ARTICLE IN PRESS

Research in Accounting Regulation ■■ (2017) ■■–■■

Contents lists available at ScienceDirect

Research in Accounting Regulation

journal homepage: www.elsevier.com/locate/racreg

Regular Paper

The role of federal regulation in state and local governments and the potential impact of new reforms: An assessment of the effectiveness of reporting, disclosure, and funding

Craig Foltin *

Cleveland State University, USA

ARTICLE INFO

Article history:
Available online

Keywords:
Government accounting
Municipal securities
SEC
Tower amendment
Dodd–Frank

ABSTRACT

The state and local government accounting profession continues to contend with issues surrounding self-governance, funding for the profession's standard setting body, federal regulation and states' rights. Fiscal conditions, bankruptcies and struggling pension funds bring to question whether self-governance has been effective in the state and local government sector. Federal regulation has impacted the government accounting sector but to a much lesser extent than in the private sector. With new discussion by lawmakers in Washington regarding the appropriate levels of regulation, particularly surrounding the financial markets; more change could be on the horizon. This paper assesses the proper balance between self-governance and regulation in the government sector and how current considerations by policymakers could impact the profession.

1 Introduction

The state and local governmental accounting profession and the municipal bond market continue to be predominately a self-regulated profession. The independent Governmental Accounting Standards Board (GASB) has been setting standards since 1984. Prior to that, professional organizations like the Government Finance Officers Association (GFOA), its predecessors and the American Institute of CPA's (AICPA) had provided guidance for the profession.

The governmental sector has remained largely outside the federal regulatory environment. The Securities Act of 1933 and the Securities and Exchange Act of 1934 created the Securities and Exchange Commission (SEC) to regulate the financial markets. State and local governmental entities were exempted from these regulatory requirements including financial reporting, auditing, and municipal debt issuances. Congress amended the Securities Acts of 1933 and 1934 (The United States, 1975) and created a Municipal Securities Rule Making Board (MSRB) to promote transparency in the municipal securities market and provide rule-making power and guidance to municipal securities dealers. However, the Tower Amendment was included in this legislation which expressly limited the SEC or MSRB from requiring municipal securities issuers to file any application, report, or document with the SEC prior to issuance.

More recently, the SEC attempted unsuccessfully to obtain legislative authority to regulate the municipal bond market (Securities and Exchange Commission, 2009). The Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank) (The United States, 2010) was enacted which directed the Governmental Accountability Office to perform a study to review the role and importance of GASB in the municipal securities markets as well as the manner and level which GASB has been funded. Dodd–Frank also expanded the MSRB authority to protect municipal entities and obligated persons though requiring registration and regulation of municipal advisors. In addition, section 978 gave the SEC funding power over GASB.

The Securities and Exchange Commission (2012) provided a special report to bolster their case for more regulation again when they issued a report supporting the

* Corresponding author. Fax: 216 687-9212.
E-mail address: l.foltin@csuohio.edu.

http://dx.doi.org/10.1016/j.racreg.2017.04.003
1052-0457/

need for government intervention and recommended that legislation be enacted to, "...give the Commission the authority to take regulatory steps that it determines to be appropriate to meaningfully enhance disclosure practices by municipal issuers." Since that time, the SEC and others continue to make the case for more government regulation in the state and local government sector. Now, the current political climate surrounding regulation is at the forefront of discussions in Washington with potential for major impact in the governmental accounting profession and the related securities markets.

2 Self-regulation of the profession

Little attention was paid to reporting in the government sector until the early 1970s when revenues slowed, infrastructure was wearing out, and services were being cut. In 1973 the National Council on Governmental Accounting (NCGA) was created largely through the push from the profession. It quickly became apparent that the NCGA could not take on the task at hand due to part-time members, and limited resources. Major fiscal crises began occurring – most notably in New York City in 1975 and Cleveland in 1978 which brought national attention to the need for better guidance.

The leading state and local government professional organizations unified to plan for the creation of formal standards setting body. The Municipal Finance Officers Association (MFOA) which has become the GFOA worked with the National Association of State Auditors, Comptrollers and Treasurers (NASACT) to build consensus on the need for a full-time, formal standards setting body like the private-sector had with the Financial Accounting Standards Board (FASB).

GASB was created in 1984 as a self-regulated body for state and local government standard setting and guidance for accounting and financial reporting. They operate as the counterpart organization to FASB under the Financial Accounting Foundation (FAF). To date, they have issued 84 statements. These disclosures have added costs to state and local governments since the beginning. Ingram (1988) found that financial administration costs are positively associated with Generally Accepted Accounting Principal (GAAP) based information disclosures and with GAAP regulations. These costs and associated benefits have raised questions from the state and local government profession and have been the source of contention. The Governmental Finance Officers Association (2007) criticized GASB standard settings as being counterproductive and a waste of taxpayer money and went as far to appeal unsuccessfully to the FAF to transfer state and local government rulemaking to FASB. However, Lowensohn, Robinson, and Sanders (1996) study showed that GASB relies on steady reasoning and acts consistently with accounting principle to persuade its constituency that the rules they promulgate are appropriate. GASB has also exercised due process with pre-exposure of standards, comment letters and public hearings for each standard.

Conversely, GASB has not dealt with issues in the securities market and has lagged behind its private sector counterpart FASB on important issues such as pensions and leases. This has provided the opportunity for discussion of the need for federal intervention.

3 Municipal securities market

The municipal bond market is large and plays a major role in our nation's economy. According to the Securities Industry and Financial Markets Association (2017), the dollar amount of outstanding municipal bonds outstanding at the end of 2016 was over $3.8 trillion dollars. This amount has tripled in the last 20 years and is ten times the amount it was in 1980. However, this amount has remained relatively flat over the last decade since the housing crash and recession (see Exhibit 1). This stagnation mirrors the corporate bond market over the last ten years and points to the general fiscal condition of state and local governments across the country. As state and local governments experience budget issues and stagnant tax inflows, they are averse to taking on more debt service and have begun fewer new capital projects. The number of new issuances has been approximating the debt service that is being retired over the last decade. Similarly, another indicator of concern in the municipal securities market is data showing the average daily trading volume declining by half – from $25 billion in 2007 to $10 billion in 2016 (Securities Industry and Financial Markets Association, 2017). However, despite a flat market, most analysts agree that the municipal bond market is healthy, credit ratings are stable with expected growth in the market (Hayes, Schwartz, & Carney, 2017).

These data points highlight the magnitude and importance of the municipal bond market to the U.S economy. Pew Charitable Trusts (2016a) notes,

> "Cities in the United States play a substantial role in funding critical infrastructure with investments in capital projects such as roads, bridges, schools, and libraries. All local governments accounted for 35% of total highway and transit spending from 2008 throughout 2012. To pay for these projects, cities often sell bonds on the municipal market."

It is also important to note that this process is very localized, not only with the projects themselves, but how the debt is issued, reported, and disclosed. These decisions have fallen primarily on the shoulders of the state governments. The federal government for years has deliberated regulating more in this area, in large part through the SEC, but it still remains a parochial process.

4 States' rights and reserved powers

States have much power in determining state and local government reporting and securities issuances. Although GASB and the profession set governmental GAAP, it is up to each individual state to adopt, require and legislate that GAAP. Almost every state has substantial code surrounding reporting, disclosure and debt issuance requirements. Much of this legislation surrounds budgeting, encumbering, and spending of taxpayer resources. In addition, unlike in the private sector, states have the ultimate authority on deciding whether state and local governments be required to follow GASB standards, perform annual audits, levy

Please cite this article in press as: Craig Foltin, The role of federal regulation in state and local governments and the potential impact of new reforms: An assessment of the effectiveness of reporting, disclosure, and funding, Research in Accounting Regulation (2017), doi: 10.1016/j.racreg.2017.04.003