



June 30, 2008

Mr. David R. Bean, Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Project No. 3-18

Dear Mr. Bean:

We are writing in response to the Exposure Draft (ED) "Fund Balance Reporting and Governmental Fund Type Definitions". These comments were developed by a committee representing 16 governmental units in the State of Maryland, and 2 CPA advisors. Our comments are detailed in the following paragraphs.

Special Revenue Funds

We are concerned about situations where fluctuations in level of revenue sources can cause a fund to qualify with the proposed definition (The restricted or limited proceeds ... should comprise a significant portion of the resources reported in the fund) in some years, but not in others. We are aware of several instances where programs are designed to be operated with restricted revenues, but in periods where those revenues are temporarily down due to economic conditions or other reasons, the government provides other resources, usually from the general fund, to maintain the program. We suggest guidance similar to internal service/enterprise guidance, which would allow professional judgment in such situations so that temporary revenue fluctuations would not impact conclusions, and thus change the fund type every year. We are also unclear whether resources are meant to be a Balance Sheet (assets) measurement or a Statement of Revenues, Expenses and Changes in Fund Balances (revenue) measure. Clarification of this point is also requested. Another area of concern to us is "revolving funds". These are often established from a dedicated revenue source (for example, a Federal Grant), and continue to operate using loan repayments or other revenue sources. Over time, the original specific revenues will become inconsequential, especially relative to current year activity). We believe guidance is necessary to determine when this activity no longer qualifies as a special revenue fund, which we interpret to mean that this activity must be moved into the General Fund.

While we understand that budget policy should not drive Generally Accepted Accounting Principles, we are concerned that the definition of special revenue funds as proposed could result in significantly more Budget-to-GAAP differences to explain in the Notes to the Financial Statements unless budgets are modified to fit the GAAP fund definitions. We are concerned about the potential confusion this may cause to financial statement users.

Capital Project Funds

We believe the emphasis in this fund type definition is incorrect. The definition should focus more on "long-term non-operating projects" rather than "facilities". We identified a number of project types that we do not believe meet the proposed definition, but are valid Capital Projects.

- Multi-year computer system installations. These do not create facilities, although they meet the definition of Intangible assets included in Statement No. 51.
- Major maintenance type projects, such as roof replacements and technology upgrades, which are difficult if not impossible to complete in one fiscal year. We recognize that these projects do not always result in a capital asset, but we do believe reporting these activities in the General Fund will not improve financial reporting.
- Debt Financed acquisitions. We have concerns about taking bond-funded projects out of the capital projects fund. This will result in bond funding reported in the General Fund and may create a negative connotation, since usually bond funding in General Fund means bonds are used to finance current operations.
- Debt Financed Grants or contributions. The State of Maryland has multiple examples of debt financing capital assets of other units of government. The State government typically borrows for Capital grants to local jurisdictions. Local jurisdictions also borrow to finance construction of assets for discreetly presented component units, such as Boards of Education and Community Colleges. Since these are not for major facilities of the primary government, we are unclear if the proposed definition allows Capital Project reporting for these items.

We believe that reporting these types of activities anywhere other than capital project funds will distort annual activity comparison, and exacerbate confusion among users. This is especially critical to smaller governments where these items, especially debt-financed acquisitions, have a significant impact.

We also believe clarification is necessary on what the GASB means by ancillary items as used in paragraph 104 to describe facilities. We are concerned whether

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this includes items such as the furniture and fixtures which are needed to furnish new facilities.

Encumbrances

We do not believe the proposed presentation will reduce confusion and eliminate inconsistencies. It may actually increase inconsistencies.

Purchase orders are legal obligations, where the government has made a contract with a third party. Therefore focus is NOT that the budget isn't available, it's that the government has made a legal obligation to a contractor.

We could not come to an agreement on whether encumbrances should be reported as limited or assigned, and recognize the answer could be different depending on individual government policies related to prior year encumbrances. We suggest that additional guidance is needed to clarify what the Board intends. We also suggest additional language be inserted at beginning of paragraph 20 of the ED. The current wording leads readers to the conclusion that encumbrances default to unassigned. We are also unclear whether the requirement that limited and assigned fund balances relate to specific purposes implies that encumbrances do not meet these definitions. While paragraph 76 in the Basis for Conclusions provides much more information, we do not believe it addresses all the issues, and suggest moving some of this information into the Standard for clarity.

We strongly suggest that footnote disclosure is not sufficient. This is an important number for users to understand.

We also request GASB provide clear guidance on how to treat encumbrances under the most typical scenarios. This would include how encumbrances are treated:

- If governments reappropriate in the budget for the following year;
- If encumbrances carryover but the government does not reappropriate; or
- If encumbrances lapse.

The proposed language leaves too much to management's judgment. Paragraph 36 indicates the purpose of the proposed standard is to identify the amount of resources that is truly available. We do not believe the proposed treatment of encumbrances accomplishes this goal.

As an alternative we suggest an assigned category for encumbrances.

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Fund Balance used as a Funding Source for Subsequent Year's Budget

This topic created considerable discussion in our group. Our interpretation is that this amount does not meet the definition of limited or assigned fund balance in that it is not for a specific purpose. Most of the group felt reporting it as unassigned, with required footnote disclosure of the amount involved is appropriate. However, a number felt that this treatment is not sufficient, arguing that this amount is not really unassigned, and not reporting this on the face of the financial statement is misleading, especially with the terminology of "unassigned". A proposed compromise is an allowed reporting of "legislatively committed" within the unassigned category.

Other

We are concerned about interpretation of a government's highest level of decision making authority for purposes of defining limited fund balance, or deciding the body or official with the authority to assign fund balance. Throughout the state, our Boards of Education (BOE) are legally separate bodies with considerable autonomy. However, because the local governments have financial responsibilities for and approval of the BOE budget, the BOE's are generally presented as discretely presented component units in the Counties' financial statements. We do not believe it is clear whether the Board of Education or the County government is the highest level of decision making authority. Guidance on this issue would be extremely helpful.

We appreciate having the opportunity to respond to this Exposure Draft. If you or your staff wishes to discuss any of these comments, please contact the committee co-chairs, Karen Hawkins, Montgomery County (240-777-8828) karen.hawkins@montgomerycountymd.gov or Alfred Warfield, the Maryland-National Park and Planning Commission (301-454-1582) al.warfield@mncppc.org).

Sincerely,



Mary P. Allen, President
Maryland Government Finance Officers Association