FLORIDA GOVERNMENT FINANCE OFFICERS ASSOCIATION, INC.

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Friday, September 16, 2022

Alan Skelton
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Project No. 3-41- Proposed Statement of the Governmental Accounting Standards Board, *Certain Risk Disclosures*

Dear Mr. Skelton:

On behalf of the Florida Government Finance Officers Association (FGFOA), we are pleased to respond to the GASB Exposure Draft (ED) on Project No. 3-41, Certain Risk Disclosures. The comments below were prepared based on a review by members of the FGFOA Technical Resources Committee and the Board of Directors. We disagree with the concept of disclosing certain risks, as currently proposed by the GASB.

Although we agree that governments are exposed to certain risks (i.e. concentrations and constraints) that could negatively impact the level of service they can provide or their ability to meet obligations as they come due, much of this information is already required to be reported as supplementary information by issuers of annual comprehensive financial reports (ACFRs) in accordance with GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*, *an amendment of NCGA Statement 1*. For example, GASB Statement No. 44 requires the following:

- Principal employers
- Principal revenue payers
- Direct and overlapping debt
- Debt limitations

Consequently, to avoid duplication, we recommend that GASB, either concurrently with the release of the standard or in a subsequent standard, consider removing any items from the statistical section of the ACFR that would already be required to be reported in the certain risk disclosures portion of the notes to the financial statements.

Similarly, there is an inconsistency regarding MD&A disclosures, which require a description of currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations. The GASB should consider allowing forward-looking risk discussion in the MD&A to be consistent with the note disclosures. Alternatively, the

GASB could consider moving the proposed risk disclosures to the MD&A rather than the notes, as currently proposed.

Additional specific concerns include the following:

Certain Concentrations (Paragraph 4)

We agree that governments may be exposed to risks that create a lack of sufficient diversity related to an aspect of a significant revenue source or expense. The examples of potential concentrations are helpful in assessing where concentrations might exist, as are the illustrations provided in Appendix C. While we understand the Board cannot identify all instances of concentrations that may be applicable, we believe additional illustrations on disclosures of concentrations of *suppliers of material, labor, or services*, particularly for suppliers of materials, would be helpful to financial statement preparers.

Certain Constraints (Paragraph 5)

We agree that governments may be exposed to risks that are based on constraints common in the governmental environment that may limit their ability to acquire resources or to control spending, and that constraints may be imposed by an external party and by formal action of a government's highest level of decision-making authority. However, we believe that constraints imposed by the government's highest level of decision-making authority are still within the government's control, and therefore, do not pose a significant risk to the government.

As an example, a government's budget limits the amount of debt that may be issued, a common constraint in the governmental environment. The government's budget is a constraint imposed by the "government's highest level of decision-making authority." However, the governing body may reverse or rescind that limitation on incurring such debt at any time. If this limitation is to be a constraint that could potentially have a substantial effect on the government's ability to provide services, it should be a limitation imposed by an external party such as a higher-level state government limiting the borrowing of local governments.

Disclosure Criteria (Paragraph 6)

To summarize, this ED would require governments to disclose the effects of certain events that either have occurred or are *more likely than not to occur* within 12 months of the financial statement date or shortly thereafter, if it is at least *reasonably possible* that the events will have a *substantial* effect on the government's ability to provide services at the current level or meet obligations as they come due within three years of the financial statement date.

We agree with the general concept of disclosing concentrations and constraints as of the financial statement date, if such information is essential to the financial statement users. However, we believe the disclosure criteria in this ED, as they relate to potential future effects, would result in disclosures that are not appropriate for disclosure in accordance with GASB Concept Statement No. 7, paragraph 10(b), "predictions about the effects of future events on future financial position," primarily due to the requirement to evaluate potential effects for three years after the financial statement date.

The terms *more likely than not, reasonably possible, and substantial* can be subjective. We would support a lower threshold of *reasonably possible* for the likelihood that the event will occur and agree with threshold of *reasonably possible* for the likelihood of the effect being substantial. We believe this would result in more disclosure of risks present in the financial statements to which the government is vulnerable, and less estimation (i.e., prediction) of when an event crosses the 50% threshold of likelihood.

We also would support the term *severe impact* to describe the magnitude of the effect (as used and defined in FASB Codification Topic 275) as it implies a higher threshold than *substantial effect*. We recognize the term *substantial* has been used in previous standards, but it has not been defined. Regardless of the term used, it would be helpful to financial statement preparers and auditors to define the term within the authoritative guidance as is done in FASB Codification Topic 275, including explicit discussion that the term means more significant than *material*, and that it should be matters that are so significant they disrupt the normal functioning of the entity. We believe defining the term would reduce variability in application of the standard.

We disagree with the timeframe proposed in the ED for when the substantial effect is at least reasonably possible to be experienced (three years). Fundamentally, we do not believe note disclosures should include predictions about the future. The time frame of three years is not supported by current guidance or the conceptual framework. Paragraph 64 of Concepts Statement 1 established reliability as one of the qualitative characteristics of effective financial reporting and states that information presented in financial reports should be verifiable. It is already difficult to verify the likelihood of an event occurring, let alone the effect it could have on the government in three years. Consequently, we recommend that GASB consider shortening the three-year period to one year.

In discussions of the time frames in paragraph B34, the Board referenced GASBS No. 56. The Board suggested that going concern disclosures may be viewed as “points along the same spectrum of exposure to financial difficulty” as those described in this ED. We believe that disclosure of risk of concentrations or constraints is a disclosure of vulnerabilities, a separate topic from going concern disclosures altogether, and, therefore, should be addressed separately by the Board. If financial statement users consider the thresholds in the guidance for going concern to be too high, those disclosures should be reevaluated and addressed in the going concern guidance. There are also some key differences between this ED and going concern disclosure requirements. For instance, GASB No. 56 requires disclosure of the government officials’ plans (including relevant prospective financial information), which the Board concluded would be inappropriate in this ED.

Furthermore, we believe that “early warning signs” would be more appropriately obtained from a government’s budget documents, financial forecasts, and debt rating documents, which are intended to be forward looking, rather than from financial statements, which report the results of operations.

Notes to Financial Statements (Paragraph 7)
We generally concur with disclosure of risks of concentrations or constraints that could have a substantial impact on the financial statements, but not with the three-year timeframe, as noted previously.

We agree that if actions taken by management cause any of the criteria in paragraph 6 to no longer be met, no disclosures should be required. However, it is unclear whether the criteria in paragraph 6 would be met if the government has sufficient reserves to mitigate any potential impact from an event occurring, or whether the government officials would be required to explicitly state their intent to use reserves.

Further, the requirement to report risks based upon their probability of occurring seems inconsistent with the prohibition of disclosing planned, but not implemented, mitigation plans. Paragraph B41 asserts that disclosure of any mitigating steps that haven't actually occurred yet is "predictive" and should not be disclosed. From a fairness perspective, it seems odd to disclose potentially unfavorable risks without disclosing any proposed mitigation efforts, especially since the government at least has some control over its mitigation efforts but no control over external threats. In other words, the disclosure of potential mitigation measures should be allowable because the government has control over the mitigation efforts; consequently, such disclosures would be less predictive than the risk disclosures that GASB is proposing, which are shrouded in much more uncertainty. For consistency, we recommend that GASB consider allowing the disclosure of planned risk mitigation efforts as long as they pass the same “more likely than not” and “at least reasonably possible” probability hurdles applicable to the same risks and uncertainties that the mitigation efforts are meant to address.

Cost-Benefit Analysis
We appreciate that the expected benefit of additional information can be difficult to measure objectively. While users of the financial statements may benefit from the additional risk disclosures as proposed by this ED, we believe the three-year timeframe to evaluate the impact would present users with biased and unreliable disclosures. The subjective nature of predicted future events occurring as well as the potential impacts of those future events reduces the reliability and benefit of such disclosures.

Additionally, accumulating and evaluating events that have occurred or potential future events would result in additional time incurred by both financial statement preparers and auditors. Financial statement preparers would have to accumulate all potential concentrations and constraints and evaluate each for potential events that may occur that could have a substantial impact on the government. Auditors would need to evaluate whether preparers have an adequate process in place to identify all such potential disclosures and then evaluate management's assessments, which may be biased, as there would likely be an incentive for management to have an optimistic outlook on the future. The wide range of possible future outcomes, from most favorable to least favorable, would create challenges for auditors to objectively evaluate such management assessments within the framework of Government Auditing Standards 8.90 – 8.115, which require auditors to evaluate the sufficiency and appropriateness of audit evidence, including independent corroboration of testimonial evidence.

We thank the GASB for its efforts in preparing the Exposure Draft and for the opportunity to respond. Please feel free to contact me at (386)506-5710 or jmckinney@port-orange.org regarding the comments above.

Sincerely,

Jonathan C. McKinney, CGFO
President, Florida Government Finance Officers Association