



September 30, 2011

Mr. David Bean
Director of Research
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Project 3-20: Preliminary Views on concepts related to
“Recognition of Elements of Financial Statements and
Measurement Approaches”

Dear Mr. Bean:

The NYS GFOA Accounting, Auditing and Financial Reporting Committee has studied the Preliminary Views on concepts related to Recognition of Elements of Financial Statements and Measurement Approaches (the “PV”)

In addition to offering some comments specific to the PV, we want to take this opportunity to address broadly some concerns that we have with the current reporting model, as this conceptual PV appears aimed at rationalizing and improving that model generally.

General issues pertaining to GASB 34 and related standards that need to be addressed:

Overall we are of the school of thought that Statement No. 34 of the Governmental Accounting Standards Board (“GASB 34”) may have provided advantages for the Wall Street and rating agencies’ financial analyst but did little to enhance the understanding of the entity’s financial condition by government management, elected officials and the taxpayers (including organized citizen groups).

The most important statement in the PV document is in Chapter 3 - §27: “The understandability characteristic recognizes that users of financial statements have varying levels of knowledge about financial reporting and that information should be presented as simply as possible.” (Emphasize added.) In our opinion GASB 34 failed to meet this goal, especially for elected officials and taxpayers.

We believe that a large proportion of governmental finance officers responsible for producing financial statements cannot prepare entity-wide statements without the assistance of their auditors. In fact, many local governments don’t even issue GAAP financial statements but issue audited fund only statements based on some other basis of accounting, such as the New York State Office of the State Comptroller’s System of Accounts.

For entities that do produce GASB 34 compliant audited statements, these documents often run from 100 to 200 or more pages. We have yet to find an elected official or a taxpayer group, unless skilled in government financial analysis, who can explain these statements.

Depending on the entity's size, GASB 34 has only been applied since 2001 to 2003, yet little has been done to address the faults therein suggested in the Alternative View and many others, such as:

- 1) Why aren't comparative entity-wide statements required? How can these statements purport to show "changes" in inter-period equity when the only number that shows a change is net assets? (In our view, the required inclusion of comparative condensed financial statement information in the MD&A is too summarized to permit meaningful comparisons of all key financial statement amounts.)
- 2) If cash is king, as the saying goes, why aren't cash flow statements required for either fund or entity-wide statements? The so called borrowing, and not repaying, of money between funds is often the first sign of financial distress.
- 3) Why is the reconciliation from the fund statements to the entity-wide statements only required at the fund balance to the net asset level? Numbers in the reconciliation are often untraceable to the financial statements themselves. Sometimes they may be gleaned from the footnotes (that very few read and understand), but they are certainly are not easily traceable as currently presented.

Proposed change to "Near Term" measurement focus:

NYS GFOA is generally in agreement with the Alternative View with regard to the advantages of the current financial resources measurement focus over those of the proposed near-term financial resources measurement focus for several reasons.

We believe that what elected officials and taxpayers want to know is: (1) if governments have lived within their legally adopted budgets, no matter what accounting method was used, (2) whether there are any funds available at year end to apply towards future year budgets, and (3), if there is a deficit, how is it being addressed! Currently, this information is buried in fund statements somewhere deep within the voluminous financial statements or larger-yet CAFR.

We do not agree with GASB's View regarding the relationship to budgetary reporting when it states: "[T]he Board concluded that budgeting practices (which vary widely among governments) should not determine recognition and measurement concepts for financial statements using the near-term financial resources measurement focus." If conclusion means that there will now be three sets of financial statements required (economic, near-term and budget to actual) the result will be adding more pages to a report that elected officials and taxpayers will not understand.

Use of remeasured amounts in governmental funds:

With regard to Chapter 3 *Measurement Approaches*, we first and foremost want to say that we believe the PV articulates a comprehensive theoretical framework for a "mixed attribute" reporting model, which we agree continues to be appropriate for governmental entities. Additionally, we are in agreement with the PV position that, generally speaking, initial amounts are most appropriately used in reporting assets used in providing services while remeasured amounts are most appropriately used in reporting assets that will be converted to cash; particularly as this relates to financial statements prepared using the economic resources measurement focus.

One area of concern, however, arises when considering the potential to revalue assets in governmental funds, such as derivative instruments that do not qualify as hedging derivative instruments. Those would seem, under the proposed conceptual framework, to require revaluation in a governmental fund with the change in fair value being reported on the statement of revenues expenditures and changes in fund balances. However, we believe that would be inappropriate, unless there is reason to believe that the derivative will be terminated (voluntarily or involuntarily on the part of the reporting government).

Take, for example an interest rate swap which fails to qualify (or continue to qualify) as a hedging derivative instrument. The recognition of gains or losses from changes in market interest rates over time are not, as a practical matter, changes in current (or near-term) financial resources if the government is going to continue to pay interest at the amount determined by the swap arrangement. Because this "revaluation" amount is not likely to be "monetized" with current financial resources, it does not substantively meet the Board's preliminary view criterion that "remeasured amounts are more appropriate for assets that will be converted to cash" because the fair value changes *are not actually likely to be converted to cash with current financial resources*. However, it would meet the broader category of financial assets. Similar issues

arise when considering other financial assets – such as investments that are intended to be held to maturity where use of a revalued amount would seem to be appropriate except that the revaluation itself will not likely be converted to cash.

While potential carve-out from the revaluation for certain financial assets in a governmental fund seems to be possible simply by interpreting the PV language as excluding revaluations that will not be converted to cash, we would strongly suggest that a final proposed statement explicitly address this issue, as it is a rather significant one. If the Board were to conclude that such assets should nonetheless be revalued in a governmental fund, that would have the additional unfortunate effect of bringing fund accounting further afield from any reasonable budgetary basis. Governments can never reasonably be expected to budget for changes in market values of assets (or liabilities) which will never ultimately impact cash receipts or payments.

Summary:

Our basic recommendation would be to first focus on weaknesses in the current GASB 34 model utilizing the current financial resources measurement focus for governments rather than going to a new focus with new terms and formats in financial statements that will not be easily understood by elected officials and taxpayers, and which moves farther afield from a viable budgetary basis of accounting.

We strongly recommend that GASB address how to present financial information "as simply as possible." To us that means to elected officials and taxpayers as well as to professional government financial analysts.

This response to the Preliminary Views document has been presented to the NYS GFOA Board of Governors and approved for submission to GASB. Please direct any questions to Fred Shellard, Director of Financial and Technical Services at 518-465-1512 who can answer or direct any questions to the appropriate person to address your issues.

Sincerely,

John A. Savash II, CPA

Michele C. Yen, CPA

Co-Chairs, NYS GFOA Accounting, Auditing and Financial Reporting Committee

cc: James Olivo, Auditor, Village of Garden City
President, NYS GFOA

Maura K. Ryan, Executive Director
NYS GFOA

Approved by the NYS GFOA Accounting, Auditing and Financial Reporting Committee 9/21/2011
Approved by the NYS GFOA Board of Governors 09/28/2011