May 1, 2018

Director of Research and Technical Activities  
Project No. 4-61  
Governmental Accounting Standards Board  
Director@gasb.org  
401 Merritt 7, PO Box 5116  
Norwalk, CT 06856-5116

RE: GASB Invitation to Comment: Revenue and Expense Recognition

Dear Board Members:

The Governmental Accounting and Auditing Committee (GAA Committee) of the California Society of Certified Public Accountants (CalCPA) is pleased to provide our comments. The GAA Committee is a senior technical committee of CalCPA comprised of over forty members from international to local public accounting firms and state and local government.

We understand that GASB has two (2) major projects that will impact the financial reporting of State and Local Governments:

1. Financial Reporting Model  
2. Revenue and Expense Recognition

CalCPA supports the idea of the development of a comprehensive revenue and expense model for state and local governments. However, these projects are not independent and separate from each other.

While reviewing the ITC – Revenue and Expense Recognition, the Board has intended not to address the Measurement in this ITC. Measurement will depend on the Measurement Focus and the Basis of Accounting that the Board determines on the previous issued ITC. We strongly believe that a definitive Measurement Focus and Basis of Accounting be established before determining the Revenue and Expense Recognition Model.

We noted the Project Scope indicates that only the “economic resources” measurement focus and accrual basis of accounting have been applied to the examples illustrated in the ITC. However, those measurement bases are not typically the problem areas for local agencies. The “current financial resources” measurement focus and modified accrual basis of accounting is the area in which revenue recognition can differ greatly between local agencies.

We have provided responses to the questions as listed in the ITC for your consideration.
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?

We believe the exchange/nonexchange model would provide a suitable basis for classifying transactions and recognizing revenue and expenses. The basis of exchange/nonexchange model includes guidance that currently exists in the GASB authoritative literature and is familiar to stakeholders. We are in support of enhancing and expanding this existing model that is currently used and closing gaps in the current literature. The Board should also consider addressing the following:

1. **Clarifying concepts** - Although some of the concepts introduced under the Performance Obligation/No Performance Obligation Model could be used to clarify existing guidance and terms, the introduction of a new concept to replace the existing exchange terminology does not appear to be necessary. Instead, the same could be achieved with guidance that uses existing terminology.

2. **Guidance for exchange/exchange like transactions** – The current guidance under Statement 33 on exchange transactions is very limited, but this type of transaction is commonly used by private companies and governments. Although it would be helpful for local agencies to have an extensive list of examples for recognizing revenue under Statement 33, any guidance issued cannot be expected to cover every example to the point of thinking that different governments will not have different recognition outcomes.

   Guidance for recognition methods for typical revenue sources for governments would be helpful. For example, some local agencies record unearned revenue for certain permit or inspection fee collections at or near the fiscal year end, knowing the related services were not yet provided, while other local agencies do not. That inconsistency may be eliminated through guidance issued in a conceptual framework format, like the ITC.

3. **Guidance on the determination of eligibility requirements for certain non-exchange transactions** – Adding the Eligibility Requirements will certainly help in clearing the confusion of when to recognize grant revenue. In most cases, governments account for grants in special revenue funds. The Board should consider recognizing both revenue and expense in the same accounting period using these eligibility requirements in order to eliminate self-created fund balance deficits in the instances where government did not meet the “availability” criteria under the modified accrual basis.

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?

We do not believe the performance obligation/no performance obligation model that is introduced in this ITC is suitable for Governments. Our bases are as follows:

- The GAA Committee recognizes other standards setters are considering or implementing principles-based revenue recognition guidance using a performance obligation approach. However, we do not believe that following other standards setters will benefit the government sector.
In September 2017, GASB issued a white paper on “Why Governmental Accounting and Financial Reporting—And Should Be—Different”. It is very clear in its Executive Summary as follows:

Governments are fundamentally different from for-profit business enterprises in several important ways. Their organizational purposes, processes of generating revenues, stakeholders, budgetary obligations, and propensity for longevity differ. These differences require separate accounting and financial reporting standards in order to provide information to meet the needs of stakeholders to assess government accountability and to make political, social, and economic decisions.

The primary purpose of governments is to enhance or maintain the well-being of citizens by providing services in accordance with the public policy goals. Instead, for-profit businesses focus on wealth creation and interact primarily with those segments of society that help them fulfill their mission to generate a financial return on investment for their shareholders.

Performance Obligation measures gear toward private business since it is important to determine the net income/loss and have an impact on the earnings per share, therefore it is important that revenues are recognized in the correct accounting period. However, governments should focus on their available resources; therefore, the focus on performance obligation became irrelevant and creates more confusion for governments.

Complications in Implementation of Performance Obligation/No Performance Obligation Model include:

- Technical Accounting
  - Determination of performance obligation
  - Application of contract modification guidance
  - Estimating variable considerations
  - Calculating and operationalizing backlog
  - Disclosures

- Operational and Other Challenges
  - Lack of Resources on Project Management
  - Budget Constraints
  - System implementations and changes to handle accounting changes or disclosures (dual-reporting)
  - Calculating fund balance adjustments in a way that is efficient yet auditable
  - Inadequate internal controls around the adoption
• If the Board determines that the performance obligation/no performance obligation model would provide a better basis for revenue and expense classification, recognition, and measurement, we would like the Board to provide some clarifications for the following:

• One aspect of the model mentions binding arrangements that could be formal and informal – however, informal arrangements may not be binding? And, what documentation would be required for an informal arrangement? That may cause confusion for local agencies.

• The model also mentions “distinct goods and services” with an example that includes inspection or issuance of a permit – what if the program were one subsidized by another revenue source, such as taxes? Would that change the revenue recognition? And, those services are normally provided by governmental funds, not subject to economic resources measurement focus and accrual basis of accounting. Therefore, the local agency may confuse which revenues are subject to the guidance.

• In the three examples provided in Appendix A, it does not appear there is a difference in the revenue or expense recognition between the proposed models. That further demonstrates that the performance obligation/no performance obligation model introduces new terminology that is unnecessary and could cause confusion for some. By instead providing real-world examples under the current (or the exchange/non-exchange model), diversity of practice may be minimized.

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?

Yes, the alternative model could provide a suitable basis for classifying transactions and recognizing revenue and expense, but it is not significantly different from either of the other proposed models. This model again introduces the new terminology from the performance obligation/no performance obligation model, but starts with the exchange terminology. Therefore, it may result in further confusion for local agencies.

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.

Of course, there could be another alternative for distinguishing revenue and expense transactions, but the existing exchange/non-exchange terminology for revenue is somewhat straightforward, and the need for additional alternatives does not appear to be necessary.

Although any proposed model could potentially minimize diversity in practice, revenues and expenses will continue to vary from State to State and each local agency within each State, and inconsistent recognition may continue.

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We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any question or require additional information.

Sincerely,

Kenneth Pun

Kenneth Pun, Incoming Chair
Governmental Accounting and Auditing Committee
California Society of Certified Public Accountants