



United States Government Accountability Office
Washington, DC 20548

March 16, 2012

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

Subject: Preliminary Views of the Governmental Accounting Standards Board on major issues related to *“Economic Condition Reporting: Financial Projections.”*

This letter provides the U.S. Government Accountability Office’s (GAO) comments on the Governmental Accounting Standards Board’s (GASB) November 2011 preliminary views on major issues related to *“Economic Condition Reporting: Financial Projections.”*

We support the GASB in its efforts to develop guidance for presenting information that will assist users in assessing a governmental entity’s economic condition, and we broadly support the objectives of the preliminary views document on *Economic Condition Reporting: Financial Projections*. Supplementing the current financial statements with information on an entity’s ability and willingness to meet its financial obligations and service commitments provides users more robust financial information and allows for more informed decision-making.

Accordingly, we agree with the Board that forward-looking information is necessary for users to assess a government’s ability and willingness to generate inflows of resources necessary to honor current services and to meet its financial obligations as they become due, without transferring financial obligations to future periods that do not result in commensurate benefits. As noted in the preliminary views document, accounting standards for the federal government have required reporting of certain fiscal sustainability information, beginning in fiscal year 2009.

We note financial projections are inherently subject to substantial uncertainty, and we encourage the Board to continue considering how to address the many challenges associated with economic condition reporting. Some of the significant challenges to be considered include the basis upon which financial projections should be made, the length of time to include in financial projections, and the implications for auditors’ reporting on the financial projections in required supplementary information (RSI).

Our comments on the Board's preliminary views document follow and include further discussion of these challenges.

Responses to Questions for Respondents

The Board asks respondents to consider the following specific matters for comment:

1. Do you agree with the Board's components of information necessary to assist users in assessing a governmental entity's fiscal sustainability?

Yes, we agree with the Board's components of information necessary to assist users in assessing a governmental entity's fiscal sustainability and believe that they are appropriate. We also agree that the public and decision-makers need broad information on an entity's economic condition and that fiscal sustainability reporting should provide information for users to assess a government's ability and willingness to generate inflows necessary to honor current service commitments and to meet financial obligations as they come due, without transferring financial obligations to future periods that do not result in commensurate benefits.

2. Do you agree with the Board's preliminary view 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?

Yes, we agree with the Board's preliminary views that financial projections should be based on current policy, informed by historical information, and adjusted for known events and conditions that may affect the projection periods. We also agree that the projections should be based on current policy, which includes policy changes that have been formally adopted but will not be effective until future periods. Historical information, including a look back at actual past practice, is important because it provides known, actual results as the starting point for projections and is readily understood both by governments making financial projections and users assessing fiscal sustainability based on these projections.

3. Do you agree with the Board's preliminary view that inflows and outflows should be projected on a cash basis of accounting, with financial obligations projected on an accrual basis of accounting?

Yes, we agree that inflows and outflows should be projected on a cash basis of accounting, and will provide users with information that will be useful when assessing fiscal sustainability. As the Board notes, many governmental entities are already preparing these financial projections on the cash basis of accounting. We also agree with the Board that using the accrual basis of accounting for projecting financial obligations provides more complete information, as outflows of resources

associated with long-term liabilities are not reported under the modified accrual basis of accounting.

4. Do you agree with the Board's preliminary view 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, do you agree that 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?

As stated above, we agree with the Board's preliminary view that the assumptions should be based on historical information, as well as events and conditions that have occurred and affect the projection periods. Also, we agree that 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.

5. Do you agree with the Board's preliminary view that annual financial projections should be made for a minimum of five individual years beyond the reporting period for the purpose of external reporting?

We encourage the Board to consider requiring that the financial projections be made for a projection period sufficient to illustrate long-term sustainability, subject to a minimum of five individual years. We have concerns that, in some instances, five years beyond the reporting period may not be a sufficient projection period to illustrate long-term sustainability. Also, establishing only a minimum number of years may not provide a clear principle as to when the projections would exceed the five year minimum. Further, deciding on the appropriate period of the projections should recognize that the longer the period, the greater uncertainty surrounding the financial projections.

6. Do you agree with the Board's preliminary view 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?

Yes, we support in concept the Board's preliminary view that the components of fiscal sustainability information described in the *Preliminary View* are essential and should be required to be communicated as RSI. As noted in the *Preliminary View*, the federal government's reporting on fiscal sustainability includes basic financial

information, related note disclosure, and RSI. However, we encourage the Board to consider the audit implications associated with including financial projections in RSI. Auditors may face significant challenges in reporting on or providing assurance over financial projections due to the inherent uncertainties. Further, updates to auditing guidance may be necessary before auditors can begin reporting on financial projections communicated in RSI or elsewhere.

7. Do you agree with the Board's preliminary view that all governmental entities should be required to report financial projections and related narrative discussions?

Yes, we agree with the Board's preliminary view that all government entities should be required to report financial projections and related narrative discussions to provide users with information that allows them to understand and assess the fiscal sustainability of the governmental entity.

8. Do you agree with the Board's preliminary view that a phase-in period for implementing the reporting requirements for financial projections and related narrative discussions would be appropriate?

We agree with the Board that a phase-in period for implementing reporting requirements for financial projections is appropriate. This phase-in period will permit entities and staff to develop the practices and processes necessary to report the financial projections and related narrative discussions without negatively impacting other reporting requirements. It will also permit the audit community sufficient time to make any necessary updates or revisions to guidance for auditors reporting on financial projections communicated in RSI.

Other Comments

In addition to our responses to the above questions, we are providing other comments for the GASB's consideration in developing a standard on fiscal sustainability reporting. Specifically, we believe that fiscal sustainability reporting should

- include narrative disclosures related to:
 - major factors expected to have a significant impact on the projections;
 - trends in historical and projected receipts and expenditures, including the period after the end of the projection period;
 - the results of sensitivity analyses for key assumptions to show a range of differences in the projections if such key assumptions are varied;
 - the major factors that are expected to have a significant impact upon projected receipts and spending, and how such factors are expected to change over time;

- the potential effect of any changes in current policy, known events, or conditions that occur after the end of the current year, but prior to the issuance of the financial statements; and
 - reasons for significant changes in the projections from the prior year.
- clarify the criteria to be used for determining whether an assumption is appropriate; for example, federal accounting standards for long-term fiscal projections discuss the use of “reasonable” assumptions about the future course of receipts and spending assuming the continuation of current policy without change.
- generally be consistent over time, with any modifications between reporting periods, such as the formats and assumptions and terms used, highlighted and clearly explained to enhance the comparability of the information.
- encourage the use of illustrative graphs, tables, and other presentation techniques to enhance the understandability and usefulness to the financial statement users.

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Overall, we support the general premise of presenting information on financial projection and long-term fiscal sustainability, and we encourage the Board to continue considering how to address the challenges of reporting an entity’s projections of financial condition. We thank the GASB for the opportunity to provide comments on this important project.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin", with a stylized flourish at the end.

James R. Dalkin
Director
Financial Management and Assurance