Letter of Comment No. 106
File Reference: 13-3PV
Date Received: 3/16/12

Iowa Department of Administrative Services
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DAS

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March 16, 2012

Mr. David Bean, Director of Research and Technical Activities
Project No. 13-3
Governmental Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

RE: Economic Condition Reporting: Financial Projections

Dear Mr. Bean:

We appreciate the opportunity to respond to the GASB's Preliminary Views (PV) on *Economic Condition Reporting: Financial Projections*. Our comments to the Questions for Respondents are as follows:

We understand that the issue of fiscal sustainability has become a matter of concern for some governmental entities. We also appreciate the GASB's efforts to be proactive in addressing accounting and financial issues as they emerge in practice. However, the provisions of this PV are overreaching, onerous and fraught with troublesome implications.

We are most concerned with the proposed requirements to provide cash flow projections for operating funds. We support the alternative view, particularly for these components, that reporting this information is not essential in an operational or economic context to the financial information presented in the basic financial statements and notes. Realistically, much of this activity is driven by decisions made during the annual budgetary process which is of course revisited in each successive session. Revenues in our state are projected only for the current and succeeding year, and even so, are revised quarterly in response to changing economic factors. Projections made only one year out for budgeted operating funds would be only marginally reliable, and the variances would compound each year. Also, there is no reliable method to predict significant economic fluctuations or to foresee the government's response, such as an across-the-board reduction in expenditures, to the unforeseen circumstances.

We are less concerned with the proposed requirements to present projections of the total financial obligations and major individual financial obligations, including bonds, pensions, other postemployment benefits, and long-term contracts, and projections of annual debt service payments. Although these projections would also become less precise as the timeframe expands, we currently provide much of this information in the notes to the financial statements, and assumptions are already used to project some of these obligations.

The requirement for narrative discussion of the major intergovernmental service interdependencies that exist and the nature of those service interdependencies is the least concerning of the proposed requirements. We agree that a narrative discussion of these relationships is more cost beneficial than quantitative projections and could be appropriately included in the MD&A.

From a practical application perspective, the proposed requirements pose significant implementation issues. The additional time required to develop and audit the projections would have a substantial negative impact on the timeliness of issuing financial reports. Also, we continue to become more uneasy as the sheer size and volume of information reported in CAFRs continues to grow.

Perhaps the most troubling implication of the proposed requirements is the potential impact of cash flow projections on collective bargaining. Particularly the projection of compensation rates beyond the expiration of the current collective bargaining agreement. Disclosure of assumptions for any increases in compensation rates would put the governmental employer at a competitive disadvantage as this would likely be interpreted as the starting point for labor unions in the collective bargaining negotiations.

We can envision that achieving consensus on the assumptions used to project cash flows could prove very difficult, if not impossible, in the political environment. We also are wary that these types of projections, which are so far reaching and volatile, could be easily manipulated and managed to produce desired results. We would be more comfortable with this type of reporting in financing documents, such as official statements, where users better understand the use of estimates and the probability of results based on estimates.

We believe, as is suggested in the alternative view, that a significant amount of the information is currently available in CAFR's. The ten year trend information for Changes in Net Assets (accrual basis) and Changes in Fund Balance of Governmental Funds (modified accrual), currently presented in the statistical section of the CAFR, provide users with most of the information necessary to extrapolate future periods for assessing fiscal sustainability. The Notes to the Financial Statements currently provide debt-service schedules for many of the long-term liabilities and the MD&A provides limited information on known policy changes for the next fiscal year.

We recommend that a more preferable approach to this project, is that the GASB simply fine tune the current presentation, in the RSI, the Notes, or a combination of the two, rather than the major overhaul proposed in this Preliminary view

Our brief comments to the specific Questions for Respondents are as follows:

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?

We do not agree. Although this information may assist users in assessing fiscal sustainability, we do not believe all are necessary or even that these five components represent the most suitable indicators of fiscal sustainability. Funding policies and cash reserves are just two examples of other possible indicators.

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?

This proposed methodology is reasonable and provides a realistic framework with which projections can be developed for the proposed components 3 and 4. However, changes in economic conditions as well as future policy changes that would occur for budgeted operating statements, components 1 and 2, would likely make expenditure projections unreliable and revenue projections even more so.

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?

The proposed use of the cash basis would possibly serve as well as any, absent the fact that the information for budgeted operating funds is already reported 3 separate ways, budgetary (budget to actual) modified accrual (fund statements) and accrual (government-wide statements). A fourth basis borders on unreasonable. The accrual basis would appear appropriate for projecting financial obligations.

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?

Please see the response to question 2.

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?

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We do not agree. Five years is too long to reliably project cash flows for budgeted operating funds, and probably not long enough for financial obligations, given the long-term nature and potentially significant amount of the obligations. If long-term projections of obligations are needed, we recommend these disclosures would be more appropriate in official financing documents, not in prescribed reporting standards.

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?

We do not agree that these components should be reported as required supplementary information as we do not believe they are essential in an operational or economic context to the financial information presented in the basic financial statements and notes.

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?

Given that we do not support the proposed requirements for governmental entities to report financial projections and related narrative discussions, we see no reason to establish separate reporting requirements, regardless of size, for governmental entities, as only information necessary and relevant to all governments, should be required.

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)

We have consistently been supportive of accommodating smaller governments in a phased implementation of reporting standards, patterned after that used for Statement 34.

If you have questions or need additional information regarding this response, please contact Rich Schoeppner at (515) 281-4064.

Sincerely,

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