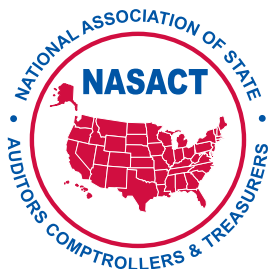




# Voluntary Interim Financial Reporting: Best Practices for State Governments

August 2013





Copyright © by the National Association of State Auditors, Comptrollers and Treasurers (NASACT).

This paper was prepared by NASACT's Continuing Disclosures Task Force, a subgroup of the Financial Management and Intergovernmental Affairs Committee (FMIAC). It was reviewed and approved by NASACT's Executive Committee on August 11, 2013.

# Voluntary Interim Financial Reporting: Best Practices for State Governments

August 2013

## Introduction

The National Association of State Auditors, Comptrollers and Treasurers (NASACT) represents the elected or appointed government officials tasked with the management of state finances. NASACT's mission is to assist state leaders in enhancing and promoting effective and efficient management of governmental resources, including developing and promoting an exchange of industry best practices and uniting efforts to improve financial management practices.

To that end, NASACT supports efforts to improve the efficiency and transparency of the municipal bond market and believes that access to low-cost capital via the bond market is critical to states' abilities to provide essential services to citizens in a timely fashion. Easy and timely access to financial and economic information is a central foundation to a transparent and efficiently operating bond market.

NASACT's efforts to improve the transparency of the municipal market began years ago. NASACT was an early supporter of the creation of a disclosure database now known as the Municipal Securities Rulemaking Board's (MSRB's)

Electronic Municipal Market Access (EMMA) System. The development of EMMA was a major enhancement to investor disclosure in the tax exempt bond market.

In 2003, a group of trade organizations in the municipal market, including NASACT, convened with the goal of creating a "template" for a minimum level of voluntary interim disclosure of financial and related information by state and local governments. NASACT hosted this group for two additional meetings, which resulted in the issuance of a series of recommendations on interim disclosure. Although several states tested the concepts outlined in the recommendations, technology constraints hampered efforts to collect and present the desired information in an efficient manner. Since that time, NASACT has remained engaged in investor disclosure issues and continues to seek ways to enhance current disclosure practices through voluntary, market-based solutions.

Recognizing that investors and regulators remain concerned over the quality and timeliness of disclosure in the municipal market, NASACT built upon past efforts to establish a

*NASACT formed the Continuing Disclosures Task Force in January 2013 to determine what steps state governments can take to address disclosure concerns. The task force developed ten best practices to be implemented by states on a **voluntary** basis to augment existing disclosure programs.*

It is important to note that the task force **did not recommend** that states produce *interim financial statements*. After careful study, it was determined that providing *currently available unaudited financial data* may be more efficient. In addition, the task force learned from investors that the interim data of most importance would not be found in financial statements. Thus, the task force focused its recommendations on certain unaudited financial data that is likely already available and that would be of value to those interested in the financial condition of a state government. **These recommended best practices are not standards or requirements, and they should be considered with a view toward adapting them to each state's particular circumstances and available information.**

## Voluntary Interim Financial Reporting: Best Practices for State Governments

Continuing Disclosures Task Force in January 2013. The task force convened to determine what steps state governments can take to address disclosure concerns. After a series of conference calls, the task force developed ten best practices to be implemented by states on a **voluntary** basis to augment existing disclosure programs. The best practices focus on enhancements to the interim disclosure practices of state governments, many of which represent the largest issuers in the municipal market.

### Background

According to the U.S. Census Bureau, there are more than 89,000 units of governments, many of which, through federal, state and local laws, raise capital through the issuance of publicly-offered municipal bonds. Once issued, municipal bonds may be sold, purchased and otherwise traded in the secondary market. Although the government issuer has no direct participation in these secondary market trades, an efficient secondary market is an important factor in the overall effectiveness of the primary market. Governmental entities that issue municipal bonds can contribute to the efficiency of the secondary market by providing financial and other material information that would assist investors in making informed investment decisions about the credit quality and value of a particular municipal bond.

Municipal securities are exempt from the registration and reporting requirements applied to corporations and other private entities under federal securities laws (the Securities Act of 1933 and the Securities Exchange Act of 1934). However, municipal issuers are not exempt from the anti-fraud provisions of federal securities laws, including and in particular Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, as well as rules promulgated by the U.S. Securities and Exchange Commission (SEC) under these laws.

SEC Rule 15c2-12 requires, with certain exceptions,

that underwriters (both bank and non-bank) of primary offerings of municipal securities review the issuers' official statements and ensure that the issuers have undertaken, in a legally binding form (e.g., a written agreement or indenture covenant), to provide to EMMA:

- Annual financial information of the nature provided in the official statement.
- Audited financial statements, if available.
- Disclosure of material events for as long as the bonds are outstanding.

Disclosure practices today largely evolved from a variety of actions by the SEC, including enforcement actions brought under the antifraud provisions of federal and state securities laws (SEC Rule 10b-5); the promulgation of SEC Rule 15c2-12; MSRB rules and the development of the MSRB's EMMA system; as well as industry developed voluntary disclosure guidelines. In addition, some issuers have developed investor relations programs and practices that provide additional information to the market as such practices may result in a lower cost of capital.

Although states over time have continued to improve their disclosure practices, the investor community and the SEC still question the quality and timeliness of such disclosure, particularly in the secondary market. The SEC conducted a broad study of the municipal securities market culminating in a July 2012 report that made several legislative recommendations that would, if enacted into law, give the Commission direct authority over municipal issuers and their disclosure.<sup>1</sup>

The Commission's recommendation that it be granted direct statutory authority over municipal issuers, including designating a state or local government's accounting standards setter and controlling the form and content of an issuer's financial statements, disregards states' rights and the basic premise of federalism. NASACT strongly believes that improvements to disclosure in the marketplace can be achieved without statutory changes.

*Disclosure and financial reporting are very important aspects of ensuring accountability and improving transparency in the market. However, NASACT strongly believes that improvements to disclosure in the marketplace can be achieved **without** statutory changes.*

Organizations such as NASACT have looked to several voluntary initiatives to improve disclosure in the marketplace and have worked with other industry groups to address disclosure improvements. Disclosure and financial reporting are very important aspects of ensuring accountability and improving transparency in the market, and the voluntary recommendations set forth in this paper aim to provide analysts and investors with relevant and more timely information that can be easily accessed online.

### Recommendations

Improving continuing disclosure is a *progressive process* that must recognize the current widely varying ability of municipal issuers to fund increased expenditures for personnel staffing, implement new or upgraded systems, and implement procedures or other steps that may be necessary to ultimately achieve the recommended best practices for interim disclosure.

#### **Best Practices for Interim Disclosure**

For those issuers unable to post all of the materials described in the section below, the enhancement of continuing disclosure should begin with the periodic posting of the unaudited information officials use to make management decisions during the fiscal year. The postings should be made on a quarterly basis (at a minimum) in a central, web-based location that is available to investors and the public.

**For those issuers with the capability to provide them, ten items are recommended to improve interim disclosure:**

#### **1. TAX REVENUES**

This report should include all major tax revenues collected during the period. The report should also include information on major changes to a state's tax base, if any. Such information could include:

- A "substantive" change to the applicability of a major tax.
- Changes in the rate of tax for any major revenue source.
- Legislative or voter initiatives that would restrict or reallocate a major source of tax revenue.
- Any changes in the allocation of major tax revenue between a state and its local governments.

Such a report could also show the amount of revenue collected relative to a state's benchmark or prior fiscal year collections.

#### **2. BUDGET UPDATES**

Most states produce intra-year updates to the governor, the legislature or taxpayers such as year-to-date, budget-to-actual reports showing major categories of revenues and expenditures for the general fund and major governmental and enterprise funds. The report would be based on appropriations and would not be a GAAP-based financial statement. Such reports are typically unaudited and may include some description of supplemental budgets that may have been passed since the beginning of the fiscal year. States should also post a notice of the budget's adoption and any mid-year budget revisions with a link to the state's annual budget.

#### **3. CASH FLOW**

A cash flow forecast or report detailing the available cash resources that provide liquidity to the state's operating funds should be provided. Such reports may include the current fiscal year as well as previous or forthcoming fiscal years.

#### **4. DEBT OUTSTANDING**

A report detailing the balances of debt outstanding for the state, including both long-term and short-term debt should be provided. The report should include changes to the amount of debt outstanding from the previous period. An updated annual debt service schedule is also recommended.

#### **5. ECONOMIC FORECASTS**

States should provide investors with updated economic forecasts, if such forecasts are being produced by the state already. Such reports likely are the basis for revenue collection assumptions and often are adjusted over the course of a fiscal year.

#### **6. PENSIONS AND OPEB**

If annual actuarial reports on a state's pension liability or other post-employment benefits (OPEB) are released, they should be included in that period's interim disclosures. If legislative changes are enacted that may impact future valuations or liabilities, those should also be included.

#### **7. INTEREST RATE SWAPS AND BANK LIQUIDITY**

Interim disclosure reports should include updates to a state's interest rate swap portfolio, including updates on mark-to-market valuations as of the

end of the quarter, and list the credit ratings of its swap counterparties. Also included should be information regarding bank liquidity and credit facilities, including standby bond purchase agreements, lines of credit, etc. Pertinent details would include any expirations, extensions or replacements of liquidity facilities which are to occur before the next report date, or any failed remarketings of any auction rate securities (if any) since the immediately preceding report date, etc.

### 8. INVESTMENTS

A report detailing the state's investment holdings, including balances in investment pools, deposits or other investment vehicles should be included. Such a report should detail the liquidity and credit quality of the state's investment holdings, including weighted average maturity, duration, and level of collateral posting for non-insured deposits.

### 9. DEBT MANAGEMENT POLICIES

If the state updates its debt management policies, those new policies should be included in the interim disclosure report for the period in which the updated policy became effective.

### 10. EMMA FILINGS

A state should include any EMMA filings, voluntary or mandatory, that have been made in the most recent period (i.e., that the audited financial statements or actuarial valuations have been published, been completed, and an item required by 15c 2-12 has been filed). A state may wish to direct an investor or interested party to the EMMA website where they can set up a MyEmma account which will allow notices to be pushed out to the individual.

## Frequency

**The first four items above should be updated regularly, and the remainder should be updated as the information changes. As a best practice, states should consider providing interim disclosure updates to investors on at least a quarterly basis.**

The updates should be regular and recurring and should be released within 40 days of the end of each quarter. If possible, the release dates should be publicized in advance to investors as early as possible. The recommendation to provide interim financial information on a quarterly basis is a *minimum* suggested practice. Governments providing monthly information should continue doing so, and those with the capacity to provide monthly information should consider doing so.

## Format

**As a best practice, states should consider providing interim disclosure updates via a dedicated investor website or webpage.** This online access is not only a recommended practice in this document but is also one suggested by the SEC in its municipal market report. Utilizing a website rather than email distribution to disseminate interim disclosure materials ensures that information is made available and accessible to investors at the same time.

Because debt financing is handled differently in each state, a link called "Investor Information" should be included on each state's main home web page, linking to the investor website containing the interim disclosure materials.

The website or webpage should include the necessary legal disclaimers. States are encouraged to work with their disclosure counsel to draft the necessary language.

States should clearly represent the latest interim disclosure material on the website and archive the older information. All material presented should be in final form and saved in a format that does not allow for editing.

State disclosure websites may be accessed in a variety of ways. EMMA allows for posting a URL to direct an investor to a state's website; states are encouraged to upload each quarter's interim disclosures to EMMA as a voluntary submission. NASACT also maintains a state profile directory ([www.nasact.org/nasact/directory/index.cfm](http://www.nasact.org/nasact/directory/index.cfm)) which provides a central location for links to the websites of state financial officials, financial statement documents, and existing interim disclosure websites.

## Assessment of Available Information

**Issuers should review the source and type of information already generated on a periodic basis, assess the reliability of such information, and determine whether such information would be appropriate to include in a voluntary ongoing disclosure program.**

As part of this analysis, states might consider the following with respect to the available information:

- What is the purpose of the information or report being generated? Is the purpose consistent with the use of that report by investors as part of an ongoing diligence review process?
- What is the reliability of information contained in the report? Is the information intended to be relied upon for making important conclusions or decisions?

Any information distributed to investors, whether on a voluntary basis or otherwise, is subject to the anti-fraud provisions under federal securities laws. Accordingly, care should be taken so that the information is not misleading and provides the consumer (i.e., investors) with as comprehensive a view as possible. Issuers providing additional disclosure on a voluntary basis should be very careful to describe the nature of the information provided so as to not overstate its relevancy or reliability or create any misgivings about the frequency of updates for that information.

In addition, a government should develop a process for:

- Periodically reviewing and revising internal controls and procedures addressing how the information is prepared to ensure its reasonableness and to guide or limit its dissemination.
- Making the context of the disclosures clear to the reader. Clarifying language should be tailored to the situation and to the disclosures. For example, a government should indicate whether financial reports are prepared on a cash or accrual basis of accounting.
- Involving bond counsel to review policies, the information to be provided and the accompanying disclaimers. Disclaimers should be structured so as not to require that bond counsel provide an opinion each time the documents are updated. However, bond counsel should be consulted for major changes to policies and information.
- Reviewing its website and the location of disclosure materials on the website to assure easy access and clear boundaries between what is intended for market review and other posted information.

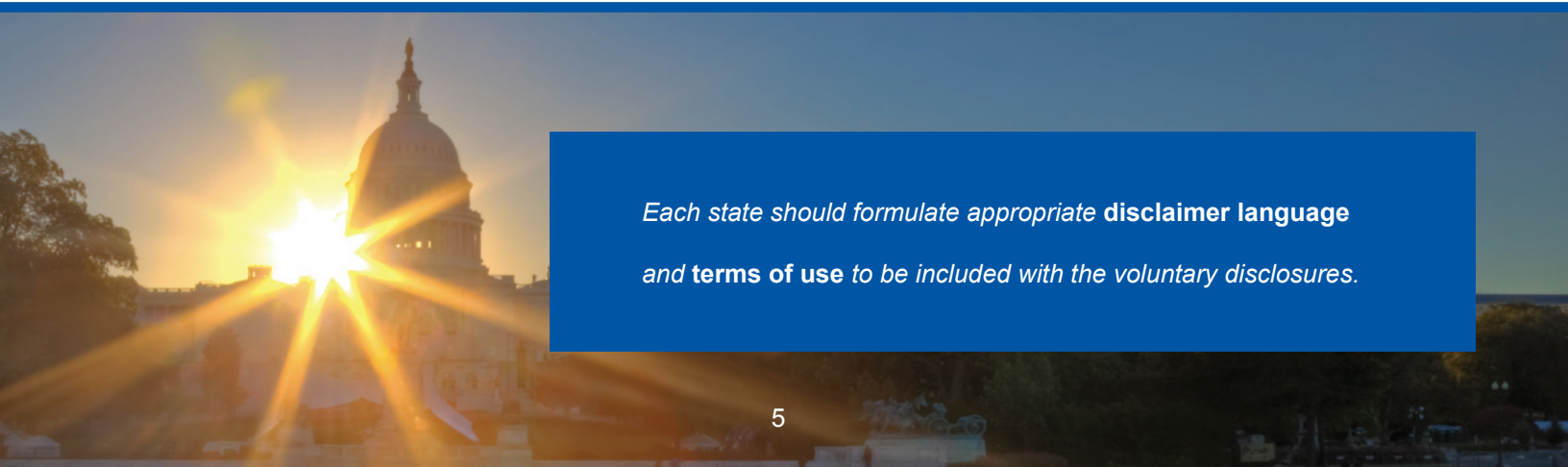
## Cautionary Information

One of the stated reasons some municipal issuers have resisted committing to a voluntary disclosure program has been the notion that such a program increases the issuer's exposure to liability under federal securities laws and the potential for either SEC enforcement action or private investor suits if any of the information provided is inaccurate.

While it is true that information provided to the market on a voluntary basis is subject to the anti-fraud provisions under federal securities laws, the SEC recently indicated in a 2013 enforcement action that there are circumstances under which information posted on a municipal issuer's website could be the subject of an enforcement action, whether or not it was specifically intended to be viewed by investors.<sup>2</sup> Thus, it is in the best interest of municipal issuers who maintain websites containing financial information to identify on the website which information is specifically intended for investor review purposes.

**Each state should formulate appropriate disclaimer language and terms of use to be included with the voluntary disclosures.** This language should be specifically tailored to the issuer and the information being provided. In addition to providing issuer-specific language, a state may wish to consider the following:

- All information provided should be clearly dated, with a caution that more recent information may be available but not yet posted.
- Additional disclaimers noting that some or all of the information is not audited.
- If forecasts (including revenue estimates and budgets) are included, special language similar to what is used in official statements should be included.
- It should be made clear that the information is provided on a voluntary basis, and that it is intended (but not required) to be updated periodically.



*Each state should formulate appropriate disclaimer language and terms of use to be included with the voluntary disclosures.*

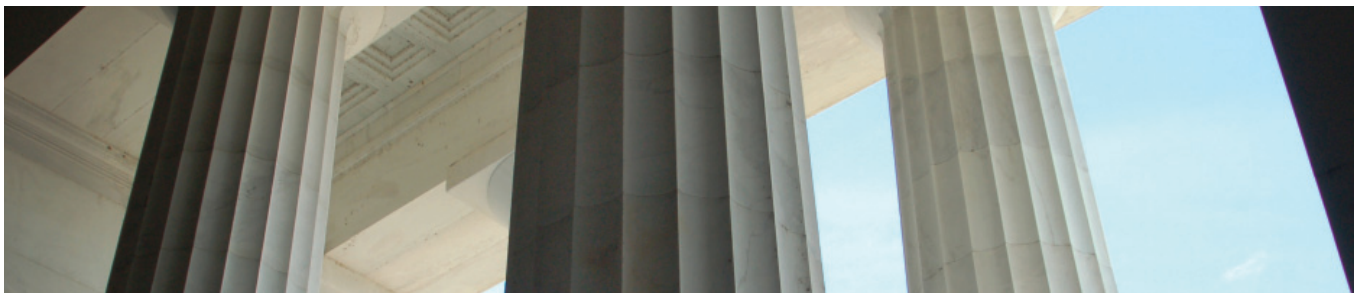
### Conclusion

**Enhancing disclosure is a progressive process. This best practice document on voluntary interim disclosures provides states with information that can be used to further enhance existing disclosure practices.** While not all states will be immediately equipped to meet all of the recommendations set forth, over time it is anticipated that more and more unaudited financial information can be made available to the investment community and the public in a manner that is relevant, timely and easily accessible. ■

### NOTES

<sup>1</sup> Report on the Municipal Securities Market, <http://www.sec.gov/news/studies/2012/munireport073112.pdf>.

<sup>2</sup> Report of Investigation in the Matter of the City of Harrisburg, Pennsylvania Concerning the Potential Liability of Public Officials with regard to Disclosure Obligations in the Secondary Market, Exchange Act Release No. 69516 (May 6, 2013).



### Continuing Disclosures Task Force

**Kim R. Wallin, Co-Chair**  
State Controller, Nevada

**Colin MacNaught, Co-Chair**  
Assistant Treasurer for Debt Management,  
Massachusetts

**Richard K. Ellis**  
State Treasurer, Utah

**Greg S. Griffin**  
State Auditor, Georgia

**Merideth Hackney**  
Bureau Chief, Systems Administration, Idaho

**David H. Lillard, Jr.**  
State Treasurer, Tennessee

**David A. Von Moll**  
State Comptroller, Virginia

### Acknowledgements

**Martin J. Benison**  
Comptroller, Massachusetts  
President, NASACT

**D. Clark Partridge**  
State Comptroller, Arizona  
Chair, Financial Management and  
Intergovernmental Affairs Committee

**National Federation of Municipal Analysts'  
Disclosure Committee**

**Ben Watkins**  
Director, Division of Bond Finance  
State of Florida

### For More Information

**R. Kinney Poynter**  
Executive Director, NASACT  
(859) 276-1147, [kpoynter@nasact.org](mailto:kpoynter@nasact.org)

**Cornelia Chebinou**  
Washington Office Director, NASACT  
(202) 624-5451, [cchebinou@nasact.org](mailto:cchebinou@nasact.org)

[www.nasact.org](http://www.nasact.org)