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Date: February 6, 2014

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- Whether allowances are taxable fringe benefits
- Reporting requirements for group term life insurance
- “Day meals” – what are they and if they are taxable
- When stipends, bonuses, and gift cards are taxable fringe benefits

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S&P: A Bumpy Road Lies Ahead For U.S. Public Pension Funded Levels.

Read the report at:

http://img.en25.com/Web/StandardPoorsRatings/A%20Bumpy%20Road%20Lies%20Ahead%20For%20U.S.%20Public%20Pension%20Funded%20Levels.pdf

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A Not-So-Public Pension's Disappearing Money.

A $25 million investment loss by the Boston-area transportation authority’s retirement fund demonstrates the need for the same transparency and oversight that other public pensions are subject to.

In 2007, nine months after leaving his post as executive director of the Massachusetts Bay Transportation Authority (MBTA) pension fund to join Fletcher Asset Management, Karl E. White pitched an investment to his former employer. The pension fund invested $25 million, all of which is now gone.

Even greater than the concern over the lost money is the MBTA pension fund's bizarre legal status in a netherworld between public and private, which made the ill-fated deal possible.

The MBTA pension fund was the only investor in the Fletcher fund. Although the company sent reports to the retirement board as late as 2011 that showed the value of the investment rising, the Fletcher fund was probably insolvent by 2008. White didn't notify the MBTA retirement board that that was the case when he left the company in November 2008.

In March of 2011, the MBTA pension fund asked for $10 million back, but the request was never fulfilled. A series of Fletcher hedge funds have gone bankrupt, and the bankruptcy trustee told the Boston Globe that those funds have "many of the characteristics of a Ponzi scheme." The FBI, the Securities and Exchange Commission, and Massachusetts' attorney general are all investigating.

The root of the problem can be traced back to the MBTA pension fund's status as a private trust, which has been upheld by two rulings from Massachusetts' highest court.

Legislation enacted last summer required the fund to publish a database of retirement benefits, but it still isn't subject to the same oversight as Massachusetts' other 105 public-pension systems. Moreover, someone in White's position would normally be prohibited from selling investments to a former employer for at least a year and possibly forever, but the MBTA pension fund is exempt from state ethics rules.

The fund is not overseen by the state Public Employee Retirement Administration Commission and isn't subject to the same disclosure rules as other public pension funds. The Fletcher investment was not mentioned in the MBTA Retirement Fund's 2007 annual report, nor was there any mention in the 2011 annual report of the unfulfilled request to have $10 million of the $25 million investment returned.

The lack of disclosure is particularly concerning because it appears that the pension fund's financial condition is deteriorating. It went from being 95 percent funded in 2006 to being 68 percent funded in 2011. From what we can piece together, it appears that part of the reason is that the retirement board has skimped on its annual contribution. In fiscal 2012, it contributed just 71 percent of the costs accrued that year.

Another part of the problem isn't new. MBTA employee pension contributions are subject to collective bargaining, which is not the case for state employees. The latest cohort of state workers contributes about 11 percent of salary to their pensions, and state government kicks in about 4 percent. In fiscal 2013, on the other hand, most MBTA employees paid only 5.5 percent, while the pension fund had to contribute over 20 percent of employee salaries.

The loss of $25 million in an investment that would not have been possible if the MBTA pension fund were considered public demonstrates that it's time to end the charade. The public — not to mention thousands of MBTA employees and retirees — deserves to know what is going on. Subjecting MBTA's retirement fund to the same oversight as other public-pension funds would allow sunlight to perform its much-needed disinfecting magic.

BY CHARLES CHIEPPO | JANUARY 13, 2014

California Leads Surpluses Making States Into Haven: Bloomberg Muni

Credit.

California is moving to pay down debt and boost reserves after an economic rebound left it with the biggest surplus in more than a decade. Hawaii may increase spending on education. Officials in Florida, New York, Minnesota and Wisconsin are considering tax cuts.

The fiscal turnaround for states, a majority of which confronted budget deficits just two years ago, is also paying off for investors in the $3.7 trillion municipal market.

State bonds are proving a haven amid the biggest muni losses since 2008. The extra yield bondholders demand on the governments' general obligations is about 1 percentage point less than the market average, close to the widest advantage since August 2011, Bank of America Merrill Lynch data show.

"The backdrop for states today is much improved versus just a few years ago," said Robert Amodeo, head of munis in New York at Western Asset Management Co., which oversees $28 billion in local debt. "They're growing and they're looking to continue to increase their share of the national economy."

The fiscal rebound is easing pressure on state credit ratings. Moody's Investors Service raised its outlook on the governments to stable from negative in August.

Economy Tailwind

State and local spending began adding to economic growth in the second quarter of last year, a reversal from 2010 to 2012, when it exerted the biggest drag on growth since World War II, Commerce Department figures show. Two years ago, 31 states faced collective deficits of $55 billion, according to the Center on Budget and Policy Priorities in Washington.

Florida, one of the places hit hardest by the real-estate crash, may cut taxes as a result of a $1 billion surplus projected during the next budget year. Michigan anticipates about $1 billion in extra funds. California Governor Jerry Brown has proposed using surplus funds to boost spending, bolster reserves and repay debt used to fill prior shortfalls.

California general obligations maturing in October 2023 traded this week at an average yield of 2.74 percent, or about 0.5 percentage point more than benchmark munis, data compiled by Bloomberg show. That compares with an average gap of 0.8 percentage point since July 30.

Credit Move

Standard & Poor's cited the plans by Brown, a Democrat, when it raised the outlook this week to positive on $75 billion of California debt, a step toward raising its A rating, five levels below the top.

Not all states provide forecasts and some haven't released plans for next fiscal year, which begins July 1 in most municipalities. Yet at least a dozen states, including Texas, Florida and Michigan, see surpluses after revenue exceeded projections.

States also stand to benefit when individuals file income-tax returns this year, after the stock-market rally that has pushed the S&P 500 index of shares to record highs, said Scott Pattison, executive director of the National Association of State Budget Officers in Washington.

"A lot of states are going to have some pretty decent surpluses," said Pattison. "I expect there will be some fairly robust revenue surprises coming in."

Revenue Surprise

States had anticipated that revenue growth would slow this year to 0.8 percent, from 5.7 percent in 2013, according to the budget officers group. In the July-to-September quarter, collections exceeded the projected pace, rising by 6.1 percent, according to the Nelson A. Rockefeller Institute of Government in Albany, New York.

Local governments remain hesitant to borrow after emerging from the longest recession since the 1930s. Muni bond issuance fell 15 percent last year. Nor have governments payrolls returned to peak levels. There were 163,000 fewer state workers in December than in August 2008, Labor Department figures show.

Illinois, Pennsylvania and Maryland are among states still facing deficits.

“States are in a lot better shape than they were,” said Pattison of the budget officers group. “But you still had a lot of states that cut budgets significantly, and they’re not going to have enough money to make up for all the cuts that were made.”

In New York, Governor Andrew Cuomo, a Democrat, this month proposed using a surplus to cut taxes by $2.2 billion, much of which would be used to limit increases on property levies. In Minnesota, Democratic Governor Mark Dayton may cut business taxes as a result of a $1 billion surplus expected there. Florida Governor Rick Scott, a Republican, is using the state surplus to press for a $500 million tax reduction.

Prudency Pause

“Things certainly are better for states, but the question is when things have improved, when revenues have increased, whether or not they remain prudent,” said Konstantine “Dino” Mallas, who helps oversee $20 billion of munis at T. Rowe Price Group Inc. in Baltimore. “That’s always the challenge.”

Issuers nationwide have scheduled about $7 billion of sales in the next 30 days, down from the one-year average of $9.1 billion.

They’re issuing with yields close to a two-month low. Individual investors added money to muni mutual funds this week for the first time since May, Lipper US Fund Flows data show.

The interest rate on AAA 10-year munis is 2.71 percent, the lowest since November and compared with 2.84 percent on similar-maturity Treasuries.

The ratio of the yields, a measure of relative value, is about 95 percent, close to the lowest since May. The smaller the number, the more expensive munis are compared with federal securities.

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By William Selway and Brian Chappatta Jan 16, 2014 5:00 PM PT

NACo issues News Release on PILT.

WASHINGTON, D.C. – America's counties will have no option but to severely reduce or eliminate critical county services to the public if Congress fails to deliver funding for the Payment in Lieu of Taxes (PILT) program in the FY2014 Omnibus spending bill.

Without annual PILT payments, many services including fire and EMS, search and rescue, public health, law enforcement and justice operations could be affected. In many cases, counties will face more severe consequences including insolvency, default, and bankruptcy.

"We are deeply concerned that Congress would turn its back on more than 1,850 counties impacted by the presence of the U.S. government's extensive holdings of public land," said Matt Chase, Executive Director of the National Association of Counties (NACo). "Since October, counties have in good faith delivered vital county services to our citizens and visitors with the expectation that the federal government would honor its 37-year commitment to county governments who are unable to collect property taxes on more than 600 million acres of federal land."

Through the federal government shutdown and despite the uncertainty in the federal budget, counties have been open for business. In many cases, counties have had to front the costs of services typically supported with annual PILT payments, something that most rural counties cannot afford to do much longer.

"There is still time to act, and we respectfully ask that the House and Senate leadership work to fully fund PILT for the current fiscal year in the Omnibus spending bill or through another legislative vehicle," Chase said.

Since 1976, PILT has provided critical funding to nearly 1,850 counties in 49 states. The PILT program funds offset losses in tax revenues due to the presence of substantial acreage of federal land in their jurisdictions. In many counties, more than 50 percent of the land is owned by the federal government.

PILT payments allow local governments to provide critical government services for residents such as education, solid waste disposal, law enforcement, search and rescue, health care, environmental compliance, firefighting and parks and recreation.

by Hadi Sedigh on 1/13/2014 4:08 PM

Single-Family Securitized Financing: A Blueprint for the Future?

In November 2013, Invitation Homes LP, the Blackstone subsidiary that is the largest of the REO-t--rental operations, completed the first securitized financing of REO-to-rental properties (Invitation Homes 2013-SFR1). The private placement was very well received by the market, producing more favorable terms than many had anticipated. In this short article, we walk through why the deal was done, how it was structured, and what the financing means for the market.

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Motivation for the Deal

The first question many people have is why this securitization was done. The answer is straightforward: Invitation Homes owns and manages approximately 39,000 scattered-site single-family rental homes, and property managers can generate a higher return for their equity investors if they use leverage. With home prices up nationwide by 22 percent from their 2011 low, and up even more where REO-to-rental investors are active, moderate leverage is needed to attract new money to the space and to keep returns attractive to current equity investors. Leverage can take the form of securitization, bank loans, or preferred stock offerings. Invitation Homes is the first securitization.

An example will make this clear. Let's assume a home sold for $90,000 and needed $10,000 of repairs, for a total cost of $100,000, and it could be rented out at $1,200 a month, or $14,400 a year. That home would be generating a gross cash-on-cash return (often referred to as a gross capitalization rate) of 14.4 percent ($14,400/$100,000). Out of this, the property owner must pay taxes, insurance, homeowners' association dues, and both routine and emergency maintenance on the property. The property owner must also account for tenant turnover: the property may sit vacant part of the year, an agency may charge fees to rent to another party, and there will be fees to screen potential tenants and repaint the home. Let us assume these fees total $500 a month, or $6, 000 a year. Taking all these expenses into account, the property owner would be left with a net cash-o--cash return (net capitalization rate) of 8.4 percent ($8,400/$100,000), plus any property appreciation.

Now assume that $90,000 home goes up in value and sells for $120,000, plus the same $10,000 in repairs, for a total cost of $130,000. If the rent and expenses stay the same, the gross capitalization rate is 11.1 percent ($14,400/$130,000), and the net capitalization rate is 6.5 percent ($8,400/$130,000), much less attractive than the original 8.4 percent. Moreover, part of the anticipated price appreciation has been achieved, reducing potential future returns. (This example is fairly realistic; on the Invitation Homes deal, the actual net capitalization rate is 6.37 percent.)

Leverage can restore the appeal of the investment. Assume the property owner can borrow 75 percent of the purchase price to finance new properties, these properties also have a net capitalization rate of 6.5 percent and the rate on this borrowing is 4 percent. The investor would be receiving 6.5% + 0.75(6.5%-4%) = 8.4 percent, restoring the cash-on-cash return of 8.4 percent. In addition, because this transaction serves as the financing vehicle for further purchases, the property owner is entitled to any property appreciation on additional purchases. Thus, for each $100 investment, an investor who has borrowed 75 percent of the purchase price can purchase an additional $75 of homes, and will be entitled to the appreciation on $175.

Deal Description

The collateral for the Invitation Homes deal consisted of 3,207 properties with a total value of $638.8 million and an average value of $199,200. The loans in this deal were all acquired in the second and third quarters of 2012, had been repaired, and were currently leased. The properties had been leased for an average of 8 months; the longest lease was 16 months. The top three MSAs (as measured by balance) were Phoenix, AZ, with 34 percent; Riverside, CA, with 17.2 percent; and Los Angeles, CA, with 12.0 percent. The top three total, 63.2 percent, reflects the geographic concentration of REO-to-rental operations.

The security is collateralized by a single loan that is in turn secured by first-priority mortgages on the 3,207 income-producing single-family residences. The three rating agencies that rated this transaction (Moody's, KBRA [Kroll], and Morningstar) consider the mortgage structure superior to a

loan secured solely by an equity pledge, because the trust will have a first-priority lien on the properties. In the event of a default, the trust would be able to acquire the properties, rather than being limited to the sponsor's equity. This structure also helps protect against the bankruptcy of the guarantor or sponsor.

Structure of Invitation Homes 2013- SFR1

Capital Structure

Class Ratings (Moody's/ KBRA/Morningstar) Original Balance ($MM) Certificate Principal to BPO Value Ratio (%) Initial Maturity Date WAL (yrs.) Fully Extended Maturity Date WAL (yrs.) Assumed Final Distribution Date Rated Final Maturity Date

A Aaa(sf)/AAA(sf)/AAA 278.7 43.6 [2.0] [4.9] December 2015 December 2025

B Aa2(sf)/AA(sf)/AA 34.3 49.0 [2.1] [5.1] December 2015 December 2025

C A2(sf)/A(sf)/A 47.1 56.4 [2.1] [5.1] December 2015 December 2025

D Baa2(sf)/BBB(sf)/BBB+ 31.5 61.3 [2.1] [5.1] December 2015 December 2025

E -/BBB-(sf)/BBB- 46.0 68.5 [2.1] [5.1] December 2015 December 2025

F -/BB(sf)/- 41.5 75.0 [2.1] [5.1] December 2015 December 2025

Property Loan

Property Count 3,207 Loan Balance 479,137,000

Issuer Purchase Price ($mm) 444.7 Loan Term 2 years initial, three 1-yr extension options

Issuer Cost Basis ($mm) 542.8 Amortization Amt. 1% per year

BPO Value ($mm) 638.8 Libor Cap 2.497%

Source: Moody's, KBRA, and Morningstar.

The deal contains six tranches (A, B, C, D, E, and F), shown in table 1. Class A, the AAA tranche, was $278.7 million (43.6 percent of the $638.8 million value of the properties); the six tranches together were $479.1 million (75 percent of the $638.9 million value of the properties). The stated maturity of the deal is two years from issuance (December 2015), with three one-year extensions. The principal pay downs are made first to Class A, until that Class reaches a zero balance, then in sequential order to the other tranches. Interest accruals are also distributed sequentially. Realized losses are allocated in reverse sequential order. Just as in commercial mortgage backed securities deals, a Special Servicer, in effect chosen by the most subordinate tranche outstanding, is responsible for the servicing and administration of the loan if there is a default or reasonably foreseeable default.

Protections for the Bondholders

The deal contains a number of protections for the bondholders:

- While rents are fixed for a period, the interest payments are based on LIBOR (London Interbank Offer Rate) plus a spread. The sponsor was required to buy an interest-rate cap for the initial period to ensure the trust has sufficient cash to pay the bondholders if LIBOR increases. If the deal

is extended, future extensions also require the purchase of an interest-rate cap.
- There are modest prepayment penalties during the first year for prepayments arising from casualty or condemnation, or prepayments made in connection with the transfer of disqualified properties that do not meet certain representations and warranties.
- When individual properties are released from the securitization, the sponsor must pay the trust 105 percent of the allocated loan amount, if the released properties make up less than 10 percent of the initial balance of the securitization. This increases up to 120 percent of the allocated loan amount if released properties make up more than 20 percent of the initial balance of the securitization.
- If the loan's debt yield falls below 90 percent of the closing date debt yield (a low debt yield period), excess cash is directed to the bondholders.

Criticisms of the Deal

Whether investor ownership of single-family rental property is positive or negative for communities continues to be debated; securitization will be another factor in that discussion. Here we focus on the criticisms of the transaction raised by the rating agencies that did not rate the deal and the investor community, namely these four:

- the lack of a long term history of rents for comparison
- the geographic concentration of the homes
- Blackstone's limited equity in the deal ($63.7 million)1 may reduce the incentive to maintain the properties
- the "release of properties" clause

The first two points are inherent in any securitization of single-family rentals; the industry is new and geographically concentrated. The rating agencies clearly recognized these points, and protection has been built into the securitization, via additional required subordination. For example, the AAA bond is sized to be only 43.6 percent of the overall property value, smaller than in most commercial real estate securitizations. As to the third point, we believe any REO-to-rental operator will do the best it can for its equity investors. This means maximizing rental income and selling at as good a price as possible. Both require the properties to be maintained.

The bigger concern for investors (and also for alignment of interest) is the release-of-properties clause. In some circumstances, the interests of the debt holders and the equity holders are not aligned. In particular, the manager, representing the interest of the equity holders, may want to sell off "winning properties" (those that have appreciated) while retaining in the securitization properties that have fallen in value. As an example, recall that all properties in the Invitation Homes securitization are initially valued at 75 percent of property value. Now assume the value of 50 percent of the properties doubles while the value of the other 50 percent decreases by half. If all the appreciated properties were sold, the trust would receive 1.2 times the loan amount initially allocated to those properties. Thus, the total value of the cash plus the remaining properties in the securitization is calculated as (50% x 75% x 1.2) + (50% x 50%), which equals 70 percent of the initially allocated loan amount, although 75 percent is necessary to repay the investors. This example is very unrealistic, but investors would have been better protected had the manager been required to repay the securitization trust the greater of the allocated loan amount times 1.2 or 75 percent of the sales price. Mitigating this concern is the fact that Invitation Homes has only securitized a small amount of its total portfolio (3,207 of its approximately 39,000 homes). With the longer-run interests of their equity investors in mind, Invitation Homes is incented to keep this channel of financing available, which requires them to do a good job for debt holders.

The Future: More Securitizations, as Well as Other Sources of Leverage

The pricing on this transaction was very favorable, with most of the securities selling at higher-tha--expected levels. As a result, more such transactions are likely. Both American Homes 4 Rent (AMH), an REO-to-rental operation with 21,000 single-family homes for rent, and Colony American Homes, which has 15,000 single-family homes, have announced they are looking at similar transactions. In addition, many REO-to-rental operators have arranged for bank financing, and a number of banks have made substantial investments in the systems to monitor the risk in this lending. And AMH has already concluded two very favorable preferred stock offerings.2

One fact is abundantly clear. With home prices up from the levels at which properties were bought, and continuing to rise, institutional investors need to add moderate leverage to deliver attractive returns to their equity investors. Look for many more institutional investors in single-family properties to add leverage in 2014.

Notes:

1. The sponsor's total cost basis in the securities is $542.8 million, consisting of a purchase price of $444.7 million, closing costs of $7.9 million, other related costs of $22.5 million, and rehabilitation costs of $67.7 million. The par amount of the securities is $479.1 million, leaving Invitation Homes with hard equity exposure of $63.7 million.
2. The offerings took place in October and December 2013. They carry a lower coupon than debt but have added return potential equal to 50 percent of the home price appreciation in AMHs top 20 markets, using the FHFA's home price indices. By offering a home price appreciation kicker, AMH was able to lock in a lower rate on the transactions.

Laurie Goodman

WSJ: Pitch for Detroit Bailout Could Include Other Municipal Pensions.

DETROIT—Michigan Gov. Rick Snyder's talks with state legislators about a possible funding plan for the bankrupt city of Detroit could be part of a much broader push to shore up municipal pensions statewide, a person familiar with the matter said Thursday.

"I think it is going to be bigger than just Detroit," this person said. "You can't just sell a Detroit-only bailout."

People familiar with the matter said that the governor told legislative caucuses in the state capital of Lansing Wednesday that the state could speed Detroit out of its bankruptcy by at least matching the $330 million by local and national foundations to preserve public access to the collection of the city-owned Detroit Institute of Arts while helping to fund the city's pension obligations.

Last week, the federal mediator in the city's municipal bankruptcy case—the nation's largest—had several long conversations with Gov. Snyder, hoping to convince him that the state should consider a direct aid. Sources said that time is now running low because Detroit Emergency Manager Kevyn Orr, appointed by Gov. Snyder in March, plans to issue by Feb. 1 his plan to the bankruptcy court for cutting the city's estimated $18 billion in long-term debt.

The governor "thought it was important to start dialogue and discussion with lawmakers," Sara Wurfel, the governor's spokeswoman, said in an email Wednesday night. She added that any additional funding from the state for Detroit "would be in partnership with the Legislature."

Pushing for a bailout through the GOP-led state legislature could be a tough task for Gov. Snyder, a first-term Republican governor likely to run for a second term this year. Sources said that the governor has to straddle competing political interests wanting to limit the state's spending in cash-poor Detroit versus those expecting Detroit to be out of bankruptcy by the time of the gubernatorial election in November.

The governor and his advisers had hoped to keep the confidential briefings under wraps. But with its disclosure Wednesday night, Gov. Snyder may be more inclined to provide details about his idea during his state of the state address scheduled for Thursday evening.

In talks with legislators, the governor floated the idea of using part of the state's tobacco-litigation settlement fund as a way to pay for the bailout without new appropriations, according to the person familiar with the matter. Michigan received $256 million in fiscal year 2012 from a 1998 settlement Michigan and other states reached with tobacco manufacturers, but that annual payment is expected to decline in part due to declining cigarette sales, according to a state legislative report.

Until now, the governor has been noncommittal about whether he would financially support a rescue plan unveiled earlier this week designed to preserve the holdings of the Detroit Institute of Arts and to help reduce the city's obligations to its municipal pension funds.

On Monday, nine local and national foundations said they pledged $330 million to help pay the city for its art and place its holdings at the Detroit Institute of Arts into the hands of a new nonprofit public trust. In turn, the city could use the proceeds to help make up the shortfall in its municipal pension system, estimated by Detroit's emergency manager at $3.5 billion.

Without a bailout, there is growing fear that potential lawsuits over a possible sale of the art and a dispute over cuts to pension payments would tie up the Detroit bankruptcy case for months, if not years, people familiar with the matter said.

Originally, the federal mediator in the bankruptcy case estimated that the art deal required $500 million in outside support. But since confidential meetings began in November, the judge has indicated that the number is expected to grow, according to two people familiar with the matter.

In fact, in order for the city to be able to satisfy union and pension funds, Detroit may need to come up with close to $1 billion to help fill the pension shortfall, according to a person familiar with the matter. Then unions and pension funds would be asked to help make up the difference by accepting cuts or agreeing to benefit reductions to save money, this person said.

By MATTHEW DOLAN

Jan. 16, 2014 10:52 a.m. ET

State Budget Crisis Task Force: Revisit the Tower Amendment.

WASHINGTON — Congress should reexamine the Tower amendment and consider authorizing the Securities and Exchange Commission to require issuers to comply with "sensible" disclosure requirements as well as robust accounting standards, the State Budget Crisis Task Force recommended Tuesday in its final report.

The task force — led by former Lt. Gov. of New York Richard Ravitch and former Federal Reserve

Board Chairman Paul Volcker — also made other recommendations aimed at improving accountability and transparency of state and local governments' budgeting and financial reporting. It also said the federal government should be more aware of the impact of federal deficit reduction on state and local governments.

The Tower amendment, which was added in 1975 to the Securities Exchange Act of 1934 by former Sen. John Tower, R-Tex., prohibits the SEC and Municipal Securities Rulemaking Board from requiring issuers to directly or indirectly to file any information with them before the sale of their munis.

No other entity has the obligation or authority to require full transparency and disclosure of risk from municipal issuers, the report said. The SEC and MSRB place disclosure requirements on underwriters of munis rather than issuers. The task force wants there to be adequate disclose of the terms, conditions and risks of municipal finances.

In an interview with The Bond Buyer, Ravitch noted that the task force is not recommending repeal the Tower amendment but rather wants the issue to be publicly discussed.

In October, the National Association of State Treasurers readopted a resolution that opposes repealing or modifying the Tower amendment.

Ravitch acknowledged that requiring more disclosures ahead of sales "would be unpopular for mayors and governors and the municipal bond industry" but said that investors would be appreciative of such a change.

"It's important to maintain liquidity for cities and states," he said, adding that "these markets have to be sound, liquid, creditworthy." Sometimes governments have appetites for borrowing when they should refrain from issuing debt, such as Puerto Rico and Detroit, Ravitch said.

The former New York lieutenant governor was not aware of any interest in Congress to revisit the Tower amendment, but said, "We're going to try to rev some up."

The recommendation was among many the report made in an effort to improve states' accountability and transparency. Having reliable budget estimates and accessible data on financial and programmatic results is important for preventing and solving financial problems and could increase the public's trust in government, the report said.

The financial crisis that began in 2008 revealed states' and localities' structural budget problems, as opposed to creating the problems. "This suggests that had government, the media, taxpayers, and the electorate been aware of the poor fiscal condition of state governments and the underlying trends and causes of those conditions, they may have been able to implement preventive and ameliorative steps," the task force said.

"At their heart, the economic events beginning in 2008 generated a severe revenue crisis. Lack of transparency and accountability constitutes bad financial, government, and political practice. Self-deception, either deliberate or unwitting, causes inaction and ignorance," the report continued. "Thus, not only is transparency in budgetary and fiscal reporting desirable, the absence of it can be a major cause of government fiscal problems."

Other recommendations for state and local governments include: using modified accrual budgeting instead of cash-based budgeting; having multi-year financial plans; having reserve funds that are adequate to meet any reasonably anticipated need; and making sure that the proceeds of short-term borrowings are repaid and not treated as an element of revenue.

Ravitch said many of the recommendations in the report were similar to actions taken for New York City to avoid bankruptcy in 1975.

The task force also recommended in its report that: states have statutory processes for imposing corrective actions on local governments that have a high risk of not meeting their obligations; state and local governments produce easily understandable financial reports; the federal government be more aware of the effects of its actions on the fiscal condition of states and localities; and, the federal government be required to make projections about how its actions and policies will impact state and local finances and services.

In addition, the report makes recommendations about how to better manage the impact of federal deficit reduction. “There can be an alarming disconnect between federal and state policymakers,” the task force said.

The report urged the creation of a centralized, independent mechanism for improved reporting and analysis of state financial data, which could be housed in a federal department or the Congressional Budget Office. It also recommended the president issue an executive order to require cabinet agencies to coordinate with state and local governments on major actions affecting them. Additionally, the task force recommended that the federal government work with states to engage in a major review of policies affecting state governments.

BY NAOMI JAGODA

JAN 14, 2014 12:01am ET

Muni Variable-Rate Index Sets Record-Low as Issuance Drops: Bloomberg.

A measure of U.S. municipalities’ variable-rate borrowing costs is the lowest in more than two decades as issuance of such debt is down 87 percent since 2007.

The Sifma Municipal Swap Index, which tracks 7-day, variable-rate demand notes, fell to 0.03 percent on Jan. 8, Katrina Cavalli, a spokeswoman for the Securities Industry and Financial Markets Association, said in an e-mail. That’s the lowest since the measure began in July 1989, data compiled by Bloomberg show. Sifma, which calculates the index, is a New York-based trading group representing banks and investors.

The yield is falling as localities avoid adjustable-rate securities, said Michael Decker, co-head of Sifma’s municipal securities division. They’re favoring fixed-rate debt to lock in long-term financing as interest rates remain below historical averages. Twenty-year general obligations yielded 4.68 percent on Jan. 2, compared with the five-decade average of 5.87 percent, according to a Bond Buyer Index.

“It’s a supply-demand issue,” Decker said. “There really is a shortage of variable-rate securities and that’s driving rates down.”

The Federal Reserve’s policy of keeping its benchmark for overnight interest rates near zero is also pushing down the index, Decker said.

Local governments from California to New York issued $25 billion of variable-rate securities and derivatives in 2013, Bloomberg data show. That’s down from $195 billion in 2007. The Sifma index

has averaged 2.81 percent since it began in 1989.

The dropping index means smaller payments to investors. Bondholders receive 0.46 percent on Massachusetts general obligations that mature in January 2018 and adjust according to the Sifma index. That's down from 0.56 percent when the bonds were issued in December 2012.

The floating-rate index will probably rise in the next few weeks as issuance picks up across the municipal market from a January lull, said Lyle Fitterer, who helps manage $31 billion of munis, including the Sifma-based Massachusetts general obligations, at Wells Capital Management in Menomonee Falls, Wisconsin.

The Sifma may climb to about 0.1 percent in that period, he said.

Interest rates also fell on fixed-rate municipal debt this week as scheduled issuance remained below the one-year average.

Yields on benchmark 10-year munis fell to 2.8 percent today, the lowest since Nov. 13, data compiled by Bloomberg show. The interest rate has declined 0.19 percentage point this week, the steepest drop since December 2011.

To contact the reporter on this story: Michelle Kaske in New York at mkaske@bloomberg.net

By Michelle Kaske January 10, 2014

Muni-Bond Funds Break Redemption Streak.

Market Had $103 Million Inflow as Investors Saw Value in Beaten-Down Bonds.

Investors put a net $103 million into municipal-bond funds in the latest week, breaking a 33-week redemption streak that has weighed heavily on the market, Lipper said Thursday.

Redemptions surged in 2013 as investors first reacted to rising interest rates, and later to credit worries caused by Detroit's record municipal bankruptcy and speculation that Puerto Rico's debt would be restructured. The Lipper data include exchange-traded funds.

Municipal bonds declined 2.55% last year making it the market's worst performance since 1994, according to the Barclays Municipal Bond Index.

The fund flow data "is positive for the market considering it's the first inflow numbers we've seen in half a year," said Chris Mauro, a muni strategist at RBC Capital Markets.

The muni market has started to improve this year as fund outflows eased and fund managers saw value in bonds dragged down by the widespread selloff. Ten-year municipal-bond yields this week declined to as low as 91.29% of Treasurys, the lowest ratio since May 24, according to Thomson Reuters Municipal Market Data. The ratio was 91.90% on Thursday.

However, fixed-income funds are facing tough competition for investor cash from equity funds, which drew $5 billion in new cash in the latest week, Mr. Mauro said.

By AL YOON

Jan. 16, 2014 6:14 p.m. ET

NYT: Foundations Aim to Save Pensions in Detroit Crisis.

National and local philanthropic foundations have committed $330 million toward a deal to avoid cuts to Detroit retirees' pensions and to save the Detroit Institute of Arts' renowned collection, federal mediators involved in the city's bankruptcy proceedings announced on Monday.

The plan was a first both in the foundation world, which has not been a source of money to shore up public-sector pensions in the past, and in municipal bankruptcy cases, experts said. It also offered the first indication of progress in the intense mediation with Detroit's creditors to resolve the city's financial crisis. Those talks have been proceeding under strict secrecy guidelines.

Nine foundations, many with ties to Michigan — including the Ford Foundation, the Kresge Foundation and the John S. and James L. Knight Foundation — have pledged to pool the $330 million, which would essentially relieve the city-owned Detroit Institute of Arts museum of its responsibility to sell some of its collection to help Detroit pay its $18 billion in debts. In particular, the foundation money would help reduce a portion of the city's obligations to retirees, whose pensions are at risk of being reduced in the bankruptcy proceedings. By some estimates, the city's pensions are underfunded by $3.5 billion.

"The Wedding Dance," at the Detroit Institute of Arts, was valued at $100 million to $200 million. Fabrizio Costantini for The New York Times

As part of the plan, which negotiators have been working on quietly for more than two months, the museum would be transferred from city ownership to the control of a nonprofit, which would protect it from future municipal financial threats. The foundations would stipulate that Detroit must put the money into its pension system, said Alberto Ibargüen, president of the Knight Foundation.

The unusual effort by the foundations was not the first instance of charitable groups' and high-profile figures' trying to help the ailing city. Previous contributors include Lloyd C. Blankfein, the chief executive of Goldman Sachs, and Warren E. Buffett, the billionaire investor, who attended an event with city and state leaders in November to announce a $20 million initiative to help small businesses in Detroit.

But it is far from certain whether the new pledges will bring about a deal to save the museum while also helping the city meet its pension obligations, and several possible roadblocks remain. As much as $500 million may be needed to protect the art from an auction, officials have said, so additional philanthropic donations are being sought. Detroit is also contending with some 100,000 creditors in its federal bankruptcy case, and some are expected to oppose the plan. Even if the notion were to proceed, it would not be enough to resolve the city's pension underfunding, but merely to ease it somewhat.

Moreover, the foundation deal would address only a portion of the larger bankruptcy puzzle, a vast array of debts, creditors and assets that must be rearranged before the city can emerge from the nation's largest municipal bankruptcy.

"There's a lot of detail to work out here — it's a moving target," said Mariam C. Noland, president of the Community Foundation for Southeast Michigan, a 30-year-old philanthropy organization in Detroit that began rallying national foundations last fall after the federal judge mediating the

bankruptcy case, Gerald E. Rosen, approached her with the idea.

Still, many people saw the proposal as a positive development, and perhaps as a sign that more agreements may be coming in a case that no one wants to see linger.

“When you start seeing first settlements come down the road, you’re seeing the dawn of a Chapter 9 plan that is to be confirmed,” said James E. Spiotto, an expert on federal municipal bankruptcy, known as Chapter 9.

Kevyn D. Orr, Detroit’s emergency manager, who led the city to file for bankruptcy, said he welcomed the foundation proposal but emphasized in a statement that many issues remained.

City pension officials praised the unusual approach being taken to shore up the pension funds that are essential to 20,000 city retirees and 10,000 current workers. “Any way the process can raise funds to meet its pension obligations, we’re in support of this,” said Bruce Babiarz, a spokesman for the pension system.

Among other creditors, many of whom declined to speak on the record because the private talks were continuing, the proposal drew a more mixed response.

Some saw it as appealing, if only because it would bring the city that much closer to a relatively speedy, consensual resolution of the bankruptcy. Others objected, saying that the deal appeared to give pensioners priority over some other creditors and that the city might get more for the art by selling it.

Last year, Mr. Orr’s office hired Christie’s to appraise a portion of the collection that included many of the museum’s masterpieces. The auction house said that selling this portion would generate $454 million to $867 million. A group of creditors, including unions and financial institutions, is scheduled to challenge the appraisal in bankruptcy court next week.

Even before Detroit filed for bankruptcy, the fate of the art collection — one of the few city assets that is both highly valuable and easily portable — became linked in the public mind with the fate of pensioners. Yes, the art is a cultural and historical treasure, the reasoning went, but is it more important than payments people rely on for food and bills? If selling the paintings could help pay those checks, shouldn’t the paintings be sold? Museum officials and supporters worried about the debate’s being framed in such a way and warned that the thinking was flawed and shortsighted.

Ms. Noland, the community foundation president, said a plan to help pensioners and protect the art began to form last fall when Judge Rosen, whom she knows, called her. His office “reached out to me and said: ‘We have an idea. What do you think about raising $500 million?’ ” she said. “And I said, ‘Are you crazy?’ Actually, I didn’t say that — you don’t say that to a federal judge. I said, ‘Let me call some people I know.’ ”

Ms. Noland called a dozen foundations across the country — many with more substantial means than hers, which has about $650 million in assets — and on Nov. 5, representatives of many of those foundations met in a conference room in Detroit’s federal court building to discuss how much they would be willing to contribute.

“It became a very attractive and persuasive idea,” Ms. Noland said.

Darren Walker, president of the Ford Foundation — the nation’s second-largest private foundation, with $11 billion in assets — said that it was “unprecedented and monumental for philanthropies to undertake this kind of initiative,” but that “if there was ever a time when philanthropy should step

up, this is it." He said he was confident that the $500 million could be raised, but warned that aside from raising the money and offering a way to "break the logjam," the foundations had no other power to broker a deal.

When the idea was first proposed, foundations were not sure how to react. "It seemed like an enormous amount of money for an idea that nobody had thought through," said Mr. Ibargüen, the Knight Foundation president. "I think nobody thought then — that day, that night — that we would be able to move this as fast as possible."

Ultimately, the Knight Foundation committed $30 million, the largest single sum it has ever pledged.

By RANDY KENNEDY, MONICA DAVEY and STEVEN YACCINOJAN. 13, 2014

Wall Street Muni-Bond Fees Shrink Fourth Straight Year.

Bank of America Corp. managed the most municipal bond issues for the second-straight year.

Fees that Wall Street charges U.S. cities and states to sell their bonds fell for a fourth straight year in 2013 as dwindling debt issuance intensified competition among banks for underwriting business.

In one example of an issuer that benefited, the New Jersey Turnpike Authority in March paid banks led by JPMorgan Chase & Co. (JPM) about $1.85 million to sell $1.4 billion of bonds backed by tolls, according to an offering statement for the debt. The fee of $1.32 per $1,000 of bonds was one-third of the cost in 2010, said Donna Manuelli, chief financial officer of the agency.

The average expense last year for municipalities to issue long-term, fixed-rate bonds in the $3.7 trillion market fell to $5.42 per $1,000, the lowest since at least 2009, data compiled by Bloomberg show.

"In a declining market, they're trying to pick up market share," Manuelli said in a telephone interview. Other banks proposed similar fees, she said.

More than four years after the longest recession since the 1930s, municipalities are loath to borrow as they are starting to mend their finances, said Bart Mosley, co-president of Trident Municipal Research in New York. Long-term fixed-rate U.S. municipal bond sales fell 15 percent to about $294 billion in 2013, Bloomberg data show.

Scaling Back

U.S. localities also scaled back refinancing as Detroit's record bankruptcy filing in July and speculation that the Federal Reserve will curb its bond buying pushed borrowing costs to the highest in more than two years in September. Interest rates soared from generational lows set at the end of 2012.

Municipal issuers refunded much of their higher-cost debt before 2013 as the Fed kept its benchmark overnight interest rate near zero and purchased long-term bonds to stimulate the economy, Mosley said.

The Federal Open Market Committee in December decided to cut monthly purchases of Treasuries and mortgage debt by $10 billion, to $75 billion, citing improvement in the labor market that pushed

the jobless rate to a five-year low of 7 percent in November.

“Issuers know that banks are competing for a dwindling pool of business,” Mosley said. “Price becomes the differentiating factor.”

The shrinking commissions also reflect decisions by states and local governments to eschew complex deals laden with derivatives, which generated higher fees, in favor of simpler structures, he said.

No. 1

Bank of America Corp. managed the most municipal bond issues for the second-straight year. The Charlotte, North Carolina-based bank handled $42.2 billion of long-term, fixed-rate sales, according to Bloomberg data. New York-based JPMorgan ranked second for the second year in a row, managing about $38 billion.

The New Jersey authority oversees the 148-mile (238-kilometer) turnpike and the 172-mile Garden State Parkway. Its debt carries an A3 rating from Moody’s Investors Service, six steps below the top, and an A+ rating from Standard & Poor’s, two levels higher.

Demand for the agency’s tax-free obligations typically outstrips supply, reducing the chance that underwriters will be left with unsold bonds, said Manuelli, the chief financial officer. New Jersey residents’ top income-tax rate ranks fifth among U.S. states that assess the levy, according to the Tax Foundation, a nonprofit research group in Washington.

Excess Orders

“We’re always oversubscribed,” meaning investors place orders for more bonds than are being offered, she said. Underwriters “view the risk as a minimum.”

Manuelli said JPMorgan assured her that the lower fees wouldn’t affect the pricing of the bonds and increase borrowing costs. Ten-year Turnpike Authority bonds were priced on March 20 to yield 2.57 percent, or 0.06 percentage point below a Bloomberg index of A rated revenue bonds.

Jessica Francisco, a JPMorgan spokeswoman, declined to comment, as did Zia Ahmed, a Bank of America spokesman.

Colin MacNaught, assistant treasurer of Massachusetts, also said underwriting costs have declined.

In November, fees on long-maturity bonds typically sold with a $5 commission were issued with a $3.75 fee, the lowest in MacNaught’s six years with the state and saving taxpayers almost $500,000, he said.

Bank Bids

A September auction of about $800 million of short-dated debt drew 106 bids from 20 banks, MacNaught said. The state paid $6,500 in fees on the deal, he said.

Massachusetts issues 80 percent of its debt by competitive bid, in which underwriters bid against each other for the securities.

Nationwide last year, about 20 percent of the dollar volume of munis were sold with that method.

Localities offered the remaining 80 percent through negotiated sales, in which issuers select a bank and negotiate fees in advance of a sale, comparing qualifications, performance and fees.

The average cost for negotiated offerings in 2013 was $5.37 per $1,000 of debt, compared with $5.71 for competitive offers, Bloomberg data show.

Same Dynamic

States and localities stand to reap the benefits of lower fees for the next few years, Mosley said.

“I don’t see anything in the next few years that changes the dynamic,” he said.

The borrowing slowdown is extending into 2014, with localities scheduling about $6.5 billion of debt sales in the next 30 days, about 29 percent below the one-year average.

The issuance lull is feeding lower debt costs. Benchmark 10-year munis yield 2.84 percent, the lowest since Dec. 2, and compared with 2.97 percent on similar-maturity Treasuries.

The ratio of the interest rates, a measure of relative value, is about 96 percent, close to the lowest since May, compared with a five-year average of 99 percent. The lower the figure, the more expensive munis are compared with federal securities.

By Martin Z. Braun Jan 9, 2014 5:00 PM PT

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U.S. Local Governments Credit Scenario Builder for iPad available on S&P Ratings App.

Download the app at:

https://itunes.apple.com/us/app/s-p-creditmatters/id350924186?ls=1&mt=8

Credit FAQ: Standard & Poor’s Approach To Pension Liabilities In Light Of GASB 67 And 68.

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L.A. Wants Financial Advisors Precluded from California Broker-Dealer Work.

LOS ANGELES — Municipal bond underwriters can now apply to two Los Angeles requests for qualifications seeking financial advisors, but they aren’t likely to find the restrictions encouraging.

Los Angeles officials say a protest from Dallas, Texas-based FirstSouthwest against the exclusion of underwriting firms had nothing to do with the decision to modify the RFQs.

“We are trying to obtain as large of a pool as possible to insure that we have the best financial advisors in that pool,” said Miguel Santana, Los Angeles’ City Administrative Officer.

The city deleted the section that FirstSouthwest disputed in the original RFQs issued in November that excluded firms “that underwrite or otherwise trade in municipal bonds.”

But it added a new section stating that applicants must submit with their proposals an affirmative statement acknowledging that their firm will be precluded from participating in the underwriting or purchasing of bonds of issuers within California during the term of the contract, plus two years after the city contract ends.

It also extended the deadline for proposals to Jan. 28.

Santana said Los Angeles changed the language to have as large a financial advisor pool as possible, while still being able to conduct competitive procurements for city bond issues.

“We wanted to provide more clarity as to what the city’s expectations are, so we made some minor changes,” he said.

The Los Angeles CAO did not view excluding underwriting in the entire state for selected financial advisors as particularly conservative.

“As underwriters selling bonds in California, they might be competing in the same marketplace as our bonds,” Santana said. “If you look at the marketplace, it is not just exclusively related to the city.”

Jack Addams, vice chairman of FirstSouthwest, said his firm doesn’t agree with the stipulation that applicants agree not to underwrite bonds anywhere in California, the largest market for municipal bond issuance.

“We are not fine with the entire state of California,” Addams said. “I don’t understand how you get from implementing GFOA [Government Finance Officers Association] best practices to there.”

FirstSouthwest intends to apply for both RFQs, but the company’s affirmative statement will only state that it agrees to not act as an underwriter for Los Angeles – not all of California – if selected to act as a financial advisor for the time frame mentioned, Addams said.

“We agree with the GFOA recommendation that you can’t underwrite during the period of time you are acting as financial advisor for that issuer; and even having to lock out of underwriting for a couple of years after,” Addams said.

The broker-dealer acted as an underwriter on two California transactions during 2013 totaling roughly $70 million, according to Thomson Reuters.

It was a co-manager in a syndicate that won the competitive bid for $55.7 million of general obligation refunding bonds sold by the Los Angeles Community College District in May.

It also acted as sole underwriter on $14.04 million of water revenue bonds sold through negotiation by the Tustin Public Financing Authority in October.

“We are not a big player on the underwriting side,” Addams said. “It is the principle of the thing.”

FirstSouthwest has hired two new bankers to expand its underwriting business in California. Mike Awabis as a senior vice president in Santa Monica and Ryan Chiriboga as an assistant vice president in Phoenix, but who does all of his business in California.

“It is not a business we want to give up, because we are going to go after both financial advisor and underwriting business in California,” Addams said. “We have never been a major player underwriting in California, but I want to build that business.”

Santana said his staff has been working with the city attorney to develop language to attract a broad pool, but they didn’t want any conflicts with underwriters who do financial advisor work in California.

“This concern predates any action by the GFOA or the MSRB [Municipal Securities Rulemaking Board]”, Santana said. “We have been mindful of this conflict for a long time.”

The city’s debt management policy, adopted in 2005, deems it a conflict of interest for firms to do business with the city as both an underwriter and financial advisor.

Los Angeles’ actions come against a backdrop of regulatory changes from both the federal government and industry associations.

Regulations adopted by the MSRB, Dodd-Frank legislation, and changes proposed by the U.S. Securities and Exchange Commission that go into effect in mid-January have changed the playing field with rules regulating how FAs operate.

In November 2011, MSRB’s Rule G-23 was modified to prohibit dealers from serving as FAs and underwriters on the same municipal bond deal.

The city used underwriters as co-financial advisors before the MSRB came out with its rules, but typically only in special situations where it wanted sell-side advice on an issue, city officials said.

The MSRB is holding a press conference on Jan. 9 to discuss a proposed standards to guide the conduct of municipal advisors, including regarding their fiduciary duty to put client’s interests first.

Dodd-Frank legislation imposed a fiduciary duty on MAs and required for the first time that non-dealer MAs be subject to the same MSRB rules as broker-dealers.

BY KEELEY WEBSTER

JAN 8, 2014 4:37pm ET

Distressed Cities and the Lessons of California.

A new study finds reasons for optimism for municipal finances. But California is the outlier.

It might seem, given the spate of municipal bankruptcies of recent years, that there’s little to be hopeful about for some of America’s harder-pressed cities. But the picture may not be as bleak as we’ve thought.

A recent study from Boston College's Center for Retirement Research finds that in the wake of Detroit's bankruptcy, other cities are not poised to fall like dominoes. And contrary to what we hear with increasing frequency, pensions are not the biggest problem for cities that are in financial trouble.

But the relatively good news comes with one major caveat: None of this applies if you happen to live in California. It is from California's mistakes that other state and municipal leaders should learn.

The study, "Are City Fiscal Woes Widespread? Are Pensions the Cause?", looked at 32 American cities identified in press reports as being in financial trouble. The authors applied various measures of financial mismanagement, overall economic condition and pension burden to each city and found that financial mismanagement has the biggest impact and pension burden the least.

But California is the outlier. It is home to 10 of the 32 cities identified as being in financial trouble. For them, pensions are indeed a major problem.

The authors identify three causes of California's woes. First is the explosion of government-b--initiative that occurred in the wake of Proposition 13 in 1978, which limited skyrocketing property tax hikes. To prevent state leaders from making up for the loss of property tax revenue by raising other taxes, the measure required a two-thirds legislative majority for any tax increase.

A spate of subsequent initiatives have called for either tax cuts or new programs but, due to the required supermajority for new taxes, simply punted on finding the money to fund the initiatives. As a result, the state has lost control of its finances, and local governments have borne much of the impact.

The problems were magnified when California was hit harder than most other states by the 2008 financial crisis and subsequent recession. Even now, the state's rate of municipal revenue growth is far lower there than in most other states.

On the pension front, California retroactively expanded benefits in the 1990s, which has made its pension costs among the nation's highest. State law also protects the pension benefits of current public employees, which takes away some of the flexibility needed to address the problem.

California succumbed to two classic temptations. First, it became convinced that the good times would last forever and conferred benefits that could not be sustained during lean years. Second, it sacrificed the future for short-term political gain by enacting popular new programs or tax cuts without paying for them.

If the authors of the Boston College study are right, many municipal leaders can exhale. But their constituents can't afford for them to fall into the same traps that still have Californians reeling.

Read the study at:

http://crr.bc.edu/wp-content/uploads/2013/12/slp_36.pdf

BY CHARLES CHIEPPO | JANUARY 8, 2014

Cities That Raise the Minimum Wage May Have to Pay Their Workers More.

As a candidate for Seattle mayor last fall, Ed Murray campaigned on a pledge to lift his city's minimum wage to $15 an hour, which could make Seattle the first major U.S. city to have a wage floor that high. But Murray quickly encountered a problem that may serve as a lesson to other government leaders who chastise the private sector for paying low wages: Seattle city government would see an increase of $690,000 in labor costs if it met the standard Murray proposed, according to reporting by Crosscut.com, a nonprofit news site. That's because 663 city government employees — about 6 percent of city staff — currently make less than the living wage Murray says he wants for all workers in Seattle.

So far, the budget impact hasn't scared off Murray. For his first executive order, signed last Friday, he directed the city budget office and personnel department to draft a plan for implementing a minimum wage of $15 an hour for all full-time city employees. Ultimately, any proposal would require legislation from the city council. The estimated cost of raising wages would be less than a quarter of 1 percent of all spending in the city's 2013 budget. Still, the fact that Seattle, a bastion of liberal policy making, doesn't already pay its own employees $15 an hour, hints at the uphill battle labor unions and advocates for the working poor may face as they try to convince the private sector to increase pay amid a slow economic recovery.

Murray's interest in ratcheting up the wage floor comes at a time when President Barack Obama and Democrats in the U.S. Senate are calling for an increase to the federal minimum wage. Fast food workers have scheduled at least two national strikes in past year demanding higher pay. Last year several states decided to elevate their minimum wage above the federal standard of $7.25 an hour, either by popular vote or through legislation. The topic is likely to become a focus for some Democratic governors, such as Maryland Gov. Martin O'Malley, and other left-leaning local elected leaders in 2014.

A poll by the Pew Research Center and USA TODAY last year found that 71 percent of Americans favored a higher minimum wage (from $7.25 to $9) but support varied by political persuasion. About 87 percent of Democrats favored the proposal, but only 50 percent of Republicans. Independents fell between the two groups, with about two-thirds supporting an increase. Even when Republicans support a wage hike, as New Jersey Gov. Chris Christie did last year, it's typically with caveats, such as a multi-year phased-in approach that dilutes the impact relative to annual cost-of-living increases.

When the New Jersey State Legislature evaluated a bill to increase the state's minimum wage from $7.25 to $8.25 an hour — a more modest proposal than what's being discussed in Seattle — legislative fiscal analysts concluded that some city and county governments would see their labor costs go up. Essex County, for example, paid 211 seasonal employees in the parks department a wage of $8 per hour in 2012. Assuming the county continued to pay these workers minimum wage and kept the same number of staff, it would pay $25,800 more in labor costs. The analysis also noted that some private contractors that provide services on behalf of state, county and city government may pay their employees minimum wage and would see an increase in labor costs.

By contrast, in the District of Columbia, raising the minimum wage by $3.25 over three years would hardly make a dent in the district's labor costs. That's because no hourly government employee who works for the district today makes less than $11.75 an hour. The chief financial officer did note, however, that the district would have to hire two auditors and an administrative assistant to implement and enforce the policy change, amounting to about $225,000 per year in new labor costs for those three positions.

The Seattle proposal is on the high end of state and local minimum wages across the country. In December the city council in the District of Columbia passed legislation that would set the minimum wage at $11.50 by 2016, with future increases tied to the local Consumer Price Index (CPI), a proxy

for the rising cost of living. San Francisco's wage floor is $10.74, with automatic increases each year. Washington state has the highest state-level minimum wage at $9.32 per hour, which also goes up automatically each year.

Voters in SeaTac, a small city with a population of 27,000 residents that is best known for its international airport, passed a ballot measure in November that sets the local minimum wage at $15 an hour; however a King County Superior Court judge ruled that the law doesn't apply to workers at the airport, so the law only affects about 1,600 people who work at hotels and car services outside the airport.

Like private employers, governments can absorb the higher labor costs by reducing other costs, including the number of staff, and by charging more for services; in Seattle, for example, the city could glean extra revenue from parking fees and facility rentals at the former Seattle Sonics basketball stadium, Key Arena.

The Seattle budget office estimates assumed that the city would increase its minimum wage immediately, rather than phasing in higher wages over several years — as the District of Columbia and its neighboring Maryland counties decided to do in December. Murray has carefully worded his support of raising the minimum wage as "moving towards a $15 living wage" and has left open the possibility that Seattle would also increase the wage floor in increments.

BY J.B. WOGAN | JANUARY 7, 2014

NYT: 'Safe Harbor' in Bankruptcy Is Upended in Detroit Case.

As Detroit struggles to come up with money to improve services for its residents, two large banks are poised to receive hundreds of millions of dollars to cancel a deal that helped push the city into bankruptcy in the first place.

The two banks, UBS and Bank of America, were the only creditors that managed to reach a settlement with Detroit before the city declared bankruptcy last July. They agreed to let Detroit out of financial contracts called interest-rate swaps for 75 percent of what the city owed, or about $230 million. They also agreed to give up some casino tax proceeds that Detroit had pledged to them as collateral for the swaps.

The 75 cents on the dollar is a far better deal than the city's other creditors will probably get. And because of an unusual provision in the federal bankruptcy code, these two banks actually have a legal right to 100 cents on the dollar. The provision gives traders in swaps, options and other derivatives a so-called safe harbor, exempting them from the usual stay that blocks creditors' efforts to collect debts.

The provision has turned on its head the meaning of safe harbor in bankruptcy. Bankruptcy proceedings are supposed to give debtors like Detroit a safe place to negotiate a way out their problems under the protective eye of a federal judge.

Bankruptcy law rests on the bedrock principle that the best outcome can be achieved if everybody shares equitably in the pain and losses. But in the brave new world of municipal bankruptcy, the law gives derivatives traders an even safer harbor than Detroit's.

"These safe harbors make no logical sense in this context," said Steven L. Schwarcz, a professor at

Duke University School of Law who has written on the special treatment of derivatives in corporate bankruptcies. Detroit was in bankruptcy court last week seeking approval for its deal with Bank of America and UBS.

But on Friday, the bankruptcy judge, Steven W. Rhodes, sent the city and the banks back to confidential mediation to improve the terms for the city. The mediation was expected to continue through Christmas Eve.

But in the tangle that is Detroit's finances, the swaps deal is only one part of the equation. The city is seeking to borrow $350 million from another bank, Barclays Capital, to finance its operations in bankruptcy, and it needs to resolve the swaps deal before it can get the loan. Without the loan, lawyers for the city say, it soon might not be able to meet its payroll.

But any time a debtor tries to borrow in bankruptcy, it stirs opposition, since the new loan will worsen the insolvency. The Barclays deal also gives it priority over all the existing creditors. And the bulk of the $350 million loan will go to pay UBS and Bank of America to terminate the swap contracts. Since those two banks would no longer need Detroit's casino revenue as a backstop, the city could then use that money as collateral for the new Barclays loan.

The rest of the proceeds from the loan, $120 million, would go to the streetlights, the police, the razing of dilapidated properties and other city services that the residents of Detroit sorely need.

Last week's hearing over these arrangements broke down when Judge Rhodes asked the city's emergency manager, Kevyn Orr, to explain why 75 cents on the dollar was a good deal. Mr. Orr declined to answer the question and asked instead for the hearing to be suspended.

If the current mediation talks fail, the two banks would once again have the safe harbor advantage under law, leaving Detroit to fight back in court by arguing that the swaps were flawed in some way and unenforceable. James E. Spiotto, a bankruptcy lawyer with the law firm Chapman and Cutler in Chicago, who is not involved in Detroit's case, said that prospect might explain why Mr. Orr was unwilling to sing the praises of Detroit's swap settlement in court. If he had, it would be hard for Detroit to come back with a lawsuit contending the swaps were no good.

Bank of America and UBS declined to comment.

Congress created the safe harbor for derivatives because they could pose systemic risk — if one bankrupt institution failed to make payment, it could swiftly bankrupt its trading partners, and they, in turn, might bankrupt their other trading partners, setting off a toxic cascade.

But some bankruptcy experts question the fairness or even the effectiveness of this exception.

Professor Schwarcz said it was not clear that the safe harbors were serving their intended purpose even in cases where the debtors are companies — let alone in a municipal bankruptcy like Detroit's, where thousands of residents are being dragged along on the miserable journey.

"When you're in a municipal bankruptcy, where the debtor is a municipality, there are very strong public-interest considerations that ought to be balanced," Mr. Schwarcz said. He and other specialists said there had not been any such discussion in Detroit's case. Nor, they said, has anyone in Congress asked whether this part of the bankruptcy code was working properly.

"There is very, very strong interest-group support for keeping the safe harbors, but there's not a well-developed interest group that understands the need to change them," said David A. Skeel Jr., a corporate law professor at the University of Pennsylvania. "In my view, there ought to be strong

pressure to change the safe harbors."

Congress began exempting derivatives from the automatic stays on collecting debts in bankruptcy in 1978. The initial exemptions — options and futures, among them — were narrow, Mr. Schwarcz wrote in a legislative history of the safe harbor. But every few years after that, Congress broadened them and added new types of derivatives, including swaps in 1990.

Mr. Schwarcz found in his research that the expansion of the safe harbor helped the derivatives industry to grow. The growth then led to bigger risks of a meltdown, prompting calls from the derivatives industry for Congress to expand the safe harbor even further.

In all that growth and expansion, he said in an interview, no one stopped to make sure the safe harbor was truly reducing systemic risk or covering the right types of institutions. The surfacing of safe harbor in a bankruptcy like Detroit's seemed especially jarring.

Detroit entered into the swap contracts back in 2005, when it tapped the municipal bond market for $1.4 billion to put into its workers' pension funds. Much of the deal was structured with variable-rate debt, and the swaps were intended to work as a hedge, to protect Detroit if interest rates rose. But as things turned out, rates went down, and under those circumstances, the terms of the swaps called for Detroit to make regular payments to UBS and Merrill Lynch Capital Services, now part of Bank of America. Detroit has been doing so, even in bankruptcy. The swaps now cost it about $36 million a year.

In retrospect, it seems clear that Detroit was already struggling in 2005 and a poor candidate to borrow the $1.4 billion. The borrowing required an unusual structure to avoid violating the city's legal debt limit. In 2009, the debt was downgraded to junk, putting the city out of compliance with the terms of the swaps. So Detroit restructured the swap obligations, offering the two banks the tax revenue that it received from local casinos as a backstop.

The city's finances went from bad to worse after that. Now that Detroit is bankrupt, it needs those casino revenue, and some of its biggest battles are being fought over how it dealt with that swap restructuring back in 2009.

"You look at this transaction, and you say it smells," said Mr. Skeel, who is currently a visiting professor at New York University's law school. "It looks exactly like the sort of thing that you would want a bankruptcy judge to be in a position to sort out, and reverse if that is necessary. That's something that the safe harbors make a lot harder."

BY MARY WILLIAMS WALSH

NYT: Accounting Roundup: Year in Review—2013.

In 2013, the FASB continued to work with the IASB on the boards' various convergence projects. In addition to continuing their discussion of the feedback on the proposed leases standard, the boards have essentially completed their redeliberations of their joint revised revenue recognition ED and are planning to issue a final standard on this topic in the first quarter of 2014.

In other news, the SEC has continued to focus on its rulemaking in response to mandates of the Dodd-Frank and JOBS acts by, for example, issuing final rules on registration of municipal advisers and general solicitation related to securities offerings. The Commission has also issued FAQs on its

controversial final rule on conflict minerals, which was recently upheld by a federal court.

These and other developments are discussed in Deloitte's 2013 edition of Accounting Roundup: Year in Review. The publication summarizes final guidance that affects reporting and disclosures for the coming reporting season, and covers new standards and exposure drafts in accounting, auditing developments, governmental accounting and auditing developments, and regulatory and compliance developments. It also contains an appendix listing significant adoption dates and deadlines.

With the exception of guidance issued in December, proposed guidance, such as exposure drafts and invitations to comment, is not included. Please see our 2013 monthly and quarterly issues of Accounting Roundup for more information about these documents. In addition, note that in this year-end edition, an asterisk in the article title denotes events that occurred in December or that were not addressed in previous 2013 issues of Accounting Roundup, including updates to previously reported topics. Events without asterisks were covered in those previous issues.

So what will be the focus for 2014? In addition to issuing their joint revenue standard, the FASB and IASB expect to issue final guidance related to the classification and measurement and impairment phases of their project on financial instruments. Further, the FASB, in coordination with the PCC, is expected to issue final ASUs on its private-company alternatives related to goodwill and hedge accounting in early 2014.

View the report at:

http://deloitte.wsj.com/riskandcompliance/files/2014/01/Accounting_Roundup_2013_Review.pdf

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Detroit Emergency Manager Calls Swaps "Ticking Time Bomb."

Bankers who sold Detroit interest rate swaps placed "a ticking time bomb" in their structure, the city's emergency manager said in court as a trial resumed over a proposal for ending the swaps.

Although the city collected $40 million over eight months from the swaps deal, falling interest rates helped the banks behind the deals turn a profit, Orr testified today before U.S. Bankruptcy Judge Steven Rhodes in Detroit. Since 2009, the city has paid more than $200 million to the banks behind the swaps, according to public records.

The city has proposed paying UBS AG (UBSN) and Bank of America Corp. a $165 million termination fee to get out of the swaps contract.

Days before Detroit filed the biggest ever U.S. municipal bankruptcy in July, Orr negotiated an agreement to end the swaps at a discount. After that deal was attacked by creditors and questioned by Rhodes, the city on Dec. 24 announced a renegotiated termination payment about $65 million less than the original.

The swaps are tied to pension obligation bonds issued in 2005 and 2006. They were designed to protect against rising interest rates by requiring the banks to pay the city if rates rose above a certain level. When rates instead went down, the city was required to make monthly payments.

SEC Consulted

Orr testified that after he became emergency manager last year he had "plenty" of concern over

whether the swaps were fraudulently put together. He said he asked the U.S. Securities and Exchange Commission if it would be willing to investigate the deal.

Megan Stinson, a spokeswoman for Zurich-based UBS, said the bank couldn't immediately respond to Orr's comments.

Eventually, Orr testified, he decided to settle with the banks instead of suing them in order to avoid a risky trial and prevent any threat to casino taxes used to guarantee payment of the swaps.

Creditors led by bond insurer Syncora Guarantee Inc. oppose the settlement, saying it's too costly. The city didn't prove it would lose if it sued to cancel the contracts instead of settling with the banks, Syncora said.

Syncora said in court papers that the deal could cost it money as the insurer of some of the bonds and swaps. Under the settlement, Syncora would be released from any obligations related to the swaps, according to the city.

Bond insurer Ambac Assurance Corp. claimed Detroit could win any lawsuit against UBS and Charlotte, North Carolina-based Bank of America over the swaps.

A mediator who helped craft the latest deal recommended the $165 million settlement, saying it was in the best interest of all parties involved.

The case is In re City of Detroit, 13-bk-53846, U.S. Bankruptcy Court, Eastern District of Michigan (Detroit).

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To contact the editor responsible for this story: Andrew Dunn at adunn8@bloomberg.net

Bloomberg

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4 Public Finance Predictions for 2014.

Public finance in 2014 looks to be more stable than in previous years. But stable doesn't mean easy. Here are some predictions for the coming months.

Less action in the municipal market

The recent trend of money flowing out of the municipal market will continue into 2014. Several analysts are predicting a 12 percent decline in overall municipal bond sales (called new issue volume) next year to $285 billion total. This is mostly due to rising interest rates (thanks in part to the Fed slowing its bond buying program) curbing refinancing (or refunding) activity.

So what does this mean for governments that issue bonds? It'll be more expensive to borrow money but it's not all bad. Rising interest rates are not expected to dampen the trickle of new bond sales. RBC Capital Markets' Chris Mauro predicts that "pent-up demand, in conjunction with improved state and local government fiscal profiles" will actually push an increase in new bond sales for governments. He estimates that new issuances like these will total $185 billion in 2014 from approximately $160 billion in 2013. That's a far cry from the $252 billion-per-year average between

2000 and 2010, but it's at least moving in a positive direction.

Still more ratings confusion

The credit ratings agencies will continue to disagree on the financial stability of municipalities. Fitch Ratings Agency this month announced it expects to continue its trend of downgrading more local governments than it will upgrade. Fitch, which gives a negative outlook for local governments, cites slow revenue growth and increased spending pressures on localities.

Meanwhile, Moody's Investors Service revised its outlook this month for the U.S. local governments from negative to stable. The outlook cites stabilizing housing markets and municipalities' fund balances, and notes that cities and school districts have adjusted their expenses. Still, Moody's notes that conditions will remain more difficult for local governments than they were before the 2008 recession and pockets of serious credit pressure remain. "The 'new stable' will be an era of constrained resources, but the worst is over for local governments in most of the country," wrote Naomi Richman, a Moody's managing director, in the report 2014 Outlook — US Local Governments.

Budget stability

Capitol Hill watchers are quick to point out it's not time to sing Kumbaya and break out the marshmallows for roasting around the campfire just yet. But the proposed bi-partisan budget deal, which has cleared Congress and observers expect the president to sign, at least gives a two-year window of stability to what has been an incredibly hard four years since the economy bottomed out in 2009. The deal would increase the cap on defense and non-defense discretionary spending for the remainder of the 2014 fiscal year, which began on Oct. 1. This means that state and local programs that rely on federal grants and other funding should have a clearer picture of their operating budgets through the next two years.

That kind of relative certainty is a reprive from several years of lurching from one continuing resolution to the next and political brinksmanship forcing stalemates, which culminated in a 16-day government shutdown in October. As Chris Coleman, the National League of Cities president told Governing earlier this month, "We just can't go through what we went through this past year, the uncertainty for our communities but also the uncertainty for the market and for businesses. It's a disaster."

Of course one tiny little snag — the nation's debt ceiling — could result in another showdown when Treasury reaches its borrowing limit some time in February. Still, the consensus is that congressional lawmakers are inclined to avoid such drama after the negative fallout from October's shutdown.

Seeking advice on advising

The Securities and Exchange Commission finally issued its highly-anticipated rules on who constitutes a municipal adviser this fall and the nearly 800-page document has raised some questions. By the end of the year the commission will publish a Q&A on its definition of municipal advisers (financial advisers to state and local governments) as an effort to help folks understand how the rules should be applied come Jan. 13. But the transition will be bumpy and will likely require even more clarification as the rule is put into practice.

One big issue so far is that while the SEC's rules say who constitutes an adviser, the definition does not address what constitutes advice. Numerous groups representing issuers, bankers and lawyers have already requested clarification from the SEC on how to engage with issuers without it being

considered advice (for example, providing issuers statistics compiled by the firm) as well as other aspects of the definition.

BY LIZ FARMER | JANUARY 2, 2014

Bankrupt Cities, Municipalities List and Map: Governing.com.

Many local governments across the U.S. face steep budget deficits as they struggle to pay off debts accumulated over a number of years. As a last resort, some filed for bankruptcy.

Governing is tracking the issue, and will update this page as more municipalities seek bankruptcy protection.

Most recently, a federal judge ruled Detroit was eligible to enter bankruptcy, the largest city to ever do so. The state previously appointed an emergency financial manager for the city, saddled with debts totaling an estimated $18 billion.

Overall bankrupt municipalities remain extremely rare. A Governing analysis estimated only one of every 1,668 eligible general-purpose local governments (0.06 percent) filed for bankruptcy protection over the past five years. Excluding filings later dismissed, only one of every 2,710 eligible localities filed since 2008.

The majority of filings have not been submitted by bankrupt cities, but rather lesser-known utility authorities and other narrowly-defined special districts throughout the country. In Omaha, Neb., a dozen sanitary districts have filed for bankruptcy, accounting for nearly a third of all Chapter 9 filings since 2010.

It's also important to note that only about half of states outline laws authorizing municipal bankruptcy. View our bankruptcy laws map for each state's policies:

http://www.governing.com/gov-data/state-municipal-bankruptcy-laws-policies-map.html

List of Bankruptcy Filings Since January 2010

All Municipal Bankruptcy Filings: 38

General-Purpose Local Government Bankruptcy Filings (8):

— City of Detroit

— City of San Bernardino, Calif.

— Town of Mammoth Lakes, Calf. (Dismissed)

— City of Stockton, Calif.

— Jefferson County, Ala.

— City of Harrisburg, Pa. (Dismissed)

— City of Central Falls, R.I.

— Boise County, Idaho (Dismissed)

Municipal Bankruptcies Map

The map below shows all municipalities filing for Chapter 9 bankruptcy protection since 2010, along with local governments voting to approve a bankruptcy filing.

Cities, towns and counties are shown in red. Utility authorities and other municipalities are displayed in gray. Click a marker to view details of each filing. Multiple municipalities have filed for bankruptcy in some cities, such as Omaha, Neb., so not all markers are visible without zooming in on the map.

View the map at:

http://www.governing.com/gov-data/municipal-cities-counties-bankruptcies-and-defaults.html

Please note that several municipal bankruptcy filings have been rejected, as indicated.

Map data ©2014 Google, INEGI

U.S. State OPEB Liabilities Decline Slightly, But Continue To Vary Widely.

Read the report at:

http://img.en25.com/Web/StandardPoorsRatings/2013_1125%20State%20OPEBS%20Liabilities.pdf

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Standard & Poor's Does Not View Detroit's Chapter 9 Filing As The Start Of A New Trend.

Read the report at:

http://img.en25.com/Web/StandardPoorsRatings/Standard%20%26%20Poor%27s%20Does%20Not%20View%20Detroit%27s%20Chapter%209%20Filing%20As%20The%20Start%20Of%20A%20New%20Trend.pdf

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Snow: Every Budgeters' Worst Nightmare.

Winter weather is tightening its grip on cities. And when the temperature drops, expenses can quickly rise, as snow removal and other costs pile up along with the snow drifts.

Predicting just how much a local government will need to spend for the upcoming winter is only a best guess. Costs vary widely from year to year, depending not only on the severity of the weather, but where on the calendar storms fall and even the time of day a storm hits.

The city of Minneapolis attempts to project its snow and ice removal costs by looking at averages over the previous three to five years. For fiscal year 2013, the city budgeted about $10 million. In recent years, though, the total bill has ranged from slightly more than $7 million all the way up to $12 million. “We try and budget for an average year,” says Deputy Public Works Director Heidi Hamilton. “But there’s never an average year.”

Snow emergencies—usually when the city receives at least four inches—are particularly costly, Hamilton says. But when storms hit also matters, as overtime costs climb on the weekends. Even the mere threat of snow means crews must go out and treat roads.

This unpredictability can quickly drive up costs. Last winter, Worcester, Mass., got hit with about 80 inches of snow, one of the highest tallies in the country. The city spent about $5 million digging out. Matt Labovites, the city’s assistant commissioner of operations at the Department of Public Works and Parks, says he can’t remember the last time the city didn’t exceed its snow program budget. “It’s virtually impossible to closely budget for it,” he says. Fortunately for Worcester, snow removal costs are one of the few services for which Massachusetts allows its localities to deficit spend without incurring a penalty.

Even a single storm can wreck a budget. Back in 2011, for example, an early season storm blanketed Worcester with more than a foot of snow in the last week of October. City equipment and contractors weren’t yet ready, Labovites says. To make matters worse, residents had raked leaves in gutters for leaf collection right before it hit.

Cities, particularly those in snowbelts, opting to budget on the low end take a chance they’ll need to dig themselves out of deeper deficits if they’re hit hard. “If you’re a city that gets 30 inches of snowfall, maybe you do look at it a little bit differently” says Paul Holahan, who heads Rochester, N.Y.’s Department of Environmental Services. Rochester, which receives around 100 inches of snow each winter, budgets for an “above-average” winter. “There’s too big of a potential for a huge [snow] budget that you don’t want to try to absorb,” Holahan says.

BY MIKE MACIAG | JANUARY 2014

Regulators’ Proposal To Exclude Munis From HQLA Status To Dent Demand.

Bank regulators’ recent proposal to exclude municipal bonds from the standards for receiving HQLA status would impair Munis’ demand, notes Citi in its recent report.

George Friedlander and others at Citi Research believe a very strong case exists for including a very large proportion of investment grade municipals as HQLA. They believe municipal bonds should be given level 2A status in many cases and level 2B status in most other cases.

Several reasons for inclusion of Munis as HQLA

Recently, bank regulators proposed a set of standards that would, among other things, measure the extent to which bank holdings would meet certain standards as High Quality Liquid Assets.

According to Citi analysts, there are several compelling factors for inclusion of municipal bonds as HQLA.

For instance, the analysts point out that during 2008, when the capital markets received their most

severe tests in recent decades, both municipal general obligation bonds and revenue bonds held their value better than higher-grade and lower investment grade corporates. Furthermore, they did so roughly as well as GSE secured bonds such as those issued by Freddie Mac / Federal Home Loan Mortgage Corp (OTCBB:FMCC).

Commercial banks holdings in munis

As can be deduced from the above table, the net increase in holdings of municipal bonds by commercial banks is much greater than that of municipal bond funds. Citi analysts anticipate erosion in the value of outstanding municipal bonds without the support from commercial banks. Such a situation would also accentuate the borrowing costs of state and local governments.

Citi analysts also note the continuing superior credit strength and default history of municipal bonds in comparison with other similarly rated credits also strengthens their view for inclusion as HQLA.

The analysts also point out under Moody's credit standards, the average investment grade municipal bond (by count, not volume) is rated AA3, while the average corporate bond is rated Baa1.

Other factors justifying Munis' inclusion as HQLA

George Friedlander and team at Citi Research believe a number of sectors with greater gap-down risk than munis have been given potential HQLA standing, while municipals have not.

Furthermore, the analysts believe the following key factors also provide a strong case for inclusion of munis as HQLA and would reduce the liquidity risk profile of banks rather than increasing it. These factors are: the collapse of the municipal bond insurance sector, the severe erosion of the variable rate market as a source of capital, the collapse of the auction rate securities market, the rapid erosion and virtual disappearance of leveraged, hedged holders of municipal bonds between 2007 and 2008.

Citi analysts also believe the Agencies should adjust for the higher credit strength in the sector and for the capacity of the market to evaluate CUSIPs for a given issuer that do not trade, based upon spread to the MMD high-grade curve for those that do. The analysts opine that it would be consistent with international standards as well as public policy to include municipal securities as HQLA in the same manner that foreign state obligations are already included in the proposed rule.

WSJ: The Hidden Danger in Public Pension Funds.

Their investments expose government budgets and taxpayers to 10 times more risk than in 1975.

The threat that public-employee pensions pose to state and local government finances is well known—witness the federal ruling earlier this month that Detroit's pension obligations are not sacrosanct in a municipal bankruptcy. Less well known is that pensions are larger and their investments riskier than at any point since public employees began unionizing in earnest nearly half a century ago.

Public pensions have long been advertised as offering generous, guaranteed benefits for public employees while collecting low and stable contributions from taxpayers. But with Detroit's bankruptcy filing, citing $3.5 billion in unfunded pension liabilities, and with four of the five largest municipal bankruptcies in U.S. history occurring in the past two years, reality tells us otherwise.

How much riskier are public pensions now? According to my research, public pensions pose roughly 10 times more risk to taxpayers and government budgets than in 1975. And while elected officials—a few Democratic mayors included—are now pushing for reforms, even they may not realize the danger.

In 1975, state and local pension assets were equal to 49% of annual government expenditures, according to my analysis of Federal Reserve data. Pension assets have nearly tripled to 143% of government outlays today. That's not because plans are better funded—today's plans are no better funded than in 1980—but mostly because pension plans have grown as public workforces have aged.

The ratio of active public employees to retirees has fallen drastically, according to the State Budget Crisis Task Force. Today it is 1.75 to 1; in 1950, it was 7 to 1. This means that a loss in pension investments has three times the impact on state and local budgets than 40 years ago.

And pensions can expect to take losses more often because of increased investment risk. Public plans have historically assumed roughly an 8% rate of return. But thanks to falling yields on safe assets, pensions must invest in riskier assets to have any hope of getting 8% returns. A one-year Treasury bond in 1975 yielded a 5.9% return. In 1980, it offered 14.8%, and in 1985 an investor could expect 6.5%. Today, the Treasury yield hovers at 0.1%.

Meager yields leave America's enterprising public-pension plan managers with a choice: Accept a lower return—forcing higher taxpayer contributions—or take on more risk to keep 8% returns flowing. My estimate, based on Treasury yields and analysis from economists at the Office of the Comptroller of the Currency, is that a pension today must build a portfolio with a standard deviation—how much returns vary from year-to-year—of 14%. Such high volatility means that a fund would suffer losses roughly one out of every four years.

By contrast, in 1975 a plan could achieve 8% expected returns with a standard deviation of just 3.7%. Those portfolios would lose money once every 65 years. This level of risk varied little through the 1980s and 1990s: An 8% return portfolio in 1985 would require a standard deviation of 2.7%, and 4.3% in 1995. Risk began inching upward after 2000 and has increased rapidly since the recession as low-risk assets continue to fall.

These figures aren't theoretical. They represent public pensions' decades-long shift from safe bonds to risky stocks, along with the recent growth of "alternative investments" such as hedge funds and private equity. These alternatives are, according to Wilshire Consulting, 60% riskier than U.S. stocks and more than five times riskier than bonds.

Larger pensions and riskier investments combine to increase risk to state and local budgets. The standard deviation of public pension investments equaled 1.8% of state and local budgets in 1975. That figure crept upward to 2.2% in 1985, and reached 5.8% in 1995. Today it stands at 19.8%. Pension investment risk to budgets has risen roughly tenfold over the past four decades.

As pension plan managers in Detroit, California and elsewhere can attest, there aren't easy solutions. Mature pensions should move their investments away from risky assets, but many plan managers are doing the opposite in a double-or-nothing attempt to dig out of multitrillion-dollar funding shortfalls. In most instances, significant benefit cuts for current retirees who made the contributions asked of them is difficult to justify and legally problematic.

The only real option, then, is to make structural changes, including more modest benefits and increased risk-sharing between plan sponsors and public employees. But that will only happen if elected officials accept that they can't continue with business as usual without accumulating

tremendous risk.

By ANDREW G. BIGGS

Dec. 15, 2013 6:26 p.m. ET

Mr. Biggs is a resident scholar at the American Enterprise Institute.

Getting Creative on Public Workers' Health-Care Costs.

Miami-Dade County's mayor is pushing a compromise plan that may help get this budget-buster under control.

Miami-Dade County is the latest flashpoint in the battle to figure out how the burden of skyrocketing health-care costs should be allocated between governments and their employees. In the midst of often-intense debate, Mayor Carlos Gimenez is showing that responsible compromise is possible.

Since 2010, county employees (Miami-Dade has a consolidated city-county government) have been paying 5 percent of their base salary toward group health-care costs. The deduction was designed as a temporary measure to get the county through lean times and was intended to expire this coming Jan. 1. Earlier this month, county commissioners voted to let the contribution expire as planned for most workers.

But the rise in health-care costs is unrelenting. Allowing the contributions to sunset would open a $56 million hole in the county's $4.4 billion operating budget for this fiscal year and create an even bigger gap next year, which caused Mayor Gimenez to veto the commissioners' action.

Along with his veto, however, Gimenez sent commissioners a countermeasure that would give a one-time bonus to the lowest-paid county workers — about 7,800 of Miami-Dade's nearly 26,000 employees. Employees earning under $40,000 annually would get $1,500, while those earning between $40,000 and $50,000 would get $1,000. So an employee earning $30,000 would get his or her entire $1,500 health-care contribution back; a worker earning $20,000 would get his or her $1,000 back plus an extra $500.

The $10.2 million cost of the bonuses is a fraction of the $56 million cost of eliminating the health-care contributions, and going forward the county would not be faced with paying the full cost of ever-rising health-insurance premiums.

Although Gimenez' ability to sustain the veto appeared uncertain, on Tuesday one commissioner who originally voted to let the measure expire changed her vote and the veto was upheld. The fate of the mayor's bonus plan remains uncertain, with some commissioners saying they would prefer to permanently restore a portion of employees' pay. But the action avoids blowing up the county budget and setting a dangerous precedent by not requiring employee health-care contributions.

This case also highlights a basic problem with the way Miami-Dade approaches the allocation of employee health-care costs. In the long term, getting costs under control will require workers to be aware of the comparative expense of various insurance plans and have an incentive to select ones that don't offer more coverage than they require. Rather than charging all employees 5 percent, the county would be better served to provide workers with a variety of plans at different price points and have each employee pay a portion — perhaps one-quarter — of the plan he or she chooses.

As is almost always the case wherever this issue comes up, Miami-Dade's reaction to the employee health-care contribution issue was imperfect. But Mayor Gimenez deserves credit for coming up with a creative compromise. And if the county commissioners go along with something along the line of Gimenez' bonus proposal, there'll be plenty of credit to spread around.

BY CHARLES CHIEPPO | DECEMBER 19, 2013

Detroit Bankruptcy Ruling Could Impact San Bernardino Mediation.

LOS ANGELES — U.S. Bankruptcy Judge Steven Rhodes' ruling in the Detroit Chapter 9 bankruptcy that pensions are not in a special class above other creditors could bolster movement already made in that direction in the San Bernardino, Calif. bankruptcy.

The Detroit judge's decision is likely already impacting San Bernardino because the parties were in mediation talks led by U.S. Bankruptcy Judge Gregg Zive of Reno, Nev., hammering out the term sheet for the bankruptcy plan when "a sea change in opinion on whether pensions could be impacted" was handed down, said Karol Denniston, an authority on the California bankruptcies and partner in the San Francisco office of law firm Schiff Hardin.

As part of his favorable ruling on Detroit's eligibility to be in bankruptcy, Rhodes said that Chapter 9 allows the city to cut its pensions, despite state constitutional protections.

Rhodes found in his ruling that Michigan's constitutional protection of pensions does not apply in federal court. As contractual rights, he said pensions are subject to the bankruptcy court's authority to impair contracts.

He added that does not mean he will necessarily confirm a plan that impairs the benefits.

There have been signs that U.S. Bankruptcy Judge Meredith Jury might be willing to impair pensions in the San Bernardino bankruptcy, Denniston said. Jury, who is handling the San Bernardino bankruptcy, asked Zive to oversee mediation on the term sheet. He placed a gag order on the mediation, rendering all discussions confidential.

"If you look at the last paragraph of Jury's ruling when she found San Bernardino eligible to be in bankruptcy," Denniston said. "It looks like she is likely to impact pension contracts because the city has no money."

Judge Jury has asked the California Public Employees' Retirement System why it is fighting so hard when there is no money, Denniston said.

For its part, CalPERS blasted out a press release shortly after the Detroit ruling was announced calling it "short-sighted" and attempting to highlight differences between Michigan and California law.

"Unlike Detroit, CalPERS is not a city pension plan," according to a statement reacting to the decision from the giant pension fund. "CalPERS is an arm of the state and was formed to carry out the state's policy regarding public employees."

The bankruptcy code is clear that a federal bankruptcy court may not interfere in the relationship between a state and its municipalities, CalPERS said.

“The Detroit court failed to recognize the difference between a two-party contract and the unique nature of a state public employee retirement system, which creates a three-way relationship among a public agency, its employees and the retirement system,” CalPERS said. “In California, our members’ vested rights to their pensions are protected by the California constitution, states and case law.”

In federal bankruptcy court, Denniston said, Rhodes’ opinion carries a lot of weight, in part because it is the only ruling made on the issue so far. Michigan law is actually stronger on the issue than California, she said, because the protection was added to Michigan’s constitution after being approved by voters in 1963.

“That is much stronger than in California where it was read into case law,” Denniston said. “We don’t have a provision that is as strongly worded as Michigan.”

Rhodes opinion, as a bankruptcy judge, could trump previous case law on the issue, she said.

CalPERS’ arguments that it is a pension fund, not a pension plan like those in Detroit, also might not be enough.

Although CalPERS functions as a pension plan for its members, the contract between CalPERS and the city is for the pension fund to administer the contract agreed upon with city employees.

“If there is a shortfall, CalPERS doesn’t pay, the city pays,” Denniston said. “So the cities, which are under their own contract with employees, should be able to renegotiate with city employees consistent with the ruling in Detroit.”

Matt Fabian, a managing director with Municipal Market Advisors, said the ruling is specific to Michigan law, its history and related legal precedents; and that a ruling from a judge in California would be needed to set official precedent that applies in the Golden State.

“This likely limits its transferability to other states or pension systems without court interpretation,” Fabian said.

The near term effect in San Bernardino is most likely to be political or rhetorical, Fabian said.

“It helps provide political cover to issuers like San Bernardino who are interested in putting losses on pensioners,” Fabian said. “But it doesn’t set legal precedent. They would need their judge to rule that precedent in Detroit applies here.”

Although Fabian doesn’t believe the ruling carries formal weight in other states, he did say that the ruling is positive for bondholders.

The ruling means that pensions are not established as superior to other obligations, he said. If pensions can be impacted in a municipal bankruptcy, it could lessen the impact for bondholders, he said. He added it could result in meaningful out of court negotiations between municipalities and unions, which would be beneficial to bondholders.

BY KEELEY WEBSTER

DEC 10, 2013 3:38pm ET

GFOA Updates Municipal Advisor Rule Issue Brief.

The GFOA updated and reposted the issue brief it developed on the SEC's final definition of the term "municipal advisor." The rule will become active January 14, 2014. The update contains all of the information provided in the original issue brief, along with some new information.

The SEC is expected to release a FAQ document within the next few weeks to help the market better understand certain aspects of the rule. The GFOA has asked for clarifications related to: the status of underwriter pools; when a municipal advisor can be considered to be engaged with the issuer on a transaction, and how that should be completed in writing; a clear definition of "RFP"; and at what time in a transaction can the underwriter be considered to be engaged with the issuer for the transaction. When information on the SEC's FAQ release is available, it will be included in the GFOA's weekly newsletter.

The updated issue brief is available here:

http://gfoa.org/downloads/MARuleBrief.pdf

GASB'S New Standards on Financial Reporting for Pension Plans.

GASB Statement No. 67, Financial Reporting for Pension Plans, revises existing guidance for the financial reports of most pension plans for state and local governments. This Statement replaces the requirements of Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans and Statement 50 as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria.

The Statement builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement

of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position.

Read more:
http://www.gasb.org/cs/ContentServer?c=Page&pagename=GASB%2FPage%2FGASBSectionPage&cid=1176163527830

Download GASB Standards & Guidance.

Download the original text of all GASB Statements, Concepts Statements, and other pronouncements for free.

Each of the final Statements of Governmental Accounting Standards issued by the GASB since its establishment in 1984 is designed to provide taxpayers, legislators, municipal bond analysts, and others with information that is useful to their decision-making process regarding governmental entities.

http://www.gasb.org/jsp/GASB/Page/GASBLandingPage&cid=1176160042327

OMB Revises Form SF-SAC.

OMB Revises Form SF-SAC Used to Report Audit Results, Audit Findings and Questioned Costs as Required by the Single Audit Act.

View the Notice:

http://www.nasact.org/washington/downloads/announcements/11_13-SFSAC.pdf

View the Form:

http://www.nasact.org/washington/downloads/announcements/11_13-SFSAC_%20Form.pdf

View the Instructions:

http://www.nasact.org/washington/downloads/announcements/11_13-SFSAC_Instructions.pdf

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GASB'S New Standards on Accounting and Financial Reporting for Pensions.

Statement No. 68, Accounting and Financial Reporting for Pensions, revises and establishes new financial reporting requirements for most state and local governments that provide their employees with pension benefits.

Statement 68 replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers and Statement No. 50, Pension Disclosures, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria.

Statement 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits.

Read more:

http://www.gasb.org/cs/ContentServer?c=Page&pagename=GASB%2FPage%2FGASBSectionPage&cid=1176163527868

WSJ: Illinois Draws Demand for First Debt Issue After Pension Vote.

Results of Thursday's Bond Sale Mark Latest Sign Investors Encouraged by State's Pension Reforms

Illinois sold $350 million of taxable bonds on Thursday at lower yield premiums than a similar sale in April, marking the latest sign that investors are encouraged by the state's pension reforms.

The state sold the bonds for infrastructure and school construction to Bank of America Corp. BAC -0.46% at an average yield of 5.4%, or about 2.5 percentage points above benchmark Treasurys, according to a state spokesman. That compares with an average yield of 4.97%, or more than 3 percentage points above Treasurys, at the April sale, he said.

The sale was Illinois' first test of the municipal bond market since lawmakers last month reached agreement to close a pension gap of nearly $100 billion. The unfunded liabilities have led to credit rating downgrades and reduced demand from investors, resulting in the highest tax-exempt borrowing costs among the U.S. states.

The agreement, signed by Illinois Gov. Pat Quinn last week, faces challenges by unions, however. The law would reduce future costs by shrinking cost-of-living increases for retirees, raising retirement ages for younger employees and capping the size of pensions.

"The state clearly paid less of a penalty," than in the past, said Kathy Bramlage, director at Treasury Partners, a unit of financial-advisory firm HighTower Advisors. "The issue is whether this [trend] will hold" because it's likely the reform measures will be fought in court, she said.

Standard & Poor's this week revised its outlook on Illinois to "developing" from "negative," reflecting consensus reached by state lawmakers on pension reform. S&P said it could upgrade Illinois' A-minus rating if the state moves forward with pension reform and takes measures toward a balanced budget.

Bank of America priced the longest-term part of the taxable deal at a yield of 1.75 percentage points over Treasurys, less pre-sale indications of levels above 2 percentage points. Before the pension agreement, yields on Illinois' long-term taxable debt traded around 2.1 percentage points, Ms. Bramlage said.

Yield premiums on Illinois' tax-exempt debt have also dropped despite record redemptions in tax-exempt muni bond funds. The spread on 10-year Illinois tax-exempt debt yields over the AAA benchmark rate has declined to 1.58 percentage points from 1.73 points in late November, according to Thomson Reuters Municipal Market Data.

By AL YOON

Dec. 12, 2013 6:26 p.m. ET

Fitch 2014 Outlook: Water and Sewer Sector.

View the report at:

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=724357

Detroit Puts $1.1 Trillion of G.O.'s Under Scrutiny: Blooberg Muni Credit.

Detroit's bankruptcy has some investors fretting that the case will set a precedent for $1.1 trillion of U.S. general obligations. That hasn't kept the debt from beating revenue bonds for the first time since 2010.

A federal judge last week approved the city's record $18 billion Chapter 9 filing and said its pensions can be cut in bankruptcy. Detroit's emergency manager has sought concessions from creditors, including retirees and holders of $369 million of general obligations that the city had promised to repay using its unlimited taxing power.

The potential for losses on Detroit G.O.s means investors may now demand extra yield on obligations of localities struggling to balance budgets, said portfolio managers at T. Rowe Price Group Inc. and UBS Global Asset Management. Even with the prospect of added scrutiny, general obligations are outperforming revenue-backed munis in 2013, Bank of America Merrill Lynch data show. The bonds, the safest part of the municipal universe, are benefiting as investors favor their shorter maturities amid mounting bets that a growing economy will drive interest rates higher.

"The market will have to adjust how they price the risk, including how they judge general obligations versus revenue bonds," said Hugh McGuirk, Baltimore-based head of T. Rowe Price's muni group, which manages $20 billion. At the same time, "G.O. debt is typically shorter" in maturity, shielding it this year, he said.

Tax Backing

The borrowings account for about 30 percent of the $3.7 trillion municipal market, McGuirk said. Cities and states use the debt to finance projects such as bridges and schools, and repay investors with property-tax receipts or other local levies.

Detroit, which lost a quarter of its population in the decade through 2010, is an example of a shrinking tax base that can't support certain levels of debt, said Ebby Gerry, who helps manage $15 billion of munis at UBS Global Asset Management in New York.

General obligations "will need to be looked at with greater scrutiny," Gerry said. "The impression was that they'd just keep raising taxes and I'll always get my money on coupon payments and maturities. That's not necessarily the case if you have a horrible tax base."

Orr's Plan

In bankruptcy, general-obligation bonds are considered unsecured when they are backed only by a government's promise to repay, rather than any identifiable collateral or a revenue stream like water or sewer fees.

Before the city filed for bankruptcy in July, Kevyn Orr, its emergency manager, tried to get holders of unlimited general obligations to take less than 20 cents on the dollar. The proposal treated the securities on par with Detroit's other liabilities, including those to retirees.

Detroit may take "an aggressive posture" toward creditors, Jeffery Yorg, a Moody's Investors Service analyst, said in a Dec. 3 report.

General obligations of stressed municipalities may merit more scrutiny, Robert Kurtter, a managing director at Moody's, said Dec. 5 at a National Association of State Treasurers conference in New York.

A general-obligation pledge "simply may not mean anything," Kurtter said. "It will affect our view of credits that are under stress with high debt and pension burdens, particularly those that are in the speculative-grade space."

Better Year

Even as bondholders may be forced to take losses on Detroit general obligations, such debt has had a better year than revenue bonds.

The extra yield buyers demand to own revenue bonds instead of general obligations averaged about 0.97 percentage point for the past three months, the most since March 2012, Bank of America data show.

The bank's index of general obligations has lost 2.2 percent this year, beating the 3.3 percent drop for revenue bonds. It would be the first time for general obligations to fare better than revenue bonds since 2010.

Investor bets on Federal Reserve policy provide the backdrop for the reversal. As speculation has grown this year that an expanding economy will lead the central bank to curb its bond-buying program, shorter-maturity bonds have held their value the best, as have higher-rated securities.

The Bank of America general-obligation index has an average maturity of 12 years and a credit grade two steps below benchmark debt. For revenue debt, the average maturity is five years longer, and the rating one level weaker.

Revenue Effect

"As long-term returns have been hurt, then that would have a bigger effect on revenue bonds," McGuirk said.

General obligations have another appeal to investors: They are less prone to default than revenue debt, signaling that any Detroit precedent may have limited influence.

Of 443 issuers in default on payments as of Dec. 3, two — Detroit and Brighton, Alabama — are general obligations, Matt Fabian, a managing director at Concord, Massachusetts-based Municipal Market Advisors, said in an e-mail. The rest are backed by revenue such as from real estate developments and senior-living facilities.

California Treasurer Bill Lockyer said "big states and issuers" won't see any backlash from Detroit.

"Some investors will be nervous," Lockyer said after a panel at the treasurers' conference. "So OK, they don't buy Detroit. They don't buy some tiny hospital district issue that comes out every 12 years."

Market Week

In the municipal market this week, issuers plan to sell $11 billion of long-term debt with yields at a three-month high.

Top-rated 10-year munis yield 2.99 percent, compared with 2.86 percent on similar-maturity Treasuries.

The ratio of the interest rates, a measure of relative value, is about 105 percent, compared with a five-year average of 102 percent. The higher the figure, the cheaper munis are compared with federal securities.

Following is a pending sale:

New York state's Utility Debt Securitization Authority plans to sell $2.1 billion of revenue bonds this

week, data compiled by Bloomberg show. Proceeds will refund a portion of the Long Island Power Authority's $7 billion of debt.

By Michelle Kaske and Romy Varghese Dec 8, 2013

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NYT: Detroit Ruling on Bankruptcy Lifts Pension Protections.

DETROIT — In a ruling that could reverberate far beyond Detroit, a federal judge held on Tuesday that this battered city could formally enter bankruptcy and asserted that Detroit's obligation to pay pensions in full was not untouchable.

The judge, Steven W. Rhodes, dealt a major blow to the widely held belief that state laws preserve public pensions, and his ruling is likely to resonate in Chicago, Los Angeles, Philadelphia and many other American cities where the rising cost of pensions has been crowding out spending for public schools, police departments and other services.

The judge made it clear that public employee pensions were not protected in a federal Chapter 9 bankruptcy, even though the Michigan Constitution expressly protects them. "Pension benefits are a contractual right and are not entitled to any heightened protection in a municipal bankruptcy," he said.

James E. Spiotto, a lawyer with the firm Chapman & Cutler in Chicago who specializes in municipal bankruptcy and was not involved in the case, said: "No bankruptcy court had ruled that before. It will be instructive."

For people in Detroit, the birthplace of the Motown sound and of the American auto industry, Judge Rhodes's decision that the city qualified for bankruptcy amounted to one more miserable, if expected, assessment of its woeful circumstances. The city has lost hundreds of thousands of residents, the judge said, only a third of its ambulances function, and its Police Department closes less than 9 percent of cases.

"This once proud and prosperous city can't pay its debts," said the judge, who sits in United States Bankruptcy Court for the Eastern District of Michigan. "It's insolvent. It's eligible for bankruptcy. But it also has an opportunity for a fresh start."

Appeals were expected to be filed quickly. At least one union filed a notice of appeal on Tuesday, and other unions and pension fund representatives said they were considering contesting the outcome as well. But the ruling also allows Kevyn D. Orr, an emergency manager assigned in March by the state to oversee Detroit's finances, to proceed swiftly with a formal plan for starting over — a proposal to pay off only a portion of its $18 billion in debts and to restore essential services, like streetlights, to tolerable levels.

Mr. Orr said he intended to file the formal blueprint, known as a "plan of adjustment," by the first week of 2014. That plan could include efforts to spin off city departments to outside entities, to sell city assets and to reinvest in failing city services. Mr. Orr has said his goal is to bring Detroit, the

nation's largest city ever to find itself in bankruptcy, out of the court process by next fall.

"We have some heavy work ahead of us," Mr. Orr said Tuesday.

Around Detroit, leaders sounded somber but mildly hopeful tones. Mayor-elect Mike Duggan said that Tuesday was a day no one wanted to see, but that the city now needed to move forward. And Dave Bing, the departing mayor, whose tenure in office has been consumed by the financial distress, said it was inevitable that Detroit would ultimately be found insolvent. "We are now starting from Square 1," he said.

Municipal workers and retirees said they were shaken by the developments, and unsure what to expect. Any cut to pensions, many said, would be crushing.

"The impact of this is going to be catastrophic on families like mine on fixed income," said Brendan Milewski, 34, a Detroit firefighter who was seriously injured in an arson in 2010 and said he received a pension of $2,800 a month from the city. "Retirees are going to be put out of house and home. They're not going to be able to afford a car, food or medicine."

Bruce Babiarz, a spokesman for the Detroit Police and Fire Retirement System, was blunt in his assessment. "This is one of the strongest protected pension obligations in the country here in Michigan," he said. "If this ruling is upheld, this is the canary in a coal mine for protected pension benefits across the country. They're gone."

Since July, Mr. Orr, with approval from Gov. Rick Snyder, a Republican, has sought bankruptcy protection, and most here agree that the city's situation is dire: Annual operating deficits since 2008, a pattern of new borrowing to pay for old borrowing, miserably diminished city services, and the earmarking of about 38 percent of tax revenues for debt service. A city that was once the nation's fourth largest has dropped to 18th, losing more than half of its population since 1950. The city was once home to 1.8 million people but now has closer to 700,000.

Judge Rhodes rejected arguments by unions and other opponents that the bankruptcy filing was the result of secret and unconstitutional decisions made by Mr. Snyder and others. He agreed with opponents of the bankruptcy that the city had failed to make "good faith" attempts to negotiate with creditors, but said that such negotiations had been "impracticable."

In perhaps the most contested portion of the case, the judge made it clear that federal bankruptcy law trumps the state law when it comes to protections for public employees' pensions, making the pensions of 23,000 retirees fair game for the city to include in its plan of adjustment. But while the judge said pensions could not be treated differently from other unsecured debt, he said the court would be careful before approving any cuts in monthly payments to retirees.

That seemed to be of little comfort to union leaders, who denounced the ruling as illegal and immoral.

Lee Saunders, the president of the American Federation of State, County and Municipal Employees, said the ruling, in essence, put a "bull's eye" on the backs of municipal workers and retirees by saying pensions are vulnerable. "It sets a bad precedent for cities that are under economic distress to look at doing the easy thing: to attack the workers and attack the retirees," Mr. Saunders said.

Experts said the decision seemed unlikely to prompt a rush of bankruptcy filings by cities, but was likely to give cities more leverage over pensions in negotiations before bankruptcies. Detroit has included $3.5 billion in unfunded pension liabilities in its larger mound of debt, and city lawyers say it can simply no longer afford its pension plan.

For his part, Mr. Orr said he had a difficult reality to present to retirees. “There’s not enough money to address the situation no matter what we do,” he said. “That is clear.” At another point, he said of the pension question, “We’re trying to be very thoughtful, measured and humane about what we have to do.

By MONICA DAVEY, BILL VLASIC and MARY WILLIAMS WALSH

Published: December 3, 2013

NYT: California City’s Return to Solvency, With Pension Problem Unsolved.

Stockton’s Struggle: Before Detroit, Stockton, Calif. was the largest city to file for bankruptcy. Now, Stockton is working its way back, and city leaders see lessons in its ordeal for other struggling municipalities.

Battered by a collapse in real estate prices, a spike in pension and retiree health care costs, and unmanageable debt, this struggling city in the Central Valley has labored for months to find a way out of Chapter 9. Now having renegotiated its debt with most creditors, cobbled together layoffs and service cuts and raised the sales tax to 9 percent from 8.25 percent, Stockton is nearly ready to leave court protection.

But what Stockton, along with pretty much every other city in California that has gone into bankruptcy in recent years, has not done is address the skyrocketing public pensions that are at the heart of many of these cases.

“No city wants to take on the state pension system by itself,” said Stockton’s new mayor, Anthony Silva, referring to the California Public Employees’ Retirement System, or Calpers. “Every city thinks some other city will take care of it.”

While a federal bankruptcy judge ruled this week that Detroit could reduce public pensions to help shed its debts, Stockton has become an experiment of whether a municipality can successfully come out of bankruptcy and stabilize its finances without touching pensions. It is an effort that has come at great cost to city services and one that some critics say will simply not work once the city starts trying to restore services and hire 120 police officers it promised to get the sales-tax increase passed.

“They wanted to get out of bankruptcy in the worst possible way, and that’s just what they did,” said Dean Andal of the San Joaquin County Taxpayers Association, which fought the sales-tax increase. “If they go ahead and hire those new police officers, the city will be back in insolvency in four years.”

Stockton declared fiscal emergencies in 2010 and 2011, giving it the power to renege on annual pay increases for city workers. City services were slashed. Hundreds of municipal workers were laid off. And many retirees who had been promised health coverage for life learned that they would have to begin paying for it.

“That was the hardest part,” Councilman Elbert Holman said, “looking people in the eye and telling them sorry, you are losing your health care, but it’s absolutely necessary.”

By the time the judge found Stockton eligible for Chapter 9 bankruptcy on April 1, the city had about

$147 million in unfunded pension obligations and about $250 million in debt from various bond issues.

The years of fiscal emergency and bankruptcy have left their mark, including a skyrocketing crime rate, which city officials and many residents attribute to staffing and service cuts in the Police Department.

“I suddenly realized a few years ago that, just in my tiny, two-block neighborhood, there had been 11 residential burglaries in the previous nine months,” said Marci Walker, an emergency room nurse.

Cities go bankrupt for many reasons: a collapse in real estate prices, a spike in pension and retiree health care costs, a burden of debt from expensive city projects. Stockton has experienced all three.

When real estate prices shot up in Silicon Valley in the last decade, many commuters decided that Stockton’s cheaper housing was worth the long commute to the Bay Area. That drove up local housing prices, so when the bubble burst it had a bigger impact, giving Stockton one of the nation’s highest foreclosure rates.

City leaders had also gone on a construction spree during the flush years, building a new sports arena, a minor-league baseball stadium and a marina. Citizens still bitterly mention the 2006 concert that opened the arena, where Neil Diamond was paid $1 million to perform.

And through it all, the pension costs for city workers — particularly for police officers and firefighters, who can retire early and draw on those pensions for decades — kept going up.

No part of the city has been left unscathed. Ms. Walker’s comfortable neighborhood near the University of the Pacific campus was hit with rising crime almost immediately after the police layoffs. “When the economy got bad and we lost police officers, it all started,” she said.

So she started the Regent Street Neighborhood Watch, the first of more than 100 such organizations to sprout up in the city in the last few years.

“We don’t confront anybody, we just let them know that we know they’re there,” Ms. Walker said. She added, “Criminals do not like eyeballs on them.”

While the rising crime rate had the biggest effect on the city, other service cuts were also felt, including deteriorating streets and closed libraries and community centers. The other consequences of the downturn — shuttered storefronts, crumbling infrastructure, empty downtown sidewalks — only added to the sense of decline.

“There was just this perception that the city was not safe,” Police Chief Eric Jones said. “Downtown was impacted. Many people were reluctant to go down there.”

The crime problem is a big reason Stockton chose to keep paying into the Calpers system even as it pared other costs, including its payments to bondholders. Officials say that if the city cuts the rate at which its workers build up their pensions, workers will leave — especially police officers who were recruited with the promise of large, early pensions.

Last year, Stockton asked Calpers for a “hardship exemption,” allowing it to slow its contributions. The huge state pension system said no, fearing that if Stockton fell behind, it might never catch up.

Now, even before the ink is dry on Stockton’s proposed blueprint for getting out of bankruptcy, skeptics are worried that the plan is not comprehensive enough to solve its problems and that city

leaders will not fulfill their promise to use some of that money to hire police officers.

City officials insist their plan will work. “We got the tax, and thank God it passed,” Councilman Holman said. “I have confidence that the numbers line up.”

Nor does the Detroit ruling this week make Stockton want to revisit pension reductions. Connie Cochran, a city spokeswoman, said that city workers had already seen their pay and retiree health benefits cut. In addition, she said, Calpers told the city that its only option was to pay a $970 million termination fee to leave the system, and Stockton could not afford it.

Mayor Silva said the city’s plan would help it out of bankruptcy sometime late next spring, if all goes well, after the judge hearing the case has time to rule on its fairness and viability and negotiations can be completed with one final bondholding creditor.

“We will lose the stigma of bankruptcy, and it will buy us time,” he said.

One of three new members elected to the City Council in November, Michael Tubbs, said he was convinced that the bankruptcy plan would work, providing $28 million to $30 million in revenue each year for the next decade and allowing the city to pay down its debt while still hiring police officers.

“I am incredibly optimistic,” said Mr. Tubbs, 23, who grew up in Stockton.

Chief Jones said he was counting on the 120 new officers and planned to hire 40 a year for the next three years. In 2008, Stockton had 441 police officers. By this year, the force had fallen to 350, the second-lowest per capita staffing level in the country. The result, he said, is that all violent crimes rose in the city, which had 58 homicides in 2011 and 71 in 2012, both records.

Even before the sales-tax increase passed, Chief Jones said he had decided to reinstate some of the community outreach programs that were curtailed during the budget crunch, even if that meant slower response times for nonviolent crimes.

“We had to tell the community to be patient, we’re going to focus on violent crime,” he said.

The impact was immediate. As of mid-November, there had been only 28 homicides this year.

Still, bondholders complain that Calpers will get 100 cents on the dollar for its city debt, while they must make do with much less. Following months of negotiations, most of Stockton’s bondholders said they would not try to block the city’s plan, but Franklin Templeton Investments was girding for a fight, possibly strengthened by the Detroit ruling that federal bankruptcy law trumps state pension guarantees.

Two Franklin funds hold about $35 million of bonds that Stockton issued in 2009 and are now in default. Stockton is proposing to pay the two Franklin funds just $95,000 to discharge all the remaining debt on those bonds, amounting to less than a penny on the dollar.

Douglass Wilhoit Jr., chief executive of the Stockton Chamber of Commerce, agreed that “the elephant in the room is the pension stuff.” But he said that he was confident this plan would ease the city out of bankruptcy and start a process that would inevitably come to include some sort of pension changes. “Over all, honestly, I think the bankruptcy process has been a positive experience for Stockton,” he said. “We are going to come out of it stronger and better.”

By RICK LYMAN and MARY WILLIAMS WALSH

Published: December 5, 2013

Supreme Court Opens Door Wider for Collecting Internet Sales Taxes.

By declining to hear a challenge to New York State's "Amazon law," the U.S. Supreme Court has now helped pave the way for states and localities to collect more of the roughly $13 billion that they're owed each year in uncollected sales taxes on Internet purchases. That should encourage other states to pass similar laws, though only federal policymakers can solve the problem comprehensively.

First, some background. Previous Court decisions held that a merchant must have a "physical presence" — generally, employees or facilities — in a state before that state could require the company to charge sales taxes to its customers there. Although buyers are legally obligated to pay directly to their states any applicable taxes that the merchants don't charge, very few do.

But the Court has also said that people who aren't employed by the merchant but help market its goods constitute a "physical presence." So, New York enacted a law requiring Internet merchants with in-state "affiliates" to charge sales taxes on all taxable sales to New York customers. "Affiliates" are companies and individuals that link to an Internet retailer from their own site and receive a commission when someone clicks on the link and buys something on the merchant's site.

Amazon and Overstock, two of the many large retailers that operate affiliate programs, challenged New York's law. But New York's high court upheld the law, and yesterday the U.S. Supreme Court let that decision stand.

More than a dozen states (including New York) have enacted laws requiring Internet retailers with in-state affiliates to charge tax on all taxable sales in the state (see map). Now that New York's law has withstood all legal challenges, other states may follow its lead. Amazon laws can chip away at the problem even if they don't represent a full solution, I've explained.

A federal law that empowered states to require all sellers to collect sales tax would:

- Help states and localities maintain public services and possibly reinvest in services they cut during the recession — rehiring teachers, freezing college tuition increases, and boosting road and bridge maintenance, for example.
- Create a more level playing field for local store-based retailers, which do collect sales taxes.
- End the unfair sales tax treatment of consumers who don't shop online, including low-income people who lack computers, Internet access, or credit cards.

The federal Marketplace Fairness Act, which represents a fair and comprehensive solution to the problem of uncollected tax on Internet and other interstate sales, passed the Senate in April but is stalled in the House. Until it moves, states need to do what they can to address the problem themselves. The Supreme Court has now cleared a big obstacle in their paths.

WSJ: Borrowing Maneuver Catches Flak.

'Scoop and Toss' Involves Selling New Debt to Pay Off Existing Bonds

A budget-stretching tactic employed by strapped local governments from California to Puerto Rico is coming under market scrutiny, amid fears that Detroit's record bankruptcy filing could presage further pain for municipal-bond investors.

The maneuver, called "scoop and toss," involves selling new long-term debt to raise funds to pay off maturing bonds, effectively extending the timetable for retiring municipal borrowings. Refinancings that aim to reduce interest rates typically keep the same maturity schedule.

The practice, which has been around for decades, helps cities, states and other local entities to stay current on their obligations as they try to claw out of one of the deepest economic downturns since the Great Depression.

The debt sales often offer above-market interest rates that appeal to many bond buyers at a time of slow economic growth, easy Federal Reserve policy and low rates on relatively safe investments such as U.S. Treasury securities and bank accounts.

But some observers warn that scoop-and-toss refinancings add to interest costs while allowing civic managers to overlook structural economic difficulties. Investors purchasing the debt take on the risk that the securities will lose value, as they did in Detroit's $18 billion Chapter 9 bankruptcy case.

"It's never a good sign to see this," said John Loffredo, portfolio manager of the MainStay Tax Free Bond Fund. Mr. Loffredo said his firm recently started buying Puerto Rico bonds that carried third-party insurance guaranteeing repayment, citing the high yields.

Among the chief practitioners of scoop and toss is Puerto Rico, which since 2006 has relied on new bond sales and loans to help balance its budget and pay off old bonds coming due. The island commonwealth has restructured about $4 billion in debt from its main operating budget since then. About $70 billion of Puerto Rico debt is outstanding.

Yields on Puerto Rico's bonds have risen sharply this year, making it much more expensive to sell debt to investors, following rating-company downgrades. Puerto Rico bond prices are down about 16% in 2013.

In 2011, Puerto Rico sold $356 million of bonds that begin maturing in 2024. Some of the proceeds were used to pay off a bond from 1989 that was maturing in 2011—in effect turning a 22-year bond into a 35-year one.

Lyle Fitterer, head of tax-exempt investments at Wells Capital Management, which oversees about $33 billion in municipal-debt investments, said he would like to see cheaper bond prices or a sustainable economic recovery plan before he boosts his firm's small Puerto Rico holdings.

"The scoop-and-toss strategy might be a good strategy for a short-term solution, if you have a temporary economic recession," he said. "But obviously, the longer it goes on, the more difficult it is to argue that it's a good long-term solution."

Officials in the U.S. territory are seeking to put the island on stronger fiscal footing through tax increases and entitlement reform, and seek to end scoop and toss by 2015. "In the past, it had been restructuring after restructuring," Puerto Rico Treasury Secretary Melba Acosta said recently in an interview. "We are moving away from that."

Puerto Rico officials have said they can make it through this fiscal year without borrowing, and have been drawing down a line of credit from the Government Development Bank, according to Fitch Ratings.

U.S. companies frequently issue new bonds to pay off old debt. But investors typically worry less about corporate-debt issuers because the money can be used to expand the business, which can benefit bond buyers.

“If a corporation started going into decline, you aren’t going to see the debt rolling over and being refinanced,” said Stan Garstka, accounting professor at the Yale School of Management.

To be sure, there are signs of progress for municipalities. Over the summer, Moody’s Investors Service raised its outlook for U.S. states to stable from negative, saying “the slowly improving U.S. economy continues supporting state revenues and reserves.”

Other municipal entities have employed scoop-and-toss strategies recently. Suffolk County, N.Y., which recently declared a fiscal emergency, last year sold through an authority about $38 million in bonds backed by tobacco revenues to help cover other debt payments that were due in 2012 and 2013.

In California, the Foothill/Eastern Transportation Corridor Agency, which operates toll roads in Orange County, is looking into a scoop and toss that would pay off bonds from 1999 and extend the maturity of the debt by 13 years to 2053. The bonds are backed primarily by revenues from tolls, but traffic on the roads has grown slower than expected.

Fitch said the plan makes it easier for the authority to pay off its bonds. In 2040, the year the authority will have to pay the most, payments fall to $243 million from $297 million under the new plan. Without scoop and toss, Fitch said it would likely downgrade the outstanding bonds to junk status.

By MIKE CHERNEY

Dec. 2, 2013 8:40 p.m. ET

WSJ: Volcker Rule Could Raise Municipal Borrowing Costs, California Treasurer Says.

Worry Is That Banks May Boost Fees to Sell Municipal Securities

Implementing the Volcker rule could result in higher borrowing costs for municipalities as banks may boost fees they charge to sell securities that finance state budgets, schools and other public needs, California’s top treasury official said on Wednesday.

California Treasurer Bill Lockyer said he thought banks may boost fees on bond deals as one way to offset profits lost due to the Volcker rule. Regulators are set to vote on a final version of the rule next week. It is part of the 2010 Dodd-Frank financial overhaul legislation, and intends to curb banks from making risky bets on their own behalf.

“Borrowing costs may increase,” Mr. Lockyer said. The concern is that if banks don’t make a profit from proprietary trading, they will boost the fees they charge to customers, just as they might to anyone with a checking account, he told The Wall Street Journal. Mr. Lockyer was attending a conference in New York of the National Association of State Treasurers.

Mr. Lockyer’s comments come as the municipal bond market suffered this year amid fears of rising

interest rates and the ripple effects of large defaults, such as Detroit's. Investors have redeemed a record $51 billion from municipal bond funds this year, according to Lipper, and some analysts predict the trend to continue into 2014.

California's bond issues are routinely oversubscribed, suggesting the state is gaining, not losing, investor confidence, Mr. Lockyer said. But there are "segments where there is greater perceived risk," he said.

While higher fees are a concern, inflation and interest rates are still the "more substantial" long-term concerns surrounding the state's borrowing costs, he said.

By AL YOON

NYT: Pension Ruling in Detroit Echoes West to California.

The ruling by Judge Steven W. Rhodes, who is presiding in Detroit's bankruptcy case, that public pensions are not protected from cuts could alter the course of bankrupt cities like Stockton and San Bernardino, Calif., that had been operating under the assumption that pensions were untouchable.

Stockton's bankruptcy case, for instance, is further along than Detroit's, and until Tuesday it seemed likely to leave public pensions fully intact. Stockton sought bankruptcy protection last year and has already filed a plan of debt adjustment with the bankruptcy court in Sacramento. Its plan, which is subject to court approval, would leave city workers' pensions unchanged: They would continue to accrue benefits at the same rate as they did before the bankruptcy. (A new state law does permit Stockton to provide smaller pensions to workers hired after Jan. 1.)

That is a better deal than workers at bankrupt companies often receive. City leaders based it on the thinking that public workers had already sacrificed enough, given that the plan of adjustment already calls for them to give up contractual pay increases and valuable retiree health benefits.

Opponents of that plan have raised concerns that it would not save enough money. They point to the city of Vallejo, Calif., which spent three years in bankruptcy, emerged in 2011 without touching its workers' pensions, and is again having trouble balancing its budget. Many cities in California are struggling with pension costs because of a big benefit increase in 1999 that has been much more expensive than anticipated. State laws make it hard for cities to raise taxes enough to keep up with the costs, and because pensions are considered untouchable, local officials have had to reduce services, like policing, to balance their budgets.

Some say the situation is unsustainable. Last month, another city, Desert Hot Springs, said that its pension costs were unaffordable and that it might have to declare bankruptcy.

Early in Stockton's bankruptcy, several financial institutions tried to block its case, arguing that it had not negotiated as required with the California Public Employees' Retirement System, known as Calpers, which administers pensions for many municipalities. Those motions were denied, and in the months since then, all but one of the institutions have reached settlements with the city and stopped arguing about pensions.

The one remaining creditor is Franklin Templeton Investments, a mutual fund company that holds about $35 million worth of Stockton's bonds. Stockton's plan of adjustment proposes to give Franklin less than a penny on the dollar for its bankruptcy claims, according to court filings. Federal

bankruptcy law allows for such “cramdowns” — deals that force big losses on unwilling creditors — but for a cramdown to be approved by a bankruptcy judge, it must meet certain requirements. It must be “fair and equitable,” for example, and it must not discriminate against one creditor in favor of others.

Even before Tuesday, Franklin was warning that it would challenge to Stockton’s plan. Documents on file with the court suggest it was planning to argue that no plan could be “fair and equitable” if Calpers were paid in full while Franklin received less than a cent on the dollar.

“Their argument just got strengthened,” said Karol K. Denniston, a bankruptcy lawyer at Schiff Hardin in San Francisco who has been advising a taxpayers group that formed after Stockton declared bankruptcy. Referring to the judge’s decision in Detroit, she said, “Franklin Templeton is going to have a lot to say about this ruling.”

Another bankrupt city in California, San Bernardino, has taken a different tack from Stockton. It wants to reduce its pension obligations in bankruptcy and has already stopped sending its regular contributions to Calpers. That is something a company in Chapter 11 bankruptcy would normally do, but Calpers is fighting the move in San Bernardino’s Chapter 9 case. It argues that the city does not sincerely wish to adjust its debts, as required by bankruptcy law, but simply wants to “languish” in court. Calpers maintains that pensions cannot be reduced in California and that the only way for a city to freeze its plan is to pay a giant fee.

So far, San Bernardino’s bankruptcy judge, Meredith A. Jury, has ruled against Calpers and refused to grant it an expedited appeal to the United States Court of Appeals for the Ninth Circuit. The city’s creditors are now trying to come up with a settlement plan in mediation.

“This gives them clarity,” Ms. Denniston said. “It changes the dynamic at the negotiating table in a major way, because we’ve now had a bankruptcy judge say you can impair pensions. We’re going to go through a huge period of uncertainty because that’s going to be appealed, but for right now, that’s the law.”

Judge Rhodes’s decision in Detroit’s bankruptcy case was also noteworthy for what it did not say: It did not offer specific instructions for how large or small any pension cuts should be. Instead, he said the question should be resolved in mediation, which is already running in Detroit but has so far borne little fruit.

James E. Spiotto, a bankruptcy lawyer at Chapman & Cutler in Chicago, said officials in other cities might want to change course now if they worried that they might have promised more than they could deliver.

“If you’re not able to pay, the best thing to do is address it now,” Mr. Spiotto said. “Pay as much as you can without adversely affecting the future of the city.”

By MARY WILLIAMS WALSH

Illinois General Assembly Passes "Landmark" Pension Changes.

CHICAGO — The Illinois General Assembly approved an overhaul to the state’s pension system billed by its backers as a “landmark” reform that will stabilize both the system and the state’s fiscal foundation.

Critics attacked the plan as being either too hard on workers or too weak to repair a system saddled with $100.5 billion of unfunded liabilities. Some lawmakers also raised concerns over whether the plan can withstand the legal challenge expected from unions after Gov. Pat Quinn signs the package.

After two years of false starts and political bickering among lawmakers over how to restructure the pension system, Gov. Pat Quinn had nothing but praise for the plan and lawmakers who approved it.

“This landmark legislation is a bipartisan solution that squarely addresses the most difficult fiscal issue Illinois has ever confronted,” Quinn, who faces re-election next year, said shortly after the vote. “This bill will ensure retirement security for those who have faithfully contributed to the pension systems, end the squeeze on critical education and healthcare services, and support economic growth.”

In addition to praising the General Assembly’s leaders and members of the conference committee appointed in June to assemble a compromise plan, the Democratic governor said: “I salute the members of the General Assembly who showed great political courage by voting yes for pension reform.”

The plan is estimated to trim $160 billion off state payments owed to the system, with the goal of reaching full funded status in 30 years primarily by cutting benefits and infusing the system with supplemental state contributions in addition to scheduled annual payments. The changes would trim about $21 billion of the state’s unfunded liability tab.

The state’s five funds are currently just 39.3% funded. Contributions have been rising steadily, consuming 20% of the fiscal 2014 general fund budget, up from 12% in fiscal 2010. Under the existing funding schedule that level would rise to 26% in 2045.

The state’s pension woes and political impasse over how to overhaul the system have driven the state’s credit deterioration, with its ratings now the weakest among states, at the low-single-A level.

In addition to tarnishing its own reputation with investors, the state’s credit struggles have driven up the costs of borrowing for most Illinois-based issuers, especially those dependent on the state for aid, such as its public universities. It’s called by market participants the “Illinois penalty” or “Illinois effect.”

The state hopes to see a positive impact on its interest rates from the action as soon as next week when it takes competitively bids on a $350 million taxable general obligation issue. The three major rating agencies all assign a negative outlook to the credit. It’s unclear whether an outlook shift would occur so quickly as analysts digest the impact of the reforms and a legal challenge looms.

The vote in each chamber was nearly simultaneous and followed several hours of debate Tuesday, less than a week after the General Assembly’s leaders announced they had agreed on a plan.

Without action, House Minority Leader Rep. Jim Durkin, R-Western Springs, warned the rating agencies could “move our credit rating even lower.”

While some lawmakers warned the package didn’t go far enough to warrant a label of “comprehensive” reform, others said it went too far. Sen. William Delgado, D-Chicago, called the changes “morally wrong, morally corrupt” because of the impact on public sector employees and retirees.

The Senate tally came first with 30 members voting for the legislation which was presented in the form of a conference committee report and 24 against and three voting present. The yes votes

included 20 Democrats and 10 Republicans.

The House voted 62 to 53 in favor of the report with one voting present. The yes votes included 47 Democrats and 15 GOP members. Democrats hold a majority in the General Assembly.

BY YVETTE SHIELDS

Liabilities Growth Still Outpacing Assets, Report Finds.

The largest U.S. public retirement systems had an aggregate 0.9% growth in assets in fiscal year 2012, but a 4.1% growth in liabilities, according to the Public Fund Survey released Wednesday. In aggregate, assets increased to $2.67 trillion, while liabilities reached $3.63 trillion at the end of fiscal year 2012.

The survey, sponsored by the National Association of State Retirement Administrators and the National Council on Teacher Retirement, covers 85% of the state and local government retirement systems. The 126 plans in the survey had a median funding level of 73.1%.

The survey found most retirement systems have recognized investment losses incurred in 2008 and 2009, or are close to doing so. Retirement systems with fiscal years ending Dec. 31 had a one-year median return of 13.1%, while those with a June 30 fiscal year-end, which represent three-fourths of the plans, had a median return of 1.2%.

“We’re right on the cusp of two things: having recognized the market losses of ’08 and ’09, and the beginning of recognizing the strong gains experienced in the last months,” said Keith Brainard, NASRA research director, in an interview.

For the first time in the survey’s 12-year history, the median employee contribution rate changed, to 5.7% from 5%. Increasing employee contribution rates has been the most common change in recent years, along with an upward trend in employer contributions, Mr. Brainard said.

BY HAZEL BRADFORD

Bond Buyer: Indiana Finance Authority Named Deal of the Year.

The Indiana Finance Authority won The Bond Buyer’s 12th annual Deal of the Year award Thursday night for its Ohio River Bridges East End Crossing Project.

The public-private partnership was funded through the sale of around $675 million of tax-exempt private activity bonds, including $195 million of milestone PABs, a new security type that can serve as a template for other P3 concessions.

The deal — the largest P3 PAB offering completed to date in the U.S. municipal market — “financed a large infrastructure project that fulfilled a public need. It was innovative, replicable, and took an immense amount of cooperation across a number of sectors to come to fruition,” said Michael Scarchilli, editor in chief of The Bond Buyer, when presenting the award at a ceremony held at the Waldorf Astoria hotel in New York City.

The transaction also won the Deal of the Year award for the Midwest region, making this the second consecutive victory for that region. It also marked the first time the Deal of the Year award was given to a P3 transaction. WVB East End Partners, a consortium comprised of Vinci Concessions, Walsh Investors and Bilfinger Project Investments, was the private sector partner.

The East End Crossing was Indiana's portion of the Ohio River Bridges project, which necessitated a bi-state agreement between Indiana and Kentucky to develop two bridges, one in downtown Louisville to be developed by Kentucky, and the East End Crossing in Indiana. Kentucky plans to sell $747 million of tax-exempt and taxable debt in the week of Dec. 9 to fund its portion of the project.

This year's Freda Johnson Award honoring Trailblazing Women Issuers was given to Philadelphia Treasurer Nancy Winkler. The award recognizes a woman affiliated with an issuer who has been a leader, innovator and mentor.

For more than a decade, the editors of The Bond Buyer have selected the outstanding municipal bond transactions for special recognition, honoring the issuers who overcame myriad challenges to bring these deals to fruition.

This prestigious competition has drawn nominations that represent the full diversity of the communities and public purposes that are served by the municipal finance market. The 2013 awards, which considered deals that closed between Oct. 1, 2012, and Sept. 30, 2013, drew a record number of nominations for transactions ranging in size from a few million to billions of dollars.

Nominees this year faced stiff competition from a host of qualified deals. The transactions considered included financings of hospitals, housing, toll roads and airports. Deals ranged from cost-saving refundings representing turnaround stories for issuers once in distress, to alternative energy financing projects to a host of innovative public-private and public-public partnerships. In fact, this year, The Bond Buyer honored three P3 transactions with Deal of the Year awards, a first for this ceremony.

This year, issuers in eight categories were selected as Deal of the Year awardees. The honorees were first revealed Nov. 4-8 via individual video announcements at BondBuyer.com, along with additional information on the awards.

The other finalists were:

NORTHEAST REGION

The Allentown Neighborhood Improvement Zone Development Authority's sale of $224 million in tax revenue bonds to fund a new 8,500-seat arena, which would act as a catalyst for further redevelopment in downtown Allentown, Pa. The bonds were authorized under the Neighborhood Improvement Zone Act, under which certain taxes paid by qualified businesses within the NIZ are pledged as security towards the debt.

Allentown's 50-year concession lease of the city's water and sewer systems through a public-public partnership with the Lehigh County Authority, which generated a significant up-front payment to stabilize the city's rapidly growing unfunded pension liability and provided a foundation and path for fiscal stability.

*The two Allentown transactions, which represent a turnaround story from an economically suppressed area, were co-honorees in the Northeast category.

SOUTHWEST REGION

Dallas and Fort Worth, Texas' $2.73 billion of refunding and new-money transactions on behalf of Dallas/Fort Worth International Airport. The series of financings — mainly to finance the airport's Terminal Renewal and Improvement Program — accounted for 28% of national airport issuance over the Deal of the Year judging period.

SOUTHEAST REGION

Harnett County, N.C.'s $20 million sale of limited obligation bonds, used to purchase the general obligation debt of the county's seven small, unrated water and sewer districts, which had difficulty accessing the public capital markets individually.

FAR WEST REGION

The California Pollution Control Financing Authority's $733 million sale of water furnishing revenue bonds, issued on behalf of the San Diego County Water Authority — to fund the Carlsbad Desalination Project. The deal, executed as a public-private partnership with Poseidon Resources, represents the first-ever project financing of a seawater desalination plant in the municipal market, establishing a new asset class for investors.

NON-TRADITIONAL FINANCING

The New York Metropolitan Transportation Authority's $200 million sale of principal at-risk variable-rate notes, sold via conduit issuer MetroCat. The proceeds effectively collateralize three years of reinsurance coverage from MetroCat, a newly created Bermudan special purpose insurer, for storm surge losses incurred by the MTA through its captive insurer. The innovative, non-traditional structure allowed the MTA to close its storm surge insurance gap, following $4.9 billion in storm surge-related losses as a result of Superstorm Sandy.

HEALTH CARE FINANCING

The billion-dollar financing program resulting from the New Jersey Medical & Health Sciences Restructuring Act, which provided for the dissolution of the University of Medicine and Dentistry of New Jersey, the defeasance of its $668 million in outstanding debt, and the transfer and integration of UMDNJ assets to Rutgers University, Rowan University, and University Hospital. The complex transaction represented the largest higher education merger in United States history, and provided for the complete overhaul of New Jersey's system of public health sciences education and research.

SMALL ISSUER FINANCING

The New York State Energy Research and Development Authority's $24.3 million sale of residential energy efficiency financing revenue bonds. NYSERDA's collaboration on the transaction with the New York State Environmental Facilities Corp., which guaranteed the bonds through its State Revolving Fund program, provided the first-ever linkage between clean water and clean energy programs. Aggregating and applying QECB allocations, along with the SRF wrap, significantly lowered the bond debt service and established a nationally replicable model.

Bond Insurers Charging Less to Take on Risk.

Bond insurers Assured Guaranty and Build America Mutual are getting less compensation for risk as compressed credit spreads and competition force the businesses to cut insurance prices.

Assured reported a U.S. public finance risk-adjusted pricing ratio, a risk-versus-return measure of an insurer's portfolio in which a higher score is considered stronger, of 3.55% in the first three quarters of 2013, down from 4.46% in 2012, Standard & Poor's said in a Nov. 20 report. Build America, which ramped up its business in the beginning of the year, reported RAP of 3.46% for the same period.

The implied premium rate for bond insurance is 20% lower in 2013 than in 2012, with an average of 40 basis points in the second quarter of 2013, compared with the 60 basis point average insurance obtained in previous years. Persistent low pricing ratios could lead to ratings cuts, analyst Marc Cohen said in the S&P report.

"In a perfect world with only two players you'd think they have the market power to exercise their abilities to extract the best premiums," Cohen said in an interview. "However, the current market dynamics are hindering the bond insurers' profitability. With those market dynamics there's a heightened level of competition among those two players."

Build America's launch in July 2012 ended Assured's post-financial crisis luxury of being the only active insurer. The financial guaranty market began to split, with Assured responsible for 59% of insured bonds as of September 30. The percentage of bonds with insurance fell to 3.53% in the third quarter, from 3.71% in the second quarter, according to data from Reuters.

Issuers are shying away from insurance as interest rates remain low and make guarantees less economically valuable, Cohen said. Instead, insurance has largely been present to provide liquidity and access to the market for smaller issuers.

"When spreads are wider, insurers are able to extract a significant portion of that interest savings, so when credit spreads and muni yields are as tight as they have been, there's less money on the table to extract from their premiums," Cohen said.

The difference in yield between single-A and triple-B 10-year municipal bonds, the section on the curve where insurers do most of their business, fell from 85 basis points in November 2012 to 61 points in September. The spread between AAA GO 30-year yields and BBB bonds feel from 131 basis points a year ago to 114 in September. Since September, those spreads have either fluctuated or risen.

Analysts expect theFederal Reserve to begin tapering its quantitative easing program in the near future, which would increase yields and spreads, and encourage issuers to look to insurers for savings on new debt, Cohen said. Assured expects rising interest rates to boost demand for guarantees.

"We've already seen the positive effects of rising rates during the summertime when rates were up," Bill Hogan, director of public finance at Assured, said in an interview. "Higher rates helped us then and we expect them to go a little bit higher next year, which will be beneficial to both penetration and pricing."

As part of its rating methodology for financial guarantors, S&P places transactions into four risk categories, which determine the capital charge associated with backing a specific deal. Insurers are required to reserve a percent of the average annual debt service associated with the deal against the risk. In 2011, S&P increased that percentage, with deals in category four – charter schools, health care or private schools — requiring the largest capital charge.

Assured's gross per period weighted capital charge is 16%, compared with BAM's 11.4%. Insuring deals in the category four area has weakened Assured's pricing ratio, Hogan said, even though those

transactions make up just $200 million in par amount.

“It’s unfortunate that the high capital charges in Category 4 limit our ability to underwrite sound enterprise credits,” Hogan said. Not including category four transactions, Assured’s RAP in the first three months of the year satisfies S&P’s requirements, Hogan said.

Build America does not wrap debt in higher risk categories,

“Given the current spread environment, we are satisfied with our progress to date and look forward to continuing to serve our core market of essential public purpose municipal issuers,” Sean McCarthy, chief executive officer of BAM, said in an emailed statement.

S&P’s scrutiny into the insurers may reflect a more general concern for the industry, Mikhail Foux, a municipal strategist at Citigroup Global Markets. Foux believes insurers will likely see an uptick in market penetration but said rating agencies may be reconsidering how they look at insurers that have exposure to debt in distressed areas.

“They may be concerned about what could happen with stress in the sector and looking at how they separate high quality business from the rest,” Foux said.

The insurers’ pricing ratios are falling short of S&P’s expectations, the rating agency said in the report. S&P looks for insurers to remain in the 4% to 6% risk-adjusted pricing range, and remaining below 4% could lead to ratings downgrades.

Hogan expects the ratios to rise before year-end with large low-capital charge deals on the table.

BY OLIVER RENICK

NOV 25, 2013 4:53pm ET

Illinois Legislative Leaders Try to Sell Pension Agreement.

Illinois legislative leaders are trying to persuade lawmakers to embrace a solution for the nation’s worst-funded U.S. public pension system as unions representing hundreds of thousands of workers and retirees push against the proposal.

The holiday weekend of lobbying is the prelude to the legislature’s Dec. 3 return, when the Democrat-dominated General Assembly will consider the plan designed to save $160 billion over 30 years and restore stability to the retirement system. Within an hour of the tentative deal’s announcement, labor unions mobilized against it.

“If their new plan is in line with what’s been reported from earlier discussions, then it’s an unfair, unconstitutional scheme that undermines retirement security,” We Are One Illinois, a coalition of unions, said in a statement.

Illinois’s five pension systems had 40 percent of the assets needed to cover obligations in fiscal 2011, the lowest ratio among states, data compiled by Bloomberg show. That has led to repeated credit downgrades for the lowest-rated U.S. state.

The proposal would reduce by one percentage point the amount employees contribute from their paychecks, according to a memo released today by House Speaker Michael Madigan’s office. The

bulk of the savings would come from reductions in annual cost-of-living payments.

Benefits Delayed

Payments would be calculated against a sum equal to the number of years an employee worked, times $1,000, the memo said. The retirement age for workers younger than 45 would be raised, requiring employees to work as many as five years longer before receiving benefits. Employees could also choose a 401(k)-style retirement plan.

If the state didn't make annual pension contributions to the funds, the retirement systems would be allowed to go to the Illinois Supreme Court "to compel the state to make the required pension payment," the memo said.

The proposal, agreed to by Democratic and Republican leaders, follows months of discussions by a special legislative panel appointed to develop a compromise.

"I asked members to draft a plan that eliminated the unfunded pension debt and fully stabilized the systems, and this plan meets that standard," Democratic Governor Pat Quinn said in a statement. "We have more work to do. I look forward to working with the leaders and members of the General Assembly over the coming days to get this job done."

Repeated Attempts

Resolving Illinois's pension shortfall has proven a challenge. Lawmakers have failed at least five times in the last 15 months to restructure the plans covering 761,000 employees and retirees. Despite the backing of legislative leaders, approval by a majority of both houses is not assured.

"The Senate president will be debriefing members of his caucus in the coming days in hopes of garnering support," said Ronald Holmes, a spokesman for Senate President John Cullerton.

Illinois has the lowest credit standing among U.S. states from the three biggest rating companies, at four steps above junk. The firms have repeatedly cited the pension shortfall as the basis for the reductions.

By Tim Jones – Nov 29, 2013 11:47 AM PT

San Jose Pension Crush Spurs Bid to Ease California Pacts.

If Chuck Reed were a private employer and saw his pension costs triple in 10 years, he could cut future benefits as allowed under a federal law known as the Employee Retirement Income Security Act.

Reed, though, is mayor of San Jose, California, and the law doesn't cover the public employees he oversees. Their pensions are treated as a contract between the government and worker. While cities are allowed to make changes for new hires, union representatives say that future benefits promised to existing workers can't be modified.

The result is that San Jose, the home of Silicon Valley giants Cisco Systems Inc. (CSCO) and EBay Inc. (EBAY), spent almost one third of its general fund on pensions last year, the highest among the 25 most populous U.S. cities, according to Morningstar Inc. (MORN) Reed, a 65-year-old Democrat,

is leading a statewide voter initiative to allow changes in future benefits for existing employees as unions fight to preserve the current rules.

“The statewide measure allows us to begin to deal with the cost of skyrocketing pension and retiree health-care costs,” Reed said in an interview. “If you look at what we’ve done so far, it doesn’t solve the problem.”

San Jose, a city of 983,000 that is California’s third-largest, has been forced to make deep cuts in basic services as its retirement costs soared to $245 million in 2012 from $73 million in 2002. The city’s pension and retiree health-care liability is almost $3 billion, according to Reed, who was first elected in 2006.

Changes Approved

San Jose voters last year approved retirement changes requiring new employees to pay 50 percent of the plan’s total cost, or about twice as much as current employees. Workers already on the city’s payroll could keep their existing plans by increasing their contributions or keep their costs steady by choosing a plan with more modest benefits.

Unions including the San Jose Police Officers’ Association and the San Jose Retired Employees Association sued to block the change. The case is pending.

Reed’s ballot initiative would amend the California constitution to give local governments the power to negotiate changes to existing employees’ future pension or retiree health care, while protecting benefits they’ve already earned.

“What they’re trying to do is overturn decades of case law, Supreme Court decisions and change the California constitution to allow public employers to either change, cut or eliminate public employees’ pensions in the middle of their career,” said Dave Low, executive director of the California School Employees Association and chairman of Californians for Retirement Security, a coalition of public employees and retirees.

“It’s a vested right,” Low said.

Rhode Island

Rhode Island enacted pension changes in 2011 that will delay retirement for state employees and offer them 401(k)-type savings plans that don’t provide guaranteed benefits. Union leaders sued to prevent the measure from taking effect.

“In talking with other mayors around the state, everybody would benefit from having clear authority to be able to negotiate changes for future benefits for work yet to be performed for current employees,” Reed said of his ballot measure.

Mayors Pat Morris of bankrupt San Bernardino, Tom Tait of Anaheim and Bill Kampe of Pacific Grove are backing the plan. Santa Ana Mayor Miguel Pulido dropped out as a formal supporter and was replaced by Vallejo Vice Mayor Stephanie Gomes. Opponents include Oakland Mayor Jean Quan and San Francisco Board of Supervisors President David Chiu.

‘Threatens’ Teachers

Also assailing the plan are the California Public Employees’ Retirement System, the largest U.S. public pension, and the California State Teachers’ Retirement System, the second-biggest U.S.

public pension contending with a $70 billion unfunded liability.

The proposal “threatens the retirement security of existing and future educators, who have provided many years of service to California’s students,” Jack Ehnes, the teacher pension’s chief executive officer, said in a statement.

Reed said cities can continue to cut services and raise taxes, make employees pay more, cut benefit payments to retirees or cut benefits for current employees.

“None of those is fair, so it is better to talk about changing expectations of future accruals for future work,” Reed said.

California municipalities have limited ability to boost revenue. They can’t impose higher sales taxes without going to voters, and the state caps real-estate levies at 1 percent of a property’s most-recent sales price. The collapse of the housing market eroded tax dollars for many cities in the wake of the recession.

‘Not Sustainable’

“It’s not sustainable for cities to attempt to provide an appropriate level of health, safety and welfare services and have a significant portion of their general fund go for employment and pension costs,” Karol Denniston, a partner specializing in municipal restructuring at the San Francisco office of Schiff Hardin LLP, said in an interview.

Among potential obstacles to Reed’s plan is California Attorney General Kamala Harris. Unions were her second-largest source of campaign contributions when she won her office in 2010, according to data compiled by the National Institute on Money in State Politics, a nonpartisan group based in Helena, Montana.

Harris is responsible for writing the title and summary of the initiative before it’s circulated for signatures to qualify for the ballot. Most voters never read more than the title and summary of the text, according to the Denver-based National Conference of State Legislatures.

‘Pro-Citizen’

“You have to hope for an attorney general who is pro-citizen and impartial the way an attorney general should be, and they should not be worried about who funds their campaign,” said David Crane, a public policy lecturer at Stanford University near Palo Alto and a former special adviser to former Republican Governor Arnold Schwarzenegger.

Harris hasn’t taken a position on any initiative, Nick Pacilio, a spokesman for her, said by e-mail. Governor Jerry Brown, a Democrat, doesn’t comment on ballot measures, spokesman Evan Westrup said.

Reed said he anticipates unions will try to block signature gathering. The measure needs more than 807,000 petition signers to qualify for the ballot. Low, of Californians for Retirement Security, said he expects to discourage signature-takers.

“We generally try to keep voters informed,” Low said. “Where the signature gatherers are out there, we would probably want to at least have an opportunity to clarify for the voters what they’re signing.”

By Alison Vekshin – Nov 28, 2013 9:00 PM PT

GASB Resolves Transition Issue in Pension Standards.

Norwalk, CT, November 25, 2013—The Governmental Accounting Standards Board (GASB) today issued a Statement regarding the transition provisions of GASB's new pension standards for state and local governments. GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68, eliminates a potential source of understatement of restated beginning net position and expense in a government's first year of implementing GASB Statement No. 68, Accounting and Financial Reporting for Pensions.

To correct this potential understatement, Statement 71 requires a state or local government, when transitioning to the new pension standards, to recognize a beginning deferred outflow of resources for its pension contributions made during the time between the measurement date of the beginning net pension liability and the beginning of the initial fiscal year of implementation. This amount will be recognized regardless of whether it is practical to determine the beginning amounts of all other deferred outflows of resources and deferred inflows of resources related to pensions.

The provisions are effective simultaneously with the provisions of Statement 68, which is required to be applied in fiscal years beginning after June 15, 2014.

Statements 68 and 71 are available on the GASB website, www.gasb.org.

WSJ: Illinois Pension Fix Faces Political Test.

CHICAGO—Top lawmakers in Illinois reached a long-sought agreement to fix the nation's most broken state public-employee retirement system, but the deal faces likely resistance from some legislators and unions who fear it will mean deep cuts to pension benefits.

Democratic and Republican leaders in the Illinois legislature announced the agreement on Wednesday and are expected to release details Friday. They said the plan would save an estimated $160 billion by reducing cost-of-living increases for retirees, raising the retirement age for younger workers and capping the salary amount used to calculate pension payments. That would close the large gap between promised benefits and current assets to pay for them over the next 30 years, they said.

In coming days, legislative leaders and Gov. Pat Quinn, a Democrat, will try to sell the plan to rank-and-file members of the House and Senate, many of whom have rejected proposed changes to the retirement system over the past two years. Votes are expected Tuesday.

The governor has staked much of his tenure on righting the troubled retirement system, making passage of an overhaul plan particularly important as he prepares to run for re-election next year. He is seen as vulnerable in his bid for a second term, with a crowded field of Republicans vying to challenge him. A poll conducted by Public Policy Polling earlier this month showed 34% of those surveyed approved of Mr. Quinn's job performance.

The agreement also is expected to provide a template for Chicago Mayor Rahm Emanuel to follow for his city, which for years has paid far less into its retirement system than needed to keep it solvent. City payments to local pension funds are set to more than double to nearly $1.1 billion

starting in 2015. Mr. Emanuel has warned that if changes aren't made, the city will face a combination of property-tax increases and cuts in services, equating the scheduled increase to the cost of having 4,300 police officers on the street.

"Illinois's pension crisis will not truly be solved until relief is brought to Chicago and all of the other local governments across our state that now stand on the brink of a fiscal cliff," said Mr. Emanuel, who would face re-election in 2015.

While other states from Wyoming to Rhode Island have been paring back retirement benefits in recent years, Illinois lawmakers have remained deadlocked over how to address a pension-system shortfall that has ballooned to nearly $100 billion. The result: Illinois has the lowest credit rating among U.S. states, and the rating for Chicago is among the lowest for major U.S. cities.

To date, unions have successfully argued that government workers shouldn't be punished for decades of mismanagement by the state, which underfunded the retirement system. But union leaders have seen support erode as concern over the state's finances grows and their sway in a statehouse dominated by Democrats ebbs. "This has been an epic pension battle," said Michael Carrigan, president of the Illinois AFL-CIO. "We are marshaling our resources."

Dire fiscal problems in such places as Detroit and Puerto Rico have left lenders increasingly leery of Illinois and its largest city. While Illinois and Chicago remain in a considerably stronger financial position than those places, analysts say both Illinois and Chicago are considered distressed. Appetite for such debt has become weaker and interest costs have risen.

Howard Cure, director of municipal research at Evercore Wealth Management LLC, said Illinois finance officials have become more aggressive in marketing their bonds and have been reminding investors the state constitution puts debtholders first in line for payments. Illinois's 10-year bonds trade at a premium that is more than triple California's, but well below Puerto Rico's, according to Thomson Reuters Municipal Market Data.

Mr. Cure said if Illinois can pass an overhaul that delivers significant retirement-system savings, it could begin to win back investors. "It's a pretty diverse state. It's not as if Illinois went through what Michigan went through," he said, referring to the near-collapse of the auto industry during the recessionand Detroit's recent efforts to refinance its debt through bankruptcy.

But failure to pass an overhaul plan could have an equally damaging effect, with the higher premiums attached to Illinois debt becoming commonplace rather than a temporary exception, said Duane McAllister, a portfolio manager at BMO Global Asset Management.

"It's not Detroit, and it's not Puerto Rico. Unfortunately, it gets thrown into the same trading basket," said Mr. McAllister, referring to Detroit's bankruptcy filing and a selloff in the island's bonds amid concerns about a wide budget deficit there. He added that as an owner of Illinois debt, he is guardedly optimistic about the latest agreement.

The agreement is the first time top leaders in the state's House and Senate have backed the same plan. Senate President John Cullerton, a Democrat, pushed for a proposal earlier this year, backed by unions, that would have given employees choices over benefit cuts and found savings through retirement health care. But House Speaker Michael Madigan, also a Democrat, opposed it, saying it didn't deliver enough savings.

Now, union leaders are gearing up to fight—first at the capitol and then in court if necessary. They are encouraging members to call their legislators and visit their offices in the coming days in what

they have dubbed a pension emergency. If the bill passes, labor leaders expect to sue the state, arguing benefits promised to employees and retirees are protected under the state constitution. The challenge has long been discussed by unions, with the state likely to argue that certain benefits aren't protected, particularly in light of the state's fiscal problems.

"You would have a line at the courthouse door," said Anders Lindall, a spokesman for American Federation of State, County and Municipal Employees in Illinois. "Every teacher, every nurse, every caregiver, every public employee and retiree would have standing to sue."

By MARK PETERS and AL YOON CONNECT

Updated Nov. 28, 2013 6:29 p.m. ET

GFOA Awards for Excellence in Government Finance.

The GFOA's Awards for Excellence in Government Finance recognize innovative programs – contributions to the practice of government finance that exemplify outstanding financial management. The awards stress practical, documented work that offers leadership to the profession and promotes improved public finance. Entries may be submitted for consideration in any of the following categories:

- Accounting, auditing, and financial reporting
- Budgeting and financial planning
- Capital finance and debt administration
- Economic development and capital planning
- E-Government and technology
- Management and service delivery
- Pensions and benefits
- Treasury and investment management

Eight criteria are examined when considering an application for the award: local significance and value, technical significance, transferability, documentation, the cost/benefit analysis, efficiency, originality, and durability. Membership in the GFOA is not required to apply for an award; however, nonmembers and students must be sponsored by an active GFOA member.

Please read the FAQs for complete information about the Awards for Excellence program:

http://www.gfoa.org/index.php?option=com_content&task=view&id=1417

If you have additional questions, send an e-mail to Awards for Excellence:

http://www.gfoa.org/index.php?option=com_contact&task=view&contact_id=84&Itemid=3

Applications for the 2014 Awards for Excellence in Government Finance program are available here:

http://www.gfoa.org/downloads/GFOAAwardsforExcellenceApplication2014.pdf

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Jefferson County's Bankruptcy Left Few Winners as Debt Forgiven.

The impact of Jefferson County's bankruptcy will reverberate for decades in Alabama and in the $3.7 trillion U.S. municipal bond market.

Creditors, including JPMorgan Chase & Co. (JPM), agreed to forgive $1.4 billion of the county's $3 billion sewer bonds. Ratepayers, like Charles Hicks, a retired landscaper who lives on a fixed income in Birmingham, will see his sewer rate rise about 8 percent annually for the next four years and 3.5 percent annually thereafter, under a plan approved by a federal judge yesterday.

"There's a lot of pain going around — bondholders are taking large losses, but ratepayers are as well," said Matt Fabian, a managing director at Concord, Massachusetts-based Municipal Market Advisors.

For the next 40 years, residents and businesses that already have some of the highest sewer rates in the county will pay back more in principal and interest than they owed before the bankruptcy, according to an analysis by Jim White, a Birmingham-based financial adviser who did a financial analysis for residents challenging the bankruptcy plan. Until Detroit's July filing, Jefferson County was the nation's largest municipal bankruptcy.

The willingness of Alabama's most populous county to enter bankruptcy, along with the losses imposed on creditors, may make bondholders of other distressed municipalities more willing to to negotiate outside of court. Taxpayer groups will look at Jefferson County and see that bankruptcy won't wipe away their obligations, Fabian said.

Lawyer Fees

"It does take the thunder out of taxpayer groups who are looking to get into bankruptcy just to shed debt, because it shows that those taxpayers could also be put on the hook to contribute in the future," Fabian said.

Since filing the $4.2 billion case in November 2011, the county has spent more than $24 million on attorneys and other advisers. Most of the payments went to the county's two main law firms.

Klee, Tuchin, Bogdanoff & Stern LLP in Los Angeles, which is led by Ken Klee, the lawyer who helped rewrite the U.S. Bankruptcy Code in the 1970s, collected $10.1 million in fees and was reimbursed about $204,000 for expenses. The second firm, Bradley Arant Boult Cummings LLP, which has offices in Birmingham, collected $8.2 million in fees and was reimbursed about $294,000 for expenses.

Enforcing Rates

Under an unusual provision in the exit plan approved by a federal judge yesterday, Jefferson County's commissioners' power to set and enforce rates will be limited until the $1.84 billion on bonds sold this week to pay creditors are paid off in 2053. The trustee for bondholders can ask the court to force sewer rate increases that may be needed to pay the debt.

The challenges facing the county's finances and its sewer system won't end with bankruptcy. Because the new bond issue pushes debt service payments into the future, rising 67 percent in 2024, the county is facing a projected $1.2 billion gap in money available to maintain the sewer system. A consulting firm that conducted a feasibility study for the county said it couldn't identify where the county would get money to pay for capital spending.

The rate increases pledged to pay debt service will impose a “high burden” on ratepayers, and would cause rates to “approach the limits of reasonableness,” according to the Chicago-based consulting company, Galardi Rothstein Group.

Increasing Costs

Sewer rates will rise 7.9 percent each year for four years, starting in 2014, and by almost 3.5 percent annually through 2053. That’s on top of a 329 percent increase from 1997 to 2008 after the county embarked on a capital program to comply with a U.S. Environmental Protection Agency decree to clean up discharges into the Cahaba River.

The cost of Jefferson County’s sewer system ballooned to $3 billion as the county built treatment plants and laid pipe without a strategic plan and local officials accepted bribes from construction contractors and financial advisers seeking business with the county.

The sewer rate increases will disproportionately affect the poor. Seventy percent of the sewer system’s users reside in the commission districts with poorest residents, according to County Commissioner George Bowman, who voted against the bankruptcy.

“This whole process had been fraudulent to the ratepayer,” said Hicks, 67, who heckled Carrington after U.S. Bankruptcy Judge Thomas Bennett approved the plan.

Wealthy Benefit

Under Alabama law, sewer rates must be reasonable and nondiscriminatory. Ratepayers who objected to the county’s plan are vowing to continue legal challenges.

Some residents in wealthy Birmingham suburbs, who have septic tanks and aren’t connected to the sewer system, don’t have to pay additional charges even though they get the indirect benefit of the county having clean water.

Calvin Wood, president of the Birmingham Chapter of the Southern Christian Leadership Conference, said it was wrong that county officials didn’t spread the pain of rate increases evenly.

“Unless you’re going to put it across the board on everybody, you’re still going to have a lot of trouble,” Woods said. “All of us live in the county.”

By Martin Z. Braun

L.A. Bars Broker-Dealers in FA Bid Process, FirstSouthwest Protests.

Los Angeles is seeking financial advisors for bonds issued in several categories, but underwriters need not apply, according to two recent requests for proposals issued by the city.

FirstSouthwest sent a seven-page letter to Los Angeles officials Friday protesting the language in two RFPs seeking financial advisors but excluding firms “that underwrite or otherwise trade in municipal bonds.”

That language appears in the qualifications section of an RFP seeking a financial advisor to work on the city’s general obligation bonds and wastewater system revenue bonds.

“We feel very strongly that the RFPs should be changed to allow bidding by all qualified firms,” wrote Jack Addams, vice chairman of FirstSouthwest. “Because other qualified firms excluded under the current wording may wish to respond, we suggest the city extend the due dates if the RFP’s are modified.”

Addams said in his letter that FirstSouthwest would be responding to the RFP on Nov. 22, regardless of whether changes are made and that they would protest if their response is not considered.

The city doesn’t seem likely to make changes in the middle of an RFP process in which the deadline for responses was Nov. 8; and the city anticipates making a decision on Dec. 2.

Natalie Brill, Los Angeles’ debt manager, said she couldn’t comment on the RFP process until after the final selection is announced Dec. 2.

The protest letter was sent to Brill; City Administrative Officer Miguel Santana; City Attorney Mike Feuer; and Paul Krekorian, chair of the City Council Budget & Finance Committee.

Los Angeles’ debt management policy, adopted in 2005, deems it a conflict of interest for firms to do business with the city as both an underwriter and financial advisor.

“The city has a policy that the financial advisor must be independent and can’t have an underwriting arm,” said Jeremy Oberstein, a spokesman in Krekorian’s office.

FirstSouthwest officials don’t think the issue is quite so clear cut.

Regulations adopted by the Municipal Securities Rulemaking Board, Dodd-Frank legislation, and changes proposed by the U.S. Securities & Exchange Commission that go into effect in mid-January have changed the playing field with rules regulating how FAs operate.

FirstSouthwest would like the city to remove the language excluding underwriters noted in the first RFP and in another RFP seeking a financial advisor for eight different bond categories including general fund lease financings and tax anticipation notes, in which the city explains that while it has “in the past, accepted proposals from investment banking firms to act as financial advisors, the city now only hires independent financial advisors for general financial advisory services and the city’s various bond programs.”

It further says, “In light of the scope of the engagement and the emphasis on non-transaction-related financial advisory services, as well as the city’s desire to hire financial advisors with no vested interest in the issuance of debt, the city will not consider proposals from firms that underwrite or otherwise trade in municipal bonds to serve as the lead financial advisor, in accordance with MSRB [Municipal Securities Rulemaking Board] G-23.”

In November 2011, MSRB’s Rule G-23 was modified to prohibit dealers from serving as financial advisors and underwriters on the same municipal bond deal.

“Their debt policy that is available through their web page is somewhat less restrictive than what is in the current RFP,” said Brian Whitworth, senior vice president for FirstSouthwest.

The city used underwriters as co-financial advisors before the MSRB came out with its rules, but typically only in special situations where it wanted sell-side advice on an issue, city officials said.

Based on the language in the RFP, Whitworth said apparently the category allowing underwriters to act as co-financial advisors is now gone.

“We feel very strongly that all qualified financial advisors should be able to submit an application,” Addams said. “The city should be able to pick whoever they want. We object to the city excluding very qualified FAs from even being able to apply.”

Southwest officials question why the city frequently uses KNN Public Finance as a financial advisor, when the financial advisory firm is a division of Zions First National Bank, an underwriter. FirstSouthwest also was selected to act as a financial advisor for the Los Angeles Housing Department in 2006 and 2010, but was told it would not be considered for the city itself, its port, airports, and the Department of Water and Power, Addams said.

“There is no definition of ‘independent’ in any regulatory rules,” Addams said. “That is why we wanted them to understand the ownership structure of PFM and KNN, who currently work for the city.”

PFM, an advisor the most recent Los Angeles International Airport deal, is owned by a group of private equity investors that includes at least one underwriting firm that has an ownership interest, according to FirstSouthwest’s letter.

The MSRB’s fair-dealing rule requires underwriters to disclose to issuers that they do not have any fiduciary duty and that the transaction will be at arm’s length.

Addams thinks those disclosure rules and similar ones outlined in Dodd-Frank will ensure that if a firm that conducts underwriting business is hired as an FA there is a guarantee it will act in the city’s best interest.

The SEC is about to add its take on the issue when its municipal advisor rules takes effect by mid-January. Its rule would require anyone offering advice about municipal bonds, municipal derivatives, or the investment of bond proceeds to an issuer or other municipal entity or conduit borrower to register as a municipal advisor.

“There have been a lot of changes since the city adopted its debt policy in 2005,” Addams said. “We have made a decision as a company that we will challenge this where we see it.”

In a city as prominent as Los Angeles, Addams said, “it’s very important we challenge this.”

FirstSouthwest was successful in getting Broward County, Fla. and Broward County School District to change the language in its RFPs allowing underwriters to be considered for FA work, according to Addams.

Two issuers interviewed for the story have not heard of anyone other than Los Angeles adopting such a policy, but said they understand why an issuer might do so.

“My guess is that on a practical basis, this will make it easier for all concerned to serve either in a fiduciary, or non-fiduciary role without any overlap,” said Laura Lockwood McCall, director of debt management manager at the Oregon State Treasury.

Julia Harper Cooper, director of finance at the City of San Jose, said issuers might feel better with a “clear delineation” between who their FA is and who their underwriter is, without worrying whether the lines might be blurred.

“It becomes more comfortable for issuers,” she said.

The Government Finance Officers Association “has discussed the issue of recommending that

governments use independent FAs vs. those associated with broker/dealer firms in the past," said Timothy Firestine, GFOA president and chief administrative officer of Montgomery County, Md.

"Due to the forthcoming MA rule, it is likely that this subject will be discussed again, as GFOA looks to ensure that issuer practices are in line with the rule. From my personal experience as a CFO, it is a better practice to use an independent FA. Helps avoid even the appearance of a conflict of interest."

BY KEELEY WEBSTER

Moody's: Detroit's DIP Proposal Differs Substantially From its Corporate Predecessors.

The new Debtor-in-Possession (DIP) financing proposal that the City of Detroit's Emergency Manager put forth on October 11, 2013 is unprecedented among municipalities, says Moody's Investors Service. Because of this and some key differences from more common corporate-based DIPs, the ultimate impact of the proposal on the city's finances and existing bondholders is uncertain, says Moody's in the report "Detroit: DIPing its Toe into a Corporate Bankruptcy Tool."

DIP financings are commonly used in the corporate sector to inject liquidity into a bankrupt entity, with the objective of paving the way for eventual recovery. Although structurally similar with respect to most terms, the proposed Detroit DIP has several key differences.

The most significant difference is the use of proceeds. Corporate DIPs are traditionally used to provide operating financing and liquidity, with limited draws on the DIP commitment at closing. Conversely, Detroit's proposed DIP financing plan would immediately deploy 100% of the transaction proceeds.

"The full utilization of all note proceeds highlights the city's ongoing narrow cash position that persists despite already ceasing all debt service payments on liabilities deemed unsecured by the state-appointed emergency manager, as well as deferral of the city's employer pension contributions," says Genevieve Nolan, a Moody's Assistant Vice President.

While corporate DIP financing plans can be a credit positive by providing liquidity that facilitates continued operations, the ultimate credit impact of Detroit's DIP financing proposal is not clear at this time.

"The impact of the proposal on the city's existing creditors, as well the city's near-term financial position and long-term financial recovery, are difficult to assess at this point given the number of contingencies that remain," says Nolan.

Ultimately, it is uncertain whether the judge overseeing the current bankruptcy hearings will permit the DIP financing to proceed.

For more information, Moody's research subscribers can access this report at https://www.moodys.com/research/Detroit-DIPing-its-Toe-into-a-Corporate-Bankruptcy-Tool–PBM_PBM160112.

GASB Toolkit Helps Pension Plans Implement New Accounting Standards.

A new online toolkit designed to help preparers and auditors of state and local government pension plans implement new accounting and financial reporting standards was released today by the Governmental Accounting Standards Board (GASB). The toolkit is available at no cost at the GASB website:
http://www.gasb.org/cs/ContentServer?c=Page&pagename=GASB%2FPage%2FGASBSectionPage&cid=1176163527830

GASB Statement No. 67, Financial Reporting for Pension Plans, revises existing guidance for the financial reports of most pension plans for state and local governments. These plans are required to implement the new accounting standards in fiscal years beginning after June 15, 2013 (that is, for years ending June 30, 2014 or later).

Prepared by the GASB staff, the toolkit includes the following resources:

- The Guide to Implementation of GASB Statement 67 on Financial Reporting for Pension Plans, an authoritative resource guide
- A video featuring GASB Chairman David A. Vaudt discussing the top implementation issues facing pension plans
- A podcast featuring GASB Project Manager Michelle Czerkawski discussing the types of pension plans that will be affected by Statement 67 and the most significant changes to accounting and financial reporting for pension plans
- A background document answering frequently-asked questions regarding Statement 67 and Statement No. 68, Accounting and Financial Reporting for Pensions
- A fact sheet answering frequently-asked questions specifically relating to Statement No. 67
- An article identifying several areas plan administrators and public officials should consider as they plan, prepare, and collaborate when implementing the new standards
- A “Setting the Record Straight” document addressing common misperceptions about the new pension standards, and
- The executive summary and the full text of GASB Statement 67.

“Many of our stakeholders have requested additional educational resources to help them implement the new standards,” said GASB Chairman David A. Vaudt. “This toolkit is intended to provide guidance on how plan administrators can effectively comply with the new rules. In the coming weeks, we will add more resources to the toolkit, including short videos from GASB staff highlighting our most-asked implementation questions.”

Credit Concerns Overhang the Latest Muni Industry Conference: MuniNetGuide.

Notes from the Bloomberg State & Muni Finance Conference

As previously mentioned in this column, Bloomberg held their State and Muni Conference on November 6th in New York City. Right at the outset, the choice of venue was rather unconventional: the proceedings were held at The Cutting Room, a small rock and blues club owned by “Mr. Big” himself, Actor Chris Noth. Certainly, it was quite interesting for the panelists to be on the same stage where the likes of Ron Wood, Mick Ronson and Marty Balin will be performing.

The 300-pound gorilla in the room was, of course, Puerto Rico (PR).

Since video clips for most of the panels are available for viewing on the Bloomberg conference site, we'll just go over a few things we found noteworthy.

Perhaps to no one's surprise, credit topics dominated the discussions at the Conference, particularly those issues with potential "systemic" implications (I sat next to a representative from the FDIC, there to ferret out any and all systemic risks to our banking system!)

The Detroit situation was touched upon by several panels but no new information really emerged from the various discussions.

The 300-pound gorilla in the room was, of course, Puerto Rico (PR). In the very first session, U.S. Treasury Under-Secretary Mary Miller (a brilliant investment professional whom I've had the chance to know since her days as a muni analyst at T. Rowe Price) struck a very cautious note regarding potential Federal assistance to Puerto Rico. On the positive side, Mary confirmed that the Administration is closely monitoring the situation and is in close communication with the Padilla financial team. However, she also warned there is no existing Congressional authority for any kind of direct financial assistance to the troubled island. The Feds' role is currently limited to providing input regarding fiscal management practices and ensure that all federal monies that are due the Commonwealth be expended in the most effective manner possible.

From PR's side, Treasurer Melba Acosta and Chairman of the GDB David Chaffey were also on hand to hammer home their message to investors: default is not in the cards for now. Of note, after putting out press releases trumpeting stronger revenue collections in October, Treasurer Acosta appeared to back-track a little: she noted there was a special corporate tax payment due in October that could have inflated the numbers somewhat.

The second panel on PR featured Dick Larkin from H J Sims, Hector Negroni from Fundamental Advisors and Emily Raimes from Moody's. In response to Dick's unflaggingly strong defense of the PR credit, Hector observed that hedge funds should not be viewed as the "enemy", since they stepped in to provide liquidity to the market when the traditional buyers could no longer handle the risk. We could not agree more. Like Hector, we feel the muni market should welcome the participation from the hedge funds, as providers of liquidity at a time when the broker-dealer community is retrenching. Crossover distressed players are also more experienced than muni analysts, we believe, in evaluating trading opportunities related to capital structure. Broadening the audience for municipals can only benefit our asset class over the long run, in our view.

The Windy City is currently held hostage by the lack of pension progress at the state level, and Mayor Emanuel is viewed as running out of options.

Being Chicago-based, we were also interested in the panel on the State of Illinois, featuring our local pundit Chris Mier from Loop Capital. Chris pinned Illinois' fiscal problems on the One-Party rule and the high degree of work force unionization. All the panelists agreed that pension reform is the biggest issue facing the Prairie State, and one that won't be resolved any time soon. There was a feeling that the legislators in Springfield needed to be shocked by a real crisis – perhaps a failed State bond financing – in order to get off the dime. All noted the wider spreads on Illinois paper, close to +175, but none was willing to declare the credit a "buy" quite yet.

We were somewhat surprised by the lack of focus on the gubernatorial race, aside from a cursory comment from Chris. Surely, much of the legislative foot-dragging on pension reform must be attributable to the political maneuverings surrounding the election. As reported by the Chicago

Tribune, “the two-week fall session that starts Tuesday will unfold just weeks ahead of the deadline for candidacy petitions to be filed for next year’s elections. Taking a tough vote on pension reform before then risks drawing a challenger next year.” So, even some clarity as to who might emerge as a strong contender in this electoral season could become a catalyst for progress on pension reform.

In the context of Illinois, Chicago’s fiscal condition also came up and was deemed much more tenuous than the State’s. The Windy City is currently held hostage by the lack of pension progress at the state level, and Mayor Emanuel is viewed as running out of options. Chris Mier pointed out that, although traditionally trading at tighter spreads than Illinois, Chicago bonds have flipped over and now trade at much wider spreads. To that extent, they may eventually become a more interesting credit play than Illinois.

In summary, the overwhelming message we got from the Conference is that the muni credit landscape remains quite unsettled. This should translate into an abundance of muni credit opportunities, as long as you do your homework.

About the Author

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Over his 32-year career as a high yield/distressed municipal bond expert, Nguyen has designed, marketed and managed every type of buy-side investment product, from mutual funds to managed accounts and hedge funds.

GFOA Certificate of Conformance Program for Small Government Annual Financial Reports: Update.

The Government Finance Officers Association (GFOA) has announced that it has established a professional recognition program for small governments that prepare their financial reports on a modified cash basis.

Download a FAQ Sheet on the New Program:

http://gfoa.org/downloads/GFOAFAQsheetforCofCProgram.pdf

Details on how to become a Participant or Reviewer:

http://gfoa.org/downloads/GFOAConformanceCertificateDetails2013.pdf

The GFOA Certificate of Conformance Program for Small Government Annual Financial Reports is delighted to announce the program’s first winner of the Certificate of Conformance Award. The Town of Cashion, Oklahoma has demonstrated a high quality of financial reporting on a modified cash basis. Receiving this award demonstrates the exceptional dedication that the Town of Cashion has to transparency, accountability, and financial reporting. All parties involved in attaining this distinction for the town should be commended for their accomplishment. Congratulations!

Fitch: Stockton Bankruptcy Plan Could Influence Negotiations, Settlement Elsewhere.

If approved, Stockton's Plan for the Adjustment of Debts (plan of adjustment) identifies negotiation strategies, legal ambiguities, and their potential consequences for future municipal bankruptcies in California and elsewhere, according to a new Fitch Ratings report.

'Stockton's ability to achieve significant concessions from labor under threat of bankruptcy provides food for thought about incentives in other potential cases' said Amy Laskey, Managing Director.

'The specter of bankruptcy may have motivated labor, although not bondholders, to negotiate.' In future cases, labor may feel the risks of losing all negotiating power in a Chapter 9 proceeding are too great. On the other hand, they may feel that their employer's need to continue to provide competitive wages and benefits will adequately protect their interests.

Most notable is the elimination of other post-employment benefits (OPEBs), which was negotiated with current employees and retirees. The reduction in Stockton's post-employment costs meaningfully improves their affordability.

Despite bondholder objections about ongoing CalPERS payments, the city appears to have acted practically since the proposed two-thirds reduction in retiree benefits would have made those jobs uncompetitive.

Lease revenue bonds are expected to be significantly impaired. Incentive to repay lease debt depends on the importance of the leased assets, although Stockton's actions highlight the difficulty in assessing essentiality. Fitch assumed the Stockton City Hall would be deemed essential but those bonds' treatment appears to reveal that City Hall is just another office building. However, another office building with a crime lab and garage are deemed essential by the city and those bonds will be repaid in full.

The plan of adjustment adheres to the Bankruptcy Code's treatment of 'special revenues,' as debt secured by such revenue streams, including utility revenues and tax increment, will continue to be paid to the extent the pledged revenues are sufficient.

In addition to employees, retirees, and bondholders, taxpayers are being asked to contribute to the city's recovery by approving a three-quarter cent sales tax increase this November.

For more information, a special report titled 'Stockton Bankruptcy Perspectives' is available on the Fitch Ratings' web site at www.fitchratings.com.

GASB: Pension Standards for State and Local Governments.

This webpage offers a variety of resources designed to support the understanding of GASB Statements No. 67, Financial Reporting for Pension Plans, and No. 68, Accounting and Financial Reporting for Pensions, which substantially improve the accounting and financial reporting of public employee pensions by state and local governments that apply U.S. Generally Accepted Accounting Principles (GAAP).

http://www.gasb.org/jsp/GASB/Page/GASBSectionPage&cid=1176163528472

CalPERS Loses San Bernardino Appeal.

The California Public Employees' Retirement System filed an amicus brief last week in support of the state government in a case involving the successor agency to San Bernardino's former redevelopment agency.

The filing came the same day that U.S. Bankruptcy Judge Meredith Jury ruled against CalPERS' appeal of the city's eligibility to be in bankruptcy.

The pension fund's attorneys argued in the appeal that the judge granted eligibility on Aug. 28 despite shortcomings in the city's case.

CalPERS filed the amicus brief on Thursday in support of two other state agencies – the Department of Finance and the Office of the State Controller – in their ongoing dispute with the San Bernardino over tax revenues relating to the dissolution of the city's redevelopment agency and the operations of the successor agency.

The state government shut down redevelopment agencies in 2012, and says San Bernardino inappropriately held on to $15 million that belonged to the former city redevelopment agency.

San Bernardino City Attorney James Penman argued in his filing against the state agencies that the city could not afford the $15 million and would be forced to shut down. Bankruptcy protection prevents creditors from seizing assets or from suing entities under that protection. Penman is trying to make the DOF order part of the bankruptcy case.

The city lost the first round on that issue when Jury ruled on Sept. 11 that the city and the successor agency to its redevelopment agency are separate entities, making it a non-bankruptcy court issue.

In that ruling, Jury said in court documents that if the successor agency had a dispute with the state's Department of Finance, it should take the issue to state court. Jury also left the door open for the city to file before her a second time, which the city did.

She has yet to rule on the second filing.

The Department of Finance filed an appeal Oct. 1 with the U.S. Ninth District Court of Appeals arguing that Judge Jury doesn't have jurisdiction on the redevelopment issues.

In its "friend of the court" brief in support of the state agencies, CalPERS argues that the 11th Amendment to the U.S. Constitution protects state agencies from being "hauled into federal court against their will" by a municipality, which is a creation of the state. The brief also describes CalPERS as a state agency in an attempt to point out similarities between the pension fund and the state agencies.

CalPERS has been attempting to get relief from the automatic stay protecting entities in bankruptcy from being sued in state court, in order to file suit in district court against the city for the $17 million in missed fees, payments and interest currently owed by the city.

CalPERS brief argues in support of the DOF's appeal to district court on the grounds that bankruptcy is not an exception to state sovereignty.

"By characterizing [the city's] proceeding as merely one to prevent an action to collect on a debt, the

bankruptcy court gave short shrift to the serious federalism concerns that this proceeding raises," according to CalPERS brief.

In CalPERS appeal of the city's eligibility to be in bankruptcy, the pension fund's attorneys used some of the same arguments related to state sovereignty.

Jury said in denying without prejudice CalPERS appeal of the city's eligibility to be in bankruptcy that "the eligibility orders do not finally resolve or seriously affect any substantive rights of CalPERS."

The judge cited as precedent the case of Silver Sage Partners, Ltd. v. City of Desert Hot Springs, Calif. where the appeals court ruled that, "We are not convinced that Congress's whole municipal bankruptcy statutory scheme is so skewed in favor of the municipality that the commencement of proceedings itself causes irreparable injury."

BY KEELEY WEBSTER

Firm Seeks Confirmation That Benefit Pools Qualify as Minimum Essential Coverage.

Erin Sweeney of Dickstein Shapiro LLP, writing on behalf of the TML Intergovernmental Employee Benefits Pool, has asked the IRS to make clear in proposed healthcare regulations (REG-132455-11) that health benefit pools qualify as minimum essential coverage, thus triggering a reporting obligation under section 6055.

October 3, 2013

Internal Revenue Service

Re: Information Reporting of Minimum Essential Coverage

Sir or Madam:

We write on behalf of the TML Intergovernmental Employee Benefits Pool ("TML IEBP") to comment in connection with the notice of proposed rulemaking ("Proposed Rule") published in the Federal Register on September 9, 2013, by the Department of the Treasury and the Internal Revenue Service. The Proposed Rule provides guidance relating to the information reporting requirements of section 6055 of the Internal Revenue Code of 1986, as amended ("Code"), as added by the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010.

In legal terms, TML IEBP is a "risk pool" organized in 1989 pursuant to Chapter 172 of the Texas Local Government Code. A factual and functional description of TML IEBP would be to call it an interlocal cooperation employee benefits pool. A number of these pools have been formed across the country through the interlocal cooperation statutes enacted by the respective states. These entities provide pooled health benefits coverage between local governmental units. Often these pools are self-funded through the combined contributions of the members. TML IEBP is a Texas intergovernmental risk pool providing group accident and health benefits coverage to employees, officials, and retirees of political subdivisions of the State of Texas and to their dependents. This governmental pool has been successfully providing benefits to governmental entities in Texas since 1989.

We write today seeking confirmation that health coverage provided by TML IEBP may qualify as minimum essential coverage, thus triggering a reporting obligation under Section 6055 of the Code. We seek this confirmation because the regulations addressing the Shared Responsibility for Not Maintaining Minimum Essential Coverage ("Individual Mandate Regulations") are not clear that health benefit pools such as TML IEBP constitute minimum essential coverage because the term "group health insurance coverage" appears to modify the term "governmental plan". This is significant because many State health benefit pools, including TML IEBP (which are clearly "governmental plans" under section 2791(d)(8) of the Public Health Service Act ("PHSA")), are exempted from State laws regulating insurance. Without clarification, the proposed rules could be interpreted to exclude health benefit pool coverage provided by governmental plans from the definition of minimum essential coverage.

Specifically, the Individual Mandate Regulations define an "eligible employer-sponsored plan" as "[g]roup health insurance coverage offered by, or on behalf of, an employer to an employee that is . . . [a] governmental plan (within the meaning of section 2791(d)(8) of the [PHSA] (42 U.S.C. 300gg-91(d)(8))) . . ."

"Group health insurance coverage" is further defined in the Individual Mandate Regulations as having the same meaning as in section 2791(b) of the PHSA, 42 U.S.C. 300gg-91(b)(4). Under the PHSA, group health insurance coverage "means, in connection with a group health plan, health insurance coverage offered in connection with such plan."

"Health insurance coverage" is defined in the Individual Mandate Regulations as having the same meaning as in section 2791(b)(1) of the PHSA, 42 U.S.C. 300gg-91(b)(l). Under the PHSA, health insurance coverage "means benefits consisting of medical care (provided directly, through insurance or reimbursement, or otherwise and including items and services paid for as medical care) under any hospital or medical service policy or certificate, hospital or medical service plan contract, or health maintenance organization contract offered by a health insurance issuer." Although "health insurance issuer" could be read as applying only to "health maintenance organization contract", given that policies and certificates are issued by health insurance issuers, the better reading of the language appears to be that "health insurance issuer" applies to each of the delineated items — policies, certificates, plan contracts or health maintenance organization contracts.

Finally, "health insurance issuer" is defined in the Individual Mandate Regulations as having the same meaning as in section 2791(b)(2) of the PHSA, 42 U.S.C. 300gg-91(b)(2). Under the PHSA, health insurance issuer "means an insurance company, insurance service, or insurance organization which is licensed to engage in the business of insurance in a State and which is subject to State law which regulates insurance. Such term does not include a group health plan." (parentheticals omitted).

While TML IEBP is subject to limited regulation by the Texas Department of Insurance (e.g., financial oversight by the required filing of audited financial statements with the Texas Department of Insurance on an annual basis, application of certain Texas Insurance Code mandated benefits provisions, and the like), TML IEBP is not a health insurance issuer because it is not licensed by the Texas Department of Insurance. It is, however, a governmental plan.

We believe that health benefit pools such as TML IEBP and similar state health benefit pools are examples of coverage that Treasury has authority to clarify — and ought to clarify — are subject to the minimum essential coverage reporting requirements even though the health benefit pools are not subject to State laws regulating insurance. Of course, if Treasury determined that TML IEBP's health benefit pools constituted minimum essential coverage, TML IEBP would need to separately demonstrate affordability and minimum value with respect to the employer shared responsibility

payment.

Thank you for considering this comment submitted in response to the Proposed Rule issued with regard to the information reporting requirements of section 6055. If you have any questions or would like to discuss these comments further, please contact the undersigned at (202) 420-3477.

Sincerely,

Erin M. Sweeney

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DicksteinShapiro LLP

Washington, DC

WSJ: Pension Pinch Busts City Budgets.

Municipalities Grapple With Burgeoning Retiree-Benefit Costs; A Costly Perk in Springfield, Ill.

It pays for veteran firefighters and police officers here to retire around the anniversary of their hiring date—but it's costly for this city of 117,000.

Under current labor agreements, employees get a 5% bump in the pay periods around that date every year. Workers who retire during the short window get a perk: Their pensions are based on the temporarily boosted paycheck. The provision, which starts after two decades on the job, adds an average of $65,000 in lifetime payouts for each retiree who takes advantage.

Nationwide, pension costs are eating up more of city general funds, leaving less money to spend on day-to-day needs, such as garbage pickup or parks maintenance. The median spending on pensions among the country's 250 largest cities rose to 10% of general budgets in 2012, up from 7.75% in 2007, according to data provided to The Wall Street Journal by Merritt Research Services LLC. A few cities weren't available by August 2013, when Merritt collected the information.

Springfield's annual payments to the public employee retirement system have nearly tripled in the past decade to $19.8 million. The city says it spent 20% of its operations budget on pensions in the 2012 fiscal year, one of the nation's highest rates. Merritt puts the percentage at closer to 25%, based on public filings. (Merritt and the city differ on how to treat the calculation for some city employees, including those who work for Springfield's electric and water utility.)

The price of the problem can be seen around the Illinois state capital. Library branches that closed in the wake of the recession have never reopened. The Springfield Municipal Band, which was established through a 1936 referendum, has shrunk. In older neighborhoods such as Harvard Park, heavy rains overwhelm storm sewers and roads. Vacuum trucks fan out and suck up water because the city hasn't been able to afford needed road repairs.

"I have seen kids 8 and 10 years old wading waist-deep into it," said Polly Poskin, president of the Harvard Park Neighborhood Association. "The city has settled for a temporary fix, and we live with a permanent problem."

In the Enos Park neighborhood, residents have been tearing down blighted houses and building

sculpture gardens to reverse years of decline. They hoped to restore the neighborhood's pockmarked main artery to the historic brick that sits below. The city's response: It will be able to repave only eventually.

Steve Combs, president of Enos Park Neighborhood Improvement Association, said residents have become resigned to the city's constraints. For new projects, he said, "there isn't even a line right now."

Pension problems have been mounting for years in Springfield. The city contributes to three pension funds: one each for police and fire, which are controlled by local boards, and to a smaller extent, a statewide fund for other city workers. A 2008 report commissioned by the mayor at the time warned that growing pension payments would "squeeze out basic municipal services."

Years of salary increases and benefits fed the problem. The police and fire departments most recently had five-year contracts with 4% annual pay increases—plus the temporary 5% anniversary bump for veteran officers. Police agreed to a new contract last year with smaller raises, while firefighters are negotiating a new contract. Meanwhile, the number of retirees has grown.

To be sure, police and firefighters contribute a sizable chunk of their salaries to the pension funds—9.91% for police and 9.455% for firefighters. Also, as police and firefighters typically aren't eligible to collect Social Security, municipalities don't have to pay Social Security taxes on their salaries.

An analysis by Springfield officials earlier this year said below-par investment returns have exacerbated the pension problems, with the police and fire funds falling far short of the forecast annual return of 7.5%. Actuarial reports, which use an average return over several years to smooth sharp market swings, show the funds met their annual forecast only once in the past decade. That has left them with only about half the assets needed to pay all promised benefits, after being around 75%-funded a decade ago.

The result: The long-term obligations continue to increase, and funding shortfalls keep getting pushed into the future.

The police fund has called the 7.5% target set by the city increasingly unrealistic.

But Mayor J. Michael Houston, a former bank chief and investment management executive, opposes lowering the return target, saying it's realistic over the long term. In the meantime, he's cut some city positions and put surplus funds at the end of the last year into the pensions.

"The more money that we're putting in the pension funds, the less money we can put into other services for people within the community," Mr. Houston said. "This is not a problem that was created overnight. We need to approach the solution on a long-term basis."

Chicago-based consultancy Marquette Associates, which has advised the police and fire funds for the past three years, declined to comment.

Standard & Poor's Ratings Services in its most recent report on the city's finances acknowledged the steps Springfield is taking to alleviate its problems, including the workforce cuts and additional pension contributions. Still, when city debt is combined with the cost of promised pension and retiree health-care benefits, the total is $6,956 per capita. The credit-rating firm views a number more than $5,000 as high.

Although Illinois is one of only a handful of states with locally run pension funds, the state dictates

how they can invest. So while cities control salary negotiations, retirement benefits are set by the Legislature. Lawmakers, for example, voted in 2004 to give the spouse of a retired firefighter continuing benefits after any death, affecting about 290 local funds. Springfield estimated it cost an additional $653,000 in the first year.

In Springfield, the temporary pay spike may soon be a thing of the past. The new police contract ends the perk next year, and the firefighters are likely to lose it, too. Former firefighter John Sullivan, now president of the Springfield Firefighters' Pension Fund, said the benefit was originally designed to entice more highly paid older employees to leave. But, he said, "ideas have changed." Also, starting next year, the city will raise the sales tax to 8.5% from 8%. That follows an increase in sewer rates earlier this year.

The state has its own pension woes. Illinois has chronically underfunded its retirement system for state workers, university employees and teachers, while also seeing investment returns fall short of forecast levels. As a result, the state's credit rating is the lowest in the country.

As for the Legislature, so far lawmakers confronted rising costs only by reducing retirement benefits for newly hired state and local government employees. But those savings will take years to materialize.

"The real question for municipalities like the city of Springfield is: How long can we hang on?" said William McCarty, director of Springfield's budget and management office.

By MARK PETERS

Pension Bonds Draining Municipal Agencies.

Desperate to cover a $40 million shortfall in its pension fund for retired police officers and firefighters, the city of Richmond turned to an exotic loan.

But instead of tightening spending after it issued the $36 million pension obligation bond in 1999, city leaders increased the retirees' pensions.

Today, Richmond still owes more than $12 million on the bond, plus about $5 million in interest, and its pension fund remains roughly $12.5 million short. To narrow that gap and cover the debt, the city is dipping into proceeds from a supplemental property tax on residents and businesses.

The city's fiscal approach has residents like Joe Bako scratching their heads. "When you're short on funds, you don't start spending more," he said.

Some public officials and investment bankers have portrayed pension obligation bonds as a good way to shore up pension funds. The proceeds can be invested in the stock market, reaping returns potentially higher than the bonds' interest rate.

Bonds in the red

But that gamble is not panning out so far for at least five pension obligation bonds issued by California public agencies between 1999 and January, an analysis by the Center for Investigative Reporting has found.

In addition to the city of Richmond's Police and Firemen's Pension Fund, agencies with bonds in the red include Merced County and the Pasadena Fire and Police Retirement System.

Average returns on investments also have not kept pace with net interest costs on recent bonds in two other California counties: San Diego and San Bernardino. Because those bonds were issued within the past six years, it is too soon to determine how they will perform.

Since 1999, local governments and special taxing districts in California have sold more than $11 billion in bonds to shore up their pension obligations, according to the state treasurer's office.

Emboldened by the infusion of cash from pension bonds, some municipalities have enhanced employee pensions or buttressed needs elsewhere by suspending pension contributions.

"It is basically a principle where they're printing money," said Chester Spatt, a former chief economist for the Securities and Exchange Commission and a finance professor at Carnegie Mellon University. "These (bonds) strike me as irresponsible, especially in light of what we've learned" from the 2008 financial crisis.

Sign of larger problems

The bonds do not require voter approval and, by the time they are paid off, many of the public officials who approved them are long gone. "The decision happened before I got here," said Bill Lindsay, who became Richmond's city manager in 2005. "Applying hindsight to investment returns, I wish I could do that for my entire life."

Yet even after the downturn, and with growing knowledge of the risk involved, many governments continued to rely on pension bonds.

In the five places in California where pension bonds are underperforming so far, the shortfall also warns of deeper financial problems, said Thad Calabrese, assistant professor of public and nonprofit financial management at New York University. Residents of such areas might face service cuts and higher taxes, he said – or worse.

"Instead of negotiating with the unions and imposing pension reforms, for example, this is a way of kicking the can," Calabrese said.

Pension obligation bonds figured prominently in last year's bankruptcy in Stockton, which issued $125 million in pension bonds in 2007 – after it had improved retirement benefits and compensation several times. Stockton's invested pension bond proceeds lost about a third of their value in the stock market crash.

Detroit, the largest U.S. city to file for bankruptcy because of a shrinking tax base, declining population and other factors, failed to realize expected returns after issuing pension bonds in 2005 and 2006.

Agencies downgraded

Credit rating agencies increasingly are downgrading the creditworthiness of public agencies with pension bonds, which can make future borrowing more expensive. This year, Moody's downgraded pension bonds in Santa Clara, Marin, Contra Costa and Sacramento counties.

In 2010, lawmakers in Pennsylvania prohibited the state from using pension obligation bonds, citing the financial risks. And the federal Government Accountability Office has warned that pension bonds

can leave some governments “worse off than they were before.”

The nation’s first pension obligation bond was issued in 1985 for $222 million by the city of Oakland with the help of Wall Street. Roger Davis, a lawyer who consulted on the deal, said it was pulled together by the then-city manager and Goldman Sachs, with assistance from his firm, Orrick, Herrington & Sutcliffe. It may well have been conceived, he said, to enrich the pension fund without adding to the debt load.

At the time, that was a safer bet. Public agencies could issue bonds at a tax-exempt interest rate and invest in annuities, in most cases guaranteeing a rate of return higher than the owed bond interest. The next year, federal legislation removed the tax-exempt option.

A growing number of jurisdictions continued to turn to the bonds to cover raises and benefit increases given out in flush years. Then economic downturns sapped the investments.

That was the case in Oakland, which issued another pension bond for $436 million in 1997 and suffered heavy losses when the stock market plunged 11 years later. Debt deepened when the city took a 15-year break from making police and fire pension contributions. The payments resumed in 2011, but last year the city issued another pension bond for $212 million.

“They’re on their third credit card,” said Alameda City Manager John Russo, who voted against the 1997 bond when he was a member of the Oakland City Council.

Oakland’s obligations

Oakland’s current plan is to help balance the budget by taking another pension contribution holiday through June 2017. Budget problems also have forced the city to shed a quarter of its police force since 2008.

A supplementary tax on property owners in the city will generate an estimated $68 million this fiscal year, said Scott Johnson, who until last month was Oakland’s assistant city administrator. That will help repay some of the bond and the system’s unfunded pension obligations, he said.

“I feel we’re in a strong position,” Johnson said.

Jennifer Gollan is a reporter for the Center for Investigative Reporting, the country’s largest investigative reporting team. For more, visit www.cironline.org. E-mail: jgollan@cironline.org

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Moody's: Public Finance Downgrades Continue in Third Quarter but Pace Moderates.

More than 75% of US public finance rating actions in the third quarter continued to be downgrades, says Moody’s Investors Service in “US Public Finance Rating Revisions for Q3 2013: Downgrades Continue but Pace Moderates.” The exact percentage of rating actions that were downgrades in the third quarter, 77%, represented an improvement on the 83% that were downgrades for both the second and first quarters of 2013.

Moody’s expects downgrades to continue to outpace upgrades through the rest of the year despite broader economic improvement as pockets of credit pressure remain.

Specifically, of the 235 rating actions Moody's took in the third quarter, 182 were downgrades. By par amount, Moody's downgraded $53.9 billion of public finance debt in the third quarter, down from the $92 billion downgraded in the second quarter but more than the $27 billion downgraded in the first quarter.

The number of quarterly upgrades has increased modestly during 2013, from 36 in the first quarter to 45 and 53 in the second and third quarters. However, the par amount upgraded was $8 billion in the third quarter, down slightly from the $12 billion in each of the previous two quarters.

During the third quarter eight of the 10 largest downgrades in terms of par value were local governments. The most prominent of these were the City of Chicago, to A3 from Aa3, affecting $8.2 billion in debt, Chicago Board of Education, to A3 from A2, affecting $6.3 billion in debt and Philadelphia School District, to Ba2 from Ba1, affecting $3.3 billion.

In all there were 145 downgrades of local governments during the quarter, affecting $42 billion in debt. Nineteen local government downgrades were based on Moody's new approach for analyzing state and local government pensions, including those taken on the cities of Chicago, Cincinnati, and Minneapolis.

"The preponderance of local government downgrades underscores the credit pressure some local governments continue to face," says Moody's Analyst Chandra Ghosal. "We also see that despite broader economic improvement, there are still regional pockets of concentrated credit pressure."

One sign of these concentrations is the high share of downgrades in California, Illinois, and Michigan, where Moody's downgraded ratings of 79 issuers, accounting for over 40% of downgrades in the quarter.

The largest upgrade among the local governments was for the City of Atlanta's Water and Wastewater enterprise bonds to Aa3 from A1, affecting $3.1 billion in par amount of debt.

In the higher education sector, Moody's downgraded 16 institutions with $3.6 billion in debt in the third quarter, while it upgraded just three institutions with $467 million in debt. Seven of the eight public universities Moody's rates in Illinois were downgraded because of their high dependence on state funding, which has been delayed or reduced for several years. Among them was the University of Illinois, which Moody's downgraded to Aa3 from Aa2, affecting $1.56 billion in debt.

In the infrastructure sector, there were no positive rating actions in the third quarter, while there were eight downgrades affecting $4.5 billion. Of the seven, two were municipal electric utilities with exposure to nuclear-generation assets, highlighting the higher costs and risks associated with these facilities.

In the not-for-profit hospital sector, Moody's downgraded 10 hospitals and $2.67 billion in debt and upgraded eight hospitals with $2.31 billion in debt. Decline in patient admission volumes was a common driver of a majority of the downgrades. One significant upgrade in the sector was for the Indiana University Health, to Aa3 from A1, affecting $1.4 billion par amount of debt.

The housing sector was the only one where upgrades outpaced downgrades, with 10 upgrades on $474 million in debt against two downgrades on $452 million in debt. The majority of rating actions were to privatized military housing credits.

For more information, Moody's research subscribers can access this report at:

https://www.moodys.com/research/US-Public-Finance-Rating-Revisions-for-Q3-2013-Do-

ngrades-Continue–PBM_PBM159581.

Moody's: US Regulated Utilities to Continue Steady M&A.

Mergers and acquisitions in the US utilities industry will keep to a steady pace over the next few years, says Moody's Investors Service, as utilities look to expand and diversify. Moody's says utility deals have been generally neutral to credit quality because they have been financed with a balanced mix of debt and equity.

Slow growth in electricity use is forcing the utilities to look beyond their service territories for growth, says Moody's in the report "US Regulated Utilities: Expansion, Diversification Goals Continue to Support Steady Utility M&A."

"Load growth has been moderating in recent years, the slower pace driven primarily by energy conservation and efficiency, increased distributed generation and the economic downturn," says Jeffrey Cassella, a Moody's Analyst. "The slower growth has pushed some utilities to look beyond their service territories for additional load growth in areas that are growing faster than the national average."

Many utilities are also looking to expand their regulated businesses as a way to increase the stability and predictability of their cash flows, while at the same time they add to their operational efficiency as they spread operating and maintenance costs over a wider customer base.

Declining returns on equity among the utilities will also motivate the utilities to look to mergers as a way to lower costs as they seek to capture synergies and reduce overhead costs.

"The industrial logic behind consolidating a homogenous, fragmented industry sector makes sense," added Cassella, "because spreading fixed costs across a larger asset platform is more efficient and should benefit consumers longer term."

Capital markets are likely to be conducive to deals, says Moody's, access to these markets having improved since the economic downturn. Better access as well as the improved credit quality of the utilities will support more leveraged transactions.

Moody's expects regulators to remain receptive to consolidation in this fragmented industry, although regulatory intervention remains a risk. Higher interest rates may slow down the pace of debt-financed acquisitions, but rates should still remain at levels that will not hinder the financing of future deals.

For more information, Moody's research subscribers can access this report at:
https://www.moodys.com/research/US-Regulated-Utilities-Expans-on-Diversification-Goals-Continue-to-Support-Steady–PBC_159270

2013 BDA Conference Public Finance Panel Video.

BDA's Public Finance panel from the 5th Annual National Fixed Income Conference is now available on video.

Ronald Bernardi, president and CEO, Bernardi Securities, Inc., moderated a panel discussion on critical municipal bond market topics at the Bond Dealers of America (BDA) annual conference held in Chicago earlier this month.

To access video of the panel, click here:

http://www.bernardisecurities.com/research-insights/webinar/2013-bda-conference-public-finance-panel

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FASB Finalizes Guidance for Defining a Public Business.

After considering public feedback, the Financial Accounting Standards Board on October 30 finalized guidance that will establish a single definition of a public business entity for use in future accounting standards, but the board will not undertake a project on defining nonpublic entities until its future rulemaking agenda is prioritized.

After considering public feedback, the Financial Accounting Standards Board on October 30 finalized guidance that will establish a single definition of a public business entity for use in future accounting standards, but the board will not undertake a project on defining nonpublic entities until its future rulemaking agenda is prioritized.

At a meeting in Norwalk, Conn., FASB directed its staff to prepare a final accounting standards update that would amend the Accounting Standards Codification (ASC), but board members agreed that no effective date will be provided for the standard. Rather, the board decided that the final definition of a public business would be established when the term is used in a future amendment to the ASC.

The board's discussion indicated that alternative guidance to U.S. generally accepted accounting principles developed by FASB's advisory group, the Private Company Council, could be the first accounting standards to reference the new definition of a public business entity.

On August 7 FASB issued the proposed accounting standards update "Definition of a Public Business Entity: An Amendment to the Master Glossary," which set criteria for identifying a public business entity, including a requirement to file or furnish financial statements with the SEC or another regulatory agency for purposes of issuing securities.

Before finalizing the proposed guidance, board members agreed to clarify the proposal to address stakeholder concerns about the criteria for identifying a public business entity and about linking the definition of a public business entity to existing regulatory requirements.

The board ultimately voted against a staff recommendation to eliminate a criterion that an entity that has unrestricted securities and is required to periodically provide publicly available U.S. GAAP financial statements in accordance with all legal, contractual, or regulatory requirements should be considered a public business.

Callie Haley, a postgraduate technical assistant at FASB, said the staff is not aware of many instances in which an entity would be considered a public business entity based on that criterion alone. She added that the criterion conflicts with the project's objective of simplifying the process of identifying a public business entity because it introduces unnecessary complexity into the definition.

However, FASB member Thomas Linsmeier supported retaining the criterion, saying its scope would help protect the board from having to continually update its definition of a public business entity as the financial markets evolve over time.

The board accepted the staff recommendation to delay its decision about whether to amend the existing definitions of a nonpublic entity in the ASC given the board's current agenda prioritization effort.

According to Haley, the staff believes that FASB and the Private Company Council should have more time to evaluate any potential implementation issues regarding the final definition of a public business as future accounting alternatives are provided to private entities.

by Thomas Jaworski

Sandy's High Costs Spur Municipal Finance Innovation.

Faced with nearly $5 billion in losses from Hurricane Sandy's storm surge alone, severely constrained in the conventional global reinsurance market and with its premiums for traditional reinsurance essentially doubled, officials from the Metropolitan Transportation Authority turned to an alternative vehicle — catastrophe bonds.

The $200 million MetroCat Re Ltd. Series 2013-1 is the first catastrophe bond that covers storm-surge risk arising from named storms.

The deal is only one example of Sandy affecting public finance. As the one-year anniversary of the megastorm beckons, municipal issuers are still grasping what they need to do, how to do it and how to pay for it.

New York City Mayor Michael Bloomberg in June released a 420-page storm-resistance plan, which also raised a long list of questions. Who would fund what is left for the successor to Bloomberg, who will leave office Jan. 1. Bloomberg's 250 recommendations include calls for levees, floodwalls, surge barriers, bulkheads and other features for shoreline areas.

At the local level, concerns range from liquidity to the role of the federal government — how much cities and towns will receive and what strings may come — to relocating valuable assets such as police headquarters from vulnerable locations.

According to MTA chairman Thomas Prendergast, the MetroCat deal represents a capital markets breakthrough. "We anticipate that this deal represents the start of a long-term alternative reinsurance option that diversifies MTA's risk-management strategy," he said.

Risk Management Solutions Inc. of Newark, Calif., provided the risk analysis, using its North Atlantic hurricane model. RMS officials say it's the only hurricane model in the industry that quantifies risk from catastrophic hurricane-driven storm surge.

Standard & Poor's issued its first surge-only rating, assigning BB-minus which reflects the principal at-risk nature of the offering. MetroCat Re is collateralizing the reinsurance through a cat bond and has its own credit rating separate from mainstream MTA credits such as transportation revenue bonds and dedicated tax fund bonds.

Sandy was not even a hurricane at landfall, yet it struck the Northeast with an 18-foot Category 2 surge. Sandy's $71 billion worth of damage ranks second behind $108 billion Katrina, which hammered the Gulf Coast in 2005.

Peter Nakada, a managing director for capital markets at RMS, has seen a trend the past couple of years — that catastrophe bonds are more mainstream. "There's a convergence of the capital markets and reinsurance worlds," Nakada said in an interview.

"What's happened the past couple of years is that pension funds are investing more in catastrophe bonds. It's gone from a sort of fringe thing to a mainstream diversified asset."

That's a far cry from about three years ago, Nakada said.

"Pension-fund managers used to tell you that the absolute worst thing to happen was for an investment to go uncommonly wrong. If you made a 3% allocation to something like this and the wind blew too hard, they'd fire you. Now it's mainstream, something to strengthen a diversified asset class. Investors are here to stay," he said.

"This has expanded the market for insurance," Nakada said. "A lot of people think that the capital markets and reinsurance are fighting for the same pie. It's not that at all. This will actually grow the pie."

According to RMS, surge accounted for nearly two-thirds of Sandy's total insured loss. The RMS model projects a 20% chance that a U.S. hurricane will cause more damage from surge than wind, and 40% along the Northeast coast.

"Storm surge really is a separate peril,' said Nakada. "You've got to model it separately. It is the driver.

"The geography of New York City is the absolute worst for storm surge. It has a right angle. Waves are driven into the right angle. In New Jersey, New York City, Long Island it gets magnified and you saw that effect."

The MetroCat parametric index allows MTA to efficiently access capital without requiring investors to underwrite the infrastructure of the MTA, according to RMS. The index proxies MTA exposure to elevated water levels, using measurements at five key tidal gauge locations in the metropolitan area, including Battery Park in lower Manhattan.

The trigger event occurs if during a named storm, surge height reaches 8.5 feet at the Battery or 15.5 feet in Long Island Sound. This also helps the MTA plan for related capital projects such as barriers to entrances.

"The MTA gets a measuring stick and a no-haggle insurance policy," said Nakada.

According to Alan Rubin, a consultant with law firm Cozen O'Connor LP in New York, said resiliency is today's buzzword. "It used to be preparedness," said Rubin.

Federal, state and local officials called Rubin the "hurricane czar" for his work in Miami-Dade County, Fla., after Hurricane Andrew caused more than $30 billion in damage in 1992. While working in Lehman Brothers' investment banking division, Rubin helped design and underwrite the catastrophe fund for hurricane relief.

"What I like about MTA is that it did use scientific data to determine the surge level," said Rubin.

“They also used a stepped approach and they found an inexpensive source of funding for this type of protection and activity,’ Rubin said. “The biggest problem, I see, is that they need to look at debt service for these funds so that riders are not inconvenienced with fare increases at the end of the day to pay for it.”

Scientific data itself can be a variable, which can befuddle local issuers.

“You have the European model, the American model, the Asian model, all of which effectively look at different climactic effects,” said Rubin. “It’s a pretty big challenge. Part of the problem is that if you’re off by a foot in terms of a surge, the multiplier is gigantic. You try to project as close as you can get. It’s a major issue for public issuers.

“In Florida, they raise and lower the levels of the canals. Here, how you direct water is different. You have the Hudson and East rivers and essentially you want water to go a certain way.”

Rachel Barkley, an analyst at Morningstar Inc., said Sandy has made the leaders of coastal communities wiser, although planning is still difficult. “Infrastructure and liquidity are still big issues. The leaders of these affected communities want to do the right thing. The question is, what is the right thing and what is affordable? It’s hard to use a scientific approach when the scientific community can’t agree.”

And assessing cost is still incomplete, she said. “Are there capital needs down the road, direct or indirect, as a result of Hurricane Sandy? The MTA, for example, detected wires deep in the tunnels.”

MTA officials, well after extracting water from the tunnels, found corroded wires and other under-the-radar damaged equipment in its saltwater-damaged Montague and Greenpoint underwater tubes. The Montague tube, a pair of 5,000-foot tunnels, carries the R train under the East River between Manhattan and Brooklyn. The shorter Greenpoint tube transports G train riders between Brooklyn and Queens under the Newtown Creek.

“Every time you push a button, there’s a cost,” said Prendergast, while displaying some of the corroded parts at a press conference.

Some protective measures are well within the control of municipalities. Exposed areas of Long Island, for instance, are reconsidering waterfront locations for public works facilities and even first-floor headquarters for police departments.

“When you’re running a municipality, you’re not a weatherman. You wind up with your finger in the air trying to tell which way the wind is blowing,” said Anthony Figliola, the vice president of Empire Government Strategies of Uniondale, N.Y., and former deputy supervisor of Brookhaven, N.Y. “But there are tangible options to try and protect your assets with limited resources.”

Jonathan Peters, a finance professor at the College of Staten Island, said nobody envisions low-lying assets as a problem until the storm arrives. “Then the event becomes a major test,” he said. Peters referenced New Jersey Transit’s $120 million in damage to train cars left in the low-lying Kearney and Hoboken yards — despite the agency having a plan in place for four months to move the trains to higher ground.

The MTA, by contrast, moved cars to higher grounds and minimized damage.

But the MTA was vulnerable at South Ferry station in lower Manhattan, which sustained the most damage in the system — less than four years after the authority spent $600 million on a remodeling — artsy tiling and all — for an asset that sits below the water table.

“A subway station is a 50- to 100-year asset,” said Peters, whose research includes mass-transit financing. “The newest work is essentially a replacement. You can’t be doing this every four years.

“Bus rapid transit might be more reasonable to low-lying areas. The lower end of Manhattan has a lot of unanswered questions. Areas like South Street Seaport, people don’t know what to do.”

How any moves by the federal government affect local policies is still unanswered.

“There’s no clear answer,” said Peters. “No one’s saying they wouldn’t protect Kennedy Airport, but do we protect [nearby] Jamaica Bay?”

Rubin worries that Sandy has spawned “instant experts” on storm protection, further confusing local and state issuers.

“Once you have a situation like this, a very credible disaster, you get all kinds of people coming out of the woodwork, from all the agencies to scientists who say ‘oh boy, this is a chance to get a grant.’ Ninety percent of the stuff is not doable, and you have to drill down on what’s going to work and what isn’t. Otherwise, nothing happens and five years go by.”

By contrast, according to Rubin, a more focused group of engineers enabled the low-lying Netherlands to complete its $8 billion flood-defense system in 1997. It consists of computer-operated dams and sea-surge barriers. Floodgates are quickly lowered during storms.

But Nakada of RMS thinks the more ideas, the better.

“We have what we think is the best detailed surge model — the only sure model — out there, but we’re not claiming to be the single voices of truth,” he said. “We encourage our clients who are investors to do their homework.”

BY PAUL BURTON

FASB Agrees to Modify Nonprofit Cash Flow Presentation.

The Financial Accounting Standards Board on October 23 tentatively decided by a narrow vote to change the method in which several nonprofit organizations present their operating cash flows.

At a meeting in Norwalk, Conn., FASB members voted 4 to 3 to accept a proposal requiring nonprofit organizations to use the direct method of reporting cash flows from their operating activities. The direct method calls for entities to report cash flows from operating activities directly by displaying the major classes of operating cash receipts and payments.

As a result of the board’s decision, a future exposure draft would amend the existing guidance under FASB Accounting Standards Codification Topic 958, “Not-for-Profit Entities,” that encourages use of the direct method only for reporting net cash flows from operating activities. Under the existing guidance, entities that choose not to report those operating cash receipts and payments are required to report the same amount of net cash flow using an indirect method.

The board tentatively decided to no longer require nonprofits using the direct method to provide a reconciliation of net income and net cash flow provided from its operations.

A staff paper prepared for the meeting said that the feedback received from stakeholders indicated

that the direct method of reporting cash flows is more intuitive and understandable for nonprofit financial statement users, in particular donors with limited financial expertise. The paper also said the staff learned that implementation costs wouldn't represent a significant barrier from requiring use of the direct method.

FASB member Thomas Linsmeier supported the proposal to mandate the use of the direct method for reporting cash flows by nonprofit organizations, saying that the direct method better depicts operating cash flows and would make the statement of cash flows more relevant for those types of entities.

FASB member Daryl Buck, however, expressed concern about prescribing a requirement on cash flow reporting, suggesting that the board instead provide nonprofit entities with the option to select either the direct or indirect method depending on which presentation approach is more suitable for the needs of their financial statement users.

Ronald Bossio, a senior project manager at FASB, said that the cash flow statement can be most valuable for those nonprofit organizations that may experience difficulty generating cash despite receiving long-term donations and assets. "It's a very early warning sign and can be a very valuable statement," he said.

The board also considered tentative changes to the existing categories of cash flows that classify donor-restricted cash gifts for long-lived operating assets, cash dividends, and interest income from investing activities, and cash payments of interest expense on long-term capital financing activities.

FASB's latest decisions were made as part of its project on reexamining the standards for nonprofit financial statement presentation. The board previously decided to replace existing rules that require a nonprofit to present information about its funding and resources.

According to Bossio, the next steps of the nonprofit financial reporting project plan will be to complete discussions on how best to improve the information provided about a nonprofit's liquidity and address potential improvements to the entity's statement of functional expenses.

Share-Based Payments

FASB also released the proposed accounting standards update, "Compensation — Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period."

On October 2 FASB ratified the final consensus of the board's Emerging Issues Task Force to invite public comment on proposed guidance that would require that performance targets for share-based payment awards that can be met after the completion of an employee's requisite service period be treated as a performance condition that affects the vesting of the awards.

FASB will accept written comments on the proposal until December 23.

The proposal is available at:

http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176163531340.)

by Thomas Jaworski

Fitch: U.S. Public Finance Downgrades Exceed Upgrades in 3Q'13.

Fitch Ratings-New York-24 October 2013: Fitch Ratings notes that during the third quarter of 2013 (3Q’13) and for the 19th consecutive quarter, U.S. public finance rating downgrades outnumbered upgrades. Both the number of downgrades and upgrades decreased compared to the second quarter. While the number of downgrades was at its lowest level since 3Q’10, it should be noted that the number of downgrades for the first three quarters of this year (164) is similar to the number of downgrades during the first three quarters of 2012 (157).

Negative actions are expected to remain elevated, as Negative Rating Outlooks exceeded Positive Rating Outlooks (3.2:1) at the end of 3Q’13. However, the ratio of Negative Outlooks to Positive Outlooks has been slowly decreasing for the last eight quarters and is at its lowest level since 3Q’09. The vast majority of rating actions (88%) during the third quarter were affirmations, with no change in Rating Outlook or Rating Watch status. Furthermore, 90% of ratings had a Stable Rating Outlook at the end of the third quarter.

Downgrades still account for a small percentage of total public finance rating actions. Fitch Ratings downgraded 39 credits, which represented approximately 4.6% of all rating actions and $40.5 billion in par value. In 2Q’13, Fitch downgraded 68 credits. Fitch upgraded 23 credits, which represented 2.7% of all rating actions and $94.3 billion in par value. In 2Q’13, Fitch upgraded 24 credits.

The number of downgrades exceeded upgrades by a margin of 1.7:1, which decreased from 2.8:1 in the prior quarter. The downgrade to upgrade ratio by par value also decreased to 0.4:1 from 5.5:1 in the prior quarter. The dramatic decrease in the ratio is largely due to the upgrade of California’s GO bonds in August.

The full report ‘U.S. Public Finance Rating Actions for Third Quarter 2013’ summarizes these rating actions by sector and can be found at www.fitchratings.com.

Proposed Lease Accounting Standard Could Raise Costs, AICPA Says.

A proposed accounting standard on leases fails to resolve concerns for current lease accounting standards and may impose additional costs on financial statement preparers, the American Institute of Certified Public Accountants said in an October 14 letter to the Financial Accounting Standards Board.

October 14, 2013

Ms. Susan M. Cosper

Technical Director

Financial Accounting Standards Board

401 Merritt 7

P.O. Box 5116

Norwalk, CT 06856-5116

File Reference No. 2013-270

Dear Ms. Cosper:

The Financial Reporting Executive Committee (FinREC) of the American Institute of Certified Public Accountants (AICPA) is pleased to offer its comments on the FASB's May 16, 2013, Exposure Draft (ED) of a proposed Accounting Standards Update (ASU) Leases (Topic 842).

We appreciate the significant efforts made to address the concerns raised by constituents on the previous exposure draft issued in 2010.

Leasing is pervasive. The depth and breadth of the market, the desire to achieve symmetry between lessees and lessors, as well as the variety of terms and economics inherent in leasing arrangements makes the task of reaching consensus on revisions to leasing guidance a real challenge.

FinREC has been supportive of the board's project to revise lease accounting and the issues identified in the March 19, 2009, Discussion Paper Leases: Preliminary Views. The FASB and IASB identified three criticisms of current lease accounting requirements:

a. Many leases are off-balance sheet despite the fact that financial statement users believe that they give rise to assets and liabilities that should be recognized in the financial statements of lessees. This forces users to adjust the reported amounts in the financial statements in connection with those transactions.

b. The existence of two very different accounting models for leases means that similar transactions can be accounted for very differently, which reduces comparability for users.

c. Existing lease accounting standards provide transaction structuring opportunities that make the financial statements less transparent for users.

Cost benefit

A cornerstone of the response to these criticisms is that a lessee should recognize the assets and liabilities arising from a lease. We agree with this core principle and with the notion that many leases inherently include a financing component that justifies the recognition of a liability by the lessee, and the conceptual merit of recognizing the associated rights conveyed in exchange for assuming the liability. However, FinREC is concerned that other important objectives have not been met and that the overall standard is not a sufficient improvement over today's guidance to support adoption of the proposals in the ED. We are also concerned that adoption of the provisions of the ED will impose significant costs on financial statement preparers — both on transition and on an ongoing basis. Some costs represent the investment in new accounting systems and associated controls that may ease financial reporting burdens once implemented. However, the complexity inherent in the construct of the dual model, specifically the distinction based on whether the leased item is property, and the ongoing required judgments, represent a permanent increased level of effort. A lease accounting model that is general enough to consider all the various types of leasing arrangements and provides a single recognition and measurement approach has proven to be a challenge. As such, we understand why the ED proposes a dual model; however, the dual model as currently proposed is not sufficiently operational and does not incrementally improve financial reporting in a cost-effective manner.

We believe that, in formulating a final standard, the board should give robust consideration to cost/benefit. That could include performing additional field testing of the standard and evaluate how to strike a better balance between the technical and practical/operational aspects of any proposed

changes to leasing. FinREC believes that any transition to a model with most leases on balance sheet will by necessity involve a significant level of effort. However, it would appear that additional accommodations with respect to classification, transition and remeasurement, some of which we will discuss later in this letter, would reduce the cost without sacrificing transparency objectives of this project.

Impact on Lessors

FinREC believes that the emphasis on recognition of the liability by the lessee, and the desire for symmetry, creates significant challenges for lessors — notably the notion that recognition of the right to use a small portion of a nonproperty asset represents a sale on the part of the lessor of a corresponding portion of the leased asset. FinREC understands the desire for symmetry between lessors and lessees, but we believe this has complicated efforts to achieve consensus on a new standard that meets the key objectives laid out in the discussion paper while providing users with improved relevant and representationally faithful information. While symmetry is a desirable goal it is not a requirement, particularly when it could result in financial reporting that is less relevant to financial statement users than that provided today. Even under today's model, leasing often results in asymmetrical results (e.g., built-to-suit leasing, real estate sale-leaseback transactions, sales type leases of real estate). Nor is this confined to leasing. Asymmetrical accounting between the parties involved in a transaction is pervasive.

The introduction of the dual model goes some way toward mitigating concerns expressed by property lessors, but does not go far enough for certain lessors of other long-lived assets that they believe share many economic characteristics of property leases. We also have concerns that a model requiring classification based on the nature of the leased asset, rather than the economics inherent in the contract, may not provide users with the most decision-useful information — particularly with respect to lessors.

Lease classification

While the proposals in the ED represent an improvement relative to the initial ED in 2010, the ED's proposals do not resolve the second and third criticisms of current lease accounting standards identified by the boards. Further, it appears that the proposed disclosure requirements reflect a clear expectation that financial statement users will continue to find it necessary to make adjustments to the reported amounts in the financial statements in connection with leasing transactions, and may even need to do so for more transactions than under current lease accounting standards because users currently do not differentiate between leases on the basis of consumption.

Further, retaining a requirement to classify leases retains significant complexity inherent in today's GAAP, but with a dividing line that may not properly reflect the economics of the underlying arrangement, which adds unnecessary complexity — particularly in terms of how components are identified and classified. This is particularly apparent in leases of power plants and other assets likely to be seen as a single component but that contain aspects of both property and nonproperty. This will add to the already challenging task of splitting multiple-element arrangements into their components.

FinREC supports an approach for lessee accounting in which all leases other than short-term leases are recognized on-balance sheet by lessees. However, FinREC believes that the board should reconsider the proposed lease classification tests for income statement purposes. The ED's proposed classification tests do not appear to be responsive to the needs of financial statement users or provide benefits that outweigh the related costs. As an alternative to the current proposals, and in an effort to identify a solution that results in converged lease standards, FinREC recommends a dual

recognition method in which the pattern of recognition would depend on whether the economic arrangement is more consistent with an in-substance financed purchase or motivated more by a desire for finite usage of a given asset. We believe this classification test should be based on clearly articulated principles and field tested to ensure that it is operational. Leases consistent with in-substance financed purchases would be accounted for as Type A leases and other leases as Type B leases, both as contemplated in the ED.

If consensus resulted in classification on the basis of the guidance contained in International Accounting Standard (IAS) 17 Leases, we would not object to this split, particularly since it is similar to current proposals for property and to current lease classification guidance under U.S. GAAP but without the much criticized bright lines. This would not alter some of the conceptual and other concerns discussed above. But if a dual model is included in the standard, it may be preferable to use one that is well understood in practice and familiar to financial statement users. Such an approach would —

- Be responsive to constituents who believe there is more than one type of lease arrangement (e.g., some leases are more akin to financing of an asset and others are obtaining the right to use an asset for a finite period).
- Retain a lease classification test that is well understood in practice and familiar to certain financial statement users. This alternative does not eliminate the complexity in today's accounting guidance but would be less complex than the ED as it benefits from experience of those applying IFRS.
- Still address a key objective of bringing lease-related assets and liabilities on balance sheet.

We are aware that some have called for removing lessor accounting from the proposed guidance. This would retain many of the bright line tests inherent in U.S. GAAP today and carry forward lessor accounting. As such, we also recommend addressing lease classification for lessors in a manner consistent with the preceding paragraph, a solution that would address the above concerns but is likely to otherwise be similar to today's lessor model.

Other matters

In addition to the concerns we express with respect to the dual model, there are a number of areas in which the concepts contained in the ED could be more clearly articulated, in which current proposals might be challenging to apply, or in which guidance does not appear to produce benefits that are justified in relation to their expected costs.

The primary areas of concern include:

We welcome revisions made to the identification of embedded leases. However, we believe that the guidance as currently proposed may be difficult to apply in practice and could be improved to highlight the key factors that drove the accounting conclusion. This would enhance consistency in application for transactions with similar circumstances. We expect that this issue will be particularly significant in circumstances in which a lease is embedded in a multiple-element service contract.

How preparers should determine whether assets that are functionally interdependent represent one or more than one unit of account. In the ED, the board has provided examples of a power plant and manufacturing facility. The examples concluded that the former has one component and the latter two. This determination has a potentially significant impact on income statement presentation, but the examples are unclear as to whether this conclusion is based on the nature of the asset, the perceived relative costs of separating the property from nonproperty, or some other factor.

How the guidance in the ED will be applied to services contracts where an underlying asset is not

the primary motivation for executing the arrangement. A good example of this is naming rights for a sports facility. The primary economic motivation for such an arrangement is marketing, but the arrangement constitutes a right not dissimilar to the use of a billboard.

Irrespective of the decision the board makes, implementing a standard on such a pervasive topic will be a challenge. FinREC recommends that the board establish a post-issuance lease implementation process to ensure consistent application of the final principles across different asset classes and industries.

We provide further information and commentary on these and other areas in our responses to the board's questions in the ED in the appendix to this letter.

Representatives of FinREC and the FinREC Leases Task Force are available to discuss our comments with board members or staff at their convenience.

Sincerely,

Richard Paul

Chairman

FinREC

Chad Soares

Chairman

FinREC Leases Task Force

American Institute of CPAs

New York, NY

CC:

Hans Hoogervorst, Chairman

International Accounting Standards Board

Attachment

Question 1: Identifying a Lease

Do you agree with the definition of a lease and the proposed requirements for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease?Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

We believe that it is appropriate to evaluate whether an agreement contains a lease based on whether it contains (1) an identified asset and (2) whether the lessee obtains the right to control the use of the asset for a particular period. However, we believe that the guidance and related examples, as currently proposed, may be difficult to apply in practice and could be improved to highlight the key factors that drove the accounting conclusion. This would enhance consistency in

application for transactions with similar circumstances. We expect that this issue will be particularly significant in circumstances in which a lease is embedded in a multiple-element service contract.

FinREC believes that control is inherent in a lease relationship and that the focus should be on principles rather than bright lines. However, we believe additional guidance is needed on how to weight factors that seemingly indicate control against factors that would seemingly indicate an absence of control. We are concerned that the examples included in the ED do not clearly illustrate how to evaluate involvement in different phases of the arrangement (relative weight for design versus operation of the asset) or how to identify significant decisions — particularly those made in connection with the delivery of nonlease services contracted for under the arrangement. Some FinREC members also suggested that, in cases in which the asset has no utility without services provided by the lessor, the entire arrangement is better reflected as a service contract. One potential example of this would be cable television boxes, which have little stand-alone value without the associated subscription. It is one simple example of the complexity inherent in applying the control model.

FinREC believes the final standard will benefit from more detailed examples, especially on how to weight conflicting indicators when making "close calls" — this would enhance consistency in application and aid financial statement users in evaluating reported results.

In addition, we are not clear on to how to apply the phrase "throughout the term of the contract" in evaluating whether the customer has the ability to direct the activities that most significantly affect the economic benefits to be derived from use of an asset or can derive substantially all of the potential economic benefits from its use. Is it the Board's intent to apply a model similar to ASC 810-10/IFRS 10, or does this control model attempt to assign decisions (including those agreed to in the contract) to each of the involved parties?

We also believe it would be helpful to address how decision making inherent in nonlease elements ties into the assessment of control and associated benefits. Is this based solely on output, or must it consider the lessee's own circumstances and other assets to be used in concert with the leased asset?

FinREC also believes it is important to reconcile the guidance on control in the ED to that for sale-leaseback transactions, which appears to consider control based on risks and rewards (e.g., lease term and present value of lease payments).

FinREC is not seeking bright lines but rather is trying to ensure that the guidance can be applied consistently considering the impact that these judgments could have on preparers' financial statements.

In addition to seeking clarity regarding control, we believe that the guidance with respect to substitution rights could be improved. Specifically, we believe that the ED's examples appear to downplay the economic and operational costs of substitution. FinREC believes that when substantive substitution rights are present, they often represent the end of a lease of one asset and the start of the lease of a different asset and substitution is more relevant in considering the lease term than the presence of a lease. Notwithstanding our view, FinREC recognizes that there are contracts in certain industries (e.g., IT outsourcing arrangements) for which substitution rights and attendant costs reinforce the view that the overall arrangement is a service contract more appropriately reflected as an executory contract. This may be especially true when equipment is replaced without the customer's knowledge and/or control.

Finally, we are also concerned that the board's proposal to consider not only assets available to the

lessor, but also those that could be acquired, assumes insight the lessee likely will lack as well as the availability of additional assets and the willingness of a lessor to acquire or deploy additional assets in support of a contract. FinREC believes it would be better to consider changes in assets available to the lessor as a trigger for reassessing whether the contract is in scope, rather than rely on assumptions that could be highly subjective. Should the board elect to retain the guidance proposed in the ED, we believe that it would be necessary to provide additional guidance on how to evaluate the costs of substitution. Are such costs considered relative to a given asset or to the aggregate value of lease elements in a multiple-element arrangement? Should the analysis factor in lessor incentives with respect to substitution? Under existing GAAP, if utility was an important consideration in determining when an arrangement contained a lease, substitution rights were arguably more relevant considering that a lessee may have little or no control over the asset. With control at the heart of the leasing analysis in the ED, its utility to identifying embedded leases has lessened.

Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If no, what alternative approach would you propose and why?

As discussed in the forepart of this letter, FinREC recommends a dual-model approach for lessee and lessor accounting in which all leases other than short-term leases are recognized on-balance sheet by lessees. However, FinREC believes that the board should reconsider the proposed lease classification tests. The ED's proposed classification tests do not appear to be responsive to the needs of financial statement users or provide benefits that outweigh the related costs. FinREC recommends a dual recognition method in which the pattern of recognition would depend on whether the economic arrangement is more consistent with an in-substance financed purchase or motivated more by a desire for finite usage of a given asset. We believe this classification test should be based on clearly articulated principles and field tested to ensure that it is operational. Leases consistent with in-substance financed purchases would be accounted for as Type A leases and other leases as Type B leases, both as contemplated in the ED.

If consensus resulted in classification on the basis of the guidance contained in International Accounting Standard (IAS) 17 Leases, we would not object to this split, particularly since it is similar to current proposals for property and to current lease classification guidance under U.S. GAAP but without the much criticized bright lines. FinREC believes that, if a dual model is included in the standard, it may be preferable to use one that is well understood in practice and familiar to financial statement users.

Question 3: Lessor Accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

FinREC believes that the emphasis on recognition of the liability by the lessee, and the desire for symmetry, creates significant challenges for lessors — notably the notion that recognition of the right to use a small portion of a nonproperty asset represents a sale on the part of the lessor of a corresponding portion of the leased asset. FinREC understands the desire for symmetry between lessors and lessees, but we believe this has complicated efforts to achieve consensus on a new

standard that meets the key objectives of this project while providing users with improved relevant and representationally faithful information. While symmetry is a desirable goal, leasing today often results in asymmetrical results (e.g., built to suit leasing, real estate sale-leaseback transactions, sales type leases of real estate), and this is not confined only to leasing. It has been our experience that symmetry is often the exception rather than the rule.

The introduction of the dual model goes some way toward mitigating concerns expressed by property lessors, but does not go far enough for certain lessors of other long-lived assets that they believe share many economic characteristics of property leases. We also have concerns that a model requiring classification based on the nature of the leased asset, rather than the economics inherent in the contract, may not provide users with the most decision-useful information — particularly with respect to lessors.

FinREC believes that the concerns expressed above can be addressed without dropping lessor accounting from the project and by incorporating income statement classification on the basis of

IAS 17. This would leave lessor accounting largely unchanged (with the exception of removing bright line tests and leveraged lease accounting) and symmetrical with proposals for the lessee.

If FinREC's proposal for revised lease classification guidance is not accepted, we strongly recommend that the board consider dropping proposed changes to lessor accounting until the issues raised by stakeholders can be addressed. If such a path is chosen by the board, FinREC supports a very narrow change to lessor accounting to remove the guidance for leverage leases.

Question 4: Classification of Leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the [ED] requirements, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

FinREC does not support an income statement classification model based on the nature of the leased asset. This classification approach introduces significant complexity with a dividing line that may not properly reflect the economics of the underlying arrangement and may reduce the utility of information to financial statement users. This unnecessary complexity is likely to only increase the complexity of ongoing compliance with the proposed model — particularly to the already challenging task of splitting multiple-element arrangements into their components.

As discussed in our response to Question 2, FinREC recommends a dual recognition method in which the pattern of recognition would depend on whether the economic arrangement is more consistent with an in-substance financed purchase or motivated more by a desire for finite usage of a given asset. Leases consistent with in-substance financed purchases would be accounted for as Type A leases and other leases as Type B leases, both as contemplated in the ED.

If consensus resulted in classification on the basis of the guidance contained in IAS 17 Leases, we would not object to this split, particularly since it is similar to current proposals for property and to current lease classification guidance under U.S. GAAP but without the much criticized bright lines. We believe the principles-based guidance inherent in IAS 17 is a superior approach to the consumption model, without sacrificing its benefits, and that the concerns about today's classification approach are largely grounded in the off-balance-sheet nature of operating leases and the associated bright lines, rather than concerns with classification based on risks and rewards.

Question 5: Lease Term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

FinREC supports the board's view that lease term should be reassessed to reflect changes in relevant circumstances. This will not only limit potential structuring opportunities, but it will also provide more timely information to financial statement users. We also support the board's proposals that renewals be included only when economic incentives suggest renewal is likely. However, in light of the guidance in the basis for conclusions, we believe that the standard should consider renewals that are "reasonably assured" to avoid confusion as to the possible difference between this concept and that of significant economic incentive.

FinREC believes the proposal should provide explicit examples of indicators that may indicate a change in assumptions. Of the indicators provided in 842-10-55-4, only one, the addition of significant leasehold improvements, is likely to be clear to constituents. The remaining examples cited in the guidance all seem to be market-based indicators, which ASC 842-10-55-5 indicates will not, in isolation, trigger a reassessment. Many preparers have substantial lease portfolios and have expressed concern over the cost of having to consider incentives on what is a highly subjective basis to ensure there has been no change at each balance sheet date. Reassessment is desirable to minimize structuring opportunities and to provide for more decision-useful information for users, but it must be balanced against the cost of compliance. Further clarity is needed on the non-marke--based factors a preparer may need to consider when applying this guidance over the life of the lease.

FinREC believes that there should be clarity with regard to how management's intent is factored into the reassessment model. Many would consider management's stated intent to be a fairly compelling data point in determining the lease term, but it is not apparent how intent factors into the market-, contract-, asset- and entity-based factors cited in ASC 842-10-55-4.

We believe that the guidance in the ED should be clarified with respect to determination of short-term leases. Specifically, we believe the board should specifically address how lessees and lessors should evaluate month-to-month leases and those that contain one-party termination provisions.

Question 6: Variable Lease Payments

Do you agree with the proposals on the measurement of variable lease payments, including the reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We understand why the board would seek to remeasure the asset and liability for changes to an index subsequent to initial recognition — particularly in jurisdictions where adjustments are significant either annually or over the life of the arrangement. However, there is significant confusion as to the frequency of such adjustments. Some FinREC members believe the lease liability should not be remeasured for changes to the index subsequent to the initial measurement. This would be consistent with how other liabilities (e.g., variable rate debt) would be treated.

FinREC recognizes that, unlike typical variable rate debt, some lease indexation (e.g., based on changes to the Consumer Price Index (CPI)) typically has an upward ratchet only and that the concepts in the ED regarding variable lease payments are reasonable. However, we believe that

remeasurement should not be required as this adds an additional layer of complexity to lease accounting for which there may be no significant economic benefit to financial statement users. We instead recommend an update to the future minimum lease commitment disclosure so that when a CPI adjustment is factored into rent payments, the disclosure is updated to reflect the future cash outflows based on the current amount of rent the lessee is paying (which would include increases in CPI). This is information that preparers will have readily available once the index resets, and it will provide users with timely notice of the changes in lease payments. Presenting this on an undiscounted basis is unlikely to hamper its utility but it will reduce the cost of compliance.

If the board moves forward with the requirement to reassess the lease obligation, FinREC recommends that remeasurement be required only when the cash flows related to the lease change. For example, if the lease payments are adjusted annually by reference to the CPI, the lease liability should not be adjusted for interim changes in the CPI but only at the point that cash payments reset for a given lease. Since changes to CPI today trigger updates to lease payments, reassessment at this time is likely to impose less of a burden than the guidance as currently proposed. FinREC believes that remeasurements more frequently than the reset provisions stipulated in a given lease would reflect a false precision and that the cost would exceed the benefits.

Question 7: Transition

The ED states that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the Boards should consider? If yes, what are they and why?

FinREC is supportive of the board's proposed transition provisions overall, but believes that additional improvement is possible. Specifically, we believe that the board should consider additional practical expedients to ease the transition burden for nonpublic entities and to address differences in transition under the revenue recognition standard and those in the ED. Lessors in particular may have to evaluate the same contract twice — once in connection with the adoption of the revenue recognition standard and again with respect to leasing. Depending on the board's response to our recommendation with respect to the income statement, we believe that the board should consider whether lessees and lessors should be permitted to adopt the proposals in the leases ED using a simplified approach as defined in paragraph 133 of the Proposed Accounting Standards Update on Revenue Recognition and the "modified approach that was decided on in February 2013.

Under the "modified approach" an entity would recognize "the cumulative effect of initially applying the revenue standard as an adjustment to the opening balance of retained earnings in the year of initial application (that is, comparative years would not be restated)." The standard would apply to new contracts created on or after the effective date and to existing contracts as of the effective date but would not apply to contracts that were completed before the effective date.

In the year of adoption, entities would also be required to disclose the financial statement line items that have been directly affected by the standard's application.

FinREC believes a similar model would mitigate some of the concerns expressed by lessors and likely reduce the population of leases that a preparer must consider. We believe that the simplified approach should be an option, and that the full and modified retrospective approach should also be retained. Whichever method is chosen, focus should be around good disclosure around noncomparable transactions (e.g., real estate sale-leaseback arrangements).

In addition, with respect to current transition options, we believe that the board should clarify certain aspects of transition. For example, although the board has indicated that hindsight can be used in evaluating lease arrangements, it is unclear whether this will be applied by asset class, to all arrangements, or to specific subsets (e.g., to all leases where the preparer is a lessor). Companies have a variety of assets under lease and are often a lessor even when this is not their core activity. Providing greater insight into how to apply these practical expedients would be helpful.

The ED contains very limited guidance with respect to certain aspects of leasing (e.g., leveraged lease accounting, how to transition capital leases arising solely as a result of problematic default provisions). This gap in guidance is likely to create diversity in practice — particularly when considered along with other gaps such as the issue with hindsight mentioned above. In addition, we would ask to board to consider whether to —

- Stipulate that previous sale conclusions for all sale-leaseback transactions need not be reconsidered;
- Stipulate, solely for transition purposes with respect to sale-leaseback transactions, that ownership by an entity may be deemed to occur when title transfers, not when the entity has executed a purchase order or assigned a purchase order to another party in an agreement that contains provisions exposing the entity to constructive risks of asset ownership (e.g., an indemnification of the assignee);
- Permit lessees and lessors to apply the discount rate used to classify and account for a lease under existing GAAP (i.e., the discount rate determined at lease inception) except in cases where incentives would affect the lease term;
- Permit or require lessors applying the discount rate determined at lease inception under existing GAAP to measure the residual asset for leases classified as Type A leases at the present value of the estimated future residual value at lease inception under existing GAAP accreted to the date of initial application;
- Permit lessors to apply a discount rate determined using information at the beginning of the earliest comparative period presented when the residual asset is measured using information as of that date;
- Clarify whether any of the specified transition reliefs are available to entities that elect full retrospective application; and
- Clarify how an entity applying the modified retrospective transition approach would determine the classification of a preexisting lease upon adoption of the proposed requirements.

We would also like the board to consider whether additional guidance should be provided with respect to —

- How a lessor should reflect assets it acquired in a sale-leaseback that contains a lessee purchase option.
- Whether the transition rate should be set at the effective date rather than the implementation date.
- How to evaluate arrangements in which a leased asset is under construction and the lessee is considered the owner of that asset at the transition date. Is derecognition in transition appropriate? Will this require consideration of sale-leaseback accounting? In cases where the lessee has a purchase option, does the application of sale-leaseback accounting affect presentation of the arrangement by the lessor?

Question 8: Disclosure

The ED sets out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about

variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

FinREC believes the board's proposals with respect to disclosure would impose a significant burden for both public and nonpublic entities and contain elements that affect the utility for financial statement users. Although additional information may aid users, the depth and scale is significant, and the associated costs must be considered as well. It is also important to consider whether the scale of disclosure is consistent with the notion that the recognition of an asset and liability is of paramount importance to users.

The proposed disclosure requirements appear to be excessive in many respects given the extra visibility lease assets and obligations are proposed to have in the basic financial statements, but appear to be inadequate in relation to variable lease payments (see last point below).

Although the proposals would allow entities to consider the extent of detail provided, the board has not provided sufficient guidance about how to determine the appropriate level of aggregation in the disclosures.

Finally, we believe that the board should consider whether to require disclosure by lessees and lessors of aggregate undiscounted estimated variable lease payments (other than those based on an index or rate) on an annual basis for a minimum period of five years from the balance sheet date, and a comparison of actual variable lease payments with estimated variable lease payments for each comparative period presented. The board should not require discounting or require disclosure beyond a reasonable estimate to avoid the false precision such disclosures may suggest. This, along with the limit to the periods required to be disclosed, should ease preparers' concerns with respect to the cost and effort of preparing these disclosures while providing users with valuable incremental information. Under proposals in the ED, the only data provided on variable payments will be historical, and that limits its utility to users.

Question 9: Nonpublic Entities

Will the specified reliefs [in the ED] for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

FinREC is supportive of including relief for nonpublic entities to help reduce the cost of implementing the proposals in the ED. However, we do not support the proposal to permit a policy election to use a risk-free discount rate to measure the lease liability. We observe that a risk-free rate would almost certainly not be the rate that the lessor charges the lessee and, therefore, would almost certainly result in an inaccurate measurement. We would favor proposals to allow the lessee to apply a best estimates approach to determining the incremental borrowing rate when the implicit rate is not known.

We also noted the board's proposal for an exception to the requirement that a lessee provide a reconciliation of the opening and closing balances of the liabilities to make lease payments. The basis for this exemption is the fact that users of nonpublic entities' financial statements generally have greater ability to directly access management and to obtain additional information beyond what is included in financial statements; as a result, the benefits of preparing this information do not outweigh the cost. FinREC does not object to this exemption, but requests that the board consider whether it should be extended to entities that sublease property as an ancillary activity.

We recommend that the board allow private companies the option of deferring the effective date for

one or two years after the effective date for public companies. We believe it is appropriate to allow private companies more time to put in place the necessary systems and processes to apply the guidance and also capitalize on the experience of public companies.

Question 10: Related Party Leases

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases? If not, what different recognition and measurement requirements do you propose and why?

Transactions between related parties carry with them the inherent risk that contractual terms are not consistent with those that would be available between unrelated parties operating on an arm's-length basis and may result in lease payments or other contractual terms geared to achieve financial reporting objectives or to permit use of property or nonproperty without an explicit contractual arrangement. However, this risk is not unique to leasing transactions and FinREC agrees with the board that the costs associated with adjusting contractual arrangements to reflect their economic substance does exceed the expected benefit. FinREC believes the appropriate response to this risk is disclosure of the relevant terms and conditions. Such disclosure permits financial statement users to evaluate the arrangement and determine what adjustments, if any, may be appropriate.

Question 11: Related Party Leases

Do you agree that it is not necessary to provide additional disclosures for related party leases? If not, what additional disclosure requirements would you propose and why?

As discussed on our response to question 10, we do not believe that it is appropriate to provide different recognition and measurement requirements for related party leases. However, we believe that the board should consider what additional disclosures may be relevant to financial statement users. FinREC believes that it may be helpful to specifically require management to explain the basis for establishing the terms of its related party leases and, in cases in which the asset is leased from a third party, disclose the terms of the associated head lease.

Moody's: Charter Schools Pose Growing Risks for Urban Public Schools.

The dramatic rise in charter school enrollments in the US is likely to create negative credit pressure on school districts in economically weak urban areas. Charter schools tend to proliferate in areas showing economic and demographic stress, and they can pull students and revenues away from districts faster than the districts can reduce their cost.

Press Release:

https://www.moodys.com/research/Moodys-Charter-schools-pose-greatest-credit-challenge-t--school-districts–PR_284505

Purchase the Full Report:

https://www.moodys.com/MdcAccessDeniedCh.aspx?lang=en&cy=global&Source=https%3a%2f%2fwww.moodys.com%2fviewresearchdoc.aspx%3fdocid%3dPBM_PBM158801%26lang%3den%26cy%3dglobal

GFOA: 18th Annual Governmental GAAP Update.

Live-streaming event

November 7, 2013 – 1:00–5:00 p.m. Eastern

Encore Presentation: December 5, 2013, 1:00-5:00 p.m. Eastern (Register by November 1 and save)

The agenda is available at:

http://www.gfoa.org/index.php?option=com_content&task=view&id=2844

For more information, go to:

http://www.gfoa.org/index.php?option=com_content&task=view&id=2818

GFOA Executive Board Approves 14 Best Practices.

On October 4, 2013, the GFOA's Executive Board approved 14 best practices – eight new and six revised – on topics from managing health-care costs to pension funding policy. Additional information about these best practices is available here:

http://www.gfoa.org/index.php?option=com_content&task=view&id=2840

Debt-Ceiling Alarm Freezes Market With Least Supply: Muni Credit.

Municipalities are borrowing at the slowest pace in more than two years, showing how the partial federal shutdown and prospect of a U.S. default are dissuading localities from taking on financing for new projects.

Cities and states are offering $4.3 billion of bonds this week after $3.7 billion last week, when the U.S. government shutdown began, data compiled by Bloomberg show. Excluding holidays, it's the skimpiest stretch of financing since May 2011, even as benchmark muni-bond yields have fallen from a two-year high.

Enlarge image

San Francisco and a school district in Utah are among issuers that may shift sales scheduled for Oct. 17, the day U.S. borrowing authority lapses. Photographer: David Paul Morris/Bloomberg

As the political stalemate persists, supply may dwindle further. San Francisco and a school district in Utah are among issuers that may shift sales scheduled for Oct. 17, the day U.S. borrowing authority lapses. The ebbing tide of new bonds is echoed in diminished trading: Volatility on benchmark 10-year muni yields has dropped close to a 10-month low.

"Without new issues to give a little bit of price discovery, offers are drying up, bids are getting quiet, and when you add in the politics, the shutdown and the debt ceiling, it seems like people are sitting

on their hands," said Dan Toboja, vice president of muni trading at Ziegler Capital Markets in Chicago. "I would almost call it complete malaise."

Already Down

The federal gridlock is exacerbating a drop in local financings as interest rates have risen from generational lows seen in December. Cities and states have issued $233 billion of fixed-rate long-term debt through Oct. 4, down 15 percent from the same period last year, data compiled by Bloomberg show.

Municipalities planning their financing amid the standoff in Washington have to consider the potential impact on market interest rates and the economy. The Treasury Department has said any U.S. default from failing to raise the $16.7 trillion federal debt limit could have catastrophic consequences that might last decades.

The Sevier County School District in Utah, with about 4,500 students, has a $36 million bond sale set for Oct. 17. Proceeds from the competitive deal will go toward building a high school. Patrick Wilson, the district's business administrator, said he has talked with his financial adviser about possibly changing the date.

"I have a little bit of concern" about selling the day of the debt-ceiling deadline, he said in an interview. "The market could be pretty wild."

Volatility Vanquished

The federal government's first partial shutdown in 17 years began Oct. 1, halting a rebound in the municipal market fueled by the Federal Reserve's surprise decision in September to maintain the pace of its monthly bond buying.

Ten-year benchmark muni yields have barely budged over the past two weeks, fluctuating just 0.02 percentage point, Bloomberg data show. Volatility has tumbled, deadening the market swings that generate trading opportunities. For 10-year yields, 60-day volatility is close to the lowest since December, data compiled by Bloomberg show.

A stable muni market is uncommon in October. Benchmark 10-year muni yields have jumped about 0.24 percentage point on average in the month since 2009, Bloomberg data show.

"The market is quiet right now, and that's pretty rare, especially in October," Toboja said.

Investing Antipathy

The federal government shutdown has slowed other fixed-income markets too. Corporate bond sales in the U.S. have dropped to $15.2 billion this month from $48.1 billion in the year-earlier period, according to Bloomberg data.

"Underwriters are very hesitant to advise issuers to come to market during somewhat unsettled times," said Bart Mosley, co-president of Trident Municipal Research in New York. The shutdown and debt-ceiling debate are "keeping investors from feeling like they have to take action, which has led to subdued activity."

San Francisco plans to sell about $37 million of tax-exempt bonds in a competitive deal Oct. 17 to pay for work at ports, including a cruise-ship terminal, and refinance commercial paper issued to move the project along.

The city has until 1 p.m. local time the day before the sale to postpone, said Nadia Sesay, director of the city controller's office of public finance.

As Advertised

"We have advertised for a sale on the 17th and we're hoping we can keep it, but we're going to continue to monitor the market and see what's happening with the debt ceiling," Sesay said in an interview.

Cicero, an Indiana town of about 4,800 residents, has a $2.4 million sewer-revenue bond deal set for Oct. 17. Deen Rogers at H.J. Umbaugh & Associates, the town's financial adviser, said officials have flexibility to shift the sale if necessary because of the debt-ceiling debate.

Stephen DeGroat, finance commissioner of Rockland County north of New York, said he's concerned that its $34 million general-obligation issue is scheduled for Oct. 17. He said he plans to call the county's financial advisers and is open to moving the date.

In 2011, Republicans and Democrats reached a deal to raise the borrowing limit ahead of an Aug. 2 deadline and avoid default. Similar to this month's reduced volatility, 10-year benchmark muni yields were unchanged that year from the end of June to the end of July, Bloomberg data show.

Offsetting Interests

"Sellers are saying maybe the market will tighten up if we pass the debt ceiling," Toboja said. "Buyers are saying if we get any kind of supply, the market is going to cheapen up. The end result is you've got nobody doing anything."

Deals in the municipal market this week include a $563 million general-obligation sale from Wisconsin.

The state is issuing with top-rated 10-year munis yielding 2.72 percent, close to the lowest since June. The interest rate compares with 2.66 percent for similar-maturity Treasuries.

The ratio of the yields, a gauge of relative value, is about 102 percent, compared with an average of 93 percent since 2001. The higher the figure, the cheaper munis are compared with federal securities.

GASB Fact Sheet on Statement 34.

The Governmental Accounting Standards Board has begun research reexamining the standards related to the financial reporting model for state and local governments – most notably, Statement No. 34, *Basic Financial Analysis – and Management's Discussion and Analysis – for State and Local Governments.*

The Fact Sheet is available at:

http://www.gasb.org/cs/ContentServer?c=Document_C&pagename=GASB%2FDocument_C%2FGASBDocumentPage&cid=1176163449012

NFMA: Introduction to Municipal Bond Credit Analysis.

Philadelphia on November 7 & 8 at Le Meridien.

To view the Program, click here:

http://www.nfma.org/assets/documents/education/intro13/intro.program.short.2013.pdf

To Register, click here:

https://nfma.memberclicks.net/index.php?option=com_mc&view=formlogin&form=149678&return=L2luZGV4LnBocD9vcHRpb249Y29tX21jJnZpZXc9bWMmbWNpZD1mb3JtXzE0OTY3OD9zZXJ2SWQ9MjcyNiZvcHRpb249Y29tX21jJnZpZXc9bWMmbWNpZD1mb3JtXzE0OTY3OA==

SEC Exempts Accountants from Municipal Advisor Registration.

The US Securities and Exchange Commission (SEC) last month adopted rules establishing a permanent registration regime for municipal advisors as required by the Dodd-Frank Act; however, an accountant who provides audit or other attestation services will not have to register as a municipal advisor.

The new rule approved by the SEC on September 18 requires a municipal advisor to permanently register with the SEC if the advisor provides advice on the issuance of municipal securities or about certain “investment strategies” or municipal derivatives.

State and local governments that issue municipal bonds frequently rely on advisors to help them decide how and when to issue the securities and how to invest proceeds from the sales. These advisors receive fees for the services they provide.

Prior to the passage of the Dodd-Frank Act in 2010, municipal advisors were not required to register with the SEC like other market intermediaries. According to the SEC, this left many municipalities relying on advice from unregulated advisors, and they were often unaware of any conflicts of interest a municipal advisor may have had.

After the Dodd-Frank Act became law, the SEC established a temporary registration regime, and more than 1,100 municipal advisors have since registered with the SEC.

While the SEC’s definition of municipal advisor in the original proposed rule would not have required accountants who perform audits of financial statements to register, the rule would have encompassed accountants who perform other audit and attestation services, according to Barry Melancon, CPA, CGMA, president and CEO of the American Institute of CPAs (AICPA).

The final SEC rule states accountants do not have to register as municipal advisors if they provide accounting services that include audit or other attest services, preparation of financial statements, or issuance of letters for underwriters.

“Accountants providing audit and attestation services are already subject to layers of regulation that are intended to protect investors,” Melancon said in a written statement on September 27. “We are pleased that the SEC expanded the accountant exemption to include audit and attestation

engagements, preparation of financial statements, and the issuance of letters for underwriters. We commend the SEC for its flexibility on this issue."

WSJ: Muni Bond Issuers Slow to Report Finances, Study Shows.

State and local governments are still slow to provide investors with reports on their fiscal health despite a push by municipal bond investors and regulators to get municipalities to improve their disclosures.

It took almost six months after the end of their fiscal year for state and local governments to complete their audited financial statements, about two months longer than the time frame regulators suggest, a Merritt Research Services study said.

After looking at more than 8,000 fiscal 2012 audit reports from municipal bond issuers received by August 30, Merritt found that states, counties and cities were among the slowest groups to complete their audits, taking an average of 174 days, 172 days and 171 days respectively from the end of their fiscal year.

In the wake of Detroit's record-setting municipal bankruptcy and amid growing concerns about the fiscal health of Puerto Rico, delayed financial filings are an increasing frustration for municipal bond investors. Puerto Rico, whose bonds have traded recently at yields as high as 10%, just filed its 2012 audit this month, more than a year after the close of that fiscal year and about four months after it was promised to investors.

"The ones that are coming in so late are often the ones we really want to see," said Richard Ciccarone, Merritt's president and chief executive. "It creates a problem for bondholders."

Private universities, hospitals and wholesale electric utilities were among the fastest groups to complete their audits, with median times of 113 days, 109 days and 95 days respectively, Merritt said.

Merritt measured the days it took an issuer to complete an audit by counting the time between a municipality's fiscal year-end and the date an auditor signed off on its financial report. The median audit time for all 15 municipal bond sectors Merritt studied for fiscal 2012 was 139 days.

Regulators, such as the Securities and Exchange Commission, have encouraged, but not required, municipalities to file their financial audits within 120 days after the close of their fiscal year, but there is no punishment when they don't comply, Mr. Ciccarone said. The SEC only has the power to go after municipalities in cases of fraud.

For 2012, only about 8% of the cities and counties and roughly 6% of states came within the SEC's recommended 120-day time threshold, according to Merritt data. About 1% of cities and about 2% counties had their audit done within 90 days. No states filed their audits within 90 days, Merritt data showed.

The SEC requires publicly traded companies to file their audited financials in a 60 to 90 day time frame.

Indeed, there is some evidence that the more fiscally stressed a local government is, the longer it takes that government to complete its audited financials, Mr. Ciccarone said.

Audited 2012 financials haven't been received from Stockton and San Bernardino, two California cities currently in municipal bankruptcy. Those cities took 506 days and 517 days, respectively, to complete their fiscal 2011 audits, Merritt data showed.

Likewise, Harrisburg–Pennsylvania's state capital that has flirted with bankruptcy thanks to a debt load from a failed trash incinerator project–took 496 days to turn in its fiscal 2011 audit and hasn't completed its fiscal 2012 audit, according to Merritt's data.

For fiscal 2011, the median audit reporting time for all municipal sectors Merritt studied was 146 days, the same as fiscal 2010.

GFOA: 18th Annual Governmental GAAP Update.

Encore Presentation: December 5, 2013, 1:00-5:00 p.m. Eastern (Register by November 1 and save)

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Register online:

http://www.estoregfoa.org/Source/Meetings/cMeetingFunctionDetail.cfm?PRODUCT_MAJOR=GAAP13&FUNCTIONSTARTDISPLAYROW=1

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.

"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."

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.

MuniNetGuide.com

James Spiotto

Richard Ciccarone

Mardee Handler

NFMA Board of Governors endorses the Voluntary Interim Financial Reporting: Best Practices for State Governments.

The NFMA Board of Governors endorsed the "Voluntary Interim Financial Reporting: Best Practices for State Governments" approved by the National Association of State Auditors, Comptrollers and Treasurers (NASACT) in August.

See the press release here:

http://www.nfma.org/assets/documents/position.stmt/pr.nasact.best.practices.9.13.pdf

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Registration form:

http://www.gfoa.org/downloads/GFOA2013GAAPRegistrationForm.pdf

Register online (group discounts cannot be applied to online registrations):

http://www.estoregfoa.org/Source/Meetings/cMeetingFunctionDetail.cfm?PRODUCT_MAJOR=GAAP13&FUNCTIONSTARTDISPLAYROW=1

Group spreadsheet template:

http://gfoa.org/downloads/GFOAGAAPUpdateExcelFormNOV.xlsx

Internal Auditors Society Annual Conference.

November 3-6, 2013 – Delray Beach Marriott, FL

The 2013 Internal Auditors Society (IAS) Annual Conference brings together financial services audit professionals, industry experts and regulators to share insights and experiences on:

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Register at:

https://mbrservices.net/ConferenceRegistration/MeetingRegistration.aspx?meetingid=1152

ELFA Opposes Lease Accounting Proposal In Comment Letter To Accounting Standards Boards.

Washington, D.C., Sept. 10, 2013 — The Equipment Leasing and Finance Association (ELFA) raised serious concerns today that a revised proposal to change lease accounting rules would increase the cost and complexity of lease accounting without significantly improving the quality and relevance of financial statements. In a letter to the Financial Accounting Standards Board and the International Accounting Standards Board (the Boards) on the second Exposure Draft of the proposed standard, ELFA concluded that it could not support the issuance of a final standard based on the revised proposal.

The letter is available at: www.elfaonline.org/Issues/Accounting/pdfs/ELFACmntLtr_091013.pdf.

“Leases account for hundreds of billions of dollars in equipment acquisition annually, contributing not only to businesses’ success, but also to U.S. economic growth, manufacturing and jobs,” said William G. Sutton, CAE, ELFA President and CEO. “The primary reasons to lease equipment will remain intact despite the lease accounting proposal. However, it is essential that the standards setters carefully consider comprehensive public input during their re-deliberation period to ensure that if, indeed, a new standard is warranted, it does not harm American businesses and the U.S. economy. We call on the Boards to seriously examine the views and alternatives suggested by our comment letter as well as other comment letters and feedback they receive.”

ELFA’s comment letter argues that the proposed lease accounting rules are unnecessarily complex, create a significant compliance burden for lessees and lessors, and replace sound lessor accounting models with untried approaches that do not reflect the economics of the transaction. The letter cautions that financial reporting by both lessees and lessors will be less transparent and more difficult to understand under the proposal.

The letter highlights significant concerns, including the following:

- The proposed new lessor accounting model is not based on user needs; rather, it reflects an attempt to make lessor and lessee accounting symmetrical without regard to lessor business models.
- The proposed changes to lease accounting present compliance costs and unintended consequences for small- and mid-sized businesses that are unacceptable.
- The new lease classification approach changes the lessee expense recognition pattern for equipment transactions (vs. property leases) from straight-line to front-loaded, which is inconsistent with the economics of the transaction.
- The proposal will have a negative impact on the economy at large by increasing the cost of capital.

More Information

For more information about the Lease Accounting Project, visit the ELFA website at http://www.elfaonline.org/ind/topics/Acctg/. To schedule an interview with an ELFA expert on the lease accounting project, please contact Amy Vogtat 202-238-3438 or avogt@elfaonline.org.

About ELFA

The Equipment Leasing and Finance Association (ELFA) is the trade association that represents companies in the $725 billion equipment finance sector, which includes financial services companies and manufacturers engaged in financing capital goods. ELFA members are the driving force behind the growth in the commercial equipment finance market and contribute to capital formation in the U.S. and abroad. Its 580 members include independent and captive leasing and finance companies, banks, financial services corporations, broker/packagers and investment banks, as well as manufacturers and service providers. For more information, please visit www.elfaonline.org.

September 10, 2013

Mr. Russell Golden, Chairman

Financial Accounting Standards Board

401 Merritt 7

PO Box 5116

Norwalk, CT 06856

———–

Mr. Hans Hoogervorst, Chairman

International Accounting Standards Board

30 Cannon Street

London EC4M 6XH

United Kingdom

Submitted via electronic mail to director@fasb.org

Re: File Reference No 2013-270, Exposure Draft: Leases (Topic 842): a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)

Dear Chairman Golden and Chairman Hoogervorst:

The Equipment Leasing and Finance Association (ELFA) welcomes the opportunity to respond to the request for comments from the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) on the proposal contained in the FASB Exposure Draft (ED), Proposed Accounting Standards Update: Leases (Topic 842).

The Equipment Leasing and Finance Association (ELFA) is the trade association representing over 580 financial services companies and manufacturers in the $725 billion U.S. equipment finance sector. ELFA members are the driving force behind the growth in the commercial equipment leasing and finance market and contribute to capital formation in the U.S. and abroad. Overall, business investment in equipment and software accounts for 8.0 percent of the nation’s GDP; the commercial equipment finance sector contributes about 4.5 percent to the GDP. For more information, please visit http://www.elfaonline.org.

In addition to our summary comments, below, we have included in an attachment our detailed answers to the ED's Questions for Respondents.

Equipment Leasing and Finance Industry

All types of companies lease and finance equipment, but leasing is an especially significant source of financing of operating assets for small- and medium-sized (SME) companies and large non-investment grade (NIG) businesses. The SME sector is cited as the largest potential source of the job growth needed to reinvigorate the economy worldwide. Access to capital and efficient use of equipment are the major drivers for leasing, as opposed to achieving off balance sheet treatment through operating lease accounting. Based on the ELFA annual Survey of Equipment Finance Activity, we estimate that over 16 million equipment lease contracts are executed each year in the United States. Further, we estimate that approximately 14 million of those leases are with SME and NIG lessees. Many of those leases involve multiple assets that are included in one lease schedule. While the number of transactions is indeed large, the dollar value of individual transactions is small reflecting the nature of the items being leased. These items include various types of office and materials handling equipment, for example. As a result, the ED's complexity is a major concern. Therefore, in addition to our views on the technical merits of the proposal, much of our commentary will focus on the complexity and compliance costs associated with the proposals and the areas where the ED fails to improve the decision-usefulness of financial statements.

In addition to being lessors, our members are also users of financial statements. When determining whether to enter into a lease contract with a lessee, our member organizations analyze the ability of the lessee to meet its financial obligations according to the contractual schedule. Because SMEs and NIG companies are more prone to bankruptcy than larger investment grade organizations, our members are also concerned with bankruptcy risk, requiring information about which assets and liabilities survive bankruptcy. In making the decision to lease an asset to a lessee, lessors rely on the lessee's financial statements and, in their pricing, generally model the financial statement effects of the proposed lease investment on future periods. After lease origination, they place significant reliance on the lessee's financial statements in reassessing credit worthiness and in monitoring compliance with covenants. Accordingly, our comments involve the decision-usefulness of the proposed new accounting for leases from the perspective of both preparer and user.

Economic Nature of Equipment Leases

Leases are a legal construct recognized as distinctly different in their characteristics from secured loans for the purpose of broadening access to asset-based capital. The nature and extent of the defining characteristics of a lease contract vary considerably from jurisdiction to jurisdiction. These jurisdictional differences principally arise from differences in jurisprudence (i.e., whether substance- or form-based), in the economic environment (i.e., private or government sector centric or hybrids, the presence or absence of active secondary asset markets), and the income tax system (i.e., the significance of available government incentives tied to certain asset acquisitions and permitted transfers or sharing of such incentives between the user and the investor). U.S. equipment leases differ markedly from leases originated in non-U.S. jurisdictions, as evidenced by existence of a Uniform Commercial Code (UCC), an arduous process involving each of the 50 state legislatures. The UCC draws a clear distinction in the rights and obligations of the parties involved in leases and secured financings based on the "economic realities" of the contract (notably, whether the party designated as lessor retains a meaningful interest in the residual value of the leased asset such that it must look to the secondary market as a benchmark for recovery of its investment or in asset disposition). The U.S. income tax system provides significant tax benefits for equipment and their transferability and sharing within well-defined guidelines provided the lessor has sufficient "skin in the game."

True leases are not an accounting construct. The accounting for such leases under existing U.S. GAAP generally mirrors their classification under U.S. commercial and income tax law. Today all U.S. disciplines evaluate leases based on risks and rewards. Leases classified as capital leases are generally classified as secured financings and subject to the same rights and obligations as applicable to the parties to loans. Leases classified as operating leases are generally classified as "leases" under the UCC (Article 2A) with the tax benefits arising from the lessee's use of the property allocated to the lessor who can economically share part of these benefits in the form of lower rentals, but not otherwise and subject to certain constraints so that the nature of the transactions does not constitute the sale/purchase of such benefits. Similarly, the use of the straight-line method for rentals by lessees is commonly required under existing U.S. GAAP and the U.S. income tax laws and is implicit in U.S. commercial law in defining leases as executory contracts. Hence, we believe a faithful accounting of leases must distinguish between leases based on rights and obligations of the subject jurisdiction and their economic effects.

We believe the lessee accounting model must consider the contract the unit of account and the contract should provide the basis for the accounting for the rights and obligations arising from the lease arrangement. Where we see a major deficiency is in failing to analyze and account for the rights and obligations existing in a lease. We believe that a risks and rewards analysis consistently applied to leases of all asset types identifies the basic information required to account for both capital leases and capitalized operating leases for lessees. The balance sheet and the costs recognized in the P&L must reflect the nature of the distinctly different types of leases to satisfy the basic needs of preparers and credit analysts and lenders. The legal differences between leases are significant and impact the economics of leases. They are especially important in a bankruptcy, which is an important element of credit analysis. If the lease accounting model does not allow for equipment operating lease assets and liabilities to be broken out and clearly labeled on the balance sheet and if equipment operating leases are forced into a front-ended cost pattern where the asset amortizes at a faster pace than the liability, the nature of lease liabilities will be obscured and it will appear that the lessee has claims that exceed the value of its assets. This is not a valid depiction of lease economics for lessees.

We realize that accounting is not a science with natural laws that can have only one outcome that can be proven mathematically or strongly supported by empirical evidence, but in our opinion, commercial law and its economic implications should be a factor in determining the proper accounting for leases. It is also our opinion that there is little operating lease activity in markets where commercial law does not establish clear property rights in lease contracts, and a converged leasing standard need not be developed for systems that do not support leasing markets.

Summary Comments

We appreciate many of the changes made to the lease model since issuance of the first ED. We agree that the revised definition of the lease term and lease payments represent improvements over what was first proposed in 2010. While elements of the model in the ED before us are an improvement over its predecessor, we remain concerned that it does not reflect the economics of many equipment leases and will add complexity to financial reporting by both lessors and lessees alike. Since the proposals do not reflect the economics of many lease transactions nor appear to meet the needs of users of financial statements, we believe the significant costs associated with the proposals will exceed the incremental benefits of the proposed model. Consequently, we do not support the issuance of a final standard based upon this ED.

There are several paths forward for this project. The model needs to either be revised or the Boards should pursue a disclosure-based model in place of one based on recognition and measurement. Consistent with the corporate finance view of leasing, we believe there is a range of lease

transactions. Given this range of transactions, development of a single lease model that accurately depicts transactions within the range is not possible. We agree that for accounting purposes, the differences between leases are best reflected using a two-lease model; however, we strongly disagree with the lessee classification methodology proposed in the ED. We believe that leases should not be separated based upon the nature or type of the underlying asset, but rather on the nature of the transaction; we believe an IAS 17 model would provide a reasonable basis for this distinction.

The underlying basis for lessee accounting is not clear in the ED. At times the model refers to the lease contract and at other points it refers to the underlying asset. For example, lease cost allocation is determined by reference to the underlying asset, but initial recognition is based upon the contract. We believe the model needs to be either grounded in the accounting for the underlying asset or in the contract. Our suggestion to use IAS 17 as the basis for classifying leases into Types A or B would ground lease accounting in the accounting for the underlying asset. Alternatively, the model could be based on the contract. An example of this is the display approach, under which a lessee would recognize a lease liability and lease asset based upon the present value of remaining lease payments at each period end. The P&L would reflect rent expense. This is a straightforward model that would achieve the balance sheet recognition goal of the Boards and would be cost-effective to apply.

If the Boards are not able to develop a model that is more representationally faithful and that meets the needs of users of financial statements, we believe a disclosure-based alternative should be pursued. While this would not achieve the goal of recognizing lease liabilities, it would serve the needs of users of financial statements in a cost-effective manner. Groups of financial statement users have advised the Boards they are able to process the existing lease disclosures to make rational investment decisions. These views are also supported in recently published academic research. In "Evidence that Market Participants Assess Recognized and Disclosed Items Similarly When Reliability is Not an Issue" 1, the authors note the following:

. . . The FASB or any other accounting standard-setter should not be primarily concerned that investors and creditors will underweight or ignore altogether disclosed information that meets sufficiently high reliability, accessibility, and interpretability thresholds.

These results support the view that creditors do not appear to price lease obligations differently based on recognition versus disclosure.

The goal of financial reporting is to provide users with decision-useful information and it is important that the goal be met on a cost-effective basis. These goals should not be sacrificed in order to develop accounting constructs that, while achieving certain goals, do so at an unacceptably high cost.

The Boards have generally expressed a preference for a recognition and measurement model over a disclosure-based model, and some have commented that the question of recognition versus disclosure of lease transactions is no different than the recognition debates that surrounded pension and stock option accounting. We believe that lease accounting represents a separate and distinct set of issues. Both pension and stock option accounting were concerned with basic recognition questions. In stock option accounting, the question was whether any compensation expense should be recognized at all. In pensions, it was a question of a minimum liability and how to account for future obligations that were potentially significantly greater than current expenditures. In current leasing standards, there is a recognition system, lease obligations that are not recorded are disclosed, and current rent expense is closely associated with the cash flows that will occur in future periods. Therefore, there is no relevant comparison of leasing to these other accounting debates.

Lessor Accounting

The Boards have made a number of improvements to lessor accounting over what was proposed in the first ED. While the model is improved, we are of the opinion that lessor accounting generally functions well under current GAAP and that a classification approach based upon the type of underlying asset will generally not produce a presentation that will better reflect a lessor's position in the leased asset and lease contract. The existing classification model, which determines lessor accounting based upon the lessor's position with respect to the lease contract and leased asset, produces a more faithful depiction. As the Boards move forward, it will be important that they approach lessor and lessee accounting from different perspectives. Lessor accounting is concerned with presenting the lessor's position in the lease and leased asset as well as with lessor income. Lessee accounting is concerned with the recognition of lease assets and lease obligations and with the allocation of costs arising from a lease contract. Knowing how the lease impacts the parties is important, but these are separate and distinct areas of concern. Therefore, symmetry is not required and should not be a preferred outcome.

If the Boards proceed with the model proposed in the ED, we believe lessors should have the ability to base their financial accounting presentation on their business model, as that is what users desire. Equipment operating lessors share many of the attributes of lessors of property and therefore should be able to use the operating lease method. Conversely, the direct finance lease method is the preferred approach for financial lessors, whose position is generally closer to that of a creditor. The result would be balance sheet and P&L presentations that satisfy users' needs as they reflect the substance of the respective lessors' businesses.

We also believe that, similar to current GAAP, any residual guarantee or residual insurance changes the nature of a residual from a physical asset to a financial asset, as the risk is transformed into credit risk. This is important for securitization purposes as financial assets are typically securitized. It would also better reflect the risks transferred when accounting for gross profit, which is inherent in some leases. It is also an area where we believe change in the current approach is unnecessary.

Finally, there should be a place in the proposed lease model for leveraged lease accounting. It is not appropriate to eliminate an accounting method that has been in existence for over fifty years simply because the accounting method no longer fits into contemporary accounting thought. The netting of lease receivables and nonrecourse debt is in line with the rules for the right of offset, as it is a three-party agreement where the parties agree that the rent is to be paid to the lender and cash flows will settle on that basis. Presenting rent and debt on a gross basis gives a false perception of the amount of assets and claims that exist in a bankruptcy analysis. We also believe that the MISF yield revenue recognition treats tax credits as revenue and recognizes that timing differences reduce the net funded position in an investment. Consequently, revenue is recognized to match the interest cost to fund the net investment. The leveraged lease structure may be unique to the U.S. as it has a mature capital markets and it has a tax regime that incents investors to acquire assets via tax credits and accelerated write-off of basis. The accounting accurately reflects the economic effects. The decision to eliminate the structure may be useful to gain worldwide accounting convergence but it is a setback for accounting in the U.S. and those businesses that have come to rely on its benefits. The loss of leveraged lease accounting will increase the pricing for large value leased assets, especially those with favorable tax attributes, such as tax credits that are designed to promote new alternative energy projects.

Cost Versus Benefit Considerations

It is our view that, on balance, the ED does not produce true benefits to the financial reporting system. There is some perceived benefit from the reporting of lease obligations in a lessee's balance

sheet, but the usefulness of the recognized value is uncertain. It is difficult to describe the benefit to users as more accurate reporting of lessee obligations when there are differences between the accounting definition of a liability and the differing needs of investment grade debt, high-yield debt and equity analysts. The lease obligation produced may be more precise and comparable across companies, but it is not more accurate.

The compliance costs and unintended consequences of the proposed approach are significant. These unacceptable costs would be significantly reduced if the core framework of current GAAP is maintained and lease classification based upon a risks and rewards model employed for the Type A/Type B separation. We believe there has not been an assessment of less costly alternative approaches that would still achieve the goal of improving transparency of lessee and lessor financial statements. Further, we do not believe that there has been an adequate assessment of the technology costs involved in systems requirements for both lessees and lessors that involve transition, implementation and ongoing compliance.

There are several aspects of the ED that add complexity and cost, but do not significantly improve the lease model. First, the proposed rules for both the lessee and lessor in equipment leases must be executed on a leased-asset by leased-asset basis. This is a major issue as it will add complexity in implementation and ongoing compliance, especially since this is an element of the model that does not correspond to the needs of any group of financial statement users.

In addition, many leases are routinely entered into on a sale leaseback basis for administrative purposes; a lessee will take delivery of a series of low value assets and then convert to a sale and leaseback. This is possible under current GAAP, but in transition, every lease will need to be evaluated to determine if it was executed using a sale and leaseback, and every sale will need to be reviewed. This evaluation will need to be done by the lessee and the lessor as the proposals impact both parties in a lease. The control criteria should be revisited for sale and leaseback transactions, and, at a minimum, existing sale and leaseback transactions should be grandfathered at transition.

Another feature of the ED that will add unacceptable costs are the new definitions and factors to consider when assessing the term of a lease. While the Boards intent is to bring the factors to be considered in line with existing requirements, the definition introduces new terms and concepts. This will result in the expenditure of significant resources as the new terms are studied, analyzed, implemented and audited. If the Boards' intent is to maintain existing requirements, the most cost-effective method would be simply extracting the key concepts and descriptions from existing GAAP.

The changes to lessor accounting for Type A leases is another area where changes are being proposed that will alter the way certain leases are accounted for but not to a significant or meaningful extent. The changes in the recognition and subsequent measurement of residuals in what were sales-type leases in current GAAP and the manner in which income is recognized for all Type A lease receivables and residuals represent minor changes to GAAP. In simpler terms, the receivable and residual method is only cosmetically different than current Direct Finance Lease accounting. The changes will, however, cause lessors to incur costs to revise systems and reporting routines.

Finally, the provisions that require active reassessment of lease terms and certain variable lease payments will add costs to financial reporting. The impact of these changes may not be very significant, but they will require significant investments in systems and revisions of reporting routines. If a simpler approach as recommended above is adopted, it would eliminate a portion of the reassessment accounting complexity. Lessors and lessees, however, will still need to review each and every lease contract to identify in their accounting systems the leases that require reassessment. This process will be very time intensive, but will probably have limited impact on the

amount of liability recognized.

The Boards should also weigh the cost versus benefit analysis in direct costs, other than the systems and process changes that will be borne by preparers. SME and NIG companies are the heaviest users of equipment operating leases primarily because of their limited access to debt and equity markets, the liquidity benefits of level fixed-rate payments, lower rents due to tax benefits transferred to the lessor and the "balloon effect" on pricing due to the lessor assuming a residual value as a cash flow. SME and NIG preparers are also higher bankruptcy risks and they are forced to agree to debt covenants that protect lenders in a bankruptcy scenario as noted in "Debt Covenants, Bankruptcy Risk, and Issuance Costs", by Sattar A. Mansi, Yaxuan Qi, and John K. Wald, May 4, 2011 (https://fisher.osu.edu/blogs/efa2011/files/CFE_6_3.pdf). The impact of the ED will be to be to require these entities to renegotiate debt covenants, as the ED does not label capitalized operating lease obligations as a non-debt liability. This will be a potentially costly and time consuming exercise for SMEs and NIG companies. If the lease model and classification tests are not aligned with the legal regime (i.e., the UCC in the U.S.), lenders and credit analysts will ask SMEs and NIGs to recast their lease assets and liabilities so that they may assess their position in a possible bankruptcy scenario. This is not to say we are suggesting accounting for leases assuming a bankruptcy but rather is a suggestion that the lease model should provide vital information to users just as they have under current GAAP.

Concluding Comments

The path to revising lease accounting has been long and difficult for the Boards. Leasing is a complex activity and the range of lease transactions, as noted in the corporate finance literature, is quite extensive. Leasing can range from transactions that are debt-like to transactions that are more equity-service oriented. Development of one model for all lease transactions is not practical as any model that fits one end of the spectrum will not be faithful to transactions at the other end.

We are concerned with many of the elements of the proposed lessee and lessor accounting models, as they will unnecessarily increase the cost and complexity of lease accounting without significantly improving the quality and relevance of financial statements. In some cases, we believe the quality of the information presented will be impaired and the relevance of the financial statements reduced. A lessee model that considers all equipment leases to be the equivalent to the purchase of an asset and the separate incurrence of debt is not a valid accounting model and is not grounded in the economics of leasing. We therefore cannot support the lease accounting model presented in the ED.

The lease asset and lease liability related to operating leases exist together and they should not be subject to separate and distinct accounting after lease commencement, as if they were in fact separate transactions. The accelerated cost recognition that results from the separate accounting for the lease asset and lease liability under Type A accounting should not be accepted as a natural consequence of the right of use model. Leases are not simply the seller financing of an asset sale. Inherently, leases involve the separation of use and ownership. Accordingly, lessee accounting should allocate the total consideration based on usage while lessor accounting should faithfully portray the economics of the investment, including, when significant, the tax risks or rewards arising from the underlying.

The lease accounting model does not have to be as complex as it appears in the ED. The Boards could have met their primary objective, the capitalization of lease liabilities, using a simpler approach to lessee accounting. This would have entailed amending IAS 17, Leases, and ASC Topic 840 to capitalize leases with a lease term greater than one year by merely putting an accurate value on the balance sheet and by revising the approach to allocating lease costs. Alternatively, the Boards could adopt a display only model for lessees that is different from the recognition and measurement

approach pursued to date. A display model would have lessees present value their lease obligations and record the resulting liability and asset at the end of each period, with rent expense reflected in the P&L. Either of these approaches would achieve the Boards objective of having lessees recognizing a lease asset and lease obligation without the aspects of the approach in the ED that will cause preparers and users the greatest difficulty.

As the Boards consider the leasing model during redeliberations, we think revisiting the American Accounting Association's ("AAA") comments on the G4+1 leasing paper [Exhibit A] is appropriate. In its paper, the AAA observed:

The nature of the property under lease should not affect the accounting, nor should the length of the lease.

The approach to leases should recognize that accounting for leases is a special case of accounting for contracts.

The approach should require that substantially similar lease contracts be accounted for similarly and substantially dissimilar lease contracts not be forced into a misleading appearance of comparability.

The goal for lease accounting is to represent the value of the rights and obligations conveyed by the lease, not the value of the physical assets, unless there is no material difference between the value of the physical assets and the value of the rights and obligations.

These comments were valid when they were written more than 10 years ago, and they still resonate today.

In addition, there are a number of elements in Mr. Linsmeier's alternative view that merit further consideration. In particular he observes that:

- Users will not have the information they require regarding leasing activities or the information with which to derive the information they need,
- Leases that transfer ownership rights based on IAS 17 classification criteria should be scoped out of the proposed standard and they should be treated as a financed purchase,
- The ROU asset is a unique asset and subsequent accounting should not be defined by reference to other accounting literature,
- Type B accounting should be used as it supports the view that the contract as a whole is the unit of account that should be the basis for lease accounting, and
- There should not be symmetry between lessor and lessee accounting.

We respectfully suggest the Boards consider these thoughts as it re-deliberates the ED.

We certainly appreciate the opportunity to comment on the ED, and we also thank the Boards for their policy of open communications during the standards-setting process. We remain available to help in any way needed, and we are committed to assisting in the creation of a workable lease accounting standard that reflects the economic substance of transactions and improves the clarity in financial reporting.

Sincerely,

William G. Sutton, CAE

President and CEO

Attachment — Questions for Respondents

Exhibit A

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Attachment

Questions for Respondents

ED Questions and Answers:

Question 1: Identifying a Lease

This revised Exposure Draft defines a lease as a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. An entity would determine whether a contract contains a lease by assessing whether:

1. Fulfillment of the contract depends on the use of an identified asset.

2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10--5-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Response

We generally agree with the definitions, but we also believe the Boards could simplify the proposals if they were to exclude transactions that are not leases that transfer a right of use. This would lead to leases that transfer ownership being accounted for under other areas of GAAP and would free the lease model from the perceived need to account for some lease transactions as if they were purchases with financing.

While we agree with the proposed basis for separating leases from service transactions, we believe the definitions require further field testing to determine if they work as intended and that there are no significant unintended consequences.

Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Response

We do believe there are differing lease transactions and that a general model for lessees and for

lessors is not possible given the range of transactions. We provide further commentary on this point in our response to Question 4.

We do not agree with separating leases for purposes of determining how to allocate the cost of lease transactions based upon the nature of the underlying asset. We believe contracts should be separated based upon the nature of the contract. For example, leases that transfer the significant risks and rewards of ownership or control using an IAS 17 approach could be accounted for using the Type A model and all other leases could be accounted for using the Type B model. The proposed approach in the ED will not reflect the nature of equipment lease contracts and will add costs to the model by making it harder to determine the significance of equipment leases for purposes of materiality given the nature of the Type A model.

If the Boards do not accept a classification approach based upon the nature of the contracts, a display-oriented approach should be pursued. Under this model, lessees would record a lease liability for the present value of rents at the end of each period and an asset for an equal amount. Lease costs would be recognized on the basis of rent. Under this approach, the balance sheet and income statement would not be linked, but we believe linkage is not required in a display approach.

When it comes to allocating costs in lease transactions, we believe that rent expense is the appropriate governor for allocating costs. While some users of financial statements allocate the cost of some lease transactions into interest and amortization components, they do so by allocating rent and usually do not recast the transactions as is proposed in the Type A lessee model. Rent is an important measure of the outflow of resources and the artificial allocation of costs in the Type A model does not appropriately reflect this situation.

Question 3: Lessor Accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Response

As indicated in the prior comment, we do believe there are differing lease transactions and that a general model for lessees and for lessors is not possible given the range of transactions. We provide further commentary on this point in our response to Question 4.

Lessor income recognition should either be based upon the nature of the lease transaction or lessors should be allowed to determine the accounting for their investment in a lease using the existing lessor models following a business model approach. Financial lessors like banks and finance companies should use a Type A or finance lease approach. These lessors should not use the operating lease method for their finance leases as it distorts the P&L and financial measures used by analysts. Analysts measure financial lenders/lessors by such measures as net finance revenue over interest cost (net spread/net revenue from invested funds) and operating efficiency (the ratio of net revenue to expenses). The operating lease rent and depreciation bears no relationship to the declining financial asset and its cost to carry. Mixing depreciation of leased assets with assets used in the business makes the bank/finance company appear less efficient. For the same reasons, the Boards must consider the accounting for tax credits and tax benefits for financial lessors. Reporting tax credits as tax expense rather than as a component of lease revenue and failing to recognize the reduction in cost to carry from tax shelter distorts the net revenue and operating efficiency ratios. Users want to see the results of investments considering all the elements of revenue in the

appropriate line on the P&L based on the substance of the transaction.

Similarly, operating lessors should continue to use an operating lease model as that model most accurately reflects the nature of their business, which is the management of the asset. If the Boards believe users of financial statements require additional information about lessors' residual and credit risks, this information should be provided through additional disclosure and not through recognition and measurement.

Question 4: Classification of Leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

Response

We do believe that the nature of lease agreements varies, but we do not believe they vary based upon the nature of the underlying asset. A model that proposes to recast transactions into another category of transactions, which is the central element of the Type A model, should be based upon whether those transactions are substantively in the form of the transaction they are being recast into. A nine-year lease of an asset with a ten-year life is probably substantially similar to the separate acquisition and financing of an asset purchase. A two-year lease of the same asset is probably not and should not be forced into a different form through accounting.

We do agree that the relationship of lease term to the economic life of a leased asset is one of the factors used to determine if the rights and obligations in a lease are ownership rights or merely rights of use. The significance of the lease payments in relationship to the underlying asset is another factor. It should not matter what the leased asset is — real estate or equipment. The current GAAP risks and rewards tests accomplish the goal of classifying leases according to their economic and legal nature and those factors should continue to be part of the new lease accounting model. If they are not, then users will have less information.

Question 5: Lease Term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why

Response

We understand the Boards have attempted to replicate the existing GAAP requirements for determination of lease term. This has been done by using new terms, however, and we believe this will result in new interpretations. If the intent of the Boards is to continue the current requirements, then existing terms should be used as much as is possible to reduce the costs associated with transition and ongoing compliance.

The requirement to reassess leases will add to the costs of the proposals, and we believe that lease term extensions should only be accounted for when they occur. Basing accounting recognition on anticipated outcomes is not consistent with other acquisition or service accounting models.

Question 6: Variable Lease Payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

Response

We agree with the treatment of variable lease payments if the payments are indexed, but we also believe if the impact of changes in variable rate lease payments will not result in any significant change in the lease asset and lease liability, they should be excluded from the model on a cost versus benefit basis. Changes in interest rates will not, however, have a significant impact on the measurement of the lease asset and obligation and should be excluded from reassessments.

Question 7: Transition

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Response

Lessee transition for Type A leases is far too complex because the method front loads costs and the transition method attempts to lessen the current period P&L impact. It should also be noted the entry in the 842-10-55-77 example of a Type A lease transition lacks a charge to deferred tax assets.

In 842-10-55-89 the fair value of an asset may not be readily available for many asset types. In 842-10-55-90 it seems to allow the residual to be “written up” if it is higher than the residual value at inception. To simplify things and to conform to the principle that residuals cannot be written up, we would use “at inception/commencement” data for cost/fair value, residual and implicit rate. As a result, the value of the lease at transition will be the PV of the rents and original residual using the original implicit rate as the discount rate to PV the amounts that are recorded at the transition date.

In 842-10-65-1, we would suggest the following language: “For leases that were classified as direct finance or sales-type leases in accordance with Topic 840, the carrying amount of the lease receivable and residual asset at the beginning of the earliest comparative period presented shall be the bifurcated carrying amount of the net investment in the lease immediately before that date (using the implicit rate in the lease to calculate the amounts) in accordance with Topic 840.”

Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Response

We do not agree that a lessee in a lease with services needs to disclose future non lease components/service contract payments as the same disclosure is not required for a service contract with the exact same terms that is contracted separate from the lease. Also, if an asset is owned and

a preparer enters into a service contract on the asset that has the exact same terms as the service contract connected to a lease, it would not need to be disclosed. In all the cases cited, the service contract is legally the same — it is an executory contract.

The requirements in 42-20-50-4 to disclose reconciliations for the assets and liabilities for both Type A and Type B leases present a great deal of information that we question whether users really need. This is a question that should be posed in targeted outreach with lenders, investors and analysts.

The fact that most companies lease many types of assets and have numerous leases means that the requirements in 842-20-50-3 to describe lease terms will result in very general descriptions.

Questions 9, 10, 11, 12

Responses

None

Exhibit A

Excerpts from:

Accounting Horizons

Vol. 15 No. 3

September 2001

pp. 289-298

COMMENTARY

Evaluation of the Lease

Accounting Proposed in

G4+1 Special Report

AAA Financial Accounting Standards Committee Stephen G. Ryan (Chair); Robert H. Herz; Teresa E. Iannaconi; Laureen A. Maines; Krishna G. Palepu; Katherine Schipper; Catherine

M. Schrand; Douglas J. Skinner; Linda Vincent

CHARACTERISTICS OF A CONCEPTUALLY SOUND LEASING STANDARD

The Committee supports development of a single, conceptually sound approach to accounting for all types of leases and believes that such an approach should have the following characteristics:

1. The approach should recognize that all leases, regardless of their specific terms and conditions, convey rights and obligations, and so create assets and liabilities. The nature of the property under lease should not affect the accounting, nor should the length of the lease.

2. The approach should recognize that accounting for leases is a special case of accounting for

contracts. Accounting for all contracts should be placed on a sound conceptual footing, and the principles developed for leases should be both internally consistent and generalizable, in the sense that the principles governing accounting for leases should be suitable for application to accounting for contracts generally.

3. The approach should be robust to shifts in the contractual details of lease contracts when such shifts do not materially alter the economic substance of the arrangements. In particular, the approach should require that substantially similar lease contracts be accounted for similarly and substantially dissimilar lease contracts not be forced into a misleading appearance of comparability.

4. The approach should take account of practiced realities of the leasing market that make measuring lease assets and liabilities difficult. Because lease contracts are frequently tailored to the desires of the parties to the lease, it can be difficult or even infeasible to identify similar lease contracts. Moreover, public information about the specifics of lease contracts is often unavailable. For these reasons, the markets for trading lease assets and liabilities are relatively undeveloped. In addition, the existence of transaction costs associated with relocating and releasing assets under lease may yield incentives that affect the contractual lease provisions.

While the measurement difficulties discussed in point 4 above must be considered carefully, the Committee believes that the principles governing accounting for lease receivables and liabilities should conform to the accounting for other financial instruments. In this regard, we note that in previous comment letters to the FASB (most recently, to its December 1999 Preliminary Views "Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value"), the Committee stated its support for fair value accounting for financial instruments once the conceptual and measurement issues are resolved.

FOOTNOTE

1 THE ACCOUNTING REVIEW Vol. 88, No. 4 DOI: 10.2308/accr-50421 July 2013 pp. 1179-1210.

GASB Proposes Measurement Concepts for Assets and Liabilities and Standards for Measuring, Applying, and Disclosing Fair Value.

In June, the GASB issued an Exposure Draft, Measurement of Elements of Financial Statements, and a Preliminary Views, Fair Value Measurement and Application. The Exposure Draft proposes new accounting concepts to guide how the GASB sets standards for the measurement of assets, liabilities, and other items reported in financial statements. The Preliminary Views presents the Board's initial thinking on how fair value should be determined, what should be measured at fair value, and what note disclosures should be included with those measurements.

The GASB also issued a Plain-Language Supplement that summarizes the proposals for users of governmental financial information. The GASB will be conducting a webcast on September 5 at 3:00 pm Eastern time to explain the proposals and collect feedback from users.

This article summarizes and explains the proposals in the due process documents at a very high level for users of governmental financial information. It addresses the Exposure Draft on measurement concepts first, and then discusses the Preliminary Views on fair value. Information about how to participate in the September 5 webcast and provide your feedback to the GASB is included.

Measurement Concepts

GASB Concepts Statements are meant to provide a framework of interrelated objectives and fundamental concepts that can be used as a basis for the GASB establishing consistent accounting and financial reporting standards. Measurement concepts will address how to calculate the appropriate amounts for assets and liabilities. As such, they will provide a foundation for depicting a government's financial health as of a specific point in time, referred to as the government's "financial position," and its financial activity during a certain period, referred to as the government's "results of operations" or "financial performance."

Measurement concepts help the Board to develop standards that require largely the same treatment for similar transactions. This promotes the user's ability to compare relevant, reliable, and understandable financial information across governments. Ultimately, accounting standards based on these concepts should maximize the likelihood that different governments would come up with comparable measurement amounts for comparable assets or liabilities obtained or incurred under comparable circumstances.

Measurement approaches

A measurement is associated with a point in time; a "measurement approach" tells you what that point in time is. The GASB is proposing that assets and liabilities be measured using one of two measurement approaches:

- Initial Amount—The transaction price or amount assigned when an asset was acquired or a liability was incurred, including subsequent modifications (for example, depreciation) to that price or amount. Initial amounts also are known as initial-transaction-date-based measurements.
- Remeasured Amount—The amount assigned when an asset or liability is remeasured as of the financial statement date. Remeasured amounts also are known as current-financial-statement-d-te-based measurements.

While initial amounts may be adjusted in later years, such as through amortization or because of impairment, the original value of the asset or liability is not remeasured. Remeasured amounts, on the other hand, are newly measured as of the date of each year's financial statements. The GASB has proposed two approaches, rather than a single approach for all assets and liabilities, because it believes both are needed to meet the various objectives of financial reporting and to achieve balance among the qualitative characteristics (reliability, comparability, consistency, relevance, understandability, and timeliness) of information in government financial reporting.

The Board believes that the use of initial amounts is generally better suited to achieving reporting objectives associated with the cost of providing services. A capital asset—an elementary school, for example—is acquired at a given time but is used to provide services for many years afterward. Including the cost of the school in the cost of providing services in each of those years is more informative if the cost of the school is measured at the initial amount.

The Board also believes that remeasured amounts are better suited to achieve financial reporting objectives related to portraying financial position. For example, using the remeasured amount for a government's investments that will ultimately be converted to cash will provide a clear picture of a government's current financial health and the resources available to it for providing services or satisfying obligations.

The Board recognizes that it may not be possible to report some assets or liabilities using a measurement approach that promotes the objectives of both (a) providing information about the cost of current-year services and (b) providing information about the financial position of a governmental entity to be used in assessing the level of services that can be provided by the governmental entity.

Because only one measurement approach should be applied for a specific asset or liability, one objective will necessarily be given priority over the other. In these circumstances, the Board believes that the cost-of-services information has greater relevance in the governmental environment than the service-potential information because of the importance of providing information that can be used to assess interperiod equity.

Measurement attributes

The GASB is proposing to place four basic measurement tools in its conceptual framework tool box that it can use in standards-setting. These tools are referred to as measurement attributes. A measurement attribute is a particular characteristic of the asset or liability that is being measured. The proposed Concepts Statement identifies and defines four measurement attributes:

- Historical cost is the price actually paid to acquire an asset or, with respect to a liability, the proceeds actually received when the liability was incurred.
- Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- Replacement cost is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the measurement date.
- Settlement amount is the amount at which an asset could be realized or a liability could be liquidated with the counterparty, other than in an active market.

Historical cost can be used to measure initial amounts only, while the other measurement attributes can be used to measure both initial amounts and remeasured amounts.

Implications for users

The proposed concepts will not directly affect the information that is reported in governmental financial reports because Concepts Statements do not set standards. Indirectly, however, the concepts guide the GASB when it is establishing standards and, therefore, will help to ensure that the standards adequately balance the need for understandable, relevant, and reliable information that is prepared consistently and comparably and presented in a timely fashion.

Fair Value Measurement and Application

Defining fair value

The notion of fair value has been used for many years in the governmental accounting environment to measure investments predominantly, as well as some other assets and liabilities. Under the Preliminary Views, fair value would be defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In the Board’s view, fair value is a market-based measurement and represents an exit price.

Implications for users.

The primary result of the new definition should be to improve the comparability and consistency of governments’ measures of fair value. It clarifies certain issues that are important to pinpointing fair value, such as the fact that it is an exit price rather than an entry price, which under certain circumstances can be very different amounts. The fair value definition also is consistent with the Financial Accounting Standards Board’s definition of fair value—one that many users are already familiar with.

Measuring fair value

The GASB's Preliminary Views describes three acceptable "valuation approaches" for measuring fair value:

- The market approach uses information resulting from market transactions for identical or comparable assets or liabilities (for example, the stock exchange).
- The cost approach bases fair value on the amount necessary to replace an asset's present capacity for providing service (for example, an appraisal).
- The income approach calculates fair value by converting future amounts to a single current amount. A government might project cash flows from an asset—like a royalty interest in an oil-producing property—and discount them to their present value, for example.

The GASB's preliminary view is that the use of a variety of "valuation techniques" for establishing fair value could be acceptable, depending on the specific circumstances of the measurement, provided that:

- The valuation technique used by a government is consistent with the three valuation approaches, and
- The valuation technique is based as much as possible on "observable inputs."

"Inputs" are the assumptions market participants make when deciding on the price for an asset or liability, such as the degree of perceived risk. Observable inputs are those that are readily accessible to the public, such as the previously mentioned stock exchange. Unobservable inputs are based on assumptions a government uses to best estimate the fair value of an asset or liability in the absence of market data.

The Preliminary Views describes a three-level hierarchy of inputs for measuring fair value:

- Level 1 inputs are quoted prices from markets with many transactions for identical assets and liabilities. When market information that qualifies as a Level 1 input is available for measuring fair value, a government would use the market valuation approach rather than the cost or income approach.
- Level 2 inputs are either directly observable, like quoted market prices but for similar assets and liabilities, or correlated or corroborated from observable market information. Level 2 inputs generally would not be used unless Level 1 inputs are not available.
- Level 3 inputs are assumptions a government develops based on the best information available to it.

Level 3 inputs would not be used unless Level 1 inputs and Level 2 inputs are unavailable.

The distinction between the three levels relates to the reliability of the measurement of an asset or liability's fair value. Observable inputs are more reliable than unobservable inputs because it is easier to verify observable inputs.

Alternative investments. Some governmental entities hold investments for which there is not a "readily determinable fair value." These often relate to "alternative investments," such as shares in a hedge fund. Governments with investments in hedge funds and certain other entities that calculate "net asset value per share" would be allowed to use a practical expedient to determine the value of those investments. In other words, governments would not establish the fair value of their investment themselves but would calculate an amount based on their proportion of the fair value determined by the issuer of the investment (the hedge fund, for example).

Implications for users. The valuation techniques and hierarchy of inputs, which form the basis for

determining fair value, are applicable to all investments and, thereby, promote consistency and comparability. They also are consistent with the FASB's requirements, which are familiar to many users.

A principle concern among users when looking at fair value amounts reported in financial statements is where they came from. Certain sources of fair value, such as market data, are considered inherently more reliable by users, whereas users are more uncertain about fair value determined by governments internally using unobservable inputs. When combined with disclosure requirements that are detailed below, this proposal should have the effect of making it easier for users to assess the acceptability of fair value measures and reduce the degree of uncertainty they face.

Applying fair value

The Board's preliminary view is that investments generally should continue to be measured at fair value. The GASB has proposed defining an investment as a security or other asset that a government holds primarily for the purpose of income or profit, the present service capacity of which is based solely on its ability to generate cash, to be sold to generate cash, or to procure services.

Exceptions to fair value. At present, several types of investments are not required to be reported at fair value. These include investments with a maturity of one year or less at the time of purchase, investments in 2a7-like external investment pools (which are a type of government-sponsored, short-term investment pool), and most investments in life insurance. Under the GASB's preliminary view, these exemptions to applying fair value would continue.

Under the preliminary view of the GASB, certain assets currently required to be measured at fair value would be measured at acquisition value instead. These include:

- Capital assets received in a nonexchange transaction, such as capital assets received by donation
- Works of art and historical treasures received by donation
- Certain assets received in nonmonetary transactions.

While fair value is an exit price, acquisition value is an entry price—that is, the price a government would have to pay to acquire a similar asset with similar service capacity.

Transaction costs.

Currently, many defined benefit pension plans and retiree health insurance plans subtract significant related transaction costs when measuring fair value. Under the preliminary view of the GASB, transaction costs would instead be reported as expenses when incurred and not netted against the fair value of investments.

Implications for users. Under the proposed definition of an investment, some items not currently reported as investments could be considered investments going forward. Consequently, governments would have to measure their fair value going forward. Similarly, some assets currently reported as investments would no longer be reported at their fair value. However, it is not expected that the changes would be substantial.

Fair value disclosures

In order to allow users to better understand how governments calculate fair values when they are not based on observable market data, the GASB has proposed a more detailed set of disclosures than is currently required that take into account the levels of inputs a government uses to measure fair

value and their characteristic degrees of uncertainty and subjectivity.

These disclosures would be organized by type or class of asset or liability. The extent of disaggregation would depend on a number of factors, including the nature, characteristics, and risks of the assets or liabilities, the level of inputs used to measure the assets or liabilities, whether other standards specifically require separate disclosure (such as derivative instruments), and the value of the assets or liabilities measured at fair value relative to all the assets or liabilities. The GASB is proposing that governments disclose:

- The fair value amounts as of the date of the financial statements and the levels of inputs used in their determination
- The valuation techniques and assumptions used
- Changes in techniques and inputs having a significant impact on the measurement of fair value and the reasons behind the changes
- Additional quantitative information that describes the nature of any significant Level 3 inputs used to measure fair value
- A narrative description of the degree to which fair value measurements are sensitive to changes in Level 3 inputs.

Importantly, the amount of disclosure is greater when Level 3 inputs are used because they are harder to verify. The proposed disclosures would give users the information needed to evaluate the measurement techniques used and the resulting fair value measurements themselves.

To reiterate, governments would be able to use a practical expedient to value certain alternative investments because these investments do not have a readily determinable fair value. Consequently, their value would be less certain and more subjective than the fair value measurements of other investments. As a result, the GASB believes additional disclosures are necessary for alternative investments. These disclosures would include the following for each type of alternative investment:

- The fair value amounts as of the date of the financial statements
- Significant investment strategies of the entities in which the government has invested
- The amount of any related commitments the government has for which it has not set aside resources
- Terms and conditions under which the government may redeem the investments
- Restrictions preventing the government from redeeming an investment that is otherwise redeemable and the expected duration of the restriction
- Other significant restrictions on the government’s ability to sell the investments.

Implications for users.

If the proposals related to fair value disclosures are ultimately reflected in final standards, the fair value information about assets and liabilities by type, class, valuation approach, and input levels would significantly enhance the depth and breadth of users’ understanding of governmental entities’ financial health. Disclosures about the assumptions made in estimating fair value, particularly for alternative investments, directly address the concerns that users have about understanding how fair value is determined.

Disclosures related to Level 3 inputs, particularly those related to more complex items, such as securitized fixed income and alternative investments, would assist users in analyzing the financial condition and activity of governments. For example, these disclosures would potentially provide a clearer understanding of the extent of an entity’s diversification among alternative investments, other inherent risk factors, and the nature and quality of the measurements involved.

How Can Users Help the GASB with These Projects?

When the GASB sets standards and establishes concepts, a critical part of its due process activities involves publishing documents for public discussion and comment. Users of financial statements are in the best position to assist the GASB in understanding whether or not the information that would result from the proposals would be important for fulfilling their informational needs. You can help the GASB by reviewing the Plain-Language Supplement prepared specifically for users of financial statements, and commenting on the questions posed throughout the supplement. You are also invited to comment on the Exposure Draft and the Preliminary Views themselves.

Copies of the Plain-Language Supplement, Exposure Draft, and Preliminary Views may be downloaded free of charge from www.gasb.org. The comment deadline for all three documents is September 30.

As previously noted, the GASB has scheduled a webcast designed specifically with financial statement users in mind for September 5, 2013, at 3:00 p.m. Eastern time. The webcast will summarize the proposals described in this document and provide an opportunity for users to ask questions. The webcast will be followed immediately by a web-based survey allowing users to offer their views. The webcast may be viewed and the survey completed on that date or on any day following through the September 30 comment deadline.

A public hearing on the Exposure Draft and Preliminary Views is scheduled for November 1, 2013, at the Sheraton LaGuardia East Hotel, 135-20 39th Avenue, Flushing, NY. The deadline for providing written notice of intent to participate in the public hearing is September 30.

Additional details on how to provide comments to the GASB and about participating in the public hearing are available in the front of the Exposure Draft and the Preliminary Views.

FASB Releases Updates in its Definition of a Nonpublic Entity Project.

The objective of this project is to re-examine the definitions of a nonpublic entity and public entity in the FASB Accounting Standards Codification. The project will focus on defining what constitutes a public business entity to distinguish between different types of entities for standard-setting purposes and on determining which companies are to be excluded from the scope of the Private Company Decision-Making Framework. The project will also focus on whether a distinction or distinctions between not-for-profit entities is necessary and, if so, how that distinction or distinctions between particular types of not-for-profit entities might best be made.

The updates are available at:

http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176159865920#due_process

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GFOA Certified Public Finance Officers Certification Program.

The Certified Public Finance Officers Program (Certification Program) of the Government Finance Officers Association of the United States and Canada (GFOA) is a broad educational self-study

program designed to verify knowledge in the disciplines of government finance. The Certification Program is governed by the Council on Certification.

Click here for information on the Certified Public Finance Officers Program:

http://www.gfoa-cpfo.org/

FAF Review Concludes GASB Standard on Risk Financing and Insurance-Related Activity Achieve Their Purposes.

Two accounting standards established to improve the consistency and comparability in reporting U.S. state and local governments' insurance activities achieve their purpose.

That was the overall conclusion of the Post-Implementation Review (PIR) of Governmental Accounting Standards Board (GASB) Statements No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, and No. 30, Risk Financing Omnibus, an amendment of GASB Statement No. 10. The Statements establish accounting and financial reporting standards for risk financing and insurance-related activities of state and local governments, including public risk pools.

The review of Statements 10 and 30 was undertaken by an independent team of the Financial Accounting Foundation (FAF), the parent organization of the GASB and the Financial Accounting Standards Board (FASB). The team's formal report is available at www.accountingfoundation.org.

FAF President and CEO Teresa S. Polley said: "On behalf of the FAF and the GASB, I'd like to thank the stakeholders who helped the PIR team assess the real-world application, usefulness, and effectiveness of the insurance and risk financing standards for state and local governments."

GASB Chairman David A. Vaudt said: "The post-implementation review report on Statements 10 and 30 identified many positive aspects of the insurance and risk financing standards, including their decision-usefulness to users.

"We are considering the reported findings and will provide our initial response in the coming weeks. Additionally, the FASB is working on a project to amend its guidance for insurance activities. The GASB is actively monitoring that project and, when complete, will determine whether action by the GASB is appropriate."

The PIR team received input from analysts and other financial statement users, as well as from preparers and auditors. Based on its research, the review team concluded that, overall, Statements 10 and 30 are accomplishing their stated purpose. In particular, their research indicates:

- Statements 10 and 30 resolve the issues underlying their need.
- Preparers and experienced practitioners are able to understand and apply the standards as intended.
- The standards have increased consistency and comparability across governments' insurance activities.
- The resulting information is reliable and decision useful for those who use it.
- The standards did not result in significant unexpected changes to financial reporting or operating practices, nor did they have any significant unanticipated consequences.
- The implementation and continuing application costs appear to be consistent with the costs that

the GASB considered and stakeholders expected, and the benefits appear to be consistent with what the GASB intended.

The PIR team for Statements 10 and 30 also concluded that the standard-setting process worked well overall and contributed to successful standards. The PIR team had no significant standard-setting process recommendations as a result of the review.

GASB Statements 10 and 30 PIR Report:

http://www.accountingfoundation.org/cs/BlobServer?blobkey=id&blobwhere=1175827510281&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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Registration Opens for September 5 Webcast in Focus: Overview of GASB Proposals for Financial Statement Users.

Registration is now open for the upcoming Governmental Accounting Standards Board (GASB) webcast, IN FOCUS: Overview of GASB Proposals for Financial Statement Users. This live webcast, offered free of charge, will take place on Thursday, September 5, 2013, from 3:00 to 4:00 p.m. Eastern Daylight Time. Participants in the live broadcast will be eligible for up to 1 hour of CPE credit. (Please note that CPE credit is not available for group viewing of the live broadcast.)

The webcast will provide an overview of the GASB's proposals on asset and liability measurement concepts and the measurement, application, and disclosure of fair value based on its plain-language due process document for users, Measurement Concepts for Assets and Liabilities and Fair Value Measurement and Application. Aimed at users of governmental financial information—for example, representatives from citizen groups (research organizations), those that participate in the lending process (bond analysts), and legislative and oversight bodies (legislative analysts)—its goal is to provide users with the background information they need to participate in the due process associated with the GASB proposals.

The areas covered will include:

- The provisions of the GASB's proposed Concepts Statement, Measurement of Elements of Financial Statements
- The provisions of the GASB's Preliminary Views, Fair Value Measurement and Application, and how they would affect:
- How governments measure the fair value of assets
- What assets are measured at fair value
- The fair value information disclosed in the notes to the financial statements
- How the proposals would impact the information that users receive.

At the end of the program, participants will understand the changes the GASB is proposing and their potential effect on the information that users receive in financial statements and note disclosures. They also will be asked to respond to a brief survey after the webcast that will provide the GASB feedback on its proposals. Participants will have the opportunity to email questions to the speakers during the event.

An archive of the webcast will be available on the GASB website through Wednesday, December 4, 2013. (CPE credit will not be available to those who view only the archived webcast.)

Course Description and Registration:

http://www.gasb.org/cs/ContentServer?c=Page&pagename=GASB%2FPage%2FGASBSectionPage&cid=1176158838207

Internal Auditors Society Annual Conference 2013.

November 3-6, 2013

Delray Beach Marriott | Delray Beach , FL

Early bird rates to end on October 4, 2013.

The 2013 Internal Auditors Society (IAS) Annual Conference brings together financial services audit professionals, industry experts and regulators to share insights and experiences on:

- Enhancing the value of Internal Audit to the organization
- Partnering with the second line of defense
- Regulatory updates and their impact on Internal Audit
- Auditing emerging risks and threats
- Using data mining and analytics to discern actionable information from noise

Join us November 3-6 to network with internal audit, risk and compliance colleagues, and industry regulators, to discuss the future of Internal Audit, and to learn how a strong Internal Audit function can lead to better business results.

Conference attendees will be eligible for 15 hours of CPE credit.

Register at:

https://mbrservices.net/ConferenceRegistration/MeetingRegistration.aspx?meetingid=1152

GFOA Marketplace Fairness Act Resource Center.

On May 6 the Senate passed S 763 – the Marketplace Fairness Act by a vote of 69-27. The legislation would give state and local governments the option to collect taxes on remote sales, which are already owed to them under current law. Despite the broad bipartisan approval of the measure in the Senate, the legislation has languished in the House and faces an uncertain future without significant engagement by state and local government officials and other supporters. The GFOA is working with our state and local government coalition partners to encourage House action on the Marketplace Fairness Act, but we need your help to get the House to consider this important legislation!

What Can You Do?

GFOA's Federal Liaison Center has developed a suite of advocacy materials to assist you in your outreach to your federal elected leaders to request their support for the House version of the Marketplace Fairness Act (HR 684). These materials include:

Talking points to help you in your discussions with your members of Congress on the bill.

http://www.gfoa.org/downloads/GFOAMFATalkingPoints.doc

A factsheet discussing the inaccuracies of many of the arguments being used against Marketplace.

http://gfoa.org/downloads/GFOADRAFTMFAMythbusterFactsheet.pdf

A draft letter to send to your members of the House of Representatives to request their cosponsorship of the bill (HR 684).

http://gfoa.org/downloads/GFOADRAFTCosponsorMFALtr.docx

A draft thank you letter for you to send to your members of Congress if they are already a cosponsor of the bill.

http://gfoa.org/downloads/GFOADRAFTMarketplaceTYltr.docx

A draft Op-Ed for you to send to your local paper to continue to increase awareness for the need to enact this important bill.

http://gfoa.org/downloads/GFOADraftOPEDMarketplaceFairnessAct2013.docx

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GFOA Annual Meeting Sessions Available on CD.

GFOA would like to thank everyone who attended the 2013 annual conference.

Missed some sessions from the annual conference? The session CDs are now available.

Click here to access the order form:

http://gfoa.org/downloads/GFOA2013SanFranciscoCDOrderForm.pdf

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SIFMA Releases Mid-Year 2013 Economic Forecast.

Washington, D.C., July 24, 2013-SIFMA's Economic Advisory Roundtable today released its outlook for the second half of 2013 and predictions for 2014, forecasting that the economy will grow at a rate of 1.7 percent in full-year 2013 and 2.6 percent in 2014.

"Our Roundtable maintains their forecast for moderate economic growth for 2013 and 2014, with upside and downside drivers varied among respondents," said Kyle Brandon, managing director and director of research at SIFMA. "Generally, the continued housing recovery and low energy prices were seen as positive drivers of growth, while external factors such as Europe and emerging markets featured as the downside risks to the economy."

The Economy

The median forecast called for gross domestic product (GDP) to rise 1.7 percent in 2013 on a year-

over-year basis, and by 2.0 percent on a fourth quarter-to-fourth quarter basis. For full year 2014, the median forecast was 2.6 percent year-over-year; on a quarterly basis, the first two quarters of 2014 were expected to stabilize at 2.7 and 2.9 percent annualized GDP growth, respectively.

Unemployment was expected to remain at elevated levels throughout 2013 and 2014. Survey respondents expected the full-year average unemployment rate to decline to 7.5 percent in 2013, a slight improvement from the end-year 2012 forecast of 7.7 percent, and a further decline to 6.9 percent expected in 2014.

Monetary Policy

Three-fourths of respondents expect the FOMC to reduce the pace of securities purchases as early as September 2013, with the remainder expecting a reduction sometime in the fourth quarter of 2013 or at the latest January 2014, an assessment noted by Chairman Ben Bernanke in his semiannual monetary report to Congress. Opinions diverged slightly more when asked about timing for the end of securities purchases, with over half expecting an end in the second quarter of 2014, slightly less than a third expecting an end in the first quarter of 2014, and the balance in the third quarter of 2014.

Impact of Sequestration and the Debt Ceiling

Sequestration, the result of budget negotiations from 2011 and 2012, came into effect on March 1, impacting approximately $85 billion of federal spending. Nearly 90 percent of respondents believed the impact of sequestration lowered GDP growth in full-year 2013 by up to 100 basis points. One respondent noted that higher taxes would be a “larger drag on economic growth in 2013 than spending cuts.”

Respondents were relatively unanimous in their opinion that debt ceiling negotiations would not impact GDP in a meaningful way in 2013, with one respondent noting that a fiscal deal was likely to be reached without a government shutdown or “excessive brinksmanship.” Another noted that the deficit was shrinking “rapidly” and that in fact the resulting increase in revenues as a percentage of GDP “could result in considerable, unexpected fiscal drag in 2014.”

The full report can be found at the following link: http://www.sifma.org/econoutlook20132h/.

FAF to Conduct Post-Implementation Review of GASB Standard on Impairment of Capital Assets.

Norwalk, CT, July 17, 2013—The Financial Accounting Foundation (FAF) today announced that it will conduct a Post-Implementation Review (PIR) of an accounting and financial reporting standard for state and local governments regarding the impairment of capital assets and insurance recoveries.

Issued in 2003, Governmental Accounting Standards Board (GASB) Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries, http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175824062940&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs establishes measurement guidance for capital asset impairments and requires governments to report the effects of those impairments when they occur, rather than as a part of the ongoing depreciation expense for the capital asset or upon disposal of the capital asset. It also provides uniform reporting guidance for insurance recoveries of state and local governments.

Stakeholders who would like the opportunity to participate in PIR surveys on GASB Statement 42, conducted by an independent survey firm on behalf of the FAF, should register online. http://www.accountingfoundation.org/cs/ContentServer?c=Page&pagename=Foundation%2FPage%2FFAFSectionPage&cid=1176159648816

The PIR team recently completed its review of GASB Statements No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175824062544&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs and No. 30, Risk Financing Omnibus, http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175824063444&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs which establish accounting and financial reporting standards for risk financing and insurance-related activities of state and local governments, including public risk pools. The FAF expects to issue the review report in August.

FASB to Propose New Definition of Public Businesses.

As part of a project on determining which entities qualify for alternative private company accounting rules, the Financial Accounting Standards Board on July 10 decided to propose guidance that would help define what constitutes a public business

At a meeting in Norwalk, Conn., the board unanimously supported a staff recommendation not to amend the existing definitions of a nonpublic entity in the Accounting Standards Codification (ASC). Rather, the board agreed to propose a new definition of a public business entity that would be added to the ASC master glossary for use in future guidance.

According to the staff, a business entity would be regarded as public if it has met any of the criteria established in prior board decisions for determining which entities should be excluded from the alternative rules developed for private companies. Those criteria include a requirement to file or furnish financial statements with the SEC or another regulatory agency for purposes of issuing securities.

FASB member Thomas Linsmeier supported the staff recommendation, saying that the board must gain more experience making scope decisions about the companies that FASB and its advisory group, the Private Company Council (PCC), will not be considering for potential rulemaking differences.

Linsmeier added, however, that the new definition of a public business entity that will be proposed will create some differences from the existing general definition. “We should think about the entities that will be affected by those differences — if at all possible — and try to seek them out for comment,” he said.

According to Linsmeier, FASB should make an effort to gather feedback from those entities offering unrestricted securities that would be classified as public because they must provide periodic financial reports to the public under a legal or regulatory requirement.

FASB decided that the proposed guidance on defining a public business entity would be released for a 45-day public comment period.

Elizabeth Gagnon, a FASB project manager, said that if the proposal can be released later this month, the timing of the comment period should allow for the feedback to be received before the PCC's meeting scheduled for October.

New Pension Numbers for Books, Budgets, and Bonds.

Public pension data have become more complex as GASB, the rating agencies, and governments themselves may all be using different sets of pension numbers for different purposes. The GFOA and other leading national associations representing state and local governments, agencies, and officials have developed a one-page summary to help everyone concerned understand the differences among these numbers, the intended purpose and audience, and new resources available to lawmakers to address pension funding.

http://gfoa.org/downloads/JointFundingGuidelinesOverview.pdf

Registration Opens for Two FASB Webcasts on Insurance Contracts.

Webcasts Examine Different Aspects of FASB Proposal

Registration is now open for two live webcasts hosted by the Financial Accounting Standards Board (FASB).

IN FOCUS: The Insurance Contracts Project—Part I, Scope will take place on Tuesday, July 30, 2013, from 1:00 to 2:00 p.m. EDT. Participants in the live broadcast will be eligible for up to 1 hour of CPE credit.

IN FOCUS: The Insurance Contracts Project—Part II, The Models will take place on Thursday, August 1, from 1:00 to 3:05 p.m. EDT. Participants in the live broadcast will be eligible for up to 2.5 hours of CPE credit.

(Please note that CPE credit is not available for group viewing of the live broadcasts.)

IN FOCUS: The Insurance Contracts Project—Part I, Scope (1 CPE credit)

The first Insurance Contracts webcast will feature Hal Schroeder, FASB member; Jennifer Weiner, FASB senior practice fellow; and Lauren Alexander, FASB associate practice fellow discussing the scope of FASB's June 27th Exposure Draft on Insurance Contracts. The proposed guidance would apply to all companies that issue insurance contracts as defined in the Exposure Draft, including those that are not insurance companies, unless those contracts are specifically excluded from the scope. The webcast will cover the following areas:

- Why the proposed guidance would apply to all companies issuing insurance contracts rather than just to insurance companies
- Contractual features that may require contracts to be accounted for using the proposed guidance
- Examples of contracts issued by noninsurance companies to which the proposed guidance would apply

- How the proposal improves existing accounting
- Next steps in the project.

Register at:

http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176163088722

IN FOCUS: The Insurance Contracts Project—Part II, The Models (2.5 CPE credits)

The second Insurance Contracts webcast will feature Tom Linsmeier, FASB member; Marc Siegel, FASB member; Jennifer Weiner, FASB senior practice fellow; Christopher Irwin, FASB practice fellow; and Lauren Alexander, FASB associate practice fellow. Topics of discussion will include:

- Why the FASB has an insurance contracts project on its agenda
- When investment and service components should be disaggregated from the insurance component and accounted for using the financial instruments or revenue recognition guidance, respectively
- Determining which approach to apply: the building block approach or the premium allocation approach
- Details of the two approaches, including measurement of the insurance contracts liability/asset and the recognition of revenue and expenses
- How the proposal improves existing accounting
- Next steps in the project.

An archive of each webcast will be available on the FASB website through October 28 and October 30, respectively. (CPE credit will not be available to those who view only the archived webcast.)

Register at:

http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176163088783

FASB Issues Standard Deferring Some Disclosures for Nonpublic Employee Benefit Plans.

The Financial Accounting Standards Board (FASB) has published a new Accounting Standards Update that defers indefinitely certain disclosures about investments held by nonpublic employee benefit plans in their plan sponsors' own nonpublic equity securities. The Update, which was approved on June 12, is available to download at no cost on the FASB website.

Accounting Standards Update No. 2013-09, Fair Value Measurement (Topic 820): Deferral of the Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update No. 2011-04, applies to disclosures of certain quantitative information about the significant unobservable inputs used in Level 3 fair value measurement for investments held by certain employee benefit plans.

The deferral applies specifically to employee benefit plans—other than those plans that are subject to Securities and Exchange Commission filing requirements—that hold investments in their plan sponsors' own nonpublic entity equity securities, including equity securities of their nonpublic

affiliated entities.

“The Update addresses private company stakeholder concerns that certain disclosure requirements would potentially provide proprietary information when their employee benefit plans’ financial statements are posted on the plan regulator’s website,” said FASB Chairman Russell G. Golden.

The deferral is effective immediately for all financial statements that have not yet been issued.

The full Update is available at:

http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176156316498

GASB Issues Proposal Addressing Transition Issue in Pension Standards.

Norwalk, CT, July 2, 2013—The Governmental Accounting Standards Board (GASB) today issued for public comment a proposed Statement regarding the transition provisions of GASB’s new pension standards for state and local governments. The proposal would eliminate a potential source of understatement of restated beginning net position and expense in a government’s first year of implementing GASB Statement No. 68, Accounting and Financial Reporting for Pensions.

To correct this potential understatement, the proposed Statement would require a state or local government, when transitioning to the new pension standards, to recognize a beginning deferred outflow of resources for its pension contributions made during the time between the measurement date of the beginning net pension liability and the beginning of the initial fiscal year of implementation. This amount would be recognized regardless of whether it is practical to determine the beginning amounts of all other deferred outflows of resources and deferred inflows of resources related to pensions.

The provisions would be effective simultaneously with the provisions of Statement 68, which is required to be to be applied in fiscal years beginning after June 15, 2014.

The Exposure Draft is available on the GASB website, www.gasb.org. Stakeholders are encouraged to review the proposal and provide comment by August 26, 2013.

Read the Exposure Draft at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175827275726&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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GFOA Executive Board Approves Best Practice on Actuarial Valuation Reports.

At its recent meeting in San Francisco, the GFOA Executive Board approved a new best practice, titled Reviewing, Understanding and Using the Actuarial Valuation Report and Its Role in Plan Funding. This new best practice, forwarded by the Committee on Retirement and Benefits Administration, recommends that state and local government finance officials and others with

decision-making authority carefully review and understand their actuarial valuation report and use the information it contains to make policy decisions that ensure that pension benefits are funded in a sustainable manner.

http://www.gfoa.org/downloads/GFOABestPracticeonActuarialValuationReports.pdf

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GASB Issues Implementation Guide for Pension Plans.

Norwalk, CT, June 27, 2013—The Governmental Accounting Standards Board (GASB) today published an Implementation Guide for the new GASB standards regarding financial reporting for state and local government pension plans. The Guide to Implementation of GASB Statement 67 on Financial Reporting for Pension Plans is an authoritative resource designed to assist preparers and auditors of state and local government pension plan financial reports as they prepare to implement the standards, which are effective for periods beginning after June 15, 2013.

Prepared by the GASB staff, the Implementation Guide answers key questions about putting the new standards into practice. Topics addressed in the Guide include:

- The scope and applicability of GASB Statement No. 67, Financial Reporting for Pension Plans
- The classification of pensions as defined benefit or defined contribution
- The determination of the number of pension plans that should be reported
- The recognition of certain transactions and other events in defined benefit pension plan financial statements
- Note disclosures and required supplementary information
- The calculation of the net pension liability

“During the development and after the issuance of Statement 67, users, preparers, and auditors of pension plan financial reports posed questions to the GASB staff regarding the application of the standards,” said GASB Chairman Robert H. Attmore. “This Implementation Guide is written in a question and answer format and provides illustrative examples to assist stakeholders when applying the new standards for pension plan reporting.”

Mr. Attmore continued, “We are also pleased to announce that a digital version of the Guide will be the first guide to be offered on the GASB website as a download at no cost. Furthermore, all subsequent guides will be available on the GASB website at no cost moving forward.”

A hard copy bound edition of the Guide can be ordered for $46.50 plus shipping by visiting the GASB store, or by calling the GASB Order Department at (800) 748-0659.

An additional implementation guide for GASB Statement No. 68, Accounting and Financial Reporting for Pensions, will be available in early 2014. The provisions in Statement 68 are effective for periods beginning after June 15, 2014.

The Implementation Guide is available at:

http://www.gasb.org/cs/ContentServer?c=Page&pagename=GASB%2FPage%2FGASBSectionPage&cid=1176163026371

GASB Issues Proposals on Concepts for Measurement of Assets and Liabilities and on the Measurement and Application of Fair Value.

The Governmental Accounting Standards Board (GASB) today issued for public comment a proposed Concepts Statement that would guide the GASB when establishing standards regarding the measurement of assets and liabilities for U.S. state and local governments. The GASB also issued its Preliminary Views regarding the measurement of fair value and the application of fair value, including note disclosures. Finally, the GASB issued a Plain-Language Supplement that addresses both proposals and is intended to solicit feedback on the proposals from non-accountant financial statement users.

“The proposed Concepts Statement would establish concepts for both measurement approaches and measurement attributes,” said GASB Chairman Robert H. Attmore. “Measurement is a necessary component of a complete GASB conceptual framework, which will enhance consistency in future standards setting for state and local governments.”

Regarding the Preliminary Views on fair value, Mr. Attmore said, “In conjunction with the proposed Concepts Statement, the proposed changes to GASB’s fair value standards are intended to increase consistency and comparability in governments’ fair value measurements and related disclosures. The goal is to enhance financial statement users’ ability to assess a government’s financial health and accountability.”

Measurement Concepts

The Exposure Draft, Measurement of Elements of Financial Statements, proposes concepts that will inform the GASB’s decisions when establishing future standards for how state and local governments would determine the dollar amount at which to report assets and liabilities.

The GASB is proposing two approaches to measuring assets and liabilities—initial amounts and remeasured amounts. Initial amounts are determined at the time an asset is acquired or a liability is incurred. Remeasured amounts are determined anew as of the date of each year’s financial statements.

The GASB also is proposing four measurement attributes (the characteristic of an asset or liability that is being measured):

Historical cost is the price paid to acquire to acquire an asset or the amount received when a liability is incurred in an actual transaction.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Replacement cost is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the measurement date.

Settlement amount is the amount at which an asset could be realized or a liability could be liquidated with the counterparty, other than in an active market.

Fair Value Measurement and Application

The Preliminary Views, Fair Value Measurement and Application, describes how fair value should be

defined and measured, what assets and liabilities should be measured at fair value, and what information about fair value should be disclosed in the notes to the financial statements.

It is the GASB's preliminary view that investments generally should be measured at fair value. An investment would be defined as a security or other asset that a government holds primarily for the purpose of income or profit and the present service capacity of which is based solely on its ability to generate cash, to be sold to generate cash, or to procure services for the citizenry.

Certain investments would be excluded from measurement at fair value and should continue to be measured according to existing GASB standards, such as investments in money market instruments with remaining maturity at time of purchase of one year or less.

Under current accounting standards, state and local governments are required to disclose how they arrived at their measures of fair value if they are not based on quoted market prices. In the Preliminary Views document, the GASB proposes expanding those disclosures to include the levels of inputs a government uses to measure fair value and the judgments made to arrive at those inputs.

Providing Feedback

Both proposals and the Plain-Language Supplement are available on the GASB website, www.gasb.org. Stakeholders are encouraged to review the proposals and provide comment by September 30, 2013. The GASB also is planning to host a public hearing on both proposals in Flushing, New York, on November 1, 2013, at 8:30 a.m. EST.

For the Preliminary Views on Fair Value Measurement and Application, the GASB will be conducting a field test (in which governments go through the hypothetical process of applying the proposed standards) and is seeking state and local governments to participate. Governments interested in participating should contact GASB Project Manager Randy Finden at rjfinden@gasb.org.

The Exposure Draft is available at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175827186082&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

Preliminary Views are available at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175827186112&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

Plain Language Supplement available at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175827186097&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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Internet Seminar on the GFOA's New Program for Small Governments that Prepare Modified Cash Basis Financial Reports.

Sign up to participate in GFOA's complimentary one-hour Internet training seminar, The GFOA's New Program for Small Governments that Prepare Modified Cash Basis Financial Reports. This course is designed for the accounting or auditor professional interested in modified cash basis

financial reporting and the new award program recently announced by the GFOA. The interactive training will offer guidance on the practical application of the modified cash basis for financial reporting as well as the format and contents of a small government annual financial report (SGAFR).

Click on individual dates to register: July 11, 2013; September 18, 2013; or download the Registration form. Earn 1 CPE credit with your participation.

July 11, 2013:

http://gfoa.org/index.php?option=com_content&task=view&id=2670

September 18, 2013:

http://gfoa.org/index.php?option=com_content&task=view&id=2671

Download the registration form at:

http://gfoa.org/downloads/GFOATrainingCertificateofConformance.pdf

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FASB Indefinitely Defers Certain Disclosures for Nonpublic Employee Benefit Plans.

Norwalk, CT, June 12, 2013—The Financial Accounting Standards Board (FASB) today voted to indefinitely defer certain disclosures about investments held by a nonpublic employee benefit plan in its plan sponsor's own nonpublic equity securities. The FASB will issue an Accounting Standards Update, Fair Value Measurement (Topic 820): Deferral of the Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update No. 2011-04, in the next few weeks.

The indefinite deferral applies to disclosures of certain quantitative information about the significant unobservable inputs used in Level 3 fair value measurement for investments held by certain employee benefit plans. The deferral applies specifically to employee benefit plans—other than those plans that are subject to Securities and Exchange Commission filing requirements—that hold investments in their plan sponsors' own nonpublic entity equity securities, including equity securities of their nonpublic affiliated entities.

A summary of decisions reached will be available on the project page of the FASB's website at www.fasb.org.

"Today's decision is responsive to private company stakeholders, addressing their concern that certain disclosure requirements would potentially provide proprietary information when their employee benefit plans' financial statements are posted on the plan regulator's website," said FASB Chairman Leslie F. Seidman.

The deferral will become effective upon issuance of the final Update for all financial statements that have not yet been issued, which is expected to be issued in the next few weeks. It will be available on the FASB website at www.fasb.org.

The summary is available at:

http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2

FProjectUpdatePage&cid=1176162354675

Non-Issuers and Nonprofits May Be Excluded From FASB's Private Entity Guidance.

The Financial Accounting Standards Board on June 6 tentatively decided that some private companies and nonprofit organizations may be excluded from the population of nonpublic entities that would be eligible for alternative accounting rules developed by the board.

The Financial Accounting Standards Board on June 6 tentatively decided that some private companies and nonprofit organizations may be excluded from the population of nonpublic entities that would be eligible for alternative accounting rules developed by the board.

At a meeting in Norwalk, Conn., the board decided that the category of reporting entities classified as non-issuers that file or furnish financial statements with the SEC would be excluded from the scope of a proposed decision-making framework for determining whether alternative guidance is required for private companies reporting under U.S. generally accepted accounting principles.

Elizabeth Gagnon, a FASB project manager, said that while non-issuers do not register their securities with the SEC, those entities are typically engaged in the business of facilitating securities transactions and should not be considered private companies. Non-issuers could include broker-dealers, nationally recognized statistical rating organizations, and some registered investment advisers, she added.

In previous deliberations on defining what constitutes a nonpublic entity, the board decided to exclude an entity that is required to file or furnish financial statements with the SEC for purposes of issuing securities to be traded in a public market.

Because the public availability of U.S. GAAP financial statements is used as a criterion to determine which entities should be considered public, FASB also agreed to include within that classification any entity offering unrestricted securities that provides periodic financial reports to the public under a legal or regulatory requirement.

Regarding nonprofit organizations, the board decided that they should not be considered nonpublic or public entities but instead should be treated as a separate category of entities for financial reporting purposes.

Gagnon suggested that when FASB is determining whether alternative guidance under U.S. GAAP should be provided for business entities within the scope of the private company decision-making framework, the board should also consider whether any modifications or simplifications should be extended to nonprofit entities.

Gagnon said that under the proposed approach, the board could consider on a standard-by-standard basis whether all or some nonprofit entities should be eligible to apply the accounting and reporting alternatives provided for private companies.

A staff paper prepared for the meeting said the proposed scope of the private company decision-making framework doesn’t include nonprofit organizations. The paper also explained how nonprofit organizations have diverse missions, saying that some entities serve as charitable entities with “clear public purposes,” while other entities, such as credit unions and mutual insurance companies

that provide a direct benefit for their members, are treated as for-profit business entities for financial reporting purposes.

FASB member Thomas Linsmeier supported the staff proposal but expressed concern that the board would begin to naturally extend its decisions on private company accounting to nonprofit organizations.

Linsmeier said the board must continue to recognize the substantive differences between the financial reporting practices of nonprofit organizations and those of private companies, as well as the differences between their respective audiences of financial statement users.

by Thomas Jaworski

Financial Accounting Foundation Publishes 2012 Annual Report.

Norwalk, CT, May 22, 2013—The Financial Accounting Foundation (FAF) today published its 2012 Annual Report. The FAF is the independent, private-sector organization responsible for the oversight of the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB).

http://www.accountingfoundation.org/cs/BlobServer?blobkey=id&blobwhere=1175826969164&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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GFOA Members Voting on Public Policy Statement at 2013 Business Meeting.

At the 2013 Annual Business meeting, the GFOA membership will be voting on a new public policy statement recommended by the Executive Board for approval. The policy statement, Opposition to Giving the SEC Authority Over the Content, Timing and Frequency of State and Local Government Financial Statements and Disclosure Documents, explains GFOA's positions related to a July 2012 Municipal Securities Report issued by the Securities and Exchange Commission. The policy statement reiterates GFOA's opposition to legislative or regulatory action that would allow the SEC to interfere with or regulate state and local government bond disclosure documents, and financial information. The statement also opposes the SEC paper's suggestion that the SEC should have a role overseeing GASB. Support for industry efforts related to bond disclosure and increased bond pricing transparency, is noted in the statement.

The statement is available at:

http://gfoa.org/downloads/GFOASECPublicPolicyMay2013.pdf

SEC Commissioner Says Accounting Standards Must Be Clear and Effectively Enforced.

New accounting standards should make sense of rapidly changing financial markets, be useful to investors, and be "appropriately and consistently applied, and then effectively enforced," SEC

Commissioner Elisse B. Walter said in a May 30 speech.

Keynote Luncheon Speech

by

Commissioner Elisse B. Walter

U.S. Securities and Exchange Commission

32nd Annual SEC and Financial Reporting Institute Conference

Pasadena, CA

May 30, 2013

Introduction

Good afternoon and thank you, Dean Bill (Holder) for your kind introduction, and thanks to Randy (Beatty) for inviting me to share my views at the 32nd Annual SEC and Financial Reporting Institute Conference here at USC. I am delighted to be here with all of you today.

You may not hear this too often from people outside your profession, but I have always had a passion for accounting and auditing. I think this has its roots in the time I spent with my father, who was a CPA and the CFO of a publicly-held company; he helped me begin to understand just how important accounting is to business and the financial system. Of course, in my more than two decades with the SEC, which included close to a decade in the Division of Corporation Finance, I have developed a deeper and more complete understanding of the critical role accounting and auditing professionals play in our capital markets.

And today, I am pleased to see that we are working to adapt and expand that role to serve investors and other stakeholders even more effectively in the years ahead, by addressing critical issues at a moment of great change and important progress in the worlds of finance and accounting.

Before I go on, I have a disclosure requirement of my own. I need to remind you that the views I express today are my own, and not those of the Commission, my fellow Commissioners or the Commission's staff.1

High-Quality Financial Reporting

Because financial information is the starting point for an investor's decision-making process, high quality accounting standards are critical. Accurate and useful financial information creates the environment in which capital formation sprouts, grows and, sadly, sometimes withers. That is why, when developing accounting standards that will shape an increasingly complex financial environment, it is critical that they accurately reflect the underlying economics of the transactions they document.

Of course, as we know from the many standards-setting processes underway, there is often a diversity of views on how the economics of business transactions should be considered when developing accounting and disclosure requirements, and reconciling them is a primary task of any good standard setter — the development of high-quality accounting standards is certainly dependent upon it.

Reconciling diverse views on corporate finance issues is something I have spent a lot of time on as a Commissioner and regulator. And from my perspective, the most effective way to resolve these differences is to set a standard that expresses a transaction's economics in a fashion that meaningfully informs investors and resonates with them as they study a company's disclosures.

FASB/IASB Convergence Projects

We are seeing this dynamic play out in the FASB and IASB priority convergence projects. Earlier today, you discussed significant progress towards an alignment of accounting standards in four key areas — revenue, leases, financial instruments, and insurance.

This progress is a positive development, with both the FASB and the IASB showing great skill in working together to create common standards that will effectively serve investors the world over. However, as Paul [Beswick] noted this morning, publication of the standards is just the starting point. The challenge you face, as CPAs, is to successfully implement any new accounting standards, and thereby collectively protect investors in this evolving financial market.

And, finishing the convergence projects is, of course, not the end of the story for the United States and IFRS. I continue to look forward to a day when there is one set of global accounting standards, and we are taking a number of steps in that direction at the SEC, including soliciting views from U.S. publicly held companies regarding these issues. As Paul noted earlier, the IFRS already plays an important role in the U.S. capital markets. For example, today with US foreign private issuers already using IFRS, we have a significant public market — with approximately 450 companies with a market capitalization in the trillions — already trading on the basis of financial statements prepared in accordance with those standards.

I hope that, as these common standards come on line, you will work with accounting colleagues and corporate managers to ensure a successful transition resting on four pillars.

The first pillar of successful implementation is training, and these projects will require training across all constituents at all levels within the organization — from the staff accountant performing the filing review to the senior management. In addition, we all need to consider how we can make sure that investors understand the changes that are occurring. In order for that to happen, you and all of the other affected personnel at the entities you represent will first need to take as much time as necessary to fully understand the new standards yourselves.

The next pillar is resources. It is important that companies devote sufficient time and resources to updating their financial reporting systems in the wake of these changes. We can already see that the standard-setters understand the significance of the changes and the need for a sufficiently long implementation period. But companies themselves must also be sure to allot adequate time to amending processes and systems, and resources necessary to run parallel systems, until they feel fully comfortable reporting financial information using the new standards.

The third pillar is identification of interpretative issues. The standard-setters are spending a great deal of effort now to ensure that the new standards are as precise as possible. But there will always be areas that demand interpretation. It will be important to identify areas where there is diversity in application and address them through interpretative guidance so that investors are not harmed and financial statements are transparent. I expect the SEC staff will be fairly active in this space.

In addition, I commend the FASB for proactively addressing this area by bringing together a broad spectrum of representative constituents into an implementation group that will raise practice interpretation issues related to the proposed revenue standard. This is about timely communication

that allows thoughtful deliberation, and the goal is to do this in an open and transparent manner. I also think is it a positive sign that the IASB has agreed to participate in this initiative and that we, through the SEC staff, will be an observer. Perhaps this could serve as a pilot for all of the new standards in development and a new tool for the profession.

The final pillar is a focus on investor understanding. When there is an accounting policy choice, we should select the accounting that best reflects the basic economics of the transaction. With more principles-based standards, it is of the utmost importance to consider the substance of the transaction and the economics. Disclosure that is transparent and communicates the critical judgments will allow the investor to see transactions through managements' eyes, allowing them to better understand the motivations and the potential pitfalls or benefits of the transaction, and to make more informed decisions. Depending upon the transaction, this may mean going beyond the explicit disclosure requirements. Again, I encourage you to look beyond abstract accounting standards and disclosure checklists and think about what would be meaningful to an investor seeking to understand a transaction's importance. A check-the-box mentality may not produce the best financial information.

Increase Outreach to Investors Related to Financial Reporting

Increased investor understanding should always be a primary goal of new standards. But to end up with standards which support that goal, we need to start the standard-setting process with investor outreach. Finding out what is on investors' minds is a necessary step because this will improve the overall quality of the standards.

Recently, we have seen an increase in investor outreach, in large part thanks to a strong effort by FASB, but I believe there is still room for improvement. For example, the FASB, in its due process, should emphasize collecting feedback from users. We need to ask ourselves: "Do we really know what matters to an investor?" "What information is the investor looking for?" And "have we received feedback from a cross-section of the different types of investors?"

As the SEC looks to update its guidance as a result of final new accounting standards, we, too, will be seeking to understand the needs of investors in advance of any amendments.

Disclosures

One of the parts of my job that I enjoy most is the opportunity to interact with individuals who are devoted to providing investors with high-quality financial reporting. In these interactions, I get to hear all of the wonderful things that the Commission is doing well and, not surprisingly, what the Commission could do better. One issue that has been raised in these discussions is the level of required disclosures that are included in a company's filings with the Commission.

When I hear this sort of comment, I think the natural inclination is to be somewhat skeptical of a company not wanting to be as transparent as possible with their investors. But increasingly, we hear that the level of disclosures is interfering with a registrant's ability to communicate with investors. Of course, we need to investigate and evaluate that assertion. But, if for now, I accept this assumption to be a fact, then what are the appropriate next steps? In my view, there seem to be two potential next steps to research the issue and consider potential improvements. One path would be to rethink the entire regime. While this route may sound encouraging on first blush, it fails to acknowledge that our current disclosure regime has served investors well for decades. And, because of the enormity of the task, it runs the risk of taking too long while not being as impactful as it might otherwise be. A more targeted review of some of the areas where the information is not perceived to be as valuable has the advantage of being completed more quickly and therefore have a more

immediate impact.

In addition to important areas of line item disclosure, I believe that the prime target for improvement is Management's Discussion and Analysis ("MD&A"). As I have said many times before, these disclosures about where a company's been and where it's going "should be made in a way that communicates — truly speaks — to shareholders. . . . [that] truly enables the owners [of the company], the shareholders, to view the company and its prospects through the eyes of its insiders."2 So I encourage you all to give us your thoughts on disclosure requirements; we really need to work together to ensure that disclosure truly serves to inform.

Role of the Auditor

Stepping back for a moment from front-line accounting, it is important that, as we shape the financial reporting structure of the future, we continue to emphasize and enhance the role of the auditors who serve as gatekeepers to the public securities markets. The integrity and reliability of the financial reporting system relies heavily on auditors having significant responsibility for the large volume of financial information that supports the Commission's full disclosure system.

Congress, in creating our system, granted the accounting profession an important public trust. This trust in auditors, combined with the vigilance of the Public Company Accounting Oversight Board ("PCAOB"), helps to form the foundation of the financial reporting process. We look to auditors not only to help detect problems, but, most importantly, to prevent problems from occurring in the first place, by deterring those who would fudge numbers, take shortcuts, or, more subtly, tolerate inappropriate biases that have the effect of making an otherwise reasonable estimate or judgment unreasonable.

Role of the PCAOB

Experience teaches us that there is value in auditing the auditors as well, and, since its creation 10 years ago, the PCAOB has grown into an important regulatory body with a significant investor protection role in this area.

The PCAOB is in a unique and fortunate position of having its standard setting, inspections, and enforcement all under one roof. The potential benefits of this structure are remarkable because they are all critical components of what some have called the "audit performance feedback loop" — the processes of, for example, leveraging the information gathered during inspections and enforcement actions to develop high quality standards.

More than 2,300 accounting firms are registered with the PCAOB, about 900 of them based overseas. As you know, one of the PCAOB's most important mandates is to conduct inspections of accounting firms registered with the Board. And since 2002, it has conducted inspections of thousands of audits of U.S. public companies in the U.S. and abroad.

One area that has been nearest and dearest to my heart in overseeing the PCAOB is auditor performance standards.

As I have often said, I would like to see the PCAOB devote more attention to updating and maintaining their performance standards and quality control, which have the most direct effect on how audits are performed. High quality audit standards that set clear expectations for auditor performance are absolutely critical to our financial system.

I'm encouraged that standards regarding the auditing of related parties and significant unusual transactions, as well as auditing accounting estimates, including fair value measurements, are on

the PCAOB's current standard setting agenda. However, I think more can be done to enhance the development and maintenance of high quality auditing standards. There are also a number of very important auditing matters under consideration globally, such as the considerations for changes to the auditor's reporting model. It is important that the PCAOB be a leader in advancing the continuing improvement of audit quality, including by sharing experiences, knowledge and views between regulators. This also includes monitoring the activities of other regulators, standard setters, and legislative bodies as they explore changes to the way audits are conducted or auditors are overseen.

A second priority is expanding the PCAOB's ability to perform inspections in certain jurisdictions outside the U.S. The Board has made remarkable progress over the past year in advancing new cooperative agreements and developing relationships with non-U.S. regulators, enabling advancements of inspections of audits around the globe. A strong, global inspection program is critical to evaluating audit performance and provides important information necessary for the PCAOB to improve their auditing and quality control standards as well as for firms to improve their own quality controls.

Audits of Broker Dealers

The Dodd-Frank Act gave the Board explicit authority over the audits and auditors of broker-dealers' financial statements. Currently, the Board has an interim broker/dealer inspection program in place, and it issued its first public progress report on that program last year. The initial results were concerning. The Board plans to continue inspections under the interim program until rules for a permanent program take effect. Its next progress report is expected later this year and will cover a much larger number of firms and audits. I will be very much interested in the results.

In addition, in June 2011, the Commission proposed amendments to Rule 17a-5, the rule that contains the financial reporting requirements for brokers and dealers. Among other things, the proposed amendments are intended to increase focus on certain financial and custodial requirements and facilitate the PCAOB's implementation of its oversight of broker-dealer audits. In July 2011, the PCAOB proposed new auditing and attestation standards that would apply to the audits of broker and dealers. I am hopeful that the Commission will move forward to finalize its rules in the near future and that, once we do, the PCAOB will likewise move forward expeditiously.

PCAOB Inspection Reports — Enhancing Inspection Report Content

I understand that one of the PCAOB's new near term priority projects is directed at improving the content and readability of inspection reports and that the Board is in the early stages of conducting outreach as part of this efforts. I'm encouraged by this development — higher quality inspection reports will promote better understanding of the issues and help to prevent similar problems going forward. In particular, I believe that PCAOB inspection reports should include citations to aspects of the relevant standards or rules and an evaluation of how the auditor's performance compared to such requirements.

Conclusion

We are all charged with creating and implementing an accounting and audit foundation that will allow investors to make sense of the rapidly changing financial markets, and ensure that the results are not only timely and accurate, but also comprehensible and useful to investors. The new standards that are developed should be informed by thoughtful and robust analytical thinking and with the needs of investors uppermost in our minds. These new standards need to be clear, appropriately and consistently applied, and then effectively enforced. Timely communication

between all players leading up to the effective date will be critical to help pave the road to success.

Thank you for your time, and I look forward to answering your questions.

FOOTNOTES

1 The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publications or statements by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission, other Commissioners, or the Commission staff.

2 Commissioner Elisse B. Walter, Remarks before WESFACCA, "Let the Story Shine Through" (March 5, 2010), available at http://www.sec.gov/news/speech/2010/spch030510ebw.htm.

GASB Improves Reporting for Nonexchange Financial Guarantees.

Norwalk, CT, April 22, 2013—The Governmental Accounting Standards Board (GASB) today approved a new Statement that provides accounting and financial reporting guidance to state and local governments that offer nonexchange financial guarantees and for governments that receive guarantees on their obligations.

GASB Statement No. 70, Accounting and Financial Reporting for Nonexchange Financial Guarantees, requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement.

A nonexchange financial guarantee is a credit enhancement or assurance offered by a guarantor without receiving equal or approximately equal value in exchange. The guarantor agrees to pay an obligation holder in the event that the issuer of the obligation is not able to make its required payments to the obligation holder. Nonexchange financial guarantees can include guarantees by a state for bonds issued by local governments within that state or guarantees of mortgage loans to individuals, if equal or approximately equal value is not received in exchange.

Nonexchange financial guarantees often are not reflected in the financial statements or notes of either the government guarantor or the government issuer of the obligation because such guarantees are typically extended without any payment in return. Nonetheless, financial guarantees represent potential claims on a government's resources when it is the guarantor, and a potential reduction of a government's obligations when it is the issuer of the obligation.

"In the current economic environment, investors are increasingly seeking credit enhancements and assurances, including financial guarantees, to minimize the possibility of nonpayment," said GASB Chairman Robert H. Attmore. "Statement 70 responds to the need for consistent recognition and disclosure guidance for nonexchange financial guarantees. This Statement also will enable financial statement users to better assess the probability that governments will repay obligation holders."

Statement 70 also requires:

A government guarantor to consider qualitative factors when determining if a payment on its guarantee is more likely than not to be required. Such factors may include whether the issuer of the guaranteed obligation is experiencing significant financial difficulty or initiating the process of entering into bankruptcy or financial reorganization.

An issuer government that is required to repay a guarantor for guarantee payments made to continue to report a liability unless legally released. When a government is released, the government would recognize revenue as a result of being relieved of the obligation.

A government guarantor or issuer to disclose information about the amounts and nature of nonexchange financial guarantees.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2013. Early application of the standard is encouraged.

Statement 70 will be available for download at no cost from the GASB website in May. Printed copies of the Statement will be available for purchase soon thereafter. A plain-language description of the new requirements also will be available on the GASB website.

FASB, IASB Issue Revamped Lease Accounting Proposal.

U.S. and international standard setters on May 16 issued a revised proposal intended to improve transparency in public and private entities' accounting for leases by requiring them to recognize assets and liabilities arising from leasing transactions on their balance sheet.

The exposure draft, "Leases (Topic 842): a revision of the 2010 proposed Accounting Standards Update, Leases (Topic 840)," modifies the proposed guidance issued by the Financial Accounting Standards Board and the International Accounting Standards Board in August 2010. (Prior coverage .)

Under the latest proposal, a lessee would be required to recognize assets and liabilities for the rights and obligations created by leases. The proposal also directs lessees and lessors to classify their leases according to whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the leased asset.

During a webcast introducing the proposal, FASB member Russell Golden said leasing is an important activity for many organizations because it represents a "means of gathering access to assets, obtaining finance, and reducing an organization's exposure to the risk of asset ownership."

Golden, whose term as FASB chair begins July 1, said the existing accounting models, which require lessees and lessors to classify their leases as either capital leases or operating leases, often don't accurately represent leasing transactions. Several users have to adjust reported financial information to reflect the assets and liabilities arising from leases, he added.

According to FASB, the proposed dual-model approach for the recognition, measurement, and presentation of expenses and cash flows from leases will better reflect the differing economics of leasing transactions. Under the proposed approach, a lessee would report a straight-line lease expense in its income statement for most property leases, but for most leases of assets other than property, the lessee would present the interest on the lease liability separately from the amortization of the right-of-use asset.

Golden said it's important for statements' users to have a "complete and understandable picture of an organization's leasing activity," which can include leases of real estate, vehicles, and construction equipment. He added that the proposed guidance would require lessees to provide disclosures that enable investors and users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from the leases.

Despite its perceived benefits, the revised approach for lease accounting was opposed by some constituents and FASB members, whose alternative views are presented in the exposure draft.

Current FASB Chair Leslie Seidman said in a release that the decision to revise the original proposal to distinguish among types of leases for income statement and cash flow purposes was made in response to feedback received from stakeholders. The revised, converged proposal is responsive to the "widespread view of investors that leases are liabilities that belong on the balance sheet," she added.

FASB and the IASB also made changes to the accounting model for lessors to ensure consistency with both the lessee accounting proposal and the revenue recognition standard.

FASB and the IASB decided that the existing separate accounting model for leveraged leases would not be retained for the proposed guidance. The exposure draft proposes to amend guidance in Accounting Standards Codification Topic 740, "Income Taxes," regarding leveraged leases.

According to the proposal, respondents are encouraged to submit one comment letter to either FASB or the IASB. An effective date for the proposed requirements will be determined after the public feedback has been jointly considered by the boards.

Warren Kitchens of Dixon Hughes Goodman LLP told Tax Analysts the new framework will make companies' assessments of leasing transactions more complex. Some companies implementing the new requirements will have to contend with significant timing differences that could result in additional deferred tax assets and liabilities, he said.

FASB and the IASB will accept written comment on the revised exposure draft until September 13.

The full proposal is available at:

http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175826935767&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs.)

by Thomas Jaworski

Finance Committee Releases Options Paper on Economic and Community Development Incentives.

Incentives for economic and community development is the subject of the Senate Finance Committee's sixth tax reform options paper, which the committee released May 15.

Options listed for reforming the mortgage interest deduction include gradually repealing it, reducing the amount of the deduction for more expensive homes, denying the deduction for second homes, converting the deduction to a credit, and converting it to an above-the-line deduction.

The low-income housing tax credit is also discussed in the paper. Options for it include its repeal, reform, or expansion, or an equivalent reduction in tax on rental income.

The paper suggests that the state and local sales tax deduction could be repealed, permanently extended, limited in value, or capped based on adjusted gross income. Another option the paper lists is allowing non-itemizers to claim either the sales tax deduction or a deduction for state and local real property taxes.

The paper also looks at the tax treatment of bonds and community development incentives, such as the new markets tax credit, the historic preservation tax credit, and tax relief packages for declared national disaster areas. It also discusses options for providing state and local tax uniformity, listing several ideas that would serve as alternatives or exemptions to the Marketplace Fairness Act.

The full paper is available at:

http://www.finance.senate.gov/issue/?id=9d5f328c-d707-44e1-af07-c31d8340c4f8

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The requirements of this Statement are effective for reporting periods beginning after June 15, 2013. Early application of the standard is encouraged.

The full report can be found at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175826859554&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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Reuters: As U.S. Municipalities Turn More to Bank Loans, Market Races to Catch Up.

Private bank loans are riding a wave of popularity among cities, counties and other U.S. local governments, leaving the $3.7 trillion municipal bond market racing to assess and contain any risks they may pose, a white paper said on Wednesday.

“Bank loans provide issuers with access to capital, supply needed cash flow…and can be easier and less costly to obtain for an issuer than a public debt issuance,” a task force that included members of nine major banking, investing, trading, and bond organizations said in the white paper.

But a loan could “introduce potential risks that may impact a bondholder’s willingness to continue to hold the issuer’s bonds, affect bond ratings or impact pricing in the secondary market.”

The climb in borrowing, either by selling bonds to banks or through direct loans, has been swift and steep. U.S. banks held a record high level of municipal bonds and loans in the final quarter of 2012, $363.1 billion, according to the Federal Reserve, one of the few sources of data on the loans.

The public is often in the dark about the details of the borrowing, with investors and regulators sometimes having to wait for annual statements to learn loans even exist.

“I think it’s great that there’s again another opportunity, another tool for state and local governments to tap, but I do think we do need to be vigilant about some of the pitfalls in that private funding market,” Municipal Securities Rulemaking Board (MSRB) Executive Director Lynnette Kelly said last month.

“What are the terms of those bank loans and do state and local governments really understand the risks involved with bank loans? Are those loans being disclosed? Is there a refinancing risk in five years, seven years, 10 years – whenever these great loans come due?” she added in a speech to a meeting of state treasurers.

The MSRB is a self-regulatory organization that writes the rules for the market that the Securities and Exchange Commission enforces. In a statement on Wednesday, Kelly commended the task force for assisting issuers by laying out possible ways to disclose the loans.

Issuers do not have to provide offering documents when they take out the loans, and they do not have to tell traders in the secondary market about them. Last year, though, the MSRB began pushing for voluntary disclosure.

The task force, which included representatives from the American Bankers Association and the Securities Industry and Financial Markets Association, suggested disclosing bank documents such as the financing agreements or providing summaries that cover the loan's terms. It emphasized that issuers should promptly post the information.

Banks have long made tax-exempt and taxable bank loans to issuers, but since 2009, they have been more willing "to make an increasing amount of tax-exempt bank loans to issuers as an alternative to publicly offered tax-exempt bond issues," according to the white paper.

The 2009 federal stimulus plan raised the amounts of "bank-qualified obligations" that banks could hold, as part of a grander scheme to thaw a municipal credit freeze. In 2009 and 2010, issuance of the obligations doubled.

Essentially, the obligations are exceptions to part of the tax code that prevents banks from deducting the carrying cost of municipal bonds from their taxes. By doing so, the tax code eliminates the appeal of most tax-exempt debt for banks.

When the stimulus plan expired issuance of the qualified obligations slowed, but the public sector continued relying on banks in general, the task force found.

"Contrary to the expectations of many participants in the municipal market, however, banks have continued to make a substantial amount of bank loans on a non-bank-qualified basis since Jan. 1, 2011," according to the white paper.

Many loans are being used as substitutes for the liquidity facilities and letters of credit that banks provide to back variable-rate demand bonds, according to Thomas Jacobs, who tracks products related to municipal bonds as a vice president for Moody's Investors Service.

Direct borrowing is less expensive for both issuers and banks than selling variable-rate bonds with support facilities, according to the rating agency.

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http://www.eventscribe.com/2013/GFOA/

U.S. Conference of Mayors: New Report Shows Cost-Saving Tools for City Water Projects.

The United States Conference of Mayors (USCM) has released a report that shows how efficient procurement practices can reduce public infrastructure costs allowing local government to contain costs and reduce the need to increase consumer rates. Prepared by the USCM Mayors Water Council, the report titled Municipal Procurement Process Improvements Yield Cost-Effective Public Benefits, focuses on the short-comings of traditional procurement practices, and uses procurement of public water and wastewater pipes to illustrate the benefits of applying life-cycle analysis to identify pipe materials that offer cost savings and extend the useful design performance of the system.

The full report is available at:

http://usmayors.org/pressreleases/uploads/2013/0422-release-waterreport.pdf

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Moody's: Sequestration's impact on local governments isolated and generally limited.

Only a few, isolated local governments are likely to experience significant negative pressure on their finances because of the ongoing federal sequestration, says Moody’s Investors Service in the report “The Sequester Series: Limited Impacts on Local Governments.” Those vulnerable are in regions with economies heavily dependent on defense spending or health care.

“Sequestration will strain the US economy to some extent, but any material impact on regional economies will be limited to areas with substantial dependence on defense spending or health care,” says Rachel Cortez, a Moody’s Vice President — Senior Analyst. “In these regions, local governments relying on revenues from income taxes and sales taxes may face some budget pressures as layoffs, furloughs, and hiring freezes reduce disposable income and consumer spending.”

Direct government funding makes up only 5% of the general revenue of local governments taken together. Therefore the impact of the sequestration on local government budgets is mainly through its drag on the economy, which reduces local government income tax and sales tax revenues because of declines in disposable income and consumer spending. These tax sources make up about 10% of local government revenues.

Defense spending cuts will moderately pressure several regional economies, as the sequestration requires a 7.8% cut in discretionary defense spending in federal fiscal year 2013. Areas with relatively high dependence on federal employment include the Georgia MSAs of Warner Robins and Hinesville-Fort Stewart. Areas with large exposures to federal procurement contracts include Oshkosh-Neenah WI, Idaho Falls, ID, and Amarillo, TX.

Sequestration cuts also include a 2% reduction in Medicare reimbursement to hospitals and other healthcare providers. As hospitals cope with tighter operating margins, areas with significant healthcare employment may see some economic consequences. Such areas include Rochester, MN,

McAllen-Edinburg-Mission, TX, and Brownsville-Harlingen, TX.

For more information, Moody’s research subscribers can access this report at:

http://www.moodys.com/research/The-Sequester-Series-Limited-Impacts-on-Local-Governments–PBM_PBM152247.

GASB White Paper: Why Governmental Accounting and Financial Reporting Is - And Should Be - Different.

The Governmental Accounting Standards Board has released a white paper articulating the differences between private sector and governmental accounting.

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175826684726&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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