New, Expanded Municipal Bond Audit Timing Study Shows Little Change from Previous Years

When it comes to the release of municipal bond audits, timely reporting continues to show a wide variation by credit sector and individual borrowers. The range in reporting times continues to be considerable, especially in contrast to the regulated reporting schedules that govern the corporate bond market. As has been the case over the past five years, some credit sectors, particularly those related to revenue bond enterprises and special purpose governmental entities, are consistently able to complete their audits faster than state and local governments.

There appears to be little reason to cheer about the timeliness of municipal audit timing, according to a recent analysis conducted by Merritt Research Services, LLC, an independent municipal bond data and research company. The 2012 study, which covered the period from 2007 to 2011, reveals that municipal borrowers continue to complete their audits on essentially the same schedule that they have for the past five years, despite SEC jawboning and market participant complaints on the issue.

This conclusion runs somewhat counter to the recent study conducted by the Municipal Securities Rulemaking Board (MSRB), which found that continuing disclosure documents filed by municipal bond issuers increased by 12% over the one-year period from July 1, 2011 to June 30, 2012. While the MSRB study has more to do with municipal borrowers channeling their disclosure notices to the MSRB's Electronic Municipal Market Access (EMMA) repository once they have an announcement or a report available, it does not address the time it took issuers to complete their audits.

In 2010, Merritt completed its first analysis of the timing between the end of a municipal bond issuer's fiscal year and the completion of its audit ("*Just How Slowly Do Municipal Bond Annual Audit Reports Waddle in After the Close of the Fiscal Year*"). That report, which examined a sample of 14,000 audits on more than 4,600 different municipal bond entities over a three-year time period (fiscal years ending in 2007 through 2009), found that, depending on the municipal credit sector, most municipal borrowers generally completed their audits in around five to six months.

This year's examination covered a significantly larger sample of borrowers both on a single year and for the historical five-year period. The results showed very little change from the findings of past studies. When analyzed on a sector-by-sector basis, general obligation bonds issued by states, cities and counties continue to show a clearly slower timeline to get their audits completed than municipal revenue bonds related to non-government borrowers such as hospitals, universities, electric authorities. Special purpose governmental entities including airports, tollways, water and school districts were among those sectors that fell somewhat in the middle.

The importance of receiving timely credit information in the municipal bond market was reinforced over the past year by bankruptcy or default concerns related to a small but significant number of highly publicized distressed cities that have been in the headlines. Timely financial reporting can make a difference in warning investors, as well as taxpayers, about potential credit vulnerabilities, and can also clarify credit standing in cases where distress has already been identified. Stale financial reports dilute the value of the documents and their capacity to help assess the issuer's credit quality.

The Findings:

- The median audit time for fiscal year 2011 across all sectors was 145 days, compared to 146 days in 2010, 145 days in 2009, 147 days in 2008 and 148 days in 2007. The 2012 study analyzed 38,112 audits over a five-year period in 16 municipal bond credit sectors, and 8,083 audits for the 2011 year alone. While the analysis does not cover all borrowers in the municipal market, the vast number of audits included in the study presents a strong case that the median numbers are statistically significant for each credit sector.

- Generally speaking, municipal bond analysts and investors continue to expect a six-month lag between the end of a fiscal year and the completion of the audit; however, there is wide variation by sector and among individual borrowers. With a median reporting time of 107 days (just over three months), the wholesale electric sector continued to be fastest to complete audits for fiscal 2011, while the states and territories sector continued to hold its place as the slowest credit sector, with a median audit turnaround time of 182 days (just over six months). While both sectors held the same respective rankings in each of the past five years, the sector median for wholesale electric borrowers took a significant downward adjustment from its 2010 speed of 92 days. Those waiting for the reports should keep in mind that just because the audit was signed does not necessarily mean that the report will be imminently available. The official governance board may take additional time to sign off on the report after it is completed by the auditor.

- The three credit sectors that completed their audits the fastest in 2011 were, respectively: wholesale electric (107 days), not-for-profit hospitals (110 days), and private higher education (113 days). Like wholesale electric, hospitals and private higher education have consistently ranked as the top three fastest sectors for the past five years. The three slowest credit sectors in fiscal 2011 were states (182 days), counties (173 days), and cities (169 days). Once again, these sectors needed the most time to finish their audits in all five years of the Merritt study.

- The MSRB has been on record that it would like municipal borrowers to have their audits sent to its EMMA disclosure clearinghouse within 120 days of the close of the fiscal year. There currently are no enforcement penalties for non-compliance by either the MSRB or the SEC, although the SEC has raised the issue for potential change in its recent 2012 white paper on municipal bond regulatory matters. In the corporate bond market, annual audit reports (in the form of a 10-K) are required to be submitted within 60 to 90 days of the close of the fiscal business year. If a 120-day rule were put into effect for the municipal bond market, the wholesale electric, hospital, and private higher education sectors would likely experience the easiest time conforming, because most of those organizations in those sectors already meet that guideline. In 2011, 75.2% of all wholesale electric borrowers would comply, while 43% of issuers in that sector would also meet the 90-day rule. Seventy three percent (73%) of all hospital issuers would comply with a 120-day rule, although only 29% of hospitals would meet the 90-day guideline. In the private higher education sector, 70.7% of issuers completed in 120 days and 17% in 90 days. On the other hand, general obligation borrowers would, on the whole, likely find it very challenging to meet the 120-day rule – no less the 90-day target. The study found that only 3.8% of all states, 7.4% of cities, and 7.8% of counties would meet the 120-day rule.

- Fastest and slowest individual borrowers by audit reporting times (by days after the close of their fiscal year) for 2011, listed by key sectors:

  - **Airports** (out of 125)
    - Best: Chesapeake Regional Airport, VA 51
    - Worst: Fresno Yosemite International Airport, CA 274

  - **Cities** (out of 1,074)
    - Best: Moore, OK 63
    - Worst: Freeport Village, NY 438

  - **Counties** (out of 649)
    - Best: Grundy County, IL 40
    - Worst: Kings County, CA 396

  - **Hospitals** (out of 1104)
    - Best: Oak Valley Hospital District, CA 36
    - Worst: Signature Healthcare Corporation, MA 266

- **Private Higher Education**
  - Best: **Syracuse University, NY** **28**
    [Best overall - large credits]
  - Worst: Bank Street College of Education, NY 273
    Hobart & William Smith Colleges, NY 273

- **Public Higher Education**
  - Best: University of South Alabama, AL 46
  - Worst: University of Mary Washington, VA 378

- **Retail Electric**
  - Best: Floresville Electric. Light & Power System, TX 29
  - Worst: Princeton Electric Fund, IL 477
    [Worst Overall]

- **School Districts**
  - Best: **Harbor Springs Public Schools, MI** **13**
    [Best overall- small credits]
  - Worst: Effingham County Board of Education, GA 390

- **States & Territories**
  - Best: New York 116
  - Worst: New Mexico 356
    South Dakota 356
- **Tollway**
  - Best: Maine Turnpike Authority, ME 45
  - Worst: Eagle Pass International Bridge, TX 238

- **Water Sewer**
  - Best: Titus County Fresh Water District #1, TX 21
  - Worst: Woodland Sewer Fund, CA 391

- **Wholesale Electric**
  - Best: Bonneville Power Administration, OR 27
  - Worst: Western Area Power Administration, CO 196

- Syracuse University, NY, deserves special mention as a large municipal borrower that consistently leads the way when it comes to timely reporting. Its glossy, well constructed annual report and independent audit has consistently been completed within a range of 27 to 37 days in each of the last five years. It's a fine statement when an academic institution teaches a best practice by its reliable example.

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Merritt Research Services, LLC
September 12, 2012

Background on Merritt Research Services, LLC

Merritt Research Services, LLC is an independent municipal bond data and research provider focused on credit information related to municipal bonds. Founded originally in 1985 as a part of Van Kampen Merritt Inc., it first began to collect municipal bond audits for its initial database software product called The Merritt System, which was launched in 1986. Ten years later, The Merritt System partnered with Investortools, Inc. to primarily release its data through Creditscope. In 2001, Merritt Research Services LLC was spun off from the Van Kampen Funds to become an independent municipal data research company. Today, Merritt Research, headquartered in Hiawatha, Iowa, collects municipal bond audits on over 8,000 municipal bond credits.