

Response to GASB's Preliminary Views Economic Condition Reporting: Financial Projections

Kirk Schanzenbach, CPA, CFE, PMP

Overall, I believe that the preliminary views (views) represent a good step forward for improving government financial reporting. The views, if implemented as written, will provide useful information for all levels of government financial information users, particularly those that review and approve budgets. As outlined in my response to the questions laid out in the views, I am primarily concerned with balancing the cost of providing the information with the benefits of requiring the information, and attempting to provide for consistency and comparability between governments. I also offer several other suggestions.

The following are my thoughts/suggestions/considerations related to the above Preliminary Views document:

Question 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?

Agree with the 5 components of reporting for fiscal sustainability that are laid out. I would however add to them by also suggesting that the Board require:

- Reporting the difference between inflows and outflows for each year to clearly delineate the potential additional funding requirements in future years. While the examples show

this element, it would be best to show it as a required element because it is such an important piece of information. It demonstrates a gap in funding that needs to be addressed.

- A narrative in the Management Discussion and Analysis (MD & A) section to discuss any plans to address gaps in the difference between total cash inflows and outflows, in the funding mechanisms related to projections of the total financial obligations, and/or any disruptions in major intergovernmental service interdependences. If there are no plans to address these areas, the government should be required to so state.

Question 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?

Agree with this view. However, I suggest that the Board consider including additional standards to help promote consistency and comparability. Additional standards could include, but are not necessarily limited to (some may already be required or suggested):

- For cash inflows (revenues) that are adjusted annually based on budget needs (e.g., real property taxes), the projection should be based on the most recently adopted assessments and rate(s). The assessments and rates could be for the last or the next fiscal year, depending on which was last officially adopted.
- Where cash outflows (expenditures) are optional based on availability of funds (e.g., capital investment dollars included in the current budget), the projections should be based on an average of the last 3 to 5 years’ budgeted amounts or other objective measure.
- Where cash outflows (expenditures) are for operations/administrative expenses (e.g., staffing, supplies, etc.), they should be based on current rates, staffing and budgets unless there are specific changes adopted (e.g., next year’s budget, employee contracts, etc.).
- Financial obligation projections should be based on current GASB standards (e.g., pensions, postemployment benefits, etc.).

Question 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?

I suggest that the inflows and outflows be required to be projected on the same basis as the government presents their budgets. While budgets are generally developed on a cash basis, that isn’t always the case. If a government adopts their budget on a basis other than cash, it would be confusing and difficult for them to prepare financial projections on a cash basis. Regardless, a government should be required to explain any significant differences between their budget basis and the cash basis.

Agree that financial obligations should be projected on the accrual basis. The bigger question is whether and to what extent the calculation of financial obligations should include an element of discounted future values. This element should be clearly defined if the Board requires it.

Question 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?

Agree with this view. However, I suggest that the Board consider additional standards as outlined in my response to question 2, for the purpose of promoting consistency and comparability. In any case, as required, all significant assumptions should be disclosed.

Question 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?

Agree with this view. As pointed out in the preliminary views document, requiring one or two year projections would probably not be a sufficient time period for effective disclosure. In addition, requiring more than five year projections could create a more subjective environment and probably complicate the calculations by requiring estimation of future economic conditions.

Question 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 (RSI) (Chapter 5, paragraphs 7–12). Do you agree with this view? Why or why not?

Agree with this view. However, the Board should understand that the addition of all the components of fiscal sustainability as RSI will mean significant additional effort by the government staff and additional audit work during the annual financial audit. Therefore, the cost of producing the annual financial report and audit for governments where this information is required will increase. However, as a means to reduce the cost and complexity of implementation, the Board should consider a phased, extended implementation and exemptions for smaller units of government (as suggested in the response to Questions 7 and 8 below) and requiring only the reporting of inflow and outflow information for the general fund and governmental activities initially (as suggested in bullet #2 under Additional Potential Issues).

Question 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?

Suggest that the Board consider providing for an extended implementation period for or exempt very small units of government from reporting this information. Small could be defined as having a population of anywhere from less than 1,000 to less than 5,000 (or other objective measure). While acknowledging that taxpayers and governing board members might be interested in the information, I believe that the users in the financial markets are generally not significantly concerned with governments in that size range. Of course, smaller units of government could voluntarily comply with the requirements.

Question 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)?

Suggest that the Board consider phasing-in the requirements by size of the government, with the largest governments being asked to include this information in RSI first. That way the medium and smaller governments will have a template to follow and the benefit of the experiences of the larger governments. In addition, maybe there should also be an adjustment period between implementation by the largest and the medium size governments. This adjustment period could allow for implementation learning adjustments to the methodology and requirements by GASB.

Additional Potential Issues

These may be additional potential issues the Board may want to consider as they advance to the next review phase:

- Agree with the definition of fiscal sustainability, including the ability and willingness components. I also agree with the Boards preliminary views decisions, as presented in Chapter 3, paragraph 27, item (c) (political ability and willingness....). However, I suggest that the extent of any use of the information outlined in Chapter 3, paragraph 27 and other related information should be disclosed.
- The extent that projections for inflows and outflows are required should be considered carefully in the process for each type of activity: governmental, business-type and component units. The more types that are required to be included in the projection process the greater the complications and cost of implementation. For example, the implementation could start with requiring just the general fund for reporting inflows and outflows. It could progress to including all governmental activities. Business-type activities and component units could be added to the requirements at future dates, as the Board deems necessary. The projections for financial obligations and the intergovernmental interdependencies should be required on the government-wide basis.
- If future economic conditions are required to be factored into the projections (not recommended), the Board should define a standard that should be used or allowed in the projections in order to promote comparability across governments.
- The Board should consider a better definition than “professional judgment” for intergovernmental service interdependencies disclosures. Maybe a definition similar to those for major inflows and major outflows would be appropriate (e.g., a program with revenues of 10% (or other appropriate percentage) of total revenues/inflows provided by another government should require disclosure of any material changes that are planned).
- Chapter 5, paragraph 28 (Cautionary Notice), is very important and I agree with the Board decision to require it to be included in the financial statements where projections are required.