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Could a Market Penalty Shrink Lag Time on Municipal Bond Audits?

While public corporations are required to file an annual audit within 60 days after the close of the year, municipal bond borrowers often take close to triple that time or longer.

Although this issue has been lingering for decades, the time it takes to complete and sign an audit after the close of the fiscal year hasn't changed much over the last 10 years. The county, state and city sectors are the poorest performers even amid an improvement since 2015.

While investors need the audit documents for credit evaluation and securities pricing purposes, they are not the only stakeholders that have a need to see timely audited financial reports.

Governing boards associated with public bodies and not-for-profit organizations need to review the audits in order to fulfill their duty for proper oversight. Like municipal bond analysts and investors, they are better able to respond to issues disclosed in an audit if the documents are timelier.

Audit timeliness is a simple, common sense principle based on the expectation that accountability and transparency are best achieved if audited financial reporting is swiftly dispatched. That should hold true not only as a standard for responsible government but also for investors and taxpayers.

There's an added fiduciary responsibility for municipal bondholders in that late or stale audits inhibit accurate bond pricing and cloud assessments of risk. The absence of significant improvement in the overall speed in which audits are signed and delivered begs the question as to why the market is not imposing a greater penalty on those that consistently are late to report.

Merritt Research Services, LLC, an independent municipal bond credit data and research company based in Hiawatha, Iowa and Chicago has been tracking the time it takes municipal bond borrowers to complete their audits since Merritt Research released its first report in 2010. Its latest findings looked at more than 10,500 Fiscal Year 2017 audits by credit sector and over 110,000 audits since 2008.

Latest Results

The latest analysis focused on 2017 audits found a modicum of good news in that there was a modest improvement in completion time rates over the past two years as governmental audits have made the adjustments to more detailed pension reporting in line with changes in GASB rules 67 and 68 that occurred mostly in the 2015 audits. Audits from non-governmental municipal bond borrowers, such as power agencies, hospitals and private universities, finished much faster than those for governments.

As has been the case in other years, the median completion time for reports related to governmental type municipal bonds still hovers between 170 and 180 days. That's still a long way from the target reporting times in the corporate bond market and well below what the municipal bond industry considers to be a muni guideline of 120 days.

Merritt Research's latest report continues to show that certain types of municipal bond borrowers, mostly associated with corporate like enterprise entities and not-for-profit organizations (issued under the IRS 501c-3 code), are consistently faster to finish their audits than the governmental state and local governmental sectors. These non-governmental issuer sectors have median times which range from 99 days to 161 days.

Consistently placing fastest on the list of all municipal bond credit sectors are (1) public power wholesale electric agencies (also known as joint action agencies and quasi-government enterprises), (2) hospitals, (3) private higher education institutions and (4) Tollroads. Each of these sectors show a median audit completion time of 120 days or less, meeting the unofficial municipal bond guideline most frequently cited as best practice.

Fastest Reporting Sectors for Fiscal Year 2017

Public Power Wholesale electric audits achieved the best sector reporting time, boasting a median completion time of 99 days after the close of the fiscal year.

Hospitals, which often carry higher interest rates since many consider them as one of the riskier major credit sectors in the muni market, annually place nearly as well as wholesale electric entities in the audit time contest. As a group, they recorded a median audit completion time of 111 days, the same as the prior year.

The Private Higher Education sector took the third best sector finish for fiscal year 2017 with a median audit time of 115 days. Again, this sector has consistently completed its audits in a narrow range of between 107 and 115 days since 2008.

The Tollroads sector showed the best gain of any of the categories by improving its median from its already good audit time level of 126 days to 120 days. Fifty-one percent of the sector completed their audits in 120 days.

Slowest Reporting Sectors in Fiscal Year

On the other side of the speed continuum were the main governmental sectors – counties, states and cities.

Despite their absolutely disappointing finish times, each of these sectors showed a modest improvement and reduction in their median audit times from last year and further progress since 2015.

That's the year in which governments were required to apply more detailed pension accounting information in line with the new Governmental Accounting Standards Board (GASB) 67 and 68 rules concerning pension accounting that went into effect.

The County Sector showed the slowest financial reporting as a group. The median sector audit time came in at 179 days, several days better than two years ago and one day better than last year, but still nothing to boast.

States & Territories, which was the second slowest sector in 2017 and the tardiest of all sectors in the previous two years, inched up a notch with a median audit time of 175 days. Only 5.7% of this sector was able to have their audits signed for completion within 120 days.

The City Sector was the third slowest sector, albeit the best, among the major governmental categories. Its median audit time was 173 days. Like states and counties, it has fallen among the

bottom three in each of the last 10 years. It tied states for having the same 5.7% of signed audits within 120 days of the end of the fiscal year.

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