Letter of Comment No. 018
File Reference: FR2
Date Received: 02/01/2019

January 28, 2019

Mr. David Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

RE: Project No. 3-25, Preliminary Views, Financial Reporting Model Improvements

Dear Mr. Bean:

I have reviewed the Preliminary Views (PV) on Financial Reporting Model Improvements. I appreciate that the GASB staff and Board have provided this opportunity to comment on it.

The PV requested stakeholder feedback on six issue; four of which I am providing feedback on.

- Recognition concepts and application for governmental funds
- Presentation of governmental fund financial statements

Unearned Revenues I do not believe that the PV has adequately addressed the treatment of unearned revenues. The PV seems to be proposing that at least some unearned revenues will be recognized as revenue prior to earning them.

One example that I am aware of is business licenses sold with a three-year term or any term greater than one year.

As I understand the PV, the "unearned portion" would not be recorded in the General Fund and the amount that will be earned in the next 12 months would be taken in to revenue in the current year.

Assume, for example, that you sold the license at the beginning of the fiscal year. At the end of the year under the current standards, you'd recognize one year of business license revenues. Under the PV, you would recognize two years.

This would result in an increase in Fund Balance that has not been earned in the current year.

Fund Balance is often perceived by the elected officials of our respective government's as resources available to spend.

It could also create the appearance of accumulating an excess amount of funds, which would be an issue for tax objectors and result in additional expenses for governments who then may have to send their legal representatives to court to defend their fund balances against the objections.

This could also be considered an attractive idea to governments looking to increase their fund balances in the hopes of obtaining a better bond rating, or possibly to satisfy an existing bond covenant or even to be compliant with their existing fund balance target policy.

I also have concerns about the ability to track transactions under this criteria of "from the inception of the transaction or other event" (Chapter 2, paragraph 11, parts a and b). Wouldn't the government with the three year business licenses have to track each renewal when the renewal is done, instead of the period for which it is held? Administratively, the government may elect to start getting the licenses renewed 3-4 months prior to the old ones expiring. If the “inception of the transaction” is the point from which we need to evaluate the “within one year”, then our current systems, which are built around tracking for the period of the business license, would not provide the correct figures for this criteria. Even if they didn’t start renewals prior to the expiration of the previous license, not all renewals would occur on the same day or even the same month, which would still require a software modification that would track by when the renewal was paid, rather than what period it is for. This could be an expensive proposition for governments to implement these software modifications.

Prepaids and Inventory Staff have explained that the intent of the PV is to move Prepaids and Inventory out of Nonspendable Fund Balance and into either Unassigned (for General Fund) or Assigned Fund Balance (for all other governmental funds). I have concerns regarding this change. Fund Balances, in particular the assigned and unassigned portions, are often perceived by the elected officials of our respective governments as resources available to spend, whereas this change will increase those fund balance amounts when there are no additional resources to spend as they have already been expended. This is also a matter of concern regarding our state officials in Illinois as they have previously eyed municipal fund balances as possible sources of repairing their own financial position vis-a-vie reducing shared revenues. It would also seem to “improve” their financial position by increasing their fund balances, when in reality their financial position has not changed at all.

Both of these changes, which would increase fund balances either in total or in the unassigned or assigned portions, also become a point of concern in dealing with tax objectors as they might incorrectly infer that we have accumulated an excess accumulation of funds. This could result in additional expenses for governments in having to defend themselves in court against these objections.

- Budgetary comparison information

It is not apparent exactly which budgetary comparisons are to be included. In particular, at what level are nonmajor funds to be presented? Are they to be presented individually or in the aggregate? Would these also be in RSI?

I also do not agree with adding a variance between the two budget amounts. It is my belief that the more you “clutter” up a financial statement, the less value a user gets from it. Further, if someone using a financial statement is curious about the variance amount they could readily determine what the amount was as both amounts are presented on the statement.

- Schedule of government-wide expenses by natural classification

I do not agree that the benefits that may be provided by this schedule outweigh the costs of providing it. In particular, for some entities whose current account structure doesn’t provide sufficient flexibility to derive this information, the cost of providing this schedule could be prohibitive. I also find it curious that the board has indicated that not all governments need to comply with this disclosure, only those that prepare CAFRs. If it is not considered important enough

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to be required of all governments, are the benefits to be derived from it that significant? As stated in paragraph 6 of Chapter 6, “Based on existing standards, information about natural classification of expenses by function or program or by different identifiable activity could be presented in another part of a government’s general purpose external financial report.” Therefore, why not leave this part of current standards unchanged? Then, any government who believed there was enough value to this schedule to provide it would do so. If users believed it had great value, they would also push governments to provide this schedule or request it separately (bond rating agencies, etc.).

“Normally” concept – I believe this will result in confusion and differences despite the intent to do otherwise. I am also concerned that it will distort the picture for at least some governments as they will be compelled to classify transactions as short-term when theirs are actually long-term in nature or visa versa.

Overall, not enthusiastic about the short-term financial resources concept. My reservations primarily center around the relative ease with which governments could manipulate their financials with it. If they wanted to “increase” their fund balance, there are a number of ways in which they could do so without improving their financial position. I am concerned that some governments, seeing the opportunity to improve their fund balances may engage in practices that would not be to the longer-term benefit of the government in an effort to improve their short-term outlook.

Our current financial resources perspective provides fiscal accountability to our constituents, this proposal provides less fiscal accountability. I don’t think providing less fiscal accountability is a desirable direction to go.

As I’ve mentioned above, I am also concerned with the potential cost to implement/track transactions from their inception date.

Finally, I think the “normally” concept is likely to distort government’s real picture in pursuit of improving comparability between governments. Not all governments provide the same services or even if they do, they do not all do so in the same manner or even finance them in the same way.

Sincerely,

Rita A. Trainor
Finance Director
Wheaton Park District