

February 15, 2021

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David R. Bean
Director of Research and Technical Activities
Government Accounting Standard Board

Re: Project 3-20 (Proposed Statement-Recognition of Financial Statement Elements
Project 3-25 (Proposed Statement- Financial Reporting Model Improvements

Dear Director Bean,

It is of the utmost ethical and moral importance that the accounting and reporting standards for state and local governments be of **higher quality** than those for non-governmental organizations (corporations, partnerships, non-profits, etc.). The financial accounting and reporting standards of any organization should be truthful, relevant and transparent. They should enable all variety users to make informed decisions, to develop trust and confidence in the organization, and to oversee, monitor and analyze the organization. The financial sustainability of the organization is one the key, if not key, pieces information that users in general need. Sustainability of services is a key piece of information for many users as well.

This is not the situation for State governments and local governmental entities. Their accounting and reporting standards are severely deficient in providing the most useful information to the various users for accountability purposes. The changes called for in No. 3-20 and No. 3-25 go nowhere near what is needed to give many users the information they need to determine the financial sustainability and the sustainability of services. The citizens, voters, taxpayers and investors who provide the revenue and capital for the state and local governments to operate absolutely need truthful, relevant, transparent and trustworthy information.

The GASB should not proceed with the changes as outlined in the Exposure Drafts. To not require fund balance accounting using total financial resources measurement focus and accrual basis of accounting because it is expensive is not prudent. That measure indicates the sustainability of the organization or entity and of their services. If it is not sustainable, bankruptcy or some method of resolution is the end point.

The GASB has long over-emphasized short-term issues. The lack of full-accrual accounting has allowed income statements and balance sheets to be misleading. Statement 34 (1999) used a "modified accrual basis" that was largely cash-based. This short-term orientation lead many entities to say they have "balanced the budget" for decades and decades while they evolved to

where they are financially unsustainable and their service activities are not being sustained. Service activities are declining in both quality and quantity.

While the Board concluded on page 48 of the Exposure Draft that individual funds should be identified as self-sustaining or requiring subsidization. Inexplicably, this is not applied to the government wide entity overall (the general fund). How can individual funds be subsidized if the entire entity is not sustainable? All necessary subsidizing funds must come from somewhere else in the governmental entity.

The following information is on the State of Illinois, the city of Chicago and the Chicago Public School ("CPS") system. (While they might be extreme examples, I have spent the majority of my life in suburban Chicago. I have seen and lived with some of the consequences of decisions based on the financial reporting statements of those entities.).

(in \$ millions)	2010	2019
State of Illinois		
General Fund Balance	-8,818	-7,517
Unrestricted Net Position	-54,790	-214,547
City of Chicago		
General Fund Balance	136	336
Unrestricted Net Position	-8,014	-38,068
Chicago Public Schools		
General Fund Balance	424	471
Unrestricted Net Position	-1,916	-14,223

The severe financial decline in those three entities have not been at all adequately communicated to the various users of the information. The accounting standards and reporting have not required it. Those governmental units are financially unsustainable and their services to their citizens have not been sustained. The financial accounting standards have been fundamentally flawed for decades and border on gross negligence.

For the State of Illinois, between fiscal 2000 and 2020, the inflation adjusted growth of pensions was 501%, health insurance increased 127%, education was up 21% and all other spending **decreased** 32%. Total spending was up 15%. Other spending included State police, DCFS, human resources and public health. Clearly there has been a severe diminution of services for the citizens over the last two decades. (See footnote 1).

Given the time and process the GASB took to create Statement 34 in 1999 (15 years according to P. 27 of the Exposure Draft) and the time it has taken to create this exposure draft, the GASB must be much more urgent and aggressive as well as taking an ethical and moral approach.

While I can understand why the GASB might not use a “clean slate” approach, there are four reasons for the real need for urgency. First, the adjustments needed to be made to reach financial sustainability take a long-time. Significant taxation, fee and service adjustments will have to be made. Adjustments made in a crisis tend to have unwanted side effects.

Taxes and fees at the state and local levels are usually regressive. Service adjustments will tend to largely affect the poor. These all add to the issue of inequality in society. The quicker and less thought-out the adjustments are made, the larger the contribution to inequality they will be.

Second, the Federal government provides states with over 30+% of their revenue along with requirements on how some of those funds must be spent. Before the COVID pandemic hit, the Congressional Budget Office (“CBO”) had estimated that by the mid 2030s that interest, Social Security, healthcare and defense expenditures would be greater than all expected Federal revenue. Discretionary spending would logically have to be zero.

State and local governments must have excellent accounting standards and reporting if they are going to work through the significant and difficult changes and trade-offs that will be needed to react to the coming changes in Federal government’s provision of revenue.

Third, non-governmental entities have accounting standards and reporting that give a much better warning that the financial sustainability of the organization is in question. When their financials indicate pressure on financial sustainability, those organizations usually restructure their operations, which often work. If not, they merge or winddown their operations. Suppliers of capital force changes as well. Finally, if nothing else will work, the non-governmental organizations can utilize the well-defined, tested and proven bankruptcy system which has been operating and evolving in the US since 1898.

A review of the bankruptcies/restructurings of Puerto Rico, Detroit, Jefferson County and Harrisburg gives one no confidence in the process of State, cities or local entities have to restructure to become financially sustainable. A state cannot go into bankruptcy and cities and local entities can only do it if their state law allows it. New York state created the Municipal Assistance Corporation to restructure New York City’s finances in 1975. It was in existence for over three decades.

Fourth, imagine how differently the myriad of users might have acted if the recognition of pension fund and health care expenses for retired government employees on balance sheets had occurred in the 1990s instead of 2015 and 2017.

Quality accounting standards and reporting are necessary to enable society to understand and make the difficult policy trade-offs through the political process and system.

The reasons for an ethical and moral approach is that certain products, services and functions the governmental units provide are today, often significantly more important, than those the non-government sector provides (food, clothing, shelter, leisure, automotive transport).

First, the governmental sector provides the environment in which non-governmental entities operate in, i.e. external and internal security, a legal and regulatory system. If that environment functions poorly, the private/non-governmental economy would not function very well. Other public goods provided are highways, parks and libraries.

Second, education is almost exclusively a governmental responsibility. K-12 education and college and universities are largely the responsibility of, and funded by, local and state governments. For K-12, education is largely public schools that are funded locally and by the States. Private schools educate about 10% of those students.

At the college and university level, there is a vibrant and well-respected sector of private schools. Most of the top-ranked colleges and universities are private. They educate about 26% of all students.

People from both political parties and all political points of view see education as of the utmost importance and part of the long-term solutions to many problems in the US. These groups all suggest a myriad of reforms, but rarely the same ones. Local and state governments are generally not covering the costs of the existing education system. When one adds in the costs of the reforms to education being called for, the costs will go nowhere but up and financial sustainability becomes even more remote.

Third, civic and social organizations historically have provided certain, important functions to the populace. Over time, these organizations have become conduits for state and local governments. Those organizations rely on state and local governments for funding and those governments expect those organizations to provide their services to the citizenry. Their funding is being reduced and their provision of services is declining.

Fourth, retirement income and post-employment healthcare are a significant part of government employees compensation packages. They are significant to the those employees as they work and once they have retired. Those people plan and act on the assumption that those benefits will be there.

Finally, for citizens of lesser means, those with disabilities and for many children, healthcare through Medicaid is absolutely crucial. It is the only way they can access healthcare.

In a private, market-oriented, capitalist economy, the public/citizens are used to continually changing products and services and their providers. Products, services, pricing, distribution, quality, technology and other non-financial characteristics change. Consumers are used to these changes. Competition changing and the rise and fall of companies is quite normal.

Bankruptcy is extremely rare, an infinitesimal part of the time, and can be a cause of the consumer to change products and services.

As compared to the non-government economy, there are few, if any, alternatives to the services provided in the public sector. Switching costs to move to another government jurisdiction are incredibly high, whether it is to a different community within a state or to a different state. It is an all or none decision.

Moving a family, changing social connections, children changing schools and friends, finding a new job, funding the out-of-pocket expenses for a move are daunting challenges that very few families have the financial, social and psychological capacity to do.

For non-governmental entities there is a web of groups who provide oversight of accounting standards, accountability and performance. These are both inside and outside of the government. The SEC has been providing such oversight since it was set up in 1932. With the Sarbanes-Oxley Act (SARBOX) in 2002, Congress created a number of oversight mechanisms such as the Public Company Accounting Oversight Board, legislation to enhance auditor independence and to increase corporate responsibility (including financial penalties for senior executives) and required enhanced financial disclosure.

The accounting profession (AICPA) has been involved in developing and improving accounting standards, professional standards and accountability since it started in 1887. As the profession performed well below the government's and the public's expectation, it faced severe economic consequences. SARBOX separated their consulting businesses from the auditing business. The Big Eight became the Big Four.

For non-governmental entities, the "going concern" concept has been part of their audits since 1989. The addresses the financial sustainability of those organizations. There is no comparable judgments made for government entities.

Part of the web of oversight is investigative journalism and media. Along with the academy and think tanks, they have had a focus on accounting standards, accountability and performance of non-governmental entities. That oversight only works if the accounting standards and reporting methods are good enough for those in web of oversight to function.

The standards set forth by the FASB and SEC have provided, and keep evolving, so the private economy is working and there a few concerns about sustainability. If there are, taking care of the sustainability issues can be ably managed.

The GASB must have a higher level of accounting standards. There are no independent third parties overseeing their government accountings standards like there is with FASB and non-governmental entities. The financial and service sustainability of State and local entities are in question. The services they provide are of the utmost importance to the public and their citizenry. They require much improved tools to address these issues. The proposed approach

fails to do this. Requiring fund balance accounting using total financial resources focus measurement and accrual basis of accounting is the tool necessary for the political system and the public to successfully address these issues.

The importance of the services that state and local governments provide to the voters, citizens, their families and future generations is incredibly high. **It is unethical and immoral not to have accounting and reporting standards that do not present the financial viability/sustainability of the entities and their ability to provide the services as expected.**

(1) Data from an Illinois Policy Institute article “Illinois Public Services Being Cut To Pay Unsustainable Pension Costs” by Adam Schuster, date 9/8/2019. Based on information from a Freedom Of Information Act request to the Governor’s Office of Management and Budget, Commission on Government Forecasting and Accountability Fiscal 2020 Budget Summary.