



# National Federation of Municipal Analysts

## POSITION PAPER ON VOLUNTARY INTERIM DISCLOSURES BY STATE AND LOCAL GOVERNMENTS

To promote provision of more timely and complete disclosure in the municipal securities market, the NFMA endorses a recent proposal put forth by the National Association of State Auditors, Comptrollers and Treasurers (“NASACT”) relating to voluntary interim disclosure (the “NASACT Proposal”).<sup>1</sup> For reasons summarized below, we strongly believe that it is in the best interest of state and local government units and political instrumentalities thereof to provide investors on a voluntary basis with timely disclosure reports derived from information maintained in the normal course of operations. To the extent that governmental issuers have relevant financial information on hand, the benefits of providing voluntary interim disclosure vastly outweigh any administrative burden entailed in disseminating this information to the market.

**Suggested Minimum Quarterly Disclosures:** The NASACT Proposal identifies four specific items as a recommended minimum set of financial information to be provided to investors and the general public at least quarterly:

1. Budget-to-actual operations, showing major categories of revenues and expenditures, for the general fund and major governmental and enterprise funds, year-to-date, and an explanation of the major variances.
2. Cash receipts and cash disbursements in the general fund and major governmental and enterprise funds, year-to-date, compared to the previous fiscal year.
3. Balances and changes in long-term and short-term debt, year-to-date.
4. Significant events (e.g., loss of a major employer or taxpayer, a natural disaster, change in the tax laws that would have a substantial effect on its financial condition, etc.).

As noted by NASACT, the NFMA believes that disclosure of this information should place little or no additional burden on governments, since it is generally already prepared for use in the course of normal operations. These four disclosures are a recommended minimum only. NFMA agrees with NASACT that each government should assess whether additional information on hand might be helpful in providing a better understanding of the government’s operations, financial position, and outlook. NFMA also agrees that Governments should consider the significance of their available information and consider more frequent disclosure. Entities that are providing monthly information should continue to do so, and others that have the capacity to provide monthly information should consider doing so.

**Internet Policy:** The NFMA also supports NASACT’s recommendation that governmental issuers use their web sites for disclosure. Entities should include easily identified link(s) to “Financial Information” on their home pages which would automatically transfer users to all available disclosure reports including: (i) interim quarterly information for recent quarters; (ii) comprehensive annual financial report(s); and (iii) other financial reports that governments might prepare and publish. NFMA additionally supports comprehensive use of the newly established Municipal disclosure central post office, DisclosureUSA, as a means of

promoting more efficient and uniform dissemination of disclosure information in the municipal market.

**Other Considerations:** The NASACT Proposal sets forth other recommendations which the NFMA endorses. First, government issuers should have internal procedures in place to ensure that the information publicly released is accurate and not misleading. Second, since timeliness is a key factor in interim reporting, issuers are encouraged to publish interim information two-to-four weeks after the end of the month or quarter. Third, since governmental issuers bear ultimate responsibility for disclosure content, measures should be taken to mitigate the risk of material misstatements. As noted in the NASACT Proposal, issuers should use prudence and due diligence in compiling and publishing information and include an explanation of any interim information. In particular, NASACT notes it is important for issuers to state clearly at least the following:

- The information presented is unaudited and has not been subjected to customary fiscal period closing procedures (verification, reconciliation and adjustment).
- Projections of results for subsequent dates are estimates, and actual results will almost certainly differ.
- Describe the bases of accounting used for this information.

For a more complete discussion of these recommendations, readers are referred to the text of the NASACT Proposal itself which is appended as Exhibit A.

**Benefits of Disclosure:** Complete, accurate information is essential to the role of analysts in the capital markets. Accordingly, the NFMA strongly believes it is in the best interest of all governmental issuers to disclose all material financial information and operating data to investors, and to do so on a regular basis. As demonstrated throughout all capital markets, issuers that disclose information on a fair and regular basis secure better market rates.

Set forth below are numerous reasons why it is highly advantageous for all governmental issuers to provide complete, timely and accurate information to investors.

### **Market Factors**

- Improved disclosure elicits wider bidding which extends liquidity and reduces borrowing costs, particularly in a rising interest rate environment
- Good disclosure facilitates investor relations and improves market access
- Good disclosure is consistent with issuer practices in all capital markets
- Accurate, timely and complete disclosure greatly lessens the need for regulation
- Good disclosure supports secondary market trading prices of related securities by broadening the underlying investor base
- Financial disclosure serves as a critical internal guide to promote effective financial management
- Reluctance to disclose erodes investor confidence in management

- Collectively, improved municipal disclosure strengthens the global competitive position of municipal bonds as an asset class
- Good disclosure serves as an effective compass to guide portfolio management which leads to improved demand for bonds and better borrowing terms
- Good disclosure promotes comparative analysis of governmental issuers which facilitates creation of peer group medians and benchmarks
- If favorable information exists, good disclosure amplifies a positive credit profile that will improve trading value and overall market access
- If unfavorable information exists, good disclosure demonstrates the full extent of management's grasp of financial problems and its ability to implement remedial action
- Good disclosure is demonstrative of management sophistication and a pro-active approach to financial administration

### **Legal Factors**

- Clear, accurate and timely disclosure promotes the efficient allocation of capital, a basic objective of our nation's securities markets
- Contrary to prior legal myth, issuers are not prevented from providing information beyond the bare minimum required by SEC Rule 15c2-1
- Clear and accurate disclosure promotes compliance with SEC Rule 10(b)(5)
- Clear and accurate disclosure promotes compliance with SEC Rule 15c2-12

### **Economic Factors**

- Used in conjunction with a FAQ file <sup>2</sup> written disclosure increases productivity
- Good disclosure is wholly consistent with the market's expectations about the increased availability of information driven by the growth of the Internet
- Good disclosure is wholly consistent with the market's expectations about the ongoing evolution of good governance standards.

### **Administrative Factors**

- Periodic disclosure is emblematic of responsible financial management
- Good disclosure promotes greater accountability and public trust in government
- Written disclosure promotes even-handed provision of information to all
- It makes considerable sense to leverage information already on tap to derive multiple benefits that attend good disclosure practices
- Good disclosure promotes a more informed citizenry which is essential

to the effective management of democratic government

## Notes

1. NASACT Position Paper entitled: "A Proposal: Results of the Deliberations at the Meeting about Voluntary Interim Disclosures by State and Local Governments, September 25, 2003" issued by the National Association of State Auditors, Comptrollers and Treasurers on December 17, 2003.
2. FAQ stands for 'frequently asked questions'. Development of a FAQ file enables financial managers to distill answers to frequently asked questions into prepared text to avoid the need to provide answers to recurring questions over and over again.

*Exhibit A appears on next page*

# Exhibit A

## NASACT PROPOSAL

### Results of the Deliberations at the Meeting about Voluntary Interim Disclosures by State and Local Governments, September 25, 2003

#### Introduction

A group of individuals interested in discussing the possibility of creating a “template” for a minimum level of voluntary interim disclosures of financial and related information by state and local governments met in Washington, D.C., on May 22 and 23, 2003, and again on September 25, 2003. It was understood that the opinions expressed by those in attendance were their own and did not necessarily represent the associations with which they are affiliated. The names of those who attended the September meeting are listed as Attachment 3 to this paper.

#### Suggested Minimum Quarterly Disclosures

The group identified the following four specific items as a recommended minimum set of financial information to be provided to investors and the general public at least quarterly:

1. Budget-to-actual operations, showing major categories of revenues and expenditures, for the general fund and major governmental and enterprise funds, year-to-date, and an explanation of the major variances.
2. Cash receipts and cash disbursements in the general fund and major governmental and enterprise funds, year-to-date, compared to the previous fiscal year.
3. Balances and changes in long-term and short-term debt, year-to-date.
4. Significant events (e.g., loss of a major employer or taxpayer, a natural disaster, change in the tax laws that would have a substantial effect on its financial condition, etc.).

Disclosure of this information should place little or no additional burden on governments, since it is generally already prepared for use in the course of normal operations.

These four disclosures are a recommended minimum only. Each government should assess whether additional information that it has might be helpful in providing a better understanding of the government's operations, financial position, and outlook. Expansion and experimentation are encouraged. The recommendation to provide interim information on a quarterly basis is also a minimum. Entities that are providing monthly information should continue to do so, and others that have the capacity to provide monthly information should consider doing so.

#### Cautionary Information

In addition to identifying specific items that governments might provide on a quarterly basis, the group considered what recommendations it might make regarding explanatory and descriptive materials that should accompany interim information. There was general agreement on the following:

- A government should have internal procedures to ensure that the information which it releases is accurate and not misleading.
- A government should make the context of the disclosures clear to the reader. An example of the explanatory information that accompanies Wisconsin's *Monthly General Fund Financial Information* is provided below (Attachment 2). A government should tailor such clarifying language to its own situation and to the disclosures it is providing.
- A government should ask its attorney to review its interim information and the accompanying disclaimers.

#### Availability of Template Information

The group agreed that it was important to make it broadly available and as easy as possible for people interested in interim information to find. There was consensus that governments that provide financial information on their Web sites should have a link to **"Financial Information"** on the home pages of their Web sites. This link would take the reader to another page with further links – to interim information for recent quarters (at least all quarters of the current fiscal year), to the comprehensive annual financial report(s), and to other financial reports that the government might prepare and publish.

#### Implementing the Proposal

The states of Delaware and Indiana have agreed to serve as pilot projects for implementing the recommended set of minimum disclosures. They will provide interim disclosures for the third quarter of their 2004 fiscal years (i.e., the information will be published sometime in April 2004 for the period ended on March 31). Efforts will be made to identify cities and counties for pilots also. Outreach efforts will be made to the National Association of State Comptrollers, the National League of Cities, the Government Finance Officers Association, the National Association of Counties and other municipal organizations.

In addition, efforts will be made to get the topic of voluntary minimum interim disclosures on the agendas of meetings of the abovementioned organizations as well as the AICPA government conference and the conference of the National Federation of Municipal Analysts.

The hope is that not only will interim financial-related information be routinely posted on a government's Web site, but also that it will be part of the public discourse about that government. Discussion of this information should be on the agendas of public meetings of government officials (city or county council meetings, for example) immediately following its publication. Reaching the public and the press with this information will assist in educating them and in enhancing the transparency and accountability of their government.

## Attachment 1

### Background and Basis for the Proposal

The National Association of State Auditors, Comptrollers and Treasurers offered to lead an investigation about how some of governments' basic and critical financial-related information might be provided on a more timely basis than the traditional annual financial reports which appear five to six months after fiscal year end. NASACT convened a meeting on May 22-23, 2003, of all parties interested in exploring the possibility of creating a template of perhaps six to ten basic disclosures that state and local governmental entities might voluntarily provide on a quarterly basis. These disclosures would not be interim financial statements, but rather timely information that would be of use to bond raters, bond holders, and others interested in the financial condition of particular state or local governments.

It was important to attract to the meeting as wide a group as possible of people and associations interested in financial reporting by and the financial position of state and local governments. Invitations were extended to all organizations represented on the Municipal Council and on the Governmental Accounting Standards Advisory Council as well as to representatives from the bond rating agencies.

Thirty-six people attended one or both days of the session.

NASACT convened the meeting to discuss how to encourage and help governments to provide interim financial-related information to the public. Although annual financial reports are typically audited (and therefore are assumed to be accurate), the information therein is neither timely nor useful for making many management and investment decisions. Providing timely information is part of the professional responsibility of governmental financial managers, and is now well within their technological capacity. The group was charged with (1) investigating the feasibility of government's providing some basic and critical financial-related information on a quarterly or monthly basis and (2) possibly creating a template of basic disclosures that state and local governments might provide without significant additional effort.

The agenda for the meeting involved participants from particular groups addressing various questions:

- Representatives from state and local governments, agencies and other governmental entities spoke about what they are presently doing with regard to interim disclosures.
- Representatives from bond rating agencies, institutional investors, bond analysts and the banking community discussed what they, as users of financial information, would like to have available on a monthly or quarterly basis.
- Representatives from the Securities and Exchange Commission encouraged delivery of an increased amount of timely financial information to investors and potential investors.
- Representatives from the American Bar Association and the National Association of Bond Lawyers addressed the legal implications of interim disclosures and the steps that should be taken to mitigate the risk of providing misleading information.
- Representatives from the U.S. Bureau of Economic Analysis and the Census Bureau described what their data-collection processes are and how greater availability of financial-related information from state and local governments could assist their efforts.

During the two days of discussion, the participants addressed many aspects of the subject. Certain themes recurred:

1. The information a government makes available on an interim basis should be information that it develops as part of its normal course of operations.
2. The following are general recommendations for the kinds of information that would be of interest and use to a variety of users of this information:
  - A. Budget to actual operations to date, presenting aggregated revenue and expenditure data.
  - B. Information about cash flows.

- C. Information related to debt capacity.
  - D. Economic data and significant events.
3. Along with this information, a government should provide the following cautions:
- A. An explanation about the source of the data and how they were compiled.
  - B. A note that different bases of accounting may be used for different information.
  - C. A reminder that projections are estimates and that actual results may differ.
  - D. A note that the data are unaudited.

### The Governmental Environment

Attendees at the meeting joined in an exploration of a wide variety of issues related to financial reporting. Beyond the basic questions of which information should be made available and how often which particular items of information should be reported, these other issues were discussed:

- Who is the audience for interim reporting? Is it only the investment community, or are legislators, policy-makers and perhaps the general public also interested in interim financial-related information? The consensus was that a wide range of governmental policy-makers and managers should be interested in this information to assist them in more effectively carrying out the responsibilities of their positions. This information would likely also be of interest at least to the “watchdogs” among the general public.
- Who should issue interim financial-related information? Should all governments be encouraged to provide some interim data, or should the emphasis be on those governments that issue debt? Also, in large state and municipalities, there are often several offices involved in financial management; some agreement would be needed as to which office would provide interim information. About thirty states have central data collection centers – these would be logical sources of data for their states.
- Timeliness is the key factor in interim reporting. The users of interim information, whether they be bond analysts, budget analysts, or citizens interested in government, can make better-informed decisions to the extent that the data which they are using are current. **A suggestion was made that a goal for the publication of interim information might be two-to-four weeks after the end of the month or quarter.**
- The attendees understood that there is a trade-off between timeliness and accuracy of data. Clearly, information that is released within two-to-four weeks of the end of the period will be relatively “raw”, without the benefit of review and reconciliation given for more formal reports, and also without the benefit of audit. In most cases, the information will be presented on the cash-basis.
- Where should interim financial-related data be published? Should it be sent to the central post office envisioned by the Muni Council? Should it be sent to the Nationally Recognized Municipal Securities Information Repositories? Would it be sufficient for a government to post its information on its Web site?

### Legal Considerations

A government is responsible for its external financial reporting and its potential liability if that reporting is judged to be misleading, or worse, fraudulent. Since the source of litigation is most likely to come from the bond market, one may ask which governmental reports “speak to the market”? The general agreement was that almost all public statements are speaking to the market, even publications as passive as postings on a Web site. While there are no riskless disclosures, measures may be taken to mitigate risk. Government should use prudence and due diligence in compiling and publishing the information. They should also include an explanation of any interim information that is published. In particular, it is important to state clearly at least the following:

- The information presented is unaudited and has not been subjected to customary fiscal period closing procedures (verification, reconciliation and adjustment).
- Projections of results for subsequent dates are estimates, and actual results will almost certainly differ.
- Describe the bases of accounting used for this information.



In addition, it is prudent for a government to state that this information is being reported voluntarily and that the government may discontinue making the information available if it does not have the resources to publish it.

Two references for disclaimers met with the general approval of the group:

1. "Cautionary Information" attached to Wisconsin's *Monthly General Fund Financial Information* (see Attachment 2).
2. GFOA's "Sample Web Site Disclaimer Language", from J. Ben Watkins, III, and Lucy H. Harris, "Using Your Web Site to Enhance Bond Market Disclosure", *Government Finance Review*, June 2002, p. 8.

### The Subsequent Meeting

A follow-up meeting of the group was held on September 25, 2003, to identify the specific disclosures that would be recommended. This Proposal, and specifically the four suggested minimum quarterly disclosures listed on page 1, are the outcome of that meeting.

These disclosures will provide users with timely information in several important areas, allowing the public and government decision-makers to follow closely and alter the fiscal policy of their government when necessary. The first disclosure will show how results of operations in budgeted funds stand in relation to expectations. It will also explain significant variances between budgetary figures and results of operations. This report will help users to assess whether operations are going as anticipated or whether significant overages or underages have occurred. The second disclosure will provide information about the government's cash position, its ability to meet its short-term cash needs and unbudgeted funds.. Item #3 will provide information about whether the government is increasing or decreasing its short-term and long-term debt. The fourth item will provide information about significant events happening in the government's environment.

The individuals who attended the September 25 meeting are listed in Attachment 3 to the Proposal.

## Attachment 2

The State of Wisconsin publishes monthly information about its general fund. The following list of general and specific cautions is derived from the clarifying and explanatory materials which accompany Wisconsin's monthly disclosures.

### *Cautionary Information*

The general fund financial information in this document has been prepared using what is believed to be the best available data for these purposes. The tables in this document have been prepared using the same procedures used to prepare similar information for the government's other financial reports. This information is, however, preliminary in nature and subject to change.

1. This information is unaudited and is not a "financial statement". None of the data presented here have been subjected to customary fiscal period closing procedures or the procedures used in the preparation of a financial statement, including verification, reconciliation and identified adjustments.
2. This information speaks only as of the date on which it was prepared.
3. Statements of information for dates before the date this information is prepared will almost certainly be subject to restatement and revision. Information classified as "actual", and any difference from any prior estimate, does not signify a change to official estimates. Any official revenue or expenditure re-estimates that do occur will be separately identified and, if material, appropriately noticed.
4. Data in these tables of financial information are subject to revision and reclassification for prior periods. This is particularly true for revenue data, where proper classification depends on tax returns which may be received and processed significantly after the tax payments are received through electronic transfers.
5. Some data are presented on a cash basis of accounting while other data are presented on a budgetary basis. Users should not compare data that are presented with different bases of accounting.
6. Comparison of monthly or quarterly general fund financial information has many inherent problems. Unforeseen events (including even a change in weather conditions) or variation from underlying assumptions may cause a decrease in receipts or an increase in disbursements from those projected for a given month.
7. The government is not obligated to provide this information or make it available on its Web site.