Letter of Comment No. 125 File Reference: 13-3PV Date Received: 3/16/12



March 16, 2012

Mr. David Bean
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Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Project No. 13-3

Dear Dave:

We are providing comments on the Governmental Accounting Standards Board's (GASB's) Preliminary Views 'Economic Condition Reporting: Financial Projections (PV)', dated November 29, 2011. In assessing the concepts presented in the PV, we agree the financial statement user community requires forward looking information to assess a government's fiscal sustainability, however, we strongly disagree such information should be incorporated into an Annual Financial Report or Comprehensive Annual Financial Report. We support the conclusions detailed in the Alternative View presented in PV Chapter 6.

We believe there are fundamental differences between accounting/financial reporting requirements addressing historic, known events and the contemplated PV financial projection requirements that would be applied to Pennsylvania's future economy. Current GASB reporting requirements yield financial statements which are based on actual, factual information. We contend the GASB should retain fact based financial reporting and avoid speculation and subjective reporting as provided in the PV. Incorporating financial projections into the GPEFR will open the reports to financial statement user misinterpretations by introducing a presumed but nonexistent level of assurance that the projections are audited and accurate as consistent with the traditional GPEFR reported information. The definitions of 'reported' (within the financial statements themselves) and 'disclosed' (within the notes to the financial statements), along with the term 'present fairly,' must not be diminished by the inclusion of financial projections within general purpose external financial reports (GPEFR). We firmly believe the financial statement user community relies on the GPEFR to timely communicate financial results based on actual known balances and transactions for events which are known, rather than projected or extrapolated.

In Pennsylvania, the Governor's Budget Office presently formulates projections for budgetary purposes using primarily cash receipts and disbursements. These projections are included in the annual proposed budget and are based on applicable Pennsylvania laws, regulations, and/or policies and expected economic factors; they are not based on GASB accounting and financial reporting standards. We believe financial projections are best presented in budgetary and programmatic formats for funding decisions and are not suitable or appropriate for GPEFR.

We regard the perceived user needs for inclusion of financial projections and other information about the future within GPEFR as contradictory to users' longstanding desire that state and local governments issue GPEFR on a timelier basis. We believe the inclusion of the contemplated financial projections would substantially delay the issuance of GPEFR and, therefore, not meet user needs. The GASB has periodically expressed its interest in the timeliness of financial reporting and supports the goal of faster financial reporting.

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For example, in its March 2011 Research Brief 'The Timeliness of Financial Reporting by State and Local Governments Compared with the Needs of Users,' the GASB clearly presented its survey results that the utility of GPEFR to users deteriorates with the passage of time. We agree with the conclusions in the Research Brief about the diminished utility of financial statements as a function of the length of time to prepare, audit and issue such financial statements. Preparing basic financial statements in accordance with existing GASB requirements is an enormous, complex and costly task. We have spent, and continue to spend, exhaustive planning and staff hours working on ways to issue a quality Comprehensive Annual Financial Report (CAFR) faster. Pennsylvania has a devoted and qualified staff that prepares the CAFR each year based on existing GASB requirements. Within its CAFR reporting staff, Pennsylvania does not have dedicated staff resources which specialize in projections. Developing and calculating the projections as contemplated in the PV would require Pennsylvania to add special skills and staff resources to its CAFR reporting team at a time when annual staff reductions are routine. Both the GASB and the financial statement user community must clearly understand that introducing financial projections into the CAFR will significantly delay CAFR issuance, increase costs to produce the CAFR, and diminish the usefulness of the CAFR to users.

GASB Board members need to be mindful of the information already incorporated into GPEFR such as the Supplemental Information which provides 10 years of factual financial trends and demographics; the financial outlook presented in the Managements Discussion & Analysis; and the debt and long term commitments presented in the CAFR notes, as well as other existing publicly available information such as the budgetary policies, economic forecasts, and financial assumptions and projections available in government annual budget documents and programmatic reports. We recommend that GASB discontinue the current path of developing a standard that incorporates financial projections into the GPEFR and, instead, ensure that users are aware of the existence of budgetary projections currently provided via the state and local government budgetary processes and sources. If the currently available budgetary information is deemed incomplete by the GASB, we recommend GASB consider developing a standard that requires a separate report provided independent of the Annual Financial Reports and CAFRs.

We have included as an attachment to this letter, our responses to the eight questions for respondents included in the PV. We hope that the GASB will give our comments serious consideration. Please direct any questions to me at akiehl@pa.gov or (717) 787-6496.

Best regards,

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Anna Maria Kiehl

Attachment

cc: Mr. R. Kinney Poynter, NASACT Michael Burns Lauren Dungan Eric Bartholomew Mr. David Bean March 16, 2012 Project: 13-3 Page 3

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(Attachment)

'Questions for Respondents' - Commonwealth of Pennsylvania Responses/Comments

We disagree with the PV.

We can agree with the definition of economic condition if two words -- 'and willingness' -- are removed. We believe that GASB Statement 44 "Economic Condition Reporting: The Statistical Section" (GASB 44) continues to sufficiently communicate economic condition to financial statement user community/constituencies/groups (users) and that no further GASB action is required in the context of economic condition. We do not agree with the content in Chapter 2 [paragraph 4]. 'Willingness' cannot be quantified and should not be included in general purpose external financial reports (GPEFR) in any way.

The PV states that economic condition and fiscal sustainability are related. We believe that fiscal sustainability is very similar to economic condition but is distinguished from economic condition in a way that would be detrimental to the general public's understanding of GPEFR. The general public may not understand that 'Fiscal sustainability is the forward-looking aspect of economic condition.'

GPEFR cannot serve as a single source, document or location to meet all user needs (Chapter 1 paragraph 8). Fiscal sustainability, as defined and used in the PV, should not be and cannot be an objective of financial reporting or GPEFR.

From a practical standpoint, developing and producing the five components for inclusion in GPEFR in strict accordance with the contemplated 'Basis and Methodology for Projections' in Chapter 4 would likely involve enormously difficult tasks and procedures. Current-day projections might not include all contemplated 'known events and conditions' as given in Chapter 4 [paragraph 6]. We believe that the projections would involve far more cost to us than benefit to users due to the uncertainties and untimely availability of useful information.

Projections of Cash Inflows/Outflows, Financial Obligations and Annual Debt Service Payments

Presently, the Office of Comptroller Operations develops some fund-level cash inflow/outflow projections. Also, some offices/organizations external to the Office of Comptroller Operations develop program-level cash inflow/outflow projections. The Governor's Budget Office, for instance, develops five-year projections for the General Fund and several other special (non-General) Funds. The Governor's Budget Office also prepares five-year projections of potential general obligation (GO) bond issuances, related debt service obligations and debt service payments. We would not be able to project, with any degree of confidence, what future-year obligations might be for any other, non-GO financial obligations, such as those identified in Chapter 3 [paragraph 15]. For instance, we are not aware of any office/organization within Pennsylvania which currently projects future-year lease obligations. We are able to disclose actual lease obligations as of each fiscal year end, because these amounts are known. We currently report several long term liabilities based on the services of outside actuaries which may or may not employ the 'Basis and Methodology for Projections'. Part of the difficulty with projecting non-GO financial obligations is that they are subject to considerable volatility which would be very difficult to explain in a narrative format. Since some level of projections are already a part of the Governor's Executive Budget, it makes more sense for Pennsylvania to continue to include certain meaningful and available projection data in that published, annual source.

Importantly, from a financial statement user perspective, the fact that there could be considerable year-over-year variation in payments for the financial obligations greatly diminishes the value, and usefulness, of such projections.

Projections of Major Intergovernmental Service Interdependencies

Public education as a service may be the best example of communicating to the GASB how difficult it would be for us to discuss a service interdependency between Pennsylvania and our 500 school districts and other local education agencies (LEAs). We are required to finance public education in Pennsylvania but are not responsible for delivering Mr. David Bean March 16, 2012 Project: 13-3

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public education. We do not separately pay the school districts/LEAs to deliver public education. The PV oversimplifies our relationship with school districts/LEAs, as if they were Pennsylvania contractors or vendors, as given in the PV [Illustrations 6, 10 and/or 14].

2. We believe there is insufficient content and clarity within the PV concerning the three components of the 'Basis and Methodology for Projections'. We remind the GASB that the Commonwealth is not able to predict all future outcomes with any degree of certainty.

We would likely not be able to rely on present-day schemas to produce the projections. We would have to develop projection schemas which include 'Basis and Methodology for Projections' as provided in Chapter 4 and we would have to finance the development of the schemas, the monitoring of the schemas and possible changes to the schemas to strictly comply with 'Basis and Methodology for Projections.'

3. We remind the GASB that the inflows and outflows included in the PV are cash inflows and cash outflows and that the financial obligations included in the PV only exist, on a reported basis, using the accrual basis of accounting. The content included in Chapter 4 [paragraphs 9-12] is not necessary.

4. We disagree with the PV.

We envision considerable, cost-prohibitive efforts which would be required to develop and produce projections using a principles-based approach as given in Chapter 4 [paragraphs 13-16]. As preparers of GPEFR, we are aware of Actuarial Standards of Practice and Statements on Auditing Standards but the commonwealth staff skills do not include this specific expertise. Also, as the GASB knows, its Statement 49 employs a unique method of quantifying pollution remediation obligations. We do not regard the content in Chapter 4 [paragraphs 13-16] to be very helpful from our standpoint.

5. We disagree with the PV.

Through our legislative process, we enact annual (one fiscal year) budgets. As given in GASB Concepts Statement 1 [paragraphs 19 and 20], we continue to regard our annual budget and the annual processes leading to that budget as our expression of public policy and financial intent. We do not budget for five individual years at a time. Further, the amounts budgeted are prepared using our basis of budgeting, which is not a basis of accounting. Chapter 4 [paragraph 21] states that a majority of research participants believed that financial projections spanning more than five individual years would be unreliable. Part of the 'cautionary notice' in Chapter 5 [paragraph 28] is that the contemplated projections are not forecasts or predictions of the most likely outcome. We firmly believe that, because of the contemplated 'cautionary notice,' the consensus among our ordinary citizenry (which is of critical importance to us) would be that none of the projections within the five individual years would be reliable. If the amounts are not forecasts or predictions, our GPEFR readers would be puzzled as to what the actual projections themselves are. As financial statement preparers, we ourselves are not entirely clear about what the projections themselves are.

6. We disagree with the PV.

We do not agree that the proposed projections constitute required supplementary information (RSI), as given in Chapter 5 [paragraphs 7 – 12]. One of the reasons for disagreement is the contemplated 'cautionary notice' preceding the financial projections and related narrative discussions themselves. If the financial statement user community/constituencies/groups regard the financial projections as having very little value, as we predict they would, how can such content be RSI and reviewed by audits for reasonableness? Further, since we ourselves (who would ostensibly include such content in GPEFR) regard the financial projections as having very little value, how can the benefit of such information justify the cost?

In Chapter 5 [paragraphs 3 and 4], we do not understand how nor agree that the six qualitative characteristics of financial information identified and described in GASB Concepts Statement 1 are equally applicable to financial projections and related narrative discussions.

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7. We disagree with the PV.

We do not believe that any state or local government should be required to report financial projections and related narrative discussions in their GPEFRs. We believe that such content should be included in the annual Governor's Executive Budget or GPEFR on a strictly voluntary basis. We have too many value and cost concerns about the contemplated projections for them to be required as part of GPEFR.

8. We disagree with the PV.

We understand that the GASB is exploring a potential phase-in period, as in the implementation of GASB Statement 34, given in Chapter 5 [paragraph 14]. But we do not believe the contemplated content should be required as part of GPEFR given the perceived value of such information and the costs. Furthermore, Pennsylvania would be unable to provide the contemplated projections if implementation would increase consulting, audit or staff costs. Each Pennsylvania agency budget was cut an average of 5% this year, so there is no longer slack in the budget to absorb added costs. Also, among state and local governments, we believe states would have the most difficult providing the financial projections; therefore, states should be allowed to be the last group to phase-in.