



National Association of State Auditors, Comptrollers and Treasurers

June 29, 2010

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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 Exposure Draft (ED), *The Financial Reporting Entity*.

We have reviewed the ED and believe the Board's clarifications of key concepts within GASB 14 will provide all users with decision useful information. Below are our comments for the Board to consider as it finalizes this document.

General comments:

- Some of our members are concerned about the effective date for implementation. There is a time challenge due to the number of component units. There are also a large number of entities that will have to be re-examined in light of these changes. Therefore, we would prefer the implementation date be extended for at least one year.
- This proposal does not address a major issue, which is the ability to obtain timely information from discretely presented component units. This has a significant impact on the completion of a primary government's Comprehensive Annual Financial Report (CAFR) and will continue to impede an earlier CAFR release date. A *possible* solution could be an option to incorporate discrete component unit financial information for the previous fiscal year when current year data is not available. This option should also require disclosures to indicate the information is for a different fiscal year.
- We would like the Board to expand on (in the final statement) the treatment of funds or departments that are legally separate entities but operate like the government's own funds or departments. Specifically, we would like to see those funds or departments that are in the government's treasury that are required to have their spending approved by the legislature or governing body be treated the same as the other funds or departments of the government. We believe these types of entities should be blended, but neither the proposed exposure draft nor the current standards allow for blending based on this similarity.
- The Board may wish to explore the underlying rationale of exactly what constitutes "legally separate", which was not included in the scope of the current reexamination. We also suggest the Board codify guidance of the definition of what entities constitute "governmental."

Amendments to the “Misleading to Exclude” Criterion (paragraphs 4-5 of the ED)

- Determining whether or not financial burdens are other-than-temporary would require that payment history and other recipient-specific data be reviewed and that judgments about future events be made. Also, as part of the proposed changes to GASB 14, paragraph 41, if potential significant financial benefit/burden determined to be other-than-temporary were the sole criteria for ‘financially integrated’, states could conceivably be required to include some school districts or numerous other local education agencies or community colleges. In addition, there are myriad organizations which routinely receive funding and are not evaluated as potential component units because of the lack of appointment authority.
- We recommend that footnote 5b to paragraph 41 include “service plans” to read: “Financial integration may be exhibited and documented through the policies, practices, *service plans*, or organizational documents....” This would make it clear to local government entities that are formed this way and are interrelated, that they should prepare combining financial statements.

Amendments to Inclusion under the Financial Accountability Concept (paragraph 6 of the ED)

We support the Board’s efforts to define the reporting entity more accurately. By adding a “financial benefit or burden” criteria to the requirements for inclusion, the revised statement sets a higher accepted minimum criteria, which should raise the level of quality in reporting. The new language also has the positive effect of streamlining the reporting requirements for primary governments, thus alleviating much of the compilation that is required under the current standards. Entities will be excluded that should be excluded. However, we do have the following comments:

- Paragraph 21(b) states, “The primary government **may be** financially accountable” and goes on to define the conditions. Paragraph 27 states the primary government **is** (versus may be) financially accountable under the same conditions.
- The second sentence of paragraph 32 (in the Basis for Conclusions) provides clear guidance and Board intent that we believe should also be included in the standard (i.e., paragraph 6 of the ED).
- For amended paragraph 34, we suggest the Board clarify the intent of “potential to provide.” Does this mean past experience has demonstrated this potential? Clarity could be provided in a footnote similar to that used in footnote a of GASB 39, paragraph 5, to clarify *ability to otherwise access* (i.e., in the example of the footnote; however, we understand the concepts are different).

Amendments to the Major Component Unit Requirements (paragraph 7 of the ED)

- Paragraphs 35 to 40 of the ED (in the Basis for Conclusions) give the Board’s basis for conclusions related to the major component unit determination. Based on those paragraphs, some respondents believe that GASB is not referring to size when it uses the term “significant.” The Board concluded that “a quantitative approach to determining major component units would not be appropriate.” Rather, items like the types of potential transactions with the reporting entity or the provision of services by the component unit to the citizenry could make the component unit major regardless of the size. Yet, the wording in paragraph 51 continues to use the word significant in a way that implies size. For example, the paragraph refers to “significant financial benefit or burden” or “nature and significance of its relationship.”

We agree with the three proposed factors in paragraph 51 and the focus on the nature of the relationships between the primary government and its component units. However, quantitative factors between the primary government and its component units should be allowed in order to further distinguish component units that are of greater interest and significance to financial statement users. For example, a state may have many colleges and universities as component units, each of them providing an important education service to the state's citizenry, and each get a large appropriation from the state. However, some of the institutions are clearly immaterial to the state while others are very large. Currently, only the large ones are considered major. However, as the basis for conclusions suggests, if size is not used as a determining factor, then we must either conclude that all of the institutions are major or none of them are since they all perform the same service and get the same support. Major component units should include only those that have significant (large and important) relationships or transactions with the primary government or those where there is a significant (large) financial benefit or burden to the primary government. Otherwise, the statements may be needlessly cluttered with many major component units all providing the same services and having similar transactions.

- For amended paragraph 51, we suggest the following change to item (2): “the reporting entity’s basic **financial** statements after....”

Amendments to the Criteria for Blending Component Units (paragraph 8 of the ED)

- Amended paragraph 53a fails to achieve the desired purpose because footnote 7 is retained that prevents the application to a state government. The footnote requires the entire city council/state legislature to be on the governing board of the component unit to qualify for blending. GASB has indicated in the footnote that the “substantively the same” criterion will rarely, if ever, apply to state government. We recommend that GASB provide additional guidance to assist state governments in making their determination. Specifically, we recommend that GASB include a more comprehensive discussion of the terms “substantially the same”, “governing body”, and “management.” Furthermore, we believe that the definition in footnote 7 has significant reporting implications and merits inclusion in the body of the standard instead of as footnote.
- We would like to see amended paragraph 53b changed to explicitly allow blending of component units, which provide financing services for operational items such as grants. The current interpretation of the “financing services” language in that paragraph covers only component units, which provide financing services for capital construction.
- Amended paragraph 53c focuses on debt and the revenues that will be used to repay debt. If the debt is repaid with revenues pledged by the primary government, then blending is required. We believe GASB should have focused on overall revenues used to finance the operations of the component unit, not just revenues used to pay debt. If a component unit relies on pledged revenues for operations, we believe it should be blended as well. Transactions should not change reporting; only the granting or revoking of new powers should change the reporting of a component unit. The Board should focus on the entirety of the component unit’s revenues rather than just the revenue used to pay debt. Generally, the inability to raise significant revenue independent of the primary government ought to be a strong argument for blending.
- The second sentence of amended paragraph 53c says that payment of debt *generally* occurs through a continuing irrevocable pledge and appropriation by the primary government to the blended component unit. Unless GASB intended to eliminate from consideration circumstances when the appropriation for repayment is made to another agency that is making payments to the

blended component unit for repayment of debt, GASB may want to omit the second sentence or say “generally but not always.”

- Also in amended paragraph 53c, there can be no assurance that one fiscal year’s irrevocable pledge is not revoked in another fiscal year. The availability of these resources is subject to annual appropriation. An irrevocable pledge in one state may not constitute an irrevocable pledge elsewhere.

Amendments to the Requirements for Reporting the Funds of a Blended Component Unit
(paragraph 9 of the ED)

- The proposed amendment to paragraph 54 raises the question of whether blended component units should be presented in their own columns within the fund financial statements. We would appreciate clarification of what it means to include the blended component units “with the primary government’s other funds in the appropriate fund financial statements.” Also, the proposed amendment to paragraph 54 states that for governments “engaged only in business-type activities that use a single column for financial statement presentation, the component units may be blended by consolidating their financial statement data into a single column for the primary government and presenting combining information in the notes.” More detail about the required/suggested format of these statements would be appreciated.

Amendments to Note Disclosures (paragraph 11 of the ED)

- The amendment to paragraph 61 states that a disclosure in the notes should be made for each component unit. We suggest the Board clarify whether this disclosure is made for each material component unit, or for all component units, regardless of materiality. We believe the Board should also clarify whether the disclosure should be a separate narrative about each component unit, or if the information about the blended component units could be provided in a condensed version, with a list of blended component units.

Amendments for Component Units and Related Organizations with Joint Venture Characteristics (paragraph 12 of the ED)

- We would like some clarification for amended paragraph 35 of Statement 34. Is it the case in all circumstances that minority interest in component units will be considered “restricted net assets” because the use of such equity interest is constrained (paragraph 57 of the Basis for Conclusions)? If that is not the case, it would appear that an “unrestricted” classification would be appropriate if the use of such equity interest could be used for any purpose of the government.

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 NASC at (859) 276-1147 or me at (304) 558-2251.

Sincerely,



Glen B. Gainer III
NASACT President