PROJECT NO. 3-20 PROPOSED CHANGES MAY OBSCURE GOVERNMENT FISCAL HEALTH

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Financial Reporting Model Improvements; Recognition of Elements of Financial Statements  
Agency: Governmental Accounting Standards Board  
Comment Period Opens: June 30, 2020; June 17, 2020  
Comment Period Closes: February 26, 2021  
Comment Submitted: February 26, 2021  
Project No. 3-25; Project No. 3-20

Old habits die hard, as project no. 3-20 demonstrates. The proposal largely reverses much of the progress toward producing meaningful and transparent financial statements made in a decade of movement toward requiring that pension and health benefit liabilities be properly reported on the governmental funds balance sheets. Just as state and local governments are finally accounting for their healthcare benefit liabilities, project no. 3-20 threatens to allow state and local governments to exclude pension and healthcare benefit liabilities from their general fund balances. The focus on short-term financing also hides the full fiscal impact of policy decisions by shifting some of the costs ahead to future years rather than the year in which the liability for the costs is created.

Project no. 3-20 does state and local governments no favors. It may shield current office holders and administrators from accountability for problems that they leave for their successors, but doing so is hardly a benefit for the government or its citizens. Eventually those problems will have to be addressed, and by the time they are addressed, they are usually worse. Decades of experience with the data reported by governments have taught a harsh lesson: whatever isn’t measured isn’t managed. Government accounting standards should help local governments make the right choices and provide the transparency needed to evaluate the impact of those choices. The proposal does the opposite.

The Mercatus Center at George Mason University and the Institute for the Study of Economic Growth at Wichita State University are dedicated to bridging the gap between academic ideas and real-world problems and to advancing knowledge about the effects of regulation on society. This public interest comment, therefore, does not represent the views of any particular
affected party or special interest group, but rather is intended to inform the Governmental Accounting Standards Board (GASB) on how to achieve meaningful reform.

The Mercatus Center and the Institute for the Study of Economic Growth are currently jointly producing a state fiscal rankings report, continuing the series of state fiscal rankings reports produced by the Mercatus Center from 2014 to 2018. These reports measure how well states can meet short-term and long-term bills by examining states’ financial statements. The goal for this research is to establish a consistent set of financial data and basic indicators with which to evaluate individual state performance, better understand the factors that drive changes in performance, and identify areas where financial reporting may improve.

For example, past state fiscal rankings reports find that long-term liabilities increased significantly in fiscal year 2015, but that increase was largely the result of new GASB rules that required states to report unfunded pension obligations on the balance sheet. The size of state long-term liabilities did not increase as a result of the new rules; rather they were revealed, allowing policymakers to better understand them and respond.

These reports have shown that states with long-running structural deficits and large unfunded pension obligations tend also to have either skipped or reduced their contributions to employee pension and health benefit plans; they have then issued debt to cover budget shortfalls or pension contributions, effectively adding to future obligations. The project no. 3-20 proposal would make it easier for states to continue these unhealthy fiscal practices by permitting states to hide what they are doing.

Studying how each state is performing with respect to a variety of fiscal indicators can help state policymakers address persistent issues and anticipate potential problems. However, the proposal would allow state and local governments to close their eyes to growing unfunded liabilities for pensions and for healthcare costs. These unfunded liabilities remain an ongoing problem for many states, and the problem is likely to worsen in the era of COVID-19. The proposal may cause increases in unfunded liabilities to disappear from reported general fund balances, but that only masks the magnitude of the problem.

We disagree with the short-term focus of the proposal, including how it obscures the distinction between restricted and unrestricted funds. As stated in the executive summary of the proposal,

The recognition concepts for the short-term financial resources measurement focus and accrual basis of accounting would be based on whether items arise from short-term or long-term transactions and other events. Balances, outflows of resources, and inflows of resources from short-term transactions and other events would be recognized as the underlying transaction or other event occurs. Balances, outflows of resources, and inflows of resources from long-term transactions and other events would be recognized when payments are due.

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Short-term accounting, as described in the proposal, is of questionable value to decision makers because it does not permit them to assess the full fiscal impact of the decisions they make. Short-term accounting may have some limited utility in helping decision makers understand the short-term financial situation and ascertain the availability of adequate funds. A short-term focus may also help with the proposal’s stated goal of promoting consistency in financial statements across governments. But any such benefits are outweighed by the loss of relevant information needed to evaluate the financial costs of policy decisions because the financial impacts will usually be spread over several time periods.

Put another way, the short-term focus allows current administrations to take actions in the near future without accounting for costs that will fall later. Then the costs of the decision only show up later, when they are due, often on the watch of another administration.

We urge that GASB reject these proposed changes.