



September 30, 2022

Mr. Alan Skelton
Director of Research and Technical Activities
Governmental Accounting Standards Board

RE: Project No. 3-41, Certain Risk Disclosures

Dear Mr. Skelton,

The Governmental Executive Committee (Committee) is pleased to comment on the exposure draft of the Proposed Statement arising from Project 3-41, Certain Risk Disclosures. Our comments represent the collective view of the Committee and not the individual views of the members or organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

We appreciate the work of both the Board and its staff to identify concentrations and constraints common to the governmental environment and its goal to enhance timely disclosure of a government's inability to continue to provide services at the current level or meet its obligations when they come due. While we appreciate the potential usefulness of this information, we do not concur with the direction of the Board's Proposed Statement and agree with the alternative viewpoint that any real-life disclosures under the Proposed Statement will be either too infrequent or late to be useful.

Our prevailing opinion is the Board should seriously reconsider the Proposed Statement in light of our concerns about (1) scope creep, (2) the Board's perceived cost/benefit analysis, and (3) the subjectivity of the Board's proposed disclosure criteria. First, we see the Board's Proposed Standard as scope creep in financial reporting from the aspect that it establishes more of a risk *forecasting* procedure standard as opposed to the Board furthering the development of *retrospective* financial accounting and related reporting of a government's results. While some element of forecasting already exists for going concern disclosures within Statement No. 56, this Proposed Standard requires a government to predict and disclose what could potentially happen in three years, a much longer time period than what is required currently and a much more difficult exercise given how quickly things can change in today's economy. Second, we are concerned about the Board's consideration of the perceived costs and benefits of the Proposed Statement, especially the impact this Proposed Statement would have on smaller local governments. In our opinion, larger governments will likely have sufficient diversity such that they will not have to spend much time analyzing potential concentrations outside of the (usually) very public collective bargaining process and corresponding agreements. However, as the size of a government decreases, the potential for insufficient diversity skyrockets, increasing the sheer volume of potential concentrations typically under-resourced local governments will need to consider and analyze for disclosure. This Proposed Standard, if adopted, will likely become an additional unfunded burden on the smaller governments which comply with generally accepted accounting principles. Finally, we believe the disclosure criteria proposed by the Board are too subjective and will lead to diversity in practice that may allow governments adverse to disclosure to not report concentrations and constraints. For instance, the terminology "at least reasonably possible" meaning "more likely than remote" uses two subjective phrases that appear to provide standardization; however, these phrases are only likely to begin a major debate about what these terms mean between management and auditors in attempting to apply this

guidance in a real-life scenario, especially without detailed example scenarios management and auditors can use as guideposts to implement the Proposed Standard.

If the prevailing arguments are unpersuasive to the Board, we then believe the Board should suspend its activity on this Proposed Statement until it can complete its work on the related going concern disclosures project. This approach would have two significant benefits. First, the Board will have fully vetted factors which are likely to contribute to severe financial distress. Second, the Board can issue one comprehensive statement addressing all the factors which should require disclosure to facilitate an early warning process, all the way from the initial development of a problem that could impact a government's ability to provide services or meet its obligations as they become due all the way down the path to full blown financial distress. In our opinion, a piecemeal approach to applying disclosures of certain risks, but not all possible risks that could severely impact a government's ability to provide services or meet its obligations as they become due, while also having to apply the existing going concern guidance within Statement No. 56 is likely to result in confusion, ultimately resulting in diversity in practice.

In the event the Board chooses not to combine its certain risk disclosures and going concern projects together, our Committee developed three alternatives for the Board to consider during the Board's redeliberation process on this Proposed Statement. Of these alternatives, our preferred approach is Alternative 3.

Alternative 1

The Board proceeds with issuing the Proposed Statement; however, the Board modifies both (1) the disclosure criteria for a concentration or a constraint in paragraph 7 and (2) the scope of the disclosures within paragraph 8.

Under this alternative, we propose the Board change paragraphs 7 and 8 to require all governments:

- 1) disclose significant concentrations where insufficient diversity exists which were material to one or more reporting units of the primary government either (1) during the period covered by the financial statements or (2) at any time during the next three years, if an event has occurred before the issuance of the financial statements which is more likely than not to result in a significant concentration;
- 2) disclose significant constraints which materially limit the ability of one or more reporting units to acquire resources or control spending either (1) during the period covered by the financial statements or (2) at any time during the next three years, if an event has occurred before the issuance of the financial statements which is more likely than not to result in a significant constraint;
- 3) a brief description of the concentration or constraint such that a user could understand the who, what, when, where, why, and how of the matter (such as the name of the names of the principal employers or industries, the citation of the statute or ordinance, etc.); and,
- 4) disclosure of whether the significant concentration or constraint is expected to continue beyond the current period and, if known, when the constraint will expire (such as the end date of a collective bargaining agreement) within the next three years.

This approach would provide users of financial statements with objective and verifiable information that could be audited. From this information, users could perform their own evaluation about the risk posed by disclosed concentrations or constraints and its impact on the ability of the primary government to continue to provide services at the current level or meet its obligations when they come due. Further, by removing the analysis by management from the notes to the financial statements, this change would significantly benefit preparers and auditors. From the preparer's perspective, this approach would not put management in a position where they are responsible for (1) forecasting the likelihood of events that have not yet, and may never, occur (outside of routine accounting estimations) and (2) evaluating the possible

response by the entity's governing board (which may not even have firm membership due to an intervening general election) and management team to mitigate the risk such that the concentration or constraint will not require disclosure under the Board's one-year and three-year time frames. From an auditor's perspective, this approach limits liability exposure arising from the risk of providing users with assurance about the likelihood of future events where the auditor really has no expertise in evaluating the likelihood of the risk and the need for disclosure. This approach would balance the need to provide users with additional audited disclosure about a government's concentrations and constraints, while not putting preparers and auditors in an awkward position.

Alternative 2

If the Board was to proceed with issuing the Proposed Statement without significant revisions, we believe disclosure within the notes to the financial statements is not the best location within a primary government's Annual Comprehensive Financial Report for users to find this information. We believe this information should be presented as part of management's discussion and analysis (MD&A).

First, we believe MD&A is more appropriate than the audited notes because circumstances which may evolve into an event occurring up to three years from the balance sheet date necessarily involves significant discussion and analysis – including assumptions about *future* events and the potential responses to these *future* events by a government's *future* governing board and management – by *current* management about something that has not yet, and may never, occur. Second, this analysis could be extremely difficult to prepare by current management, as current management's assessment will necessarily involve the weighing of the likelihood of a potential constellation of results on the impact to the government's service levels and or ability to meet its obligations when they come due to determine the likelihood any specific concentration or constraint will meet the Board's two disclosure thresholds. Third, this analysis would be extremely difficult, if not impossible, for auditors to opine on the fairness of the disclosure or, more likely, management's decision to not make a disclosure as this disclosure necessarily requires an assessment of *future* risks up to three years from now and an analysis of those *future* risks not typically associated with routine audit services. Fourth, the auditing of this analysis may necessitate an auditor's specialist, which could significantly increase the cost of the financial statement audit without providing, in our opinion, a commiserate perceived benefit in the usefulness of the financial statements to a normal user. Finally, MD&A, as required supplementary information (RSI), has a level of responsibility taken by the auditor under AU-C § 730 that is appropriate to an auditor's service capabilities to this type of a disclosure, including:

- 1) inquiring with management about how the information was prepared and presented as RSI;
- 2) comparing the prepared information for consistency with management's explanations;
- 3) obtaining written representations that current management acknowledges its responsibility for the RSI, the RSI is presented in accordance with prescribed guidelines established by the Board, and whether the methods of measurement or presentation have changed from those used in the prior period and, if so, the reasons for such changes; and,
- 4) any significant assumptions or interpretations underlying the presentation of the RSI.

Additionally, we believe the Board should consider changing paragraph 7(c) of the Proposed Standard by (1) making the disclosure optional, (2) adding some slight modifiers to the text of the sentence, or (3) eliminating the disclosure unless the concentration or constraint has reached the point when the government's ability to continue as a going concern is in doubt. Initially, we believe the disclosure within paragraph 7(c) necessarily implies that a government *should have taken* some action to mitigate the impact of the concentration or constraint, which may not have been (1) possible or practicable, (2) within the control of the government, or (3) the subject of either the governing board's ongoing deliberative process or a referendum question. As such, we believe whether disclosure is appropriate should be left up to the professional judgment of management at the government when considering the facts and circumstances on the ground at that specific government. Alternatively, the Board could modify

paragraph 7(c)'s sentence to state, "A *brief* description of actions taken by the government, *if any*, prior to the issuance of the financial statements to mitigate the substantial effect." The final option, which is preferable in our opinion, would be to eliminate this disclosure requirement completely and only require reference to the disclosures required by paragraph 19 of Statement No. 56 when any concentration or constraint gives rise to substantial doubt about the government's ability to continue as a going concern.

Alternative 3

The Board proceeds with issuing the Proposed Statement; however, the Board implements our suggested changes (1) from Alternative 1 to both (a) the disclosure criteria for a concentration or a constraint in paragraph 7 and (b) the scope of the disclosures within paragraph 8 and (2) from Alternative 2 to move the disclosure from the notes to the MD&A with a modification to paragraph 7(c). This would combine the best of the proposed changes from Alternative 1's focus on what to disclose and Alternative 2's focus on where to disclose.

Again, we appreciate the opportunity to offer our comments and suggestions.

Sincerely,

Jason Coyle, CPA
Chair, Governmental Executive Committee

APPENDIX A

ILLINOIS CPA SOCIETY GOVERNMENTAL EXECUTIVE COMMITTEE ORGANIZATION AND OPERATING PROCEDURES 2022-2023

The Governmental Executive Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from government and public accounting. These members have Committee service ranging from newly appointed to more than 30 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of governmental accounting and auditing standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed, and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint.

Current members of the Committee and their business affiliations are as follows:

Public Accounting/Professional Service Firms:

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| Linda Abernethy, CPA | RSM US LLP |
| Julie Barrientos, CPA | KPMG LLP |
| Kevin Bissell | PKF Mueller |
| John Blackburn, CPA | Swartztrauber & Co. |
| Jason Coyle, CPA, Chair | Baker Tilly Virchow Krause, LLP |
| John Epperson, CPA | Miller Cooper & Company Ltd. |
| Jennifer Martinson | Lauterbach & Amen, LLP |
| Leilani Rodrigo, CPA | Roth & Co., LLP |
| James Savio, CPA | Sikich LLP |
| Colin Thompson, CPA | Legacy Professionals LLP |
| Christine Torres, CPA | Crowe LLP |
| Sheila Weinberg, CPA | Institute for Truth in Accounting |

Government/Others:

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| Mary Kosinski, CPA | State of Illinois, Department of Employment Security |
| Joan Li, CPA | Northern Trust |
| Daniel Nugent, JD, CPA | University of Wisconsin-Platteville |
| Kenneth Oliven, CPA | Village of Alsip |
| William Schmidt, CPA | Skokie Park District |
| Kent Sorenson, CPA | Sauk Valley Community College |
| Rita Trainor, CPA | Wheaton Park District |
| Alise White, CPA | Illinois State Board of Investments |

Staff Representative:

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| Oralia Guajardo | Illinois CPA Society |
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