

Virginia G F O A 2008 Fall Conference

Intergovernmental Financial Dependency And Related Risks— Proposed Reporting by State and Local Governments

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What is at Stake?

- ❖ Direct Intergovernmental revenues received from other governments, including:
 - **\$100's of billions in Federal grants and contributions to the states**
 - **\$10's of billions in Federal and State grants and contributions to local governments**

- ❖ Investment income from:
 - **\$100's of billions in Federal Treasury obligations held by states and local governments**

What is at Stake? (cont'd)

- ❖ Indirect contributions to economic activities and tax revenues within state and local government jurisdictions, through:
 - **\$100 of billions of Federal and state procured goods and services**
 - **\$100 of billions of Federal social security, and Federal and state government retirement and health care benefits, paid to individual citizens**
 - **\$10's of billions in Federal and state leased or owned buildings and facilities and housed operations**
 - **\$100's of billions in military bases, facilities, and operations**

What are the Risks?

- ❖ Significant and unplanned disruptions to current intergovernmental revenue flows
- ❖ Potential disruptions to investment income and asset values as foreign governments and other parties assess, renew, and/or modify their holdings of U.S. Treasury Securities.
- ❖ A too limited opportunity for the senior leadership of state and local governments to propose initiatives and exert shared leadership

Key Indicators of Federal Financial Stress

❖ Insufficient Annual Revenues (in billions):

2007 Revenue: **\$2,627**

Budget Deficit: **\$ 163***

Accrual-Based Operating Deficit: **\$ 275**

***Projected 2009 Deficit: \$500 to \$950 billion**

❖ Excessive Reported Liabilities (in billions):

Publicly-held Debt: **\$5,078**

Owed to Social Security and Medicare “Trust Funds”: **\$3,962**

Federal Employee & VA Benefits Owed: **\$4,769**

Source: 2007 Financial Report of U.S. Government

Key Indicators of Federal Financial Stress (cont'd)

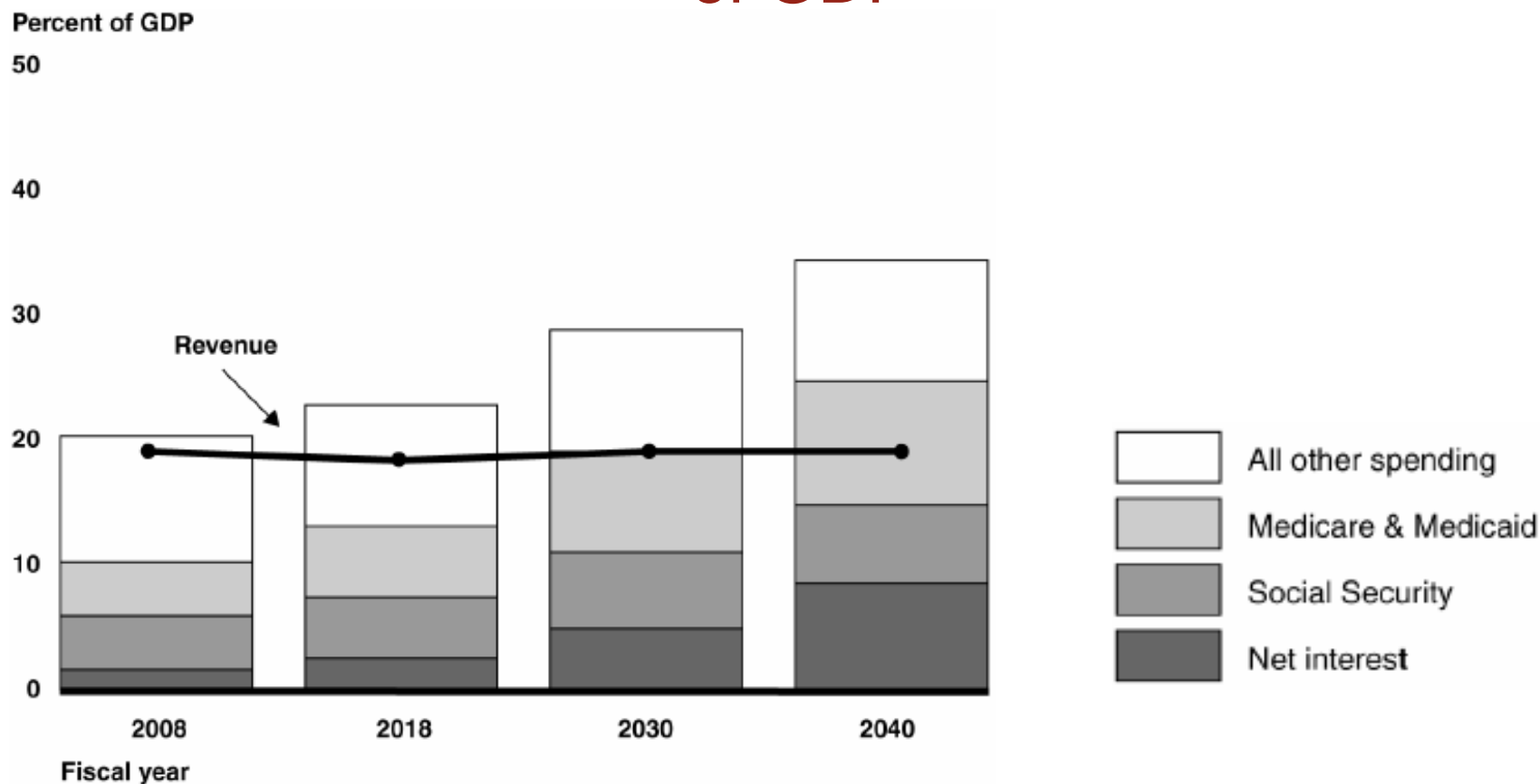
❖ Unsupportable Federal “Stewardship” Obligations* (in billions)

Social Security	\$16,265
Medicare Part A:	\$12,044
Medicare Part B:	\$10,374
Medicare Part D (Drug Benefit):	\$6,273
Other	\$133
Memorandum Total:	<u>\$45,062</u>**

* Present Value 75 Year Projections of Expenditures Net of Contributions & Earmarked Taxes

**Unaudited and not reflected in consolidated financial statements, but included in a separate section of the 2007 Financial Report of U.S. Government

Potential Fiscal Outcomes: Revenues and Composition of Spending as Shares of GDP



Notes: Discretionary spending grows with GDP after 2008. The AMT exemption amount is retained at the 2007 level through 2018 and expiring tax provisions are extended. After 2018, revenue as a share of GDP is brought to its historical level of 18.3 percent plus expected revenues from deferred taxes (i.e., taxes on withdrawals from retirement accounts). Medicare spending is based on the Trustees' 2008 projections adjusted for CMS's alternative assumption that physician payments are not reduced as specified under current law.

What Have Key Federal Officials Said About the Federal Financial Condition?

❖ **Comptroller General Walker:**

- o “Our Nation is on an imprudent and unsustainable long-term fiscal path that is getting worse with the passage of time”

Source: 2007 Annual Report of U.S. Government

❖ **Secretary of the Treasury Paulson**

“We must now look ahead to the future claims on spending for Social Security and Medicare and squarely face the challenge of fundamental reform to ensure the sustainability of these programs.”

Source: 2007 Annual Report of U.S. Government

❖ **Fed Chairman Bernanke**

- o “If early and meaningful action is not taken, the U.S. economy could be seriously weakened, with future generations bearing much of the cost.”

Source: Bloomberg 1/18/07

Citizen's Guide to the 2007 Federal Financial Report

❖ Cited--An Unsustainable Fiscal Path

○ **Benefit payments begin to exceed the program's tax revenue:**

→2007, Medicare Part A

→2017, Social Security

○ **Trust Fund assets will not be enough to pay full benefits:**

→2019, Medicare Part A. Under current law, benefits would be reduced to 79 percent of scheduled benefits in 2019, declining to 29 percent by 2081

→2041, Social Security. Under current law, benefits for all retirees would be reduced to 75 percent of scheduled benefits in 2041, declining to 70 percent by 2081.

Source: Department of the Treasury's Financial Management Service

What Can be Done?

Formulate a Response to the Reported Threat

- ❖ State and Local Governments should:
 - o Anticipate the threats and risks associated with intergovernmental financial dependency
 - o Increase internal and public visibility and understanding regarding such threats and risks through—in part—formal reporting
 - o Create collaborative initiatives to address the threats and risks, and exert shared leadership with Federal elected officials

Recognize That Current Financial Reports Do Not Adequately Report on Intergovernmental Financial Dependency

- ❖ Intergovernmental revenues are:
 - o not separately recognized in Government-wide Financial Statements
 - o highly aggregated in Fund Financial Statement
 - o seldom addressed in MD&A as to amount or reliance
- ❖ Related risks are not addressed in the notes to financial statements
- ❖ Statistical Section trend information lacks relevant focus and does not address key dependency factors

Intergovernmental Financial Dependency and Related Risks

A Summary of Proposed Reporting by Local Governments*

*A separate set of proposed reporting requirements has been tailored to state governments

Reporting within MD&A

1. Size of and reliance on intergovernmental revenues and assessment of adverse condition of state/Federal government
2. Current/prior year revenues by Federal dept./agency
3. Current/prior year revenues by state department/program
4. Employees funded by Federal funds
5. Federal payments to individuals within jurisdiction
6. Federal purchases of goods and services within jurisdiction
7. Buildings owned/leased by Federal government in jurisdiction
8. Federal military bases in local jurisdiction
9. Changes in state law impacting current and future years
10. State's exports, imports, and balance of trade

Reporting in Notes to Financial Statements

1. Summary of Federal revenue and changes from prior year
2. Schedule of Operating and Capital--Grants and Contributions disaggregated by Federal, state government and other sources – presenting % of total revenues.
3. Reconciliation of Federal and state grants and contributions reported in (a) Government-wide and (b) Fund Financial Statements
4. Schedule of U.S. Treasury Securities held by locality
5. Disclosure of excerpts of reported adverse state and Federal financial condition in relation to concentration of state and Federal revenue and associated risks

Reporting as Required Supplementary Information

1. A schedule of Federal and state revenues within Operating and Capital—Grants and Contributions, disaggregated by
 - a. Primary government functions
 - b. Business-type activities, and
 - c. Component units

Illustrating the percentage of expenses supported by Federal revenues and state government revenues

Reporting within the Statistical Section

1. Ten-year schedules of federal revenues, by:
 - a. Five Federal departments/agencies providing largest amounts
 - b. Individual Programs providing 80% of Federal revenues
2. Ten-year schedule of State revenues
3. Ten-year schedule of Federal debt obligations held by local government
4. Ten-year schedule of publicly held U.S. debt securities, by major holders
5. Ten-year schedule of major foreign holders of publicly held U.S. debt securities

Reporting within the Statistical Section

(cont'd)

6. Ten-year schedule of publicly held U.S. debt maturities
7. Ten-year schedule of monetary fluctuations of U.S. dollar against major foreign currencies
8. Ten-year schedule of U.S. National Savings Rate
9. Ten-year schedule of U.S. National Balance of Trade

Actual Numbers—Sample City Virginia--07

1. Federal Revenues to State: \$8 billion or 21% of total
2. Federal grants to VA localities: \$700 million—49% public welfare, 24% K-12 education
3. Risks of reported Federal condition: changing revenues, changing matching requirements, disrupted investment revenues and values on U.S. debt securities
4. Risks of reported State condition: changing revenues from use of Revenue Stabilization Fund, budget shortfall, market conditions
5. Major contributing Federal Depts: HHS—16% EdD—37%
6. 06 to 07 increased Federal revenues: \$15 million, including: \$6 HUD, \$6 DOT, \$1 EdD

Actual Numbers-Sample City Virginia-2007 (cont'd)

6. \$2.7 billion Federal payments to individuals: 14% Social Security, 48% military/civil salaries, 22% Fed'l Retirement
7. \$797 million Federal purchases: 90% DOD
8. Federal leased/owned buildings: 56,946 square ft. for the five largest buildings
9. Military bases and facilities:
 - a. 5 bases
 - b. 759 buildings
 - c. \$2 billion replacement value
 - d. 8,604 acres held
 - e. 9,524 military and civilian employees

Actual Numbers-Sample City Virginia-2007 (cont'd)

11. State law changes impacting subsequent years:

Increases:

None

decreases:

Compensation Board

Dept. of Criminal Justice Service

Dept. of Juvenile Justice

Comprehensive Services for at-risk youth and families

12. 1997-2007--Cummulative increase in Federal \$: 64%

Highest year to year: 2007—18% DOL, HUD

Lowest year to year: 2006—(0.66)%

13. Federal debt securities held by Sample City: \$82 million

14. Virginia exports \$14.1 billion--82% mfg goods--16% increase 138,000 or 4.5% of workforce employed by U.S. subsidiaries

Real Numbers-Sample City Virginia-2007 (cont'd)

14. Federal debt held by:

Social Security/Medicare Trust Funds: \$3.6 trillion

Federal Reserve: \$.8 trillion

Publicly held: \$4.0 trillion

Held by state and local governments: \$628 billion (15.5%)

50% held by foreign countries/organizations

31% of that by Japan

21% of that by China

60% matures in less than 3 years

15. U.S. Balance of Trade deficit: \$838 billion

Cumulative increase (in deficit) since 1997: 322%

Anticipated Publication of Proposed Reporting Requirements

- ❖ The proposed reporting requirements will be included in a Report to be published in late 2008. The Report contents will include:
 - **Preface and Acknowledgements**
 - **Executive Summary**
 - **Recommended Reporting Model**
 - **Summary**
 - **Introduction**
 - **Recommended Reporting Requirements and Modifications to GASB Standards**
 - **Background of Project**
 - **Basis Underlying the Recommended Requirements and Modifications**
 - **Illustrations of Reporting Requirements for a State Government**
 - **Illustrations of Reporting Requirements for a Local Government**
 - **Preparation Guidance for State Governments Illustrations**
 - **Preparation Guidance for Local Governments Illustrations**

Anticipated Publication of Proposed Reporting Requirements (cont'd)

❖ Contents (cont'd)

- **Invitation to Comment and to Conduct a Pilot Test**

- **Supplemental Appendices**

 - A: Literature Research

 - B: GASB-Sponsored Independent Research Project

 - C: Fiscal Wake-up Call Tour

 - D: GAO Study, “State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge within the Next Decade”

 - E: GASB Memorandum, April 2007, “Intergovernmental Financial Dependency Risk Project Perspective”

 - F: Comments from October 2006 ABFM Forum

 - G: Works Cited and Additional Readings

 - H: Relevant Quotations

Anticipated Results

- ❖ If applied and tested voluntarily by state and local government preparers, the reporting will:
 - o Ensure that their leaders and annual financial report users understand:
 - the government's reliance upon direct and indirect intergovernmental financial flows,
 - the government's exposure to changes in intergovernmental flows, investment income, and asset values, and
 - trends in key national and state-level economic indicators relevant to the sustainability of intergovernmental financial flows.



**What questions
do you have?**

Presenter Contact Information

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