



March 13, 2012

Mr. David Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
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Dear Mr. Bean,

On behalf of CliftonLarsonAllen LLP, we appreciate the opportunity to provide comments on the Preliminary Views (PV) document of November 29, 2011, titled "Economic Condition Reporting: Financial Projections." The views expressed herein are those of the firm's State and Local Government Services Practice and are based on discussions held among several of our leading partners who serve state and local governments. We are hopeful that our comments, observations, and recommendations will be helpful to members of the Governmental Accounting Standards Board (GASB).

General Views

We appreciate the GASB's intention to strengthen reporting by state and local governments so that the users of General Purpose External Financial Reports (GPEFR) will have an improved understanding of the economic condition and fiscal sustainability of reporting governments. Since the banking crisis of 2008, the subsequent recession, and the current slow economic recovery, state and local governments have experienced varying degrees of financial distress which, in many cases, have impacted their on-going service capacity and, in some cases, their fiscal capacity to meet important obligations. We agree with the GASB's general contention that some "users may not be able to assess a governmental entity's *ongoing* ability to generate resources and meet financial obligations and service commitments." Although we appreciate the GASB's efforts to study this perceived deficiency in reporting, we have, as detailed below, significant concerns with the reporting structure articulated within the PV document.

In the broadest sense, we question whether the overall concept for reporting financial projections is consistent with GASB's Concept Statements. In this limited respect, we are sympathetic to the concerns expressed within the Alternative View, appearing in Chapter 6 of the PV. However, unlike the specific concerns expressed in the Alternative View, we contend the issue extends beyond whether certain information helpful to assessing fiscal sustainability is "essential for placing basic financial statements and notes to basic financial statements in an appropriate operational, economic, or historical context." Rather, we assert that certain information which may support a greater understanding of fiscal sustainability can be reported directly, under established GASB standards, within MD&A, notes to the basic financial statements, and Economic Condition Reporting: The Statistical Section.

As a firm that performs audits of state and local governments, we contend that the inclusion of the proposed projections as part of GPEFR would result in increased subjectivity associated with management's assertions, which would reduce overall reporting reliability. Currently, Required Supplementary Information (RSI) is associated with historical and objective information available at the end of the reporting period and thus reporting reliability is maintained. The PV asserts that information concerning fiscal sustainability can best be viewed if set apart from the basic financial statements, notes to the basic statements, and MD&A. We believe this could weaken the reporting structure established by Statement 34.

Detailed Comments

In this section, we wish to address the specific questions posed within the PV. Rather than repeat the entire question, we will present the questions in the order shown within the PV. Please note that in answering these specific questions, we do not endorse the proposition that fiscal sustainability should be reported upon and disclosed utilizing the reporting mechanism of financial projections as put forward in the PV.

1. Regarding whether the five described components of information are necessary to assist users in assessing a governmental entity's fiscal sustainability:

The elements of information found in the five components are relevant to understanding fiscal sustainability. However, their presentation as financial projections does not constitute an appropriate, practical, or cost-effective way of assisting users in assessing fiscal sustainability. Key observations and assertions supporting our view include:

- Information required for projections will be unduly difficult for governments to compile and possibly further delay production of GPEFRs.
- The prescribed projections would be subject to significant misinterpretation and therefore not uniformly understandable. In turn, that could lead to incorrect conclusions by key stakeholders and incorrectly lower the risk profile of the reporting government.
- The inclusion of certain projections, especially those based on trends from previous years, pose significant risks to the preparers and other stakeholders should those "projections" vary from actual results.
- Schedules of current financial obligations, current debt service payments, and future debt service payments are essential for understanding the financial position and results of operations of a government and the focus on these factors needs to remain resident with the basic financial statement and their notes.
- The requirement to project future inflows associated with grants, contracts, and contributions would result, where applicable, in a conflict between such projections and current disclosures by governments—usually within "commitment and contingencies" and/or "notes to accounts receivable"—to the effect that future grant receipts are uncertain and that there is a possibility that certain received grant funds will have to be returned.

2. Regarding the definition of financial projections:

Developing projections of inflows and outflows based on historical information bears with it several risks. For example, historical trends, where they exist, associated with inflows or outflows, can have little relation to future periods due to decisions that are not under the control of government, changes in leadership among elected officials, and other economic and demographic factors. In addition, projections informed by historical information introduce the risk of management judgment and bias.

In addition, auditors will be presented with significant challenges and risks when providing a level of assurance appropriate to RSI in instances where projections are "informed by historical information." Even when such projections are based on current policy and adjusted for known events that affect future periods, it may be possible for preparers to only disclose the general direction of changes in inflows or outflows, rather than specific dollar amounts.

Finally, governments are able, under current GAAP, to make disclosures pertaining to fiscal sustainability based on current policy, adjusted for known events and conditions that affect future periods. However, we have observed that such reporting is not uniform or comparable across governments. Some governments do not make such disclosures, while other governments might disclose the future effects of authoritative actions that have a significant probability of occurring as a "subsequent event," or within a disclosure related to "commitments and contingencies."

3. Regarding the basis of accounting to be used for inflows and outflows and for financial obligations:

The requirement to project inflows and outflows on a cash basis runs contradictory to most all efforts by GASB, including those accomplished through the issuance of Statement 34, to have the financial statements of governments more appropriately reflect the complexity of such governments and improve the clarity of what occurs within certain time periods. In fact, there has been a growing emphasis in recent GASB pronouncements regarding the importance of acknowledging interperiod equity.

Additionally, it would be confusing for the preparer and the user to understand and correctly bridge between information currently presented on an accrual or modified accrual basis and projections that would be presented on a cash basis.

4. Regarding the assumption that financial projections should be guided by a principles-based approach:

Using a principles-based approach in identifying and developing assumptions for making financial projections not only seems appropriate, is likely the only practical approach. However, reliance on a principles-based approach will create differences between how governments develop their assumptions and open the door to the risks of introducing management's judgment and bias.

Accordingly, comparability between governments would suffer under new requirements for presenting financial projections. Fostering comparability in reporting the financial position and results of operations of a government, including information pertaining to the fiscal capacity, has been a key characteristic embraced by the GASB in its various authoritative pronouncements. We believe that this emphasis on comparability should remain.

5. Regarding annual financial projections made on a five-years reporting period:

For certain types of information, five years is simply too long of a period: Authoritative actions and known events may not extend to that length of time. An example is the case of a temporary two-year tax assessment that may or may not continue. In contrast, for certain types of information, five years is simply too short of a period: Long-term fiscal sustainability may not be captured within that length of time, as in, for example, unfunded financial obligations.

Additionally, proposing projections over five years will necessitate users (a) understanding the "starting point for the projections," and (b) anticipating the circumstances surrounding the "ending point for the projections." This may "box in" the thinking of certain users who would otherwise more correctly interpret the long-term view of a government's fiscal sustainability utilizing currently available information sources.

6. Regarding whether fiscal sustainability information is essential for placing basic statements and notes in an operational or economic context and communicated as RSI:

We do not agree that all the components of fiscal sustainability information set forth in the PV are essential for placing the basic financial statements and notes to the basic financial statement in an operational or economical context. To do so would draw the attention of the user away from the presentation of information that is already established under GASB standards that is “essential for understanding the financial position and results of operations of the government,” such as (a) the currently required disclosure of debt service and financial obligations information and (b) information about known future events that have financial impact. In addition, the proposed projections could lead to conflicts and confusion between discussions presented within MD&A and information presented through Components 1-5.

The proposal to place the financial projections within RSI suggests an underlying belief that GPEFRs can reflect all information necessary to assess fiscal sustainability. Traditionally, that has not been an accepted belief. Instead, stakeholders wishing to understand long-term fiscal sustainability have both relied on the reporting of historical information within the GPEFRs as well as information presented in formally adopted operating and long-term capital budget documents and strategic plans, the availability of which can be noted in GPEFRs.

7. Regarding whether all governmental entities should be required to report financial projections:

Given the size and complexity of an individual government there is likely to be a range of factors and considerations relevant to an assessment of fiscal sustainability. Accordingly, for certain special purpose or smaller governments the methodology presented within the PV simply may not be applicable. Even some larger governments may be dependent on a limited number of income flows, which, in turn, might be restrictive.

8. Regarding establishing a phase-in period for implementation of reporting requirements for financial projections:

Rather than stipulate that “all governments” must report or to try to stratify how and when the proposals should be adopted, it would be preferable to let governments decide on applying what is most useful within the methodology put forward within the PV.

Our general and specific comments presented above suggest that there may be other options for reporting on fiscal sustainability in contrast to those presented in the PV. The interest of the GASB in promoting reporting, disclosures, and discussions relevant to fiscal sustainability is certainly most appropriate—especially given the current and likely future national economic environment within which state and local governments must operate. Thus, we have included specific recommendations for reporting information regarding fiscal sustainability identified below.

Recommendations

We suggest that the voiced concerns with the methodology set forth in the PV could be overcome, and the reporting of information relating to fiscal sustainability could be significantly improved, if the GASB issued a Statement or Interpretation on the reporting of fiscal sustainability that would:

Enhance MD&A, through modification or interpretation of Statement 34 par. 11, to require the presentation and discussion of information pertaining to fiscal sustainability. Specifically, by requiring:

1. A separate section where management can concentrate the presentation and discussion of information concerning fiscal sustainability. Such a section could include, but not be limited to, a discussion that:
 - a. Identifies and consolidates all significant factors impacting fiscal sustainability found within the basic statements and notes, including revenue, expenditures, financial obligations, debt service payments, concentrations of revenues at risk, commitments and contingencies, and associated causes of fluctuations.
 - b. Identifies the potential effects of the underlying economy and the effects of changing demographics.
2. The presentation of a two-year (or multi-year) summary schedule of “indicators” of a government’s current level of “willingness” to “honor current service commitments and to meet financial obligations when they come due, without transferring financial obligations to future periods that do not result in commensurate benefits,” where such indicators might include:
 - a. Unfunded pension liabilities and the percentage of unfunded liabilities
 - b. Unfunded OPEB liabilities and the percentage of unfunded liabilities
 - c. Accounts payable due over 30 days
 - d. Past due receivables owed the government
 - e. Changes in capital outlay investments in relation to changes in total net asset values
 - f. Changes in constitutionally authorized debt limits
 - g. Changes in a government’s formal assessment of its working debt limit
 - h. Changes in a government’s tax base.
3. A quantification of intergovernmental revenues and other major revenues as a percentage of the government’s total revenues shown on the Statement of Activities, together with an identification of any sources of intergovernmental revenues and other major revenues that have formally reported fiscal sustainability concerns.
4. A discussion of the degree to which the expenditures of the primary government and component units are funded by revenues not controlled by the reporting government, such as intergovernmental revenue flows.
5. An explanation of (a) commitments made for capital expenditures to include “future principal and interest for debt obligations that have been authorized but not yet issued at the end of the reporting period,”(b) any changes in credit ratings, and (c) debt limitations that may affect the financing of planned facilities or services.

Disclose within the Notes to the Basic Financial Statements, through a modification or interpretation of Statements 34, 40, and 62, as applicable, the following:

1. A schedule of Operating Grants and Contributions and Capital Grants and Contributions that would disaggregate the amounts reported on the Statement of Activities into revenues from the federal government, the state government, and other sources.
2. A concentration of revenues that would report (a) the amount of intergovernmental financial flows and other major financial flows, (b) the identification of vulnerability to change of these flows, and (c) a discussion of “changes in the level of services provided by another governmental entity (that) may impact the level or cost to continue providing services to the reporting governmental entity’s constituents.”

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3. A concentration of investment credit risk that would identify the total amount of U.S. Treasury Securities and federal agency securities held by the primary government, its component units, and fiduciary funds, where that total of all such holdings is at least 5 percent of all investments, and noting the credit rating assigned to those securities. The note would include a discussion of changes in interest-related revenues and asset values associated with holding such securities.
4. A contingency that (a) identifies probable future losses in federal and/or state revenues based on enacted legislation or appropriation action and (b) identifies, as reasonably possible, future changes in federal and/or state revenues based on the reported financial condition of a government providing funding, and known activities that are more than remote in creating a change in intergovernmental funding for the reporting government

Report within Economic Condition Reporting: The Statistical Section, through a modification or interpretation of Statement 44, summarized data concerning intergovernmental grants by major funding source and program, so to better provide the user with historical information concerning the sources and programmatic affiliations of material grant funding.

Conclusion

We hope that our above comments and recommendations are helpful to the members of the Board as they give additional weight and consideration to the need for state and local governments to report information that will help general purpose users of government financial reports to “assess a governmental entity’s *ongoing* ability to generate resources and to meet financial obligations and service commitments.” As suggested by our above recommendations, we believe that authoritative pronouncements are currently available and set precedence for the Board as it seeks to ensure that governments provide information supporting the assessment of fiscal sustainability.

Respectfully submitted,
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