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

RE: Economic Condition Reporting Questions for Respondents

Dear Mr. Bean:

On behalf of the Commonwealth of Massachusetts State Comptroller's Office, we appreciate the opportunity to respond to the Governmental Accounting Standards Board's Preliminary Views document, *Economic Condition Reporting: Financial Projections*.

We agree with Preliminary Views' position that the issue of fiscal sustainability is an important consideration for users of government financial statements in general and users of state government financial statements in particular. We also agree that some standardization of forward-looking information across governmental entities would be helpful to users in evaluating the fiscal sustainability of government entities.

However, we disagree that such projections should be included in the CAFR as RSI. The attached document provides in depth answers to the "Questions for Respondents" and sets out our position in detail. To summarize, we believe that five-year projections are not essential for placing the basic financial statements in context, as the basic financial statements and notes stand on their own. We feel that the MD&A, notes and current RSI already place the basic financial statements in an operational and/or economic context. The information in the CAFR is properly historical in nature, and users are able to draw conclusions and make informed decisions as to fiscal sustainability by analyzing information in the CAFR, budgetary basis reports and documents, Continuing Disclosures or Official Statements. Requiring governments to produce

five-year projections would necessarily introduce an element of subjectivity into the RSI that would contravene GASB Concepts Statement 3, Paragraph 34.

We are also concerned that requiring five-year projections as RSI would add significant complexity to the process of issuing the CAFR. As participants in the field test of the Preliminary Views, it has become clear to us that projections would require significant additional resources and time to produce the CAFR, further increasing the gap between the close of fiscal year and the time needed to produce the CAFR. It would also divert resources needed to produce the basic financial statements, MD&A and notes. This could jeopardize the timeliness and accuracy of the report, making it less useful to users.

We appreciate the opportunity to provide our comments to the GASB on this important subject. Should you have any questions or need additional information regarding our response, please feel free to contact me at me (617) 973 2315.

Sincerely,

Martin J. Benison  
Comptroller

Attachment

**Question 1:** Do you agree with the Board’s preliminary view 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 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 fluctuation 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)

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

**Response:** While we believe that each of these components is important in evaluating the long-term fiscal health of government entities, we would note projections of debt service and pension and post-employment benefit obligations (which comprise the great majority of components 3 and 4) are covered in the CAFR footnotes, without requiring preparers to make subjective judgments about the effect of future political decisions that will affect those obligations. In addition, any issue that could affect the fiscal sustainability of the government should already be discussed in the MD&A or if necessary subsequent event footnote of the CAFR.

**Question 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?

**Response:** While current policy, historical information and known events and conditions that affect the projection period are necessary factors in making financial projections, we believe they are not sufficient. Projections of tax revenues and spending on programs sensitive to the economic cycle (such as Medicaid and other safety net programs, which are the largest single components of state outflows) necessarily require reliance on economic forecasts that are subjective. In such cases, relying on simple “historical trends” is not a valid projection methodology. We believe the statement should be clear when appropriate economic forecasts should be used in conjunction with historical trends. Because there is no general agreement even among economists as to which economic assumptions are the most reasonable, projections of different government entities may challenge auditors when reviewing RSI as required by the audit literature.

For governments that have balanced budget requirements (all states except Vermont), spending *must* adjust to available revenues, so projections of total state spending based on past spending trends are not independent of revenues. While previously incurred legal obligations such as debt service and pensions are easier to project without requiring preparers to make subjective judgments, most other expenditures are not pre-determined and will adjust to available revenue demands. Even in the case of debt service, the decision to engage in debt-funded capital spending and the structuring of debt service are also discretionary, determined in part by available revenues. Such adjustments are a normal part of the annual budget process, and ignoring likely future adjustments of this type because they are not “known events and conditions” would lead to inaccurate projections. (In fact, current constitutional or legal restrictions

may *require* that such future adjustments be made to maintain a balanced budget.) Similarly, the tax and fee structure that determines available revenue may also change from year-to-year in response to fiscal and political changes (and the ability to change the tax structure differs from state to state), and there is no particular reason why the tax structure at a particular point in time should be the one used for making projections, rendering such projections subjective at best. Again, such changes are inherent in the annual budget process, so making longer-term projections without taking such changes into account may lead to the government producing two forecasts -- one based on the GASB standard and one reflecting the government's plan (or executive's plan) to bring the forecast into balance. However, we understand recognizing these projections inevitably introduce subjectivity into the process. We do not have a solution but wanted to note this concern that a government may have two sets of what appear to be similar projections. If the board moves away from RSI to a standalone document of some kind, they may want to consider some baseline projection followed by some flexibility.

The Board should also consider whether statutorily enacted changes subsequent to the close of the reporting period should be taken into account in projections. For example, permanent tax law or benefit eligibility changes enacted after the close of the reporting period would affect all subsequent reporting periods covered by a five year projection. Excluding the impact of such changes in making projections could render such projections outdated by the time they are released and therefore not relevant to users.

**Question 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?

**Response:** We believe that five year projections, whether presented in RSI or in outside the CAFR, should be presented on a cash basis, due to the impracticality of producing such projections on a GAAP basis.

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

**Response:** We agree that any financial projections should be guided by principles as opposed to a rules-based approach. This would provide governments with needed flexibility in applying its professional judgment and expertise in making projections. As discussed in the answer to question one we suggest the board may want to be more explicit that trends events and conditions, where appropriate would include economic forecasts. Areas where we believe economic forecasts would be used in conjunction with historical trends would include, income and corporate taxes, unemployment rate, healthcare inflation rates, and safety net caseload forecasts. This issue may be less applicable to municipal projections but seems essential and we assume implied in the PV.

**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 (Chapter 4, paragraphs 19–23). Do you agree with this view? Why or why not?

**Response:** We believe five years is a reasonable benchmark for budget projections. However, for certain financial obligations such as pensions and OPEB five years might not be a long horizon given the long-term nature and potentially significant amount of these obligations.

**Question 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?

**Response:** We disagree with this view. The basic financial statements and notes stand on their own. We feel that the MD&A and current RSI already place the basic financial statements, including the notes, in an operational and/or economic context. Bond raters, investors, insurers and other users are able to gather information directly from the CAFR, the Statutory Basis Financial Report, Continuing Disclosures or Official Statements in order to make informed decisions regarding the fiscal sustainability of the State. As mentioned in the response to Question 1, projections necessarily introduce subjective assessments, and thus will be useful in placing the basic financial statements and notes in an accurate operational or economic context. An alternative might be a special purpose report or voluntary guidelines. As more government documents become available online the Board may want to consider references to other available forecast rather than inclusion in a fixed format in RSI.

**Question 7:** The Board’s PV 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?

**Response:** We are concerned about the burden on smaller governments of developing and reporting financial projections, but we defer to those governments on the challenges this may pose.

**Questions 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 (Chapter 5, paragraph 14)?

**Response:** If this requirement is implemented, then a phase-in period similar to the one for GASB 34 should be used in order to provide entities enough time to gather, compile and audit the information.

**General Comments:** Because political, economic and other factors greatly influence the development of the annual budget from year to year, including five year projections as RSI would be highly subjective. We are of the opinion that, as such, such projection would contravene Concept Statement 3, paragraph 44, which states:

“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.”

Furthermore, we believe that the cost of acquiring the required skills and information to properly forecast inflows, outflows and financial obligations five years into the future would far outweigh the benefits of providing such information. Projections would require preparers to obtain, compile, check and validate the information provided by outside consultants and other professionals. Based on previous experience in projecting financial information, as well as our experience of participating in the GASB field test of these Preliminary Views, we estimate that properly producing these projections would require the Comptroller’s Office to expend several weeks of additional staff time.

This requirement will also increase the time required to produce and audit the CAFR, which is already difficult to accomplish within the required six-month timeframe, and may result in a document that is untimely and thus less useful to users.