



G A O

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

January 18, 2011

The Honorable Tim Johnson
The Honorable Richard C. Shelby
United States Senate

The Honorable Spencer Bachus
Chairman
The Honorable Barney Frank
Ranking Member
Committee on Financial Services
House of Representatives

Subject: *Dodd-Frank Wall Street Reform Act: Role of the Governmental Accounting Standards Board in the Municipal Securities Markets and Its Past Funding*

This letter formally transmits the documents used for an oral briefing we gave to your offices on January 12-13, 2011, in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹ See enclosure 1 for a copy of our briefing slides. GAO was directed to study the role and importance of the Governmental Accounting Standards Board (GASB) in the municipal securities markets as well as the manner and level at which GASB has been funded. GASB establishes standards of accounting and financial reporting for U.S. state and local governments. Established in 1984 as an operating component of the Financial Accounting Foundation (the Foundation), GASB is recognized by the American Institute of Certified Public Accountants as the body that sets generally accepted accounting principles (GAAP) for state and local governments.

In conducting this study, GAO was to consult with the principal organizations representing state governors, legislators, local elected officials, and state and local finance officers. Specifically, in accordance with the mandate and discussions with your offices, our objectives were to address the following key questions: (1) What are key stakeholder views on the role and relevance of GASB in the municipal securities markets? and (2) What is the manner and the level at which GASB has been funded?

To address these objectives, we:

- Reviewed academic studies and other documentation derived from numerous sources, including GASB itself.

¹ Pub. L. No. 111-203, §978(b), 124 Stat. 1376, 1925 (July 21, 2010).

- Consulted with key stakeholders through structured interviews, a roundtable discussion held at GAO headquarters, teleconferences, and meetings. As required by the mandate, these consultations included organizations representing state governors, legislators, local elected officials, and state and local finance officers. To ensure that we obtained the perspectives of a broad base of knowledgeable and interested stakeholders, we also consulted with users of state and local governments' financial statements, such as investors, rating agencies, and bond insurers; auditors; and other participants in the municipal securities markets, including GASB and the Foundation.
- Obtained and reviewed audited financial statements of the Foundation and other financial data specific to GASB.

As further elaborated in the attached briefing slides, stakeholders expressed a range of views on the role and relevance of GASB in the municipal securities markets. This discussion was framed around the following topics: the use of GASB's accounting principles, benefits and limitations of GAAP reporting, GAAP use after the credit crisis, and GASB's continuing role in the municipal securities markets. For example, while some stakeholders indicated that GASB's responses to the evolving needs of the securities markets have been appropriate, others indicated that GASB could do more to alleviate the burden that the cost and complexity of preparing GAAP-basis financial statements places on governments. With regard to the manner and level at which GASB has been funded, our briefing slides include an overview of the Foundation's financial responsibilities with regard to GASB as well as information on GASB expenses and sources of funding for 2006 through 2009. In our consultations with stakeholders on GASB funding issues, they expressed a range of views. For example, while most stakeholders agreed that GASB needed a steady, sustainable stream of funding, several stakeholders were concerned with the level and nature of GASB's expenditures as well as a perceived lack of transparency associated with its budget process.

We conducted our work from September 2010 to January 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions. See enclosure 2 for further details on our scope and methodology. See enclosure 3 for a list of organizations that participated in our study. Enclosure 4 provides an overview of academic research on the impact of GAAP on municipal securities markets. Enclosure 5 provides a schedule of GASB's program expenses from 2006 through 2009. Enclosure 6 provides GAO contact information and acknowledges contributors to this report.

We are sending copies of this report to the appropriate congressional committees, the Chairman of the Board of Trustees of the Financial Accounting Foundation, the President and Chief Executive Officer of the Financial Accounting Foundation, the Chairman of the Governmental Accounting Standards Board, and the Chairman of the

Securities and Exchange Commission. We are also sending copies to the roundtable participants, the stakeholders with whom we consulted, and other interested parties. This report will also be available at no charge on our Web site at <http://www.gao.gov>. Should you or your staffs have any questions concerning this report, please contact either of us at rasconap@gao.gov or (202) 512-9816 or williamso@gao.gov or (202) 512-8678. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.



Paula M. Rascona
Director
Financial Management and Assurance



Orice Williams Brown
Director
Financial Markets and Community Investments

Enclosures



Dodd-Frank Wall Street Reform Act: Role of the Governmental Accounting Standards Board in the Municipal Securities Markets and Its Past Funding

Briefing for offices of the

Committee on Banking, Housing, and Urban Affairs
United States Senate

Committee on Financial Services
House of Representatives

January 12 and 13, 2011

Introduction

Objectives

Scope and Methodology

Background

Results

Enclosures

- 2: Scope and Methodology
- 3: Organizations That Participated in GAO's Study
- 4: Academic Research
- 5: GASB Program Expenses
- 6: Contacts and Acknowledgments

- The Dodd-Frank Wall Street Reform and Consumer Protection Act included a requirement for GAO to study the role and importance of the Governmental Accounting Standards Board (GASB) in the municipal securities markets and the manner and level at which GASB has been funded.
- GASB establishes standards of accounting and financial reporting for U.S. state and local governmental entities. Established in 1984 as an operating component of the Financial Accounting Foundation (the Foundation), GASB is recognized by the American Institute of Certified Public Accountants as the body that sets generally accepted accounting principles (GAAP) for state and local governments.
- The Municipal Securities Rulemaking Board (MSRB)¹ reported that there were over 10 million trades of municipal securities in the secondary market amounting to approximately \$3.8 trillion in 2009.
 - Issuers of municipal securities include states, counties, cities and towns, school districts, and special government districts, such as public benefit corporations and authorities, public employee retirement systems, governmental utilities, public hospitals and other public health care providers, and public colleges and universities.

¹MSRB was established by Congress to promote a fair and efficient municipal securities market. MSRB makes rules regulating securities firms (but not issuers) in the municipal securities market. The Securities and Exchange Commission (SEC) is charged with oversight of MSRB.

In accordance with the mandate and discussions with committee offices, our study addressed the following key questions:

- Objective 1: What are key stakeholder² views on the role and relevance of GASB in the municipal securities markets?
- Objective 2: What is the manner and the level at which GASB has been funded?

²In this report, we use the term “stakeholder” to mean a person or group with an interest in GASB and its impact on the municipal securities markets.

Objective 1: To obtain key stakeholder views on the role and relevance of GASB in the municipal securities markets, we:

- Consulted with key stakeholders through structured interviews and a roundtable discussion held at GAO headquarters. The roundtable discussion was organized around the following four general topics:
 - Topic 1: Use of GASB's accounting principles
 - Topic 2: Benefits and limitations of GAAP reporting
 - Topic 3: GAAP use after the credit crisis
 - Topic 4: GASB's continuing role in the municipal securities markets
- Reviewed academic studies that analyzed the impact of financial statements prepared in accordance with GAAP on municipal securities markets.

Objective 2: To describe the manner and level at which GASB has been funded, we:

- Obtained and reviewed audited financial statements of the Foundation, which included certain key financial data of GASB.
- Interviewed officials from GASB to obtain and discuss unaudited financial data specific to GASB, including separate operating financial data and the percentage of the Foundation's allocation of common costs to GASB.
- Provided key facts related to GASB funding to Foundation officials for their confirmation.

- Consulted with key stakeholders through teleconferences and meetings.

For both objectives:

- As required by the mandate, we consulted with the principal organizations representing state governors, legislators, local elected officials, and state and local finance officers.
- To obtain the perspectives of a broad base of knowledgeable and interested stakeholders, we also consulted with users of state and local governments' financial statements, such as investors, rating agencies, and bond insurers; auditors; and other participants in the municipal securities markets, including GASB and the Financial Accounting Foundation.

The summary of views included in this report captures the collective discussion of roundtable participants and the comments made by stakeholders in numerous interviews and consultations. The views summarized are not attributable to any individual or organization and do not necessarily represent the views of any single organization, including GAO.

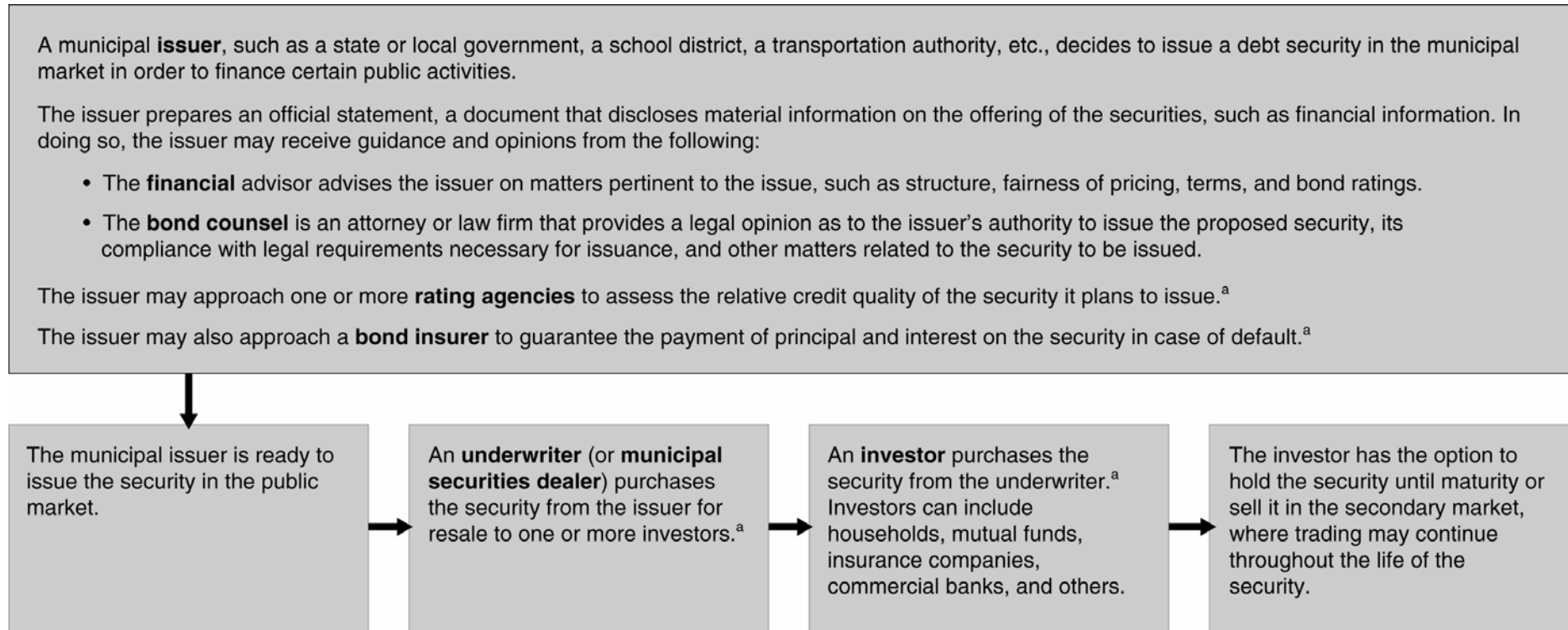
Enclosure 2 includes details on our scope and methodology. Enclosure 3 provides a list of organizations that participated in our study.

We conducted our work from September 2010 to January 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions.

GASB's mission is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports, and guide and educate the public, including issuers, auditors, and users of those financial reports.

- GAAP encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. It includes not only broad guidelines for general application, but also detailed practices and procedures. Those conventions, rules, and procedures provide a standard by which to measure financial presentations.
- An independent auditor's report may contain an opinion as to whether the financial statements present fairly an entity's financial position in conformity with GAAP.
- Audited financial statements are used by a variety of stakeholders in the municipal securities markets. See figure 1 for a description of the key steps in the issuance of a municipal security and the stakeholders that typically use issuers' audited financial statements in their review of a security.

Figure 1: Issuance of a Municipal Security: Key Steps and Stakeholders



Sources: MSRB (data); stakeholder interviews (data); GAO (graphic).

^aAt these points in the process, analysts typically review audited financial statements as part of their evaluation of the security. These statements may or may not be prepared in accordance with GAAP standards.

Topic 1: Use of GASB's accounting principles

Publicly traded companies are required by the Securities and Exchange Commission (SEC) to prepare and issue financial statements based on GAAP; however, municipal issuers are not subject to this requirement. State requirements regarding the use of GAAP by local governments vary, but institutional investors and rating agencies generally agreed that most municipal issuers use GAAP.

- While all state governments use GAAP for state-level financial reporting, GAAP use by local governmental entities varies. Some states require, either by state law or regulation, that the local governmental entities within those states use GAAP. Other states, however, do not require GAAP use by their local governments.
- We identified no definitive studies quantifying the use of GAAP by municipal issuers. However, representatives of several institutional investors and rating agencies agreed that most of the issuers whose securities they evaluate use GAAP.
- In states where GAAP use is not required for local governments, local governments preparing GAAP-basis financial statements tend to be
 - larger, or
 - more frequent debt issuers.

Topic 2: Benefits and limitations of GAAP reporting

Stakeholders viewed GAAP-basis financial statements as highly useful for assessing the quality of municipal securities.

- Several analysts, issuers, and other stakeholders stated that GAAP-basis financial statements are comprehensive.³ These views included:
 - GAAP-basis financial statements provide a fuller, more transparent picture of a government’s financial position than those prepared in accordance with other bases of accounting.
 - GAAP-basis financial statements provide important information on topics such as pensions, post-employment benefit plans, and derivatives.
 - The statistical reporting section in GAAP-basis financial statements provides helpful longer-term trend information, and the management discussion and analysis section and enhanced disclosures in the notes sections provide context on an issuer’s financial position.

³For the purposes of this work, the term “analysts” refers collectively to institutional or retail investors, rating agencies, and bond insurers—entities that employ professional staff who analyze the credit quality of municipal bonds—that we interviewed or participated in our roundtable. “Issuers” refers to those state and local governments and associations representing state and local governments and their finance officers that we interviewed or who participated in our roundtable. Where appropriate, we attribute the comments to subgroups.

Topic 2: Benefits and limitations of GAAP reporting

(continued)

- Stakeholders generally agreed that use of GAAP's reporting framework provides consistency and facilitates comparability of financial information across different municipal issuers and securities.
- A few analysts stated that they might bypass a security from an issuer that does not have GAAP-basis financial statements because of the greater amount of analysis required to understand its financial position.

Topic 2: Benefits and limitations of GAAP reporting

Analysts generally agreed that, while GAAP-basis financial statements are important, they are not the only source of information they use to assess the quality of municipal securities, nor does the use of GAAP necessarily equate to a high-quality security.

- For example, several analysts stated that they value budgets for forward-looking financial information.
- A few representatives of rating agencies and bond insurers pointed out that, unlike other market participants, they are able to ask issuers for any additional information they need to conduct a credit assessment. Therefore, the lack of GAAP-basis financial statements does not necessarily lead to a higher credit risk determination.
- A few stakeholders commented that analysts and investors should take caution to not confuse GAAP-basis reporting with a good financial position or good credit quality.

Topic 2: Benefits and limitations of GAAP reporting

Several stakeholders believed that GAAP-basis financial statements are associated with lower borrowing costs, although others stated that it is difficult to attribute lower costs to the use of GAAP alone.

- Several issuers stated that they do not know exactly how GAAP impacts their borrowing costs, but they hope or believe their costs are lower as a result of using GAAP.
- A few stakeholders, including issuers and investors, stated that many factors impact borrowing costs, such as strong financial management, income tax revenues, and use of bond insurance, and that isolating the impact of GAAP use on borrowing costs is difficult.
- Enclosure 4 discusses the key findings and limitations of several studies that evaluate the impact of GAAP-basis financial statements on the municipal securities markets, including borrowing costs.

Topic 2: Benefits and limitations of GAAP reporting

Stakeholders stated that GAAP-basis financial statements are complex and expensive to prepare, particularly for small, infrequent issuers.

- A few stakeholders told us that preparing GAAP-basis financial statements requires issuers to hire or outsource accounting professionals with an advanced skill set. This can be cost-prohibitive for many small issuers with limited resources, particularly those that do not issue debt on a regular basis.
- A rating agency analyst and several issuers stated that governments, if given the option of whether to use GAAP or another basis of accounting, must weigh the cost of preparing GAAP-basis financial statements against potential benefits, such as potentially reduced borrowing costs.

Topic 2: Benefits and limitations of GAAP reporting

Stakeholders generally agreed that governments are not always timely in issuing audited financial statements, making them less useful to analysts and other users, although a few stakeholders maintained that other publicly available information compensates for the lack of timeliness.

- Issuers and analysts explained that the delay in completing GAAP-basis financial statements is due to:
 - the complex and comprehensive nature of GAAP;
 - the complexity of state and local governments;
 - limited staff time and resources; and
 - higher priority placed by elected officials on the preparation of the annual budget.

A National Association of State Comptrollers survey found that states completed their Fiscal Year 2009 audited financial statements in an average of 206 days, or nearly 7 months, from the end of their fiscal year. Seven states took over 9 months to issue their financial statements.⁴

⁴National Association of State Comptrollers, *Time to Complete the States' CAFRs, Fiscal Years 2005, 2006, 2007, 2008 and 2009*. Received from the National Association of State Auditors, Comptrollers, and Treasurers via e-mail on November 19, 2010.

Topic 2: Benefits and limitations of GAAP reporting

(continued)

- Untimely financial statements may require analysts to rely on outdated information or to try to obtain additional, unaudited information from issuers.
- Issuers noted that they are aware of the timeliness issue, and some are taking steps to address the problem. For example, the National Association of State Auditors, Comptrollers, and Treasurers (NASACT) has established a working group to identify states' top obstacles and opportunities with regard to issuing faster annual financial reports.

Unlike corporations, state and local governments also often post annual budgets, board meeting agendas, and meeting minutes online; and public hearings are frequently accessible online or through the news media. Such publicly available information may mitigate the lack of timeliness to some extent, according to two issuers.

Topic 3: GAAP use after the credit crisis

According to a study by a rating agency and discussions with bond insurers, the percentage of newly issued securities with insurance has decreased from over 50 percent in 2005 to less than 10 percent of newly issued securities in 2010.⁵ As the use of bond insurance has decreased, analysts and investors may be more reliant on GAAP-basis financial statements to determine the quality of municipal securities.

- A few analysts said that, rather than focusing strictly on the bond insurer's rating in cases where issuers purchase insurance, they have always evaluated the credit quality of the underlying bond they are considering. In conducting this analysis, GAAP-basis financial statements have been important to them.
- Several analysts said the decrease in the availability of bond insurance forces analysts and investors to look more carefully at the credit quality of issuers. As such, they will likely place more importance now on the issuer's financial statements and other disclosures.

⁵Standard & Poor's, *For The U.S. Bond Insurance Market, There May Be No Turning Back*, January 20, 2010.

Topic 4: GASB's continuing role in the municipal securities markets

Stakeholders discussed several issues related to GASB's ongoing standards setting and outreach efforts.

- A few stakeholders noted that GASB has improved the quantity and quality of its education materials and has worked hard to teach stakeholders more about financial statements and GAAP.
- A few stakeholders also indicated that GASB-issued standards have made government accounting more complex and expensive and that GASB could do more to facilitate discussion about the relationship between the costs and benefits of GAAP-basis financial reporting. Others commented on the complexity of Financial Accounting Standards Board (FASB) standards and noted that complex financial reporting is a reflection of the complexity of the organization being reported on.⁶
- According to a GASB official, drivers of new standards or revisions to existing standards included user needs, internal research, and conformance with global or FASB standards.

⁶FASB, organized in 1973, establishes standards of accounting and reporting for private sector entities, including businesses and not-for-profit organizations. Like GASB, FASB is an operating component of the Foundation.

Topic 4: GASB's continuing role in the municipal securities markets

(continued)

- One issuer said that slowing down the rate at which GASB changes its standards so that smaller governments and other issuers can keep up would be helpful. Recently, GASB has issued new accounting standards almost every year.
- One issuer recommended that preparers and users of financial information conduct additional discussions on the costs and benefits of GAAP compliance.

Overview of GASB Funding

The Financial Accounting Foundation, the parent organization of GASB and FASB, is a private-sector non-stock corporation qualified as a tax exempt organization under section 501(c)(3) of the U.S. Internal Revenue Code. The Foundation's mission is to establish and improve financial accounting and reporting standards to foster financial reporting that provides decision-useful information to users of financial reports.

Through its Board of Trustees and its executive management, the Foundation oversees FASB and GASB, including the standards boards' procedures for due process and maintaining independence.

Under the bylaws of the Foundation, the Governmental Accounting Standards Advisory Council, a standing advisory committee of GASB, is responsible for providing technical and other support to GASB, including consulting with GASB on a variety of matters, such as major technical issues and providing input on GASB's agenda of projects and assigning of priorities.

Overview of GASB Funding (continued)

The Foundation is responsible for the oversight, administration, and finances for GASB and FASB. The Foundation currently receives its funding from subscription and publications revenues, accounting support fees for FASB pursuant to the Sarbanes-Oxley Act of 2002, and voluntary contributions in support of GASB.⁷

- For each of the 4 years that we reviewed, the Foundation’s independent auditors, McGladrey & Pullen, LLP, issued unqualified “clean” opinions for the Foundation’s financial statements.
- The GASB and FASB Chairmen are responsible for preparing annual budgets, with advice of their respective members, for review and approval by the Foundation's Board of Trustees.
- Establishment of the FASB annual accounting support fees through the Foundation's annual budget process is subject to review by SEC.

⁷In accordance with section 109 of the Act, FASB is funded by an annual accounting support fee allocated among securities issuers based on each issuer’s proportional market capitalization.

Overview of GASB Funding (continued)

The Dodd-Frank Wall Street Reform and Consumer Protection Act granted SEC the authority to require a registered national securities association to establish

- a reasonable annual support fee to adequately fund GASB, and
- rules and procedures to provide for the equitable assessment and collection of the support fee from the members of the national securities association.⁸

As of January 4, 2011, SEC had not acted on this authority.

⁸If SEC exercised this authority, SEC said it would require the Financial Industry Regulatory Authority (FINRA), a registered national securities association under the Securities Exchange Act of 1934, to establish the accounting support fee.

Overview of GASB Funding (continued)

According to the Foundation's annual reports, in 1981, the Foundation established a Reserve Fund, which is currently intended to

- provide the Foundation, FASB, and GASB with sufficient reserves to fund expenditures not funded by accounting support fees or subscription and publication revenues;
- operate the Foundation, FASB, and GASB during any temporary or permanent funding transition periods; and
- fund any other unforeseen contingencies.

The Foundation's Trustees have adopted a policy establishing a targeted year-end Reserve Fund balance equal to 1 year of budgeted expenses for the entire organization, including the Foundation, FASB, and GASB, plus a working capital reserve equal to one quarter of the net operating expenses for the entire organization. Reserve Fund investments are unrestricted assets of the Foundation. Reserve Fund year-end balances for 2006 through 2009 were \$51.9 million, \$54.6 million, \$51.0 million, and \$54.4 million, respectively.

Overview of GASB Funding (continued)

Foundation officials have said that they have had to use Foundation funds from the Reserve Fund to compensate for annual shortfalls in GASB's funding. The officials said that in recent years additions to the Reserve Fund have primarily resulted from (1) revenue from the sale of subscriptions and publications that exceeded operational needs and (2) investment income.

As described in the notes to the Foundation's audited financial statements, the Foundation presents its Statements of Activities based on the concept that standard setting is the sole program of the Foundation. Accordingly, these statements set forth separately the revenue, cost of sales, and certain program expenses of FASB and GASB, as deemed appropriate by management.

Table 1 provides information on GASB's voluntary monetary contributions and related program expenses as reported in the Foundation's Statements of Activities and related notes, along with unaudited information provided by Foundation officials on allocated support expenses. The allocation reflects additional Foundation services for accounting and finance, human resources, facilities management, technology and information systems, legal, development, and general administrative operating assistance.

Overview of GASB Funding (continued)

Table 1: Selected Foundation Information on GASB Funding

(Dollars in millions)

	2006	2007	2008	2009
Voluntary monetary contributions to GASB ^a	\$2.1	\$1.6	\$1.5	\$1.2
Less: GASB program expenses ^b	4.5	4.4	5.0	5.3
Less: Allocation of Foundation support expenses to GASB	<u>1.5</u>	<u>1.3</u>	<u>1.2</u>	<u>1.3</u>
Excess of GASB expenses over GASB revenue from voluntary monetary contributions	(\$3.9)	(\$4.1)	(\$4.8)	(\$5.3)

Source: GAO analysis of 2007, 2008, and 2009 Financial Accounting Foundation Annual Reports and additional unaudited information provided by Foundation officials. Reported amounts are rounded.

^a According to GASB officials, the Foundation’s reported 2006 contributions include contributed services of \$14,000. Contributed services were not included in the other years’ financial statements. For comparability, we have eliminated contributed services from the 2006 data presented here.

^b See enclosure 5 for detail on GASB program expenses.

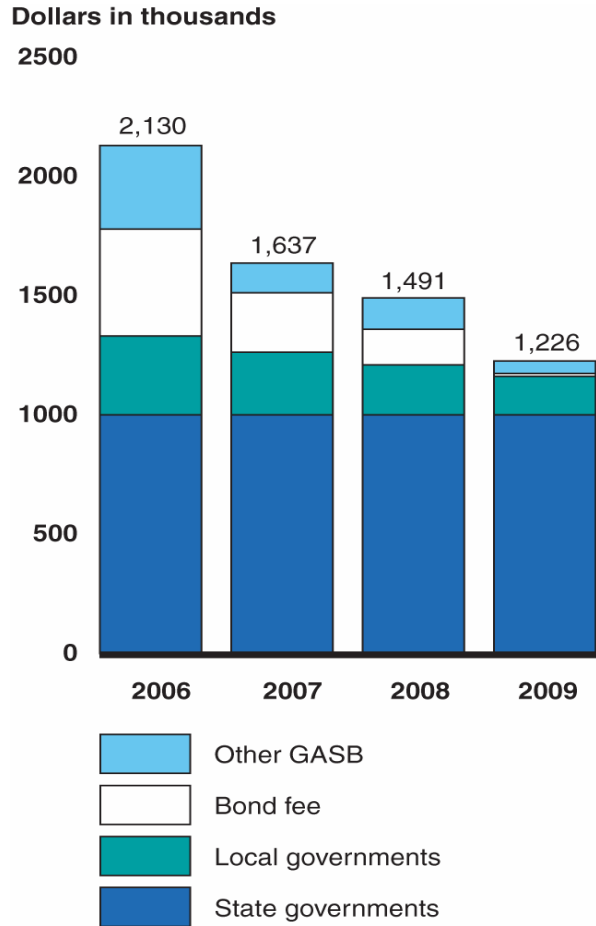
The Foundation’s audited financial statements reported net subscription and publication revenues for FASB and GASB related product offerings of \$10.7 million, \$9.1 million, \$10.2 million, and \$8.2 million for 2006 through 2009, respectively. According to Foundation officials, the Foundation has used these revenues to fund the GASB funding shortfall indicated in table 1.

Sources of GASB Voluntary Monetary Contributions

As shown in figure 2, contributions from state governments are the largest single source of voluntary monetary contributions, and have remained steady in each of the 4 years.

- Combined contributions from state governments totaled \$1 million in each of the past 4 years. According to an official of the National Association of State Auditors, Comptrollers, and Treasurers (NASACT), the amount is not based on a written or contractual agreement.
- The total contribution is remitted by NASACT, which handles the administrative responsibilities of determining annual assessments for each state, invoicing and collecting the amounts, and remitting quarterly payments of \$250,000 to the Foundation. Assessments are calculated for each state based on a fixed amount per state and a variable amount calculated based on the state's population.
- According to a NASACT official, while all states and the District of Columbia are assessed a portion of the total remittance, contributions are voluntary and not all states contribute to GASB every year.

Figure 2: Sources of GASB Voluntary Monetary Contributions, 2006-2009



Source: Financial Accounting Foundation annual reports for years ending December 31, 2007, 2008, 2009.

Sources of GASB Voluntary Monetary Contributions (continued)

According to GASB officials, the Foundation's trustees have explored various options to obtain stable sources of funding for GASB over the past several years. Three of the larger voluntary sources of contributions have been (1) annual municipal government support, (2) the Municipal Bond Fee Assessment Program (a voluntary 3-year trial program that collected fees from participating issuers and concluded in 2007), and (3) direct solicitation and grant funding. The officials provided the following information on these funding options and stated none of these options has succeeded in providing a long-term, permanent, and sufficient funding source to GASB:

- A municipal government support campaign directed at the largest city and county governments, which peaked at nearly \$150,000 in 2006, declined to less than \$40,000 in 2009.
- Collections from the Municipal Bond Fee Assessment Program declined from a high of nearly \$450,000 in 2006 to residual collections of \$12,000 in 2009.
- Private funding by a not-for-profit organization, which totaled over \$1 million over a 7-year period, ended in 2006.

Stakeholder Views on the Manner and Level of GASB Funding

As required by the mandate, we consulted with key stakeholders on the manner and level at which GASB has been funded. The following is a summary of the stakeholder views:

- Officials from most issuer organizations agreed that GASB needed a steady, sustainable stream of funding.
- Several stakeholders were concerned with the level and nature of GASB's expenditures—such as the amounts spent on staff salaries and office space—as well as a perceived lack of transparency associated with its budget process.
- Stakeholders expressed mixed views on whether certain GASB projects and initiatives were redundant with FASB projects or fell outside of what they considered the scope of GASB's mission of promulgating governmental accounting principles. For example, several stakeholders expressed concern regarding GASB's work on accounting for certain retirement benefits, referred to as Other Post-Employment Benefits, while others voiced support for it.

Enclosure 2: Scope and Methodology

To obtain views on the role and relevance of the Governmental Accounting Standards Board (GASB) in the municipal securities market, we consulted with key stakeholders through structured interviews and a roundtable forum held at GAO headquarters. These consultations included organizations representing state governors, legislators, local elected officials, and state and local finance officers. They also included users of state and local governments' financial statements, such as investors, rating agencies, and bond insurers; auditors; and other participants in the municipal securities market. Enclosure 3 provides a list of organizations that participated in our study.

To prepare for the roundtable discussion, which was held on November 9, 2010, we conducted 15 telephone interviews with stakeholders from the organizations mentioned above. We conducted these interviews to obtain a broad-based perspective on GASB and the municipal securities market and to develop relevant topics and questions for the roundtable. The roundtable discussion was organized around the following four general topics:

- Topic 1: The use of GASB's accounting principles
- Topic 2: Benefits and limitations of generally accepted accounting principles (GAAP) reporting
- Topic 3: GAAP use after the credit crisis
- Topic 4: GASB's continuing role in the municipal securities markets

The roundtable was moderated by GAO officials responsible for this report.

We also conducted a review of academic studies that analyzed the impact of financial statements prepared in accordance with GAAP on municipal securities markets. We limited our survey of academic literature to those studies using data from 1984 or later. We did this because GASB, the organization that determines GAAP for U.S. state and local governmental entities, was formed in 1984. We identified five relevant studies by searching the EconLit, the JSTOR, the National Bureau of Economic Research (NBER) Working Paper Series, and the Social Science Research Network (SSRN) databases.¹ We reviewed these studies and identified their key findings and limitations. (See encl. 4.) These studies were conducted for research purposes and their inclusion does not imply that we deem them to be definitive.

To describe the manner and level at which GASB has been funded, we obtained and reviewed audited financial statements of the Financial Accounting Foundation (the Foundation) for the years ended December 31, 2007, 2008, and 2009, which included certain key financial data of GASB. These audited financial statements presented

¹The American Economic Association provides EconLit, an electronic bibliography of economics literature, including journal articles and working papers; JSTOR is a nonprofit service that offers a digital archive of academic journals; the NBER Working Paper Series is a database of working papers submitted by NBER researchers; and SSRN publishes abstracts and working papers submitted by researchers, journals, publishers and institutions.

comparative financial information for the year audited and the prior year. Thus, the financial statements for 2007 also included audited data for the year ended December 31, 2006. The scope of our work did not include verifying the work of the Foundation's independent public accountant. We provided key facts related to GASB funding to Foundation officials for their confirmation and incorporated their comments as appropriate.

In addition, we:

- interviewed officials from GASB and the Foundation to obtain and discuss unaudited financial data specific to GASB, including separate operating financial data and the percentage of the Foundation's allocation of common costs to GASB;
- reviewed management's reports on financial responsibility and internal controls for the years 2007 through 2009 and the report of independent auditors for the Foundation's annual report to understand internal controls over the Foundation's financial reporting; and
- consulted with key stakeholders through teleconferences and meetings.

For both objectives, as required by the mandate, we consulted with the principal organizations representing state governors, legislators, local elected officials, and state and local finance officers. To obtain the perspectives of a broad base of knowledgeable and interested stakeholders, we also consulted with users of state and local governments' financial statements, such as investors, rating agencies, and bond insurers; auditors; and other participants in the municipal securities markets, including GASB and the Foundation.

The summary of views included in this report captures the collective discussion of roundtable participants and the comments made by stakeholders in numerous interviews and consultations. The views summarized are not attributable to any individual or organization and do not necessarily represent the views of any single organization, including GAO.

It is important to note GAO is recognized for its expertise in the area of accounting and auditing standard setting. GAO staff have served on numerous advisory panels in this area, including the Governmental Accounting Standards Advisory Council (GASAC). Under the bylaws of the Foundation, the parent organization of GASB, GASAC is responsible for providing technical and other support to GASB, including consulting with GASB on a variety of matters such as major technical issues and providing input on GASB's agenda of projects and assigning of priorities. GAO's participation in GASAC's activities is in the capacity of an observer. We do not believe that GAO's role in serving on GASAC impaired our ability to perform this engagement objectively as mandated by Congress.

We conducted our work from September 2010 to January 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions.

Enclosure 3: Organizations That Participated in GAO's Study

State Governors

National Governors Association

Legislators

Council of State Governments

National Conference of State Legislatures

Local Elected Officials

National Association of Counties

National League of Cities

State, Local, and Tribal Government Finance Officers

Association of Government Accountants

Association of School Business Officials International

Government Finance Officers Association

International City/County Management Association

National Association of College and University Business Officers

National Association of State Auditors, Comptrollers and Treasurers

National Association of State Budget Officers

National Association of State Retirement Administrators

Native American Finance Officers Association

Others

Analysts

Association of Financial Guaranty Insurers

National Federation of Municipal Analysts

Auditors

American Institute of Certified Public Accountants

Arizona Office of the Auditor General

Association of Local Government Auditors

Tennessee Division of State Audit

Investors

American Association of Individual Investors

Insurance Industry Investors

Investment Company Institute

Preparers/Issuers

City of Carrollton, Texas, Office of the Assistant City Manager for Finance

Colorado Office of the State Controller and Department of the Treasury

Maryland State Treasurer's Office and Office of the Comptroller

Tennessee Office of State and Local Finance

Rating Agencies

Fitch Ratings
Moody's Investors Service
Standard & Poor's

Securities Firms

Securities Industry and Financial Markets Association

Standard Setting/Regulators

Financial Accounting Foundation
Governmental Accounting Standards Board
Municipal Securities Rulemaking Board
U.S. Securities and Exchange Commission

Enclosure 4: Academic Research on the Impact of GAAP on Municipal Securities Markets

We identified five academic studies that analyzed the impact of financial statements prepared in accordance with generally accepted accounting principles (GAAP) on municipal securities markets.² The five studies we identified are

- A.K. Gore, “The Effects of GAAP Regulation and Bond Market Interaction on Local Government Disclosure,” *Journal of Accounting and Public Policy* 23, 2004, 23-52.
- A.K. Gore, K. Sachs, and C. Trzcinka, “Financial Disclosure and Bond Insurance,” *Journal of Law and Economics* 47(1), April 2004, 275-306.
- W.R. Baber and A.K. Gore, “Consequences of GAAP Disclosure Regulation: Evidence from Municipal Debt Issues,” *The Accounting Review* 83(3), 2008, 565-591.
- J. Marlowe, “GASB 34’s Information Relevance: Evidence from New Issue Government Debt,” Apr. 13, 2010, available at SSRN: <http://ssrn.com/abstract=1589343>.
- E. Plummer, P.D. Hutchison, and T. K. Patton, “GASB No. 34’s Governmental Financial Reporting Model: Evidence on Its Information Relevance,” *The Accounting Review* 82(1), 2007, 205-240.

All five studies use regression analysis to estimate the effect of GAAP-basis financial disclosure on municipal securities markets. As a result, they all take into account a wide variety of factors that affect these markets. The following is a summary of the key findings of these studies and overall limitations of their data and methodology that we have identified.

Summary of Key Findings

- State laws that require municipalities to issue financial statements according to GAAP may have a greater effect on disclosures by municipalities that issue relatively small amounts of debt than on disclosures by municipalities that issue relatively large amounts of debt. In 1995, municipalities that issued relatively large amounts of debt tended to issue financial statements containing more of the disclosure elements required by GAAP, even when they were not required to do so by the state.³ In contrast, municipalities that issued relatively small amounts of

²See encl. 2 for a description of our literature review methodology.

³Gore (2004). This study examines financial statements issued by municipalities in Michigan and Pennsylvania in 1995. Michigan requires municipalities to issue GAAP-basis financial statements, and Pennsylvania does not. The study measures the extent to which a municipality issues GAAP-basis financial statements using a checklist of 18 disclosure elements required by GAAP. A municipality’s financial statement may include some, but not all, of these disclosure elements. For example, municipalities in Pennsylvania reported a median of 13 of the disclosure elements in their financial statements, and municipalities in Michigan reported a median of 17 of the disclosure elements in their financial statements.

debt did not typically issue financial statements containing GAAP-required disclosure elements unless they were required to do so by the state.⁴

- GAAP-basis financial statements appear to be an alternative to bond insurance as a means for municipalities to communicate their creditworthiness to bondholders. In a state that does not regulate municipal disclosures, municipalities that insured more of their bonds in 1995-1999 reported fewer GAAP-required disclosure elements on their financial statements in 1995.⁵ Similarly, bonds issued in 1995-1999 by municipalities that reported a large number of GAAP-required disclosure elements on their financial statements in 1995 were less likely to be insured than bonds issued by municipalities that reported a small number of GAAP-required disclosure elements on their financial statements.⁶
- Mandating GAAP-basis financial statements for all municipalities appears to be associated with lower public debt interest costs, but does not impact the debt market so significantly that the overall amount of debt issued is affected. In 1995-2002 large municipalities in states that required GAAP-basis financial statements issued about the same amount of debt as those in states that did not regulate municipal financial disclosure, while small municipalities in states that required GAAP-basis financial statements issue more debt than those in states that do not regulate financial disclosure.⁷
- In 1995-2002, public debt was a larger fraction of total debt issued by municipalities in states that require municipalities to issue GAAP-basis financial statements than it was in states that do not regulate municipal financial disclosure.⁸
- Interest costs on new public debt issued in 1995-2002 by municipalities in states that required GAAP-basis financial statements were about 16 basis points lower than interest costs on new debt issued in 1995-2002 by municipalities in states that did not regulate financial disclosure; the difference in interest costs was smaller for large municipalities and larger for small municipalities.⁹
- Changes in the disclosure elements required by GASB in 1999, and phased in over 2001-2004, appear to have made GAAP-basis financial statements more useful to market participants. Controlling for other factors, credit ratings and interest costs on municipal bonds issued in 2003-2007 were correlated with information that

⁴Gore (2004).

⁵Gore, Sachs, and Trzcinka (2004). This study measures the extent to which a municipality issues GAAP-basis financial statements using the same method as Gore (2004); see footnote 2.

⁶Gore, Sachs, and Trzcinka (2004).

⁷Baber and Gore (2008). The study did not examine municipalities in states that regulate financial disclosure but that do not require all municipalities to issue GAAP-basis financial statements.

⁸Baber and Gore (2008). Municipalities can issue public debt in the form of municipal bonds or they can negotiate arrangements with private lenders, such as banks, insurance firms, or pension funds.

⁹Baber and Gore (2008).

became available when municipalities prepared government-wide financial statements on the full accrual basis of accounting.¹⁰ For example, it is now a GAAP requirement to report government-wide unrestricted net assets and revenue on a full accrual basis, whereas under the previous GAAP financial reporting model it was not. Controlling for other factors, the credit ratings on a municipality's bonds were positively correlated with the ratio of unrestricted net assets to total revenues in 2003-2006.¹¹

Overall Limitations of the Studies

- To the extent that studies use data for a specific time period or for a subset of states, municipalities, and types of debt, the results may not be current or applicable to the universe of states, municipalities, and types of debt.
- The reported effects of state laws requiring municipalities to issue GAAP-basis financial statements cannot necessarily be interpreted as the effects of GAAP-basis financial disclosure by municipalities. Studies that analyze the effects of such state laws do not measure the actual level of GAAP disclosure by municipalities. Because enforcement of these laws may not be perfect, and because municipalities in states that do not require GAAP disclosures may choose to prepare GAAP-basis financial statements anyway, what the existence of these mandates actually measures is not clear. State laws requiring municipalities to issue GAAP-basis financial statements may indicate the extent to which states are involved in the municipal accounting process in general, rather than the extent to which municipalities prepare GAAP-basis financial statements.
- The reported effects of state laws requiring municipalities to issue GAAP-basis financial statements may be a result of other factors, rather than the result of municipalities issuing GAAP-basis financial statements. Studies that analyze the effects of such state laws do not fully account for differences among states that do and do not mandate these requirements. Specifically, states that require municipalities to issue GAAP-basis financial statements may differ from states that do not in ways that affect the quantity, type, and cost of municipal debt. The reported effects of these state laws may be a result of those other differences, rather than the result of municipalities issuing GAAP-basis financial statements.
- None of the studies estimates the cost to municipalities of issuing GAAP-basis financial statements.

¹⁰Marlowe (2010). In 1999, GASB issued Statement 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Government," which established a new requirement that state and local governments present, among other information, a set of government-wide financial statements prepared on an accrual basis, in addition to the fund accounting previously required. This study examined the relevance of information presented in the government-wide financial statements of municipalities to credit analysts and investors.

¹¹Marlowe (2010). Plummer, Hutchison, and Patton (2007) found a similar result: municipal credit ratings for Texas school districts in 2003 were correlated with some of the full-accrual disclosure elements in their 2002 financial statements.

Enclosure 5: GASB Program Expenses

Table 1 provides information on the Governmental Accounting Standards Board's (GASB) program expenses as reported in the Financial Accounting Foundation's (the Foundation) Statements of Activities and related notes.

Table 1: Schedule of GASB Program Expenses, 2006-2009

(Dollars in thousands)

	2006	2007	2008	2009
Salaries and wages	\$2,951	\$3,108	\$3,535	\$3,594
Employee benefits	749	770	857	1,133
Occupancy and equipment expenses	228	224	237	218
Professional fees	^a	73	109	57
Other operating expenses	594	231	271	285
Total program expenses	\$4,522	\$4,406	\$5,009	\$5,287

Source: GAO analysis of 2007, 2008, and 2009 Financial Accounting Foundation Annual Reports.

^aThe Foundation did not itemize professional fees in its 2006 financial statements.

Enclosure 6: GAO Contacts and Staff Acknowledgments

GAO Contacts

Paula M. Rascona, (202) 512-9816 or rasconap@gao.gov
Orice Williams Brown, (202) 512-8678 or williamso@gao.gov

Acknowledgments

In addition to the contacts named above, Marcia Buchanan, Paul Kinney, and Karen Tremba, Assistant Directors; Laura Acosta, Silvia Arbelaez-Ellis, William Chatlos, Francine DeVecchio, Rachel DeMarcus, Abe Dymond, Patrick Frey, Marci Goasdone, Jacquelyn Hamilton, Eric Holbrook, Stefanie Jonkman, Courtney LaFountain, Edward Nannenhorn, Mitchell Owings, Laura Pacheco, Robert Pollard, Paul Proctor, Lisa Reynolds, and Kim Sureff made key contributions to this report.

(197301)

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548