

# Assessing and Responding to Virginia's Financial Dependency on the Federal Government

Presented to the  
Virginia Government Finance Officers' Association

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# Opportunities for VGFOA Member Leadership

- Assess the implications of intergovernmental financial dependency and related risks (IFD) on Virginia and your local government
- Explore available options for communicating IFD information to your government's stakeholders
- Identify ways in which your senior elected officials can share leadership with the governor and other elected state officials 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.

# Comments on Federal Fiscal Sustainability



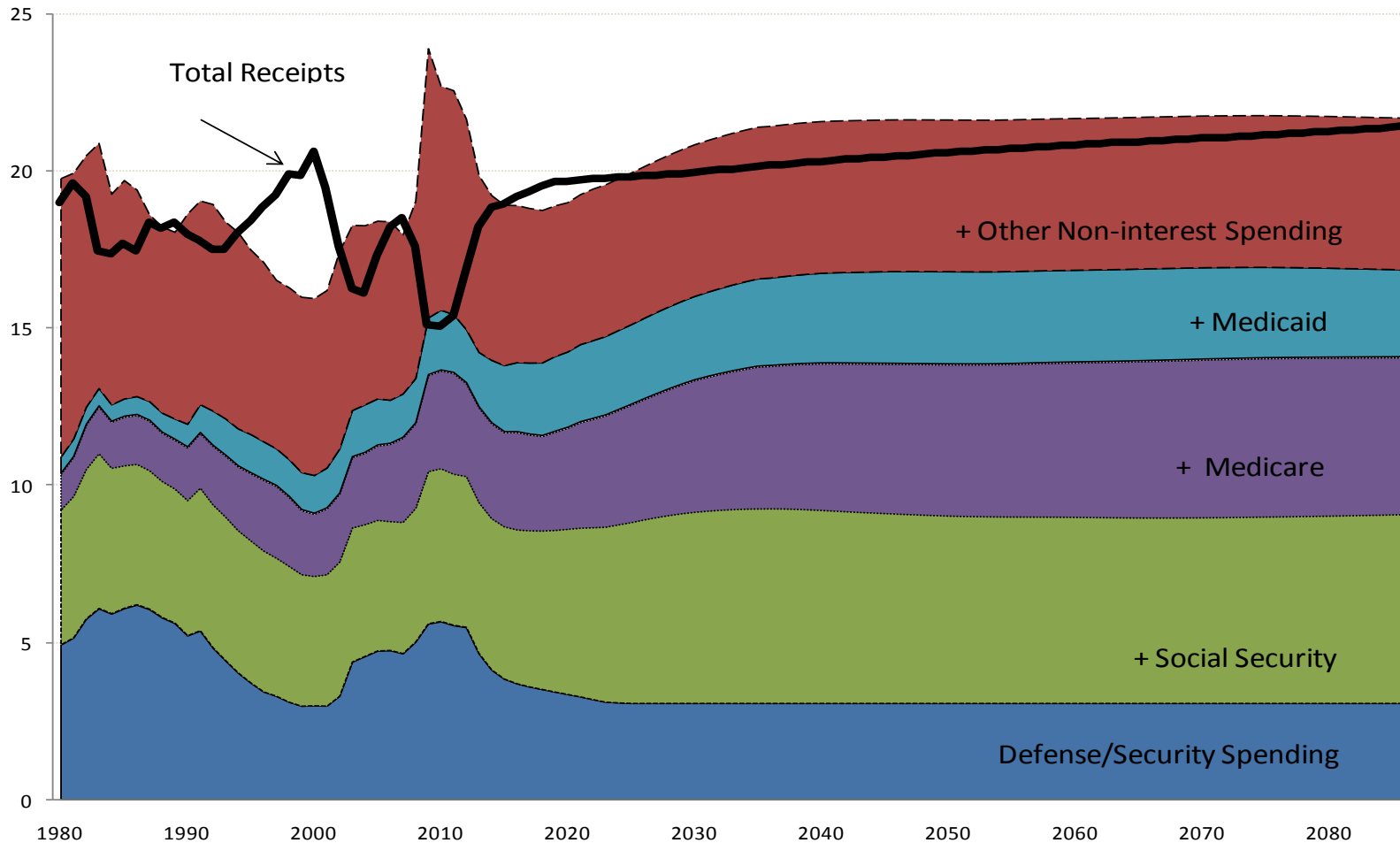
# Action Forcing Events

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. Federal programs will be cut \$2.1 Trillion over ten years under August 2011 legislation to raise the nation's debt limit.
4. 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".

# Future Expenditures Are Unsustainable

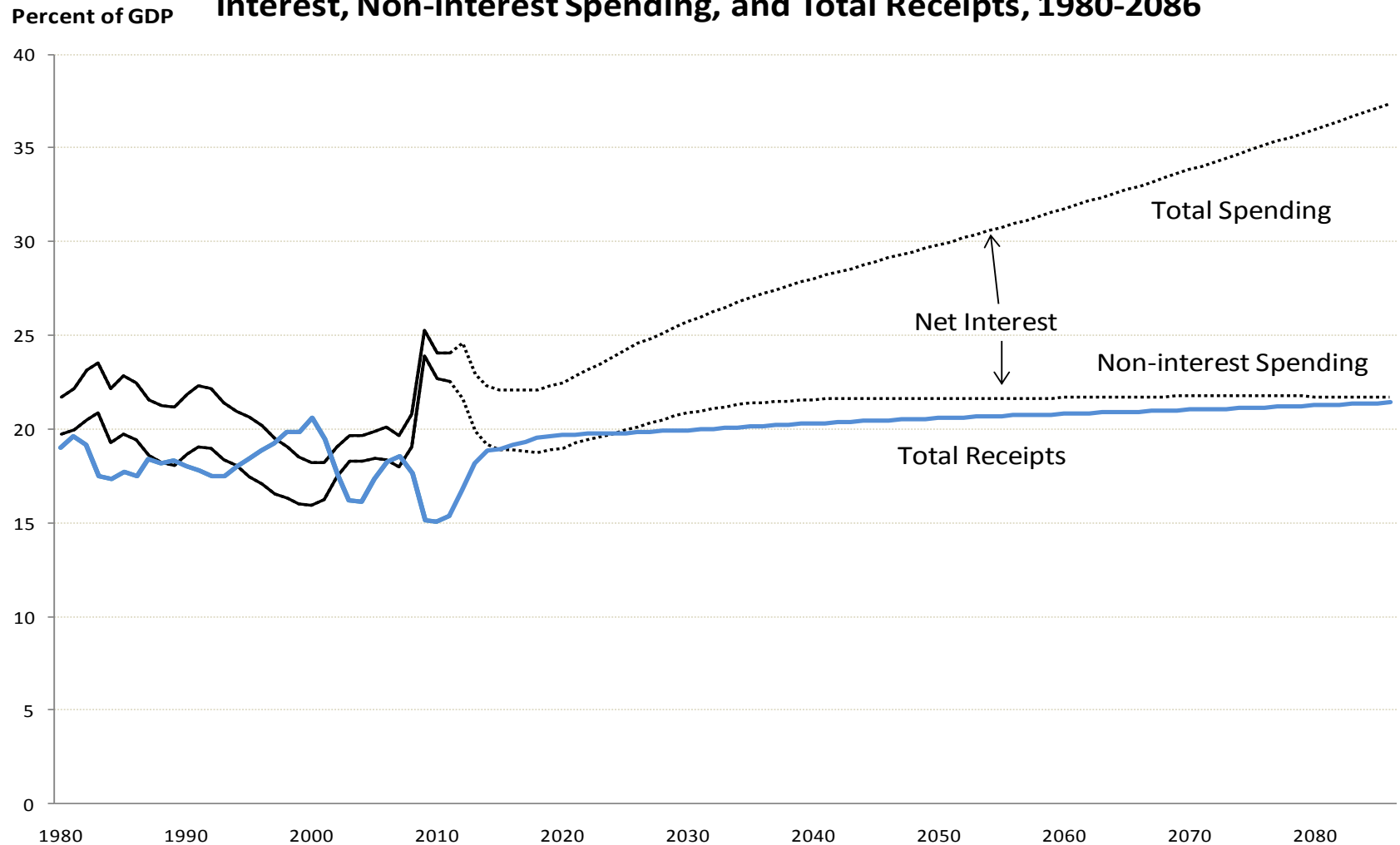
**Chart 2: Historical and Current Policy Projections for the Composition of Non-interest Spending**

Percent of GDP



# Unsustainable Total Costs

**Chart 4: History and Current Policy Projections for Total Spending, Net Interest, Non-interest Spending, and Total Receipts, 1980-2086**



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

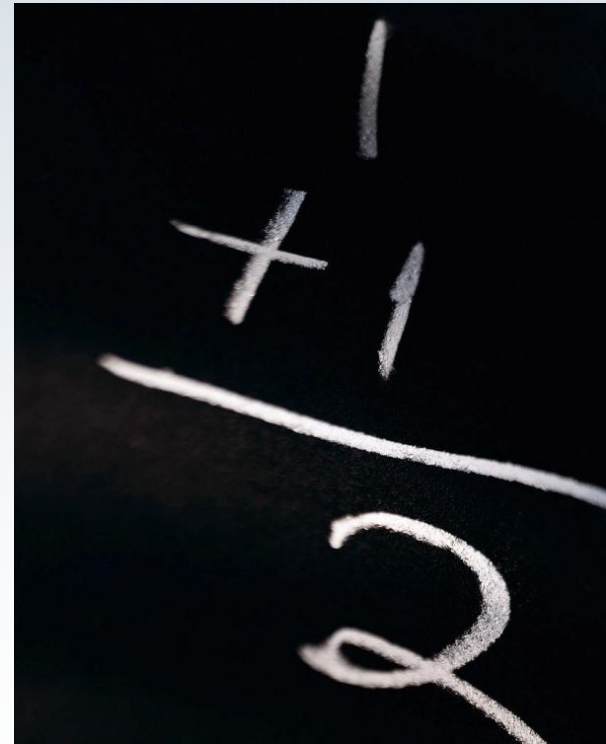
	<u>\$ Billions</u>	
	<u>2011</u>	<u>2010</u>
<b><u>Federal Liabilities:</u></b>		
<b>Publicly-held Debt</b>	<b>\$10,174*</b>	<b>\$9,060**</b>
<b>Federal Employee &amp; VA Benefits</b>	<b>5,792</b>	<b>5,720</b>
<b>Other</b>	<b>1,526</b>	<b>1,576</b>
<b><u>Intragovernmental Debt—Owed to Social Security, Medicare/Other Trust Funds</u></b>	<b>4,711</b>	<b>4,577</b>
<b><u>Federal Social Insurance Obligations</u></b>		
<b>Social Security</b>	<b>9,157</b>	<b>7,947</b>
<b>Medicare—Parts A, B &amp; D</b>	<b>24,572</b>	<b>22,813</b>
<b>Other</b>	<b>101</b>	<b>97</b>
<b>Total Liabilities, Intragovernmental Debt &amp; SI Obligations</b>	<b><u>\$56,033</u></b>	<b><u>\$51,790</u></b>
<b>Current-dollar GDP 3<sup>rd</sup> qtr 2011, 4<sup>th</sup> qtr 2010 (Source: BEA)</b>	<b><u>\$15,176</u></b>	<b><u>\$14,755</u></b>
<b>Liabilities and Obligations as % GDP</b>	<b>369%</b>	<b>351%</b>

\*67% of 2011 GDP    \*\*62% of 2010 GDP

Source of Data: 2011 Financial Report of U.S. Government



# Key Measures of State Government Intergovernmental Financial Dependency



# Key Dependency Measures

Nebraska, Maryland, Virginia, and Total U.S. (\$ in Billions)

<u>Key Dependency Measurement</u>	<u>NE</u> <u>2010</u>	<u>MD</u> <u>2010</u>	<u>VA</u> <u>2010</u>	<u>Total</u> <u>U.S.</u> <u>2010</u>
Direct Federal Revenues to State	\$3.3	\$13.2	\$14.0	\$787.0
Percentage of Total State Revenues – All Sources	32.3%	35.9%	31.2%	39.7%*
Direct Federal Grants to Local Governments (2009)	\$0.3	\$1.1	\$1.1	\$57.6
Federal Purchases from State Businesses	\$1.3	\$26.5	\$58.3	\$474.2
Federal Payments to Individuals – Wages, Pensions, Social Security, Medicare	\$10.4	\$51.7	\$62.6	\$1,937.3
Total Direct and Indirect Federal Flows	<u>\$15.3</u>	<u>\$92.5</u>	<u>\$136.0</u>	<u>\$3,256.1</u>

# Key Dependency Measures

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<u>Key Dependency Measurement</u>	<u>NE</u> <u>2010</u>	<u>MD</u> <u>2010</u>	<u>VA</u> <u>2010</u>	<u>Total</u> <u>U.S.</u> <u>2010</u>
Total Direct and Indirect Federal Flows	\$15.3	\$92.5	\$136.0	\$3,256.1
Real GDP by State Inflation Adjusted to 2005~	\$79.7	\$264.9	\$380.6	\$13,006.1
<u>Total Federal Flows</u> Gross State Product	19.1%	34.9%	35.7%	\$26.8%*
Military Facilities- Count	122	120	232	4,150
Military Facilities- Present Replacement Value	\$3.1	\$21.9	\$45.0	\$676.1
Military Facilities – Military and Civilian Personnel (thousands)	12.3	125.0	221.3	2,536
Federal Leased/Owned Buildings (millions sq/ft) (2011)	1.9	29.2	28.6	300.1

\* = Average

11 ~ = Source: BEA, obtained 1/12/12

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# 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- South Dakota	\$2.5	55.2%
2- Rhode Island	\$5.8	54.7%
3- Louisiana	\$18.2	54.2%
4- Arizona	\$16.3	51.7%
5- Georgia	\$25.3	49.6%
<u>State (Median)</u>		
25- Florida	\$40.4	41.0%
26- California	\$97.7	39.9%
<u>State (Lowest)</u>		
50- Wyoming	\$1.1	15.6%

**Average 50 States = 39.7%**

# 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	\$58.7	\$144.6	40.6%
2- West Virginia	\$21.7	\$56.0	38.8%
3- Alabama	\$57.6	\$154.1	37.4%
4- Virginia	\$136.1	\$380.6	35.7%
5- New Mexico	\$25.9	\$72.8	35.5%
<b><u>State (Median)</u></b>			
25- Kansas	\$30.2	\$114.0	26.5%
26- Ohio	\$110.2	\$426.1	25.9%
<b><u>State (Lowest)</u></b>			
50- Delaware	\$8.1	\$56.2	14.5%

**50 State Average = 26.8%**

# Other Key Dependency Measures

## Top 5 States per Category

<u>State</u>	<u>Military Facilities</u>
1- California	349
2- Montana	252
3- Virginia	232
4- North Dakota	200
5- Florida	182

<u>State</u>	<u>Military Personnel</u>
1- California	267,475
2- Virginia	221,279
3- Texas	219,534
4- Georgia	166,264
5- North Carolina	164,706

<u>State</u>	<u>Federal Leased/Owned Buildings (Sq. Ft)</u>
1- Maryland	29,239,031
2- Virginia	28,617,619
3- California	25,734,634
4- Texas	21,667,759
5- New York	17,033,000

# 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!

## Current Risk Level????

Very high!

Immediate!

Material!



# Direct Evidence of Current Risk

## The Budget Control Act of August 2011:

- Reduced federal discretionary spending by \$917 billion over 10 years beginning in fiscal year 2013.
- Imposed an additional \$1.2 trillion in across-the-board cuts\* over nine years, automatically triggered to begin on January 2<sup>nd</sup>, 2013, evenly divided between discretionary:
  - ◇ national security and
  - ◇ non-security programs.

\*Following the failure of the Congressional “super-committee” to find \$1.5 trillion more in cuts

# Other Evidence of Current 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 Apr 2012  
“...like the federal government, the state and local government sector faces persistent and long-term fiscal pressures.”

# Other Evidence of Current Risk (cont'd)

- Five Metrics Used in Analysis of Federal Linkage\*
  - 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 Conference, San Diego, Emily Raimes, V.P-Senior Credit Officer

# Other Evidence of Current Risk (cont'd)

- August 5, 2011, S&P lowers 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 warns 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

# Communicating Current Risk to Stakeholders



# Significant Public Admonitions

“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

# A Focus for Reporting--Fiscal Sustainability and Intergovernmental Financial Dependency

“A government's ability and willingness to generate inflows of resources necessary to honor current service commitments and to meet financial obligations as they come due, without transferring financial obligations to future periods that do not result in commensurate benefits.”

**Source:** GASB Preliminary Views , Economic Condition Reporting: Financial Projections

# Rational for Reporting Fiscal Sustainability and Intergovernmental Financial Dependency--NOW

- Fulfill professional and stewardship responsibilities that apply senior government financial executives
- Inform stakeholders of risk prior to actual reductions in federal spending
- Facilitate timely and constructive actions by Governors, Legislators, and other elected officials
- Alert citizens, employees, students, local governments and others likely to be impacted by federal cuts



# Will Proactive Action be Positively Recognized?

## Attempts to Mitigate Federal Risks\*

- With potential US cuts to states, options available to states include:
  - ◇ Creating special reserve funds to deal with cuts
  - ◇ Raise additional revenues
  - ◇ Cut expenditures
  - ◇ Deferring expenditures
  - ◇ Reductions in aid to local governments
  - ◇ Tapping rainy day funds and other sources of liquidity

\*States Prepare for Federal Cuts, AGA Conference, San Diego,  
Emily Raimos, V.P-Senior Credit Officer

# Will Proactive Action be Rewarded? (cont'd)

In September 2011, VA created a reserve fund to mitigate susceptibility to federal revenues\*

◇ Currently funded at \$30 million

◇ Reserve fund 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 Conference, San Diego,  
Emily Raimos, V.P-Senior Credit Officer

# Options for Reporting to Stakeholders\*

## 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 Reporting to Stakeholders\*\* (cont'd)

## 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 change in level 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, GASB Statements No. 40 and 62

# Options for Reporting to Stakeholders (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

# A Local Government's Choice in Facing Federal Cuts

\* \* \* \* \*

Become Informed and Proactive

**OR**

Be Reactive?



# How to be Proactive

1. Track proposals by the Congress and the administration to assess their impact on state revenues and on federal grants and contributions to the state and its local governments
2. Assist elected officials with interpreting the impact of proposed changes and communicating with citizens about those changes
3. Exchange information with other local elected and appointed officials and state officials
4. Support the Governor in seeking opportunities to testify before Congressional committees on reshaping the Federal government

# How to be Proactive (cont'd)

**“States can exert powerful shared leadership with the Congress if each governor appointed a working group of senior officials who would provide sustained focus, from a state perspective, on ways to reduce federal deficit spending and slow and reverse the growth in publicly-held federal debt.**

Source: AGA 2012 Professional Development Conference,  
Session M121, *“How States Can Help Drive Federal  
Change and Reduce Deficit Spending.”*

*Moderator: Clark Partridge*

Panelists: Tom Salmon, Danny Werfel, Kinney Poynter



# Closing Thoughts

**“As a nation, we have experienced both the successes and benefits of effective intergovernmental cooperation. We are facing a fiscal crisis that we will either meet with courage and leadership or defer to solutions imposed by those who hold our Nation's debt. The issue discussed today is whether we can come together at the highest levels of accountability and responsibility to proactively and peacefully work together to restore fiscal balance to the Federal government.”**

Source: AGA 2012 Professional Development Conference,  
Session M121, *“How States Can Help Drive Federal  
Change and Reduce Deficit Spending.”*

*Moderator: Clark Partridge*

# CLA Published Guidance on IFD

## CLA Published Reports

***Intergovernmental Financial Dependency: A Study of Key Dependency Measures for the 50 States, March 2012***

[www.cliftonlarsenallen.com/IFD50statestudy](http://www.cliftonlarsenallen.com/IFD50statestudy)

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

[www.cliftonlarsenallen.com/IFDspecialreportguide](http://www.cliftonlarsenallen.com/IFDspecialreportguide)

## Ed Mazur Authored Articles

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

[www.journalofaccountancy.com/issues/2011/Oct/20114206](http://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.cliftonlarsenallen.com/walkingatightrope](http://www.cliftonlarsenallen.com/walkingatightrope)

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