Letter of Comment No. 22
File Reference: 13-3PV
Date Received: 2/22/12

STATE OF ALASKA

Department of Administration
Division of Finance

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

Subject: GASB Preliminary View – Economic Condition Reporting: Financial Projects
Project No. 13-3

Dear Mr. Bean :

Thank you for the opportunity to provide input on this Preliminary View (PV) document. This letter represents a joint effort to summarize the viewpoint of the State of Alaska from the Offices of the Comptroller, within the Department of Administration, and Treasurer, within the Department of Revenue.

The State of Alaska is not in agreement with the basic premise of the PV. Including financial projections within the Comprehensive Annual Financial Report (CAFR), as contemplated by this PV, would be misleading to the users of the CAFR, and would infer that users may place reliance upon on this data on a level that is unmerited by the data itself. This process may be potentially damaging to the credibility of the data currently contained in the CAFR.

Additionally, Governments are structured differently than the private sector. State government's prospective financial activities are subject to change with each legislative session. The timing of the CAFR and the legislative session in Alaska is such that it is possible that major assumptions may change, invalidating the projection data in the CAFR within weeks of publication. State governments, unlike private sector organizations, also have the power of taxation so in difficult financial times, they have the ability to exercise those powers and provide for additional revenue as necessary.

Further, although projections are not typically presented within the CAFR, some forward looking information has historically been required to be included within the Management, Discussion, and Analysis (MD&A), the Letter of Transmittal, and note disclosures as they relate to long-term debt activity, which we feel provides a fair assessment of anticipated economic activity and its impact on our organization.

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Finally, the State's CAFR is required to be submitted by a statutory deadline, and the requirement to provide this additional information would place additional burdens on the CAFR staff, whom are already struggling to meet that deadline. This, combined with the fact that many of the State's systems are not currently programmed to provide data in this manner, make implementing this PV prohibitively expensive, effectively overshadowing any benefit we believe could be gained by its implementation.

The following provides comments to the specific questions posed by the Board in the PV document.

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:
The State of Alaska agrees that the five components listed above would be useful in assessing a government's fiscal sustainability; however, we do not agree that the CAFR is the correct vehicle for communicating this information.

Components 1 and 2: The State of Alaska currently has a process to identify General Fund net cash balances and fluctuations for the next fiscal year. Approximately 90% of our state revenues are derived from petroleum based taxes which take into account both production and price. Our cash flow analysis utilizes historical trends to predict cash flow needs in the year ahead, with adjustments made for changes in oil revenues and other anticipated changes. It is used primarily as a short term cash sufficiency exercise. Looking forward as far as five years would be of limited value from a cash flow basis due to the volatility of oil prices and production. To separate the inflows from the outflows would require a tremendous investment of staff and additional technology and we do not believe that the cost of doing so would justify the benefit obtained.

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Components 3 and 4: These items are sufficiently covered in note disclosures for pensions, OPEB, and long-term debts.

Component 5: Intergovernmental service interdependencies that exist and the nature of those interdependencies are displayed within the statistical and MD&A sections of the CAFR, especially as it relates to Federal Grants in Aid activity. Currently, the State has insufficient data to report on the impact of these relationships on local and municipal governments.

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:
The State of Alaska agrees that financial projections should be based upon the three items outlined above. However, we do not believe that the CAFR is the correct vehicle for the additional financial projections contemplated. The State of Alaska's main revenue source is related to petroleum revenue. That tax structure undergoes scrutiny in every administration and certainly within each legislative session. The Department of Revenue currently publishes a Revenue Sources Book twice a year, which makes projections specifically on our revenue sources. The timing of these projections within the Spring and Fall are necessary due to the volatility of revenue collections. Legislative sessions routinely include the introduction of legislation providing for changes in the tax structure, including tax credits, fees and tax rate reductions or increases. Because the CAFR is only prepared one time per year, as of a specific date and timed just prior to the start of the legislative session, the projections contemplated by this PV would likely be less useful than the projections contained in the Revenue Sources Book. Additionally, the skill sets involved in CAFR preparation are significantly different than those required to prepare financial projections, creating uncertainty about who is ultimately responsible for the data contained in the document.

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:
The State of Alaska does not agree with this view. The readers of the CAFR have become accustomed to the modified/full accrual basis of accounting. Mixing the cash basis for outflows and inflows (components 1 and 2) with the accrual basis for financial obligations within the same presentation would be confusing to the reader and potentially misleading. Further, the process of looking at inflows and outflows on a cash basis would also not take into consideration reserve funds that have been set aside against the future potential for decreased revenues. In Alaska, such reserves are substantial as a result of being able to save during periods of high oil prices.

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:
The State of Alaska agrees that in the development of financial projections, historical information as well as known events that will impact future projected periods should be considered and guided by a principles-based approach. As indicated above, these are currently discussed in the MD&A of the CAFR. Including additional projected economic data, however, may cause undue reliance on these projections where significant events or occurrences, where unforeseen, and have potentially devastating impacts.

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:
The State of Alaska concurs that the further out projections are made, the more risk they have in their accuracy and therefore their value. Shorter periods are more reliable; thus, we concur that five years seems reasonable. We currently provide additional data as part of our Continuing Disclosure Statements to assist users looking for a longer forecasting period in their decision making processes and believe that this is the correct vehicles for doing so.

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:
The State of Alaska does not agree with this view. The basic financial statements and notes stand on their own. We disagree that financial projections should be provided within the CAFR publication. The financial statements, notes and current statistical information are historical in nature and accountants are well versed in reporting this information. Bond rating companies, investors, and interested parties have been able to gather necessary information directly from the CAFR, State of Alaska Revenue Source Book, and Continuing Disclosure and Official Statements to make informed decisions regarding the fiscal sustainability of the State of Alaska. Therefore fiscal sustainability is not an essential component of the CAFR.

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:
The State of Alaska believes that rules should be applied consistently; however, we also understand that small governmental entities may have a difficult time providing the information contained within this PV without significant assistance and planning. There is already a requirement to report a going concern issue within the notes to the financial statements per GASBS #56; therefore, this appears to be somewhat redundant. Also, Alaska has a statutory requirement to pass a balanced budget, further ensuring our existence as an ongoing concern that will not overreach the limits of its continuing revenues.

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 it is determined that financial projections and related narrative discussions would be appropriate, the State of Alaska agrees that the effective date should be well into the future for all governmental entities and believes that a phase in based on size of governmental entities seems reasonable, similar to what was effective for GASBS #34.

Sincerely,

Angela M Rodell

Scot Arehart
Director of Finance
Department of Administration

Angela Rodell
Deputy Commissioner
Department of Revenue

cc: NASACT, NASC & NAST