### State of Arkansas

## Department of Finance and Administration

## Preliminary Views of the Government Accounting Standards Board:

# Economic Condition Reporting: Financial Projections

Response by the State of Arkansas Department of Finance and Administration, Office of Accounting

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## To the Director of Research and Technical Activities

RE: Project 13-3

We appreciate the opportunity to present our comments on the preliminary views of the Governmental Accounting Standards Board. The information needs of decision-makers and users of financial information require careful study and input from preparers.

In general, we do not support the Board's preliminary views on economic conditions reporting. While providing users with information on fiscal sustainability is a worthy objective, we believe that the view of the Board conflict with the objectives of Concepts Statement 3. In particular, the view that this information should be presented as required supplementary information (RSI) is not in agreement with paragraph 44 of Concepts Statement 3 in that the information contemplated by the Board's preliminary view would be predictive in nature and not directly connected to information in the financial statements. Paragraph 44 states that RSI should not include information that is "predictions about the effects of future events on future financial position" or "information unrelated to the financial statements." In addition, we believe only larger governmental entities would be able to provide meaningful financial projections. Smaller governmental entities would find the task of preparing the projections difficult and costly.

On the following pages are our responses to the questions posed in the preliminary view document.

1. The Board's preliminary view is that there are five components of information that are necessary to assist users in assessing a governmental entity's fiscal sustainability (Chapter 3, paragraph 2):

- Component 1—Projections of the total cash inflows and major individual cash inflows, in dollars and as a percentage of total cash inflows, with explanations of the known causes of fluctuations in cash inflows (Chapter 3, paragraphs 4–9)
- Component 2—Projections of the total cash outflows and major individual cash outflows, in dollars and as a percentage of total cash outflows, with explanations of the known causes of fluctuations in cash outflows (Chapter 3, paragraphs 10–14)
- Component 3—Projections of the total financial obligations and major individual financial obligations, including bonds, pensions, other postemployment benefits, and long-term contracts, with explanations of the known causes of fluctuations in financial obligations (Chapter 3, paragraphs 15–20)
- Component 4—Projections of annual debt service payments (principal and interest) (Chapter 3, paragraphs 21–23)
- Component 5—Narrative discussion of the major intergovernmental service interdependencies that exist and the nature of those service interdependencies (Chapter 3, paragraphs 24–26). Do you agree with this view? Why or why not?

**Response:** We agree that the five components would assist users in assessing fiscal sustainability. However, the first two components are essentially predictions of cash flows. As such, they are not suitable for RSI. The information in components 3 and 4 can be derived from information in the notes to financial. Thus, presenting the information as RSI would create redundant information. Component 5 could be addressed within management discussion and analysis (MD&A).

2. The Board's preliminary view is that financial projections should be (a) based on current policy, (b) informed by historical information, and (c) adjusted for known events and conditions that affect the projection periods. Current policy includes policy changes that have been formally adopted by the end of the reporting period but that will not be effective until future periods (Chapter 4, paragraphs 2–7). Do you agree with this view? Why or why not?

**Response:** While we agree that reliable financial projections should be based on currently known events and policies as well as historical information, the information could be outdated quickly due to changes in known events and policies that occur after issuance of the financial report. In our opinion, this is a serious flaw in the economic conditions reporting envisioned by the Board. Thus, the information could be of no value to users soon after issuance.

3. The Board's preliminary view is that inflows and outflows should be projected on a cash basis of accounting, and financial obligations should be projected on an accrual basis of accounting (Chapter 4, paragraphs 8–12). Do you agree with this view? Why or why not?

**Response:** We do not agree with this view. The use of two different bases of accounting for making projections that should relate to one another could lead to confusion among users and not allow for proper analysis.

4. The Board's preliminary view is that the identification and development of assumptions for making financial projections should be guided by a principles-based approach. Such an approach would set forth principles that require assumptions to be based on relevant historical information, as well as events and conditions that have occurred and affect the projection periods. Furthermore, these assumptions should be (a) consistent with each other (where appropriate) and with the information used as the basis for the assumptions and (b) comprehensive by considering significant trends, events, and conditions (Chapter 4, paragraphs 13–16). Do you agree with this view? Why or why not?

**Response:** We agree that the selection of assumptions used in financial projections should be based on principles. However, having the assumptions based only on relevant historical information and events and conditions that have occurred could make the projections dated and irrelevant with just a short passage of time. Thus, the preliminary views of the Board, could lead to the reporting of information of time-limited use.

5. The Board's preliminary view is that annual financial projections should be made for a minimum of five individual years beyond the reporting period for the purpose of external reporting (Chapter 4, paragraphs 19–23). Do you agree with this view? Why or why not?

**Response:** We disagree with this view. As stated in our general comments, we do not believe the five-year financial projection is consistent with Concepts Statement 3, paragraph 44.

6. The Board's preliminary view is that all of the components of fiscal sustainability information are essential for placing the basic financial statements and notes to the basic financial statements in an operational or economic context and therefore should be required and communicated as required supplementary information (Chapter 5, paragraphs 7–12). Do you agree with this view? Why or why not?

**Response:** We disagree with this view. As stated in our general comments, we do not believe that reporting the components as RSI is consistent with Concepts Statement 3, paragraph 44.

7. The Board's preliminary view is that all governmental entities should be required to report financial projections and related narrative discussions (Chapter 5, paragraphs 13 and 14). Do you agree with this view? Why or why not?

**Response:** We disagree with this view. Smaller governmental entities would not have the in-house talent to prepare the financial projections. Thus, they would have to hire professional services at significant cost.

8. Do you believe that a phase-in period for implementing the reporting requirements for financial projections and related narrative discussions would be appropriate (for example, requiring governmental entities over certain dollar thresholds to implement first)? If so, what phase-in criteria would you recommend (Chapter 5, paragraph 14)?

**Response:** We disagree with this view. As stated in our response to question 7, smaller governments would have to incur significant costs to prepare the financial projections. Since they are unlikely to incur such preparation costs, any phased-in implementation would be meaningless.