April 12, 2017

Mr. David Bean
Director of Research and Technical Activities
Project No. 3-18
Governmental Accounting Standards Board
PO Box 5116
Norwalk, CT 06856-5116

Dear David,

Thank you for the opportunity to comment on “Financial Reporting Model Improvements – Governmental Funds”. We believe that the issues being considered by the Governmental Accounting Standards Board in this invitation to comment are important in its efforts to provide more and better information to financial statement users. After careful consideration of the material, we offer the following comments.

The North Carolina General Statutes have given the responsibility to the Local Government Commission, through its staff, to monitor the financial condition of approximately 1,350 local governments and public authorities across the State. These units include municipalities, counties, schools, public hospitals, water and sewer authorities, and other public authorities, all of which are required to submit to us an annual audit prepared under generally accepted accounting principles. Our primary vehicle for gathering the data that is used in the monitoring process is the annual audit. Because all of our units report on the same basis of accounting, we are able to analyze data across units utilizing a variety of data points and parameters. This analysis assists us in prioritizing our work so that our resources are more focused on those units that need the most help.

Another responsibility we have is to advocate for local governments with regulatory groups including the GASB. Our response was formulated considering not only our needs as users of the financial statements but also their needs for clear, reasonable, and cost-effective reporting standards. Of the approximately 1,350 units that report to us, only about 175 have publicly traded debt outstanding. Obviously these units of government will need to continue to follow GASB standards for their annual financial reports. Considering the increasing complexity of reporting standards and the difficulty in explaining the different reporting perspectives for each type of statement or fund, we as a regulatory body will have to consider the possibility of moving...
to a reporting requirement utilizing some other comprehensive basis of accounting for those units that are not in the public debt market.

One area we were hoping the GASB would address in this project is the accountability of the unit of government to its citizens through the budget. Under current GAAP, the only audited financials that compare the unit’s performance against budget are those for the general fund and any annually budgeted major special revenue funds, if the unit chooses to include these in the basic financial statements. Otherwise they are relegated to required supplementary information, which is not audited. Budgetary comparisons for non-major special revenue funds, special revenue funds budgeted on a multi-year basis, all capital project funds, debt service funds and enterprise funds are not required to be presented. If a unit chooses to include them, they also are part of RSI and therefore not audited. The State and Local Government Finance Division (SLGFD) requires all units that report a general fund and any annually budgeted major special revenue funds to include those budgetary comparisons in the basic financial statements. We believe it would be beneficial to all users of the financial statements, including our agency, if all statutorily required budgeted funds were included in the audited financial statements. The audit opinion gives a level of comfort to the user of the statements that the comparison is materially correct. Currently this level of assurance is missing from the statements and is not addressed in any of the three proposed changes to the fund statement reporting model. We believe this is the information that the average citizen user of the financial report is most interested in utilizing and analyzing.

As regulators we utilize this information as key data in our analysis of a unit’s fiscal compliance and operations. One of the primary ways that we see local governments get into financial trouble is to not adhere to their budgets, particularly in the more significant funds like the general fund, the capital project fund(s) and the enterprise funds if they offer utility services. Presenting audited budgetary comparisons of these funds gives the user assurance that the story these comparisons tell is materially accurate. We strongly encourage GASB to include this concept in its future considerations.

We acknowledge that requiring all statutorily required budgetary comparisons to be audited statements will increase audit costs but this is a cost increase we believe is worth the additional outlay because it is in exchange for additional assurance. If the GASB will not consider increasing the scope of budgetary comparisons to be included in the audited financials, we strongly urge you to not reduce or eliminate what is currently permitted.

Our statutes require that units of government budget on a modified accrual basis of accounting, and we have a statutorily defined fund balance restriction that is calculated each fiscal year to prevent governments from appropriating more fund balance than they have available in cash after payables are liquidated. After reviewing the ITC it is clear to us that these parts of our local government finance statutes will have to be changed since modified accrual accounting will no longer be recognized as GAAP. The primary reason local governments are required to budget on the modified accrual basis of accounting is that it is less likely to be manipulated than the cash basis of budgeting. We believe we can use an alternative such as cash plus encumbrances
to achieve a similar result for budgeting purposes. However, we believe we will need at least five years lead time to secure all the necessary changes in our statutes.

The following is our specific commentary on the three options that the GASB has proposed for the fund statements. I will start out by saying that we don’t believe that any of these proposals provide significant benefits over the current modified accrual model of reporting.

**Near-Term Basis of Reporting**

The near-term basis of reporting is the option that is closest to the current modified accrual approach, and closest to our proposed change for budgeting to cash plus encumbrances. However, the two are not identical so units would have four different reporting structures within one audit report – government-wide reporting on activities on full accrual, governmental funds on near-term, proprietary funds on full accrual, and budget on cash plus encumbrances. One thing that we struggle with now is how to explain the differences between the government-wide and the two different sets of fund financials. We believe units, especially our smaller units, will struggle to keep their books in such a manner that all the various reporting methodologies could be followed.

We like that most items that are due and payable within 60 to 90 days of fiscal year end would be reported. We believe this provides more consistency to the reporting. However, we do find it potentially misleading that debt principal payments are not included as they are not considered payable until due. Like the current reporting model, fund balance could be considered misleading because an upcoming debt payment has not been included in the calculation.

**Short-Term Financial Resources**

We believe the short-term method would be very difficult to tie to the budgetary basis of reporting because short-term essentially encompasses two years of debt transactions and units cannot be expected to budget two years of debt service utilizing only one year of resources. We do not know at this time what the cost would be to allocate pension and OPEB liabilities, as well as other liabilities, between short and long-term, and therefore cannot weigh in on the cost effectiveness of making this allocation. The reporting titles utilized by the short-term are similar and we believe this will cause confusion for the users of the financial statements. Once again the units will have four different aspects of their accounting systems to manage – one for government-wide activities, one for short-term governmental, one for proprietary, and one for budget. They may need significant (and potentially costly) changes to accounting software to accommodate the necessary changes.

We like the concept of the short-term financial resources basis in that it encompasses the next fiscal year. Well-managed units should be thinking and planning at least a year ahead for operations. This model forces them to at least recognize what is coming due in the next business cycle.
Long-Term Financial Resources

We believe the long-term financial resources method is not an appropriate method for governmental fund financial reporting. The government-wide statements present the long-term perspective already; we do not believe that it is useful to provide fund statements that are similar (but not the same) in perspective. We believe the users would find the two different perspectives confusing. In addition, tying fund operating statements that are prepared on a long-term perspective to a budget that has been prepared on a much shorter term perspective would be extremely difficult.

In summary, we understand the GASB’s position on having a conceptual framework that supports the reporting for the governmental fund statements. While each of the proposed basis have theoretical merits, all of them have operational shortcomings as well. The basis of accounting used to prepare our budgets will change regardless of which option the GASB chooses to pursue. This means changes to our statutes and re-education of over 1,300 units’ finance and budget staff, management, and elected officials. Further, changes in the reporting structure can and likely will result in significant changes in accounting software which will be burdensome for all units of government. Changes to the reporting model need to produce meaningful outputs that improve financial reporting and accountability in order to be cost effective. We do not believe that these proposals achieve those goals.

Sincerely,

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State and Local Government Finance Division