February 8, 2019

Via Electronic Mail

Director of Research and Technical Activities
Project No. 3-25
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Response to GASB Preliminary Views – Financial Reporting Model Improvements

Dear Mr. Bean:

The Office of the Washington State Auditor appreciates the opportunity to give input on the GASB’s proposed Preliminary Views – Financial Reporting Model Improvements (Project No. 3-25). In our constitutional role as the auditor of public accounts for the State of Washington, our Office performs the financial audit of the State of Washington and annually performs or reviews financial audits of the State’s agencies and all types of local governments, along with their component units.

Chapter 1: Objectives, Background, Applicability, and Scope

We appreciate that the Board is seeking ways to improve financial reporting for governments and addressing practice issues and praise the Board for providing useful illustrations and examples in the Preliminary Views. We agree with the Board’s stated concerns regarding the issues with the current model (Chapter 1, par 3). Moreover, we are concerned that the unique basis of accounting for governmental funds creates a large social cost and barrier to the understandability of statements for preparers, auditors, and users. The lack of alignment within the reporting model – with different basis of accounting and statement formats used for government-wide, governmental fund and proprietary fund statements – introduces an inordinate amount of complexity for both preparers and users. For preparers, the complexity precludes effective interim reporting and slows annual report preparation. Financial reporting that is not timely impairs its usefulness for decision making or assessing a government’s accountability.
Chapter 2: Recognition Concepts and Application for Governmental Funds

Overall, the proposed (Chapter 2) short-term focus is confusing and we believe this approach will lead to inconsistent financial reporting and reduce the ability for comparability across governmental fund reports. For example, the application of what is “normal” based on classes of transactions (Chapter 2, par 11, 13, 14) could lead to incorrect application of the proposed short-term focus.

The Board views the proposed short-term focus as a way to provide users with period-end fund balance that would be available for spending in the next period (Chapter 2, par 9). However, the proposed short-term focus leaves out known receivables and inflows, and liabilities and outflows, that arise from longer-term transactions but are expected to be received or paid in the next period. We believe that omitting these transactions – such as bond payments due in the next period – would be misleading if statements are used to determine fund balance available for spending at period end.

Chapter 3 – Presentation of Governmental Fund Financial Statements

We believe it is the use of a unique basis of accounting and a lack of alignment within the reporting model that causes confusion. The proposed illustrated statement (Ill. 3) further diverges governmental fund financial statement from terminology and accounting standards commonly known and shared across industries. We suggest the Board maintain the use of “revenues” and “expenditures” terminology as opposed to the new inflows and outflows terminology. We are concerned that this could cause more confusion rather than less. If the Board is concerned with potential confusion that may arise from users due to the unique measurement focus, we would suggest the Board seek to avoid confusion in the first place by better aligning the presentation format and measurement focus with the rest of the reporting model. For example, a user would naturally expect a short-term focus to align with current assets and current liabilities reported on the government-wide statements. Also, a user will naturally find it hard to relate the governmental fund statements to the government-wide statements and reconciliation because the format of the statements is so different.

We agree with the statement in Chapter 3, Paragraph 4, that the separation of transfers in and transfers out between short and long-term classifications is overly complex.

Chapter 4 – Presentation of Proprietary Fund Financial Statements

We agree that reporting clearly defined operating revenues and expenses (Chapter 4, par 8) will provide a more accurate representation of results from operations than the current reporting model for proprietary funds. We also agree that the separate reporting of subsidies, (if GASB provides expanded definitions to the current definitions in Chapter 4, Paragraph 9) will also provide valuable information to users.

However, we believe that changing the proprietary fund statement of revenues, expense, and changes in fund net position to a format that is not parallel with any other format used in the reporting model will continue to cause confusion and errors. The current reporting model requires multiple formats of similar information in Management’s Discussion and Analysis, government-
wide statements, each of the different fund statements, and the statistical section. We recommend that the Board pick a single format that can be used consistently throughout the reporting model.

Chapter 5 – Budgetary Comparison Information

We agree with a consistent requirement for budgetary comparison information to be reported as required supplementary information (Chapter 5, par 3). This requirement will provide consistent reporting across governments and allow for users to locate this information quickly.

We agree that the requirements for variance columns (Chapter 5, par 2) will potentially provide information to users that assist in the assessment of the government’s ability to forecast, on non-reoccurring events, and hold the government accountable over their resources. However we are concerned that it may not accommodate governments that prepare two year budgets.

Chapter 6 – Other Issues

We concur with requiring governments to report major component unit financial statements as combining financial statements in the basic financial statements, after the fund financial statements, if the government is unable to report them as separate column(s) in the government-wide statements (Chapter 6, par 2). This will create more consistency in government financial reporting and simplify the standards.

In regards to the proposed Schedule of Government-Wide Expenses by Natural Classification, we appreciate that the proposed new schedule will only be required for a comprehensive annual financial report schedule (Chapter 6, par 8). From the auditor perspective, this information is both valuable and useful in assessing the government’s type of expenses.

We appreciate the Board’s request for input on the natural classifications. We would suggest the following natural classifications:

- Salaries and Wages
- Personnel Benefits
- Supplies
- Professional Services
- Interest Expenses and Other Debt Issuance Costs
- Depreciation and Amortization
- Prior period adjustments

Chapter 7 – Alternative Views

We believe that the alternative views proposed in Chapter 7 for the modified short-term measurement focus are more conceptually consistent, easier to comprehend, less confusing and less complex than the proposed method in Chapter 2. Specifically:

- It is easier and less costly to evaluate when an asset will be received or a liability will be paid. This evaluation is aligned with what governments already consider for government-wide reporting. In contrast, reporting based on whether the item arose from what was
originally a short-term transaction or a long-term transaction is more complex and requires information that governments don’t currently track or consider.

- Including financial assets and liabilities that are expected to be received or paid within the next period will result in a consistently symmetrical presentation. In contrast, omission of assets, liabilities, inflows and outflows that are expected to occur during the period will impair the representational faithfulness of statements. For example, including the property tax revenue used to pay debt, but omitting related bond payments will mislead users regarding the fund balance available for spending. This would be like including your salary but not including the mortgage payment in your family budget.

- The concept of “normally” would undermine representational faithfulness and consistency by requiring reporting based on form rather than substance.

- The alternative view is more conceptually consistent and more closely matches the common understanding of short-term assets and liabilities. This reduces the potential for confusion and, hence, reduces the perceived need for unique statement titles, terminology and disclaimers, which we believe will result in more confusion rather than less.

However, we do not agree with the alternative views on a proposed government-wide statement of cash flows. The Board states that governments do not manage cash at the individual fund level (Chapter 7, par 21 and 22). However, this would seem contrary to the concept of fund accounting and the need for fund-level statements.

The Board stated that the statement of cash flows would provide information that would allow users to assess the government’s ability to generate cash and provide an evaluation of the entity’s cash position (Chapter 7, par 18). In the current reporting model, a government-wide statement of cash flows seems duplicative. While this is partially addressed by proposing to eliminate the fund-level statement of cash flows for proprietary funds, governmental funds are still reported on a short-term basis that provides users with similar information to a statement of cash flows.

Other Comments:

Our Office’s mission is to provide value and transparency to citizens through our audit work. Accordingly, we are advocating for changes that will make financial statements more understandable and useful for governments to demonstrate accountability for public dollars.
We continue to stand behind our views that the reporting model needs to be simplified by making statement formats and the basis of accounting consistent between and among fund statements and the government-wide statements. Please see our attached letter, as provided to the Board on March 31, 2017.

Thank you for the opportunity to provide our comments. Any inquiries may be directed to me at (360) 902-0360.

Sincerely,

Pat McCarthy
State Auditor

Attachment: 2017 Response Letter to GASB, ITC on Reporting Model
March 31, 2017

Via Electronic Mail

Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Response to GASB Invitation to Comment – Financial Reporting Model Improvements—Governmental Funds

The Office of the Washington State Auditor appreciates the opportunity to respond to the GASB’s Invitation to Comment (Project No. 3-25I). In our constitutional role as the auditor of public accounts, our Office performs the financial audit of the State of Washington and annually performs or reviews over 850 financial audits of all types of local governments and state agencies, along with their component units.

The current reporting model needs to change

The goal of public accountability requires that citizens, legislators and other users have timely, accessible financial statements for their state and local governments.

However, the current reporting model results in financial statements for state and local governments that take longer to prepare, at a higher cost, and are more lengthy and complicated than those of any other organization. These results, while unintended, undermine the goal of public accountability and the objectives and characteristics of financial reporting described in GASB Concept Statement 1.

The Comprehensive Annual Financial Report (CAFR) is the longest financial report in the world, commonly exceeding the length of reports for sovereign nations and the world’s largest multi-national corporations or nonprofit entities as shown in Exhibit 1. Moreover, the current reporting model requires US state and local governments to report more basic statements and supplementary information than any other type of organization as shown in Exhibit 2. To the degree it increases costs and reduces the accessibility of the reports, this outcome does not serve the public interest.
Moreover, due to the unique government-wide and major fund presentation, materiality for accounting and reporting purposes can be up to 20 times lower for a US state or local government than for another entity of similar overall size, leading to higher preparation and audit costs than otherwise necessary.

\[\text{Exhibit 2: Current model requires too many statements and schedules}\]

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Over the long term, the lack of convergence with other standard setting bodies puts governments and their auditors at a disadvantage for recruiting, training and retaining staff with sufficient understanding of this unique reporting model. More importantly, it creates a barrier to understanding for citizens, policy-makers and other users, possibly undermining public trust in government and impairing public discourse and decision-making.

**Reporting model suggestions to reduce cost and complexity**

Our Office favors changes that reduce the cost and complexity of the reporting model. The cost and complexity arise, to a large degree, from the lack of alignment of accounting methods within the current reporting model, as summarized in Exhibit 3. We believe that alignment of government-wide, governmental fund and proprietary fund statements is necessary. Further, we believe that greater consideration of convergence with other standard setting bodies is needed.

The Board has invited comment on three approaches to governmental funds. All three approaches continue the lack of alignment within the reporting model. We continue to advocate for a common approach and presentation for all fund types, as shown in Exhibit 4. Specifically, we urge the Board to consider:

- A full-accrual basis of accounting for governmental funds, consistent with that used for government-wide and proprietary fund statements.

- Providing shorter-term information consistently within the reporting model by choosing to require either budget-to-actual statements, cash flow statements or a near-term basis of accounting (rather than all three as in the current model).

- Choosing a presentation of shorter-term information at either the government-wide level or the fund level, rather than both as is being considered.

- A consistent presentation layout for the statement of resource flows at government-wide and fund levels (rather than three different layouts, as in the current model). We would suggest moving to a traditional operating and non-operating format for the government-wide statement of activities and governmental fund statements, consistent with current proprietary fund statements.
• Providing consistent classification structures for:
  
  o Revenues by source or by function (rather than both as in the current model), and

  o Expenses by character or by function (rather than a mix of both as in the current model).

Exhibit 3: Current Model

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<thead>
<tr>
<th>Government-wide Statements</th>
<th>Governmental Fund Statements</th>
<th>Proprietary Fund Statements</th>
<th>Fiduciary Fund Statements</th>
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<td>Budgetary</td>
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<td>Cash Flows</td>
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Exhibit 4: Suggested Model

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<th>Proprietary Fund Statements</th>
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<tr>
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<td>Pick one short-term approach</td>
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<tr>
<td>Cash Flows</td>
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<td>X</td>
<td>Pick one level to present as</td>
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Further, budgetary practices vary among governments and some budget on a cash basis. For those situations, the Board may wish to provide an option allowing the budgetary statements to be an acceptable substitute for a statement of cash flows to avoid duplication of effort.

Additional suggestions to reduce cost and complexity

We also encourage consideration of further simplifications in connection with the re-examination project, such as:

• Choosing whether details should be provided as major fund reporting, classification by function, combining fund reporting or segment reporting, rather than all four as in the current model.

• Moving fund-level statements to required supplementary information to eliminate the opinion unit concept. Audit requirements for required supplementary information in AU-C §730 include comparing the information for consistency with the basic financial statements. This would be appropriate if fund level statements are derivatives of government-wide statements, similar to segment information.

• Eliminating the additional requirement to present a reconciliation to operating income in the statement of cash flows (that is, the indirect method), because the direct method is already required for presentation.

• Reducing the amount of required supplementary information, re-classifying required supplementary information as CAFR schedules, and reducing the amount of CAFR schedules. For example, this could be achieved by requiring Management’s Discussion and Analysis only for CAFRs and combining it with transmittal letter (NCGAS 1 par 138) and financial trend information (GASB 44 par 8) requirements.

Consideration of cost and benefit

Finally, we urge greater consideration of the costs and benefits, as discussed in GASB Concept Statement 1, par 73. At the Office of the Washington State Auditor, we are committed to providing
meaningful assurance in our financial audits while containing audit costs, which are ultimately paid by taxpayers.

We believe the length and complexity of the current reporting model not only contribute to higher costs, but also impede the timeliness, accessibility and comprehensibility of this information for most users. Accordingly, we urge the Board to prioritize changes that reduce the cost and complexity of the reporting model as part of their re-examination.

Thank you for the opportunity to provide our comments. Any inquiries may be directed to me at 360-902-0360.

Sincerely,

[Signature]

Pat McCarthy
State Auditor

cc.
Ms. Kim O’Ryan, NASC Association Director
National Association of State Auditors, Comptrollers and Treasurers