March 8, 2012

Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Response to the Preliminary Views of the Governmental Accounting Standards Board (GASB) on major issues related to Economic Condition Reporting: Financial Projections.

Dear Director of Research and Technical Activities:

The Association of Local Government Auditors (ALGA) appreciates the opportunity to respond to the Governmental Accounting Standards Board (GASB) Preliminary Views on Economic Condition Reporting: Financial Projections. Our organization represents 300 audit organizations, totaling more than 1,750 members.

We acknowledge the importance of economic condition and fiscal sustainability reporting. We agree with the concepts behind Economic Condition reporting, though we have some concerns about the cost and benefit of the requirements for some jurisdictions. In providing our comments we have made use of the current International Public Sector Accounting Standards Board (IPSASB) Exposure Draft, Reporting on the Long-Term Sustainability of a Public Sector Entity’s Finances and credit rating agencies’ publications, specifically Moody’s Rating Methodology.

Our response to the eight questions for respondents are as follows:

1. In general we 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. However, to provide additional clarity the following should be considered:

   • Components 1 and 2 – The cash inflows and outflows should correlate when feasible (i.e., revenue is restricted for a particular obligation). This should be addressed in Chapter 3, paragraphs 4-9 and 10-14. The relationship should be depicted in the entity’s illustrations (schedules) or explained in the narrative. For example, if there is a temporary cash inflow (ARRA), which is considered major, that is attributed to a one-time obligation the user might not see the correlation if the obligation is lumped with other cash
outflows and the narrative does not provide clarification. In addition, there should be guidance on presentation of cash inflows, as there was for cash outflows (i.e., Consistent with Statement No. 34, by object (source), or by activity (type)).

- Component 4 – We agree that the annual debt service information is already addressed in the notes to the basic financial statements and, in general, the information is available outside of the basic financial statements (i.e., preliminary and final official statements for bond indentures are available to the public). To provide further clarification, however, this information should be specifically addressed within the other fiscal sustainability components, as necessary.

- Other Board Considerations - (Chapter 3, paragraphs 27-30), the Board explains its belief that underlying economic conditions are sufficiently addressed in cash inflows and cash outflows (Chapter 3, paragraphs 4-14) and therefore do not require a separate category within a fiscal sustainability report. While we agree that reporting on known fluctuations in cash inflows and cash outflows covers many underlying economic variables, we believe this should be supplemented with a discussion of general economic characteristics (employment, education, demographics, the political ability of the government entity to act, etc.) and trends in the Component 5 narrative section (Chapter 3, paragraphs 24-26)

2. In general, we agree with the Board’s preliminary view 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. Furthermore, we generally agree that 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. However, to provide additional clarity the following should be considered:

- In Chapter 4, paragraph 4, consider adding “contracts and grant agreements” in the sentence, “For the purpose of reporting financial projections, current policy is defined as the present course of action formally adopted and pursued by a governmental entity through established laws, regulations, administrative rules, and contracts and grant agreements.”

- In Chapter 3, paragraph 30 it was stated that the “overall environment” concept (economic and demographic) would be considered when projecting the individual major cash inflows and outflows. Consider enhancing Chapter 4, paragraphs 6 and 13-16 to include “overall environment” when projecting financial information.
Consider adding that the entity should assess the extent to which it can draw on the projections and methodologies prepared by other governmental bodies and credit rating agencies (i.e., Moody’s) in order to reduce the cost of such reporting, particularly for smaller entities (Chapter 4, paragraphs 2-7). For example, if a state prepared a projection related to pass-through resources to a county, the county should be able to use the state’s projections. The county, however, should still be responsible for assessing the reliability of the information prior to using and should disclose the source of the information.

3. We agree with the Board’s preliminary view 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.

4. We agree with the Board’s preliminary view 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.

5. We agree with the Board’s preliminary view that annual financial projections should be made for a minimum of five individual years beyond the reporting period for the purpose of external reporting.

6. In general, we agree with the Board’s preliminary view 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.

The fiscal sustainability information should be considered required supplementary information. Certain limited procedures should be performed by an independent auditor on required supplementary information. This would include determining (1) whether the information was measured and presented in accordance with prescribed guidelines; (2) whether methods measurement and presentation have changed from those used in the prior period; and (3) whether there were any significant assumptions or interpretations underlying the measurement or presentation of the information. These reviews are essential if the fiscal sustainability information is going to be presented in the government entity’s annual financial report or comprehensive annual financial report.
7. We do not agree with the Board’s preliminary view that all governmental entities should be required to report financial projections and related narrative discussions. In this case, we do agree with the Alternative View that the question of the cost-benefit relationship for some governmental entities in reporting financial projections and related narrative discussions should be further assessed. This requirement will likely cost jurisdictions more staff time and financial resources to implement. Particularly for smaller jurisdictions with more limited staff and funding for auditors to review the material, this may be difficult to put in place. Some jurisdictions, even larger ones, are already challenged to get out their statements in a timely manner, and this requirement may have the unintended consequence of making them come out even later. We recommend that you consider this requirement very carefully.

8. Should fiscal sustainability reporting be required, we agree that a phased-in implementation period would be appropriate. We believe that the type of phase-in period should be decided after the determination of what government entities should be required to report. The example provided that governmental entities over a certain dollar threshold would implement first is sound.

In addition, we have some comments for GASB to consider that are outside of the questions for respondents provided in the preliminary views, which are as follows:

- In Chapter 2, pages 5-6 the definition of economic condition and fiscal sustainability includes both the “ability and willingness to meet its obligations”. The Preliminary Views address ability when determining projections; however, it does not address willingness. Chapter 3, paragraph 32, discusses that the “projection of a governments’ willingness is difficult, if not impractical”. Nevertheless, the definition in Chapter 2, paragraph 4 is clear that in order to assess economic condition, users need information regarding both ability and willingness. We feel that without addressing both, the information will not be as complete, even if it is a difficult task. At the very least, willingness should be addressed in the narrative.

- In Chapter 2, page 6-7, the definition of the further explanatory language of fiscal sustainability should include the aspect of vulnerability. Vulnerability is the extent to which an entity is fiscally dependent upon funding sources outside its control. In addition, we believe the definition provided in paragraph 8, on page 6, should read, “…government’s ability and willingness to generate or seek inflows of resources…” It seems that some entities when they have reliance on others for resources might not be able to generate enough resources to cover their short falls; however, they may be able to seek other avenues for those resources. For example, a local parks program may not generate enough resources to maintain all their parks; however, certain grants may be available to help compensate those shortfalls.
In Chapter 5, paragraphs 18-20, the preliminary views refers to the primary governments facing the reporting requirement, and not having to include projections on discretely presented component units. This information seems a little confusing in comparison to the rest of the preliminary views information when the document refers to “all governments”. We suggest that be clarified. For example, should a semi-independent agency be required to report on fiscal sustainability? If the requirement reads “all governments” it seems like they would have to, but if it read “all primary” then they would not.

We appreciate the opportunity to respond to this preliminary view.

Respectfully Submitted,

Kristine Adams-Wannberg
Chair, Professional Issues Committee
Public Testimony from the Association of Local Government Auditors to the Governmental Accounting Standards Board on major issues related to Economic Condition Reporting: Financial Projections

March 29, 2012

Chairman Attmore and members of the Governmental Accounting Standards Board, for the record my name is Kristine Adams-Wannberg. I represent the Association of Local Government Auditors (ALGA), where I serve as the Professional Issues Committee Chair. Our organization represents 300 audit organizations, totaling more than 1,750 members.

Thank you for the opportunity to provide testimony today on the matter of GASB’s Preliminary Views on major issues related to Economic Condition Reporting: Financial Projections. This is certainly a topic of interest to ALGA’s membership.

Our detailed comments were submitted to GASB staff on March 8th, but I would like to highlight our position on the preliminary views.

ALGA acknowledges the importance of economic condition and fiscal sustainability reporting. We agree with the concepts behind Economic Condition reporting, though we do have some concerns about the cost and benefit of the requirements for some jurisdictions.

I would like to cover our response to the eight questions GASB requested feedback on:

1. In general we agree with the preliminary view that there are five components of information that are necessary to assist users in assessing a governmental entity’s fiscal sustainability. However, to provide additional clarity ALGA recommends following be considered:

   - Components 1 and 2 – The cash inflows and outflows should correlate when feasible (i.e., revenue is restricted for a particular obligation).

   - Component 4 – We agree that the annual debt service information is already addressed in the notes to the basic financial statements and, in general, the information is available outside of the basic financial statements (i.e., preliminary and final official statements for bond indentures are available to the public). To provide further clarification, however, this information should be specifically addressed within the other fiscal sustainability components, as necessary.

   - Other Board Considerations - (Chapter 3, paragraphs 27-30), the Board explains its belief that underlying economic conditions are
sufficiently addressed in cash inflows and cash outflows (Chapter 3, paragraphs 4-14) and therefore do not require a separate category within a fiscal sustainability report. While we agree that reporting on known fluctuations in cash inflows and cash outflows covers many underlying economic variables, we believe this should be supplemented with a discussion of general economic characteristics (employment, education, demographics, the political ability of the government entity to act, etc.) and trends in the Component 5 narrative section (Chapter 3, paragraphs 24-26).

2. In general, we agree with the Board’s preliminary view 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. Furthermore, we generally agree that 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.

- ALGA recommends GASB consider adding that the entity should assess the extent to which it can draw on the projections and methodologies prepared by other governmental bodies and credit rating agencies (i.e., Moody’s) in order to reduce the cost of such reporting, particularly for smaller entities (Chapter 4, paragraphs 2-7).

3. We agree with the Board’s preliminary view 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.

4. We agree with the Board’s preliminary view 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.

5. We agree with the Board’s preliminary view that annual financial projections should be made for a minimum of five individual years beyond the reporting period for the purpose of external reporting.

6. In general, we agree with the Board’s preliminary view 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.
Certain limited procedures should be performed by an independent auditor on required supplementary information. This would include determining:

- Whether the information was measured and presented in accordance with prescribed guidelines;
- Whether methods measurement and presentation have changed from those used in the prior period; and
- Whether there were any significant assumptions or interpretations underlying the measurement or presentation of the information.

These reviews are essential if the fiscal sustainability information is going to be presented in the government entity’s annual financial report or comprehensive annual financial report.

7. We do not agree with the Board’s preliminary view that all governmental entities should be required to report financial projections and related narrative discussions. In this case, we do agree with the Alternative View that the question of the cost-benefit relationship for some governmental entities in reporting financial projections and related narrative discussions should be further assessed. This requirement will likely cost jurisdictions more staff time and financial resources to implement. Particularly for smaller jurisdictions with more limited staff and funding for auditors to review the material, this may be difficult to put in place. Some jurisdictions, even larger ones, are already challenged to get out their statements in a timely manner, and this requirement may have the unintended consequence of making them come out even later. We recommend that you consider this requirement very carefully.

8. Should fiscal sustainability reporting be required, we agree that a phased-in implementation period would be appropriate. We believe that the type of phase-in period should be decided after the determination of what government entities should be required to report. The example provided that governmental entities over a certain dollar threshold would implement first is sound.

The Association of Local Government Auditors appreciates the opportunity to provide testimony on GASB’s preliminary view. I would like to thank the Board for considering our comments. That concludes my presentation. Thank you.