

State of Colorado



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August 29, 2011

Director of Research and Technical Activities
Project No. 3-20
Governmental Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

This letter is the Colorado Office of the State Controller's response to the Preliminary Views document titled Recognition of Elements of Financial Statements and Measurement Approaches. Thank you for the opportunity to participate in this important due process.

In general, we believe the Board's preliminary views on measurement focus (initial amounts and remeasured amounts) represent an improvement in the conceptual framework that would support the GASB's development of future standards. However, we do not see similar improvement in the framework for recognition of the elements of financial statements – specifically for funds now reported under the current financial resources measurement focus. The near-term financial resources measurement focus resolves some of the anomalies of the current financial resources measurement focus; however, as demonstrated in the alternative view, it does not resolve all anomalies and indeed creates others that are potentially more significant (such as, short-term borrowing to enhance year end position). The near-term financial resources focus may be a more defensible conceptual framework than is current financial resources; however, we believe the anomalies of the current financial resources measurement focus existed because its attributes developed organically from predominant practice rather than from a theoretical basis. From the perspective of accountability reporting to users, when the incentive of aligning with existing budgetary practice is removed, there is no sound conceptual basis for either the current flows or near-term flows measurement focus. Both measurement foci enable and promote a short-term view of a government's finances that has proved to be detrimental to many if not most governments. We find little value in theoretical purification of a questionable recognition model. If we must have a short-term measurement focus, then it should be the one that aligns with current budgetary practice and minimizes unnecessary disruption. Introducing significant change to marginally enhance conceptual soundness will be completely lost on the citizens and government managers who will be adversely affected by the significant changes in standards likely to proceed from this conceptual framework.

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We believe the Board developed a beneficial classification system for remeasurement versus initial value in separating assets to be used directly in operations from those that will be converted to cash prior to use in operations. We found the Board's arguments supporting the use of initial amounts to report assets used directly in providing services to be convincing. We agree that the use of initial amounts is supported by cost benefit analysis and the need for timely reporting, and we agree that remeasurement generally provides for more accurate assessment of capacity to meet future obligations. However, we have some concerns regarding the Chapter 3 remeasurement approach.

Although we believe the Board attempted to deliberate all relevant issues in its development of the PV, the minimal discussion in the PV regarding the need for or benefit expected to be derived from a less than full accrual basis of accounting at the fund level leaves us with the impression that the proposed concept statement is designed to support the status quo rather than as a "clean slate" conceptual framework intended to support future standard development. As presented, we are concerned that the PV seems to accept without challenging the need for the current financial resource flows measurement focus, and replaces it with a measurement focus that is so similar that it does not address the major shortcomings of the current financial resources focus. We believe the Board should include in the PV a more robust discussion of why it believes a short-term measurement focus and a less than full accrual basis of accounting is appropriate at the fund level. Because of the widely varying definitions of expenditures and resource availability promulgated by legislation, we believe there are better ways than financial statements to communicate the amount available for spending. The short-term view that underlies both the current financial resources measurement focus and the near-term financial resources measurement focus does not support true accountability.

In the last bullet of Chapter 2 Paragraph 10, the board repeats an argument used in the discussion of Concept Statement 4 and GASB Statement No. 53, which we believe is not conceptually sound. Specifically, the Board asserts that changes in fair value of recognized assets and liabilities are related to an outflow or inflow of resources that **will** (emphasis added) occur in the future. This assertion is applied to support fair value presentation of derivatives while deferring the impact on the resource flows statement. However, in many, if not most instances, the objective of hedge accounting is to ensure that the inflow or outflow of resources **will not** occur in the future because the government is hedging the item specifically to avoid increasing cash outflows. There is no evidence or intent that the deferred balance will be an inflow or outflow of a future period. In addressing whether remeasurement gains and losses could be reported as deferred inflows and outflows, in Paragraph 8 of Chapter 3 the Board recognizes that, "Essential to those definitions is the concept of applicability to a future period." We do not believe the future inflows/outflow argument applied to derivatives was conceptually sound in Concept Statement No. 4 or in Statement No. 53, and this preliminary views document elucidates that conceptual conflict.

In Paragraph 23 of Chapter 3, the Board acknowledges that an alternative to fair value may be appropriate when an entity is using an asset in a manner different from how the market would view its best use. We believe the implications of this acknowledgement are that State statutes or policies requiring fixed income securities to be held to maturity should qualify those investments for alternative valuation (such as, amortized cost) and not require fair value recognition in the financial statements. In paragraph 26 the Board asserts that remeasured amounts are better suited for assessing an entity's ability to meet obligation when due. In general we agree with this assertion; however, we do not agree in the instance of unrealized losses on fixed income securities required by law to be held to maturity. Current recognition of the unrealized market loss does not reflect the entity's

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ability (or requirement) to continue to hold the investment and better meet its future obligations. Paragraph 27 argues there is common acceptance of investment valuation on an if-sold basis, but fails to acknowledge that sale may at best be an improbable contingency. If this work by the Board is formally adopted, we believe conforming changes to GASB 31 would be appropriate.

Paragraph 34 in Chapter 3 states, "Some remeasured amounts take into account the time value of money." While we believe this statement is accurate, we also believe the board should provide future standards setters and preparers some context for determining when the time value of money should or should not be applied in remeasurement. The limited discussion provided addresses price level change which is predominantly a risk attribute rather than an opportunity cost (time value) attribute.

In Chapter 4 Paragraph 3, the Board elected not to provide a definition or time period for the term "near-term" because it believes that definition is appropriately left to be addressed in standard setting. We have been verbally advised that "near-term" should be construed for purpose of our response as 60 to 90 days after reporting period end. We have done so in this response, but we believe the historical record of the due process suffers when respondents react to factors not enumerated in the due process document. In Colorado's instance, the definition of near-term will have very significant effects on the State's largest general-purpose revenue stream – income and other taxes. Colorado maintains symmetry in its recognition period for General Fund modified accrual revenues and expenditures at one year. Under this structure in Fiscal Year 2009-10, the State reported a \$1.0 billion tax receivable and a \$0.66 billion tax refund payable for inflows based on taxpayer earned income in the period that will result in receipts and disbursements approximately nine months after fiscal year end. In the event of a recognition timing standard based on the near-term financial resources conceptual model, the State would face a catastrophic reduction (\$0.34 billion) in general-purpose revenue driven solely by an accounting standard change. We suspect that the legislative reaction to such a development would be yet another departure from Generally Accepted Accounting Principles for Colorado. Because recognition timing is a core attribute upon which budgetary compliance is measured, such a GAAP departure risks further degrading expenditure and revenue recognition discipline in our state.

We agree with the Board's assertion in Chapter 4 Paragraph 4 that budget practices should not determine recognition and measurement concepts; however, those budget practices underlie most of the attributes of current financial resources focus. The conceptual similarity between current and near-term indicates the Board continues to defer to the budget view of fund level reporting. If the intent is to achieve a conceptually sound basis for disaggregated (fund level) reporting, we believe the Board must determine and explain why the combination of economic resource flows, full accrual, and cash flow statements does not apply equally to governmental funds and proprietary funds. We believe it is feasible to identify or allocate capital assets and long term liabilities to funds, and cash flow statements can provide all the cash focused information that is needed. The governmental fund accounting and reporting is far too complicate to communicate to users, and this proposed concept statement perpetuates that complexity.

In Chapter 4 Paragraph 5, the Board argues that the near-term financial resources measurement focus is not intended to support assessment of interperiod equity and suggest that users should look to financial statements prepared using the economic resources measurement focus. While the economic resources measurement focus is well suited to that purpose, the government-wide financial statements where that focus applies are not

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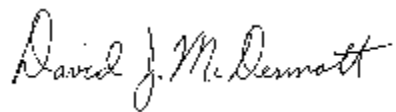
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well suited to interperiod equity assessment because they are presented at a level too highly aggregated to be meaningful to users.

In summary, we believe the only basis for preservation of either the near-term or current financial resources measurement focus is to make the GAAP financial statements relevant to government managers for budget purposes. The near-term focus provides no real benefit to other users. We believe the preliminary views disrupt the status quo without achieving conceptual integrity at the fund level.

Thank you for the opportunity to participate in this important due process.

Sincerely,

A handwritten signature in cursive script that reads "David J. McDermott".

David J. McDermott, CPA
Colorado State Controller