A Conceptual Model and a Model Concept

By Michele Mark Levine

The GASB recently issued two preliminary views (PV) documents, one on financial reporting model improvements and another that reexamines part of a conceptual framework PV.

In September 2018, the Governmental Accounting Standards Board (GASB) issued two preliminary views (PV) documents, *Financial Reporting Model Improvements* and *Recognition of Elements of Financial Statements*. The first is a follow-up to the invitation to comment (ITC) on the same project that was issued in 2016. That project grew out of a reexamination of the current financial reporting model, which was put in place by GASB Statement No. 34, *Basic Financial Statements — and Management's Discussions and Analysis — for State and Local Governments*, issued nearly 20 years ago. The second PV reexamines part of a conceptual framework PV from 2011, the remaining part of which went on to become GASB Concepts Statement No. 6, *Measurement of Elements of Financial Statements*.

GASB develops concepts statements to guide the Board's future standard-setting activities.[1] In this case, the two PVs — one a proposed standard and the other a proposed concepts statement underpinning the former's most significant proposals — were issued simultaneously. That is because a primary stated purpose of the Reporting Model PV is to provide conceptual consistency within governmental fund financial statements that the GASB believes is lacking in the current reporting model.[2] Thus, the Reporting Model PV (the proposed standard) and the Recognition PV (the proposed concepts statement) are fundamentally intertwined.

The point of overlap between the PVs[3] is a proposed new measurement focus (MF)[4] called the *short-term financial resources MF*, which would replace the *current financial resources MF* now in use for governmental fund financial statements. The Short-Term MF would divide transactions and other events (hereafter referred to jointly as transactions) into two types. The first, for transactions normally resulting in flows of cash and other short-term financial resources (hereafter referred to jointly as cash flows) *within* one year of the transaction's inception, is referred to as a short-term transaction and for fund activity reporting purposes classified as a current activity. The second, for transactions normally resulting in cash flows that *extend beyond* one year of the transaction's inception, is a long-term transaction and event, and is reported separately as a noncurrent activity. The type of transaction would dictate whether the resulting resource flows (revenues and expenditures, in current terminology) are recognized immediately upon the transaction's occurrence (short-term) or only when the related cash flows are due (long-term).

As discussed in the Reporting Model PV, short-term financial resources would include cash as well as resources that can be converted to cash or consumed in lieu of cash. Notably, this would definitively bring supplies inventories and prepaid items onto the governmental funds balance sheet, whereas governments now generally have the option of reporting expenditures for these immediately upon purchase or prepayment.

The distinction between current and noncurrent activities in the proposed Short-Term MF would essentially replace the Current MF's distinctions between revenues and expenditures on one hand, and other financing sources and uses on the other. However, there are some important distinctions between flows for noncurrent activities and other financing sources and uses. One is that all flows related to long-term transactions would be consistently characterized as such, whereas long-term debt transactions currently result in other financing sources when borrowed, but debt service expenditures when repaid. The GASB is aiming to achieve a symmetry in conceptual consistency. The Short-Term MF would have the benefit of no longer requiring the recording of another financing source (to stand in for debt proceeds) and another financing use (to stand in for capital expenditures) when lessee governments enter into capital leases.[5] As no actual flow of financial resources results from the lease transaction upon inception, there would be no recognition in a governmental fund. Lease payments would be recognized, when they are due, as outflows of current financial resources (cash) for noncurrent activities.[6]

Another important distinction between the Current MF and the Short-Term MF regards interfund activity. Interfund payables and receivables would not be reported in governmental funds in all cases when using the Short-Yerm MF, as they are when using the Current MF. Interfund balances would only be reported in governmental funds when they relate to short-term transactions. Interfund transfers, currently reported as other financing sources and uses, would instead be classified based on the short-term or long-term nature of the transactions from which they result. It is notable that using the Short-Term MF, interest — even on long-term debt and capital leases, which are themselves long-term transactions — would be recognized as it accrues because the *accrual* would be the transaction (or, in this case, the event) from which it arises, and interest is normally paid within one year from the time it accrues.

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Inflows (revenues) related to a period are only recognized to the extent that they are available, meaning that they are, or are expected to be, collected during the current period, or soon enough thereafter to be used to pay liabilities of the current period. Under the Current MF, the maximum length of time beyond the fiscal year-end that cash flows related to the reporting period may occur and the resources considered available at year end varies both within and between governments. In contrast, and in line with the GASB's focus on consistency, the Short-Term MF would use a uniform one-year availability period.

The concept of "normally," used to describe the timing of the cash flows when distinguishing between long-term and short-term transactions in the Short-Term MF, is the one articulated in the GASB's Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*. It refers to what is "normal" for all governments, rather than for a particular government or a type of government. In the Reporting Model PV, however, the GASB indicates that it intends to issue guidance to identify what would be "considered normal for specific classes of transactions."[7] Indeed, in that PV, the GASB proposes to treat all revenue anticipation and tax anticipation note issuances as short-term transactions, even if the final maturity date is beyond one year after issuance. In this way, the GASB categorically characterizes these two types of notes as short-term, as their issuance normally results in cash flows *within* one year.

When the GASB first sought feedback on this reporting model reexamination project in the form of the ITC issued in December 2016, they proposed three potential alternatives for governmental funds. While there were other differences between the approaches, one key difference was regarding the availability period that would be standard in each. In providing comments to the GASB on the ITC, GFOA favored[8] the approach that would have used an availability period of up to 90 days,[9] based on its similarity to the period of availability used in the Current MF and current budgeting practices of many governments. More generally, in the written comments and in testimony before the GASB during a public hearing on the topic, GFOA noted that we perceived no urgent need for a major change in the reporting model, the GASB's express concern about conceptual and reporting consistency notwithstanding. GFOA has not yet developed comments on the Recognition or Reporting Model PVs, but a fundamental consideration will almost certainly be whether the value of conceptual consistency is high enough to warrant the costs of implementation and education of government preparers, auditors, and a wide range of users of public-sector financial reporting that would be required by a comprehensive revision of governmental fund financial reporting. ▮

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Notes

1. *Preliminary Views of the Governmental Accounting Standards Board on Concepts Related to Recognition of Elements of Financial Statements*, Governmental Accounting Standards Board, September 2018, paragraph 1.
2. *Preliminary Views of the Governmental Accounting Standards Board on Major Issues Related to Financial Reporting Model Improvements*, GASB, September 2018, Chapter 2, paragraph 3.
3. Complete discussions of the Reporting Model PV and of the Recognition PV can be found in the October and November issues of GFOA's *GAAFR Review*, respectively.
4. The measurement focus of financial statements indicates what is being measured, such as financial or economic resources.
5. For governments that have implemented GASB Statement No. 87, *Leases*, what is said here about capital leases would be the case for all leases other than those (a) with a maximum possible term of one year, or (b) that transfer ownership of the underlying asset at the end of the lease term.
6. Of course, the long-term asset and liability related to the lease would be included as general government assets and liabilities in the governmental activities columns of government-wide financial statements, which are reported using the economic resources measurement focus.
7. Reporting Model PV, Chapter 2, paragraph 14.
8. GFOA's comment letter to GASB stated, in part: "GFOA strongly believes that governmental funds should continue to present information that reflects a shorter time perspective and that focuses on financial resources. Governments must demonstrate fiscal accountability (the raising and spending of public moneys in the short term) to the citizenry and other stakeholders. Since most governments prepare their budgets and manage their operations on an annual cycle, the use of a shorter time perspective best fits that need. It would be difficult, if not impossible, to measure fiscal accountability (a short-term concept) if long-term assets and liabilities and the related annual changes are incorporated into the governmental funds."
9. In the ITC, the GASB did not specifically identify the availability period for the "near-term approach" that GFOA favors, but the ITC indicated it would likely be in the 60- to 90-day range (*Invitation to Comment of the Governmental Accounting Standards Board on major issues related to Financial Reporting Model Improvements — Governmental Funds*, GASB, December 2016, Chapter 2, paragraph 10).

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