



## **1. The Current Measurement Focus is Conceptually Flawed**

The Division concurs with GASB's assessment that the fund financial statements are not as effective as they could be, and that the current financial resources measurement focus is conceptually flawed as it is currently utilized. The main points GASB mentions to demonstrate the issues at hand include: recognition of prepaids, inventory, tax anticipation notes, and long-term receivables. The use of different periods of availability, and the lack of a conceptual foundation for recording complex transactions, such as derivatives and service concession arrangements, were also cited as reasons for conceptual change. However, the Division believes that GASB's attempt to rectify these inconsistencies by proposing a completely new short-term financial resources measurement focus is unnecessary. Each of the above issues can be solved by providing additional guidance to be used in conjunction with the existing current financial resources measurement focus. For example, inconsistencies related to the use of different availability periods, can easily be solved by specifying one availability period for use under the current financial resources measurement focus. This was originally conceived as part of the near-term measurement focus. It has been incorporated in the new short-term resources measurement focus. This is a good idea regardless of the measurement focus.

Having said that, the Division still prefers the near-term financial resources measurement focus presented in the ITC. We believe the near-term approach is much better than amending the current financial resources measurement focus or implementing an entirely new short-term financial resources measurement focus. GASB has an opportunity to simplify accounting. We continue to believe that simple is better. We will provide additional comments at the end of this document concerning our position.

## **2. Costs Versus Benefits**

The Division does not believe the implementation effort and costs justify such a drastic change in measurement focus. The Division maintains a state-mandated uniform chart of accounts for county governments that will have to be overhauled. The Division has also developed a software program to build the required financial statements under the current financial resources measurement focus. This program will have to be rewritten with limited budget, time, and personnel resources at our disposal. Most local governments in Tennessee operate software programs that either utilize the uniform chart of accounts or something very similar. There are perhaps as many as ten different software companies that provide general ledger and financial statement programs in Tennessee. It remains to be seen whether these companies will commit to making the necessary changes to their software. Most assuredly, the cost of these software enhancements will be passed on to the local governments. Multiply these efforts by 90,000 plus governments in the United States and the financial costs will, in our opinion, be unjustifiably high. This is especially true when you consider the relatively small number of changes in revenue/expense recognition and account balances under the new short-term financial resources measurement focus as compared to the same transactions under the current financial resources measurement focus (Reference Appendix C). As GASB correctly states by virtue of its own research, the current model has worked reasonably well. Implementing the improvements recommended in Paragraph 1 above will be low in financial costs and effort in comparison to the new short-term financial resources measurement focus or the Alternative Views measurement focus.

## **3. Normal Transactions**

The Division has concerns regarding the concepts of “normally” short-term transactions and “normally” long-term transactions. We believe additional information will need to accompany the Preliminary Views in order to define “normal” for all types of transactions, since governments operate differently from entity to entity, from operation to operation, and from fund to fund. In this, we agree with the Alternative Views. GASB indicates that the new short-term financial resources measurement approach should provide for consistency for all governments and that this would be beneficial for small governments and large governments alike. The fallacy with that assessment is, very few states require small governments to report on a GAAP basis. Most small governments report on either a cash basis, modified cash basis, or regulatory basis. The reason for this is that small governments cannot apply GAAP as it currently exists because of the complexity of the accounting standards and a lack of financial resources and professional staff. GASB staff has correctly stated at public venues, the reason why GASB writes such complex accounting standards is because governments (*the Division would also add, “and their consultants”*) continue to develop increasingly difficult and complex transactions. By and large, small governments are not the governments that are creating these complex transactions.

#### **4. Alternative Views**

In our judgment, the Alternative Views approach is a more conceptually pure method for recognition than the “normally” short-term and long-term approach. However, we also believe that if the Alternative Views approach was utilized, consistency would virtually be eliminated between all types of governments, operations, and funds. If forced to choose between the Alternative Views approach and the “normally” short-term and long-term approach, the Division supports the latter. The Division believes the normally short-term and long-term approach would be the easier of the two for local governments to implement once the concept of normal is adequately defined.

Furthermore, the Alternative Views proposes the inclusion of a government-wide statement of cash flows in the basic financial statements and the elimination of fund-level cash flows statements for proprietary funds. The Division strongly opposes the inclusion of a government-wide statement of cash flows because of the additional time and effort it would require to prepare this statement. In this, we agree with GASB’s conclusions in Appendix B at Paragraphs B5-B7. We are confident that most small governments would not be able to prepare this new statement since small governments are not capable of preparing the fund-level cash flows currently required by GAAP. We disagree with the Alternative View assertion that most small governments manage cash at the entity-wide level. The reality is, most small governments manage cash at the fund level.

We believe that the only users who benefit from such an aggregated level of cash flows, would be certain sophisticated users, who apparently are able to make appropriate analyses without this information, since this information has not existed previously. If a government-wide statement of cash flows is necessary for certain governments, sophisticated users could request this information be provided by attestation engagement or by engagement letter request. The small governments in Tennessee have achieved market ratings from the national rating companies and have been able to issue debt for decades without this type of information.

*Assuming GASB requires small governments to utilize the new short-term financial resources measurement focus, and with consideration of our objections in paragraphs 1-4, the Division offers the following additional comments:*

#### **5. Presentation of Governmental Fund Financial Statements**

The Division does not disagree with the Titles of the Financial Statements, the Format of the Statements, or the Explanatory Headings. However, we believe the descriptions for the totals and sub-totals are too repetitive and lengthy.

## **6. Proprietary Funds Statement of Revenues, Expenses, and Changes in Net Position**

The Division is pleased that GASB has defined “operating” and “nonoperating” revenues and expenses. We agree with the guidance that requires “subsidiaries” to be separated from operating revenues. We consider this a significant improvement. We also agree with the presentation of financing and investing activities.

## **7. Budgetary Comparison Information**

The Division does not object to including budgetary comparison information in RSI. However, we do object to including an additional variance column between original budget and final budget. We believe this will require additional effort and costs without any benefit to users.

## **8. Communication of Major Component Unit Information**

The Division agrees with GASB’s approach to presenting Major Component Units.

## **9. Schedule of Government-wide Expenses by Natural Classification**

The Division does not see any real purpose for preparing this Schedule. Furthermore, we believe this schedule could be difficult to prepare for small governments and would provide very little value. If this Schedule is required, we do not object to including this Schedule in supplementary information.

## **10. Small Government Considerations**

The Division is grateful to GASB for considering small governments during deliberations. Within the context of a near-term financial measurement focus, the Division agrees with many of GASB’s conclusions. For example, we approve of GASB’s definitions for operating and nonoperating revenues and expenses regardless of the measurement focus. However, under the new short-term financial measurement focus, the calculation of all numbers from the balance sheet to the statement of cash flows, become more difficult and complex and particularly so for small governments. This is exactly what we do not need. GASB has an opportunity to make accounting simpler. Every financial statement and every audit will either become simpler or more complex based on the financial reporting model improvements, and thus more or less timely.

The Division noted with interest that the GFOA, NASACT, AICPA, and AGA all supported a near-term focus. These professional government organizations wanted a clear distinction between the fund financial statements and the government-wide financial statements. These organizations represent tens of thousands of state and local governments and their employees.

The Division also noted with interest the number of times the importance of “Cash” was mentioned within the Preliminary Views document and most particularly under the Alternative Views. The Near-term focus is a near-cash focus. Under our proposal below, the operating statements would become the cash flow statements.

The Division of Local Government Audit has not changed its position. Most governments in the United States are small governments, and in our judgment, small governments can have GAAP-based fund financial statements under the near-term focus as described in the ITC, because that is very close to the way they are currently recording transactions.

**11. To reiterate our primary position:**

- Governments should utilize a near-term financial resources measurement focus with an availability period of 60 days (perhaps 90 days for grants).
- Governments should utilize a near-term financial resources measurement focus for both governmental funds and proprietary/enterprise funds. The business-type activity fund statements, which are presented as part of the basic financial statements, already present an economic resources measurement focus. This duplication is unnecessary. Under our approach, the enterprise fund operating statement would essentially become the statement of cash flows.
- Therefore, because the fund financial statements are prepared on a near-cash basis, we should not require a statement of cash flows.
- Based on the Preliminary Views document, we would recommend using the near-term focus and the format of the financial statements presented in Illustrations 3, 4 and 5 of the Preliminary Views document with appropriate heading, category, and sub-total naming changes.
- We would continue to report government-wide financial statements using the economic resources measurement focus.
- Because the two measurement focuses for the government-wide and fund financial statements are so clearly distinct, one is near-cash and the other inclusive of everything else, including cash, no reconciliation between the government-wide and fund statements would be required. An explanation on the face of the financial statements similar to the statement used in the ITC would suffice. Contrary to what was stated under the small government considerations at Appendix B, Paragraph B33, we believe this would save a considerable amount of time and effort.
- We do not recommend the Schedule of Government-wide Expenses by Natural Classification.
- Any additional information, such as the Schedule of Government-wide Expenses by Natural Classification, that is needed by more sophisticated users which is not included above could be requested based on need. This information could be prepared by attestation engagement or included as supplemental schedules in the annual audit based on the engagement agreement.

## 12. A Second Option

As a second option, the Division would recommend that GASB simply propose amendments to the current financial resources measurement focus.

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The Division has written this response with small governments in mind. We did this to explain how reporting model improvements could be written to include rather than exclude small governments. We strongly believe the position we have taken would benefit small and large governments alike. Accounting would be simpler and timeframes to close accounting records, prepare financial statements, and for auditors to complete their audits would be shortened. With increasing pressure to complete audits on a more timely basis, the Division believes this makes sense.

Thank you for taking the time to consider the Division's thoughts about the Reporting Model Improvements. Be assured that, whatever GASB decides, the Division will make every effort to inform local governments of the changes and assist them in preparing GAAP financial statements.



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