Responses to the Preliminary Views of the Governmental Accounting Standards Board on major issues related to Economic Condition Reporting: Financial Projections dated November 29, 2011

My Background

I am a CPA and was in public accounting for 5 years working primarily as a governmental auditor. I worked on and prepared many governmental financial reports of varying sizes and complexities. Currently I work for a statewide governmental entity as an internal control specialist over financial reporting. Part of my job is to research new accounting standards to determine how it will affect our financial reports and the processes and controls over the financial statements. I wanted to comment on the preliminary view of financial projections from the perspective of a governmental financial statement preparer and auditor.

Question 1

I believe that the components identified in the preliminary view would be helpful to users but I don't think that they belong in the financial statements. The only component that I think would be okay to be required to be added is Component 5, the narrative discussion of major intergovernmental service interdependencies. This information would be useful to understand the government better and would be more factually based than the projections. I believe that financial statements should be a reflection of what has actually happened and that has been the focus for many years. The Management's Discussion and Analysis has some discussion of plans and what may happen in the future but that is a minor part of the financial statements and even a minor section of the MD&A.

Financial statements should be an accurate representation of what has happened. That is one reason that the financial statements are audited, to make sure that the numbers presented are accurate, can be relied upon, and a true reflection of what happened. Auditors have learned the types of questions they need to ask, types of controls to test, and documents to request to verify that the numbers and information in the financial statements is accurate. If auditors are going to be required to do some procedures over financial projections it will take them some time to learn how to do it effectively and efficiently. Most auditors' education focuses on accounting and how to account for and present transactions and events that have already taken place. The framework for accounting is in place and standardized which typically allows financial statement preparers and auditors to be able to properly account for and present transactions and events correctly as long as they have the appropriate information. There are no standards for how to properly forecast or project what will happen. There are several methods, each of which can produce different results. This will make it difficult for auditors to ask the right questions and request the proper documentation for financial projections, especially if there is no reliable documentation.

Another area of concern is that projections can be easily influenced by different factors, one of which is political influence. There are many challenges to auditing a governmental entity. One area that was easier than many other audits is that there is typically little to no incentive for management to fraudulently misrepresent the financial statements. There is also little influence from governing boards and councils other than a review of the financial statements after they had already been issued. If projections are added, I think that this will be seen by some in management and governance of governmental entities to be used as a political opportunity. They may then involve themselves in the projection process and either blatantly or subtly influence the information provided to those preparing

the financial projections. I believe that some politicians will use these projections as a tool both positively and negatively but either way the incentive for fraud will be increased.

My final thought related to this question is why do governments need to present this information? Accurate projections would be very useful for publicly traded companies as it would provide more information for investors and potential investors. However, this information is not presented in those companies' financial statements. If projections are published, they are done in a separate document. I know that accurate projections would provide a clearer picture of the government's financial position and sustainability but are the projections going to be accurate enough and in enough detail to be useful?

Question 2

I agree that if projections are required that they should be based on current policy, historical information, and adjusted for known events and conditions that affect the time period being projected as that should be a good principle to prepare the most useful projections.

Question 3

I agree that if projections are done that it would be best to do the projections on a cash basis and financial obligations on an accrual basis. This information should be the most useful for financial statement users reviewing the projections.

Question 4

I agree that the projections should be guided by a principles-based approach. However, I don't think that they should be part of financial statements unless or until projections are standardized. Also, it is difficult to be comprehensive in considering significant trends, events, and conditions. This will be improved as governments do the projections more often but the trends and conditions continually change, making it difficult to take everything into consideration that should be each year.

Question 5

I believe that the 5 year timeframe for projections is a good timeframe for useful projections for most sophisticated organizations. However, I believe than many smaller governments will not be able to provide good financial projections beyond 2 or 3 years.

Question 6

I don't think that financial projections should be part of the financial statements. If they are required, they should be issued separately. If they are going to be part of the financial statements, it should be as supplementary information and not required supplementary information. If it is just supplementary information, the auditor's opinion will not be associated with the projections and fewer procedures will be required. As an auditor, I would not want to have my opinion associated with projections, especially

if the client is not sophisticated enough to prepare them accurately. It seems that this would open more litigation issues that do not relate to the quality of the audit for the auditor.

Question 7

If governments are going to be required to prepare financial projections, only larger more sophisticated governments that meet certain requirements should be required to prepare them. As a governmental auditor, I had several clients that had no employees that were able to produce financial statements on their own. This was often due to their size and just the type of employees that they could afford to retain. To require these governmental entities to also prepare financial projections is unrealistic. Auditors are able to use the information in the financial system to prepare financial statements but that is harder to do for a projection. Also, many smaller governments prepare financial statements only because they are required to by statute. Many of them have no other reasons to prepare and file financial statements such as compliance or bond and loan covenants. I don't see how these projections will help the users as there typically are no users of these financial statements.

Question 8

If all governments are going to be required to prepare financial projections, then there should be a phase in period. I don't know how the phase in should take place but as I mentioned in the paragraph above, many smaller governments are going to need help with these financial projections and will need time to get help. Many larger governments probably do have most of the information they already need to implement this as a requirement and would need less time to prepare for implementation.

Other Thoughts

If the debt payment obligations schedule is going to be the same as what is already presented in the footnotes, due to no new debt being authorized; then that schedule should not be required in RSI.

I don't think that the financial projections in total is useful information. It seems that the projections would be more useful by major fund and then the aggregate, similar to the financial statements. If this is not done then it is difficult to really understand why significant changes may occur unless there is a lot of explanatory dialogue in the notes to the projections. In reviewing the examples, I thought that the projections for the general fund were useful but not helpful for the remaining funds.

The key to making good projections is to have the correct information. Sometimes just small mistakes or incorrect information can project very different results. Users understanding of the projections can also be significantly impacted by the information provided in the notes to the projections. Omitting a small but important factor may give a user a very different perspective of the projections. The incomplete or wrong information could be a mistake or fraud. The notes also seem like an area where too much or too little information may be provided to impact the view of financial statement users.

Overall I believe that this information could be useful but that it should not be included in the financial statements. Like a couple of the board members, if more information is going to be required in the financial statements, then I believe that it should historical information similar to what is required for a

CAFR. Finding historical trends helps financial projections and users that are most interested in projections should be able to do the projections themselves with enough historical information.

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