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October 13, 2011

David R. Bean, CPA
Director of Research and Technical Activities
GASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: June 28, 2011 Preliminary Views of the Governmental Accounting Standards Board on concepts Related to *Recognition of Elements of Financial Statements and Measurement Approaches* [Project No. 3-20]

Dear Mr. Bean:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC appreciated the opportunity to discuss its preliminary views on the proposed concepts related to recognition of elements of financial statements and measurement approaches with the GASB Chair and staff at the September 26, 2011 GASB/TIC Liaison Meeting and is now providing the following written comments for your consideration.

GENERAL COMMENTS

TIC supports the proposed recognition concepts for government-wide financial statements prepared using the economic resources measurement focus and the conceptual foundation underlying the proposed measurement approaches in the Preliminary Views (PV) document.

However, TIC cannot support the new, proposed framework for the near-term financial resources measurement focus, which would replace the current financial resources measurement focus as the framework for the financial statements of governmental funds. TIC agrees with many of the concerns expressed in the alternative view (pages 23-24 of the PV) and recommends that additional research be conducted to try to find solutions to the issues encountered in prior deliberations surrounding the current financial resources measurement focus. TIC believes that governmental fund financial statements are

important to users of all governments. Outreach efforts are needed to ensure that user needs are appropriately identified and met.

SPECIFIC COMMENTS

Recognition of Elements of Financial Statements—Near-Term Financial Resources Measurement Focus

The recognition section of this PV was very difficult to read and did not meet the stated objective of a concepts statement (i.e., to help the Board's constituents better understand the fundamental concepts underlying accounting and financial reporting standards). The comments below will describe TIC's views on the various proposed changes and why certain aspects of the proposal were not supportable.

One problem cited by the Board was the confusion and misunderstanding that exists concerning the term "current financial resources." TIC believes there is merit in the proposed terminology change from "current" financial resources to "near-term" financial resources. The term "current" can be confusing and misleading to those who don't ordinarily come in contact with governmental financial statements. Such occasional users may rely on their knowledge of the broader definition of "current" as equivalent to one year and not obtain an accurate picture of what the financial statements are trying to convey. Changing the term from current to near-term has the potential of alleviating some of the confusion. However, the preliminary views document did not completely develop the understanding of what would be included in near-term financial statements. If the near-term concept is retained, it should be specifically defined to avoid any confusion among users and differences in practice among preparers.

TIC could support the aforementioned change in terminology and would acknowledge that there are other problems with the current financial resources measurement approach. It evolved from a collection of accounting conventions adopted for practical reasons, rather than having been established from a cohesive conceptual foundation.

However, TIC cannot support the near-term financial resources measurement focus as a suitable replacement. Overall, TIC believes the Board has not developed a sound conceptual basis for adopting this new recognition framework. In particular, TIC disagreed with:

- Recording purchases of inventories and prepayments as outflows rather than assets—Inventories and prepayments should represent current or "near-term" resources because they can be used up in a subsequent period in lieu of cash outflow and thereby can reduce future cash outflow in the near term.
- Recording short-term lending/borrowing as outflows/inflows rather than assets/liabilities—There appears to be a lack of consistency between the treatment of assets that are normally receivable at year-end and due to convert to cash within the near term and liabilities that are normally payable and due within

the near term. Specifically, it appears as though preparers would include the receivables but would not include a long-term debt payment that matures within the same time period. There is little distinction that can be drawn between the current portion of a debt payment and any other liability.

- Recording interfund receivables, payables, and advances as inflows/outflows rather than assets/liabilities—It appears that interfund receivables, payables and advances will be recorded as inflows or outflows of resources whether or not there is an intent to repay these funds. This is of concern because it will allow governments to control their fund balance. If repayment is intended, these amounts should be treated as receivables and obligations rather than allow governments to potentially give a misleading impression that they have improved or worsened their financial position.

TIC believes each of the above changes would diminish the usefulness of the governmental fund financial statements to the users.

TIC also has concerns that certain principles within the near-term financial resources measurement focus could promote misleading practices by governments that would not be in the public interest. One such example was cited in the Alternative View (Chapter 4, paragraph 16) relating to financing transactions involving tax anticipation notes. Under the near-term financial resources measurement focus, they would be accounted for as inflows of resources, rather than liabilities, when the borrowed funds are received and as outflows of resources, rather than reductions of liabilities, when the borrowed funds are repaid. TIC agrees with the Alternative View assessment that:

The government would thereby give the misleading impression that it has improved its economic position by incurring obligations intended to cover near-term cash shortages and worsened its economic position when it liquidates those obligations.

TIC believes that the adoption of GASB Statement (GASBS) No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, should clarify some of the reporting issues in the fund balance sheet. TIC suggests that the Board defer consideration of this PV until GASBS No. 54 has been fully implemented. Then, the Board could re-examine the need for change. GASBS No. 54 allows the user to see correlations between some of the assets (e.g., inventory, prepaid expenses, and long-term receivables) and their availability for spending based on the classifications in the fund balance section of the balance sheet.

One of the Board's reasons for proposing a change in the measurement focus was its belief that the role of governmental fund financial statements has changed since GASBS No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, became effective (page 19, par. 2). The adoption of GASBS No. 34 and the economic resources measurement focus introduced certain accounts (such as inventories and long-term receivables) into the government-wide financial statements that previously were included only in the governmental fund financial statements. The Board seems to believe that such accounts can be removed from the governmental fund

financial statements simply because these elements are reflected in the government-wide financial statements.

TIC disputes the notion that there has been a significant shift in the role of governmental fund financial statements since the adoption of GASBS No. 34. TIC members unanimously agree that governmental fund financial statements are widely used as the primary source of pertinent information in governmental reporting for all levels of government (not just small governments). Certain, more sophisticated users may agree with the Board's views above, but, within TIC's constituency, a super-majority of governmental statement users/preparers still rely on the fund financial statements and the information that is currently being reported.

The majority of the Board also seems to believe that governmental fund financial statements do not need to help users assess interperiod equity, whereas the Alternative View implies that interperiod equity is still an important concept in the fund statements. TIC believes that users do care about interperiod equity in the fund financial statements. Unlike the government-wide financial statements, the fund financial statements will never portray a complete picture of interperiod equity due to the limitations of recording certain items. TIC believes, however, that the fund financial statements should attempt to approach true interperiod equity to the extent possible. These items are still important for the fund financial statements and governments still need to have a financial statement that can be used to assess the effectiveness of short-term decision-making. The government-wide financial statements are useful for long-term decision-making. However, the statements are aggregated at such a high level that they are not meaningful to users in assessing interperiod equity.

Although the PV provided examples of assets, liabilities, inflows and outflows, as well as deferred inflows and outflows, the lack of sample financial statements was a notable omission. TIC understands that the Board is trying to maintain a clear dividing line between the content of a concepts statement and the content of a standard. However, without such information, it is almost impossible to understand how the proposed concepts would be applied in a GASB standard or to determine whether governmental fund financial statements based on a near-term financial resources measurement focus would include sufficient changes to provide substantial benefits to the users of the financial statements.

TIC therefore shares many of the concerns expressed in the Alternative View about the near-term financial resources measurement focus. That is, the proposed concepts:

- Fail to articulate a clearly stated purpose or an explanation of what the financial statements using this measurement focus are intended to communicate, and
- Present no evidence, empirical or anecdotal, that the proposed near-term measurement focus will better serve the objectives of financial reporting as set forth in Concepts Statement 1.

If the comment process for this PV does not provide sufficient information from financial statement users, TIC believes further outreach to the user community will be needed before proceeding with the near-term financial resources approach. The conceptual framework for recognition cannot be developed until there is a clear understanding of the objective of the governmental fund financial statements.

TIC recommends that the Board continue to explore an approach that would first establish the objectives of governmental fund financial statements and then develop the recognition principles to meet the stated objectives. TIC recommends the GASB engage in outreach activities (such as webcasts, roundtables or presentations at governmental CPE conferences and elsewhere) to gain a better understanding of who the users of these statements are, why the current financial resources approach is important to them and what the objectives of the financial statements should be.

Once this understanding is obtained, the Board should publish a revised preliminary views document for public comment that would present specific findings based on its outreach efforts and provide recommendations for next steps. The paper would discuss user needs, the perceived objectives of governmental fund financial statements and would provide a conceptual framework for recognition that would meet user needs based on the stated objectives.

TIC believes the Board should not hesitate to include sample financial statements in the new PV. The explanatory language in the indented box on page vii of the PV clearly explains the limitations of the examples presented in the text and could be used with equal effectiveness to describe illustrative financial statements that would serve to explain the concepts in the PV. This approach to providing examples would ensure that readers have enough information to evaluate a conceptual framework document but would not obligate the Board to include such examples in the final Concepts Statement.

If additional research is conducted among financial statement users and governments within TIC's constituency, TIC believes the outcome will be continued support for the current financial resources measurement focus with some modifications.

For example, TIC recommends that the GASB align the fund statements with the government's budget. TIC understands that the Board does not want to set budgetary policy and has no standard-setting jurisdiction over budgetary accounting. However, the perceived usefulness of fund financial statements among users derives from the fact that they closely resemble governments' budgeting processes. There may also be concerns that there would be a lot of variations among governments. However, such variations currently exist. Governments vary greatly on the classification of various items in the funds, so comparing one government's "general" fund to another's is frequently of limited use.

TIC believes the Board should explore the above ideas as part of the outreach efforts suggested above. TIC therefore requests that this work be performed before proceeding to the exposure draft stage on this PV.

Measurement Approaches

TIC agrees with the terminology change which proposes to re-label measurement “attributes” as measurement “approaches.” Attributes denote singular characteristics, whereas an approach is a global concept that implies incremental steps needed to achieve a goal or purpose. This change is more descriptive and adds clarity. TIC also supports harmonization with the Federal Accounting Standards Advisory Board, wherever possible.

TIC also supports the proposed measurement approach. TIC agrees that the initial-transaction-date-based measurement approach (initial amounts) should be used for the majority of assets and liabilities and that the current-financial-statement-date-based measurement approach (remeasured amounts) should be applied to investments and other financial assets, as well as variable-payment liabilities.

TIC encourages the Board to provide as much guidance on fair value measurements as possible as standards are developed based on the proposed conceptual framework. Measurements involving unobservable inputs have been particularly troublesome in the private sector and would require special consideration and extensive guidance if used in the public sector.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "Philip J. Santarelli", with a long horizontal flourish extending to the right.

Philip J. Santarelli, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees