


Central Ohio AGA- 27th Regional PDC

Intergovernmental Financial Dependency

Presented By:
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Participant Objectives

- Understand the implications of intergovernmental financial dependency and related risks (IFD) for S & L governments, including:
 - The broad implications of sustainability and dependency
 - The specific implications for reporting and communications about IFD
- Consider how S&L government preparers can communicate information relating to intergovernmental financial dependency and related risks
- Consider options under the GAAP hierarchy as a guide to reporting of IFD within the CAFR
- Identify ways to support shared leadership by S & L government leaders in returning the U.S. to fiscal sustainability



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What is Intergovernmental Financial Dependency?

The relationship of the three levels of government in the U.S. involve:

- The transfer of significant amounts of revenues and,
- The direct operating activities of one government occurring within the communities of another government

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



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The BIG Picture



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Action Forcing Events

1. The U.S. Treasury Department and the U.S. Controller 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. Cuts were made to Federal programs as part of actions in August 2011 to raise the nation's debt limit.
4. A Joint Select Committee on Deficit Reduction is tasked with identifying \$1.5 Trillion in additional cuts by late November 2011.
5. Standard and Poor's has downgraded U.S. Treasury Securities to AA+. Moody's maintains an AAA rating with "negative outlook", while Fitch, maintains an AAA with "stable outlook".



Federal Fiscal Sustainability



Published Assertions on Sustainability

“...under current policies and the assumptions used in this report, the debt-to-GDP ratio will continually increase over the next 75 years and beyond, which means current policies are not sustainable.” -Supplemental Information prepared by Treasury

“These projections show continual increases in debt as a percentage of GDP, meaning fiscal policy is unsustainable over the long term.” - Statement from the Acting Comptroller General of the U.S.

Source: 2010 Financial Report of the United States Government
<http://www.gao.gov/financial/fy2010financialreport.html>

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Future Expenditures Are Unsustainable

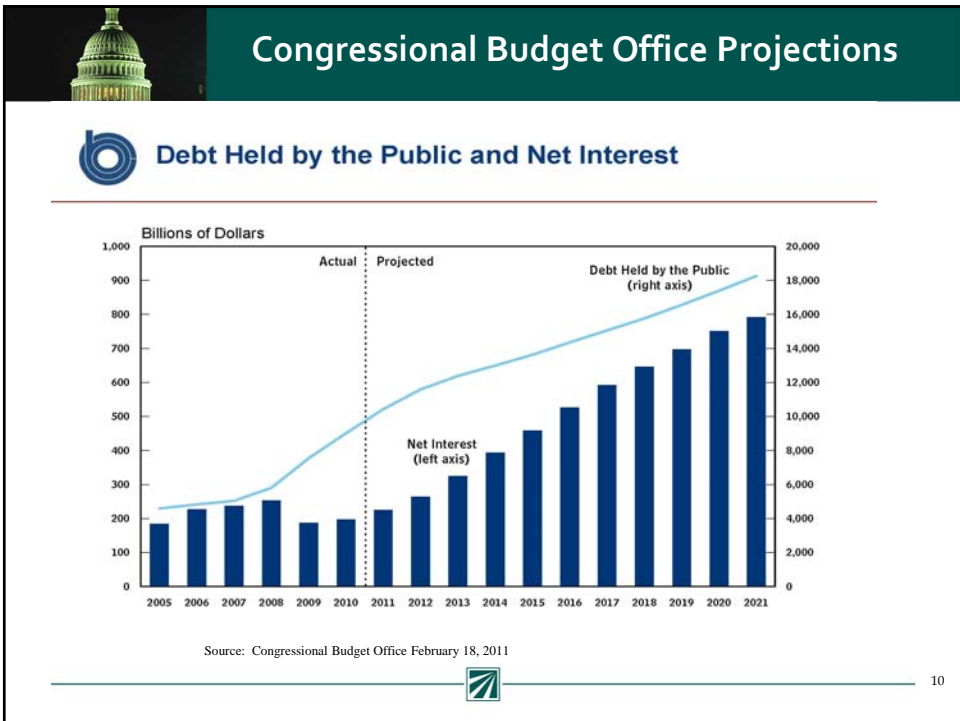
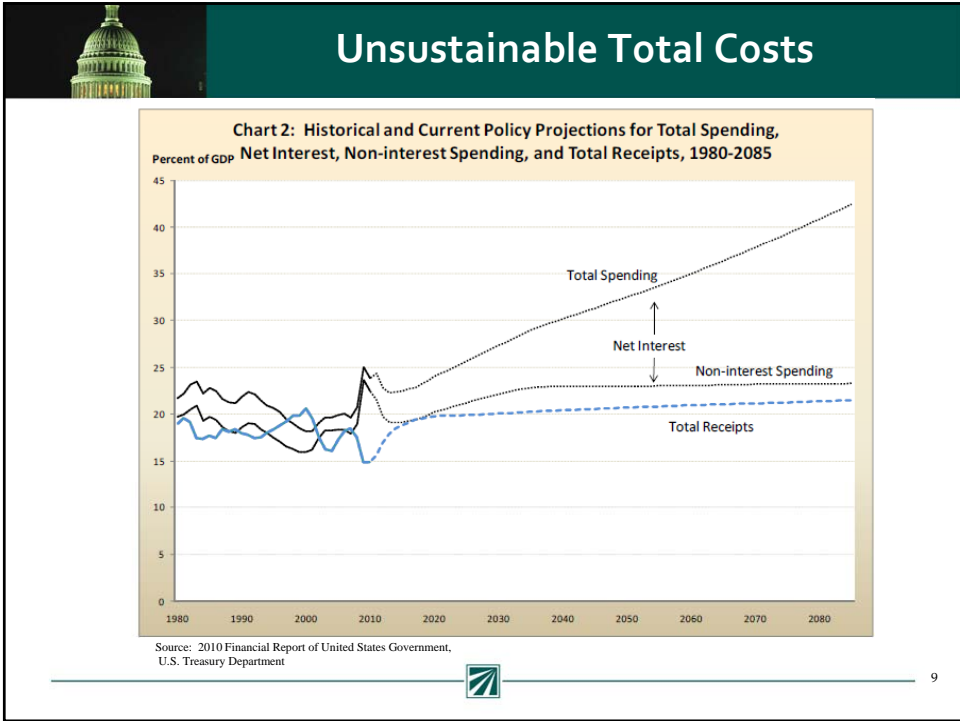
Chart I: Historical and Current Policy Projections for the Composition of Non-interest Spending


The chart displays the composition of non-interest spending as a percentage of GDP from 1980 to 2080. The y-axis represents the percentage of GDP, ranging from 0 to 25. The x-axis represents years from 1980 to 2080. The chart is divided into five stacked areas representing different spending categories: Defense (blue, bottom), Other Non-interest Spending (red), Social Security (green), Medicaid (purple), and Medicare (light blue, top). A black line represents Total Receipts. The chart shows that total non-interest spending is projected to increase significantly over time, particularly due to the growth of Medicare and Medicaid. Total receipts are shown to be insufficient to cover the projected non-interest spending, especially after 2010.

Year	Defense	Other Non-interest Spending	Social Security	Medicaid	Medicare	Total Non-interest Spending	Total Receipts
1980	5.5	8.0	3.0	1.0	1.5	19.0	19.0
1990	5.0	7.0	3.0	1.0	1.5	17.5	18.0
2000	4.5	6.0	3.0	1.0	1.5	16.0	16.0
2010	4.5	5.0	3.0	1.0	1.5	15.0	15.0
2020	4.5	5.0	3.0	1.0	1.5	15.0	15.0
2030	4.5	5.0	3.0	1.0	1.5	15.0	15.0
2040	4.5	5.0	3.0	1.0	1.5	15.0	15.0
2050	4.5	5.0	3.0	1.0	1.5	15.0	15.0
2060	4.5	5.0	3.0	1.0	1.5	15.0	15.0
2070	4.5	5.0	3.0	1.0	1.5	15.0	15.0
2080	4.5	5.0	3.0	1.0	1.5	15.0	15.0

Source: 2010 Financial Report of United States Government, U.S. Treasury Department

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

\$ Billions


	<u>2010</u>	<u>2009</u>
<u>Federal Liabilities:</u>		
Publicly-held Debt	\$9,060*	\$7,583**
Federal Employee & VA Benefits	5,720	5,284
Other	1,576	1,257
<u>Intragovernmental Debt</u> —Owed to Social Security, Medicare/Other Trust Funds	4,577	4,391
<u>Federal Social Insurance Obligations</u>		
Social Security	7,947	7,677
Medicare—Parts A, B & D	22,813	38,107
Other	97	94
Total Liabilities, Intragovernmental Debt & SI Obligations	<u>\$51,790</u>	<u>\$64,393</u>
Current-dollar GDP 3 rd qtr 2010, 4 th qtr 2009 (Source: BEA)	<u>\$14,750</u>	<u>\$14,119</u>
Liabilities and Obligations as % GDP	351%	456%

* 62% of 2010 GDP **53% of 2009 GDP

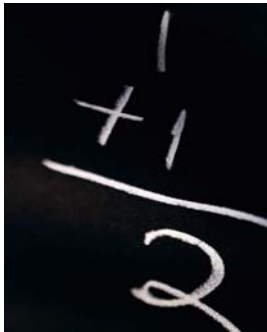

Source of Data: 2010 Financial Report of U.S. Government



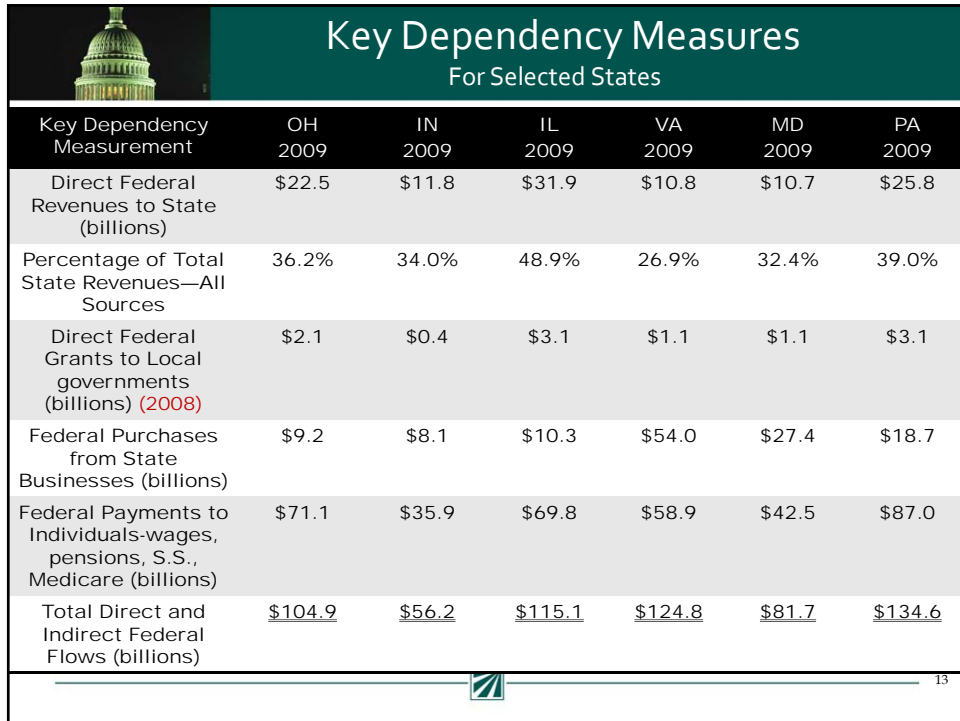
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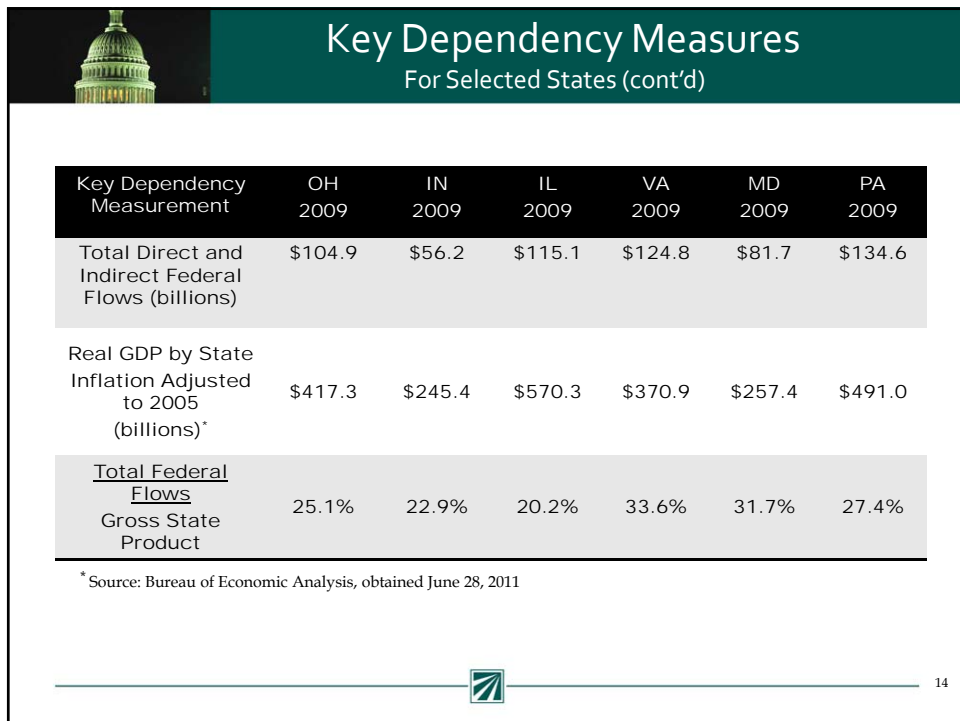
Quantifying State and Local Government Intergovernmental Financial Dependency

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Key Dependency Measurement	OH 2009	IN 2009	IL 2009	VA 2009	MD 2009	PA 2009
Direct Federal Revenues to State (billions)	\$22.5	\$11.8	\$31.9	\$10.8	\$10.7	\$25.8
Percentage of Total State Revenues—All Sources	36.2%	34.0%	48.9%	26.9%	32.4%	39.0%
Direct Federal Grants to Local governments (billions) (2008)	\$2.1	\$0.4	\$3.1	\$1.1	\$1.1	\$3.1
Federal Purchases from State Businesses (billions)	\$9.2	\$8.1	\$10.3	\$54.0	\$27.4	\$18.7
Federal Payments to Individuals—wages, pensions, S.S., Medicare (billions)	\$71.1	\$35.9	\$69.8	\$58.9	\$42.5	\$87.0
Total Direct and Indirect Federal Flows (billions)	\$104.9	\$56.2	\$115.1	\$124.8	\$81.7	\$134.6




Key Dependency Measurement	OH 2009	IN 2009	IL 2009	VA 2009	MD 2009	PA 2009
Total Direct and Indirect Federal Flows (billions)	\$104.9	\$56.2	\$115.1	\$124.8	\$81.7	\$134.6
Real GDP by State Inflation Adjusted to 2005 (billions)*	\$417.3	\$245.4	\$570.3	\$370.9	\$257.4	\$491.0
<u>Total Federal Flows</u> Gross State Product	25.1%	22.9%	20.2%	33.6%	31.7%	27.4%

* Source: Bureau of Economic Analysis, obtained June 28, 2011



Other Dependency Measures For Selected States

Key Dependency Measurement	OH 2009	IN 2009	IL 2009	VA 2009	MD 2009	PA 2009
Military Facilities	73	40	67	221	115	139
Military Facilities-- Present Replacement Value (billions)	\$9.5	\$7.2	\$12	\$44.6	\$21.2	\$11.7
Military Facilities-- Military and Civilian Personnel (thousands)	59.8	10.7	47.6	200.6	105.2	46.6
Federal Leased/Owned Buildings (millions sq/ft) (2011)	4.3	6.0	9.8	29.1	29.3	10.7



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- ## The Risks of Intergovernmental Financial Dependency
1. Significant and unplanned disruptions to current intergovernmental revenue flows
 2. Significant and unplanned disruptions to indirect flows impacting state and local government economic activity and tax revenues
 3. Potential disruptions to investment income
 4. Potential disruptions to asset values as foreign governments and other parties assess, renew, and/or modify their holdings of U.S. Treasury Securities
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The Problem

Regarding IFD and Related Risks:

1. Information flowing to S&L government leaders is fragmented and incomplete
2. Reporting to S&L government stakeholders is inadequate
3. S&L government leaders have yet to exert shared leadership in addressing Federal sustainability



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Your Government's Choice,
Become Informed and Proactive

OR

Be Reactive?




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How to be Proactive

State and local government financial management leaders and preparers are encouraged to:


- 1. Communicate with senior elected and appointed leaders on how IFD impacts their government**



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Using the CG Special Report Guide to Raise the IFD Issue




INTERGOVERNMENTAL FINANCIAL DEPENDENCY:


*A Guide for State and Local Governments
in Preparing a Special Report*



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Using the IFD Special Report Guide

“Intergovernmental Financial Dependency: A Guide for State and Local Governments in Preparing a Special Report”

Contents Include:


- **Introductory Information**
- **A Government Self-Assessment IFD Questionnaire**
- **Special Report Preparation Guidance**
- **An Example of an Illustrative Report using the Commonwealth of Virginia**

Principal Author: *Edward J. Mazur, CPA*
 Principal Researcher: *Taylor R. Powell*
 Available at: www.cliftoncpa.com/resources/IFDspecialreportguide


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Limited IFD Self-Assessment Exercise

1. If your government develops a strategic plan, does that plan address, in a comprehensive way, the flows of funds from other levels of government...?
2. Have the elected leaders of your government, in either its executive or legislative branch, ever received formal briefings on the current and anticipated financial condition of governments that provide funding to your government?
3. Are there employees of your government whose salaries or wages are specifically paid for – in whole or in part – with funds provided by another level of government? Are the numbers of such employees so funded and the name of the government, institution, department, or agency with which they are affiliated readily available?
4. If asked, would it be possible for financial management staff in your government to provide a schedule that illustrates the amount of expense-by-function, as listed in the government-wide statement of activities, that are supported by Federal revenues?


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How to be Proactive

State and Local Government Financial Leaders are encouraged to:

1. Communicate with senior elected and appointed leaders on how IFD impacts their government
2. **Explore and pursue reporting options so that government stakeholders have appropriate and relevant information relating to IFD**



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Risk and Reporting Implications

1. Is the reporting and disclosure of information concerning intergovernmental financial dependency and related risks “essential” to understanding the financial position and results of operations of a state or local government?
2. Do State and Local Government preparers have a current obligation to report on the existence of IFD?





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Key Assertions

1. GASB pronouncements constitute “minimum reporting and disclosure requirements” and do not bar inclusion of additional information that does not conflict with GAAP.
2. GASB Statement No.55, “The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments”, permits drawing guidance from
 - GASB Statements and Interpretations, Technical Bulletins, and Implementation Guides
 - AICPA Statements of Position, applicable and cleared by GASB
 - Other accounting literature, e.g. issued by FASB, and FASAB



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Potential Applicable GAAP

FASB Codification 275

AICPA SOP 94-6

GASBCS No.3




GASB Statements No.34 and 37

GASB Statement No.40

GASB Statement No.44

GASB Statement No.62

* See Handout: GASB Pronouncements and Other GAAP as Basis for Reporting IFD for details


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Reporting IFD in S & L Gov't CAFRs

Reporting options when a preparer decides, or is encouraged, to report IFD information within the CAFR:

- a) Within the financial statements:**
 - i. As a contingency note regarding enacted future and/or subsequent year changes in intergovernmental revenues
 - ii. As a concentration of revenues note demonstrating financial significance and risk of change
 - iii. As a concentration of investment credit risk note for held Treasury securities



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Reporting IFD in CAFRs (Cont'd)

Reporting options (cont'd) :

- b) Within MD&A:**
 - i. As a narrative quantifying IFD and identifying related risks
 - ii. As a schedule of federal grants and contributions
- c) As supplemental information:**
 - i. Within the transmittal letter citing presence of IFD and risks of changing revenue flows and asset values
 - ii. Within Economic Condition Reporting: The Statistical Section as multi-year schedule of intergovernmental grants and flows



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Reporting Options- Supplemental Information within Transmittal Letter

Example Transmittal Letter Disclosure for the City of Durham, North Carolina:

The City depends on financial resources flowing from, or associated with, both the federal government and the State of North Carolina. Because of this dependency, the City is subject to changes in specific flows of intergovernmental revenues based on modifications to federal and state laws and federal and state appropriations. It is also subject to changes in investment earnings and asset values associated with U.S. treasury securities because of actions by foreign governments and other holders of publicly held U.S. treasury securities.



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How to be Proactive

State and Local Government Financial Leaders are encouraged to:

1. Communicate with senior elected and appointed leaders on how IFD impacts their government
2. Explore and pursue reporting options so that government stakeholders have appropriate and relevant information relating to IFD
3. **Support shared leadership by S & L government leaders in returning the U.S. to fiscal sustainability**



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A Case for Shared Leadership by State and Local Governments

“The size and extent of the Federal Government’s fiscal imbalance is so great that it can only be adequately addressed through a conscious, significant and disciplined reshaping of federal activities.”

“... it is difficult to imagine how the states and individual citizen can be shielded from making significant sacrifices.”

“... the capacity of state governments to serve can be sustained if our nation’s governors exert shared leadership with the administration and Congress.”



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Benefits of Shared Leadership

1. Governors can help Congress and the administration make better decisions
2. Governors have the ability to interpret the potential impacts of proposed changes and effectively communicate with citizens about those changes
3. As changes occur at the federal level it may be states who will be the most effective in protecting the foundational knowledge – through colleges and universities – needed to recover and rebuild



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Suggestions on How To Execute Shared Leadership

1. Understand the potential state and citizen level impact of recommendations made by the National Commission on Fiscal Responsibility and Reform and other related nonpartisan studies
2. Assess the impact of Federal budget reductions adopted as part of the August 2011 debt limit legislation
3. Track federal legislative proposals to assess their impact on state revenues and federal grants and contributions
4. Host a day-long town meeting to discuss published and planned recommendations for rebuilding federal fiscal sustainability



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Suggestions on How To Execute Shared Leadership (cont'd)

4. Exchange information with other state and local elected officials
5. Request opportunities to regularly testify before Congressional committees on reshaping the Federal government
6. Strengthen citizen appreciation for services and benefits received from state and local government



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S & L Governments Are On a Tightrope Without a Net

- *"We have no expectation or intention to get involved in state and local finance." The states "should not expect loans from the Fed."*
– Ben Bernanke, Chairman, Federal Reserve, Jan. 7, 2011.
- *"I think most of the solutions for state government will have to come from state government."*
– U.S. Sen. Harry Reid, Senate Majority Leader, Jan. 18, 2011.
- *"If we bail out one state, then all of the debt of all of the states ... is almost explicitly put on the books of the federal government."
"There seems to be some sort of implicit belief that these are federally backed. They're not."*
– U.S. Rep. Paul Ryan, Chairman, House Budget Committee, Jan. 16, 2011



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Concluding Thoughts

As government financial management professionals, are we meeting the information needs of government stakeholders, including citizens, reflective of today's national fiscal environment?

"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
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