



NORTH CAROLINA
DEPARTMENT OF STATE TREASURER

Letter of Comment No. 49
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STATE TREASURER OF NORTH CAROLINA
DALE R. FOLWELL, CPA

STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

GREGORY C. GASKINS
DEPUTY TREASURER

April 27, 2018

Mr. David Bean
Director of Research and Technical Activities
Project No. 3-18
Governmental Accounting Standards Board
PO Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean,

Thank you for the opportunity to comment on the *Invitation to Comment – Major Issues Related to Revenue and Expense Recognition*. We believe that the issues being discussed in this document are important in the GASB's efforts to provide better and more complete information to financial statement users. After careful consideration of the material, we offer the following comments.

The State and Local Government Finance Division (SLGFD), as staff to the Local Government Commission (LGC), has oversight over local governments in North Carolina. The primary way we exercise that oversight for most of our local governments is through review of the annually audited financial statements. The statements are audited by independent CPAs, submitted to the SLGFD, and reviewed by our staff for GAAP presentation and signs of financial weaknesses. Almost all of our entities have a June 30 fiscal year end and because they all issue GAAP statements, we are able to compare statements and study trend data utilizing a number of variables including size or type of government.

Based on our reviews of audited financials over the years, we believe that principle based guidance does work. North Carolina governments appear to have had little trouble applying the existing guidance on exchange and non-exchange transactions. We believe that any of the models that GASB is proposing could be made to work with the proper guidance. However, we also believe that changes should only be made to correct deficiencies in reporting, and that the cost-effectiveness of any change must be considered before final decisions are made. Lastly, we believe it is important to consider the usefulness of the results of the change being considered – will the users of the financial statements get better information as a result?

The following are our answers to the specific questions that appear in the ITC.

Question 2.1 Do you believe the exchange/nonexchange model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?

We believe the exchange/nonexchange model does provide a suitable basis for classifying transactions and recognizing revenue and expense. With regards to the revenue and expense recognition on the basis of exchange or non-exchange classification, we have not seen many issues with consistency in reporting. Our

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general purpose governments are where the majority of our utility operations reside, and they do not have any difficulty distinguishing between exchange and non-exchange transactions. We also have not seen units having any significant issues distinguishing between purpose restrictions and eligibility requirements for particular funds.

Based on arguments made in the ITC perhaps guidance on the exchange side could be enhanced but it's not something we have had significant problems with in North Carolina. We also are not overly concerned with the issue of determining value. If both giver and received perceive that the value of a transaction is relatively equal then there is no problem; if there are concerns the assumption is that cost approximates value. Once again, this is not something we have had significant issues with in North Carolina.

In its white paper, the GASB discusses the differences between tax revenues (generated by nonexchange transactions), as the primary source of revenue for government, and business revenue (generated by voluntary exchange transactions). Those differences obviously still exist; we believe we should continue to use these classifications to recognize these types of transactions.

3.1. Do you believe the performance obligation/no performance obligation model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?

We believe the performance obligation/no performance obligation model could provide a suitable basis for classifying transactions and recognizing revenue and expense but we do not believe there is enough justification to change from the current model. One of the reasons discussed in the ITC is the issue of convergence with other accounting standards. We don't believe this should be a significant concern. Again, in its white paper, the GASB discusses in detail why government is different and why accounting for its transactions should be different. Those circumstances have not changed.

In North Carolina, implementation of the performance/no performance obligation model would result in significant changes in the timing of revenue recognition of intergovernmental grants. Although commonly referred to as taxes, they are not levied by the governments receiving them; recognition of the revenue could be delayed until the funds are spent on allowable purposes. Some governments hold funds in reserve for several years in anticipation of funding specific projects. There could be lengthy lags between recognition by the levying government and the government that is ultimately spending the funds.

We believe this model will be costly to implement because it represents such a material change from the current practice. We also believe there will be confusion over the definitions of performance obligations as they can be complex, again making implementation difficult. Finally, and as discussed previously, we will lose the ability to track trends in our data, a process that is becoming an increasingly important part of our business processes.

4.1. Do you believe that the alternative model considered as an example in this chapter could provide a suitable basis for classifying transactions and recognizing revenue and expense? If so, what are the potential benefits and challenges of that model?

We believe the alternative model presents many of the same challenges presented by the performance/non-performance model.

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4.2. The models distinguish transactions on the basis of (a) an exchange or a nonexchange or (b) a performance obligation or no performance obligation. Do you believe there is another alternative for distinguishing revenue and expense transactions? If so, please describe that alternative and explain why you believe it would be suitable.

We do not have another more suitable alternative model to recommend at this time.

Thank you again for the opportunity to provide input on these issues.

Sincerely,

A handwritten signature in black ink that reads "Sharon Edmundson". The signature is written in a cursive, flowing style.

Sharon G. Edmundson, MPA, CPA
Director, Fiscal Management Section
State and Local Government Finance Division