



NORTH CAROLINA
DEPARTMENT OF STATE TREASURER

Letter of Comment No. 121
File Reference: REC
Project No. 3-20
Date Received: 03/25/2021

STATE TREASURER OF NORTH CAROLINA
DALE R. FOLWELL, CPA

**STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION**

SHARON EDMUNDSON
DEPUTY TREASURER

March 23, 2021

Mr. David R. Bean
Director of Research and Technical Activities
Project Nos. 3-20 and 3-25
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

Thank you for the opportunity to comment on the Governmental Accounting Standards Board (GASB or Board) Exposure Drafts, Financial Reporting Model Improvements and Recognition of Elements of Financial Statements. We believe that the issues being considered by the Governmental Accounting Standards Board in these projects are important in the Board's efforts to provide more and better information to financial statement users.

The North Carolina General Statutes have given the responsibility to the Local Government Commission, through its staff, to monitor the financial condition of approximately 1,350 local governments and public authorities across the State. These units include municipalities, counties, schools, public hospitals, water and sewer authorities, and other public authorities, all of which are required to submit to us an annual audit prepared under generally accepted accounting principles. Another responsibility we have is to advocate for local governments with regulatory groups including the GASB. Our response was formulated considering not only our needs as users of the financial statements but also their needs for clear, reasonable, and cost-effective reporting standards.

After careful review of the material contained in the Exposure Drafts and in consideration of our responsibilities, we offer the following comments.

Lack of Budgetary Variance Presentation in Audited Financial Statements

We disagree with requiring budgetary comparison information in a budgetary comparison statement of the general fund and other major, annually-budgeted special resources funds be only reported as required supplementary information. Governments have had the option of reporting this information as part of the basic financial statements since the implementation of GASB No. 34. We do not see this as an inconsistency in reporting. Rather, it is simply an optional accounting treatment. A government that chooses not to report a budgetary comparison as a basic financial statement can simply elect to report the budgetary comparison as RSI. The basis of this decision appears to be solely the Board's desire to have a single format with the majority's preference prevailing as the single choice. In our opinion, having a budgetary comparison statement as part of the basic financial statements with this information covered under the auditor's opinion provides more visibility and enhances the importance and assurance of this information than if reported solely as RSI. We are not requesting that all governments present budgetary comparisons as basic financial statements, but that the governments that find value in that particular option being allowed to continue with that accounting treatment.

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In fact, NC local governments are subject to the North Carolina Local Government Budget and Fiscal Control Act, which requires that an obligation or expenditure be budgeted (or “preaudited”) prior to the local government entering into the transaction. If expenditures exceed the budget ordinance, it is an indication that the government’s preaudit function is not working properly. Further, the government’s finance officer and his/her sureties are legally liable for any sums that could be disbursed when the disbursement is not budgeted.

We reviewed the GASB comments in Appendix B, Basis for Conclusions and Alternative View, Budgetary Comparison Information. Per the discussion in that section, there is no standardized measure for budgetary reporting. However, in North Carolina, there are long-standing, specific statutory requirements included in the Local Government Budget and Fiscal Control Act (LGBFCA), that local governments have annual budgets. In addition, the State and Local Government Finance Division publishes annual illustrative statements that provide for consistent, across the board budget to actual reporting at the legal level of budgetary control. Most local governments and their auditors use these templates which we develop and post on our website [here](#). As a result, we accomplish consistent, budget/actual reporting comparisons for NC local governments and public authorities. In addition, the basic financial statements and the notes to the financial statements are included in official statements when local governments issue public debt. We are very concerned that not allowing North Carolina governments the option of reporting budgetary comparison information in the basic financial statements would be a disservice to the users of governmental financial statements in NC reducing the value of a financial reporting mechanism that allows governing boards, citizens, and bondholders to hold NC governments and their staff accountable for unauthorized spending and other unacceptable budget practices.

We discussed this proposed reporting change with a governing board official from a small, well-run local government in NC. His concerns were that the change would make a statement that is easy for boards to understand less visible. We urge the Board to recognize that of the 1,356 local governments in NC, only 125 issued public debt in the fiscal year ended June 20, 2020. In NC, with 551 municipalities and 100 counties, less than 6% had populations of more than 100,000. All NC local governments are required to do annual audits and most of the governing board members do not have any financial background. They are paid a small stipend to do a sometimes difficult, often thankless task for wanting to serve their small communities. They are merchants, farmers, and church deacons. The budget to actual statement is the easiest tool for them to understand, and we urge you not to lose sight of the fact that this is the case for most governments. Please remember and consider these small to medium sized governments when you make your reporting decisions. Do not make governing harder for them with accounting and reporting changes that disregard them.

We agree with the Preliminary Viewers, referenced in paragraph B71, that “including budgetary comparison information as RSI would reduce the value of budgetary reporting because of the level of assurance provided on the information.” An important point is that including budgetary information as RSI does not offer any assurance from the auditor, based on what is stated in the Independent Auditor’s Report. Auditors would only perform “limited procedures” and under the “Other Matters” paragraph in the Independent Auditor’s Report, the auditor would state that “We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.” If the budgetary comparisons are reported in the basic financial statements, the auditor would provide reasonable assurance that the amounts provided are presented fairly.

In North Carolina, auditors support their opinion on budgetary information by performing procedures to ensure accounts are complete and accurate, and that payments are in accordance with appropriations. The point made by the Board, in paragraph B68 states, “The Board concluded that budgetary comparison information provides operational context (relates financial information to the activities, policies, and nonfinancial resources of a government) as to whether a government obtained and spent resources in accordance with its established budget.” One of the most common findings reported in the auditor’s report, required by Governmental Auditing Standards or required by US Auditing Standards AU-C 265, is related to budgetary controls. We are concerned

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that if governments present budgetary comparison information as only RSI, auditors would not be required to test information and these instances of noncompliance or deficiencies in internal control may not be reported.

In conclusion, we request the GASB to continue allowing the reporting of budget/actual information and related variance analysis in the basic financial statements. We are very concerned that reporting budget/actual information as RSI will reduce the value of budgetary reporting in NC. In our opinion, allowing the option of presenting budget/actual reporting in the basic financial statements holds local governmental officials and financial staff accountable for complying with state statutes in NC. Financial statement users will lose a valuable accountability tool if GASB proceeds with their plans in the Exposure Draft. We believe that holding local officials and financial staff accountable for their decisions is an outcome important for valuable governmental financial statements.

Short-term Financial Resources Measurement Focus

Under the Exposure Drafts, governmental funds will use the short-term financial resources measurement focus and accrual basis of accounting. This proposed reporting model is based on whether the contractual terms of an individual transaction or other event is short-term or long-term, which is determined by the period of time between the inception and conclusion of the transaction or other event. We are concerned that preparers of financial statements will be able to manipulate their reporting by modifying the terms of the underlying transactional arrangement or contract to affect the short-term or long-term classification of the transaction. As a result, the reporting of the transaction will be based more on its form rather than its substance. This ability to manipulate results will have a negative impact on both the comparability and decision-usefulness of the resulting financial statements.

Under the short-term financial resources measurement focus and accrual basis of accounting model, we believe that each government will make different recognition decisions for similar types of transactions that are substantively the same, but with different contract terms. Grants, special assessments, and debt are all types of transactions susceptible to inconsistent recognition. As a result, the consistency and comparability of financial statements among different governments will be negatively affected.

We also are concerned about the additional administrative burden that the contractual recognition terms add to local government and financial statement preparers since it requires analysis of each individual transaction. Many of our local governments are very small in terms of staff and their resources are constantly strained by current accounting and reporting requirements. These additional requirements will drive up their bookkeeping and financial reporting costs. These costs are already a large burden for small to medium-sized governments to bear, especially the more rural ones who struggle to recruit competent staff and, increasingly, pay third-party bookkeeping services to keep their books and prepare them for the annual audits. Additional administrative burdens will adversely affect their ability to prepare complete and accurate financial statements in a timely manner.

Coordinate Financial Reporting Model Project with Revenue and Expense Recognition Project

For practical purposes, we recommend aligning the effective dates for the proposed guidance in the Financial Reporting Model, Project 3-25, and Revenue and Expense Recognition, Project 4-6P. The projects contain concepts that are integral and inter-related with each other; therefore, significant efficiencies will be gained by implementation of the projects with an aligned date. Alignment of the implementation dates will also reduce confusion for financial statement users and preparers and training costs for our government entities since training can be combined for the new guidance. Cost and effort savings that can be realized are beneficial to our governments, especially the smaller governments with limited staff and resources.

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The continued development of the Revenue and Expense Recognition project also will be more effective and efficient if the implantation dates are aligned. The current testing being performed for the Revenue and Expense Recognition project is being conducted under the current financial reporting model, not within the proposed Financial Reporting Model. The development of the subsequent exposure draft and issuance of a final statement that is aligned with the proposed Financial Reporting Model will minimize confusion for our governments.

Finally, both implementations will create prior period adjustments to fund balances, which are often negatively viewed and misunderstood by financial statement users. It would be preferable for all prior period adjustments related to the new financial reporting model and the revenue and expense recognition changes to be reported in one fiscal year. For users of financial statements in small to medium-sized governments, consecutively issued financial statements containing prior period adjustments may be misinterpreted as a red flag concerning the government's ability to issue accurate financial statements. We are concerned that multiple prior period adjustments over more than one year will cause a loss of credibility in the statements.

We strongly urge the GASB Board to combine the two projects or postpone the effective date for the Financial Reporting Model project to coincide with the implementation date of the Revenue and Expense Recognition project.

We are available to assist you in addressing each matter discussed in this response letter. If you have any questions, please contact me at susan.mccullen@nctreasurer.com.

Sincerely,

Susan McCullen

Susan McCullen CPA
Director, Fiscal Management Section
State and Local Government Finance Division