

Addressing State and Local Government Financial Dependency on the Federal Government



Presented By
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Learning Objectives—Building A Capacity:

- To assess the implications of intergovernmental financial dependency and related risks (IFD) on local governments and the State of Florida
- To consider the impact of IFD during strategic and budgetary planning
- To consider available options for communicating IFD information to a government's stakeholders
- To identify ways in which senior state and local elected officials can share leadership in returning the federal government to fiscal sustainability

What is Intergovernmental Financial Dependency?

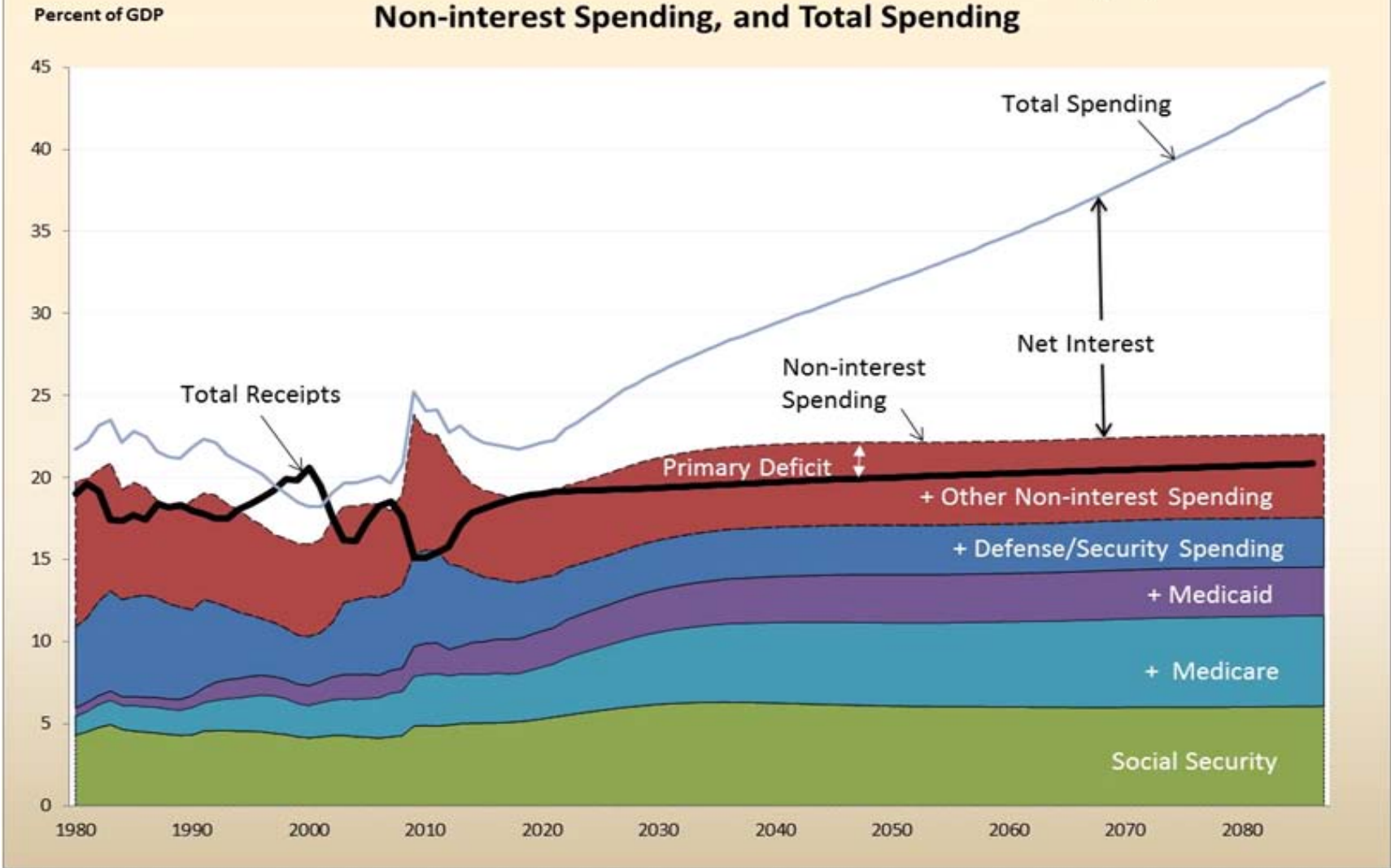
- The transfer of significant amounts of financial resources among the three levels of government in the U.S., and
- The direct operating activities of one level of government occurring within the communities of another level of government

Paraphrased from the “Intergovernmental Financial Dependency Risk Prospectus,” presented to the Government Accounting Standards Board by GASB staff, dated March 19, 2007.

Action Forcing Events

1. The U.S. Treasury Department and the U.S. Comptroller General have declared the Federal Government to be fiscally unsustainable.
2. Both Social Security and Medicare programs currently disburse more than they take in and therefore are drawing down on their trust fund balances.
3. Sequester provisions and other cuts called for in the Budget Control Act of 2011 are beginning to reduce Federal discretionary programs, and are scheduled to total \$2.1 Trillion over ten years.

Chart 5: History and Current Policy Projections for Receipts, Non-interest Spending, and Total Spending



Source: A Citizen's Guide to the 2012 Financial Report of the U.S. Government

Analysis of Federal Liabilities, Intragovernmental Debt, and Social Insurance Obligations

\$ Billions

	<u>2012</u>	<u>2011</u>
<u>Federal Liabilities:</u>		
Publicly-held Debt	\$11,332*	\$10,174 **
Federal Employee & VA Benefits	6,274	5,792
Other	1,243	1,526
<u>Intragovernmental Debt—Owed to Social Security, Medicare and other Trust Funds</u>	4,853	4,711
<u>Federal Social Insurance Obligations</u>		
Social Security	11,278	9,157
Medicare—Parts A, B & D	27,174	24,572
Other	102	101
Total Liabilities, Intragovernmental Debt & SI Obligations	<u>\$62,256</u>	<u>\$56,033</u>
Current-dollar GDP, Weighted Avg. FY (Source: OMB MSR)	<u>\$15,550</u>	<u>\$15,176</u>
Liabilities and Obligations as % GDP	400%	369%

*73% of 2012 GDP **67% of 2011 GDP

Source of Financial Statement Data: 2012 Financial Report of U.S. Government

Key Measures of State Government Intergovernmental Financial Dependency

Key Dependency Measures

Florida, Georgia, Virginia, and Total U.S. (\$ in Billions)

<u>Key Dependency Measurement</u>	<u>FL</u> <u>2011</u>	<u>GA</u> <u>2011</u>	<u>VA</u> <u>2011</u>	<u>Total</u> <u>U.S.</u> <u>2011</u>
Direct Federal Revenues to State	\$41.1	\$22.4	\$14.4	\$806.7
Percentage of Total State Revenues – All Sources	40.7%	44.2%	28.6%	39.0%*
Direct Federal Grants to Local Governments (2010)	\$3.6	\$1.4	\$1.6	\$64.5
Federal Purchases from State Businesses	\$16.4	\$10.3	\$60.0	\$454.9
Federal Payments to Individuals (2010) – Wages, Pensions, Social Security, Medicare	\$137.7	\$61.2	\$62.6	\$1,937.3
Total Direct and Indirect Federal Flows	<u>\$198.8</u>	<u>\$95.4</u>	<u>\$138.6</u>	<u>\$3,263.4</u>

* Average

Key Dependency Measures

Florida, Georgia, Virginia, and Total U.S. (\$ in Billions)

<u>Key Dependency Measurement</u>	<u>FL</u> <u>2011</u>	<u>GA</u> <u>2011</u>	<u>VA</u> <u>2011</u>	<u>Total</u> <u>U.S.</u> <u>2011</u>
Total Direct and Indirect Federal Flows	\$198.8	\$95.4	\$138.6	\$3,263.4
Real GDP by State Inflation Adjusted to 2005~	\$661.1	\$365.8	\$375.7	\$13,016.8
<u>Total Federal Flows</u> Gross State Product	30.1%	26.1%	36.9%	\$27.1%*
Military Facilities- Count	238	71	236	4,429
Military Facilities- Present Replacement Value	\$24.5	\$27.5	\$48.0	\$674.0
Military Facilities – Military and Civilian Personnel (thousands)	85.9	272.8	478.5	3,170
Federal Leased/Owned Buildings (millions sq/ft) (2012)	10.9	10.7	27.1	302.8

* Average of individual state percentages

~ Source: BEA, obtained 12/6/2012

Key Dependency Measures

States by Percentage of Revenue

<u>State (Top 5)</u>	<u>Direct Federal Revenues to State</u> (billions)	<u>Percentage of Total State Revenues – All Sources</u>
1- Rhode Island	\$5.3	62.3%
2- Tennessee	\$20.7	57.1%
3- South Dakota	\$2.7	56.2%
4- Louisiana	\$17.6	50.9%
5- Arizona	\$16.2	50.1%
<u>State (Median)</u>		
25- Washington	\$17.3	37.9%
26- Kansas	\$6.6	37.6%
<u>State (Lowest)</u>		
50- Wyoming	\$1.1	13.9%

Average 50 States = 39.0%

Key Dependency Measures

States by Percentage of State GDP

<u>State (Top 5)</u>	<u>Total Direct and Indirect Federal Flows (\$ Billions)</u>	<u>Real GDP by State (\$ Billions)</u>	<u>Direct and Indirect Federal Flows as Percentage of GDP</u>
1- Kentucky	\$57.6	\$141.3	40.8%
2- West Virginia	\$22.2	\$55.8	39.8%
3- Alabama	\$58.4	\$150.3	38.8%
4- Virginia	\$138.6	\$375.7	36.9%
5- Maryland	\$93	\$264.4	35.2%
<u>State (Median)</u>			
25 - Kansas	\$29.7	\$113.4	26.2%
26 - Georgia	\$95.4	\$365.8	26.1%
<u>State (Lowest)</u>			
50 - Delaware	\$8.5	\$57.3	14.8%

50 State Average = 27.1%

Other Key Dependency Measures

Top 5 States per Category

<u>State</u>	<u>Military Facilities</u>
1- California	345
2- Montana	254
3- Florida	238
4- Virginia	236
5- New York	206

<u>State</u>	<u>Military Personnel</u>
1- Virginia	478,528
2- California	400,178
3- North Carolina	303,254
4- Georgia	272,755
5- Texas	238,842

<u>State</u>	<u>Federal Leased/Owned Buildings (Sq. Ft)</u>
1- Maryland	29,586,611
2- Virginia	27,125,852
3- California	26,103,257
4- Texas	22,046,514
5- New York	17,044,596

The Risks of Intergovernmental Financial Dependency for States and Local Governments

- Significant fluctuations in:
 - direct intergovernmental revenue flows and
 - indirect flows which impact economic activity and tax revenues!
- Potential fluctuations to income and asset values associated with U.S. Treasury Securities, considering changes in:
 - Federal Reserve policy and
 - levels of holdings by foreign governments!

What is the Current Level of IFD-Related Risk?

It is probably:

Very high!

Immediate!

Material!

Additional Evidence of Current IFD Risk

- The July *Report of the State Budget Crisis Task Force* identified six major fiscal threats to U.S. states:
 - health care spending,
 - **federal deficit reduction**,
 - underfunded retirement funds,
 - eroding tax bases,
 - local economic stress, and
 - state laws.
- GAO State & Local Governments' Fiscal Outlook April 2012
“...like the federal government, the state and local government sector faces persistent and long-term fiscal pressures.

Additional Evidence of Current IFD Risk (cont'd)

- In 2012, Moody's instituted five metrics to assess the impact of Federal activity within a state or local government jurisdiction:
 - Economic Sensitivity: Federal employment to total unemployment
 - Economic Sensitivity: Federal procurement to GDP
 - Economic Sensitivity: Healthcare employment to total employment
 - Exposure to Federal Transfers: Medicaid expenditures to total state expenditures
 - Capital Markets Exposure: Short-term and puttable debt to available resources

* States Prepare for Federal Cuts, AGA PDC, July 2012, Emily Raimes,
V.P-Senior Credit Officer

Additional Evidence of Current IFD Risk (cont'd)

Fitch:

“...certain municipal bonds whose repayments are secured by guarantees issued by agencies of the United States government...now reflect an affirmation of their 'AAA' rating and Negative Outlook as of the July 19 date, corresponding to Fitch's July 10, 2012 affirmation of the United States sovereign rating.”

Press Release: Fitch Ratings – Fri, Dec 7, 2012 6:19 PM EST

Additional Evidence of Current IFD Risk (cont'd)

- August 5, 2011, S&P lowered U.S. credit rating to AA+
“...reflects our view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal challenges...”
- June 8, 2012, S&P warned there’s a 1-in-3 chance it will further downgrade its AA+ rating on U.S. debt within two years
 - “Recent shifts in ideologies of the two major political parties...could raise uncertainties about the government’s ability and willingness to sustain public finances consistently over the long term.”

Source: USA Today, August 7, 2012

Responding to Current IFD Risks

A Government's Choice in Facing Federal Cuts and Program Changes

* * * * *

Become Informed and Proactive

OR

Be Reactive?

Options for Being Proactive

1. *For currently known reductions in Federal activity:*
 - a. Identify each distinct revenue flow that will be impacted. For example:
 - i. Specific grants and contributions
 - ii. Corporate tax revenues from Federal suppliers
 - iii. Income tax revenues from employees of the Federal government or its suppliers
 - b. Estimate current and future year revenue impacts
 - c. Identify opportunities to reassign staff and government generated revenues
 - d. Update strategic plans to modify service capacity and expected performance

Options for Being Proactive (cont'd)

2. Track future Congressional actions and changes in administrative regulations to assess likely impact on government revenues and operations, through “Federal Funds Information for States” at: <http://www.ffis.org/>
3. Exchange information with other elected and appointed officials at the state and local level
4. Support actions by the Governor and other elected officials in seeking opportunities to testify before Congressional committees on restoring fiscal balance to the Federal government

Communicating Actions to Manage IFD Risks

A Key Assertion:

Difficult change, when managed well, is a positive!

It signifies:

- a. Effective leadership by elected and appointed officials
- a. Respect for stakeholders, whether they be individual citizens or interest groups
- a. Appreciation that individuals and groups within a complex society need advanced warning to adequately prepare for change

Bond Rating Firms Expect Solid Management of Risks—and Welcome Timely Communications

Moody's has cited approaches to mitigate Federal risks:*

With potential US cuts to states, options available to states include:

- ◇ Creating special reserve funds to deal with cuts
- ◇ Raising additional revenues
- ◇ Cutting expenditures
- ◇ Deferring expenditures
- ◇ Reducing aid to local governments
- ◇ Tapping rainy day funds and other sources of liquidity

*States Prepare for Federal Cuts, AGA PDC, July 2012,

Emily Raimes, V.P.-Senior Credit Officer

Will Actions to Manage IFD Risk be Rewarded?

Moody's published recognition, in September 2011, applauding the Commonwealth of Virginia for having created a reserve fund to mitigate susceptibility to federal revenues*

- ◇ To be funded at \$30 million
- ◇ So that funds would be available to
 - continue programs affected by federal cuts,
 - help cover unfunded federal mandates
 - replace lost revenue from lower corporate taxes owing to defense or procurement cuts

*States Prepare for Federal Cuts, AGA PDC, July 2012

Emily Raimos, V.P-Senior Credit Officer

Options for Financial Reporting of IFD Risk

Disclose within the Notes to the Basic Financial Statements:*

- A schedule disaggregating sources of grants and contributions shown in the Statement of Activities
- A concentration of revenues note, identifying intergovernmental financial flows, the vulnerability of these flows, and potential changes in levels of service
- A concentration of investment credit risk note, identifying total U.S. Treasury Securities held and indicating the credit rating of all such securities
- A contingency note, identifying probable future losses of revenue from enacted legislation and/or the financial condition of the funding entity

*As allowed by FASB Cod. Sec. 275, and by GASB Statements No. 40 and 62

Options for Financial Reporting of IFD Risk (cont'd)

Enhance MD&A**by:

- Establishing a separate section communicating fiscal sustainability
- Presenting a two-year schedule of “indicators” of an entity’s “willingness” to meet financial obligations when they come due
- Quantifying intergovernmental revenues and other major revenues as a percentage of total revenues
- Discussing the degree expenditures are funded from revenues beyond the entity’s control
- Explaining of commitments for debt obligations authorized but not yet issued

**As allowed under GASB Statements No. 34, Par. 11 and 37, Par. 4

Options for Financial Reporting of IFD Risk (cont'd)

- **Report within the CAFR's Economic Condition Reporting-
The Statistical Section*****

Summarized data concerning intergovernmental grants by major funding source and program, so to better provide the user with historical information concerning the sources and programmatic affiliations of material grant funding.

- **Publish a “Special Report on Intergovernmental Financial Dependency” separate from the CAFR******

***As allowed by GASB Statement No. 44

****As allowed by GASB Concept Statement No. 3

Significant Public Admonitions to Address Fiscal Sustainability by Our Governments

“Only an informed public can demand that the political systems, federal, state and local, recognize these problems and take effective action,”

- State Budget Crisis Task Force Chairmen Richard Ravitch and Paul Volcker

“There is no easy way out of our debt problem, so everything must be on the table. A sensible, realistic plan requires shared sacrifice...”

National Commission on Fiscal Responsibility and Reform
December 2010

CLA Published Guidance on IFD

CLA Published Reports

Intergovernmental Financial Dependency 2013: An Annual Study of Key Dependency Measures for the 50 States, March 2013

<http://www.cliftonlarsonallen.com/IFD2013/>

Intergovernmental Financial Dependency: A Guide for State and Local Governments in Preparing a Special Report, August 2011

www.cliftonlarsonallen.com/IFDspecialreportguide

Related Articles Authored by Edward Mazur, CLA Senior Advisor for Public Services

“Intergovernmental Financial Dependency: Why It Matters!”, *AICPA Journal of Accountancy*, October 2011

www.journalofaccountancy.com/issues/2011/Oct/20114206

“Our Nation’s Governors—Walking a Tightrope Without a Net,” *AGA Journal of Government Financial Management*, Summer 2011

www.cliftonlarsonallen.com/walkingatightrope

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