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March 23, 2012

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RE: Project No. 13-3, Preliminary Views on major issues related to  
*Economic Condition Reporting: Financial Projections*

Dear Mr. Bean:

The National Association of Bond Lawyers (“NABL”) respectfully submits the attached response to the Government Accounting Standards Board (“GASB”) solicitation for comments on Project No. 13-3, Preliminary Views on major issues related to *Economic Condition Reporting: Financial Projections*, dated November 29, 2011 (“*Preliminary Views*”). These comments were prepared by an ad hoc subcommittee of NABL’s Securities Law and Disclosure Committee comprised of those individuals listed on Exhibit A, and was approved by the NABL Board of Directors.

As noted herein, NABL limits its comments to the areas in which its members are most knowledgeable: the ramifications under the federal securities laws of the application of the accounting and financial reporting requirements proposed in the Preliminary Views on the bond offerings of governmental entities. NABL hopes that the attached comments will assist GASB, especially with respect to the impact on the municipal markets which the Preliminary Views are likely to have.

NABL exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the laws affecting public finance. A professional association incorporated in 1979, NABL has approximately 2,800 members and is headquartered in Washington, D.C.

If you have any questions concerning the comments, please feel free to contact Bill Daly, NABL’s Director of Governmental Affairs at 202-503-3303 (or via e-mail at [bdaly@nabl.org](mailto:bdaly@nabl.org)).

Thank you in advance for your consideration of these comments.

Sincerely,

Kristin H.R. Franceschi

**Comments of  
The National Association of Bond Lawyers  
regarding  
Project No. 13-3  
Preliminary Views of the Governmental Accounting Standards Board  
on major issues related to  
*Economic Condition Reporting: Financial Projections***

On November 29, 2011, the Governmental Accounting Standards Board (“GASB”) published its Preliminary Views (Project No. 13-3) (“*Preliminary Views*”) presenting “its current views on what it believes are the most fundamental issues associated with the reporting of financial projections and related narrative discussions that will assist users in assessing a governmental entity’s economic condition.”

In their professional capacities, NABL members provide legal advice to state and local governments as well as users of their financial statements. NABL members review and assist in the preparation of primary and secondary disclosure documents, which include the financial statements of governmental entities. Accordingly, while NABL members are necessarily familiar with financial accounting and reporting standards for state and local governments, NABL defers to other organizations for technical comments on the feasibility or usefulness of implementing the accounting and financial reporting standards addressing fiscal sustainability described in the Preliminary Views, and is not providing responses to GASB’s questions posed on pages viii-ix of the Preliminary Views.

In summary, NABL’s observations are:

(1) If the projections<sup>1</sup> contemplated by the Preliminary Views to be included as “Required Supplementary Information” (“RSI”) are included as part of the financial statements included in offering documents or continuing disclosure reports for municipal securities, these projections will be subject to scrutiny under the antifraud provisions of federal securities laws.<sup>2</sup> Issuers will need to consider at the time of any offering of securities or filing of annual or other

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<sup>1</sup> GASB distinguishes between “projections” and “forecasts” and “predictions.” Preliminary Views at 16. However, this distinction between “projections” and “forecasts” may not exempt these projections from liability under the securities laws as “forward-looking statements.” For example, Section 21E of the Securities Exchange Act of 1934, which establishes a safe harbor for forward-looking statements in corporate securities offerings, defines “forward-looking statements” to include “a statement containing a *projection* of revenues.”

<sup>2</sup> Many issuers include in their offering documents and continuing disclosure reports the independent auditor's report, management's discussion and analysis, government-wide financial statements, fund financial statements, notes to the financial statements, required supplementary information and combining financial statements and schedules (which combining financial statements and schedules are sometimes referred to as “supplemental information”). Those issuers which prepare a comprehensive annual financial report (“CAFR”), which in addition to the above-mentioned information, also includes a statistical section which includes additional financial, economic, and demographic information, include the CAFR in their offering documents and continuing disclosure reports. In either case, under the Preliminary Views, financial projections would be included as part of RSI and NABL believes that it is unlikely that issuers (and underwriters) would include financial statements in an offering document or continuing disclosure report which excluded GASB-mandated RSI.

reports whether projections included in financial statements (regardless of any disclaimer that they are outdated as of their date) would be misleading in light of subsequent events.

(2) Under the antifraud provisions of federal securities laws applicable to registered offerings, the assumptions used in projections communicated to investors must be reasonable and must also be believed by the issuer to be reasonable statements of expected future performance. If this standard is applied by analogy to offerings of municipal securities, GASB should make sure that the process it is requiring for the development of the assumptions for projections will satisfy these reasonableness requirements, as opposed to required assumptions that may result in pro forma projections that are not reasonably expected by the governmental entity to be attained.

(3) If an offering document includes a financial projection with the issuer's audited financial statements, will auditors which are "associated" with offering documents be unable or unwilling to authorize the inclusion of their audit reports with the financial statements if the projections included as RSI are not updated? Although it is possible that some accounting firms will be unwilling to provide governmental entities with inclusion letters if projections either are not included in RSI or are not updated in an offering document to take into account subsequent events, it is our understanding that an auditor's opinion on the fairness of presentation of financial statements in accordance with generally accepted accounting principles ("GAAP") would not be affected by the presentation of RSI or the failure to present some or all of the RSI.<sup>3</sup> However, investors may incorrectly perceive that an auditor's report signifies that the financial projections have been "subsequently reviewed."

(4) The proposed cautionary notice set forth in Paragraph 28 of the Preliminary Views is probably insufficient to enable governmental entities or underwriters to avail themselves of the "bespeaks caution" doctrine under federal securities laws for forward-looking statements made in offering documents for corporate securities. The "bespeaks caution" doctrine, a judicial doctrine which also has been incorporated into statutory safe harbors for corporate securities in the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act"), requires that forward-looking statements be accompanied by meaningful, cautionary statements, specifically identifying those factors which could cause actual results to differ materially from those set forth in the forward-looking statements. Accordingly, if the "bespeaks caution" doctrine is applied analogously to municipal securities, if financial statements which include forward-looking statements are included as part of an offering document, it is likely that appropriate cautionary language will need to be added to the offering document.

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<sup>3</sup> If NABL's understanding of this auditing process is incorrect or this process were to change in response to the implementation of the Preliminary Views, NABL believes that it is likely that the cost of obtaining inclusion letters will increase.

## Impact of the Preliminary Views on Offering Documents and Continuing Disclosure Reports

Although state and local governments are exempt from the registration and reporting provisions of the 1933 Act and the 1934 Act, any offering of municipal securities (as well as other statements made in connection with the purchase and sale of those securities, such as continuing disclosure reports filed with the Municipal Securities Rulemaking Board) are nevertheless governed by the antifraud provisions of Section 17(a) of the 1933 Act and/or Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.<sup>4</sup> Generally, these antifraud provisions prohibit issuers and other municipal market participants, in any statement made in connection with the purchase or sale of securities, from making material misrepresentations and omitting material facts.

As the Preliminary Views points out, “the use of financial projections is not new to annual financial reports,”<sup>5</sup> nor is the use of financial projections new to the offerings of municipal securities. However, under Section 17(a) and Rule 10b-5, issuers which include projections (required to be included as RSI by the Preliminary Views) in their financial statements, and then include these financial statements in their offering documents and annual continuing disclosure report filings, are subjecting all of these projections to securities law scrutiny. To avoid a violation of federal securities laws, these projections must not only be correct statements of the issuer’s belief as of the date of the financial statements, but also must not be misleading as of the date of their publication in any offering document or continuing disclosure report filing. If these projections use materially outdated assumptions, then an issuer either will need to alert investors to that fact (or risk misleading investors that the projections in the financial statements are still currently believed by the issuer),<sup>6</sup> or may need to update these projections in order to provide the proper context.

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Section 17(a) of the 1933 Act prohibits misrepresentations or omissions of material facts in the offer or sale of securities. Section 10(b) of the 1934 Act and Rule 10b-5 prohibit misrepresentations or omissions of material fact in connection with the purchase or sale of any security. These provisions prohibit the making of any untrue statement of material fact or omitting to state a material fact in connection with the offer, purchase, or sale of securities.

<sup>5</sup> “The use of financial projections is not new to annual financial reports...[but] the projections themselves are not displayed in the financial statements.” Preliminary Views at 1-2. While in certain circumstances issuers of municipal securities have included projections in offering documents, there currently is no requirement to update these projections. See below, footnote 6.

<sup>6</sup> It should be noted that the municipal market previously has not considered projections to be included as part of a state or local government’s financial statements, or as part of its “annual financial information,” for purposes of Rule 15c2-12 (the “Rule”). At the time that the Rule was amended to include continuing disclosure provisions (effective July 3, 1995), the Securities and Exchange Commission responded to a number of questions posed by municipal market participants. In response to a question posed by NABL asking, in part, whether “forecasts and demographic information [are] considered to be financial information or operating data required to be updated under the Rule,” the SEC replied,

Forecasts regarding the obligated person’s operations contained in a final official statement do not need to be updated because the forecasts themselves are not operating data. The components of these forecasts (i.e., sources of revenue or expenses), however, would identify the type of actual operating data to be provided as part of annual financial information. *Similarly, if a feasibility study or other type of expertised report included in the final official statement contains components of*

As a consequence, if, as contemplated by the Preliminary Views, issuers are expected to include projections in RSI and if financial statements (including outdated projections) are included in an offering statement, then issuers and other municipal market participants may need to review these projections at the time of each offering or continuing disclosure filing, and determine whether the projections set forth as RSI in the financial statements should (a) be replicated and replaced, or (b) kept, but updated and/or explained. The end result is that there could potentially be multiple intra-year updates of these projections.<sup>7</sup>

It should be kept in mind that financial statements included in offering documents of governmental entities are *per se* outdated. For example, the auditing process for a governmental entity with a June 30 fiscal year end generally will not be completed until December. If the Preliminary Views are adopted as drafted, if a governmental entity were to issue bonds in November, then its offering document will include audited financial statements which are 17 months old, and also will have projections included as RSI which are based on 17-month old assumptions (and which probably will have been shown, by 17 months of historical information, to have been overstated or understated). If, due to material changes in an issuer's financial condition, an issuer must explain in an offering document or continuing disclosure report why the historic financial information set forth in its audited financial statements no longer reflects the issuer's current financial position, it seems likely that an issuer also would have to consider whether outdated projections in the RSI which are included in the financial statements included in an offering document or continuing disclosure report, also should be reviewed and commented upon in order to provide context for an issuer's current financial position.<sup>8</sup>

#### Impact of Assumptions Used in Projections in Preliminary Views

Under the antifraud provisions of federal securities laws, the assumptions used in projections communicated to investors must be reasonable and must also be actually believed by the issuer to be reasonable statements of expected future performance. While the Preliminary

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*operating data, only the results of these actual operations need be provided on an annual basis pursuant to the undertaking.*

Letter from Robert L.D. Colby to National Association of Bond Lawyers dated June 23, 1995, Question 5. (Emphasis added)

<sup>7</sup> For frequent municipal issuers, each offering document presumably would require that projections be updated, with a "ripple" effect for future projections. For a further discussion, see the final section of these comments, "Forward-Looking Statements and the 'Bespeaks Caution' Doctrine."

<sup>8</sup> Recent SEC enforcement actions underscore why issuers should be concerned. In the City of Miami enforcement action, the SEC restated its position that municipal issuers have an affirmative obligation to know the contents of their securities disclosure documents, including their financial statements, and that, due to material changes in the City's financial condition, the CAFR included in the City's offering documents contained materially misleading information which should have been updated to reflect the City's current financial position. "We have previously found antifraud violations where a municipal issuer failed to disclose that its cash flow position had materially declined (since the close of the prior fiscal year's financial statements included with its Official Statements) and misrepresented that there had been no material change in its financial condition." City of Miami, Fla., SEC Rel. Nos. 33-8213, 34-47552 (March 21, 2003).

Views outlines the types of assumptions that would be required in projections, NABL wishes to stress that any process that GASB uses to develop assumptions to prepare these projections will need to be consistent with the requirements of the antifraud provisions of federal securities laws for projections which would be published in offering documents and continuing disclosure report filings. If the assumptions do not match up, then issuers either will be required to include disclosure that identifies which assumptions they no longer think are reasonable expectations of future performance, or issuers will need to present a potentially different set of projections in the offering document. In either instance, the likely ensuing result will be to confuse investors and the general public.

#### Auditor Associations with Offering Statements in Non-Registered Offerings

It is a common practice for issuers to seek the consent of their auditors to use their audit reports in offering documents. By “consenting” to the inclusion of its report in an offering document, the accountants will be considered to have become “associated” with the official statement, and will be expected to perform certain “keeping current” (also referred to as “subsequent events”) and consistency procedures.<sup>9</sup>

The Preliminary Views, if adopted in its present form, would require that projections be included in RSI.<sup>10</sup> If an offering document were to include financial statements which have (a) financial projections as RSI and (b) an accountant’s report, an investor might reasonably expect that the financial projections will have been subject to a post-audit review, *notwithstanding* the use of explicit disclaimers or other efforts by an issuer to emphasize that an investor should not have such an expectation.

Under Statement of Auditing Standards No. 120, *Required Supplementary Information*, RSI is defined as

Information that a designated accounting standard setter [GASB for governmental entities] requires to accompany an entity's basic financial statements. RSI is not part of the basic financial statements; however a designated accounting standard setter considers the information to be an essential part of financial reporting for placing

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<sup>9</sup> See, County of Orange, Cal., SEC Rel. Nos. 33-7260, 34-36730 (Jan. 24, 1996). The County included its auditor’s audit report without obtaining its consent to inclusion. “In fact, Orange County did not obtain the consent of the auditors to include their report in the Official Statements, and the auditors did not conduct any post-audit review. That the auditor had not consented to the inclusion of its audit report accompanying the County’s financial statement in these Official Statements was important. *Reasonable investors rely on audited financial statements in making investment decisions.*” (emphasis added)

<sup>10</sup> Under GASB’s Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* (issued June 1999) (“GASB 34”), RSI currently includes, among other information, “Management’s Discussion and Analysis” and budgetary comparison schedules presenting both “(a) the original and (b) the final appropriated budgets for the reporting period as well as (c) actual inflows, outflows, and balances, stated on the government’s budgetary basis.”

the basic financial statements in an appropriate operational, economic, or historical context.<sup>11</sup>

Further,

Because RSI accompanies the basic financial statements, the auditor's report on the financial statements includes a discussion of the responsibility taken by the auditor on that information. *However, because the RSI is not part of the basic financial statements, the auditor's opinion on the fairness of presentation of such financial statements in accordance with the applicable financial reporting framework is not affected by the presentation of the entity of the RSI or the failure to present some or all of such RSI.* Furthermore, if the RSI is omitted by the entity, the auditor does not have a responsibility to present that information. (emphasis added).<sup>12</sup>

In other words, although an auditor would have to include an explanatory paragraph in his report on the financial statements to explain the circumstances surrounding why some of the RSI is missing or whether it is presented in accordance with prescribed guidelines,<sup>13</sup> the auditor's opinion on the fairness of presentation of financial statements in accordance with GAAP would not be affected by the inclusion or exclusion of financial projections in RSI.<sup>14</sup>

As stated earlier, NABL is not commenting on the accounting and financial reporting aspects of the Preliminary Views. However, if financial projections are included as RSI in an offering document with an auditor's report, investors may incorrectly expect that an auditor's report signifies that the financial projections have undergone a subsequent review.<sup>15</sup> NABL suggests that GASB consider adding language to its cautionary notice emphasizing that, unless otherwise expressly indicated, RSI has not been audited.

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<sup>11</sup> AICPA Audit and Accounting Guide: State and Local Governments, Appendix D, SAS No. 120, Required Supplementary Information , AU Sec. 558.04.

<sup>12</sup> AICPA Audit and Accounting Guide: State and Local Governments, Appendix D, SAS No. 120, Required Supplementary Information , AU Sec. 558.A2.

<sup>13</sup> For examples, see AICPA Audit and Accounting Guide: State and Local Governments, Appendix D, SAS No. 120, Required Supplementary Information , AU Sec. 558.A3.

<sup>14</sup> The standard practice of accounting firms is to apply certain limited procedures (primarily consisting of inquiries of management regarding the methods of measurement and presentation) to RSI, but their reports state that the RSI has not been audited, and they do not express an opinion on the RSI. AICPA Audit and Accounting Guide: State and Local Governments, Appendix D, SAS No. 120, AU Sec. 558.A3.

<sup>15</sup> Of course, governmental entities could choose (or try) not to associate accountants with their offering documents and intentionally exclude audit reports from financial statements, thereby signaling that no subsequent review of financial information has occurred. The significance of such intentional exclusions should be explained in the offering document.

## Forward-Looking Statements and the “Bespeaks Caution” Doctrine

Under developed federal securities law antifraud case law, the proposed “Cautionary Notice” language set forth in the Preliminary Views may not be sufficient to protect issuers should financial statements, including these forward-looking statements, be included in offering documents and continuing disclosure filings related to municipal securities.

Paragraph 28 of the Preliminary Views sets forth GASB’s suggested language for a notice which would precede the financial projections:

The financial projections that follow assume current fiscal policies would be continued, with consideration of historical information as well as known events and conditions that affect the projection periods. These financial projections may be used to assess whether projected cash inflows will be sufficient to sustain public services and to meet financial obligations as they come due. However, it is important to note that projections of cash inflows, cash outflows, and accrued financial obligations based on current policy do not represent a forecast or a prediction of the most likely outcome.

Financial projections may be based upon assumptions regarding changes in social, economic, and demographic events and conditions that are inherently subject to uncertainties. Therefore, readers are cautioned that actual future financial results of [government name] may be significantly different from the financial projections that are reported.

This suggested Preliminary Views language is intended to provide a safe harbor for the preparers of such projections. NABL supports this intent, but is concerned that governmental entities that include these projections in the financial statements that are part of an offering document or continuing disclosure report may subject themselves to securities liability if they do not also include language in the offering document or continuing disclosure report that satisfies the conditions of the “bespeaks caution” doctrine.<sup>16</sup>

Although issuers of municipal securities are not entitled to avail themselves of the statutory safe harbors provided to registered offerings under Section 27A of the 1933 Act and Section 21E of 1934 Act,<sup>17</sup> “the common law doctrine from which the safe harbor was derived is an antifraud concept and therefore applicable to municipal issuers.”<sup>18</sup> Under the “bespeaks caution” doctrine,

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<sup>16</sup> The essence of the doctrine is that where an offering statement, such as a prospectus, includes statements of future forecasts, projections and expectations with adequate cautionary language, those statements are not actionable as securities fraud. SEC Rel. Nos. 33-7101; 34-34831 (October 13, 1994) Safe Harbor For Forward-Looking Statements,

<sup>17</sup> Section 21E of the 1934 Act, which applies only to registered offerings, among other things, provides a safe harbor for persons who make a forward-looking statement if the statement is “(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement, or (ii) immaterial.” Section 21E (c)(1)(A)(i) and (ii).

<sup>18</sup> *Disclosure Roles of Counsel in State and Local Government Securities Offerings*, 3d ed. (2009) at 226.



[C]autionary language, as a part of the “total mix” of information, may render a predictive statement immaterial as a matter of law or make it unreasonable for an investor to rely upon a predictive statement...[S]ome courts have warned, however, that cautionary language, in and of itself, is not necessarily sufficient. "To suffice, the cautionary statements must be substantive and tailored to the specific future projections, estimates or opinions in the prospectus which the plaintiffs challenge"<sup>19</sup>

While NABL believes that the views of GASB with respect to the requirements for financial statements will be given great weight, it would be advisable for state and local governments and underwriters to add specific cautionary statements<sup>20</sup> to their offering documents and continuing disclosure reports which temper specific future projections, estimates or opinions set forth in the financial statements included in the offering documents or continuing disclosure reports.<sup>21</sup>

It should be noted that even if specific cautionary statements are used, the “bespeaks caution” doctrine would not protect the use of forward-looking information that is known to be incorrect, regardless of cautionary statements. As a result, issuers and underwriters, without further guidance, in connection with every offering document (or continuing disclosure report), will need to make a determination as to whether projections should be updated. As projected results, by

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<sup>19</sup> SEC Rel. Nos. 33-7101; 34-34831 (October 13, 1994), *Safe Harbor For Forward-Looking Statements*.

<sup>20</sup> For registered offerings, these cautionary statements customarily take the form of a bold or italicized statement, followed by an explanation. Examples of “meaningful cautionary statements” for a municipal securities offering might involve, for example, the following:

***The projections in the RSI do not project the effect of future legislative or executive branch actions.***

The five year projections in the RSI are current year estimates of current services prepared as of [date], but do not represent a projection or estimate of actual results. They do not take into account future electoral, legislative, or executive actions, none of which are capable of prediction. As a result, they represent a modeling, based on assumptions considered reasonable, of future outcomes based on current policies. Actual results will depend on, among other things, actual electoral, legislative and executive actions.

or

***The five year projections cannot be realized because they are contrary to law.***

The projected cash flows indicate, on a current services basis, a deficit in some years. The [state] has a constitutional and statutory balanced budget requirement. As a result, the legislature cannot lawfully authorize expenditures that will be consistent with these projections. Consistent with existing constitutional and statutory requirements, the legislature will need to adopt a budget which (i) provides a basis for different revenue projections; (ii) authorizes different appropriations; or (iii) combines both adjustments. Future legislative enactments, as they may be affected by the Governor’s line-item veto, allotment, impoundment and rescission authority, cannot be predicted. As a result, the five year projections, while useful, are not indicative of future results.

<sup>21</sup> NABL notes that many issuers do not engage counsel when filing their financial statements as part of their continuing disclosure reports, and may not be aware that the requirements of the “bespeaks caution” doctrine would also apply to continuing disclosure reports.

their nature, are rendered stale almost immediately, issuers and underwriters may decide that these projections must be updated.<sup>22</sup>

### Conclusion

In early 2010, the Securities and Exchange Commission (“SEC”) approached NABL and other municipal market participants and asked each to suggest enhancements to SEC Release No. 33-7049 (also referred to as the “1994 Interpretive Release”), which was released at the time the continuing disclosure rules were introduced. In response, NABL submitted two statements, one in 2010, and an additional statement in 2011. In these, NABL requested that the SEC’s update “provide guidance as to how issuers and obligated persons, through the use of appropriate disclaimers, can reasonably limit liability under the antifraud provisions for secondary market disclosure of interim financial and other information.” NABL 2011 Interpretive Release Statement at 5. If the Preliminary Views are adopted as drafted, NABL hopes that the SEC will also provide guidance as to what disclaimers may be appropriate for financial projections included as RSI in financial statements included in offering documents and continuing disclosure reports.

Although the potential risks of securities laws liability to state and local governments resulting from including projections as RSI in financial statements can be mitigated by disclaimers or other language drafted to caution a user from overreliance on their use, NABL hopes that an appropriate balance can be struck among GASB, underwriters, state and local governments, attorneys and accountants to ensure that including financial projections in state and local government offering documents is done in a cost-effective manner.

We would be happy to discuss these comments with you at any time.

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<sup>22</sup> By way of example, suppose that a municipality adopts a budget which addresses a projected current services deficit. Any prior five year projections, which would have been similarly based on prior years’ budgets, although once possibly useful, would immediately no longer be authoritative or useful. Can their staleness be addressed with an appropriately phrased cautionary statement, or must they be updated? For a further discussion, see the first section of these comments, “*Impact of Assumptions Used in Projections in Preliminary Views.*”

## Exhibit A

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