MUNICIPAL MARKET DISCLOSURE: CAFR FILINGS

A TEST OF COMPLIANCE AMONG CALIFORNIA ISSUERS

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION | CDIAC No. 11-04

INTRODUCTION

The Securities and Exchange Commission (SEC) Rule 15c2-12 obligates government bond issuers to meet specific continuing disclosure standards. Issuers of municipal bonds sold to the public enter into continuing disclosure agreements, promising to provide certain annual financial information and notices of specified events to the public.

Prior to 2009, issuers submitted required disclosure documents through four Nationally Recognized Municipal Securities Information Repositories (NRMSIRs). In July 2009, the Municipal Securities Rulemaking Board (MSRB) implemented the Electronic Municipal Market Access (EMMA) as a centralized repository for the collection and reporting of all bond related data. This includes continuing disclosure filings of financial information specific to the issuer along with any event notices.

In 2009, the SEC made changes to Rule 15c2-12 that required these filings to be made electronically at the EMMA portal. In response to these changes the Government Finance Officers Association (GFOA) encouraged governments to incorporate robust disclosure practices in order to enhance their credibility with investors, credit rating agencies, and the public. In their October 2010 Best Practice, *Understanding Your Continuing Disclosure*, GFOA suggests, along with a wide spectrum of proposed disclosure reporting practices, that the submission of the Comprehensive Annual Financial Report (CAFR) may fulfill annual financial information obligations.

Earlier this year, a disclosure research paper titled, *Recent Trends in Municipal Continuing Disclosure Activities*, published by DPC Data, stated that over half of the issuers studied were one or more years delinquent in submitting annual financial statements and a fifth of those studied failed to file a CAFR at any time during the study period.

Given the SEC changes, increased research on disclosure, and emphasis on best practices, the California Debt and Investment Advisory Commission (CDIAC) conducted this study to present a view of California state and local government issuer performance in meeting their obligation to file annual financial information. CDIAC recognizes that issuers are required to produce and submit a wide variety of disclosure related documentation. Given 15c2-12 and the practices of financial reporting by public agencies, CDIAC believed that a review of CAFR submissions was a valid test of issuer compliance with their financial disclosure obligations as stated in their Continuing Disclosure Undertaking (CDU).

In addition to reviewing overall performance, the study assessed CDIAC's assumptions that 1) older issues might have lower compliance rates than newer issues, and 2) there may be some disparity in compliance rates based on issue characteristics.

STUDY STRUCTURE

The goal of the study was to determine the percentage of California state and local government issuers who met their obligation to submit their 2010 CAFR to EMMA during 2010 for bonds issued during the years 2005-2009. This obligation is set forth in the issuer's CDU contained within the offering documents.[1]

CDIAC used bond issuance data from its Debt Issuance Database along with electronic versions of official statements (OS) and CAFR filing dates from EMMA. CDIAC studied whether issuers submitted their 2010 CAFR to EMMA for bonds issued during the five year period 2005-2009. Issuers were defined by the issuer type in-

[1] The deadline for filing an annual report varies by issuance and is set in the Continuing Disclosure Undertaking (CDU). The time period is typically greater than 6 months following the end of the issuer's fiscal year. CDIAC used the actual language in the OS that specified the due date.

cluded in the CDIAC database. The obligor (if any) was not included in the study.

Using a random sample of long-term bond issuance drawn from the CDIAC database for each year within the five year period, sample issues were cross-referenced individually with the EMMA database to determine when, and if, issuers sent a 2010 CAFR to EMMA and whether the submission was within the time period set forth in the CDU. The specific research protocol is described below:

1. All long-term issues in the CDIAC database for the five year time period were extracted and randomly rank ordered by year. A total of 5,447 issues met the criteria.

2. Following the random ordering, CDIAC staff then attempted to find each issue in the EMMA database. Issues that could not be found, did not require a CAFR, or were identified as duplicates for other issues covered by the same OS were removed from the survey.

3. This process continued until 250 unique, randomly sampled issues, with a calendar year 2010 filing requirement were identified for each of the five years being surveyed.

4. With the full sample of 1,250 observations identified, staff then researched the continuing disclosure section of the EMMA portal to see if and when each issuer fulfilled their calendar year 2010 filing requirement and cataloged the actual filing date.

5. For issues identified as not filing, an additional analysis was performed to determine if the issue was refunded or called. Staff found 23 refunded or called issues. They were eliminated, reducing the sample to 1,227.

6. CDIAC staff then calculated the difference, in days, between the obligated filing date and the actual filing date.

The issues were sorted into one of the following categories.

1. FILED ON TIME. Filed within the date committed and published in the OS.

2. FILED 1 TO 30 DAYS LATE. Filed within 1 to 30 days after the date committed and published in the OS.

3. FILED OVER 30 DAYS LATE. Filed over 30 days after the date committed and published in the OS.

4. DID NOT FILE. Failed to file any time after the date committed and published in the OS.

FINDINGS - OVERALL

Figure 1 shows the percentage of issuers that met their obligation to file their 2010 CAFR with EMMA as reported in the OS by year of issuance. The average for all sample issues between 2005 and 2009 studied show 72.0 percent filing on time, 7.2 percent filed late, but within 30 days of due date, and 11.0 percent filed over 30 days late. On average, 9.8 percent of issuers in the study failed to file a required CAFR with EMMA. As seen in Figure 1, the results show the performance of issuers that met their obligation to file a CAFR are consistent over the range of years studied and there does not appear to be any material relationship between meeting the 2010 CAFR obligation and the year the bond was issued.

Table 1 describes the average number of days issuers were late in submitting a CAFR in 2010 by year of issuance. Issuers averaged 12 days late for those in the 1-30 days late category. Those filing over 30 days late averaged 147 days late, with almost half filing over 90 days late.

ANALYSIS BY ISSUER CHARACTERISTIC

Once a bond is sold, the issuer is required to provide CDIAC with a report of sale document containing selected information and characteristics of the issue. CDIAC used the information

Figure 1

2010 CAFR COMPLIANCE BY YEAR OF ISSUANCE

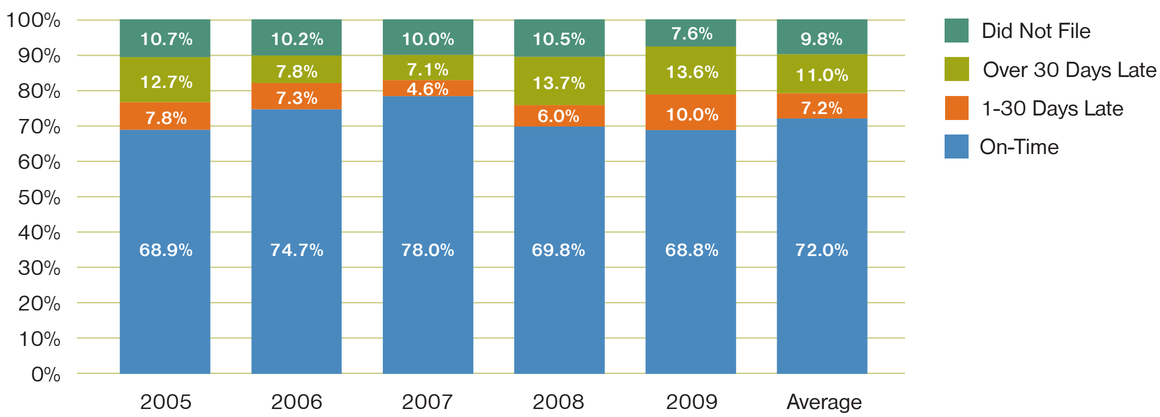


Table 1

2010 CAFR MEAN DAYS LATE BY YEAR OF ISSUANCE

YEAR OF ISSUANCE	MEAN DAYS LATE	STANDARD DEVIATION
2005	94	107
2006	69	93
2007	102	130
2008	91	112
2009	107	129
TOTAL SAMPLE	94	116

Table 2

SAMPLE BY ISSUER TYPE

ISSUER TYPE	NUMBER IN SAMPLE	PERCENT OF SAMPLE
K-12 School District	391	31.8
Community Facilities District	146	11.9
JPA, Marks Roos	142	11.6
Redevelopment Agency	123	10.1
All Other	425	34.6
TOTAL SAMPLE	1,227	100.0

contained in these reports to analyze compliance performance.

Issuers have varying organizational and administrative systems in place to issue and monitor bond financing. In addition, large issuers who come to market frequently have the experience and resources to establish ongoing procedures in issuance and continuing disclosure. In an attempt to review compliance in light of these differences, CDIAC segmented the sample by specific issuer characteristics. Given the scope of this study, CDIAC chose to analyze issuer type to provide additional insight on compliance. As information is assembled from the results of this study, CDIAC will continue its research on additional variables that may affect the ability to submit annual financial data on a timely basis.

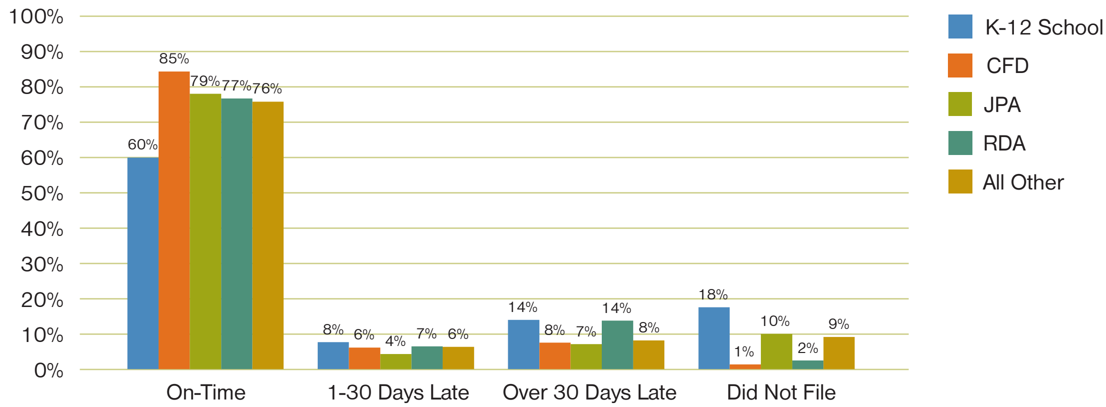
CAFR COMPLIANCE BY ISSUER CHARACTERISTIC

To facilitate this analysis, the sample was broken out into the following five issuer categories with a frequency distribution included as Table 2.

- K-12 School Districts used for school construction and improvement
- Community Facilities Districts (CFD) set up to authorize the issuance of bonds for infrastructure improvement

Figure 2

2010 CAFR COMPLIANCE BY ISSUER ALL YEARS



- Marks-Roos Joint Powers Authorities (JPA) are public authorities pooling resources and operating collectively
- Redevelopment Agencies (RDA) established to provide investment in blighted areas
- All Other, including the State of California, counties, cities, and special districts

Figure 2 displays the aggregate average compliance rates of the five selected categories along with the percent who submitted at least one day late. Of the above major categories, K-12 school districts showed the lowest aggregate average rate of compliance (60 percent) in meeting the obligation to submit a 2010 CAFR, while CFDs showed the highest rate of compliance (85 percent). The remaining categories averaged around 77 percent.

Table 3 describes the mean and standard deviation of the number of days late for those issuers who submitted a CAFR to EMMA after the due date by issuer type.

As with the on-time compliance shown in Figure 2, a similar pattern is presented in the data related to submission after the due date. CFDs, although late, submitted CAFRs relatively early after the due date (average 40, maximum 113 days), while K-12 School Districts and JPAs averaged around four months late. Although Redevelopment Agencies exhibited a high relative percent of late filings in Figure 2 (21 percent), the majority of the late filings were submitted within 60 days. This contributed to their low relative average shown in Table 3.

STATE VERSUS LOCAL AGENCY COMPLIANCE

The State of California, including all departments and instrumentalities, were incorporated under the "All Other" category. The total number of issues included in the study was 48 sample records. The State achieved the highest average compli-

Table 3

2010 CAFR MEAN DAYS LATE BY ISSUER TYPE

ISSUER TYPE	MEAN DAYS LATE	STANDARD DEVIATION
K-12 School District	113	128
Community Facilities District	40	32
JPA, Marks Roos	112	137
Redevelopment Agency	58	67
All Other	91	110
TOTAL SAMPLE	94	116

ance rate of all issuers at 94 percent. Of the three State cases that did not comply on time, two were instrumentalities that filed with other NRMSIRs and one was an educational institution that filed over 30 days late.

SUMMARY

With the MSRB's initiation of the EMMA portal in 2009, new best practices from the GFOA and some sobering research on municipal disclosure practices from a DPC Data study, CDIAC initiated this research to review the performance of California municipal issuers in meeting their CAFR reporting obligations in calendar year 2010.

This study reviewed whether the 2010 CAFR for bonds issued by state and local governments in 2005, 2006, 2007, 2008 and 2009 were timely filed using a sample of California municipal issuers identified in the CDIAC database. In aggregate, California issuers included in this study complied at an average rate of 72.0 percent, with 17.2 percent submitting late and 9.8 percent failing to file a CAFR at any time. Overall, there was no meaningful difference in compliance based on year of issuance, but examining compliance by issuer type did show some variations in fulfilling the obligation to submit a timely CAFR to EMMA in 2010.

With overall compliance in timely CAFR submission at 72.0 percent, along with disparities observed by bond issuer type, this study may lead California municipal finance managers to review their current bond administration policies and motivate improved performance going forward. Nationally, the failure of issuers to comply with obligations under continuing disclosure rules may reduce the ability of the municipal market to resist calls for greater regulation on municipal bonds.

Based on the results of this study, CDIAC plans to initiate additional in-depth research based on the frequency of issuance, differing administrative procedures, organizational, and education factors that may lead to further discussion related to the factors that affect the timely submission of continuing disclosure documents.

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