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MuniNetGuide: Does Muni Bond Credit Quality Impact Annual Audit Times?

Increased attention on local government fiscal stress and Chapter 9 bankruptcy filings has heightened concerns over municipal bond credit quality in wider circles than ever before. But while the Securities and Exchange Commission (SEC) requires certain issuers of corporate bonds to file annual audited financial statements within 60 to 90 days after the close of their fiscal year, no such regulatory standards are currently in place for municipal borrowers.

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In its third annual study of audit completion times, entitled “Focus on Credit Quality Puts Sharper Spotlight on Municipal Bond Audit Times,” Merritt Research Services found that states, counties, and cities continue to complete their annual financial audits nearly six months after the end of their fiscal year. Audit time – calculated as the time between the close of the fiscal year and the date of the signature on the audit letter – for several municipal credit sectors showed a slight improvement over the year before, but “on the whole, municipal bond audits continue to substantially lag the completion time for issuers of corporate bonds.”

The expectation for faster audit preparation by municipal borrowers may be on the horizon, according to Richard Ciccarone, President and Chief Executive Officer of Merritt Research Services.

While the Tower Amendment prevents direct regulation of state and local borrowers by the SEC, it still has authorization over dealer requirements setting forth underwriting standards for documentation. The SEC charges against the City of Harrisburg, Pennsylvania, which included implications that its financial information was outdated and incomplete, might be considered ‘a shot across the bow’ for municipal issuers with a tendency to take their time in releasing secondary market disclosure materials, Ciccarone said.

This year’s Merritt audit timing study revealed that governmental bodies that issue general obligation (G.O.) bonds are generally slower to turn in their audits than those that issue revenue bonds. The median audit time for States and Territories, which have more complicated governmental structures and financial ledgers, was 174 days in 2012. While the audit time for this sector was an improvement over last year, it remains far beyond the regulators’ 120-day recommendation.

Other highlights from this year’s Merritt audit timing study:

- The Wholesale Electric Public Power sector had the shortest median audit time of 95 days, continuing its six-year run as the fastest sector to complete its audits.
- The Hospital and Private Higher Education sectors took second and third place honors, respectively.

- The median audit time for Cities and Counties was slightly better than for States, but still well above the median across all sectors.
- Size was not a consistent factor in determining the length of time for an issuer to complete its annual audit after the close of its fiscal year. In fact, Rapid River Public Schools, Michigan, one of the smallest school districts in the study, completed its audit in a mere 18 days after the end of its fiscal year. The district has completed its annual audit in less than 60 days in each of the last six years.
- Credit quality did appear to have an effect on audit timing in some sectors, including Cities, Counties, Hospitals, Airports, and to some extent, States. Merritt found a correlation between financial trends and audit completion times, particularly in these sectors.

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