March 15, 2012

Mr. David Bean  
Director of Research and Technical Activities  
Project No. 13-3  
Governmental Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the University of Colorado, we appreciate the opportunity to respond to the Governmental Accounting Standards Board's (GASB) Preliminary Views Document, Economic Condition Reporting: Financial Projections (PV).

We have reviewed the PV and generally disagree with its provisions. As requested, this letter will address each of the eight questions posed by the PV. However, in summary, we believe the concept of including five year financial projections as Required Supplementary Information fundamentally shifts the historical and time-tested role of general purpose external financial reporting (GPEFR) from that of providing quantifiable and auditable financial information for the years under audit to that of a forward-looking document based on multiple unknowns and assumptions often beyond the control of the entity. This belief is supported by the fact that the PV includes in footnote 2 the definitions of “forecast”, “predict”, “prediction”, and “projection.” If such definitions are necessary in the PV to ensure practitioners understand the difference between a “forecast” and a “projection” it is unrealistic to believe users of the financial statements will discern the difference.

Furthermore, the PV states that projections are already included in the financial statements as evidenced by the following quote: “While the projections themselves are not displayed in the financial statements, the information reported is based on projections that are informed by assumptions about the future, such as (a) the projection of estimated useful lives when determining current-period depreciation expense for capital assets, (b) the projected future costs of closure and postclosure care for landfills and pollution remediation reported as a liability in the current period, and (c) the projected future benefit payments for pension and other postemployment benefits (OPEB) that are discounted to an actuarial present value for the current-period calculation of the actuarial accrued liability. Financial statement disclosures also include forward-looking information related to projections of financial obligations such as future debt service for variable rate debt, lease payments, and variable cash flows associated with a swap
derivative instrument.” We believe these examples are by their nature different than the financial projections envisioned in this PV. For example, current-period depreciation expense for capital assets and costs of closure and postclosure care for landfills and pollution remediation are estimates. Depreciation of capital assets is the systematic and rationale allocation of the cost of a capital asset over its useful life. The useful life of an asset is based on historical experience and is not subject to changes in the economic cycle or funding from external parties. Absent impairment, the depreciation recorded for a capital asset is consistent from year to year and can be recalculated based on the method used. GASB No. 18, Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs, does not use the term “projected costs.” The term “estimated costs” is used to describe the required liability to be recorded for landfill costs which are based on incurred and estimable future costs of monitoring and maintaining the landfill during the postclosure period. The reported liability and the estimated total cost of postclosure care yet to be recognized are reported in the financial statements and in the footnotes, not RSI. The actuarial accrued liability for pensions and other postemployment benefits are in varying stages of being required to be reported in the governmental entity’s financial statements—not as RSI. Therefore, there is a presumption that the methods used to develop these postclosure, pension and postemployment benefit estimates are sufficiently sophisticated to permit their inclusion in the financial statements.

Despite the “Cautionary Notice” which would precede the projections, inclusion of such information increases the probability of litigation when the projections and subsequent reality do not align. Please consider the hypothetical scenario of a governmental entity developing its financial projections in 2007 prior to the Great Recession. While assumptions used at the time may have appeared reasonable, subsequent dramatic and negative economic conditions would have made those projections wildly misleading and therefore of either no or negative value.

Questions for Respondents

1. The Board’s preliminary view is 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 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 fluctuations 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
As noted in the introduction, we disagree with the entire concept of including financial projections in a governmental entity’s GPEFR. With that said, Components 1, 2, and 3 are particularly troubling. With regards to Component 1, as an institution of higher education with a heavy research focus, our major cash inflows are tuition and grants and contracts. Tuition rates are determined on an annual basis based on the following factors: 1) the level of state aid; 2) cost of attendance; 3) potential legislative limitation on the amount of allowed increases; 4) economic conditions which impact the level of institutional student aid, among several others. Given the high degree of uncertainty with respect to factors 1), 3), and 4), the development of a five year projection of tuition with any degree of reliability, which is one of the six qualitative characteristics identified in Concepts Statement 1 for information in financial reports to be effectively communicated, is not possible. Per the PV, “forward-looking information is reliable if it is verifiable, objective, comprehensive, free from bias, and faithfully represents a governmental entity’s fiscal sustainability. The reliability of forward-looking information does not imply precision or certainty.” In the case of tuition revenue, the forward-looking information is not verifiable. By its very nature, it cannot be comprehensive due to the lack of visibility into future state budgets, legislative actions and economic conditions. Therefore, it cannot purport to faithfully represent the University’s fiscal sustainability.

With regards to grants and contracts, the level of funding is dependent to a large extent on the federal budget. Again, the assumptions used to develop a five year projection are neither verifiable nor comprehensive as the University has no impact or insight into the federal government’s five year projected spending on research. This again leads to the inability to purport to faithfully represent the University’s fiscal sustainability.

The projections required by Component 2 are heavily driven by the projections in Component 1. The University’s budgeted expenses must fall within the amount of revenue received. As demonstrated above, it is not possible to develop objective, comprehensive projections of future cash inflows. Given the correlation between cash inflows and cash outflows, it is not possible to develop the projections required by Component 2.

Component 3 required projections are problematic due to the nature of some of the items included as financial obligations – primarily pensions and postemployment benefits. In Colorado, certain University employees are members of the Public Employees’ Retirement Association (PERA). PERA is self-governed and determines benefits, contribution levels, and investments independent of the employers mandated to be a part of the organization. Therefore, once again, the lack of insight into PERA’s future plans greatly reduces the University’s ability to project the pension-related financial obligations associated with PERA participants. Based on current guidance, the University does not currently record a pension liability. Should the proposed changes to pension
reporting be enacted, the problem of lack of visibility would be compounded by a lack of verifiable history of the newly recorded pension liability.

Finally, the requirements of Component 4 are sufficiently covered by existing disclosure requirements. Authorized but unissued debt is disclosed in the footnotes to the financial statements, thus giving users adequate information about potential future claims on the governmental entity’s resources.

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
Disagree. It is our belief that there is an inherent inability to provide reliable projections regardless of the basis for those financial projections. Please see the answer to question 1 above for further elaboration.

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
Disagree. As the University disagrees with the concept of presenting projected financial information, the basis upon which it is presented is not relevant.

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
Similar to our response to question 3, the approach used to develop the projections is not relevant given the lack of reliability of the information which is being requested.
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
Disagree. It is difficult to project near term data reliably. To project that same information over five individual years beyond the reporting period for the purpose of external reporting is exponentially more difficult and is basically guaranteed to produce results that lack relevance, reliability, comparability, consistency, or understandability, which represent five of the six characteristics Concepts Statement 1 states are necessary for information in financial reports to be effectively communicated. The projections lack relevance as the further out the projection, the probability of it being useful to a user’s assessment of a governmental entity’s fiscal sustainability greatly diminishes as those projections are extremely likely to prove significantly different from actual results. Therefore, users will end up discounting longer term projections knowing that they are likely to be, at best, a moving target. The projections lack reliability for the reasons noted in the responses above. Comparability is not achieved over a five year period as the standardized procedures and practices used to develop the projections cannot be designed such that fluctuations in projections from one year to the next are inevitable. While this possibility is discussed in the PV, the constant changes in projections will result in confusion and lack of confidence on the part of the users. This same argument is applicable to consistency and understandability. Users of financial statements are accustomed to seeing comparative prior year data in financial statements that is basically unchanged from the prior year audited report. Introducing five years of projected balances into the financial report which will change from year-to-year upends this basic concept and devalues the usefulness of the entity’s financial statements.

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
Disagree. In addition to the issues with this PV discussed above, including the projected information is RSI has two fatal flaws. First, RSI is not audited. Therefore, no assurance is placed on the projections. Auditors would not in any circumstances be willing to provide any level of assurance on the information given that is it forward-looking and is therefore not verifiable or auditable. Second, there is real risk in presenting projected financial information. Despite calling this information “projections” as defined by The American Heritage Dictionary, in actual use, projections and forecasts are used interchangeably. Users who do not understand the inherent lack of reliability of the projected information may make certain decisions about the governmental entity which will turn out to be incorrect. Regardless of the language placed in
front of the projected information, we believe this exposes governmental entities to needless risk of litigation for information of limited value.

7. The Board’s preliminary view 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
Disagree. Given the numerous issues associated with financial projections, we believe no government should be required to report such information.

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
Disagree. Please see response to question 7 above.

Summary

While we understand the GASB’s intent in issuing this PV, we disagree with the proposed method of achieving its aims. Reporting financial projections is replete with risks, uncertainties, and inherent lack of reliability. We believe the focus of the financial statements should remain where it has always been – reporting on verifiable, auditable historical financial results.

If GASB determines that more information should be provided to assist financial statement users, the ideas presented in Chapter 6 – Alternative View is a much more palatable and reasoned approach to filling this need. We encourage GASB to seriously consider the Alternative View offered by the two dissenting Board members. Doing so will provide reliable and auditable information which, along with the users’ own understanding of the environment in which the governmental entity operates, will allow them to make their own judgment regarding the entity’s fiscal sustainability.

We appreciate the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact Bob Kuehler at (303) 837-2112 or at Robert.Kuehler@cu.edu.

Sincerely,

[Signature]

Kelly Fox
VP and Chief Financial Officer