From: Emily Lucas [mailto:elucas@townofzebulon.org]

**Sent:** Friday, March 16, 2012 1:49 PM

**To:** Director - GASB

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

To: Director of Research and Technical Activities

Re: Project No. 13-3, Economic Condition Reporting: Financial Projections

This email is in response to the GASB's request for comment on their Preliminary View paper entitled "Economic Condition Reporting: Financial Projections." After reviewing this paper, I would like to express my serious concerns on both the ability of local governments (especially smaller governments) to complete this additional work for the annual reporting requirements, and the projected methodology and bases to be governed by GASB in completing such statements. I would like to respond to the specific questions outlined in the paper.

### Question 1 - Five Components

If this preliminary work does result in a new GASB statement requiring the reporting of financial projections, I do not have general concern with providing projections of inflows, and breaking this down between the major inflows and an aggregate of non-major cash inflows, in dollars and/or percentage. However, I believe your perceptions in **Chapter 3**, **Paragraph 6** are contradictory and inaccurate.

"The Board believes that projections of major individual cash inflows (in dollars and as a percentage of total inflows) in comparison to the *total* cash inflows would provide users with the information they

need to assess a governmental entity's reliance on one or more sources of cash inflows, rather than having a diversified stream of cash inflows. The Board determined that a governmental entity's reliance

on limited sources of cash inflows does not necessarily indicate a lack of fiscal sustainability." Anytime major sources of revenue are singled out or categorized, I believe many users of the financial statements will draw the conclusion that the local government is too reliant on a particular source of revenue, unlike your comment above. Further, major revenues already are discussed in the Notes to the Financial Statements, statistical sections of the Comprehensive Annual Financial Report, and other reports submitted to rating agencies.

In **Chapter 3, Paragraph 10**, it is stated that it is important to reflect the "entity's ability to maintain or improve the delivery of public services" and "to honor current service commitments and meet its financial obligations as they come due." First, many of this issues related to meeting current financial obligations are discussed in the Management Discussion and Analysis section of annual financial reports and can be calculated or easily interpreted using various exhibits of the financial statements. As for the delivery of public services, the demands of the citizens often change from year to year, new mandates are handed down from federal or state agencies that force governmental entities to change the type of public service provided. Using only historical data to make future projections about outflows will not take this into account, especially when budgets approved by the governmental entities own governing board cannot be used as a reasonable basis for the estimation of outflows.

In **Chapter 3, Paragraph 11**, GASB has pronounced that these projections of outflows can be calculated either by function or object. I believe that if these projections are required in the future, they should only be allowed by function. Since historical financial data is reported by function in the financial statements, reporting future financial projections by object will provide no accurate basis for

comparison. Reporting projected financial outflows by object also increases the chances that the data cannot be used for comparison between governmental entities.

In **Chapter 3, Paragraph 15**, the financial obligations listed are already included as liabilities on the financial statements and discussed at length in the Notes to the Financial Statements, including the future payment requirements, parameters of debt service, pension obligations, revenue bonds, etc. Reporting this information, whether individually or in aggregate, creates additional work that is unnecessary. In addition, it is possible that your requirements for calculation of future obligations of this nature will differ from the established parameters already pronounced in previous GASB statements, creating confusion among the users of these statements about which set of information is reliable.

In **Chapter 3, Paragraph 23**, GASB has already noted that which was pointed out in my previous comment. Many of the items related to future debt service obligations already are stated within the required statements and notes. To restate information is not cost beneficial to the governmental entity or the user. I understand that you want to put these obligations in the context of the other projected future outflows; however, when the governmental entities cannot use reasonable, established practices as the basis of the outflows requested to be presented, then these comparisons will be inaccurate and give the user of the financial statements unreliable data.

# In Chapter 3, Paragraph 25, I refer to GASB's definition

"The Board believes that an intergovernmental service interdependency exists when one governmental entity provides a service on behalf of another governmental entity or together with one or more

governmental entities."

This definition does not coincide with what are considered intergovernmental service interdependencies for the purposes of reporting historical financial data. Again, users of the financial statements will not be able to accurate compare historical financial data with future projections and make reasonable assumptions.

### **Question 2 – Basis of Financial Projections**

While I believe that the three components of the basis of making and reporting financial conditions are important ones to include, I believe that only including these three basis points is limiting in providing a complete and more accurate projection. In reference to Chapter 4, Paragraph 3, you note the difference between projections and forecasts, noting that projections use known events while forecasts can also include unknown events. However, if the projections to be reported are to use only known events and conditions that exist at the time of the report, it makes the report less reliable than a forecast that takes into account conditions that are likely or have a high probability of occurring in the future. For local governments with experience in areas such as rate modeling, using forecasted rates would be a more accurate picture than only using current or enacted rates, as most local governments, while knowing what future rates should be for many services only enact them on a year-to-year basis, and your proposed rules would limit the use of such models. Furthermore, many government entities already adopt multi-year capital improvement plans. While these are subject to review and adjustment on an annual basis, they are the government's best estimated of future needs and costs. However, under your proposed rules, other models would have to be formulated that are in total disagreement with the plan approved by the entity's governing body and don't necessarily utilize a better model for incorporating future needs than the capital improvements plan. If users of the financial statements review a published budget document along with the financial projections included in the annual financial statements, this will likely lead to much confusion and possible distrust of the government entity about its ability to provide reliable information.

# Question 3 - Cash & Accrual Basis

I agree with the basis for inflows and outflows and financial obligations, GASB contradicts itself again in **Chapter 4, Paragraph 10**, and further complicates the process for the entity responsible for preparing these projections. It is stated that

"governmental entities are already preparing these financial projections on the cash basis of accounting."

While this may be true, the fact that in other sections of this prelimary view, the GASB has already stated entities can only use certain information and facts in completing these projections (because other information would be considered a "forecast"), makes your statement irrelevant and your proposal has little benefit to the entities that will be required to compute the information for these additional statements.

### **Question 4 – Identification & Development of Assumptions**

The principles listed are useful ones for local governments in developing assumptions, however I feel that using only these would limit the entity's ability to make comprehensive useful assumptions for the users of the financial statements. As stated in **Chapter 4**, **Paragraph 15** "inconsistent assumptions, could provide misleading information to users..." If a user is also referring to approved budgets and forecasts already created by the government entity which may be based on some likely, but specifically unknown assumptions, this also will be misleading to the users. Your example in **Chapter 4**, **Paragraph 16** is an example. Based on the preliminary rules, a government entity might know or feel that it is significantly likely that a 3 percent increases in property tax revenue is not likely to continue in say, year 4 of the 5-year plan, but could not report this information based on the criteria you have suggested because it does not fall under the rules stated in previous chapters and paragraphs.

#### **Question 5 – Period of Projections**

It seems reasonable that if this preliminary view comes to full standard, a five-year projection period is reasonable, with the caveat expressed as a response to Question 8 below. I feel that if this is implemented, the five-year period should be a firm number, not a minimum of five years for purposes of comparison between government entities.

### **Question 6 - Placement of the Projections**

I do not agree with the GASB on their position that these projections should be required supplementary information. I feel that this information may be useful, but not essential to the user of the financial statements. As previously stated, it is possible that these projections will conflict with forecasts and other projections already produced by the local government and approved the governing body. I also believe that auditors will have conflicts in reviewing this information in the same manner that they do other required supplementary information, whether the criteria for developing the assumptions for the projections remains as presented in this preliminary view or are amended prior to any possible statement formation.

## **Question 7 – Determination of Reporting Requirement**

As stated in responses to previous questions, my overall view is that this should not be implemented at all for various reasons. Many larger governmental entities create multi-year projections with their budget documents that use sound, relevant information. However, this requirement potentially be detrimental to small government entities who do not have the quantity of staff, expertise of staff, time or extra financial resources to complete these potential requirements. It appears this preliminary view is a reactive measure to the mismanagement of larger governments who have taken on too many future obligations without a proper plan for meeting service needs, debts and financial obligations and/or have implemented bad policies and practices that have led to these situations without proper oversight. Creating an extra reporting requirement will not solve these problems, only create additional burdens with very little benefit to the governmental entities and the constituents they serve.

#### **Question 8 – Phase-in Period**

If this preliminary view is formulated into a full statement required of government entities, then a phase-in period should not only be addressed based on the government size, but a phase-in of the total projection period of five years should allowed. GASB appears to fail to understand the impact this reporting requirement will have on local governments, nor does it appear to have a reasonable grasp on the information it is expecting to see in a projection period of up to five years. As stated in previous sections of the preliminary view, the longer the period of the projections, the more likely it is that the projections will be inaccurate. Stating with a shorted time period and better identifying the various measures, methods and assumptions that will be used by local government entities will provide the opportunity to make technical corrections and build up to a full five-year reporting period. Having this time to make adjustments will better ensure consistency and uniformity of the projections.

Thank you for your consideration of my comments on this matter.

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