March 16, 2012

To: Director of Research and Technical Activities, Project No. 13-3
From: PMA Financial Network, Inc. – Naperville, Illinois
Re: Financial Projections Preliminary View Response

Thank you for the opportunity to participate in this study on financial projections. We appreciate the effort that is being invested in this project on behalf of government entities. We believe that this potential new reporting requirement is worthwhile and beneficial to local governments and their respective stakeholders; and it is in complete alignment with the GASB vision of greater accountability and well-informed decision making through excellence in public-sector financial reporting.

As a point of disclosure, PMA Financial Network, Inc. was founded in 1984 and is a for-profit, private sector entity that exclusively serves the financial needs of the public sector. The firm and its affiliates provide various financial services to nearly 2,000 local governments across the country. Of relevance to this project, PMA has provided financial projection services for more than ten years, serving more than 300 units of government in that time.

PMA feels compelled to participate in this study for several reasons:
- We are passionate about the long term financial benefits and strategic planning value that projections provide.
- We can testify that the process of executing a financial projection, along with the data generated, provides increased financial vision and improves administrative decision making and board level governance.
- We have witnessed improved relationships between local governments and communities through the increased transparency and accountability that financial projections provide.

PMA created its initial financial projection platform after being involved in two community engagement projects in the late 1990’s. In the process of observing these two local governments endeavor to educate the public about the complexities of government finance, PMA decided to create a tool that would allow a government to perform complex financial analysis while generating understandable and community friendly output. Over a ten year period the product has continued to evolve to meet the needs of both local governments and their stakeholders.

In the process of marketing these services over the last decade, we have heard all of the arguments against the value of financial projections. The most common argument is that financial projections are a waste of time and resources because the future cannot be predicted. A number of people will oppose this GASB initiative and will use, as an example, the unpredictability of the global financial collapse of 2008 as the ultimate invalidation of projection efforts.
We would agree that it is impossible to predict the future with 100% accuracy. And we admit, with respect to the economic collapse, that we never suggested incorporating a financial meltdown scenario into our clients’ projections pre-2008. However, with the benefit of hindsight, we are even more convinced of the value that financial projections offer. We can confidently attest that our clients who have integrated a dynamic projection process into their decision making have successfully navigated our nation’s recent economic turmoil. Hindsight should not be the reason to avoid financial planning efforts, rather historical experience can and should be used to strengthen overall fiscal management and strategy.

We have seen many of our clients successfully use their projections to communicate financial strength and sound management policies in their conversations with national rating agencies (NRSROs). Since the financial collapse in 2008 and the subsequent contraction of the bond insurance industry, local governments have become more dependent on bond ratings in order to gain cost effective access to the credit markets. Well documented financial plans have been integral in helping local governments achieve higher bond ratings with resultant lower borrowing costs.

We believe that many local governments already execute detailed financial projections and should be able to easily comply with the proposed requirements. But, as you consider the merits of mandatory financial projections for all local governments, be encouraged that you will initiate a process for many local governments that will be as valuable as the resulting output. Organizing financial data, studying economic variables, performing scenario analysis, transforming data into charts and graphs…all of these activities are extremely valuable, and in fact essential, to optimizing the financial performance of local governments.

At a foundational level, one might make a similar argument regarding the basic GASB requirement of producing audited financial reports – that the process, and all of the related supporting controls and activities, of complying with generally accepted accounting principles is as valuable as the final report that is produced. Both the requirement and the standardized template drive organizational discipline, transparency, and excellence.

Again, we commend the efforts and vision of the GASB. We hope that our comments will be received in the context of the many positive experiences we have had helping local governments with financial projections. It is from these experiences that we can confidently encourage you to approve this measure. The resulting benefits to our country at a local and national level will be both immense and sustaining.

Respectfully submitted,

Michael R. English, President
PMA Financial Network, Inc.
Question 1

We agree with the Board’s preliminary view and add the following insights:

In addition, and while potentially difficult to incorporate into a financial projection, we also believe that economic trends at national, state, and local levels impact the financial performance of local governments.

Of specific concern (and an issue that should be disclosed in financial statements), would be the future impact of enacted legislative changes to funding formulas or situations in which a government entity is delinquent, or considering delinquency, with respect to payments owed to another government entity. It would be potentially misleading to prognosticate hypothetical political and legislative scenarios, however known issues or decisions may be relevant in the assessment of service sustainability.

In addition to the foregoing, the impact of long term employment contracts and the status of long term capital plans/needs are of significant importance to the rating agencies (NRSROs) as well as bond investors.

Question 2

We agree with the Board’s views with the following situational observations:

1. Simply extending a “current” policy may not be accurate if economic fundamentals do not allow current policy to be extended. For example, a balanced budget policy would not rationalize a projection of a balanced budget if projected economic factors would prohibit the projected balanced budget or an implied level of government service.

2. As commonly quoted in the financial markets, “past performance is not indicative of future results.” We believe that historical performance can provide insight to the overall management of a government. Further, the direction of the trend can be telling in terms of viability of the future projection or plans. However, it is the accuracy of the forward looking assumptions that are most relevant to a government’s financial projections.

3. Historical one-time events should be disclosed especially if they involve non-recurring revenue sources. In recent years, ARRA funds were distributed to many local governments. But, the fact that this was a non-recurring revenue source masked pending financial strain of many local governments.

Question 3

We generally agree with the stated accounting methodology.

However, we also believe that cash/fund balances at the end of a fiscal year does not always represent true strength, especially for government entities that have revenue
collections just prior to fiscal year end. As part of the requirement to discuss large inflows and outflows, it may be useful for a reporting entity to disclose their low cash position for the year as well as the need (if any) to borrow money to support intra-year cash flow. We do believe that it is important to view financial obligations on an accrual basis in order to assess the magnitude of these payments.

**Question 4**

We agree with all of the Board’s views on assumptions.

The assumptions used should be guided by a principles-based approach. The assumptions should be consistent with each other and should not be contradictory with each other or known facts. For example, a straight line assumption of investment earnings at a long term average rate of 4% would be inconsistent with the likelihood of achieving such a return in the current investment environment. Similarly, a high investment rate assumption might contradict an assumption of low borrowing rates.

Disclosure of the assumptions is a key element for the reader of a financial projection to be able to ascertain the overall strength of the entity as well as the viability of any future financial plans incorporated into the projection.

In addition to providing the assumptions, we believe that it is useful for the entity to understand the financial impact of a variance in one or more of the key assumptions. While we do not believe that local governments should have to report multivariate scenarios as a part of their submitted projection, we believe the best managed entities understand and calculate the impact of potential variances in key assumptions including potential legislative changes.

**Question 5**

We agree with the Board’s view on the length of financial projections.

We agree that if significant known issues or events lie beyond the fifth year that the projection should be extended to include it (within reason). For example, a Tax Increment Financing district expiring in the sixth year may warrant extending the projection by one year.

From experience, we do not believe that projections should be shorter than five years. Although, it is likely that the first three years of a projection are the most accurate, the fourth and fifth year usually provide important trend information. It is important to have a five year view to pick up the impact of long term labor contracts or pending capital plans. Additionally, some significant local government revenue sources can be linked to formulas that have lag factors making a five year forecast more indicative.
Question 6

We agree with the Board’s view.

We believe that the inclusion of fiscal sustainability reporting in an annual financial report would allow this valuable information to reach its largest possible audience, and create the most meaningful financial statements. Additionally, we do not believe that this will put an undue or unrealistic burden on auditors. As required supplementary information, the entity’s auditor will only need to assess the math and the reasonableness of the projection and will not be in a position of having to certify a prognostication of future events. We also hope that the financial projections included in the annual financial report are only the culmination of a process that leads to a greater understanding of key economic factors, future fiscal challenges and the possible financial future of an entity, and that the process leads to a more informed governing board and community.

Question 7

We agree with the Board’s view.

Generating financial projections is both a fundamental and strategic process. By requiring all government entities to perform this type of analysis, you will allow readers of financial statements to better understand and assess the sustainability of the entity as well as the services provided by the entity. Simultaneously, the government entity will have an opportunity to think critically about their economic situation as well as have a vehicle to communicate their situation to stakeholders.

Question 8

In our dealings with nearly 2,000 clients, we believe that many high-performing local governments currently perform five year financial projections, so the production of such a report will not be difficult. In order to facilitate a timely release of the basic financial information in the AFR, you may need to consider a supplemental filing of the financial projection. A 90 day period would provide sufficient time to produce the projection while incorporating the most recent audited results.

We do not believe that this new requirement is nearly as complicated as the implementation of previous Statements such as 34 and 45. Therefore, a phase-in period may not need to be as long. In fact, the potential benefits of financial projections are so significant and they may justify an accelerated implementation timeline.