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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

March 15, 2012

Mr. David R. 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

Dear Mr. Bean:

We have read the Governmental Accounting Standards Board's (Board) preliminary views (PV) on major issues related to *Economic Condition Reporting: Financial Projections* and primarily agree with the alternative view expressed by a minority of the Board in that we do not consider financial projections and the related narrative discussions as essential for placing the basic financial statements and notes to the basic financial statements "in an appropriate, operational, economic, or historic context" (GASB Concepts Statement 3, paragraph 42). As such, we do not agree that this information should be required supplementary information in an annual financial report (AFR) or a comprehensive annual financial report (CAFR). This information seems more appropriate in a separately issued report as some governments have done, as mentioned in paragraph 10. Our responses to the questions posed by the Board in the PV are not intended to reflect agreement with the majority view expressed in the PV but rather to provide feedback on the specific issues raised in each question.

Questions for Respondents

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).*

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Do you agree with this view? Why or why not?

In theory, we would agree that, as a group, the above mentioned information would be a basis to assess a government's fiscal sustainability. However, of the five components listed, we consider comparisons of projected cash inflows (Component 1) and projected cash outflows (Component 2) as the key aspects of assessing fiscal sustainability.

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?

It seems as though a wide range of financial projections could be reported and still be justified as under "current policy," such that we would still consider such projections as very subjective. We view financial projections as inherently reliant upon assumptions of what will happen in the future. For example, if a government has not granted a raise to its employees in the past three years, is a projection of no increases in the future appropriate, or is it more appropriate to assume that since they have not been granted a raise recently that raises in the future are likely? Or, if the long term trend is to show wage raises of approximately 1 percent per year and yet other shorter term trends show a government's primary tax base as declining, is it appropriate to project wage expenses as increasing when it is possible that there may need to be layoffs due to an eroding of the tax base? If these projections were simply mathematical logarithms of what has occurred in the past, we would not view that as necessarily useful information since past experience is not necessarily an indicator of future results. Even if the Board required projections to be based on items a. through c. as posed in the above question, key assumptions in the projection should be disclosed in the notes to this information.

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?

We do not agree with this view. Most users of governmental financial statements have become accustomed to interpreting financial statements on a modified accrual or full accrual basis. Requiring the use of a cash basis of accounting introduces an additional inconsistency within an annual financial report or a CAFR and is another reason why we would consider this type of information to be more appropriately reported in a document separate from an AFR or CAFR.

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,

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events, and conditions (Chapter 4, paragraphs 13–16). Do you agree with this view? Why or why not?

While we view assumptions as necessary in developing projections, we also consider these assumptions as the primary reason why projections are subjective in nature. Projections should be based on what the entity thinks will happen in the future, which might not necessarily be based on past results. Projections of major revenue inflows such as sales taxes, income taxes, and property taxes would seemingly need to be based upon assumptions of the overall economy, retail sales, wages, and real property values. If the Board were to require financial projections as RSI an AFR or a CAFR, we suggest that key assumptions be included in notes to the RSI.

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?

We do not share this view. Any such projections should be of a short term nature, no more than 2 years. Any projection includes uncertainty. Going beyond 2 years introduces far too much uncertainty to be useful, or place any reliance on. This is especially true for larger entities such as states. There are far too many variables, including elections, which can result in fundamental policy changes that would make longer term projections extremely speculative.

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 share this view. Existing disclosures regarding debt service, pension and OPEB liabilities, lease commitments, contingencies, etc., provide users with sufficient details regarding known facts as of the date of the financial statements. In addition, existing accounting and auditing standards regarding an entity's ability to continue as a going concern provide users with sufficient information to assess the near term fiscal sustainability of a unit of government.

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?

Since pension plans already take the step of obtaining an actuarial report to attest to its fiscal sustainability, we suggest that AFR or CAFR's of pension plans not be subjected to this type of reporting. With that in mind, we support applying accounting standards to all units of government in a uniform manner, rather than attempting to establish GAAP for differing sizes of entities.

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

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governmental entities over certain dollar thresholds to implement first)? If so, what phase-in criteria -would you recommend (Chapter 5, paragraph 14)?

If the Board requires projection information to be included as RSI, a phase-in approach should be used. Sophisticated entities such as states that have budget offices and fiscal support staff would be better prepared to create the voluminous schedules required in the PV as compared to smaller governments. If the Board were to proceed with this project, we suggest that states be the first to implement such reporting, followed by very large municipal governments (more than \$1 billion of net assets) and then all other governmental entities.

We appreciate the opportunity to provide feedback on these important issues. If you have any questions regarding our comments, please contact me or Craig M. Murray, C.P.A., Director of Professional Practice.

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General

Via e-mail