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Letter of Comment No. 79
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March 14, 2012

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

Dear Mr. Bean:

Re: Preliminary Views (PV) on Economic Condition Reporting: Financial Projections

The Large Public Power Council (LPPC) is an organization comprised of 25 of the nation's largest locally owned and controlled, not-for-profit power systems. The American Public Power Association (APPA) is the national association representing the interests of the approximately 2,000 locally owned and controlled, not-for-profit power systems. As units of state and local government, public power systems typically are required to follow the pronouncements of the Governmental Accounting Standards Board's (GASB). The LPPC and the APPA appreciate the opportunity to respond to GASB's Preliminary Views (PV) on Economic Condition Reporting: Financial Projections.

General Comments

Overall, we have some very serious concerns with the PV as it relates to governmental entities in general and, particularly, as it relates to public power companies. In our case, we believe that the PV would place public power at a strategic and competitive disadvantage with investor owned utilities. The proposed five-year projected statement of cash inflows and outflows is not required financial information in the annual report to the stockholders nor in the financial statements filed with the Securities and Exchange Commission (SEC) in Form 10-K nor any supplementary information to the financial statements. The limited forward looking information that investor-owned utilities (IOUs) provide is protected under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Public power does not enjoy this protection. In some cases, i.e. mergers, projected data is provided by IOUs as unaudited information. If the Financial Accounting Standards Board (FASB) and the SEC do not require projected cash flow statements in annual reports to the stockholders in a market-driven environment, why should GASB require this highly subjective information from governmental entities?

In addition we are concerned about the subjectivity of financial forecasts, and the potential for such information to be misleading to readers, which would increase liability for our members. In our opinion, the information required under GASB 38 discloses in the notes to financial statements adequate forward-looking information with minimal subjectivity.

These are:

- Debt service requirements to maturity, identifying principal and interest for the subsequent five years and in five-year increments thereafter
- Obligations under leases for each of the five subsequent years and in five-year increments thereafter

These are based on outstanding obligations at the date of financial statements without any projections.

Finally, our members are concerned about the increased costs to comply with the proposed requirements and litigation risks of making financial projections. The proposed requirements are burdensome and far outweigh the benefits, if any, to users of the annual reports and related supplementary information.

Responses to the specific questions from the Board are listed below:

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. Do you agree with this view?

   Response: LPPC and APPA disagree with a mandatory requirement to include in comprehensive annual financial reports (CAFR) or annual financial reports (AFR), hereinafter referred to as annual reports, any of the five components listed. Components 1 and 2 related to projected cash inflows and outflows for five years are especially troublesome due to the subjectivity involved, the strategic and competitive disadvantages, and risks of litigation. The revenues of many member companies include a significant amount of off-system sales that could vary significantly based on the electric's generation capacity in any given year and economic forces.

   Long-term financial projections are highly subjective and are more appropriately developed for internal financial planning purposes. The annual report is meant to provide historical information and should only provide forward-looking information for the financial implications of known events that have actually transpired before the end of the year and prior to the issuance of the annual report.

   Moreover, many of the key assumptions underlying financial projections for public power entities are highly sensitive. For example, disclosing assumptions regarding fuel prices, off system sales volumes, hedging positions, or other business planning strategies could negatively impact negotiations for fuel and power contracts (the largest expense for our members). Similarly, disclosure of projected salary adjustments or other benefit levels could impact union negotiations in future years. Our members have equal concerns regarding disclosure of assumptions regarding any adjustments to customer rates. The disclosure of these and many other assumptions could put public power entities at a serious competitive disadvantage to IOUs.

We are also concerned about additional cost and time required to prepare such forecasts for inclusion in the annual report. Most LPPD or APPA members that issue bonds are required, as specified in their bond resolutions, to deliver audited financial statements to their bondholders or trustees within a specific number of days after year end. In order to comply with the proposed five components, our members will be faced with additional preparation time and additional audit time which may lengthen the final completion date for the audited financial statements and possibly cause the required delivery date to be missed. Finally, governmental entities will need to hire outside consultants, such as actuaries to calculate projections for pension and other postemployment benefits that will assist the entity in satisfying the new requirements. These consultants will add time and cost to the preparation of the financial statements and resulting issuance of the final audit.

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

   Response: We agree that the proposed methodology represents a proper basis for making financial forecasts to be used internally by utilities, but disagree that projections should be included in annual reports. Financial forecasts are planning tools used in the decision making process of individual entities and not supplementary financial information that should be included in annual reports. Other related rationale for consideration is expressed throughout our comments.

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

   Response: We do not believe cash inflows and outflows projections, whether cash or accrual, should be included in the annual report. Forward looking information is already required by current standards such as future payments associated with capital and operating leases, capital expenditures, debt service to maturity and other disclosures. To project in the annual report cash flows for anticipated debt service not issued that may or may not take place in the future would create, at a minimum, confusion to the reader of financial statements. Conflicting information could appear between the notes to the financial statements and the supplementary information. The fact that the preliminary views state some information would be on a cash basis and others on an accrual basis is by itself confusing. If the Board is not persuaded by our arguments and proceeds to issue an exposure draft, we suggest that the Board incorporates only the accrual basis to be consistent with the rest of the financial reporting documents.

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

Response: We agree with explaining the basic standardized set of principles and underlying assumptions in making any financial projection. The problem lies with including this highly subjective and sensitive data in the annual report. In addition to the sensitive nature of underlying assumptions (see response to Question 1), our members are concerned about the lack of specific guidelines in their development. We believe GASB would need to provide more prescriptive guidelines on how to project weather patterns, gas prices, off-system sales, general economic conditions and many other factors that could significantly impact the outcome of the projected information.

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

   Response: Many of our members prepare five year financial plans, to use as internal strategic planning tools. Therefore, we agree in principle with the Board's view. However, these plans are generally high level in nature, often include multiple scenarios, and do not contain detailed forecast of inflows and outflows. While based on the best information at the time, the longer the forecast period, the less reliable the data becomes. Our members make a distinction between a) disclosing forward looking data for <u>known events</u> as of the end of the period, and b) making financial projections for possible events that may or may not take place in the future. We believe GASB should continue requiring disclosure of known events.

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

   Response: Our members do not agree that financial sustainability can be determined through accounting means. We do not believe that it is appropriate to place financial statements in an operational or economic context. In fact, we believe that the Board is considering adopting a statement that is contrary to the essence of accounting principles. The function of accounting is to record past and present transactions and to report the information based on Generally Accepted Accounting Principles (GAAP). Adoption of these concepts as part of GAAP for government entities, not only would provide potentially misleading information to users of financial statements, it will be an open invitation to future lawsuits thus exposing our members to significant risks.

7. The Board's preliminary view is that all governmental entities should be required to report financial projections and related narrative discussions. Do you agree with this view? Why or why not?

Response: Our member companies do not agree that financial projections and related discussions should be included as required supplementary information in annual reports of any governmental entity for the reasons stated previously throughout our response.

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?

   Response: The proposed reporting requirements should not be adopted by GASB. If, in spite of all of these concerns, GASB decides to adopt a standard, ample training should be provided and legal advice should be sought by GASB prior to issuance. Also, entities will need to plan for additional expenditures and resources to comply with such a requirement as the stated disclosures would increase the time and costs of compliance. The entities will also need to plan and get approval for additional costs for external auditors and other third-parties (i.e. actuaries) who will likely have to review all the disclosure information requirements.

Summary

The LPPC and the APPA endorse the alternative views expressed in the PV by two board members. The projected financial information is subjective, not in accordance with the basic principles of accounting, could impact the timeliness of the preparation of the reports, provides confidential information to competitors and it is not cost-justified. If GASB is not persuaded by these arguments, at a minimum, we request that GASB take into consideration the nature of public power and the disadvantages public power would face in an environment that is becoming more competitive.

Again, we thank GASB for the opportunity to provide comments on GASB's Preliminary Views on Economic Condition Reporting. Please feel free to contact us if you have any questions or would like to discuss any of our comments.

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American Public Power Association, Diane Moody, 202-467-2979