January 29, 2021
Director of Research and Technical Activities
Project No. 4-6P
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To Whom It May Concern:

We appreciate the opportunity to respond to the preliminary view of the Governmental Accounting Standards Board (the Board) on the Revenue and Expense Recognition. In general, we have concerns over the new guidance the Board is attempting to address through the preliminary view. We offer the following comments for further consideration.

Overall Observations

Financial Reporting Model Improvements

We believe the Board should implement improvements related to revenue and expense recognition before or in concert with the Financial Reporting Model Improvements project (Project No. 3-25). We caution the Board against overhauling how financial activity is reported before first establishing how preparers will account for revenues and expenses, which are the most important financial statement elements for many users. Additionally, proposing two substantial changes to the financial reporting structure over numerous years reduces the comparability of the financial statements from year to year, which is a point of emphasis in GASB Concept Statement No. 1, Objectives of Financial Reporting. The inability of users to use comparable financial statements year over year, coupled with the complexity and significance of the changes proposed in these two projects and other recent projects, will make it difficult for users to understand whether their financial position is improving or deteriorating, and in understanding the reasons for improvement or deterioration. Delaying Financial Reporting Model Improvements would also allow preparers and auditors more time to implement and educate users and would eliminate the need for tiered implementation for smaller and larger governments, which may result in complications when larger primary governments depend on financial information from material component units that fall under the $75 million threshold.

We believe there is an unnecessary conceptual disconnect between the Financial Reporting Model Improvements and Revenue and Expense Recognition projects as it relates to chapter 7 – Short-Term Financial Resources Measurement Focus and Accrual Basis of Accounting Application. Financial Reporting Model Improvements requires preparers to establish the measurement focus and basis of accounting as short-term or long-term at the level of a transaction, whereas Revenue and Expense Recognition requires preparers to establish revenue and expense categorization and recognition at the level of a binding arrangement. While the two requirements achieve different
purposes, establishing one consistent unit of measurement and recognition may enhance conceptual consistency and improve understandability and application for users and preparers.

Primarily, we believe the costs and complexities associated with transaction-level classifications far outweigh the benefits to the user and that a higher-level unit of classification should be established for measurement focus and basis of accounting. The Board may specifically consider whether binding arrangements should be an appropriate unit for both projects. Not only would this create conceptual consistency and enhance understandability and application for users and preparers, but would also create a logical association for preparers in determining when a long-term payment is due for the purposes of the short-term financial resources measurement focus. Under the proposed financial reporting model, preparers may experience some challenges in determining the due date for recognition when there is not a written payment schedule within a binding arrangement, especially when related parties are involved. Therefore, the Board may consider additional guidance around determining the due date, focusing first on what is provided within a binding arrangement and secondly providing guidance on determining the due date when a payment schedule is not explicitly provided in a binding arrangement.

Comprehensive Model

The overall objective of the project is to develop a comprehensive model that establishes categorization, recognition, and measurement guidance for revenue and expense transactions. However, the model appears to be unnecessarily complex in order to address something as fundamental as revenues and expenses. Existing terms clearly understood throughout the industry, such as ‘earned’, ‘incurred’, ‘matching principle’, and exchange/non-exchange would now be replaced with ‘category A/B’, ‘mutual assent’, ‘substantive/interdependent rights and obligations’, and ‘performance obligations’. Despite redefining a significant amount of terminology and introducing multi-step assessments, we do not believe the preliminary views would generally result in substantial changes to our current financial reporting. In order to ensure that benefits of the preliminary views exceed the costs, we suggest the Board look for opportunities to simplify the guidance, wherever possible. For example, steps 1 and 2 outlined within the categorization methodology (chapter 3 - paragraph 3) are separated, but the nature of a binding arrangement typically implies mutual assent between the parties involved. We believe that some simplifications related to the model could be made that would not change the application of the guidance but would remove unnecessary complexity.

Category A and Category B Terminology

The Board should consider revising the terminology for Category A and Category B. Excluding the nature of the categories from the titles obscures what the model is intending to accomplish for preparers and makes the categorizations meaningless to users. In practice, preparers may also include these non-descript categories in their summaries of significant accounting policies within the footnotes to describe the categories’ application in the financial statements, which may be difficult to fully explain and put into context for users. The Board should consider terminology that financial statement preparers and users can discern without extensive additional context.

Pledges

We agree with the proposed guidance regarding the recognition and reporting of pledges in chapter 4, paragraphs 43 and 44. This additional guidance will assist financial statement preparers in determining how and when to recognize revenue for pledges. We believe Case 10 - Pledge provides an appropriate example of how this guidance should be applied.

Purpose-Restricted and Expenditure-Driven Grant Revenue Recognition

We believe the guidance surrounding the determination process for grants as either purpose-restricted or expenditure-driven is not clear or easily interpreted without reviewing the examples provided in the preliminary view. The guidance appears to link expenditure-driven grants to the provisions of goods and services and purpose-driven grants to the use of resources for specific purposes, but those two concepts are not mutually exclusive. Specifically,
there are instances when a purpose restriction is so narrow, that the only plausible use of the funding would be in the provision of goods and services. For example, based on the guidance within the preliminary view, we would have applied the purpose-restricted grant recognition for the CARES Act funding. However, the Board provided additional information that determined the proper recognition for CARES Act is the expenditure-driven grant recognition in GASB Technical Bulletin No. 2020-1 – Accounting and Financial Reporting Issues Related to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and Coronavirus Disease. To reduce subjectivity and inconsistency around this assessment, the Board may consider consistent recognition around both types of grants, simplification of the guidance around substantive and interdependent rights and obligations, and/or additional clarity over the definition of each grant type.

Cost of Time and Effort

We are concerned that extensive costs may be incurred to incorporate the changes required by the Revenue and Expense Recognition project. We believe a significant amount of time would be required to analyze all binding arrangements and transactions to ensure revenues and expenses are properly recognized based on the new guidance. State and local governments may also have to redesign their accounting system(s) to ensure the proper categorization is applied. Additionally, this may result in challenges and additional expense for localities when changing auditors, as the new auditors will be required to perform assessments over the categorization methods for the applicable locality. These extra requirements will result in increased audit costs for localities. We do not see this only as an implementation cost but as a continuous cost for all parties involved.

Additionally, we have concerns over the audit approach that will need to take place to determine reasonableness over the categories. Chapter 3, paragraphs six through nine indicate that governments are not required to have absolute certainty about the enforceability of a binding arrangement. Obtaining sufficient appropriate audit evidence over the rebuttable presumption of enforceability will be subjective, increase audit risk, and reduce audit efficiency.

Conclusion

We understand the concerns that the Board is attempting to address through the proposed preliminary view; however, we believe that the limited benefit to financial statement preparers and users with the proposed changes do not adequately address the limitations under the current revenue and expense recognition application in a cost effective manner.

We appreciate the efforts of the Board and the opportunity to provide our comments. Should you have any questions or need additional information concerning our response, please contact Zach Borgerding or me at (804) 225-3350.

Sincerely,

Staci Henshaw
Auditor of Public Accounts