



## National Association of State Auditors, Comptrollers and Treasurers

September 30, 2011

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Mr. David Bean  
Director of Research  
Governmental Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the National Association of State Auditors, Comptrollers and Treasurers, we appreciate the opportunity to respond to the Governmental Accounting Standards Board's Preliminary Views (PV) document, *Recognition of Elements of Financial Statements and Measurement Approaches*.

In general, we believe the Board's preliminary views on measurement focus (initial amounts and remeasured amounts) represent an improvement in the conceptual framework that would support the GASB's development of future standards.

However, we do not see similar improvement in the framework for recognition of the elements of financial statements – specifically for funds now reported under the current financial resources measurement focus. The near-term financial resources measurement focus resolves some of the anomalies of the current financial resources measurement focus; however, as demonstrated in the alternative view, it does not resolve all anomalies and indeed creates others that are potentially more significant (such as short-term borrowing to enhance year-end position).

Accordingly, we are not convinced that the near-term measurement focus is superior to the current resources measurement focus. Although the current measurement focus may have conceptual inconsistencies, it has been in practice for many years and many of the anomalies have developed from predominant practice rather than from a theoretical basis. From the perspective of accountability reporting to users, when the incentive of aligning with existing budgetary practice is removed, there is no sound conceptual basis for either the current flows or near-term measurement focus.

In lieu of abandoning the current resources measurement focus, the Board should first address and explain the more basic question – what is the purpose of the fund level financial statements and who are they intended to serve? We recommend that the Board revisit the purpose of existing fund financial statements and either move closer to a budgetary basis measurement focus or to the economic resources measurement focus. The choice between the budgetary basis measurement focus or the economic resources measurement focus should depend on whether the Board determines the fund financial statements should serve as a resource for determining how governments performed relative to their budget or demonstrate the overall long-term financial position of a fund relative to the government-wide statements.

In addition to the general concerns expressed above, we have the following specific comments that we believe the board should consider as it finalizes this statement.

#### Chapter 2 *General Comment*

Several members voiced concerns that they were unclear as to how prepaid items would be reported. Additional discussion of prepaids would be beneficial (specifically in Chapter 2, Paragraphs 8, 10 and 11).

*Paragraph 4*

- We agree with the underlying concern that the existing method of preparing financial statements using the current financial resources measurement focus is inconsistent at times, particularly in the application. However, we also believe that the proposed changes will result in some inconsistencies as well, and possibly result in potentially misleading statements being issued. We are particularly concerned with the proposed treatment of prepaid items, inventory, and other non capital assets or expenditures that are purchased or paid for in one period but are used up in in another. We also are concerned about the proposed treatment of revenue anticipation notes, and what we see as inconsistencies in the treatment of some expenditures (principal payments and accrued interest for example).
- The implications for fund balance reporting, if any, do not appear to be addressed. For example, given the nature of deferred inflows and deferred outflows, the Board should clarify if the net deferred amount should be reported as nonspendable fund balance.
- We do not agree that the measurement focus should be renamed to “near-term financial resources measurement focus.” The use of new terminology such as “near-term financial resources measurement focus” leads to confusion for the financial statement preparers and users. We acknowledge that some modifications may need to be made to achieve consistency among governments. However, we believe that government financial statements are currently prepared in a manner similar enough to the “near-term” concept that a complete change in terminology is not warranted. In addition, the proposed “near-term” concept does not appear to require any additional disclosures or a change in the way data is presented in the financial statements.

*Paragraph 6*

While we agree with part (a) of this paragraph, it is not clear why principal payments that are due in the near-term would not be recognized in a similar fashion. The inconsistency in treatment could result in misleading financial statements being issued. For example, a unit of government could report at fiscal year-end that revenues exceeded expenditures and therefore fund balance increased. What would not be clear is the effect on fund balance if that same government owed a large debt payment of both principal and interest shortly after year-end. The interest would be accrued and a corresponding expenditure recorded but the principal payment would not be recorded. Readers could incorrectly assume that the government has more funds available in fund balance than really exist.

*Paragraph 7*

We believe this category of inflows should not include short-term borrowing. Governments could distort their financial condition simply with the timing of a transaction. Short-term borrowing that is entered into at the end of one fiscal year inflates fund balance, making a government look to be in better condition than its actual status. Assuming the debt is paid back in the next year with no additional borrowing, it is only then the true financial condition of the entity is disclosed in the near-term financial statements. Unfortunately, it is more likely that a government will increase its short-term borrowing to again inflate its financial position, and will continue to do so until the market will no longer provide affordable short-term credit. We believe the Board should avoid promulgating a concept that has the potential for such a perverse incentive. Although it does not result in external resources to the financial reporting entity, a similar problem could occur in misstating the resources of individual funds within the entity in the instance of interfund loans that move cash from fund to fund that will not be paid back in the near-term.

*Paragraph 8*

This paragraph states “assets recognized under the near-term financial resources measurement focus are cash, financial resources that can be converted to cash, and financial resources that are receivable at period-end and normally are due within the near term.” We would like clarification on what is meant by “normally are due within the near term.” The use of “normally” seems to leave this open to interpretation. It would be helpful to include within the concepts statement an example of a receivable not received in the near-term that would be acceptable to report in the governmental funds.

*Paragraph 9*

Please clarify if this would require the accrual of the liability for bond (debt service fund) interest and not the related bond payment that is due in the near-term. If so, we would like to know if the principal payments also need to be accrued. In this paragraph also the use of “normally” seems to leave this open to interpretation. It would be helpful to include within the concepts statement an example of a liability not payable in the near-term that would be reported under the near-term financial resources measurement focus.

*Paragraph 10*

The wording in the bullets is not clear. The examples are rather narrow and readers might benefit from listing other examples. The fourth bullet is written in such a way as to obscure the meaning of the sentence and the underlying concept is not readily apparent. It refers to “the item” and its relation to an outflow or inflow of resources. The example clarifies what “the item” might be; however, the wording in the bullet is not clear.

*Paragraph 10 (last bullet)*

The Board asserts that changes in fair value of recognized assets and liabilities are related to an outflow or inflow of resources that **will** occur in the future. This assertion is applied to support fair value presentation of derivatives while deferring the impact on the resource flows statement. However, in many, if not most instances, the objective of hedge accounting is to ensure that the inflow or outflow of resources **will not** occur in the future because the government is hedging the item specifically to avoid increasing cash outflows. There is no evidence or intent that the deferred balance will be an inflow or outflow of a future period.

Chapter 3

*General comment*

Several paragraphs in this chapter include capital assets in both approaches. We interpret this to be dependent on the capital asset. For example, when an asset is initially purchased or constructed to provide services, when constructed or purchased to generate revenues, when impaired, etc. We ask that the Board please provide specific examples to envision what the Board means these to be.

*Paragraph 3*

For the names of the measurement approaches we suggest the Board consider using the terms “Initial Amount” and “Remeasured Amount” in the Concepts Statement rather than the long hyphenated names in the PV document.

*Paragraph 18*

We agree that assets and liabilities that will be used to provide services are best valued at the initial amount. Over time, as services are provided, the assets and liabilities will be reduced through depreciation expense or payment of liabilities.

*Paragraph 20*

Remeasured amounts may reflect the conditions in effect at the end of the reporting period, but we have seen how those same conditions may change dramatically by the time the report is issued. When this happens, the remeasured amount is no more relevant than the initial amount including subsequent modifications. Such remeasurements could limit the information’s usefulness by introducing volatility into the operating statements and distort information about current-period cost of services. Unless the remeasurement is based on easily assessable current market prices, remeasured amounts can be costly, hard to obtain and audit, and may sacrifice timeliness--the other valuable component of reporting.

*Paragraph 23*

The Board acknowledges that an alternative to fair value may be appropriate when an entity is using an asset in a manner different from the way the market would view its best use. We believe the implications of this acknowledgement are that state statutes or policies requiring fixed income securities to be held to maturity should qualify those investments for alternative valuation (such as, amortized cost) and not

Mr. David Bean  
September 30, 2011  
Page 4

require fair value recognition in the financial statements. In paragraph 26 the Board asserts that remeasured amounts are better suited for assessing an entity's ability to meet an obligation when due. In general, we agree with this assertion; however, we do not agree in the instance of unrealized losses on fixed income securities required by law to be held to maturity. Current recognition of the unrealized market loss does not reflect the entity's ability (or requirement) to continue to hold the investment and better meet its future obligations.

*Paragraph 34*

We agree that assets that will be converted to cash should be valued at the remeasured amount as this represents the amount of cash that could be obtained at the balance sheet date.

Chapter 4

*Paragraph 16*

The alternative view of the two minority Board members discusses valid points that should be considered by the Board. For example, this paragraph discusses tax anticipation notes, which are currently recorded as liabilities when the borrowed funds are received, and the liability reduced when the funds are repaid. We agree that the proposed "near term financial resources measurement focus" would be misleading (e.g., by recording the receipt of funds as an inflow of resources rather than a liability and the repayment of funds as an outflow of resources rather than a reduction of the aforementioned liability). Inaccurately portraying that a government has improved its economic position by incurring obligations intended to cover near-term cash shortages (and worsened its economic position when it satisfies those obligations) results in weakened government financial reporting, not better.

We appreciate the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact Kim O'Ryan of NASACT at (859) 276-1147 or me at (334) 242-9200.

Sincerely,



Ronald L. Jones  
NASACT President