



Proposed Improvements to GASB's Accounting of Governmental Funds

Prepared by: Truth in Accounting

Thank you for your interest in and review of our feedback on the Governmental Accounting Standards Board's (GASB) Financial Reporting Model Improvements projects. We remain concerned about your proposed concept statement and accounting standard. Our recommendations and concerns include:

- **Establish True Accrual Accounting for Governmental Funds Statements**
- **Don't Call Your Proposals Accrual Accounting**
- **Don't Call it a Balance Sheet**
- **Post a Warning Label for Statement of Short-Term Financial Resources**
- **Avoid Fake Solvency – Some Lessons From History**

Establish True Accrual Accounting for Governmental Funds Statements.

Truth in Accounting has long been advocating for “FACT-Based Accounting” for state and local governments. In fact, this was one of Sheila Weinberg’s earliest motivators for starting Truth in Accounting in 2002. GASB has since adopted recognition of long-term liabilities for employee retirement benefit obligations and related full-accrual bases for the Statement of Net Position and Statement of Activities, which we appreciate. However, as we have tried to highlight for you, many state and local governments -- including some of the largest in the nation -- continue to rely on flimsy cash-like-accounting bases for governmental funds statements as the foundation for their false claims to “balanced budgets.” Sadly, they cite GASB generally accepted accounting principles (GAAP) for justification and support. We believe the time has come for full-accrual-basis accounting for governmental funds statements. In fact, that day is long overdue -- and the USA is lagging international developments, including the efforts of the International Public Sector Accounting Standards Board (IPSASB), on this score.

Don't Call Your Proposals Accrual Accounting.

We object to your asserted conceptual foundation – and, in particular, calling it a “short-term financial resources measurement focus and accrual basis of accounting.” We aren't alone in this objection, and especially appreciate some of the related concerns and ideas expressed in the Alternative View and in a comment letter by Martin Ives, former vice-chair of GASB. We agree and align ourselves with Mr. Ives' summary statement that “stating that the Board's proposal regarding fund reporting results in the ‘accrual basis of accounting’ is grossly misleading and must be dropped.” In our view your proposed “short-term financial resources measurement focus and accrual basis of accounting” sets up an oxymoron – a contradiction in terms. Again, we urge you to adopt full-accrual accounting for

government funds statements, but if you fail on that score, as you do in your proposed concept statement and standard, you should refrain from calling that conceptual foundation “accrual basis of accounting.”

Don't Call It a Balance Sheet.

We object to calling your proposed governmental funds statement a “Short-Term Financial Resources Balance Sheet.” These statements will show a positive bottom-line “balance” for many governments that are actually UNBALANCED in their accrual-based Statement of Net Position. Accrual-basis accounting reflects debt as it is incurred in a balance sheet, and does not allow debt to go unrecognized simply because payment of that debt is due beyond an arbitrary short-term time horizon. We fear that many governments will continue to rely on your proposed governmental funds statements, and particularly this proposed statement to bolster false claims to “surpluses,” even on their “balance sheets.” If you retain this proposed framework and set of statements for governmental funds, please call the statement a “Statement of Short-Term Financial Resources.” And please refrain from using “balance” in the title of any bottom-line residual in this statement. For example, you could call the bottom-line something like “Short-Term Financial Resources, Net.”

Post a Warning Label for Statement of Short-Term Financial Resources.

If you choose to retain this proposed statement and its framework (which we advise against), the proposed “balance sheet” should a) not be called a “balance sheet,” and b) include a short warning label that would lie above, not below, the statement, saying something like the following: “This statement is NOT relevant, by itself, for an assessment of the financial strength or solvency of a government entity. This statement may aid in understanding liquidity, but is misleading if used to summarize an entity’s overall financial condition.”

Avoid Fake Solvency – Some Lessons From History.

Again, we urge you not to adopt your proposed short-term financial resources measurement focus, or whatever you end up calling it, for governmental funds statements. Please consider lessons from the savings and loan crisis in the 1980s. Back then, deceptive regulatory and other accounting principles enabled economically insolvent entities to pretend solvency. They were allowed to stay in business, and government guarantees like deposit insurance kept money flowing in. Longer story short (and we can recommend some excellent resources for you), this enabled much of the industry to “gamble for resurrection,” and take higher risks, by counting on the prospect that gains could be captured while losses could be socialized. The resulting set of incentives magnified the losses ultimately borne by U.S. taxpayers, and ultimately underscored the importance of truthful balance sheets and prompt corrective action for failing enterprises gambling on the public purse. We fear that GASB’s past negligence and current proposals are setting citizens and taxpayers up for more sad lessons along these lines -- for many state and local governments sponsoring woefully underfunded (insolvent) pension and retiree health care plans. These schemes may not have formal government insurance corporations behind them, but their access to the public purse and the attendant moral hazard is even more direct, particularly in states with strong legal protections for public employee retirement benefits.

Thank you again for your interest and appreciation for our feedback on your proposals.