



March 16, 2012

Director of Research and Technical Activities  
Project No. 13-3  
GASB  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

**RE: Preliminary Views Economic Condition Reporting: Financial Projections**

Dear Director of Research:

The Securities Industry and Financial Markets Association<sup>1</sup> (SIFMA) appreciates the opportunity to provide comments on the Governmental Accounting Standards Board's (GASB) Preliminary Views Economic Condition Reporting: Financial Projections (PV). We commend the Board's efforts to provide guidance on communication of other information needed by users to assess economic conditions, specifically the fiscal sustainability of a governmental entity. We support the Board's efforts to provide greater transparency in financial reporting, as this transparency is critical not only in the evaluation of underwriting transactions but also to secondary market participants.

Conceptually, we are supportive of the Board's initiative to provide projections to assist in the evaluation of a governmental entity's fiscal sustainability. However, our support is not absolute as we recommend the Board to take into consideration implementation may be problematic, costs will increase, and delayed filing of financial reports may occur. Therefore, we also recommend

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<sup>1</sup> The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

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that the Board not require financial projections and related narrative to be communicated as required supplementary information (RSI) in the annual financial report (AFR) or comprehensive annual financial report (CAFR) but rather recommend it be communicated as supplementary information (SI). We agree with the Alternative View as presented in paragraphs 1 and 2 in Chapter 6 of the PV.

The following are our responses to questions raised in the Preliminary Views and other comments in the event the Board decides to issue guidelines or develop a standard.

***Question One:** 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).*

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In providing our response we ask the Board to consider the view that there are two components to fiscal sustainability for governmental agencies; a liquidity component and a solvency component. Liquidity is best addressed by cash flow projections where both the cash inflows and outflows are shown. Solvency can be determined with the use of accrual-based accounting where liabilities and guarantees are reflected on financial statements with appropriate footnote disclosures. We make this distinction regarding fiscal sustainability as short-term liquidity issues can often be addressed with financing, whereas solvency issues often require structural changes.

#### Component 1 – Projections of Cash Inflows

We agree with Component 1 including the requirement for projections of nonrecurring and temporary sources of cash inflows; cash inflows from other governmental agencies (which should be separately identified and discussed).

#### Component 2 - Projections of Cash Outflows

We agree with Component 2 but have concerns. While we agree that outflows by program or function are useful, the projections may not be reliable unless actual cash flows are consistently reflected by the same program or with the same functional classifications. We agree that the projections should be based upon current service levels together with projections of new programs approved and/or initiated.

#### Component 3 – Projections of Financial Obligations

We agree with Component 3 even though some of this information may be reflected in the financial statements of governmental entities using a GASB Statement 34 format. That said a narrative for financial obligations would be useful to users.

We are skeptical if the information provided will really provide users the ability to determine if a governmental entity is deferring costs to future periods. If a governmental entity is deferring costs to future periods, we would suggest that such information be disclosed and/or discussed.

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For complex items such as pensions and other post employment benefits, commonly referred to as OPEBs, where liabilities are being incurred but cash payments are not being made, such deferrals should be set forth in “Plain English”. We would also suggest that items such as defeasements and other off balance sheet items be shown and discussed in “Plain English”.

We would like to reinforce our earlier comment regarding solvency and reiterate that all liabilities (i.e., non-debt financial obligations) should be “on balance sheet”. This will greatly assist with determining the projected financial obligations and assessing an entity’s solvency.

#### Component 4 – Projections of Annual Debt Service Payments

We agree with Component 4. Having the amounts of authorized but not yet issued debt and expected debt issuances over the projection period is very useful information in assessing an entity’s fiscal sustainability.

Regarding Components 2, 3 & 4, we have some concerns about the accuracy regarding projecting cash outflows on authorized unissued debt as the debt projection is a “best estimate” until the day of pricing. Also, the allocation of cash between governmental and enterprise activities can only be “second guessed”, resulting in a speculative projection at best.

#### Component 5 – Narrative Discussion of Major Intergovernmental Service Interdependencies

We agree with Component 5 that a qualitative discussion of service interdependencies is sufficient. However, where the interdependencies are significant a quantitative amount should also be disclosed. (For example: If a state funds local school systems and the municipality could not support those operations without the intergovernmental support.)

Additionally, quantitative disclosures should be made when intergovernmental services payments are received from another entity and those cash funds are co-mingled and used for other purposes (i.e., general funds).

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General comments:

Although generally supportive of the use of cash projections we have concerns regarding potential confusion by the users regarding the audited financial statements which are typically presented on an accrual basis versus the use of cash projections. Users may assume that projections are “audited” and as reliable as the audited financial statements. Issues may also arise if users attempt to reconcile the projections to the statement of activities.

***Question Two:*** *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?*

Generally we agree that projections should be based on current policy, historic information and adjusted for known events (i.e., formally adopted). However, we would suggest that if there is material planned policy changes these items should be disclosed or discussed and an attempt should be made to quantify their impact on the financial projections.

***Question Three:*** *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?*

We believe that cash projections provide the most useful and reliable analysis for assessing a governmental entity’s liquidity status. We also believe that users of financial statement need to be able to assess a governmental entity’s solvency for which accrual based financial information is the most appropriate accounting method for that assessment.

Our concern with the “mixed use” of both cash and accrual basis in the projections is that users may believe that “cash payments” are to be made for the financial obligations when they may not. This assumption might then lead users

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to a potentially more favorable assessment of an entity's –fiscal sustainability than would be accurate.

We would request the Board to rethink its definition of fiscal sustainability in terms of liquidity (a short term measure) and solvency (a long term measure), which we view as the two distinct components of fiscal sustainability.

We agree with the Board's decision not to require the modified accrual basis.

General comments:

At this time we would also like to mention potential operational issues for the Board to consider. Not all municipalities have audited financial statements or present their financials under GASB. Some states have “statutory accounting mandates” that differ from GASB reporting requirements which is disclosed to the user.

If the financial projections are to be communicated as RSI external auditing costs will increase for these governmental entities, which may be passed on to the issuer. We also would suggest the Board consider the impact on the audit if these supplementary schedules are required to be audited, thereby increase the auditing costs to the governmental entity as well as increasing the time to complete an audit – impacting the timeliness of the information.

***Question Four:*** *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?*

We agree that the financial projections should be principles-based and significant assumptions disclosed.

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***Question Five:** 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?*

We agree that financial projections should be made for a minimum five year period beyond the reporting period.

We would ask the Board to also consider a requirement for a “true up” of the projections to actual results (or new projection). The current preliminary view provides no mechanism for a user to determine if historically the entity has been providing reliable projections. A reconciliation and discussion of the accuracy of the previous projections would be useful to both the user and the preparer of the projections.

***Question Six:** 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?*

We agree that the six qualitative characteristics in Concepts Statement 1 are equally applicable to financial projections. One of the Qualitative Characteristics of reliability notes that “forward-looking information is reliable if it is verifiable”. If as defined in the Encarta Dictionary, verifiable is “to prove that something is true”, we ask that the Board share its thinking as to why financial projections are verifiable.

We believe that the financial projections and related narrative discussion should be communicated as supplementary information (SI) following any applicable GASB issued or GASB cleared guidance regarding the format and content of that information. Our decision is guided by paragraph 44 in Concepts Statement 3 that states “subjective assessments of the effects of reported information on the reporting unit’s future financial position is excluded from RSI”. **Furthermore, paragraph 45 in Concepts Statement 3 states that “items of information that meet the definition of and criteria for RSI is essential for placing basic financial statements and notes to the basic financial statements**

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**in a context and is required to be presented with basic financial statements and notes”. We do not agree that this information is “essential” but rather “useful”. This information does not rise to the level as stated in paragraph 42 in Concepts Statement 3.**

### **General comments**

Financial projections should include both governmental activities and business-type activities, with net subtotals for the general fund , other governmental activities, total governmental activities and total business-type activities, and a net total for the entire government, inclusive of a narrative discussion of which activities significantly impact the fiscal sustainability of the primary government.

Governmental entities should not be required to report financial projections on their discretely presented component units, but the relationship with the component unit should be discussed/disclosed and information provided on the location of the financial statements for those component units.

We agree with the Board’s approach to define “major” as at least 10% for cash inflows, cash outflows and financial obligations and the use of professional judgment be used in defining “major” with respect to intergovernmental service interdependencies. However, in situations where a program/service could not be sustained without the intergovernmental support that information should be discussed/disclosed even if it does not reach the 10% threshold.

We are concerned that continuous update throughout the projection periods as what is “major” could be burdensome for some governmental entities as defined by time, manpower and cost. If this information is required to be communicated as RSI an unintended consequence could be to produce disincentives to report on a GASB basis where possible.

We agree that a forcefully worded Cautionary Notice accompany the projections.

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***Question Seven:** 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?*

We agree in theory that all governmental entities should report financial projections and the related narrative discussion. But we also suggest that the Board be sensitive to operational issues and the cost this requirement may impose. The Board might consider a scope exemption from the reporting requirements for governmental entities particularly small in size.

***Question Eight:** 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)?*

We do not believe that a phase-in period should be part of the implementation given sufficient lead time to adopt. Frequently pooling arrangements exist as a funding mechanism and different phase-in periods may cause different disclosure standards for entities within the same financing pool.

#### Alternative View

We agree with paragraphs one and two of the Alternative View in Chapter 6 of the PV and therefore have suggested that the financial projections and related discussion be treated as supplementary information (SI), as previously discussed.

#### **Conclusion**

SIFMA appreciates GASB’s continuing efforts to support transparency in financial reporting. We are generally supportive of the initiative to provide projections and related discussions in order to assess governmental fiscal sustainability. We expect that implementation as required supplementary information (RSI) may be problematic, may potentially increase reporting costs or delay filings. We support communication of this information as supplementary information (SI) in agreement with the Alternative View, paragraphs one and two in Chapter 6 of the PV. We ask the Board to consider a “scope” exception for small governmental entities.

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SIFMA sincerely appreciates the opportunity to comment on GASB's Preliminary Views Economic Condition Reporting: Financial Projections and would be pleased to discuss our response with the GASB staff. Please do not hesitate to call me with any questions at 212-313-1265.

Sincerely yours,

A handwritten signature in blue ink that reads "David L. Cohen". The signature is fluid and cursive, with the first letters of each name being capitalized and prominent.

David L. Cohen  
Managing Director and  
Associate General Counsel

Cc: Mary Kay Scucci, CPA, PhD, Managing Director, US Business Policy and Practices, SIFMA  
Anne Ross, SIFMA's representative to GASAC