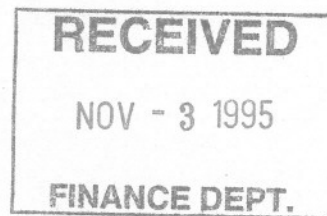


ILLINOIS  
GOVERNMENT FINANCE  
OFFICERS ASSOCIATION  
*Incorporated 1958*



October 27, 1995

David R. Bean  
Director of Research  
Project No. 3-4  
Government Accounting Standards Board  
401 Merritt 7, P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Dear Mr. Bean:

The Illinois Government Finance Officers Association (IGFOA) is an organization in excess of 700 members comprised of public finance officers, auditors, accountants, bankers, and others interested in public finance in the state of Illinois. Our organization is dedicated to the common goal of developing better understanding and cooperation among those concerned with public jurisdictions and other objectives of mutual interest to public finance officers.

The IGFOA has several committees actively involved in the achievement of greater success in efficiency and service of government. The Technical Accounting Review Committee (TARC) was created for the purpose of reviewing accounting, auditing, and financial reporting requirements as they effect the membership of the IGFOA. In fulfilling this purpose, we have consistently responded to due process documents issued by the Government Accounting Standards Board. The following is our response to the Preliminary Views (PV), Governmental Financial Reporting Model: Core Financial Statements. Furthermore, we would like to make an oral presentation before the GASB at the hearing scheduled for November 10, 1995, in Elmhurst, Illinois. The matters discussed below will form the basis for our presentation.

In October of 1994, we responded to your Invitation to Comment (ITC), Government Financial Reporting Model. In our response, we expressed our serious concerns about both models under consideration at that time. Many of the concerns we expressed then continue to apply to the model addressed in the PV.

## *Measurement Focus and Basis of Accounting*

We recognize the dual-perspective approach taken in the PV is an attempt to meet the needs of a diverse group of financial statement users. However, we believe that presenting essentially the same financial information on two different bases will not be more informative to financial statement users. Any brief explanation which might be provided in a Management Discussion and Analysis notwithstanding, the use of two different bases of accounting would be far more likely to confuse financial statement users, particularly those who are not highly sophisticated.

Several practical problems are evident to us with the dual-perspective approach. First, the question will be asked by some users, "Which financial statements are the 'real' ones?" Although as public finance professionals we can answer this question, it should not need to be asked. Having two sets of financial statements gives the impression that governmental accounting and reporting are imprecise. Second, the fact that numbers appearing in fund perspective statements could not be traced to the entity-wide perspective statements would suggest to some financial statement readers that something has been lost. Requiring that a reconciliation be included in the financial report to detail the differences between the two sets of financial statements would remedy this problem to a degree. However, such a reconciliation would be complicated and difficult to prepare for anything other than the most simple financial statements.

Third, the dual-perspective approach would undoubtedly increase the amount of time necessary to prepare financial reports and would increase audit costs. The preparation of financial reports is already an onerous task, especially for small governments. Dual-perspective reporting will be more than many governments can handle with the staff resources available. Because auditing firms would be asked to opine on financial statements prepared on two different bases of accounting, additional testing would be required. This additional testing would certainly lead to higher audit costs.

In our response to the ITC, we presented an alternative model which simplified the current top-of-pyramid reports but retained the measurement focus and basis of accounting of the underlying fund statements. At the November 10 hearing, we will be submitting a revised version of that model to you. The revised IGFOA model will incorporate most of the suggestions which we will make below. It will again use the flow of current financial resources measurement focus and modified accrual basis of accounting in the "tax-financed funds" (renamed "governmental funds" in the revised model) and the flow of economic resources measurement focus and accrual basis of accounting in the "fee-financed funds" (renamed "business-type funds" in the revised model). We ask that you reconsider our model. We assert that the measurement focus and basis of accounting which is appropriate at the fund level is also appropriate at

the top of the pyramid. At the same time, reports can be simplified by preparing top-of-pyramid statements with only two columns (or three columns if nonblended component units are involved as discussed below), as we did in our model.

We suspect that the entity-wide perspective described in the PV was inspired by the popular reports which are now issued by some governments. We do not deny that some individuals find such reports helpful or instructive. However, as we have illustrated above, adopting the concepts underlying popular reporting as generally accepted accounting principles and incorporating them into a government's standard financial statements would create more problems than would be solved.

### *Fixed Assets and Infrastructure Reporting*

Consistent with our discussion above concerning measurement focus and basis of accounting, we do not believe that fixed assets and infrastructure belong in the financial statements of governmental funds. Our experience has been that the users of these financial statements rely on them to provide information concerning the flow of current financial resources. However, we do acknowledge that it would be helpful for financial statements to communicate how much of a government's fixed assets (motor vehicles, computer hardware, etc.) have been consumed in providing services. We maintain that the best way to do this, without degrading the usefulness of the financial statements of the governmental funds, is to require that governmental fund fixed assets be recorded in a "plant fund." This fund would be an internal service fund.

The revised IGFOA model which we will present to you on November 10 will include a plant fund. In that fund, we will record all of governmental fund fixed assets through debits and their funding sources through credits. In the case of fixed assets purchased with operating revenues, fund equity will be credited.

We propose that depreciation or a capital use charge be recorded for the fixed assets in the plant fund. The revenue of the fund would be operating charges or transfers from the appropriate governmental funds. Of course, governments would have the option of actually assessing the charges or making the transfers. However, a government's funding practices will give financial statement readers some insight into how well future fixed asset replacements are being funded.

We believe that infrastructure, as defined by NCGA Statement No. 1, should be recorded in the plant fund at the option of the reporting entity. We take this position because it can be argued that infrastructure is not directly related to a government's provision of services. In addition, recording infrastructure in the plant fund would likely cause the fund's balance sheet to show negative equity

and its operating statement to show deficits in most years. This would be the case because large capital use charges might not be offset by operating charges (revenues) or transfers-in as the vast majority of governments fund infrastructure expenditures with long-term debt. In short, recording infrastructure in the plant fund could obscure the fund's financial statements. The same would be true for the entity-wide financial statements contemplated in the PV.

### ***The Statement of Activities***

For three reasons, we take strong exception to the attempt made in the PV to match the expenditures of a government's programs with any corresponding revenues. First, most governments do not intend for their general governmental programs to be self-supporting. Showing many programs running a deficit, including probably public safety and highway and streets programs, draws attention to a matter which is of little importance. Second, for those governments which decide to allocate as much of their revenue as possible to specific programs, revenue allocation could become a totally arbitrary exercise. Thus, a financial statement reader could actually be misled concerning the self-sufficiency of a given program.

Our third concern pertains to the program approach itself. The PV appears to be promoting or perhaps even compelling the use of program accounting and budgeting. For example, you state in paragraph 11a on page x of the PV that "The Statement of Activities should be reported using a 'net program cost' format." (Italics added for emphasis.) Although the program approach certainly possesses distinct advantages, many governments prefer accounting and budgeting by line item. They believe that the line item approach is better suited to their organizations. We feel that the decision to adopt a program approach should be left to the management of the individual government. Additionally, to the extent that the reporting model would influence the budgeting practices of governments, we must point out that budgeting issues are beyond the scope of the GASB's authority.

In essence, we suggest that an operating statement be adopted which is similar in format to the present combined statement of revenues, expenditures, and changes in fund balances.

### ***The Statement of Changes in Assets and the Statement of Changes in Long-Term Liabilities***

Reporting information on changes in capital assets and long-term liabilities as financial statements seems to exaggerate its importance. Such information should continue to appear in the notes to the financial statements.

### *Budgetary Reporting*

We feel that it is ill-advised to include originally budgeted amounts in fund operating reports when amended budgets have been adopted. With respect to expenditures and expenses, the reason for including budgeted amounts in financial statements is to demonstrate compliance with the legal authority to spend. That authority is represented by the final amended budget. Presenting the originally budgeted amounts obviously invites questions. These questions cannot be adequately answered in the financial statements without greatly adding to their volume. We assert that questions about why a budget revision is or was necessary are much more appropriately and effectively addressed through budget hearings, legislative meetings, and other contacts with the public which permit dialog.

### *Statement of Cash Flows*

As you are in the process of developing a new reporting model, this would be the opportune time to discontinue the requirement for the statement of cash flows. Our experience has been that few of those who read the financial statements of governments understand the cash flows statement; an even smaller number actually use it. The cash flows statement is important for true commercial business entities whose investors and potential investors need to measure the firm's ability to weather seasonal business cycles. But for a governmental entity, this need is far less significant, even for its proprietary activities.

### *Definition of an Enterprise Fund*

We applaud your attempt to better define what constitutes an enterprise fund. We believe the guidelines included in the PV would be very helpful. Yet, we recommend you go one step further. It appears to us that your guidelines attempt to ensure that activities such as water and sewer systems, transit systems, and other activities operated with the intent to recover costs through fees be accounted for as enterprise funds. If this is your intent, it would be best if you were explicit. That is, the new model should require that water and sewer systems, transit systems, and other activities operated with the intent to recover costs through fees be accounted for as enterprise funds.

### ***Contributed Capital***

We endorse your proposal in the PV to eliminate the distinction between equity in the proprietary funds based on its origin and record capital contributions as nonoperating revenue.

### ***Extraordinary Items***

We take exception to what you would report as extraordinary items in the governmental funds. Liberal application of the "one-time" criteria presented in the PV might suggest that many items which are not truly extraordinary would be classified as "extraordinary items." Capital projects offer an excellent example of this. Many capital projects are one-time in nature but to report them as extraordinary items would be a dramatic, undesirable departure from current reporting practices. At a minimum, the definition of an extraordinary item should be refined.

### ***Trust and Agency Funds***

Currently, a workable definition of trust and agency funds does not exist. As a result, some governments report agency funds in cases where other types of funds actually should be reported. A revised definition, which establishes clear criteria for what is and is not a trust or agency fund, is needed.

We do not believe that reporting trust and agency funds in the body of the financial statements is necessary because governments do not have genuine control over them. Disclosure in the notes to the financial statements would be sufficient. Pension trust fund disclosures should be in accordance with GASB Statement Nos. 25, 26, and 27.

### ***Nonblended Component Units***

We disagree with the proposal to limit the reporting of nonblended component units to the fund perspective. We find no persuasive argument for this. If a component unit is deemed to be enough a part of the government to be included at the fund perspective, its financial activity should be carried forward to the entity-wide perspective/top of the pyramid. As alluded to above, the financial information related to nonblended component units should be presented in a third column in the top-of-pyramid statements.

**Management Discussion and Analysis, Transmittal Letter,  
and Notes to the Financial Statements**

One of the primary purposes of the proposed introduction of a Management Discussion and Analysis (MD&A) is to explain the objectives of dual-perspective reporting. If dual-perspective reporting is abandoned as we suggest, the need for an MD&A is reduced.

Another purpose for the MD&A would be to discuss matters which could have an impact on a government's financial position, results of operations, or financial condition. This essentially asks that a government's management look into the future. Although a government certainly should examine its future, the annual financial report, which is subject to audit, is not the place to present its analysis in this regard. Auditing such a discussion would be virtually impossible and would most likely result in qualified audit opinions. A government's view of its future would more appropriately be presented in an optional transmittal letter. In fact, the other items you would have discussed in an MD&A (Chapter 5, paragraph 8b-d of the PV) should be addressed in an optional transmittal letter not subject to audit.

It is disconcerting to us that the GASB is seeking to make the matters proposed for an MD&A an integral part of the financial statements. In reality, these matters are not true financial information. Here again, the GASB appears to be moving into an area which is not within its jurisdiction.

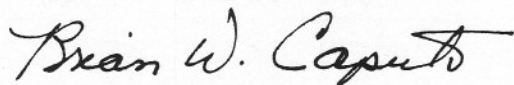
As an aside, Chapter 5, paragraph 8c of the PV states that the MD&A should provide an analysis of variations from budgeted revenue and expenditures. Assuming that originally adopted budgets and final amended budgets, as well as the MD&A, are retained in the financial statements, you should specify which budgeted amounts should be used for the analysis.

Finally, in the exposure draft on the reporting model, we recommend that you include proposed note disclosures. Doing so will provide a better picture of what financial statements using the new model will really look like. The proposed note disclosures should be scaled down as much as possible. The purposes should be to 1) explain important points directly related to the financial statements which cannot be conveyed with numbers and 2) to present important financial information which would obscure the financial statements if included in them, such as trust and agency fund information. No attempt should be made to teach accounting or financial statement analysis.

We appreciate the opportunity to respond to the PV and to testify at the upcoming hearing. If the board has any questions or needs

clarification on any issue, please let me know. I may be reached at (708) 882-9100.

Sincerely,

A handwritten signature in cursive script that reads "Brian W. Caputo".

Brian W. Caputo  
Chairman  
Technical Accounting Review Committee

cc: Leonard J. Flood, President, IGFOA  
Each IGFOA TARC member