BACK TO BASICS
What Every Government Should Check Each Time It Issues Debt

BY ROBERT W. SCOTT
While issuing bonds is a routine task for many governments, it still pays to use a basic checklist each time debt is issued, to be sure that best practices are being followed and that the jurisdiction remains in compliance with federal securities and tax laws. To be in compliance, state and local governments need to produce bond disclosure documents that do not contain misstatements or omissions of material facts. According to the Securities and Exchange Commission (SEC), material facts are “facts which a prudent investor should know in order to evaluate the offering before reaching an investment decision.”1 State and local officials must therefore have a thorough understanding of a proposed bond issue before it is approved, and ensure that all significant information about the debt is provided to potential investors.

To understand a bond issue and verify its appropriateness, finance officers need to ask the following questions:

- Why are the bonds being issued?
- What is the purpose of the bond issue, and how will the bond proceeds be used?
- What types of bonds are being issued?
- How will the bonds be repaid?
- Are there circumstances that might interfere with repayment?
- What is the jurisdiction’s financial condition, and what circumstances might cause it to change?
- What options do bondholders have if revenues are not sufficient to pay them?
- If the issuance is a refunding, has a thorough analysis of the potential cost savings been done?

**DRAWING ON OUTSIDE EXPERTISE**

When issuing bonds, a jurisdiction needs to allocate responsibilities for preparing the official statement, and to make sure the responsibilities of all participants in the transaction are clearly defined. If a government does not have sufficient in-house expertise or is an infrequent issuer of debt, it needs to engage outside professionals to assist with the debt issue and to determine who is responsible for activities before, during, and after the bond sale.

Before selecting on an outside professional, check the processes and procedures the jurisdiction has established to determine that it is appropriate to do so and that the vendor chosen is qualified. The recommendations found in the Government Finance Officers Association’s best practices on *Selecting and Managing the Method of Sale of State and Local Government Bonds, Selecting Bond Counsel, Selecting Financial Advisors,* and *Selecting Underwriters for Negotiated Bond Sale* will help assure a government’s due diligence in selecting outside professionals to assist with the bond sale.2 (Also see “Ensuring a Successful Bond Sale” in this issue of *Government Finance Review*.)

**THINKING ABOUT DISCLOSURE**

**Establishing Accuracy.** Finance officers need to think about what the jurisdiction has done to establish the accuracy of financial and operating information and its disclosure in the official statement. Has anything occurred since the date of the financial statements that needs to be disclosed? First and foremost, the government should have well-established interim and year-end financial reporting practices, including timely completion of the annual audit. Those who are responsible for developing the official statement need to work with other departments that provide operational data to make sure they understand how the data will be used for disclosure purposes, and they also need to review operational data included in the official statement with the financial advisor and/or bond counsel to determine its applicability and usefulness to investors.

If a financial advisor or other outside professional prepares the official statement, members of the government’s staff need to review the document before it is published. A review also should be done both with internal legal counsel and outside bond counsel to address any matters that are not included in the financial statements but are required to be disclosed per the government’s continuing disclosure agreement.

**Determining Potential Material Conflicts.** It is also important to find out what policies and procedures have been developed, to determine whether there are material conflicts of interest that need to be disclosed. All parties must understand the fiduciary responsibility of everyone involved in a bond sale, including the financial advisor, underwriter, and bond counsel, and the issuer needs to know who is look-
All parties must understand the fiduciary responsibility of everyone involved in a bond sale, including the financial advisor, underwriter, and bond counsel, and the issuer needs to know who is looking out for its best interest.

Describing the Scope of the Project. The issuer must also make sure it has accurately described the project, bond terms, sources of repayment, and the risks associated with the project. What procedures are established for the investment and disbursement of the bond proceeds? Clearly define what your project is intended to accomplish. If you need to tell a story to describe what the bond proceeds will be used for, be clear and concise. Identify the revenues that will be used to pay off the bonds as well as any risks that might be part of the transaction. Know the project calendar and when funds will need to be disbursed, appropriate investment vehicles and estimated interest earnings for invested bond proceeds, and spend-down requirements to ensure compliance with federal arbitrage rebate and other tax rules and state and local investment laws.

UNDERWRITERS AND RATINGS AGENCIES

Issuers also need to make sure that their procedures permit the underwriters to carry out their due diligence and other responsibilities. Due diligence is not defined under the federal securities laws, but it refers to the underwriter’s responsibility to develop a “reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings,” along with the need to establish a defense to claims that an underwriter violated antifraud provisions. The nature of an underwriter’s due diligence responsibilities and investigation might vary in different bond issues and in different contexts, including whether the municipal bond offering is negotiated or competitive and whether the firm is the lead underwriter or just a participant in the underwriting syndicate. Following both the practices outlined in this article and in the GFOA’s best practices greatly assists a jurisdiction in ensuring that the underwriter can carry out its due diligence activities.

The jurisdiction also has to be prepared to answer questions from the rating agencies. It is a good idea to work with your financial advisor to create a comprehensive list of potential questions for the rating agency, including preparing a formal agenda. If the government is meeting with the rating agency, do a run through of the presentation. If you do not know the answer to something that comes up, follow up later.

TAKING CARE OF CONTINUING DISCLOSURE

The issuer needs to be aware of the continuing disclosure responsibilities it has assumed in its continuing disclosure agreement, and ensure that there are procedures in place to meet them. Who will determine and file the annual financial and material event disclosure information with the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access (EMMA) Web site? Is there an individual designated to speak to the market on the government’s behalf?

The GFOA’s Post Issuance Compliance Checklist is an excellent resource for ensuring that ongoing disclosure obligations are met. The checklist provides a thorough review of issues that need to be addressed, explains how to coordinate and create a plan for compiling annual disclosure information, and serves as an important source of information about the bond transaction for future staff. Professional staff responsible for making disclosure filings also should familiarize themselves with EMMA, where they will furnish both mandated and, if desired, voluntary information (see “Issuer’s Continuing Disclosure Responsibilities and Using EMMA” in this issue of Government Finance Review). Government staff members might also wish to consult with their bond counsel about their disclosure responsibilities.

Jurisdictions that rely on bond counsel, financial advisors, trustees, or other outside professionals to evaluate and meet the continuing disclosure requirements need to have procedures in place to keep them apprised of the government’s financial condition and other material information. As with all relationships, communication is key to making sure that your all members of the finance team — including outside professionals — are well-versed with your government’s financial landscape. This involves apprising appropriate individuals of the availability of relevant information, including annual
financial statements (e.g., the comprehensive annual financial report), interim financial reports and budgetary projections of revenue and expenditures, any utility rate filings or changes, or other significant events that may require disclosure. Elected officials and finance staff also need to ask the following questions of outside professionals:

■ What is the nature or scope of the written opinion or certification, if any, that you are giving in this transaction and relating to the disclosure document? Have we given you access to the information you need?

■ Have you explained all aspects of the structure or nature of this transaction so that you are confident we fully understand all critical aspects? Does our official statement adequately address any concerns you have about this transaction that a reasonable investor would consider important?

■ Are there any matters regarding your participation in this transaction you should make us aware of, including potential conflicts of interest? Is there anything that would constitute a “risk factor” in the disclosure statement?

■ Has your review of the relevant financial documents and other materials, including the official statement, raised any concerns regarding this borrowing? Do these concerns need to be disclosed?

■ Are you aware of any circumstances in which we, our staff, or others have not complied with our procedures, so we can make sure that our official statement adequately and accurately describes this transaction?

CONCLUSIONS

The GFOA offers many tools to help elected officials and staff with debt issuance, including books, training opportunities, and best practice statements to help governments create a debt management policy, choose the best debt instruments for their needs, hire professionals, and ensure compliance with federal tax and securities laws. The information in this article is intended as an additional tool to ensure further compliance and development of appropriate internal policies. Although issuing bonds may seem routine, using the information available can help assure both appropriate disclosure in
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Notes


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