April 27, 2018

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

Via email to director@gasb.org

RE: Invitation to Comment of the Governmental Accounting Standards Board on major issues related to Revenue and Expense Recognition (Project No. 4-6I)

Dear David:

Our comments are based on perspectives from teaching governmental accounting, interfacing with accounting professionals in the public sector and governmental employers of our students, and researching governmental accounting issues for academic publications. We speak as individuals serving on the Accounting and Auditing Standards Committee for the Governmental and Nonprofit Accounting Section and do not represent an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the view of every individual member.

We recognize that complexities of governments present a challenge in developing a comprehensive revenue and expense model which could be applied in all real-world situations. However, we applaud the spirit of the GASB to question the base orientation for recognition of these complicated items and to work toward establishing a framework to improve comparability and provide more useful information. The following presents specific comments organized by the questions posed in the GASB Invitation to Comment, Project No. 4-6I.

**Specific Feedback Questions**

2.1. *Do you believe the exchange/nonexchange model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?*

The current exchange/nonexchange model provides a distinction between transactions in which essentially equal values are exchanged and those transactions that lack a reciprocal exchange. This model demonstrates that the activities of governmental entities do not always entail quid pro quo transactions (e.g. selling a service for a commensurate fee). It therefore helps emphasize the
difference in the goals and objectives in the governmental sector, compared to the goals and objectives in other sectors. While readers of the current guidelines may sometimes interpret the accounting guidance differently, it is not clear that the conceptual method of classification has anything to do with the differences in interpretation. An example was provided in Appendix B of the ITC (page 28, B10) in which some survey respondents reported recognizing utility fees when a good or service was “sold” and others when an obligation to the customer was fulfilled. These areas of inconsistency in reporting could be handled by providing more detailed implementation guidance rather than adopting a completely different model.

The current model of revenue and expense follows an earnings recognition approach for governmental accounting. While Altamuro, Beatty, and Weber (2005) find evidence consistent with FASB’s assertion that reporting earnings based on performance obligations prior to completion of the earning process contains value-relevant information about future performance, this type of revenue recognition process increases transactions related to unearned revenue. In the governmental setting, this may be problematic and result in increased future adjustments thus, decreasing the informativeness of financial reports.

Developing a comprehensive revenue and expense model based on the existing exchange/nonexchange model has many advantages over a new performance obligation model. First of all, the comprehensive model would encompass guidance for exchange transactions that is presented in multiple pronouncements and expand the implementation guidance of the existing model. In addition, there would be less need to re-educate users and preparers in terms of the reporting structure in governmental units, minimal cost for implementation of a comprehensive model for revenue and expense transactions, and enhanced consistency and comparability to provide more useful information.

The exposure draft mentions leaving Statement 33 provisions intact for nonexchange transactions, while the discussion during the GASB Webcast on March 14, 2018 suggested that the language in Statement 33 could be modified. We suggest that the language in Statement 33 with regard to grants and contracts is the very area in which preparers have different interpretations of when revenue should be recognized and therefore, needs to be further clarified. It is actually Statement 33 that is more in need of revisiting than the conceptual language of exchange vs. nonexchange compared to performance vs. no-performance obligation. We address this in more detail under 3.1 and 4.2 below.

3.1. Do you believe the performance obligation/no performance obligation model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?
While other standard setting bodies, in particular the FASB, are moving toward a performance obligation model, it is unclear that this move will provide more consistent, comparable data than the previous rules-based standards. The flexibility inherent in how contracts and revenue models are conceptualized by for-profit firms may allow firms to depict their revenue streams in a way that they think best shows the relationships between different performance obligations. Adopting a performance obligation/no performance obligation model for governmental accounting and thereby basing the revenue recognition on the language in legal contracts rather than the overall intent of the agreement is likely to lead to more gamesmanship of revenue recognition than the current exchange/nonexchange model. Even under the current model, governments often insert clauses that the contract could be rendered void if the legislature refuses to appropriate money for subsequent years. Current standards sometimes override this language if the likelihood of nonappropriation is low.

The performance/no performance model in the for-profit sector does not have a proven track record that the benefits will outweigh the cost to implement or the potential lack of comparability will be improved across firms based on how contracts are constructed. As academic researchers, we hesitate to suggest that this new model would be value added since there has not been sufficient time to gather evidence to support a claim. In addition, shifting to a performance/no performance model would cause significant need for re-education of preparers, auditors, and users which would likely add significant cost with no assurance of added benefit. There is no evidence at this time to suggest that a performance/no performance model would result in a more uniform interpretation of factual situations and some risk of significantly more variation. Given the potential risks and uncertainties that arise from applying the performance obligation/no performance obligation model in governmental entities, we do not recommend this basis to be used for classifying transactions and recognizing revenue and expense.

We would also like to express a concern with the terminology applied in a governmental setting. There are language nuances associated with the “no performance obligation” that could be perceived quite negatively in the governmental sector. Various types of taxes are now classified as nonexchange transactions and as noted in the ITC (page 27, B9), the majority of state and local government revenues are generated from nonexchange transactions. When voters assent to an increase in their property taxes or sales taxes for a certain purpose they see the government as having a duty to spend the money as specified or to perform certain activities with the funds collected. Under the current model, taxes are treated as revenues as soon as they are measurable and available for use in accordance with the budget. Categorizing these tax collections as having ‘no performance’ obligation would be confusing, but categorizing the taxes collected as having a performance obligation might suggest their recognition should be deferred until spent. This kind of conceptualization could 1) pose some rather thorny issues of cost allocation that are not inherent in current practice, and 2) defeat the benefits of the dual reporting model wherein modified accrual basis matches tax inflow to the appropriate budget year, rather than matching
the inflows with the associated expenditure. In addition, as noted by Marton and Wagenhofer (2010), the legal existence of a claim may differ across jurisdictions, thereby creating inconsistencies in revenue reporting and diminishing the decision usefulness of information.

As we mentioned in our answer to Question 2.1, we believe that the language in Statement 33 with regard to grants and contracts could lead to different interpretations of when revenue should be recognized and needs to be further clarified. We think that the language in Statement 33 is more in need of being revisited than the conceptual language of exchange vs. nonexchange compared to performance vs. no-performance obligation.

4.1. Do you believe that the alternative model presented as an example in Chapter 4 could provide a suitable basis for classifying transactions and recognizing revenue and expense? If so, what are the potential benefits and challenges of that model?

Based on our understanding, under this alternative model the exchange/nonexchange classification scheme would be retained, but with the details of the revenue recognition conforming conceptually with that of the FASB and other groups’ performance/no performance models.

Even though using the alternative model can perhaps provide data that would be more similar to for-profit businesses for the exchange-like transactions, we would reiterate that the performance/no performance model is as yet still an unproven model. The profession has not had enough experience with this model to determine whether exchange-like transactions would be treated more or less similarly under the new principles-based guidance. Consequently, a change to the performance/ no performance model either in totality or piecemeal would have similar risks and costs of implementation with no clear evidence of providing more comparable or meaningful information. Given the short-term nature of political actors in the governmental sector, any gains in flexibility might be perceived as providing less accountability to citizens.

4.2. The models distinguish transactions on the basis of (a) exchange or nonexchange or (b) a performance obligation or no performance obligation. Do you believe there is another alternative for distinguishing revenue and expense transactions? If so, please describe that alternative and explain why you believe it would be suitable.

We are not convinced that the current exchange/nonexchange characterization is broken. What needs more attention is the classifications in GASB Statement 33. The technical provisions for distinguishing reimbursement grants, purpose grants, and multi-year time restricted grants lead to wide variation in interpretation based on slight differences in legal language rather than the underlying substance of these arrangements. Further, in most cases the voluntary and involuntary
government mandate transactions are handled the same and do not warrant separate distinctions in GASB Statement 33. We suggest that GASB further clarify the nonexchange standards and classifications rather than the exchange ones.

Specific alternative models have been explored in other revenue recognition forums. FASB and the IASB have explored revenue recognition models including the customer consideration (similar to the performance obligation model) and the measurement model (fair value model) (Schipper, Schrand, Shevlin, and Wilks 2009). The fair value model would be extremely challenging to implement in a governmental setting, but does bring to light some key considerations when it comes to measurement, a topic left unanswered with this ITC but an integral one to the final considerations when choosing a final model. Antle and Demski (1989) carefully delineate that any revenue recognition model with an accrual piece introduces variation in information reporting that requires others to be educated about the impact of these timing adjustments. Thus, as salient as the current debate between the two main options discussed in the ITC, carefully thinking about additional options may help the GASB determine if the strengths of the current model are relevant in the fundamental debate about needing to change the revenue recognition model for governments.

**Overall Comments**

Throughout our letter we express a preference towards enhancing the exchange/non-exchange model. However, we cannot truly give a conclusive opinion due to the lack of evidence that would indicate the superiority of the performance obligation/no performance obligation model over other revenue recognition models. In addition, the performance obligation/no performance obligation model still leaves unresolved some of the motivations behind the GASB efforts in this revenue and expense recognition project. Transactions classified as no performance obligation would still be subject to the specialized guidance in Statement 33 which does not address the issues raised in paragraph five of chapter one in the ITC document (this is also acknowledged in paragraph 25.c. in chapter three).

Another motivation for this project, *subjectivity in the assessment of value* as described in paragraph five in chapter one of the ITC, is also not resolved by the performance obligation/no performance obligation model. The determination of a transaction as a performance obligation includes the concept of a binding arrangement which “includes identifiable rights and obligations of the parties that articulate in equivalent terms.” (Paragraphs 3 & 5, Chapter 3, ITC) This component of the definition of a performance obligation is analogous to the component of the definition of an exchange transaction. The concept of “articulate in equivalent terms” is very similar to the concept of equal or like value, thus users would again face *subjectivity in the assessment of value* in addition to determining the other components that define a performance obligation. Because the performance obligation/no performance obligation model seems to
address the absence of guidance for exchange transactions while not adding to the specialized guidance for non-exchange transactions, a comprehensive model may include multiple models. As such, additional analysis of the value added by other revenue recognition models (including the performance obligation/no performance obligation model) is needed for our committee and the Board to work toward improved transparency and consistency in reporting through the current revenue recognition model or a new framework comprised of several models.

We appreciate GASB’s desire to develop a comprehensive revenue and expense model for state and local governments. Thank you for your dedication to the standard setting process and allowing interested parties to provide valuable insights to create the best solution for future reporting.

Respectfully submitted,
Accounting and Auditing Standards Committee
Governmental and Nonprofit Accounting Section, American Accounting Association
Committee Members
Dara Marshall, Texas A&M University - Central Texas (Chair), Dara.marshall@tamuct.edu
Nancy Chun Feng, Suffolk University, cnfeng@suffolk.edu
Mary Fischer, the University of Texas at Tyler, mfisher@uttyler.edu
Renee Flasher, Ball State University, rflasher@bsu.edu
Amy Foshee Holmes, Trinity University, aholmes3@trinity.edu
Louella Moore, Washburn University, Louella.moore@washburn.edu
Carol M. Jessup, University of Illinois Springfield, jessup.carol@uis.edu
Daniel Neely, University of Wisconsin – Milwaukee, neely@uwm.edu
Terry Patton, Midwestern State University, terry.patton@mwsu.edu

References