Letter of Comment No. 10 File Reference: 13-3PV Date Received: 1/20/12

MEMORANDUM

TO: Director of Research and Technical Activities, Project No. 13-3

Governmental Accounting Standards Board

Via e-mail to director@gasb.org

FROM: Martha Zeigler, CPA

Utility Finance Manager

City of Durham, North Carolina martha.zeigler@durhamnc.gov

DATE: January 16, 2012

RE: Written Comments in Response to PV "Economic Condition Reporting:

Financial Projections"

Responses to "Questions for Respondents":

- 1. I agree with the potential usefulness of the five components, but disagree that mandating that these components be presented will give adequate information for users to assess a governmental entity's fiscal sustainability within the coming five years. Components 3 and 4 may be reasonably determined. However, projections of cash inflows and outflows are highly subjective and often dependent upon circumstances outside of a governmental entity's control. Moreover, political climate will likely pressure presentation of "best case" scenarios. Who in 2006 would have had any projection even close to cash inflows and outflows experienced in 2010? Narrative discussions of intergovernmental service interdependencies are nice, but many recipients are at the mercy of the donor's largesse. Back in 2002, the state of North Carolina drastically cut assistance to local governments in response to the economic distress caused by 9/11. Who in 1999 or 2000 could have projected this?
- 2. Again, I agree in theory, but not in practice. However, I do not agree with the conclusion in Chapter 4 Paragraph 7 that such estimates "are no more subjective than the estimates and assumptions currently required to be included in annual financial reports". The proportion of amounts derived from estimates in annual financial reports is by definition much less than future financial projections which are entirely estimates. Another concern I have is related to political influence. Many local governments have staggered elections every two years, and the current public frustration seems to be resulting in wide philosophical swings as voters want to "clean house." So projecting out current policy over five years with two-year elections that can result in significant revisions is quite a challenge.
- 3. I agree that inflows and outflows should be presented on a cash basis and financial obligations such as pension funding should be presented on the accrual basis. However, in my opinion, the illustrations do not provide users, especially ordinary citizens, adequate integration of this information. I suggest a "statement of cash flows" which integrates estimated beginning and ending cash of the governmental entity along with disclosure of any accumulated unfunded obligations so citizens can clearly see what demands on cash are being deferred to the future.

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Such a statement would also avoid unwarranted alarm at a deficit of outflows over inflows in any one year provided the ending cash balance would still be adequate.

- 4. Again, the theory is good, but based on my nearly two decades in local government finance, the implementation will be challenging. In this polarized political time, there are significant differences of opinion concerning how much government should spend and what levels of service are required, which will greatly impact the subjectivity of assumptions. Furthermore, a major component of future costs I did not see dealt with in this PV concerns asset management. Having specialized in water and sewer utilities for the past decade, I am acutely aware of the need for quantifying the cost of preventative maintenance, future capacity planning, and system rehabilitation of infrastructure to avoid spikes in repair expenses caused by whatever happened to break down during the year. Deferred maintenance has historically been a favored budget balancing device and without any master plan, stakeholders would have no way of determining the impact on future cash flows. Many entities, especially the smaller ones, do not have or are reluctant to spend funds for such. Unless such a plan is in place to provide realistic cost estimates, any future projections of cash outflows might as well be developed using a Magic 8-Ball.
- 5. While I agree that financial projections get rather fuzzy beyond five years, I do have great concerns that unforeseen major events can drastically change the economic environment well within the five-year window. As mentioned in my response #1 above, events like 9/11 and the head-spinning unraveling of the real estate market in 2008 would never have impacted the projections had this standard been in place the year before.
- 6. No, I do not agree that components of fiscal sustainability information should be included as RSI for the reasons provided in the Alternative View. Many governments already provide five year revenue and expenditure projections as part of the budgetary process. That is far more appropriate, as it indicates the governing body's intent to ensure adequate funding and provides businesses and individuals forewarning of any rate increases. And making auditors responsible for reviewing these highly subjective numbers in RSI can only push up the cost of annual audits.
- 7. No, I do not believe that all governmental entities should be required to report financial projections and related narrative discussions as RSI. If the purpose is to assure investors debt service will be honored, there are continuing disclosure requirements and bond covenants which can be invoked to assure adequate tax or utility rates will be assessed for future expenditures. If the purpose is to help ordinary citizens make informed voting decisions and/or provide input to the governing body, this information would be better provided in the context of approving the current year's budget, as fitting in with the entity's plan for the future. Chapter 3, paragraph 31 begins "GASB research identified that the fiscal sustainability of a governmental entity is dependent upon its ability and willingness to make decision that will keep it fiscally sound." Chapter 3, paragraph 32 continues "The Board considered and decided not to require a discussion of the ability and willingness of a governmental entity to make decisions that will keep it fiscally sound." So why do you think going through the motions of putting numbers on paper will give users of financial statements any level of confidence in the sustainability of a government? Do you expect auditors to be able to judge the "ability and willingness" of a government to follow through with the numbers it puts forth in RSI?

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8. If this reporting requirement is adopted, which I hope will not happen, I suggest a phase in similar to GASB 34 as master plans, unified development plans, and asset management programs essential to reasonable projections might take some time to fund and implement for small governments.

9. My closing comments: While I commend the Board for tackling the very real issue of local and state government financial sustainability, I believe that RSI would prove inappropriate and ineffective. Many of the recent major blows to the economy have been unanticipated and sudden and would not have been included in any financial projection. Moreover, fiscal sustainability is, as the Board has acknowledged, dependent on the ability and willingness of elected officials to make sound financial decisions. The only way to ensure the ability and willingness of elected officials to make such decisions is by empowering voters to hold them accountable or allowing creditors to hold them legally liable.