

## STATE OF WISCONSIN

# Legislative Audit Bureau

Letter of Comment No. 35 File Reference: 13-3PV Date Received: 3/7/12

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Joe Chrisman State Auditor

March 7, 2012

Director of Research and Technical Activities (Project No. 13-3) Governmental Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

Dear Director of Research:

Thank you for the opportunity to comment on the Governmental Accounting Standards Board's Preliminary Views, *Economic Condition Reporting: Financial Projections*, and to participate in this important due process. We hope the Board considers all responses in evaluating how this project should proceed. As requested, we have included our comments to the Board's specific questions in the attached document.

The State of Wisconsin Legislative Audit Bureau agrees with the Board on the components, methodology, and assumptions for developing financial projections. However, we agree with the alternative view that financial projections and related narrative discussions should not be required supplementary information in a comprehensive annual financial report (CAFR). This information is subjective, and is not essential for placing financial statements and notes in an appropriate operational, economic, or historical context. We believe that, if required, the timeliness of financial reporting will be negatively affected and that users will incorrectly assume that the auditors have provided some assurance on the accuracy of this information.

We suggest the Board terminate its efforts to set standards related to financial projections. If the Board continues, then we believe the Board should require the ten-year schedules currently found in the statistical section of the CAFR to be required supplementary information, as the alternate view suggests. Further, instead of requiring financial projections, the Board should require a disclosure be made to allow users to obtain the subsequent year's budget documents. We believe that an adopted budget provides a better indication of anticipated future financial activity than the financial projections being proposed by the Board. Finally, we acknowledge the Board could provide guidance on reporting projections, as it has done for reporting service efforts and accomplishments, for those entities that believe financial projections should be included in a CAFR. However, if this was done, we believe any reporting should be optional.

We appreciate the opportunity to provide our comments, which are enclosed. If you have any questions please contact Brian Geib, who coordinated our response, at (608) 266-2818.

Sincerely,

Toe Chrisman State Auditor

JC/BG/sm

Enclosure

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The State of Wisconsin Legislative Audit Bureau offers the following comments in response to the questions included in Governmental Accounting Standards Board's (GASB) Preliminary Views, *Economic Condition Reporting: Financial Projections*.

#### Question 1: The Five Necessary Components in Assessing Fiscal Sustainability

We agree with the Board that information on the government's potential inflows, outflows, financial obligations, and debt service payments would provide information that may help users understand the financial condition of the government. However, we do not believe it is necessary to present this information as required supplementary information.

We agree that a narrative discussion of intergovernmental service interdependencies would assist in assessing and understanding the financial condition. We suggest that the Board require a narrative on intergovernmental service interdependencies be included in the Management Discussion and Analysis.

#### **Question 2: Basis and Methodology for Projections**

We agree with the Board's position that, if projections are to be made, only information that is known and available as of the date of the report should be used in making projections. Having financial projections based on current policy, historic trends, and adjustments for known events and conditions affecting the projected periods appears to be a reasonable approach.

However, we note that policies change significantly and frequently during a government's budget cycle in response to current economic and political conditions. In our experience, we have found that individuals at the state level specialize in one of the following three areas: policy, budgeting, or financial reporting. Typically, these functions are not performed together. As a result, we believe that the costs of tracking policy changes needed to prepare this information for inclusion in a comprehensive annual financial report (CAFR) outweigh the benefits, particularly since this type of information is typically already available in the government's budget documents.

Because the individuals involved in policy and budgeting are regularly involved with the policymakers and would be aware of budget decisions, we believe that the subsequent year's budget document would provide better and more useful information than the financial projections proposed by the Board. We believe that the Board should not require financial projections in the CAFR but rather require a disclosure on how to obtain a government's budget documents for the subsequent year.

#### **Question 3: Basis of Accounting for Projections**

We generally agree with the Board's position that inflows and outflows should be on a cash basis and financial obligations should be on an accrual basis.

However, we have found that there is already significant user confusion about the different bases of accounting used in an annual financial report depending on the fund and statement. In addition, policymakers make decisions within the context of the state's budget, which is typically prepared in accordance with budgetary accounting rules. Therefore, we believe that to avoid additional user confusion, the Board should allow the basis of accounting for financial projections to be the same as that used by policymakers for budgetary purposes.

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#### **Question 4: Identification and Development of Assumptions**

We agree with the Board that financial projection assumptions should be based on relevant historical information as well as events and conditions that have occurred and pertain to the projection periods. We also agree with the Board that these assumptions should be consistent with each other and with the information being used. We agree that professional judgment is essential to selecting the most suitable assumptions for the financial projections being reported.

#### **Question 5: Projection Period**

We disagree with the Board's view that financial projections should be made for a minimum of five years.

In our experience, we have found that staff in the policy, budgeting, and evaluation areas make projections only for the next budget cycle because longer projections are of less value because policy changes occur every budget cycle in response to current economic and political conditions. If the Board requires projections, we believe they should only be reported for the next budget cycle.

Further, since this information is likely already available in the government's budget documents, we believe that the Board should require a disclosure be made to identify where a user could obtain the subsequent year's budget documents, and not require the information to be repeated in the CAFR. We believe that the subsequent year's budget information would provide a better indication of anticipated future financial activity than the financial projections proposed by the Board.

#### Question 6: Reporting of Financial Projections and Related Discussions

We strongly disagree with the Board that this information is essential to the basic financial statements and notes. We believe that financial projections should not be required supplementary information as users could reach their own conclusions on the future fiscal sustainability of the governmental entity based on the ten-year historical schedules, including the changes in net assets or the changes in fund balances of governmental funds, which are already found in the statistical section of the CAFR. These schedules provide historical trend data from which users could draw their own conclusions about a governmental entity's ability to continue to provide its current level of service.

We agree with the alternative view that, since some governmental entities do not prepare CAFRs, including these schedules as required supplementary information would provide useful information to assess fiscal sustainability. We further agree with the alternative view that instead of requiring financial projections to be included in an annual financial report, the Board should require a disclosure be made to provide the user with the information necessary to obtain the subsequent year's budget documents. We believe that an adopted budget provides a better indication of the anticipated future financial activity than the financial projections proposed by the Board.

It is noted that the Board's proposed projections would be included in annual financial reports, which include an auditor's opinion. Therefore, we are concerned that users will assume that the auditors have provided some assurance on the financial projections. We understand that the auditor's opinion would disclose that this information was not audited and that no opinion is expressed. However, since the auditor's role is to provide reasonable assurance that the financial statements are free of material misstatements based on historical facts and figures, projections and other theoretical possibilities should not be included. Alternatively, if the Board required a disclosure to be made on where a user could obtain the subsequent

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year's budget documents, this would reduce user confusion on the assurances provided by an auditor in the annual financial report.

Finally, we believe that the timeliness of annual financial reports will be negatively affected if financial projections are required to be reported. Delays in issuing a CAFR will reduce its usefulness.

## Question 7: Which Governments Should Report Financial Projections and Related Discussions

We do not agree with the Board's view to require all governmental entities to report financial projections and related narrative discussions. We believe that, at most, reporting financial projections should be optional for those governmental entities that believe it would be useful to their users.

We suspect that this information is of use to only those who use the CAFR to make policy decisions or for other specific purposes. While bond rating agencies use the CAFR in their analyses, they have their own, more sophisticated, tools to make projections.

In our experience, we have found that individuals at the State level specialize in one of the following three areas: policy, budgeting, or financial reporting. As a result, we believe that the costs of tracking policy changes needed to prepare the projections proposed by the preliminary view outweigh the benefits of doing so.

### Question 8: Would a Phase-in Period for Report Financial Projections be Appropriate

We do not agree with the Board's view to require governmental entities to report financial projections and related narrative discussions. However, if the Board decides to issue a statement that requires information related to financial projections, we believe that a phase-in criteria similar to the one used for GASB 34 should be used.