

### NOT PAYING BILLS

To maintain control over spending, state and local governments originally maintained separate bank accounts for various types of expenditures. Once a bank account balance reached zero, spending for that purpose had to stop. Unfortunately, government officials learned that they could get around this control by switching money from one bank account to another. They also determined they could simply postpone paying bills.<sup>xli</sup>

State balanced budget requirements were then enacted to stop such practices. Regrettably, cash basis budgeting still allows government officials to delay the payment of vendor bills and to defer compensation costs, such as pension and other retirement benefits. For example, the state of Illinois routinely delays Medicaid payments to healthcare providers. Each year the budget appears balanced on a cash basis even though the state does not provide sufficient funding for the Medicaid program.<sup>xliii</sup> In November 2008 Illinois Comptroller Daniel Hynes said that the state had an “unprecedented bill backlog of nearly \$4 billion.” The ability to defer such payments has created huge budget holes that will need filling in future years.

### **GAAP SURPLUSES DO NOT TELL THE TRUE STORY**

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To our surprise our Study found only four states had a negative GAAP basis ending balance for FYE 2007: Connecticut, Illinois, Massachusetts and New Jersey. All of the other forty six other states reported positive GAAP basis ending balances. In other words, their audited Balance Sheets reported that the states had Net Assets or that they had more assets than liabilities. Our concern is that this is giving states and their citizens a false indication of the states’ financial conditions. Most readers of state financial reports are unaware that the Balance Sheet liabilities only represent a small portion of the state’s actuarially determined post-employment liabilities. Truer amounts of unfunded pension liabilities are buried deep in the state CAFR and the liabilities for the states employees’ healthcare and other retirement benefits are usually not disclosed.

In Rhode Island, for example, the audited CAFR reported that the state had Net Assets totaling almost one billion dollars. The state’s actuarially determined unfunded pension liability is found deep in the CAFR on page 121. Two problems exist with this information. The first is that even though the CAFR was for fiscal year ending June 30, 2007, the most recent actuarial valuation was done on June 30, 2006. The second problem is that the state’s three retirement systems are listed separately. To determine the state’s total unfunded pension liability the annual report reader needs to add the three amounts together. If this pension liability is subtracted from the reported Net Assets, then Rhode Island had a financial hole of almost \$4 billion. We assume decision makers would make different decisions if they understood that the state had an accumulated deficit of \$4 billion versus having Net Assets of \$1 billion. If the liability for post-employment health care and benefits were calculated and reported on the state’s Statement of Net Assets, then the Rhode Islands’ financial hole would be even deeper. The Management’s Discussion and Analysis for Rhode Island, included in their June 30, 2007 CAFR, stated that the unfunded liability for post-employment benefits other than pensions equaled \$696 million as of June 30, 2005.

We were not able to determine states' true financial conditions for the following reasons:

- For some states the date of the most recent actuarial valuation of their pension plans was different than the date of the financial statements. In some cases the actuarial calculation reported was a year earlier than the date of the CAFR.
- Some state pension systems are commingled with the pension systems of local governments in their state.
- GASB GAAP has not required state and local governments to disclose the unfunded liability for other post-employment programs, such as health care.

The inability to determine state liabilities for post-employment benefits, made it impossible for us to ascertain each state's true financial condition.

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### **MANY STATE ANNUAL REPORTS ARE PUBLISHED LATE**

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The Government Financial Officer's Association has set a six month standard for the issuance of the state's annual reports. This association's members include treasurers and comptrollers who produce their state's annual reports. When compared to the federal regulations imposed on publicly traded companies, this six month standard seems somewhat self-serving. Even under this rather lax standard only slightly more than half of the states issue their annual reports within this standard. We have ranked the timeliness of the issuance of the state's annual reports in Chart A on page 35.

The State of Michigan produces the nation's most timely CAFR. According to its Office of Financial Management, the Michigan CAFR is required, by statute, to be issued within 180 days of the fiscal year end. Nevertheless, in four of the last five years, the Michigan Office of the State Budget has issued its CAFR within ninety days of its fiscal year end. This stellar performance is based on two major factors. First, the state's governors—notably of both political parties—have had a sustained commitment to meet this goal. Second, Michigan has a centralized accounting system.

John M. Engler was Michigan's governor from 1991 to 2003. Gov. Engler requested that the CAFR for FYE September 30, 2002 be issued before he left office on December 31 or approximately ninety days after the FYE. The governor's goal was achieved, despite the fact that he was a "lame duck" and would be succeeded by a new governor of the opposite political party. His successor, current Governor Jennifer Granholm, has encouraged state agencies to continue to prepare the financial information, so the CAFR can be issued within ninety days. The uniform use of the same accounting system by all state agencies, and the re-engineering of some financial management processes, have enabled the Michigan Office of the State Budget to meet the governor's request for timeliness. As a result of this timely issuance, Michigan's legislators can use the important information included in the CAFR as they engage in the budget process.