



Richard J. Berry, Mayor

# City of Albuquerque

## Department of Finance & Administrative Services

Interoffice Memorandum

Date: 12/21/2011

**TO:** Director of Research and Technical Activities Project 13-3

**FROM:** City of Albuquerque  
Lou Hoffman, DFAS Director  
Gerald Romero, Budget Officer  
Pamela Berry, Accounting Officer  
Stephanie Yara, City Council Policy Analyst

**SUBJECT:**

This memo is meant to provide feedback on the Board's preliminary views on reporting financial projections and related narrative discussions by governmental entities. We have attempted to respond to the Questions for Respondents in the Governmental Accounting Standards Series Preliminary Views relating to Economic Condition Reporting: Financial Projections

**1. There are five components proposed to assist in assessing a governmental entity's fiscal sustainability.**

- 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:

We do not agree.

- Gross Receipts Tax is the primary source of inflow for the City of Albuquerque. Gross Receipts vary depending on the level of economic activity. In these volatile economic times, we cannot predict the inflows of Gross Receipts Tax five years out with certainty and consistency.

- Legally we are required to have a balanced budget so outflows would be based on forecasted inflows and current fund balances. From what we understand, fund balance is not considered as a component in the projections of fiscal sustainability.
  - Components 1 and 2 require the forecast to be completed using the cash basis of accounting. Components 3 and 4 use the accrual basis. The five year cash flow will be much less than the total financial obligations for bonds, pensions, and other long term contracts. Readers may be misled by the differences in the accounting methods.
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:

We do not agree.

- Mayoral elections take place every four years and City Councilor elections take place every two years. Policy may change with changes in the Mayoral and City Council administrations. This would make the five year forecast mute.
- The City of Albuquerque already completes five year forecasts for the General Fund. Each year the future years in the forecast are adjusted. Explaining the changes in year over year would become tedious and time consuming due to the dynamic nature of City policy and the needs of its citizens.
- The use of financial projections in public documents exposes the City to potential liability through violation of applicable Securities and Exchange Commission Rules. This liability exists even though the projections are not in an official offering document for the City's securities. The SEC in a written decision in an enforcement action specifically highlighted that misstatements in a CAFR subjected the City of Miami to liability under the antifraud provisions. The SEC has advised that "a municipal issuer . . . when it releases information to the public that is reasonably expected to reach investors and the trading markets, those disclosures are subject to the antifraud provisions. The fact that they are not published for purposes of informing the securities markets does not alter the mandate that they not violate antifraud proscriptions." The City's annual CAFR is provided to potential investors through the City's internal website and through the SEC's Electronic Municipal Market Access ("EMMA") system, as required under the City's Continuing Disclosure Agreements. Consequently, the proposed projections must be evaluated under the antifraud analysis set forth in SEC Rule 10b-5.
- SEC Rule 10b-5, adopted pursuant to the Securities Act of 1934, is the SEC's general antifraud rule which provides that it is "unlawful for any person . . . to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." As discussed throughout this memo, the high number of variables in ensuring reliability in a projection necessarily raises the increased possibility or probability that certain of these projections may ultimately be misleading or incorrect. If a purchaser of the City's bonds relied on these projections in the CAFR in making his investment decision, and they were materially incorrect or misleading, the bondholder and/or the SEC has a potential claim against the City.

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:

We do not agree.

- We believe that inflows and outflows would also need to be reported on an accrual basis since they are presented in the financial statements on a modified accrual basis, otherwise the information could be misleading. .

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:

We do not agree:

- Due to the inconsistencies in the inflows and the economy, we feel that the assumptions may not be consistent. SEC Regulations 15.C.2-12 requires annual financial information “to be prepared on a consistent basis to enable market participants to evaluate results and perform year to year comparisons.” [108]
- We believe that there could be legal ramifications to providing a five year cash flow forecast. If the City is materially wrong, investors who bought bonds based on the projections may have the right to file lawsuits against the City. Rating agencies currently look at the City's Five Year Forecast for the General Fund.

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:

We do not agree:

- We do not believe any annual financial projections are a useful tool for the average reader of our financial statements. Bonding agencies and potential investors can look to our already published five-year forecasts for this information.

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:

We do not agree.

- We believe that providing a five year forecast as a component of the financial statements and notes will confuse readers. We believe that the MD&A should provide insight regarding the expected increases in inflows or outflows.

- Requirements to have Projections of the total financial obligations and major individual financial obligations, including bonds, pensions, other postemployment benefits, and long-term contracts is already included in the notes to the financial statements.

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:

We do not agree.

- We believe that the purpose of the MD&A is to inform readers of the financial condition of the organization and to explain changes in the financial condition as a result of the operations including economic factors. It also gives narrative on management's expectations of the future.
- We believe that requiring financial projections would require more manpower and put a burden on already strained resources. Many municipalities have a difficult time completing the Comprehensive Annual Report (CAFR) by the required deadline. This requirement would further delay the release of the CAFR. Additional resources would be needed in Accounting and Budget divisions of the City. Explaining the differences year over year could become extremely complex.
- The CAFR is a static of the financial health of a municipality. The City does calculate five year forecasts for the General Fund. We believe this is useful for internal management. However, to publish such forecasts could be misleading to the citizens and could be legally detrimental to the City. We believe that Financial Cash Flow Forecasts could be materially incorrect based on too many unknowns. Financial Statements should be materially correct and should not be misleading in any way. We believe that investors should analyze the historical data, request additional information, and make their own conclusions as to the future of an organization and not rely on the cash flow projections because there too many variables that could impact the numbers. If an investor relied on a particular forecast and circumstances changed, the City could potentially have to defend itself in a law suit.
- Auditors are not required to audit the financial forecast and therefore would give no opinion.

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:

- We do not believe this should be implemented at all.