



**Office of the Washington State Auditor
Pat McCarthy**

February 8, 2019

Via Electronic Mail

Director of Research and Technical Activities
Project No. 3-25
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Response to GASB Preliminary Views – *Financial Reporting Model Improvements*

Dear Mr. Bean:

The Office of the Washington State Auditor appreciates the opportunity to give input on the GASB's proposed Preliminary Views – *Financial Reporting Model Improvements* (Project No. 3-25). In our constitutional role as the auditor of public accounts for the State of Washington, our Office performs the financial audit of the State of Washington and annually performs or reviews financial audits of the State's agencies and all types of local governments, along with their component units.

Chapter 1: Objectives, Background, Applicability, and Scope

We appreciate that the Board is seeking ways to improve financial reporting for governments and addressing practice issues and praise the Board for providing useful illustrations and examples in the Preliminary Views. We agree with the Board's stated concerns regarding the issues with the current model (Chapter 1, par 3). Moreover, we are concerned that the unique basis of accounting for governmental funds creates a large social cost and barrier to the understandability of statements for preparers, auditors, and users. The lack of alignment within the reporting model – with different basis of accounting and statement formats used for government-wide, governmental fund and proprietary fund statements – introduces an inordinate amount of complexity for both preparers and users. For preparers, the complexity precludes effective interim reporting and slows annual report preparation. Financial reporting that is not timely impairs its usefulness for decision making or assessing a government's accountability.

Chapter 2: Recognition Concepts and Application for Governmental Funds

Overall, the proposed (Chapter 2) short-term focus is confusing and we believe this approach will lead to inconsistent financial reporting and reduce the ability for comparability across governmental fund reports. For example, the application of what is “normal” based on classes of transactions (Chapter 2, par 11, 13, 14) could lead to incorrect application of the proposed short-term focus.

The Board views the proposed short-term focus as a way to provide users with period-end fund balance that would be available for spending in the next period (Chapter 2, par 9). However, the proposed short-term focus leaves out known receivables and inflows, and liabilities and outflows, that arise from longer-term transactions but are expected to be received or paid in the next period. We believe that omitting these transactions – such as bond payments due in the next period – would be misleading if statements are used to determine fund balance available for spending at period end.

Chapter 3 – Presentation of Governmental Fund Financial Statements

We believe it is the use of a unique basis of accounting and a lack of alignment within the reporting model that causes confusion. The proposed illustrated statement (Ill. 3) further diverges governmental fund financial statement from terminology and accounting standards commonly known and shared across industries. We suggest the Board maintain the use of “revenues” and “expenditures” terminology as opposed to the new inflows and outflows terminology. We are concerned that this could cause more confusion rather than less. If the Board is concerned with potential confusion that may arise from users due to the unique measurement focus, we would suggest the Board seek to avoid confusion in the first place by better aligning the presentation format and measurement focus with the rest of the reporting model. For example, a user would naturally expect a short-term focus to align with current assets and current liabilities reported on the government-wide statements. Also, a user will naturally find it hard to relate the governmental fund statements to the government-wide statements and reconciliation because the format of the statements is so different.

We agree with the statement in Chapter 3, Paragraph 4, that the separation of transfers in and transfers out between short and long-term classifications is overly complex.

Chapter 4 – Presentation of Proprietary Fund Financial Statements

We agree that reporting clearly defined operating revenues and expenses (Chapter 4, par 8) will provide a more accurate representation of results from operations than the current reporting model for proprietary funds. We also agree that the separate reporting of subsidies, (if GASB provides expanded definitions to the current definitions in Chapter 4, Paragraph 9) will also provide valuable information to users.

However, we believe that changing the proprietary fund statement of revenues, expense, and changes in fund net position to a format that is not parallel with any other format used in the reporting model will continue to cause confusion and errors. The current reporting model requires multiple formats of similar information in Management’s Discussion and Analysis, government-

wide statements, each of the different fund statements, and the statistical section. We recommend that the Board pick a single format that can be used consistently throughout the reporting model.

Chapter 5 – Budgetary Comparison Information

We agree with a consistent requirement for budgetary comparison information to be reported as required supplementary information (Chapter 5, par 3). This requirement will provide consistent reporting across governments and allow for users to locate this information quickly.

We agree that the requirements for variance columns (Chapter 5, par 2) will potentially provide information to users that assist in the assessment of the government's ability to forecast, on non-reoccurring events, and hold the government accountable over their resources. However we are concerned that it may not accommodate governments that prepare two year budgets.

Chapter 6 – Other Issues

We concur with requiring governments to report major component unit financial statements as combining financial statements in the basic financial statements, after the fund financial statements, if the government is unable to report them as separate column(s) in the government-wide statements (Chapter 6, par 2). This will create more consistency in government financial reporting and simplify the standards.

In regards to the proposed Schedule of Government-Wide Expenses by Natural Classification, we appreciate that the proposed new schedule will only be required for a comprehensive annual financial report schedule (Chapter 6, par 8). From the auditor perspective, this information is both valuable and useful in assessing the government's type of expenses.

We appreciate the Board's request for input on the natural classifications. We would suggest the following natural classifications:

- Salaries and Wages
- Personnel Benefits
- Supplies
- Professional Services
- Interest Expenses and Other Debt Issuance Costs
- Depreciation and Amortization
- Prior period adjustments

Chapter 7 – Alternative Views

We believe that the alternative views proposed in Chapter 7 for the modified short-term measurement focus are more conceptually consistent, easier to comprehend, less confusing and less complex than the proposed method in Chapter 2. Specifically:

- It is easier and less costly to evaluate when an asset will be received or a liability will be paid. This evaluation is aligned with what governments already consider for government-wide reporting. In contrast, reporting based on whether the item arose from what was

originally a short-term transaction or a long-term transaction is more complex and requires information that governments don't currently track or consider.

- Including financial assets and liabilities that are expected to be received or paid within the next period will result in a consistently symmetrical presentation. In contrast, omission of assets, liabilities, inflows and outflows that are expected to occur during the period will impair the representational faithfulness of statements. For example, including the property tax revenue used to pay debt, but omitting related bond payments will mislead users regarding the fund balance available for spending. This would be like including your salary but not including the mortgage payment in your family budget.
- The concept of "normally" would undermine representational faithfulness and consistency by requiring reporting based on form rather than substance.
- The alternative view is more conceptually consistent and more closely matches the common understanding of short-term assets and liabilities. This reduces the potential for confusion and, hence, reduces the perceived need for unique statement titles, terminology and disclaimers, which we believe will result in more confusion rather than less.

However, we do not agree with the alternative views on a proposed government-wide statement of cash flows. The Board states that governments do not manage cash at the individual fund level (Chapter 7, par 21 and 22). However, this would seem contrary to the concept of fund accounting and the need for fund-level statements.

The Board stated that the statement of cash flows would provide information that would allow users to assess the government's ability to generate cash and provide an evaluation of the entity's cash position (Chapter 7, par 18). In the current reporting model, a government-wide statement of cash flows seems duplicative. While this is partially addressed by proposing to eliminate the fund-level statement of cash flows for proprietary funds, governmental funds are still reported on a short-term basis that provides users with similar information to a statement of cash flows.

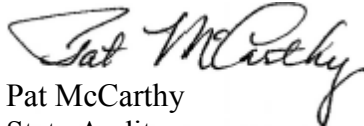
Other Comments:

Our Office's mission is to provide value and transparency to citizens through our audit work. Accordingly, we are advocating for changes that will make financial statements more understandable and useful for governments to demonstrate accountability for public dollars.

We continue to stand behind our views that the reporting model needs to be simplified by making statement formats and the basis of accounting consistent between and among fund statements and the government-wide statements. Please see our attached letter, as provided to the Board on March 31, 2017.

Thank you for the opportunity to provide our comments. Any inquiries may be directed to me at (360) 902-0360.

Sincerely,

A handwritten signature in black ink that reads "Pat McCarthy". The signature is written in a cursive style with a large, sweeping initial "P".

Pat McCarthy
State Auditor

Attachment: 2017 Response Letter to GASB, ITC on Reporting Model