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Project No. 13-3 Response to Preliminary Views on Financial Projections (PV)

As representatives of Minnesota's Government Finance Officers Association, we strongly disagree with your position that financial projections are essential for placement in a governmental annual financial report (AFR). While long-term budgets and/or financial projections are an important financial tool, it is our professional opinion that the inclusion of this type of information in an AFR is contradictory to the purpose of an AFR, and that the information is better suited for other reports already issued by government entities.

We disagree that outside financial statement users or research participants need additional information about the entity in the form of projections in order to make a determination of the entity's ongoing ability to generate resources. The rating agencies could assemble a spreadsheet of the projections this PV requires, if it was important to their ability to form an opinion of project or entity risk. Each of the issuers that have recently defaulted had projections that showed the activity to be feasible and sustainable at the time of debt issuance. Nothing in your proposed solution will change any of the conditions that led to default.

Below are comments that support our position.

1. **Contradictory to what an AFR represents.** The AFR is considered a document containing historical financial information with limited subjectivity. Including projections in this document significantly changes the traditional perspective of the AFR and may cause misconceptions about the information contained in the AFR and the amount of reliance that can be placed on the various sections of the AFR. Adding projections to the AFR will only serve to increase the gap between what unsophisticated users think an auditor's responsibility covers and what it actually does cover.
2. **Cost/benefit.** In a time of limited resources, changes to accounting standards must be sensitive to the increased cost that is incurred to comply with the change. Many governments currently prepare forward-looking financial documents that are available to users and the general public. These documents are presented in a format that suits each local entity, but may not fulfill the requirements proposed in the Preliminary Views document. Requiring all governmental entities to follow a prescribed format results in duplication of effort, as governments would continue to prepare forward-looking documents that meet internal needs along with the projections to be prepared using GASB requirements. Additionally,

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the confusion that the differences between the AFR and other forward-looking documents will cause can easily outweigh any potential good from your requirements.

The requirements of the PV document will increase internal effort and therefore internal costs for audit and financial statement preparation, much like GASB 34 and GASB 45. In addition to the added internal cost of this proposed requirement, there will be the added cost related to the increased use of financial professionals (such as actuaries, auditors, demographers and other consultants). For example, auditors will be exposed to risk beyond the traditional going-concern period of one year, which will result in increased audit effort to reduce this risk, and therefore increase the scope and fees of an audit engagement.

3. **No comparable private sector requirement.** To our knowledge, other standard setters such as IFRS and FASB do not have this topic on their agendas, which implies that this is not appropriate for AFR's. We fail to see how this information is essential for governmental entities, yet not essential for other entities, including those that are publicly traded that are at significantly greater risk of default.
4. **Other documents containing financial information are currently available.** In addition to the forward-looking financial documents identified in comment #2, there are other externally available sources of financial information such as Official Statements and rating reports related to debt issuance, SEC's Continuing Disclosure Requirements, Annual Budgets, Capital Improvement Plans, and other long-range financial management plans. As such, this PV results in duplication of effort.
5. **Timeliness.** The timely issuance of AFR's has been a recent discussion topic by many groups. The addition of financial projections will certainly extend the time necessary for the issuance of AFR's. The financial projection process cannot start until completion of the audited historical financial statements (to ensure that base year amounts are not materially misstated) and results in three additional phases prior to issuance, 1) preparation of the financial projections, 2) procedures performed by the auditor, and 3) review and acceptance by the governing body.
6. **Political pressure.** The inherent subjectivity of the information included in the financial projections could lead to political pressure on the governing body and management.
 - a) The governing body may have difficulty with GASB's projection format. For example, if a projection based on current policy were to indicate future deficits, the governing body has the ability to make the appropriate changes (either in level of service, or future revenues). Also, current assumptions used to prepare the projections may not be consistent with the views of future elected officials. The GASB's financial projection format implies the governmental entity does not have the ability and/or would not make said changes.
 - b) Financial projections that are included in an AFR potentially subjects management to political pressure to "massage" the projections to make policy makers look better.
7. **Reliance on the information contained in the AFR.** Users who rely on the information may establish expectations of future results that may not be fulfilled. As such, a governmental entity and auditors may be exposed to legal concerns and possible lawsuits based on or otherwise citing the information provided in the financial projections. Additionally, disclosing assumptions for projecting salaries and wages will complicate future labor and contract negotiations, particularly with arbitrators using the projections to imply sustainability of unreasonable demands from union members. Also, the projections may establish expectations for employees regarding future wage and benefit expectations that may not be met.

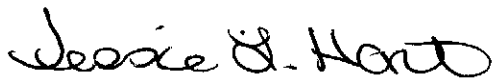
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8. **Unsophisticated users.** Users who are not familiar with governmental accounting standards and a governmental AFR have difficulty understanding the components of the AFR as currently presented. These users may not understand the limitations of RSI, especially financial projections. Many users will likely rely on the financial projections despite the cautionary notice.
9. **Limited usefulness of the proposed projection format.** The financial information contained in an AFR is historical and verifiable information as of a point in time, and for the most part, an unchanging document. In contrast, the financial projections contain information that is less certain and require continuous updating for ever-changing events. The projections are required to be based on “current policy informed by historical information and adjusted for known events and conditions”. The government would be required to use assumptions that will often times be no longer valid shortly after the projections are complete. Three examples are illustrated below:
 - a. **Internal forces that affect projections.** Assumptions used to prepare the projections will be out of date as soon after a newly elected body, “with new priorities”, take office. For instance, property taxes would be projected at historical rates even though an incoming governing body was elected based on significantly reducing property taxes. This would also apply to other revenue sources.
 - b. **External forces that affect projections.**
 - i. Intergovernmental Aid would be projected on historical amounts based on current law, even when there is a high likelihood that the law will be significantly changed due to Federal, State, or other local government budget issues within weeks of the entity’s AFR issuance.
 - ii. A governmental entity would project property tax revenue using historical increase in levy amounts, even though the State Legislature is contemplating levy limits, which would reduce the amount of increase the entity may levy. Again, State action could occur very shortly after the projections were issued, significantly reducing the usefulness of the information contained therein.

In conclusion, we firmly believe that financial projections should not be a required component of the AFR. However, some of the concerns identified in the PV can be adequately addressed by expanded disclosure requirements, such as 1) where to obtain copies of forward-looking financial documents and 2) disclosure of the method used by the entity for addressing fiscal sustainability and 3) disclosure of intergovernmental dependencies such as unfunded mandates.

Thank you for the opportunity to submit our response.

Respectfully submitted,



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Minnesota Government Finance Officers Association