



STATE OF WASHINGTON

OFFICE OF FINANCIAL MANAGEMENT

Insurance Building, PO Box 43113 | Olympia, Washington 98504-3113 | (360) 902-0555

March 16, 2012

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: Preliminary Views – Economic Condition Reporting: Financial Projections

Dear Mr. Bean:

On behalf of the Washington State Office of Financial Management (OFM), we appreciate the opportunity to offer the following comments on the Governmental Accounting Standards Board's (GASB) Preliminary Views (PV) on major issues related to Economic Condition Reporting: Financial Projections. OFM serves as the state's controller, issuing all state accounting and reporting policies as well as the state's Comprehensive Annual Financial Report (CAFR).

General Comments

We believe that fiscal sustainability is an important issue, but we strongly disagree with the Board's conclusion that the CAFR is the correct place to report financial projections.

We concur with the two dissenting members of the Board that much of the information that users could use to reach their own conclusion on future fiscal sustainability is presently available in the CAFR. The CAFR already presents (or soon will) sufficient information on the elements of economic condition related to a government's financial position and its fiscal capacity to meet financial obligations. The government-wide statements required by Statement 34 were designed to address interperiod equity:

- Did current resources pay for current year services?
- Did financial position improve or deteriorate during the year?

Current requirements to disclose debt service requirements in future years and the current pension project provide (or soon will) adequate information on the largest financial

David R. Bean
March 16, 2012
Page 2 of 6

obligations that are not discretionary. Information in the statistical section provides operating trend information to allow financial analysis.

When the GASB asked users what they wanted, did they share with the users that there would be a cost to providing additional data in terms of resources and timeliness? Governments have to make hard choices when allocating resources, and services to citizens nearly always win out over additional reporting costs. We are working with very limited resources. The financial community wants more timely financial data and the GASB wants more and more of it - we simply cannot do both. Also, we are at the point of providing the reader with so much data that, as a recent report by KPMG LLP and the Financial Executives Research Foundation noted, it has diminished the overall value of the information. Washington's fiscal year 2011 CAFR was 287 pages.

We disagree with the notion that a government's willingness to meet commitments to provide services on an ongoing basis is a reflection of economic condition. State and local government services are directly related to current revenues – there is no commitment beyond that. The decrease in revenues associated with the recent economic downturn is directly reflected in a decrease in government provided services. State and local governments have balanced budget and debt limitation restrictions; the federal government does not balance its budget and routinely raises its debt limit. Suggesting that state and local governments should prepare projections similar to the federal government does not recognize these fundamental spending differences.

We believe the requirement to report financial projections as Required Supplementary Information (RSI) will impact the timeliness of the CAFR. This impact will be seen both in the preparation of the CAFR and with the CAFR audit. Auditors are facing many changes in accounting, auditing, and federal standards as well. Adding additional items for the auditor to provide reasonable assurance on will likely increase the time needed for the CAFR audit.

Washington State currently does not make projections at the detail level proposed in the PV, and there is no central source to obtain this data. Our inquiries of agencies indicate that it would be very time intensive to obtain the required data and that some external assistance - such as actuarial - would be needed. Projections should be made by someone with the appropriate skill and training for making projections (i.e., an economist or a certified actuary). This would require the state to incur costs at a time when resources are already limited. Also, every agency contacted indicated that they would not be able to meet existing CAFR reporting deadlines if the financial projection information was required.

For all of these reasons, we strongly disagree that financial projections belong in the CAFR. Projections are available to support state budget processes and bond issuances. These projections are prepared on a quarterly basis, and are readily available on the state's website. It is not cost beneficial to restate this information and produce additional projections in the CAFR especially considering the adverse impact to its timeliness.

David R. Bean
March 16, 2012
Page 3 of 6

Our comments in response to the specific questions posed in the PV are as follows.

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:

- § 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*
- § 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*
- § 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 known causes of fluctuation in financial obligations*
- § Component 4 – Projections of annual debt service payments (principal and interest)*
- § Component 5 – Narrative discussion of the major intergovernmental service interdependencies that exist and the nature of those service interdependencies*

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

We do not agree with this view. While this information may be useful to users in assessing the state's fiscal sustainability, we do not agree that the CAFR is the correct vehicle for reporting this information.

Components 1 and 2 –The CAFR is an annual financial report including historical and known information relating to the current year. Washington State concurs with the two dissenting members of the Board who believe that forward-looking financial information is subjective. Projections are also susceptible to change due to changing economic conditions. In Washington, an independent agency that is not part of either the Executive or Legislative branches forecasts General Fund state revenues on a quarterly basis for the current and ensuing biennia. The forecasts are prepared by professional, nonpartisan economists. They are updated quarterly and readily available to the public on the state's website. To duplicate this information with static data in the CAFR would be of no value. Not only would it be outdated by the time the CAFR is published, but users might place undue reliance on it since it would be included in an audited report.

Component 3 – The CAFR already presents sufficient information related to bonds and long-term contracts in the notes to the financial statements. Reporting the same information in another section of the CAFR would be duplicative. Additional disclosures related to pensions and other postemployment benefits are already included in the GASB's *Accounting and Financial Reporting for Pensions and*

David R. Bean
March 16, 2012
Page 4 of 6

Financial Reporting for Pension Plans and the Postemployment Benefit Accounting and Financial Reporting Exposure Drafts. Also, the Washington State Treasurer's Office publishes a readily available annual *Debt Affordability Study* that comprehensively and clearly displays information about all of the state's debt obligations.

Component 4 – The CAFR already presents projections of annual debt service payments (principal and interest). The PV proposes adding the disclosure of debt service payments for debt obligations that have been authorized but not yet issued at the end of the reporting period, starting at the expected issue date. Even though the debt has been authorized, often it is not known when this debt will actually be issued. The total amount of bonds authorized but not yet issued is already disclosed in our CAFR, and we believe that information is sufficient since the state only issues debt for capital purposes. To project debt service for debt that has not been issued yet crosses into the territory of speculation.

Component 5 –We agree that a discussion of intergovernmental service dependencies would be appropriate, although not in the RSI. One of the major intergovernmental dependencies for the state is with the federal government. We already include a discussion about federal assistance in our commitments and contingencies note disclosure. It seems more appropriate to include information in the commitments and contingencies disclosure about this, rather than creating a new disclosure in the RSI.

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?*

We disagree with this view. We don't agree that the proposed financial projections should be required to be disclosed in the CAFR, and we don't agree that current policy is an appropriate basis for financial projections. Current policy is only good until the next legislative session. With all of the House and one-third of the Senate up for election every other year, current policy should not be assumed to represent future policy, and therefore is not a good base for projections.

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?*

We do not agree. The cash basis requirement is inconsistent with the Board's focus on accrual based information. Our government-wide statements are reported using the accrual basis and our fund statements are reported using the modified accrual basis. The statistical section is presented using the accrual and modified accrual basis of accounting. To add another basis of accounting for financial projections would add complexity and further confuse users who are already confused with the number of different bases of accounting used in reporting.

David R. Bean
March 16, 2012
Page 5 of 6

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 assumption and (b) comprehensive by considering significant trends, events, and conditions. Do you agree with this view? Why or why not?*

Because we do not agree that financial projections should be required to be reported in the CAFR, we do not have a response for this 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. Do you agree with this view? Why or why not?*

We disagree with the requirement for financial projections for a minimum of five years. If these projections are required, we believe they should only be reported for the current budget cycle, which would be two years at the maximum. Policy changes occur during each budget cycle due to both turnover of legislators and changes in the economic environment. Any time period beyond the current budget cycle would be difficult to project accurately. Since this information is already available in the state's budget documents, we would prefer to see a requirement for a disclosure in the CAFR of where to obtain the budget documents rather than requiring the information to be duplicated in the CAFR.

6. *The Board's preliminary view is that all of the components of fiscal sustainability information are essential for placing 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?*

We strongly disagree that this information is essential. The proposed financial projection information is subjective. As pointed out in chapter 6 (alternative view) of the PV, GASB Concepts Statement 3, paragraph 44 describes the types of information that should not be reported as RSI, and says, "RSI may include explanations of recognized amounts, analysis of known facts or conditions, or other information essential for placing the basic financial statements and notes to basic financial statements in context. However, RSI does not include (a) subjective assessments of the effects of reported information on the reporting unit's future financial position, (b) predictions about the effects of future events on future financial position, or (c) information unrelated to the financial statements." We believe the proposed projections fall under the categories of subjective assessments and prediction of future events, and therefore should not be reported as RSI.

David R. Bean
March 16, 2012
Page 6 of 6

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?*

We do not agree. We do not believe that the CAFR is the appropriate place to report financial projections. The audit opinion lends substantial credibility to the information contained in the CAFR. Although the auditors do not provide an opinion on every component of the CAFR, readers might incorrectly conclude that the projections have been audited and they may place more reliance on the financial projections data than is merited.

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?*

We do not agree that this information should be reported in the CAFR. However, if required, we believe that smaller governments that are less complex should be the initial governments to implement the proposed requirements. Since state governments are much more complex, we believe they should be given much more time before implementation.

We appreciate the opportunity to participate in the GASB's due process and thank the Board for considering our views. However, we strongly urge the GASB to reconsider and discontinue this project. If you have any questions regarding this response, please contact me at (360) 725-0185.

Sincerely,

/s/ Wendy Jarrett
Statewide Accounting Manager