

From: Kiehl, Anna Maria

To: GASB Director <director@gasb.org>

Subject: For GASB: Pennsylvania's comments on GASB's PV for Financial Reporting Model Improvements (Project No. 3-25)

Dear Dave:

Thank you for the opportunity to provide comments on the Governmental Accounting Standards Board's (GASB) Preliminary Views (PV) regarding Financial Reporting Model Improvements. We appreciate GASB's ongoing efforts to provide transparency and consistency in our financial reporting for all our financial statement stakeholders. With that in mind, we have serious concerns with many aspects of the PV related to recognition concepts and application for governmental funds, as well as the presentation of governmental fund financial statements. As identified in the alternative views, the short-term health of a government is best assessed by presenting the resources available for spending, and as such, we agree with the alternative view that recognition of all assets and liabilities should be based on the same availability period. We also do not see sufficient benefit of a supplemental schedule of government-wide expenses by natural classification to justify the increased costs. On the other hand, the proposals surrounding the proprietary fund financial statements, budgetary comparison information, and communication of major component unit information appear to enhance government financial reporting without significant implementation costs or time. We are in favor of improving financial reporting for enhanced comparability and understandability when the results provide benefits to all stakeholders that outweigh the costs.

The following comments are organized by chapter to assist GASB's further deliberations:

Chapter 2 – Recognition Concepts and Application for Governmental Funds

Overall, governmental fund statements are most beneficial to stakeholders when they are presented with a shorter-term financial resources basis, as this presentation is necessary to assess the government's fiscal accountability to its legally enacted budgets and present to readers information indicating the government's ability to cover its liabilities with its current financial resources. However, in evaluating the short-term financial resources measurement focus presented in the PV, it is unclear that the proposed reporting model provides sufficiently complete or representationally faithful information for readers to make these assessments. The PV's application of different recognition rules for short-term versus long-term transactions and the concept of normality add unnecessary complexity and confusion. Additionally, the proposed potential benefit gained of consistency across governments may be outweighed by the risk of stakeholders' misinterpretation of the individual financial information presented. Financial reporting must consider that not all stakeholders have the same financial training and should be aimed to be understandable by those with less governmental accounting expertise. There are also concerns that the overhaul of the existing reporting of governmental fund information does not provide sufficient benefit to taxpayers to justify the additional personnel, software, and audit cost that would be incurred. Governments cannot afford to lose sight of the best interests of the tax payers when assessing the concerns of the other stakeholders.

The PV indicates that the short-term financial resources measurement focus would enable assessment of the amount of fund balance at period-end available for spending in the next period. It is unclear how financial statements presented applying the short-term financial resources measurement focus provide information that achieves this when long-term transactions that have already been incurred and will be due in the next period are not included. As a result, the short-term financial resources measurement focus risks incorrect assumptions about the resources available for next year's activity and does not seem to provide information that would indicate whether a government has sufficient financial resources to cover its already-incurred, upcoming financial liabilities.

The requirement to distinguish classes of short-term transactions and other events from long-term transactions and other events based on the due date after the inception of the transaction creates several significant challenges in evaluating classes of transaction:

- With the added concept within the PV to establish a "normal" classification across all governments, there is concern that trying to gain consistency in financial reporting across governments would occur at the expense of clear and meaningful reporting of actual events applicable to individual governments. The PV does not include a prescriptive classification to be followed, and it would be challenging for preparers to determine a fair representation of groups of transactions using professional judgment alone. With a broad classification, there is a greater likelihood for individual, material transactions to be reported illogically, as what is normal for one government is not necessarily normal for another government, specifically with differing sizes and types of governments. With a narrower classification, it would be more difficult to prepare and have a greater risk of inconsistent application. Providing a prescriptive classification of what is "normal" across all governments would likely consume a significant amount of time for GASB, as well as financial statement preparers and auditors, resulting in additional preparation and audit costs.
- Example 7 within Appendix C (pg. 51 of the PV) indicates that grants are defined as short-term transactions because they are "normally" collected within one year of inception. Although some grants are for a one-year period, grants for states regularly cover multiple year projects. Neither a long-term nor a short-term classification for all grants will provide representational reporting on the grant revenue or expenses. Federal grants account for approximately 40% of the Commonwealth's governmental revenue.
- Lastly, the current infrastructure of our accounting system was designed to provide modified accrual, full accrual and budgetary accounting information. Significant modifications would need to be made to our accounting system in order to have the ability to accurately classify and appropriately recognize short-term and long-term transactions. Specifically, the emphasis on the due date of a transaction adds a complexity for which our accounting system currently does not have the means to capture.

Within the PV, there is a statement that the current presentation of governmental funds lacks a conceptual foundation. While it may not be officially codified, there is a present-day, cohesive, conceptual foundation for the current financial resources measurement focus, which provides valuable information on the resources available to the government. Any concerns related to application and inconsistencies could be better addressed through consolidating and clarifying the accounting principles and guidance currently applied to the current financial resources measurement focus. For example, the concerns regarding whether long-term receivables meet the definition of current financial assets could be addressed by prescribing a universal availability basis of 60 days to all assets and liabilities. This would

allow for comparability between governments for revenue recognition. Concerns regarding lack of guidance for complex transactions, specifically for derivatives and service concessions, within the governmental fund statements could be addressed in specific standards without creating a new recognition approach that all stakeholders would need to be trained to understand. Within existing concepts, GASB should first determine which complex transactions meet the current financial resources measurement focus criteria, and then provide guidance as to how to report those transactions within the governmental fund statements. With the above examples in mind, we do not see the need for the implementation of a new conceptual basis in order to address the concerns of certain stakeholders regarding the existing financial reporting model and current financial resource measurement focus.

Chapter 3 – Presentation of Governmental Fund Financial Statements

The financial statements already utilize the terminology of “current” and “noncurrent” in the government-wide and proprietary statements of net position. The use of the same terms in the statement of short-term financial resource flows would likely create confusion and an impression that, similarly, the items will have an impact on cash within (current) or beyond (noncurrent) one year of the statement date. Clarification would need to be added to the Summary of Significant Accounting Policies on the differing definitions of current and noncurrent. However, it is not safe to assume that all stakeholders will thoroughly read the notes to the statements and may make decisions on the assumption that they already know the meaning of current and noncurrent.

Additionally, illustration 4 within Appendix D (pg. 77 of the PV) allocates a portion of transfers in/out between current and noncurrent flows. This segregation of transfers by purpose assumes that each transfer serves only one purpose, which is not always true. It also less visibly establishes the net effect of transfers for the reader. It seems more important that a reader know whether total transfers in exceeded transfers out rather than a generic purpose. It would be time consuming to identify the current/noncurrent portion of transfers in/out within existing processes and system limitations. Additionally, for large governments, numerous transfers occur throughout the fiscal year and this segregation will add additional preparation time without significant benefit.

Chapter 4 – Presentation of Proprietary Fund Financial Statements

We agree with the proposed changes for the proprietary fund financial statements with the understanding that clarification would need to be provided related to footnote 7 of the PV. PV Footnote 7 references that GASB’s Statement 9 allowance still applies to treat “program loans” as operating. It may be beneficial to include this exception in the definition of nonoperating to eliminate potential confusion and inconsistency in application for those entities whose primary operations are to provide financing. Otherwise, the definition as it stands would leave those entities without material operating income.

Also, there was a lack of guidance for reporting transfers within a proprietary fund within the PV. With little context, we questioned whether a portion of transfers would need to be removed from the “Other Items” section of the income statement to nonoperating activity. We believe some transfers would qualify as subsidies under the proposed definition: “resources provided by another party or fund to keep rates lower than otherwise would be necessary to support the level of goods and services to be provided.” However, by separating the transfers between subsidies and other items, it will be less apparent that the net transfers for enterprise funds tie to the government-wide statement of activities. Additionally, the appendix example of this statement appeared to have renamed some transfers to captions like

appropriations or taxes, which may not clearly indicate to a reader that the resources came from within the government. Providing future guidance related to these transactions would be beneficial to achieve comparability amongst all governments.

Chapter 5 – Budgetary Comparison Information

We agree that the budgetary comparison information should be included as required supplementary information (RSI), and that the proposed required variances between the original budget to final budget and the final budget to actual expenditures add beneficial information on a government's fiscal responsibility in adopting and following its legal budget. Within our Comprehensive Annual Financial Report (CAFR), we are already currently reporting the proposed budget variances as RSI.

Chapter 6 – Other Issues

For the communication of major component unit information, within our CAFR, we currently present the information for major component units aggregated in a single column in the government-wide financial statements and then separately, in combining financial statements, after the statement of cash flows for business-type entities. It would not be feasible for the major component units to be displayed separately on the government-wide financial statements, as there are several major component units reported in our CAFR.

In evaluating the reporting of a schedule of government-wide expense by natural classification, we are concerned that the efforts to implement the supplementary schedule would outweigh the benefits. While a natural classification of expenses adds some additional detail on government spending, it may be used to inaccurately compare governments of different sizes. The statement of activities allows the reader to assess the size of the government through the comparison of revenues and expenses. However, by displaying only expenses in a schedule, the stakeholders may compare governments' natural classifications and assume that one government overspends on personnel costs compared to other when difference is actually due to the size of the government. Furthermore, this information is not currently available within our accounting system on a full accrual basis. The effort to establish natural classifications would require a substantial modification to our accounting system, an expansion of the chart of accounts, and training and internal controls to ensure manual entry of transactions within those natural classifications is accurate. As a supplemental schedule the additional expense to tax payers, potential risks of financial statement user misunderstanding and impact on an already stressed CAFR issuance timeline, limit the reasonableness of inclusion in a CAFR.

Although not clearly discussed in the PV, a phone call with GASB indicated that a natural classification for discretely presented component units would be required in addition to the primary government. The Commonwealth does not have natural classification expense information for the component units, and since the proposed requirement for the supplementary schedule is only for CAFRs, the information will not be available in the component units' financial statements. It is unlikely the Commonwealth will be able to obtain this information from each component unit.

Chapter 7 – Alternative Views

Should GASB ultimately decide to establish the short-term financial resources measurement focus as the financial reporting model for governmental fund financial statements, the modification of the short-term

financial resources measurement focus as defined in the alternative views would be the preferred model to be implemented.

The modified definition of short-term financial resources, within the alternative views, more accurately presents the resources available for spending in the next period because it recognizes all transactions on a universal availability basis of one year. It also provides clearer budgetary comparisons, since budgets include all transactions that impact cash, regardless of whether they would be for accounts payable or for a debt payment. The inclusion of all financial assets that represent cash or are expected to be converted to cash or other fund financial resources within one year from the date of the financial statements allows for better assessment of a government's ability to cover its financial liabilities with its financial resources.

Additionally, replacing the concept of normally and focusing on when a financial asset or liability will be received or paid would reduce the subjectivity in recognition of financial resources resulting in increased consistency of presentation and, therefore, understandability and usability of the financial statements. As previously stated, requiring all governments to determine and apply what is normal for all governments for each class of transaction would require a significant amount of additional time and resources to prepare the financial statements and would likely lead to illogical results within each governmental fund financial statement.

Although the Commonwealth agrees with most of the alternative view, there is disagreement with the statement that governments do not manage cash at the individual fund level. For the Commonwealth of Pennsylvania, resources are appropriated on a fund level, and cash within one fund is not available for use within a different fund. As such, a government-wide statement of cash flows is more onerous and less useful for assessing overall budgetary compliance.

The alternative view will be less costly and time-consuming for governments to prepare and audit since much of the information is already included in the current portions of assets and liabilities within the government-wide statements. Although it is worth noting that since much of the short-term information is already available to stakeholders within the current portions of the government-wide statements, it is still this government's position that the current resources measurement focus if applied using a consistent availability standard of 60 days would be best suited to provide information of the resources available at the end of a period and the assessment of a government's fiscal accountability to its legally enacted budget.

As you have read, we agree with GASB's intent to improve financial reporting by enhancing comparability and understandability in financial reporting of government entities. However, we strongly believe this goal can be achieved by consolidating and clarifying the current accounting principles and guidance applied to the current financial resources measurement focus, rather than creating a different short-term financial resource measurement focus. We believe using the terms current and noncurrent in a different context within the governmental fund financial statements will be confusing to the preparers and readers and be disadvantageous to decision making. In the event that GASB determines there is a necessity for creating a short-term financial resources measurement focus, the model described within the alternative views would most improve the information reported in the governmental fund financial statements because it is a more complete and representational presentation of financial results.

Thank you for your consideration of the above comments on the Preliminary Views document. I cannot emphasize enough the importance of the Board weighing the cost benefit of their proposals given the financial impact they have on our taxpaying citizens.

Please contact me at akiehl@pa.gov or (717) 787-6497 with any questions.

Best Regards,

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