The SEC and You

Ensuring Our Mutual Disclosure Objectives Are Met

By Emily Swenson Brock

GFOA has a long history of encouraging transparency in the municipal marketplace. Through our best practices, GFOA consistently urges our members to fully disclose material events to investors in a timely manner.[1] Accordingly, GFOA supports efforts to ensure that material information related to municipal securities credits are available to investors. The Federal Liaison's work in Washington, D.C., includes regular discussion with the Securities and Exchange Commission (SEC) to describe the existing efforts of municipal bond issuers that embody our mutual commitment to quality, timely, and meaningful disclosure to our investors.

> Comparing governments to private-sector entities with respect to timely financial reporting is comparing apples to oranges. Governments are service driven, while private-sector entities are profit driven.

RULE 15C2-12

SEC Rule 15c2-12 is a key rule that governs the continuing disclosure agreement between the issuer and the broker dealer of the municipal bond. February 28, 2019, marked the implementation date of two new amendments to SEC Rule 15c2-12.[2] The amendments are an effort to provide additional financial information to investors when an issuer may have material financial obligations that could impact bond holders. In continuing disclosure agreements entered into on or after the effective date, governments now have to state that they will disclose to the market any new and material financial obligations, and notify the market when an outstanding or new financial obligation reflects material financial difficulties.

Together with their bond and/or disclosure counsel, issuers across the country are working to determine how the new disclosure requirements relate to their specific debt programs, future bond issuance, and other financial transactions. In member alerts issued before and after implementation, the GFOA Committee on Governmental Debt Management has consistently urged issuers to review their debt management and disclosure policies, and consider adding new provisions to address the amendments.

At roughly the same time as the new disclosure amendments were implemented, the SEC Office of Municipal Securities hosted its first Municipal Securities Conference in Washington, D.C. In his opening comments, SEC Chairman Jay Clayton raised a point about the municipal securities market, which he is concerned about. Clayton said there is an "aspect of the municipal securities market that I believe can and should be improved for the benefit of our Main Street investors: disclosure about the timeliness — or lack thereof — of municipal issuer financial information." In his comments, Clayton also acknowledged the Tower Amendment, which expressly limits the authority of the SEC and the Municipal Securities Rulemaking Board (MSRB) authority to require municipal issuers to file any document with the SEC or MSRB before the issuer sells any municipal securities. So instead, Clayton suggested that "there are potential steps that the SEC and the MSRB can take — *that would be wholly consistent with the words and spirit of the Tower Amendment* — to improve transparency around the age and type of financial information."

While it is unclear if his perceptions are a response to the time difference in financial statement preparation between corporate and state and local filings, GFOA fully acknowledges that there is a significant difference between the two.

Like corporations, state and local governments make earnest attempts to provide accurate and meaningful information to all stakeholders in their financial statements. In doing so, state and local governments depend on the audit process and rely on policies and procedures to effectively carry out an audit. Despite this similarity, there are several differences between the preparation of corporate and state and local financial statements.

EXPLAINING THE DIFFERENCES

In response to Clayton's comments about the timeliness of state- and local government-audited financial information, GFOA's committees on Government Debt Management and Accounting, Auditing, and Financial Reporting, along with the Liaison Center, are working on energizing communications with the SEC about the myriad steps in the process of compiling state and local government-audited financial statements.

Some of the key points that will guide this discussion with the SEC follow

- Generally accepted accounting principles (GAAP) require state and local governments to include other separate entities, component units, in their financial statements. The component units' financial statements must be audited. Including components in a government's financial statements can cause delays in the issuance of financial statements.

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- Governments rely on the use of actuaries for determining the liabilities associated with pensions, OPEB (other postemployment benefits) and insurance claims (e.g., self-insurance for health care and workers' compensation). GAAP requires actuarial studies to be performed for pension and other postemployment benefits. The reliance on actuaries causes delays in issuing financial statements.
- Due to budget constraints, some governments are forced to use older accounting systems that limit the amount of reporting and analysis that can be automated. Some accounting systems do not have the capability to export financial information to a spreadsheet. Some accounting systems still print to dot matrix printers with green-bar paper. These older systems require that finance staff manually prepare their annual financial statements.
- At some point, virtually every government will implement a new financial system. With financial systems having a shorter lifecycle, going through the implementation process has become more frequent for governments. Implementing a new financial system is not unique to governments, but governments face different implementation challenges than private-sector entities (see below).
- Governments, like the private sector, accrue revenues earned at the end of the fiscal year. Governments have multiple revenue sources, and the type of fund where the revenue is recorded will determine how it is accrued. GAAP requires governments with governmental fund revenues (e.g., property taxes and sales taxes) to establish the number of days after the end of the fiscal year they can recognize those receivables as revenues. As listed below, revenue recognition can cause delays in the issuance of financial statements.
- In addition to preparing annual financial reports, governments have other reports that need to be submitted to state and federal agencies, often within the same timeframe.
- A limited number of audit firms have the expertise to audit state and local governments. The limited amount of auditors causes tight schedules that governments need to adhere to or run the risk of having their audit be late or having to reschedule it, which increases the cost.
- While there is no GAAP or generally accepted auditing standard requirement for governments to rotate their audit firms, some governments are required by their board to do so. As

mentioned before, there are a limited number of audit firms with the expertise to perform audits of state and local governments, so only a limited number of firms respond to public bids.

- Unfortunately, when natural disasters occur, governments must devote nearly all of their resources to preparation, response, and emergency recovery efforts. In the states of Texas and Florida, most governments end their fiscal year on September, which is during hurricane season. Finance staff who normally would be preparing financial statements are working on Federal Emergency Management Agency claims and other disaster relief efforts.

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- State and local governments have their own GAAP that must be followed, as issued by the Government Accounting Standards Board (GASB). There are currently 90 GASB statements plus thousands of GASB implementation guide questions and answers that government finance officials have to know to prepare financial statements.
- Comparing governments to private-sector entities with respect to timely financial reporting is comparing apples to oranges. Governments are service driven, while private-sector entities are profit driven.

CONCLUSIONS

While the SEC, the MSRB, and others in Congress look at potential options to address "timely" financial reporting, GFOA will continue to update the best practices and advisories that help ensure an audit process that produces reliable data for all stakeholders. The Federal Liaison Center stands ready to help federal leaders better understand what it takes to produce financial information. State and local governments consistently provide quality, timely, and meaningful information to their investors, and we look forward to continuing the conversation about how all levels of government can work together to continue a healthy and vibrant municipal bond market.

Notes

1. See the following GFOA Best Practices: *Understanding Your Continuing Disclosure Responsibilities, Primary Market Disclosure, Post-Issuance Policies and Procedures, Using Technology for Disclosure, Maintaining an Investor Relations Program, Using the Comprehensive Annual Financial Report for Meet SEC Requirements for Periodic Disclosure*, and others at gfoa.org/best-practices.
2. See GFOA Member Alert: New Amendments to SEC Rule 15c2-12 New Event Notices Related to Material Financial Obligations and Events Reflecting Financial Difficulties at gfoa.org.

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