion of the grant. In that instance, some sort of availability criteria seems warranted. We would ask the Board to consider reviewing revenue recognition for voluntary nonexchange transactions.

While no member advocated for the long-term perspective, we believe that if adopted, pension liabilities should not be reported in this perspective. We also believe that capital assets should be reported in this perspective.

Finally, the committee questioned the need for the government wide statements if the long-term perspective were adopted and capital asset reporting as included in the model.

2.7. Paragraph 6 of this chapter 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?

As a subcommittee we are not sure the language is more relevant. The subcommittee is concerned that the reconciliation as presented may require additional note disclosures.

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?

Most members of the subcommittee liked the current and long-term activity format. Cash flows which fit together, such as long-term debt and capital asset activity are grouped together in the statement.
The subcommittee did not like the splitting of transfers into short and long term. It reminded some members of residual equity transfers.

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

The subcommittee was unanimous that there should not be a statement of cash flows for governmental funds. First, we do not believe there is a cost benefit to this statement as it may not have any value to the reader. If the short-term or near-term perspective is retained this information is already provided.

Requiring a statement of cash flows will clearly add more time and expense to financial statement preparation.

The City and County of Denver’s 2015 CAFR has 189 pages. Jackson County, Colorado, a rural county with about 1,400 residents, has a financial statement, not including any yellow book or uniform guidance reports that is 90 pages long. We are concerned that this may add to the volume of financials, which we believe already causes some uncertainty for users of the financial statements.

Finally, if adopted there will be two types of cashflow statements, one using the direct method and another using the indirect method of reporting. Neither cashflow statement will mirror what is used for FASB prepared cashflow statements.

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

We believe that component preparers can produce a statement of cashflows. The issue is not difficulty is preparing the statement, the issue is the statement will not add any additional value than what is already being reported in the statements.

3.4. Are the four classifications for the statement of cash flows from Statement 9 the most appropriate for governmental funds? If not, what classifications would be most appropriate?

One of our concerns remains that the categories do not align with those reported by FASB entities. The best example of this maybe a college or university. A college or university which is reported under the not-for-profit model has the similar goals and objectives to a governmental college or university, however, the two statements of cash flows will look markedly different.
If you have any questions please feel free to contact Cheryl Wallace at cheryl.wallace@rubinbrown.com or Jim Rae at jrae@pnacpa.com, Co-Chairs of the Colorado Society of CPAs Governmental Issues Committee.

Thank you,

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