



March 29, 2017

Mr. David Bean
Director of Research and Technical Activities
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 Invitation to Comment (ITC), *Financial Reporting Model Improvements – Governmental Funds*.

We appreciate GASB's effort to improve the existing financial reporting model and for embarking on this extensive undertaking to improve reporting of governmental funds. We share GASB's desire to provide transparency and consistency in the financial reporting for all our financial statement stakeholders. We continue to support the dual-purpose approach represented by the current government-wide financial statements and separate fund financial statements.

We believe that the government-wide statements provide the necessary long-term, economic resources basis needed for a long-term view of the government's overall financial health. As seen below in the answers to the specific questions in the ITC, a clear majority of our members believe the governmental fund statements are most beneficial to stakeholders when they are presented with a shorter-term, financial resources basis needed to assess the government's fiscal accountability to its legally enacted budgets.

In this letter, we are providing information on both the "majority" and "minority" views. This is different from our normal approach where we provide an "association position." However, since this is an ITC where GASB is seeking a variety of views, we believe that providing information on different perspectives within our membership will be helpful to GASB. As GASB moves through its due process, NASACT will take a position on these issues.

Our feedback to GASB's specific questions follow:

Question 2.1 - Do you believe that governmental fund financial statements should continue to present information that reflects a shorter time perspective than the information presented in the government-wide financial statements and that focuses on financial, rather than economic, resources? Why?

Overwhelmingly (21-yes, 3-no), our members support a shorter time perspective for governmental fund financial statements and a financial resource focus.

Fund accounting's primary purpose is to provide a means to help measure fiscal accountability and budgetary and other finance-related compliance. The long-established practice of fund accounting measured based on a shorter time frame has been the most effective way to inform users who focus on a current period, such as lawmakers, executive-branch elected officials, and taxpayers. These users are interested in current-year taxes, available short-term resources, and



services that will be available. In addition to fund accounting's shorter time perspective of the sources and uses of financial resources, governmental fund financial statements provide that information in a detail that cannot be accomplished by a consolidated presentation of all activities or with a longer-term economic basis.

In addition, to maintain the link between the governmental fund financial statements and the budget, a shorter-term perspective is necessary because planning at the fund level is usually done on an annual basis. The budget is essential for evaluating the actions of government officials. In addition, the shorter time perspective is useful in evaluating the amount of unspent resources at fiscal year-end that is available for spending in the next fiscal year. That information is not available in the government-wide financial statements or by using the long-term approach.

From the minority view, a few states indicated that the shorter-term perspective or differing recognition approaches creates confusion or a lack of understanding about the governmental fund statements by financial statement users. One member expressed a preference for fund financial statements to be presented on a full accrual basis which would eliminate much of the unique complexity and difficulty in the current reporting model.

Question 2.2 - Do you believe that governmental fund financial statements should continue to present information that facilitates comparisons with a government's budgetary information? Why?

Consistent with question 2.1, an overwhelming majority (21-yes, 3-no) believe governmental fund financial statements should continue to present information that compares a government's actual inflows and outflows with its budgeted information. Having a balanced budget is a key concern for many stakeholders, and as pointed out in the ITC, many governments' enacted budgets have "legal significance" in how the government is allowed to raise and spend its resources.

Governmental fund financial statements should provide fiscal accountability that the government used its resources as legislatively required in the budget, and for the reader to assess if the fund's inflows and outflows were balanced, if there was a deficit, or if there are net funds remaining for future period spending. For this reason, the governmental fund financial statements are utilized by our state legislatures, departments of management and finance personnel of our state departments. The more the governmental funds presentation differs from the budget the less useful the information will be to these users. Accordingly, retaining the fund structure currently used in governmental fund financial statements is critical to facilitating budgetary comparison.

A very small minority did not agree because they believe such a concept is logically flawed. If budgets themselves are not comparable, then how can any financial statement approach be consistently comparable to budgets (as mentioned in paragraph 4 of the ITC)? Also, if the legal budget is the means of providing public accountability and control, then how does a financial statement that does not match the legal budget assist with this objective and avoid being misleading or confusing? Moreover, if the financial statement does match the budget, then it renders the governmental fund statements duplicate of the budgetary comparison statements or schedules also included in the reporting model.



Question 2.3 - Which of the three recognition approaches provides the most relevant information for assessing fiscal accountability of the government? Why do you consider that information most relevant?

In assessing the three methodologies presented in the ITC (near-term, short-term, and long-term), the majority of our members (17) support the near-term approach, nine support the short-term approach, and two support the long-term approach.

Near-term Approach Supporters

Supporters of the near-term approach believe it provides stakeholders with the most transparency to assess the government's performance in accordance with its legally enacted budget, and demonstrates the adequacy of inflows of resources to meet the government's services on an annual basis. Simply stated, it is more realistic about what the government has spent and what it has left to spend. This is essential information for legislators, constituents, and other governmental service beneficiaries that would not be communicated in the short-term or long-term financial resources focuses.

For most governments, it also best accommodates budgetary comparisons at individual fund levels, best measures financial-related compliance that applies to the individual fund levels, and best measures how individual funds met their cash requirements. As the short-term and long-term approaches each continue to add more and more recognition of transactions that do not reflect sources, uses, and cash requirements of the current period, these approaches will be poor measures for current-year sources and uses, budgetary compliance, finance-related compliance, and cash requirements.

The fact that the Board believes that the use of the short-term or long-term approach would require a statement of cash flows to meet the objectives of Concepts Statement No. 1 is further evidence that those approaches are not as effective as the near-term approach in meeting the objectives relevant to fund-level financial information. Furthermore, the short-term and long-term approaches attempt to include some transactions intended to insert interperiod equity measures into the fund financial statements. For many users of fund financial statements, interperiod equity is not a primary concern. Users interested in interperiod equity can find that information in the government-wide statements.

Short-term Approach Supporters

Supporters of the short-term approach believe it provides the most relevant information for assessing fiscal accountability of a government because the short-term approach has an established time frame. Also, the short-term approach includes portions of certain costs that are expected to be paid within a year, such as compensated absences, OPEB, and net pension liabilities, which are not included currently in the governmental fund financial statements or using the near-term approach.

The short-term approach also requires entities to record resources to be collected and liabilities due and payable, within one year, thereby making it a useful tool for the majority of the state and local governments that maintain their budgets on an annual basis.



With the long-term approach, information is included that is more relevant to the economic resources perspective of the government-wide statements rather than the current budget. With the near-term approach, there is greater potential for manipulation of reporting results by management. For example, a government could structure the timing of a tax anticipation note (TAN), revenue anticipation note (RAN), or other debt payment to avoid reporting it on the current-year fund financial statements under the near-term approach (must be matured by year-end). Whereas, under the short-term approach, as long as the debt payment is due within the next year, it would be reported. As such, the short-term approach would leave less room for potential manipulation of the fund balance.

Long-term Approach Supporters

Supporters of the long-term approach believe it is the most transparent of the three models by reflecting all financial liabilities, except capital-related debt. As such, it provides the most relevant information for assessing fiscal accountability because it comes closest to providing the full-accrual information.

Further, this model would eliminate most differences between the governmental fund and government-wide financial statements, a major source of confusion. Under the current model of reporting, it has been a challenge for non-accounting users of the financial statements (i.e., media) to understand the differences in reporting between the government-wide statements and the governmental fund statements. As preparers of governmental financial statements, we understand the differences in accrual reporting in the government-wide financial statements and the modified accrual reporting in the governmental fund financial statements, but to the non-accountant, trying to explain the differences reported in a specific tax revenue reported in the government-wide statements and the governmental fund statements can be challenging. It is not uncommon for certain tax revenues to increase on the accrual basis but to decrease on the modified accrual basis, which is confusing to users.

Question 2.4 - Transactions related to tax anticipation notes or revenue anticipation notes are presented differently under the three recognition approaches. In the near-term approach, borrowings on and repayments of these notes would be reported as inflows and outflows of resources on the statement of resource flows and in the reconciliation to the government-wide statement of net position. In the short-term and long-term approaches, outstanding balances of these notes would be reported as liabilities on the balance sheet, and borrowings on and repayments of these notes would be reported in the statement of cash flows. (See the discussion in Chapter 3.) Which approach to the reporting of these notes provides the most valuable information? Why?

Regarding reporting of TANs and RANs, the majority of our members (9) support the near-term approach, six support the short-term approach, and six support the long-term approach. Please note that not everyone responded to this question.

Near-term Approach Supporters

Supporters of the near-term approach believe it provides the most valuable information for a couple of reasons. Because these notes are issued in anticipation of future period revenue, it is more informative to recognize the outflow of resources for payment of the notes in the same



period that the inflow of resources used to make the payment are recognized. Also, recognizing liabilities in the current period for notes due in future periods understates fund balance available for spending at year-end.

Interestingly, a number of states mentioned that any TANs or RANs must be repaid within one year, or in some cases, by the end of the fiscal year the money was borrowed. For these governments, the near-term approach would show stakeholders the magnitude of the tax/revenue anticipation notes by reporting both the inflow and outflow directly on the statement of financial resources. Both the short-term and long-term approaches would have no impact on the balance sheet or statement of financial resource flows for these governments. A reader might incorrectly assume the transaction did not occur or be confused to see a transaction presented on a cash flow that appeared nowhere else on the face of the financial statements. Even for governments that do not pay off tax/revenue anticipation notes in the same year of issuance, the reader would see the outstanding balance in the difference between the inflow and the outflow or alternatively, simply view it on the government-wide statement of net position.

Short-term Approach Supporters

Supporters of the short-term approach believe it provides the most valuable information for a couple different reasons. Outstanding balances of tax anticipation notes or revenue anticipation notes should be reported as liabilities on the balance sheet. This approach provides a more balanced presentation and would recognize both existing resources and obligations available and due within the same period.

The near-term approach only recognizes a TAN or RAN as a liability once a payment is due no matter how close to the period-end the payment is due. By not reporting a liability, a less realistic picture is presented of the fund's health. Also, the short-term and long-term approaches would show the liability as well as the cash transactions on a cash flow statement, unlike the current approach or the near-term approach which would not report a liability unless the TAN or RAN has matured, but proceeds and principal payments are still reported on the financial resources flows statement.

Long-term Approach Supporters

Supporters of the long-term approach believe TANs and RANs should be reported as liabilities as this seems more understandable and consistent with other debt liabilities. This is the most valuable approach in that these basically are short-term loans. The government has received the money, but it expects to pay it back soon. Therefore, a liability should be shown to make it clear that a portion of cash is not actually available for other liabilities and/or expenses coming up.

The limitation of the assets and liabilities to short-term measurements, such as the postemployment benefit liabilities reported in the short-term approach, would be misleading and would produce inconsistent results. Further, in the near-term approach, additional explanation may be needed for the user to understand what the deferred inflow for the notes means. Therefore, the long-term approach provides the most valuable information in this case.

Question 2.5 - Views vary on the definition of financial resources—a concept integral to all three recognition approaches. (See the discussion in paragraphs 38–40 of Chapter 2.) What definition



of financial resources provides the most valuable information? Why? Do you consider prepaid items to be financial resources? Why? Do you consider inventory to be financial resources? Why?

Our members were more evenly split on these questions. Overall, a slight majority (11) favored “items that can be or are expected to be converted to cash or are consumable in lieu of financial resources.” Nine members favored “resources that can be or are expected to be converted into cash.” Similarly, 11 members consider inventory and prepaid items to be financial resources, while nine members did not.

Members in the majority view indicated that financial resources should be defined as cash, resources that can be or are expected to be converted to cash, and resources that are consumable in lieu of financial resources (specifically, prepaid items and inventory). These members consider both prepaid items and inventory to be considered financial resources because they are assets the government has purchased and will consume in the near future instead of making an outlay of cash for those items. Additionally, both items could be easily converted to cash (i.e., a refund in the case of a prepaid item or a sale of inventory).

Members in the minority view believe financial resources should be cash, cash equivalents, and other resources expected to be converted into cash. A government’s budget cannot present prepaid items or inventory; it instead reports these items as outflows. For the sake of consistency, it is better for the governmental fund statements to do the same. Additionally, while prepaid items and inventory can be converted to cash, it is typically not the government’s intention to convert them to cash. Unlike enterprise funds, where inventory may be used to generate sales, most governmental fund inventory would be consumptive in nature. By reporting prepaid items and inventory as assets, it may falsely give the impression that a government did not “overspend” its resources when it actually had more outflows of cash and cash-equivalents than inflows.

Question 2.6 - For the recognition approach that you believe provides the most valuable information, how would you change that recognition approach to provide information that is more valuable? How would those changes make the information more valuable?

Only some of our members described changes that they would suggest to the approach they believe provides the most valuable information. Those changes are listed below, by each approach.

Near-term Approach Supporters

We received a number of comments from this group which are listed below in no particular order or ranking. You will also note that some comments may contradict others listed.

- For the near-term approach, rather than the Board’s proposed approach of recognizing long-term assets and liabilities in the period when payments are due, we suggest the Board consider recognition criteria closer to that used in the proposed short-term approach. Under the short-term approach, a long-term asset or liability only needs to be receivable or payable at period-end and due during the subsequent operating cycle to be recognized in the current period. We believe this should be applied to the near-term approach except that the due date would be during the 60- to 90-day near-term



period. The ITC does not conceptually explain why under the near-term approach a long-term asset or liability must be due before it is recognized.

Recognizing long-term assets and liabilities under the near-term approach when receivable or payable at period-end and due in the near-term would be the same as other assets and liabilities recognized under the near-term approach. It would also be consistent with how governments budget for long-term debt payments due early in the subsequent period for which the government would use current-period resources for payment. Further, it avoids overstating fund balance at period-end and eliminates the inconsistent treatment between principle and interest payments noted in the ITC, Chapter 2, paragraph 19.a.

With this modification, liabilities under the near-term approach would be similar to the liabilities listed in paragraph 22 for the short-term approach except that the period for measuring when long-term liability payments are due would be 60-90 days rather than the subsequent operating cycle. As such, we further suggest modifying the recognition of postemployment benefits administered through trusts to be the cumulative excess of the statutorily or contractually required contribution over amounts contributed to the plan rather than actuarially determined contribution. This would be more consistent with Concepts Statement No. 4's definition of liabilities as present obligations to sacrifice resources that the government has little or no discretion to avoid. ITC, Chapter 2, footnote 10, states that an actuarially determined contribution is a recommendation, not a requirement. Therefore, the government could presumably avoid the obligation in the near-term.

- We would include prepaid items and inventory as assets.
- We prefer the near-term approach as we believe it provides the most appropriate information for assessing short-term financial position used by decision makers and for formulating budgets. With that said, we feel that 60-90 days may be too short of a period to measure certain operating accruals such as income tax underpayments and refunds payable, the net of which would be available for use in the subsequent budget cycle (which is one year in our state). We therefore suggest a longer time period of up to one year, be considered for *certain* short-term operating accruals. We do not believe it would be advisable to accrue net pension and OPEB liabilities under this approach because they do not represent legal obligations until appropriated through action of the governing body (usually effective subsequent to the balance sheet date).
- We would advocate the near-term being defined as 60 days rather than 90 days so the CAFR statements are available to readers for timely and useful decision-making. Otherwise, preparers would have to either wait 90 days after the fiscal year end to begin preparing the CAFR statements and potentially risk missing deadlines, or they would have to rely more heavily on estimations instead of waiting for actual data. (Note: this comment was mentioned by two states.)
- We believe the near-term period should be the first quarter of the subsequent fiscal year. (Note: this comment was mentioned by one state.)



Supporters of the Short-Term Approach

- While we believe the short-term approach provides valuable information for consistent financial reporting, we would recommend eliminating the potential liability for any excess of actuarially determined contributions over amounts contributed. Member employers in our state cannot contribute more than is required in accordance with statutes. To record the liability for the difference between the actuarial determined contribution and contributions would be misleading. The liability infers an obligation that the government has neglected to pay, and therefore may have a choice to reduce or eliminate the obligation.
- The short-term presentation of debt seems to have some limitations. The presentation of RANs and TANs should be determined based on the substance of the transaction rather than the name of the debt. RANs and TANs that are not capital in nature should be included on the governmental fund's balance sheet. BANs should follow the same treatment as bonds; the current guidance related to BANs that roll-over is confusing. With the exception of non-capital RANs and TANs, the near-term approach for debt of reporting when due is most appropriate and should include BANs.
- While we do not have any specific suggestions, it would be difficult to calculate the portion of many of the long-term liabilities due within one year, including compensated absences, pension, OPEB and pollution remediation. As stated in paragraph 28, these calculations would likely increase costs by requiring some actuarial estimates and may actually make comparability even more difficult.

Supporters of the Long-Term Approach

- The long-term approach would be improved if it were changed to an economic focus presentation consistent with government-wide and proprietary fund reporting.

Question 2.7 - Paragraph 6 of Chapter 2 discusses a same-page reconciliation to government-wide information and the use of specific terminology to more clearly communicate that the information in governmental fund financial statements is of a shorter time perspective than information in the government-wide financial statements and focuses on financial, rather than economic, resources. Are these changes effective in communicating that the information in governmental fund financial statements is different from the information in government-wide financial statements? How could those differences be communicated more effectively?

By a strong margin (16-yes, 6-no), our members believe a same-page reconciliation and the use of specific terminology will be effective in communicating that the information in governmental fund financial statements is different from the information in government-wide financial statements.

Supporters believe having the same page reconciliation would make it easier and more efficient for users to identify differences between the governmental and government-wide financial statements. It seems straight-forward as to the differences between the two statements and with it being on the same page it is hard to miss. In terms of using specific terminology, we are open to using it but it is important to remember that while states, counties,



cities, schools, etc., have many similarities they also have many differences. The reconciliations need to allow for the appropriate level of detail of these areas that are different (professional judgment by preparers).

Opponents stated that a same-page reconciliation would be counter-productive to effective communication, because it would create too much cluttered information for the reader to process. At some point, information gets to be too voluminous to be understandable and user-friendly. Others mentioned that the notes to the financial statements (particularly the Summary of Significant Accounting Principles) communicate the differences between the governmental fund financial statements and the government-wide. The suggested terminology for the governmental fund financial statements seems to devalue the benefits of the information presented. And, of course, supporters of the long-term approach simply stated that the most effective approach would be to eliminate differences between governmental fund reporting and reporting for government-wide and proprietary funds.

Many members (both supporters and opponents) mentioned that, in theory, adding a same-page reconciliation to the governmental fund financial statements may make the difference between these statements and the government-wide financial statements more obvious to readers. However, from a practical standpoint, doing so would require making the font very small on the statements, making the statements and the reconciliation difficult to read. States are large, complicated entities with many reconciling items. The same page presentation is not likely to fit neatly on one page and, if details must be provided in the notes to financial statements, it defeats the purpose of a same page reconciliation.

How could those differences be communicated more effectively?

We received a number of suggestions which are listed below in no particular order or ranking.

- The Board should consider whether an actual reconciliation as presented in the ITC is necessary to convey this message. Users who are confused about the differing focuses on the government-wide and governmental fund financial statements may similarly be confused by the technical nature of a reconciliation and its line-item descriptions. Further, amounts on the reconciliation do not provide users meaningful information that is not presented elsewhere in the financial statements. Instead of the reconciliation, a simple plain-English description of significant reasons the government-wide and fund financial statements are different may be more informative to those users (mentioned by multiple members). For example, we suggest the Board consider adding a sentence such as the following at the bottom of government funds balance sheet:

Certain assets and liabilities included in the governmental activities statement of net position were not included in this statement because they are long-term in nature. The most significant balances not presented in this financial statement include capital assets, postemployment benefit liabilities and other long-term liabilities.

In addition, the ITC financial statement illustrations indicate that the Board expects that there will be a note to describe more details about the differences between the statements. We also suggest that if the Board decides a note disclosure is necessary, that it consider whether a mathematical reconciliation is the best way to communicate to



users why differences exist between the two bases of accounting. We believe that such a note disclosure would be more useful if it explained in plain English the reasons for the differences and the beneficial information provided by the differing focuses.

Furthermore, regardless of what the Board suggests be included to explain the differences, we suggest the Board continue to use the language of Statement 34, paragraph 77, that the reconciliation, or other descriptive information, be presented “at the bottom of the fund financial statements” instead of a “same-page reconciliation” to avoid a literal understanding that the statement and reconciliation must be on a single page as shown in the ITC, Appendix D. The interpretation or requirement that the information must be on the same page may result in an unreasonably small font size for some governments.

- The reconciliation from the Governmental Balance Sheet to the Statement of Net Position is clear. Users tend to have confusion with the reconciliation from the Statement of Revenues, Expenditures, And Changes In Fund Balances to the Statement of Activities. In order to understand the reconciliation better, users need a better understanding of the Government-wide Statement of Activities. Since the Statement of Activities does not present as a typical income statement, changes to that format might be considered in order to help users better understand the differences between those two statements (similar to the reconciliation for the balance sheet to the Statement of Net Position).
- One improvement could be to include information in the note at the top of the statement regarding the reconciliation and what it represents. However, the specific need for the new note on the face of the financial statement is unclear when this information is clearly stated in the MD&A and in the note disclosures. If the new note is included on the face of the statement, we recommend removing the requirement to disclose the information in the notes to financial statements and the MD&A. Also, if having a note on the face of the statement indicating that it presents a short-term financial perspective is important for users of fund financial statements, would it not be just as important for users of the government-wide statements to have a note on the face of the statements indicating that they provide a longer term economic perspective?
- The introduction of new terminology makes the statements confusing. The Board should continue to use terminology that is universally known and understood by a majority of users, such as revenues and expenditures (mentioned by several members).
- A detailed reconciliation is not needed if the near-term approach is used (mentioned by many supporters of the near-term approach). One suggested that instead of a detailed reconciliation, a narrative approach which simply explains that the near-term focus does not include long-term assets, liabilities or deferrals, and that the difference between fund balance and net position is the recognition of long-term assets, liabilities and deferrals which are presented on the government-wide statement of financial position. No additional line item details would be necessary. The same approach could be taken with regard to the statement of activities.



Question 3.1 - Which format for the governmental funds resource flows statement—existing format or current and long-term activity format—provides the most valuable information about governmental funds? Why do you consider the information to be more valuable?

A clear majority (16) favor the existing format. Only three favored the current and long-term activity format discussed in the ITC.

Proponents of the existing format believe it provides more valuable information because it is less likely to create confusion for the reader. Also, it:

- is comparable to the budget format.
- is comparable to the current GASB 34 model which users are familiar with.
- demonstrates that governmental funds are significantly different than proprietary funds.

Additionally, the current format is helpful in distinguishing typical annual operating activities from activities that do not necessarily occur on an annual basis such as the issuance of debt and the sale of capital assets. A number of respondents also mentioned keeping familiar terms such as “revenues” and “expenditures.” The use of the terminology of “inflows” and “outflows” to describe revenues and expenditures is very confusing in conjunction with similar terms such as deferred inflows and deferred outflows used on the statement of net position.

Interestingly, a number of states mentioned additional costs that would be necessary to reprogram computer applications to generate a different cash flow statement format. In their views, the additional cost was not justified. Further, they do not believe the change would benefit the majority of financial statement users (i.e., governing bodies, management, and the general public).

Supporters of the current and long-term activity format stated it is preferable and provides more valuable information because it separately shows the current net flows related to long-term activities and moves capital outlay and debt service to a long-term activity which provides a more accurate picture of their true nature. However, a user might find it confusing that there is a section of the flows statement specifically related to long-term activities when the sentence at the top of the statement indicates the statement excludes items of a long-term nature.

Question 3.2 - Should a statement of cash flows be required for governmental funds? Why?

Twenty-four of 25 (96%) respondents indicated that a statement of cash flows should **not** be required for governmental funds.

In particular, those supporting the near-term approach did not believe a statement of cash flows was necessary. Because the resource flows statement under the near-term approach would not differ substantially from cash flows, these states agree with the ITC that it diminishes the potential usefulness of a cash flows statement.

Under the short-term and long-term approaches, a cash flows statement may be necessary to meet one or more Concepts Statement No. 1 objectives. However, government financial statements are already complex and lengthy, making them difficult for many users to follow or understand, difficult to prepare on a timely basis, and time consuming to audit. Adding yet one



more statement for each governmental fund only makes this worse, and would add additional preparation and audit cost.

In addition, major funds and the aggregate of nonmajor funds are typically an aggregation of multiple accounting funds or activities, for example the general fund is the accumulation of multiple disparate departments and activities, and individual special revenue, capital projects and debt service funds may be accumulations of multiple activities, grants, projects or debt instruments. Accordingly, a cash flows statement for any of these columns of financial information is already of limited value.

Lastly, the cash flows statement does not add much value to the average user of the financial statements. Users don't fully understand cash flow statements and the information being reported. Most users are going to focus on the budget to actual statements that are being included, which gives the users a sense of the cash flow. Therefore, consider focusing on the inclusion of the budget to actual statements within the financial statements.

The overwhelming majority of our members believe a statement of cash flows should not be presented under any of the approaches in the ITC.

The one state that did support inclusion of a cash flows statement believes it should be required as it provides users with information not already available in the government fund financial statements that is useful in determining a fund's liquidity.

Question 3.3 - What difficulties, if any, would arise in presenting a statement of cash flows for governmental funds?

Adding a statement of cash flows would add significant time and effort by both preparers and auditors without adding comparable value. Many constituents and legislators who rely on the CAFR are not used to reading cash flow statements, so the information presented would not assist them with decision making. Also, there are concerns that requiring new statements will impact the timeliness of issuing the CAFR (already a criticism of government financial reporting).

Preparing cash flow statements requires high levels of technical accounting skill. For smaller governments, acquiring the necessary technical accounting skill to prepare a CAFR is increasingly becoming a problem. A very large percentage of smaller governments might either need to hire more staff, or externally contract for additional financial statement preparation services on their already modest budgets.

Additionally, cash flow statements by fund are not tools that would be used by the state for monitoring cash flows for routine operating purposes. Under GASB Statement No. 9, cash flows from operating activities have a parallel to natural classification; however, governmental funds present expenditures by function/program which would make the process more involved.

Regarding complexity, here is one specific example from a state:

"If we were to attempt to prepare a cash flows statement for our governmental funds, we believe it would need to be done at a very high/summary level, unlike the proprietary funds which are done for each individual fund. This is because we have hundreds of funds that



make up the overall governmental funds of the state (i.e., approximately 365 general funds make up our General Fund as presented in the CAFR). The cash flows statements of proprietary funds are prepared individually for each fund (i.e., two major and 15 non-major enterprise funds).

Question 3.4 - Are the four classifications for the statement of cash flows from Statement No. 9, Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting, the most appropriate for governmental funds? If not, what classifications would be most appropriate?

On this question, our members were fairly evenly split: 8-yes, 4-no. Many did not answer this question because they *strongly disagree* with including a statement of cash flows for governmental funds.

Supporters indicated that the four classifications from Statement No. 9 are appropriate. Following the guidance of Statement No. 9 as opposed to developing additional classification formats unique to governmental funds would help to prevent confusion since proprietary fund cash flow statements would be in the same format.

However, some of the supporters indicated that the elements included within each classification may need further analysis and clarification. For example, while taxes and grants are categorized as "Cash Flows from Non-Capital Financing Activities" in proprietary funds, one could argue that they are "Cash Flows from Operating Activities" in governmental funds. Specifically, in special revenue funds, there would be no "operations" without a specific revenue source which is generally taxes or grants. Another state mentioned that it may be difficult when trying to distinguish the placement of some items of substance. One example would be determining if debt is related to "capital and related financing" or "noncapital financing."

Opponents stated that the four classifications from Statement No. 9 are not appropriate for governmental funds. The operating activities classification, although not a one-to-one parallel, resembles operating revenues and expenses for proprietary funds. This parallel does not exist for governmental funds. The rationale of governmental funds and proprietary funds is completely different.

Another state that disagreed with the four categories in Statement No. 9 suggested revisions to the current classifications should be considered. Since governments do not generate much operating revenue, they will most likely report a large operating loss which may mislead a user. Specifically, grants, noncapital state appropriations and general tax revenues reported as nonoperating under the current classifications constitute the majority of the government's revenues and budgeting resources, while the majority of the government's expenditures are payments to employees and payments to vendors reported under the operating classification, thus creating an operating loss. Classifications to consider:

- Cash Flows from Government Operating Activities (to include items currently considered as operating activities and add general operations taxes received, operating grants – which would include noncapital state appropriations)
- Cash Flows from Noncapital Financing Activities (to exclude operating grants and taxes)



- Cash Flows from Capital and Related Financing Activities (to include items currently in this category as well as any taxes levied for capital purposes)
- Cash Flows from Investing Activities (to include items currently in this category)

Another state suggested the classifications for governmental funds be:

- Revenues and expenditures
- Financial inflows and outflows
- Other increases and decreases in cash balances

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 (615) 741-2956.

Sincerely,

David H. Lillard, Jr.
President, NASACT
State Treasurer, Tennessee