Letter of Comment No. 52
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City of Golden

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Director of Research and Technical Activities
Governmental Accounting Standards Board

Via EMAIL

Re: Comments on Preliminary Views – Economic Condition Reporting: Financial Projections

Dear Director and Members of the GASB Board:

I have read the Preliminary Views (PV) document related to Economic Condition Reporting: Finance Projections. After much review and contemplation, and for a variety of reasons (as explained below), I am opposed to the majority viewpoint on this issue. More to the point, I don't feel this topic falls under the purview of the GASB, and I strongly encourage the GASB to cease work on this topic.

Financial Projections do not fall under the purview of the GASB

By definition, accounting is the methods involved in making a financial record of business transactions and in the preparation of financial statements. The GASB is tasked with setting the standards for government entities to follow to properly record transactions and prepare financial statements. Financial projections are not transactions that have occurred; they are a look into the future. Thus, financial projections do not fall under the definition of accounting, and they do not fall under the purview of the GASB.

This is a topic better addressed by the GFOA and their recommended best practices.

Financial Projections should not be part of the CAFR

The CAFR is a factual document that contains historical financial information, audited financial statements, and known, committed future financial obligations. Putting this degree of nonfactual information in the CAFR potentially undermines the credibility of the CAFR.

When the GASB itself acknowledges that, "...projections based on current policy do not represent a forecast or prediction of the most likely outcome...Therefore, a cautionary notice would precede the displayed financial projections and related narrative discussions advising readers that actual results may vary from the financial projections reported", the credibility of the information is already tainted and reflects poorly on the entire CAFR.

It does not make sense to me, and it flies in the face of the nature of the CAFR, to put projections in the CAFR, especially when those projections are inherently inaccurate and don't even necessarily reflect a best guess.

Five years of required projections is too long

For governments that prepare biennial budgets, the second year is rarely accurate. It is either amended (if adopted at the same time as year one), or changed before adoption. It is unrealistic to assume that the projection for year five would be even close to being accurate. I do not see a benefit to publishing five-year projections that are inherently and potentially grossly inaccurate in the CAFR.

Financial Projections should not be mandated

In general, it makes sense for a government to talk about its economic condition and fiscal sustainability. And, I agree that most government entities already have this information and conduct some level of discussion with their governing body and citizenry about their financial future. However, I don't feel that it is the GASB's role to mandate that all governments must prepare and publish financial projections.

There are a variety of valid reasons for a government entity to withhold this information from the public view for any given period of time. The farther out a projection goes, the more speculative it becomes. Using Illustration 2 on page 34 of the PV, informing the Council, employees, and citizens that, at the end of a three year period beginning in year 20X4, the entity may be over $19 million in the hole, could cause wide-spread panic and a series of knee jerk reactions. Lay-offs, cuts, furloughs, etc. may be instituted, potentially causing employees to start looking for work elsewhere, which typically results in the best employees leaving first as they are the most marketable; needed capital projects may be unnecessarily delayed; etc. In my opinion, the benefits of providing this information do not outweigh the potential negative consequences. An alternative approach might be for the City to change current policies and tone down the impact of the projection. Then, the Council, employees, and citizens may be given a false sense of security initially. If those projections prove to be grossly inaccurate, then the management and budget staff will have their heads on the chopping block.

The point is that each entity and their governing board should be allowed to determine what is in the best interests of their community – what information is made public and the timing of providing that information.

The timing of the information lends to inherent inconsistencies

Assuming a government entity's fiscal year is the calendar year, a 2011 CAFR would generally be completed in June 2012. The PV would require RSI showing 2011 actual information, and projections for 2012-2016 based on the criteria of the PV (current policy, historical information, and known events and conditions). For most governments, sometime during September to early December 2012, the 2013 Budget will be proposed and adopted. I believe it is a given that the adopted 2013 Budget will be different – potentially significantly different – than the projection in the RSI of the 2011 CAFR prepared just 3-4 months earlier.

To take this a step further, assume that this PV was adopted and in effect for fiscal years ending in 2007. Projections in the RSI of the 2007 CAFR's would show a very promising and bright future. Then the recession hit in the 4th quarter of 2008. What would be the value of those projections in the RSI of 2007 CAFR's?

Inconsistencies lead to a lack of confidence in the ability and reliability of staff

As described above, the PV proposes projections that are inherently inaccurate and the timing of such information leads to further inconsistencies. It would be naïve to think that these inaccuracies and inconsistencies would not reflect poorly on the budget and finance staff responsible for producing the information. The staff can certainly provide the suggested disclaimers and explain the variances. But, eventually, Council and the public would grow tired of the "excuses" and lose confidence in the abilities of those finance professionals.

Local Governments are required to prepare balanced budgets

Regardless of what projections may look like, local government officials know that they will prepare and propose balanced annual budgets to their governing board. Given all the potential pitfalls that can come from preparing projections as illustrated in the PV, I believe there could be a tendency at the local level to have policies in place that mandate that projections of future cash inflows and outflows shall balance. While the projected inflows and outflows would still be inherently inaccurate, the resulting bottom line projection is probably more accurate than the examples in the PV.

Financial Projections are more appropriate for the Budget document

The Budget is the document used by government entities to look towards the future. By its nature, it provides projections, predictions, and forecasts. It also has a far better chance of providing the "most likely outcome", something that the GASB acknowledges that the RSI required by the PV would not do.

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Response to the Questions for Respondents in the PV

1. In general, I am fine with the five components identified in the PV. However, I would suggest adding another component – Projections of beginning and ending cash or fund balance. The projections of excess (deficiency) of cash inflows and outflows has more meaning when netted to beginning cash or fund balance to determine the projected ending cash or fund balance.
2. I disagree. I believe that projections should attempt to convey the most likely outcome and should include a narrative that explains the assumptions used to arrive at those projections.
3. I believe that financial projections belong in the budget document. As such, the projections should be presented using the same basis as that entity's budget.
4. Again, I believe that the projections, and the assumptions used to arrive at those projections, should be based on the best information possible to present the most likely outcome. The assumptions should be consistent (where appropriate) and comprehensive by considering significant trends, events, and conditions.
5. I disagree that the projections should be for a minimum of five years. As stated earlier, I don't believe that projections should be mandated at all. I would recommend that government entities be encouraged to present at least 3-5 years of projections.
6. I strongly disagree that this information should be RSI in the CAFR. The Transmittal Letter discusses the community's Economic Condition and Outlook. I believe that is sufficient disclosure in the CAFR. The Transmittal Letter could also refer readers to the Budget or other documents for additional information on projections, fiscal sustainability, etc.
7. I strongly disagree that financial projections and related narrative should be required reporting. Again, I believe this topic is better addressed by GFOA and their recommended best practices.
8. If the GASB continues to move forward with this project, I believe a phase-in period similar to the implementation of GASB 34 would be appropriate.

In conclusion, for all the reasons described above, I strongly feel that the financial projections contemplated in the PV do not belong in the CAFR in any way, shape, or form. If they belong anywhere, they belong in the budget document. Even more importantly, I don't feel that this is a topic that falls under the purview of the GASB, and I encourage the GASB not to stray from their intended role in the future. If anyone at the GASB would like to discuss this with me further, I can be reached at 303-384-8020 or jhansen@cityofgolden.net.

Sincerely,

Jeffrey A. Hansen
Finance Director