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Fitch: Ongoing Disclosures Help Mitigate CA, Other Public Finance Delayed Audits

Fitch Ratings-Chicago/New York-17 May 2023: Delays in the release of California's GAAP-based audited financial statements are not a near-term credit concern given ample state financial disclosures, Fitch Ratings says. However, severely delayed audits can trigger negative rating pressure on U.S public finance issuers when alternative disclosures are insufficient. Fitch relies on financial statements and other relevant information to support its analysis and ratings decisions. A failure to provide fiscal data in a timely manner can lead to a negative rating action or even a rating withdrawal if the information available is not sufficient to support the rating analysis.

The state of California (AA/ Stable) has fallen behind in issuing GAAP-based audited financial statements but continues to provide timely financial disclosures, including monthly cash reports and detailed budget and revenue forecasts. Through FY18, the state released its Annual Comprehensive Financial Report (ACFR) by March 31, nine months after the end of the fiscal year and somewhat late compared to other states.

The state transitioned to a new financial accounting system, "Fi$Cal", during FY2019 and since then the release of the annual audit has become progressively later. FY19 results were released in October 2020, FY20 in February 2022, and FY21 in late March 2023. There is no current date for the release of the FY22 ACFR. Despite these delays, California continues to provide transparency in its financial operations through an abundance of robust and timely budgetary and revenue information.

GAAP-based ACFRs are an objective and important source that Fitch and other market participants typically rely on to understand a government's financial performance. The ACFR provides a set of financial statements that comply with accounting requirements established by the Governmental Accounting Standards Board (GASB) and audited by an independent auditor using generally accepted auditing standards. The ACFR presents an official account of a government's financial condition for the last fiscal year, comparing it to prior fiscal years, and includes management discussion and analysis of the results.

Habitually delayed publication of an ACFR beyond 270 days past the end of the fiscal year can be an indication of management weakness. Fitch has downgraded and/or withdrawn ratings on certain entities with chronically late financial statements. Fitch downgraded the Issuer Default Rating (IDR) of Manhattan, Kansas to 'AA' from 'AA+' on May 18, 2020, due in part to the city's repeated delays in publishing audits. Fitch withdrew the rating on Manteca Finance Authority, CA's sewer revenue bonds on April 12, 2023, because of the system's continuing inability to provide reliable financial information. Conversely, Fitch upgraded the IDR on Northport, Alabama to 'AA+' from 'AA' on March 17, 2023, noting improved budget management practices as evidenced by the steps taken to ensure the timely filing of its financial audits following a short period when such filings had been delayed.

The median audit timeline for municipal governmental bond sectors has grown from of 147 days in 2009 to 164 in 2020, according to a 2022 report from the University of Illinois, Chicago and Merritt

Research Services. Pandemic disruptions, including steep declines in state and local government employment in 2020, have likely contributed to longer audit timeframes. State and local government employment has since recovered, although it is still down slightly relative to 2019 averages, with Fitch expecting a mild recession beginning later this year.

In some states, the state auditor either conducts or signs off on the local government's audit, which typically takes more time than audits by a private firm. When financial audits are delayed, Fitch typically relies on other fiscal disclosures including unaudited actuals and monthly budget reports showing the performance of both revenues and expenditures. This additional transparency is key in Fitch's ability to perform its forward-looking credit analysis and to continue to assess an issuer's creditworthiness.

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