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Mr. Alan Skelton
Director of Research and Technical Activities
Project No. 3-41
Governmental Accounting Standards Board
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Dear Mr. Skelton,

On behalf of the Government Finance Officers Association of the United States and Canada (GFOA), we thank the Governmental Accounting Standards Board (GASB) for the opportunity to comment on the Exposure Draft (ED) document, *Certain Risk Disclosures*. This response was prepared by GFOA's Accounting, Auditing, and Financial Reporting Committee.

GFOA does not support the proposed guidance requiring certain risk disclosures. While governments should and do actively monitor the risks associated with concentrations and constraints that they are exposed to, we believe there is little value and much additional cost and burden in the proposed disclosures, and that the forward-looking information is inconsistent with the retrospective, fact-based foundations of basic financial statements. If there is any place for such information in an annual comprehensive financial report, it is in a transmittal letter, where governments are intended to include their expectations and plans (such as for mitigation of known risks) for the future. Should GASB nonetheless choose to pursue these types of disclosures, we have serious doubts about the specifics of the proposed standard.

Costs and benefits – For governments that prepare an annual comprehensive financial report (ACFR), (1) concentrations are apparent from required information in the statistical section of an ACFR, (2) events that have occurred prior to the reporting date would likely be disclosed as subsequent events, and (3) probable events would be within the parameters of a letter of transmittal. For other governments, there is significant concern about their ability to reliably identify events (more on this below) and determine the likelihood of their occurrence and their effects. We are particularly concerned with the burden on small governments, many of which do not have the staff and technology necessary to perform the projections, nor the resources to obtain them. Moreover, the extremely subjective nature of the disclosure criteria makes the likelihood of meaningful disclosure quite small. If such disclosures were mandated, we believe most preparers (and their legal counsel) will choose language that meets the minimum requirements, focusing on minimizing the risk of causing reputational or financial harm. Even if these disclosures do not quickly become boilerplate, the vagueness and broadness of language that will be used by governments will, we believe, render them essentially useless.

Shift in focus – The proposed guidance shifts the focus of disclosures to be forward looking rather than supported by actual historical events. As stated in GASB Concepts No. 7, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements: Notes to Financial Statements*, paragraph 10, the notes should not include predictions about the effects of future events on future financial position. While anchoring the proposals in the ED to existing concentrations and constraints, the ED explicitly proposes *to require* governments to make predictions of their future financial position based on future events.

Shortcomings of proposed guidance – Should GASB decide to move forward with the proposal notwithstanding the concerns raised above, we believe the ED has fatal flaws.

First and foremost, the ED does not define or even explain what constitutes an "event" that would be a trigger for including the proposed disclosures in paragraph 6b. The only source of information about the meaning of the term is the nonauthoritative illustrations, and that list only serves to raise more questions. For example,

- If a county will discontinue extensive pandemic-related public health services (vaccinations, testing) and relief programs, and this will constitute a substantial effect on services compared to the level currently provided, due to the discontinuation of federal pandemic funding, would the reduced funding be an event (as it is more likely than not to occur or has occurred) that is related to the concentration of federal funds used for such programs, even though that funding was always intended to be temporary? (This question could be generalized to any substantial nonrecurring grants and donations.)
- If it is determined to be more likely than not that a new or a stricter property tax cap for counties will be enacted within 12 months of the financial statement date or shortly thereafter, could that potential enactment be an event associated with the concentration or constraint? (If so, how is the disclosure anchored in an existing constraint or concentration? If not, would that defeat the objective of the disclosure?)
- If inflation has increased and/or is deemed reasonably certain to increase above the annual cap on property tax growth, and this growing mismatch is expected to have a substantial effect on the level of services that can be provided within the next three years, can inflation be an event associated with a concentration or constraint?
- If the election of an official (President of the United States) or a new legislative majority with an explicit platform of shrinking government, including by cutting school aid, occurs or is deemed more likely than not to occur within 12 months of the financial statement date or shortly thereafter, would the election be an event about which a school district with a high concentration of federal aid should assess the likelihood of a substantial reduction in services?
- Most importantly from the perspective of many preparers, there is no useful guidance as to how the assessments of the likelihood of the occurrence of events and likelihood of occurrence and significance of their effects on governments' ability to provide services and meet obligations, should be made. Of course, the requirements for such assessment will not be unique in GAAP if adopted, but this will likely be the hardest aspect for smaller and less sophisticated governments to implement, and may become yet another reason few elect to follow GAAP.

The ED also fails to adequately explain what constitutes a substantial reduction in services provided, and does not make clear if the assessment of substantiality has both quantitative and qualitative aspects, as do significance and materiality. It is unclear if governments should focus exclusively or primarily on essential services such as public safety and public works, or if *any* service with a substantial dollar value that was provided in the period covered by the financial statements – essential or non-essential – that may have to be reduced in the next three years as a result of an event, should be subject to disclosure. Some examples of questions that the ED does not appear to answer include:

- If a small local government usually spends a substantial amount on fireworks for the July 4 celebration but projects that fireworks will be discontinued as a result of projected budget shortfalls resulting from a property tax cap (constraint) and an increase in the federal minimum wage that will drive up wage costs (event), would the situation require disclosure in accordance with paragraph 7 of the ED because services will not be at the same level provided as the current year?
- Similarly, a government projects that services will be reduced as a result of projected budget shortfalls resulting from a property tax cap (constraint) and an increase in required contributions to a pension fund, such as a balloon payment negotiated several years ago (event). Would an event that is already known to exist require disclosure in accordance with paragraph 7 of the ED?
- If the school district in Illustration 2 enacts a budget that will discontinue nonessential services such as extracurricular activities, drivers' education and individual musical instrument lessons, without need to affect any academic offerings, increase class sizes, or otherwise reduce core, academic services, would those service reductions be considered substantial? (More on this example below.)

The proposed standard only allows for disclosure of mitigation actions that have already been taken before issuance of financial statements, while planned mitigation cannot be disclosed. Therefore, readers are left to imagine worst-case scenarios or may conclude that the government is doing nothing to mitigate the potential risk, which in most cases would be incorrect. Returning to the example above related to the school district in Illustration 2 of the ED, if the substantial reduction of nonessential services is required to be disclosed even before the budget is modified, financial statement users would know only that there will be a substantial impact, without having any way of knowing that the district has plans in place to absorb the funding reduction without affecting core educational services.

Governments should be permitted to disclose, at a minimum, that they already have developed plans for actions to mitigate the substantial effect, or to limit it to nonessential services. The restriction against disclosing planned mitigation as an attempt at objectivity belies the extremely subjective nature of the entire ED proposal.

Unintended consequences and potential misuse – While the proposed disclosures may be intended to provide users of the financial statements with an early warning about the risks associated with concentrations and constraints, we believe that the proposed disclosures could lead to unintended consequences. In the illustrative disclosure in Illustration 3 in the ED, disclosing that public safety employees will go on strike and cause a reduction in public safety services, could be used to influence negotiations, either by creating unnecessary fear in residents of increased crime, or by documenting the risk of substantial reductions in other services. The proposed disclosures could be misused by government leaders for political gain in a wide variety of situations, including by assessing the likelihood and significance of events such as the outcome of collective bargaining, an election, or legislative deliberations, as previously discussed. The notes to the financial statements should not be able to be so easily manipulated and used as a political or bargaining tool.

Audit impacts – Under the proposed guidance, governments will be required to have their financial projections and determination of likelihood evaluated for reasonableness as part of their independent audit, which will lead to an increase in the amount of documentation to be prepared, provided to and discussed with the auditor. Additionally, as "reasonable" is a low threshold, the added audit work will be of limited, if any, value to users relying on the financial statements. As noted earlier, governments should and do actively monitor the risks associated with concentrations and constraints that they are exposed to, including preparing financial projections. However, the degree of subjectivity of these financial projections is quite high, and should not be subject to auditing procedures. The communication of the existence and extent of significant constraints and concentrations is better suited for the unaudited management discussion and analysis (MD&A), significantly reducing the risk of increased audit fees and delays in issuance. As stated earlier, projections of specific future events and their likely effects should be included only in a letter of transmittal.

Other comments on the ED –

- We support the explicit language in paragraph 7 of the ED stating that if the mitigating actions taken result in the disclosure criteria to not being met, then none of the disclosure is required.
- Noting that paragraph B20 of the ED states that "the Board believes that governments should not be required to search for potential events that might result from each of the concentrations or constraints that it faces," we recommend that the Board include language in the final standard similar to guidance for capital asset impairments in GASB Codification section 1400, *Reporting Capital Assets*, paragraph 168:

  > The events or changes in circumstances affecting a capital asset that may indicate impairment are prominent - that is, conspicuous or known to the government. Absent any such events or changes in circumstances, governments are not required to perform additional procedures to identify potential impairment of capital assets beyond those already performed as part of their normal operations. The events or circumstances that may indicate impairment generally are expected to have prompted discussion by the governing board, management, or the media.

We hope that the Board decides not to pursue the ED proposal further. However, if the decision is made to move forward with any aspect of the ED, notwithstanding our assessment of the relative costs and benefits, we certainly hope that a final statement will provide clearer guidance (1) with regard to what type(s) of possible future happenings that would properly be considered "event[s] associated with the concentration or constraint," (2) to further clarify the meaning of *substantial* in this context (including the qualitative assessment of the essentiality of services), (3) to assure that disclosures of the existence of risks are not made misleading by excluding all references to plans made or being made to address them, and (4) minimizing the opportunity for intentional misuse of the disclosures.

Please feel free to contact GFOA's Director of Technical Services, Michele Mark Levine, by telephone at 312.977.9700 ext. 6101 or email at mlevine@gfoa.org, if you have any questions.

Sincerely yours,

Diane B. Allison, CPA

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