March 31, 2017

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

Dear Director Bean:

This response is written on behalf of the Tennessee Comptroller of the Treasury, Division of Local Government Audit (the Division). The Division is responsible for auditing or reviewing the audits of approximately 1300 governmental entities and 225 nonprofit entities. Our staff comprises 92 auditors. The Division and our audit clients will be directly affected by any proposed change in the financial reporting model. In general the Division is supportive of the reporting model reexamination project. We feel there are places where improvement is justified. We continue to support the two-tier approach represented by the current government-wide financial statements and separate fund financial statements. Our responses to the ITC questions are as follows.

Chapter 2: Recognition Approaches for Governmental Fund Financial Statements

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?

Answer: The Division works with local governments. We believe a shorter perspective is essential to good government. Local governments often do not understand the economic resources measurement focus of the government-wide statements nor do they utilize the government-wide statements for making financial decisions. The prime example of this is the budgeting process.
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?

Answer: The governing bodies of Tennessee cities and counties currently utilize the modified accrual basis operating statements when preparing budgets. It would be extremely disruptive to change to a longer-term model for budgeting. The current model has worked well and is simple for the ultimate preparers and users (i.e. the governing body, management, and the general public) to understand. We believe the near-term model would work even better for budgeting. We believe the expectation of management and those charged with governance is that the financial statements facilitate comparison with the budget. If the financial statements cannot be readily compared to the budget, then their usefulness will diminish.

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?

Answer: The Division strongly supports the near-term approach. We believe the near-term approach is an improvement over the existing “current financial resources measurement focus” and modified accrual basis of accounting. The near-term model closely resembles the way local governments actually operate and would be inherently more useful in assessing fiscal accountability. Both the short-term and long-term approaches require cash flow statements to analyze liquidity of a fund. This would make analysis unnecessarily cumbersome for management and those charged with governance.

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?

Answer: The Division can see benefits to both approaches. However, we do not feel that the benefits of presenting tax anticipation notes as liabilities outweighs the benefits of presenting a clear distinction between near-term resources and the economic resources already presented in the full accrual government-wide statements. That clear distinction is important. Tax anticipation notes and revenue anticipation notes are used to provide current operating resources. In Tennessee, they must by law be repaid within the fiscal year. It is very rare for local governments not to repay these notes. Therefore, in the final analysis we support presenting tax and revenue anticipation notes as an inflow and outflow of resources.
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?

**Answer:** The Division believes that assets such as prepaid items and inventory are financial resources. However, we also know that most governments budget on a basis that does not reflect a beginning and ending accounting for prepaid items and inventory. Furthermore, most local governments present insignificant amounts of prepaid items and inventory. Neither prepaid items nor inventory are normally exhausted within 60 to 90 days and any material amounts of prepaid items and inventory will be reflected at the government-wide level. There is no perfect way to reflect every transaction under a near-term approach or any approach. However, because of the long-term nature of these assets and because of the insignificance of these assets for most governments, the near-term approach should not present these types of assets as financial resources.

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?

**Answer:** The Division strongly supports the near-term approach. The Division would recommend that the period of availability be no longer than 60 days. This 60 day availability period should be required for all entities. The Division believes that the closer the new model can get to cash resources, the better the statement will be for governing bodies, management, and the general public. The farther GASB gets away from cash resources, the less important the near-term approach will be for most users. Near-term should be the equivalent of Near-Cash.

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?

**Answer:** The Division believes the methods recommended in the ITC will be effective in communicating the difference between the fund financial statements and the government-wide financial statements. We agree with the same page reconciliations and the explanatory headings for the financial statements as well as the new titles for the financial statements.
Chapter 3: Other Governmental Fund Financial Statement Issues

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?

**Answer:** The Division believes the differences between the existing format and the current and long-term format are not important enough to justify the amount of costs necessary to reprogram computer applications. In addition, we believe the change would not benefit the majority of financial statement users (i.e. governing bodies, management, and the general public).

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

**Answer:** The Division strongly supports the near-term approach. If GASB utilizes the near-term approach, which is essentially near-cash, a statement of cash flows would not be necessary or useful.

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

**Answer:** The question, in our opinion, is not about difficulty, cost, or adding more statements to the audit report. The question is about usefulness. See Question 3.2 above.

3.4. Are the four classifications for the statement of cash flows from Statement No. 9, *Reporting Cash Flows of Proprietary and Non expendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, the most appropriate for governmental funds? If not, what classifications would be most appropriate?

**Answer:** As noted above, the Division does not believe a statement of cash flows for governmental funds is necessary or useful. Should GASB choose to require a statement of cash flows for governmental funds, the Division believes that the existing categories would need to be changed.

If you have questions about the above responses, you may contact Jerry E. Durham at Jerry.Durham@cot.tn.gov or 615.401.7841.

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On behalf of
Jim Arnette, Director