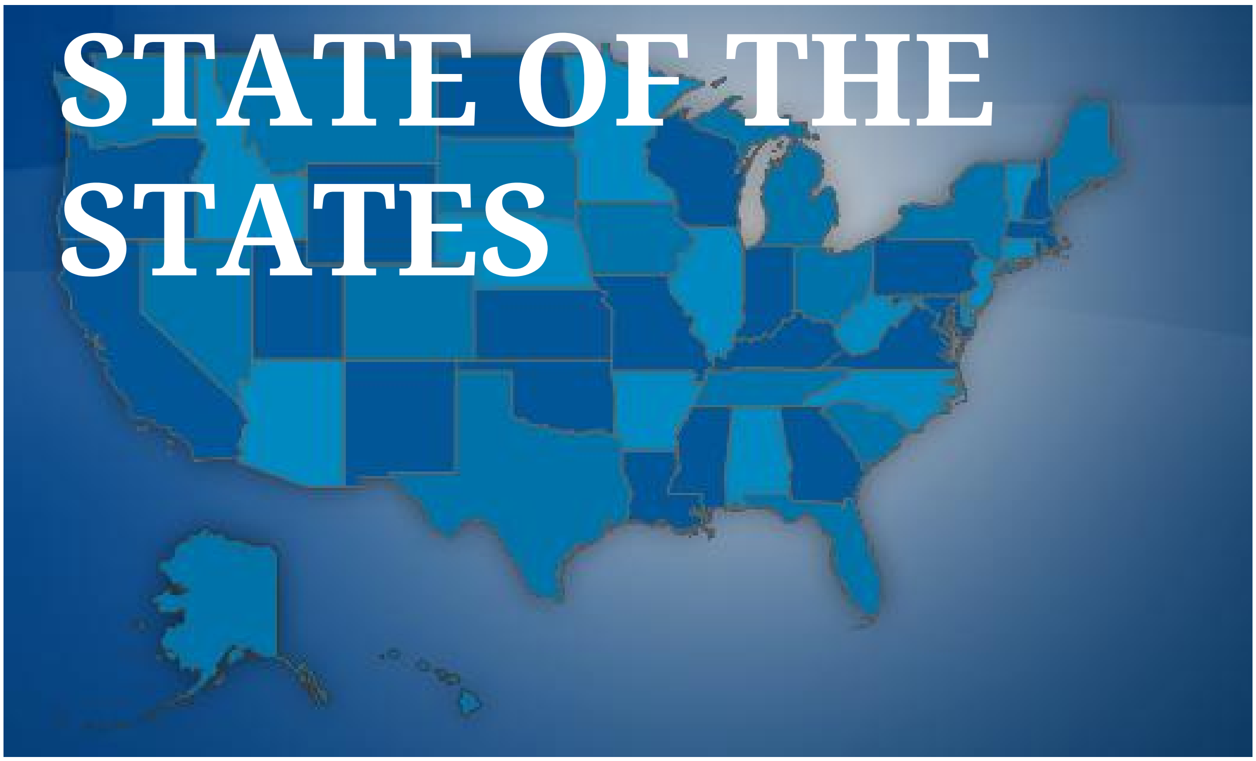
THE 2012 FINANCIAL STATE OF THE STATES



Data for this report was derived from states' fiscal year ended 2012 financial reports and related actuarial reports.

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TABLE OF CONTENTS

Contents

EXECUTIVE SUMMARY 5
SUMMARY OF 2012 FINDINGS 8
INTRODUCTION AND BACKGROUND 9
2012 FINDINGS 11
Bottom 5 Sinkhole States 11
Connecticut Taxpayer Burden Remains the Highest 11
Illinois Taxpayer Burden Increases by $3,700 to $42,200 12
Hawaii's Taxpayer Burden Increases by $3,000 to $41,300 12
New Jersey's Taxpayer Burden Decreases by $2,800 to $34,200 13
Top 5 Sunshine States 13
Two States Join the Sunshine States 13
Alaska Remains the Top Sunshine State 14
Wyoming and North Dakota Report Financial Surpluses 15
State Data Lab Adds Context to Taxpayer Burden 15
Billions of Dollars of Liabilities Are Maintained Off-Balance Sheet 16
Soon the Full Pension Liability Will Be on State Balance Sheets 17
Financial Data Is Not Released in a Timely Manner 19
Actuarial Data Is Not Released in a Timely Manner 20
A Comprehensive Approach to Analyzing State Finances 20
Ongoing Issues 22
Critical Decisions are Being Made with Inadequate Data 23
RESULTS 23
A Taxpayers' Burden Exists in Forty Two States 24
Top 5 Sunshine States and Bottom 5 Sinkhole States Identified 24
RECOMMENDATIONS 26
Recommendations to Elected Officials 26
Recommendations To State Financial Report Preparers 27
Recommendations to Accounting Standards Setters 27
Recommendations to the Public and Public Interest Organizations 28
METHODOLOGY 28

APPENDICES 29
Appendix I – Graph of Worst 25 States' Taxpayer Burden 30
Appendix II– Graph of Top 25 States' Each Taxpayer Burden *(Surplus)* 31
Appendix III – Financial State of the States Schedule 32
Appendix IV– Accumulated Bills 34
Appendix V– Schedule of Reported Vs. Unreported Retirement Liabilities 36
Appenix VI - Rankings Comparison Schedule 38
Appendix VII – Schedule of Timeliness of Financial Report Release 40
Appendix VIII – Roll-Out of the States 41
WORKS CITED 92
STATE DATA LAB - A POWERFUL ONLINE TOOL 94
Examples of Easy to Create Charts 95

EXECUTIVE SUMMARY

This is the fourth year Truth in Accounting has completed a comprehensive review of the financial reports of all 50 states to provide our fellow citizens with a clear picture of their government's financial condition. Despite an improvement in the economy, the amount of bills accumulated by the states has not decreased. States still have almost $1.3 trillion of debt which has accumulated even with the existence of balanced budget requirements in 49 of the 50 states. States do not provide citizens with the truthful and transparent information they need to be knowledgeable participants in their state's financial decisions. As a result, 42 states have dug financial holes for current and future taxpayers.

What now exists is a “Taxpayer Burden” representing the amount each taxpayer would have to send to their state’s treasury to fill their state's current financial hole. If state budgets had been truly balanced, no Taxpayer Burden would have accumulated. Taxpayer Burdens exist because costs, including those for employees' retirement benefits, were incurred by the states in prior years but responsibility for paying these costs has been shifted onto future taxpayers.

Truth in Accounting has again identified the top five “Sinkhole” states, those that have the highest per Taxpayer Burdens. Connecticut’s Taxpayer Burden is $46,000, Illinois - $42,200, Hawaii - $41,300, New Jersey - $34,200, andKentucky - $26,700. In contrast, Truth in Accounting identified the top five “Sunshine” states. Alaska, Wyoming, North Dakota, Utah and Nebraska have a per "Taxpayer Surplus" because they have assets available to pay their bills. Data for this report is derived from states’ 2012 financial reports and related retirement plans’ actuarial reports.

To add context to the Taxpayer Burden and other data included in this report Truth in Accounting now offers State Data Lab (StateDataLab.org). This online tool allows users to view demographic, economic and financial data about their state and compare their state to other states. This interactive website also provides users with the ability to easily create understandable graphs and charts.

The underlying cause of the accumulating Taxpayer Burdens is the outdated accounting practices used to calculate state budgets and financial reports. States are not held to the same accounting standards as most businesses and publicly traded companies, therefore states do not have the proper tools to balance their budgets. In fact, every year most states go even deeper into debt.

Truth in Accounting's researchers found more than $948 billion of promised retirement benefits are not reported on the state balance sheets. This study revealed states are not properly accounting for these promised benefits over the long-term. It was determined legislators and governors only focus on what is payable in the current year. Often state budget planning does not require money to be set aside to pay for future benefits. As a result current costs are being pushed onto to future taxpayers.

The lack of truth and transparency in state government budgeting and accounting makes it realistically impossible for even the most sophisticated user of state budgets and financial reports to independently determine and judge a state's financial condition. The assumptions used to calculate retirement benefits, like the rate of return earned on invested money or how long payments will need to be made to each pension participant may be unrealistic and hide the true financial obligations and contributions that are necessary to pay promised benefits.

This study is the most comprehensive study of state finances. While other organizations have compared the states' unfunded retirement liabilities, this study determined the overall financial condition of every state. This study takes into consideration all assets and all bills, including those related to retirement systems and the assets available to pay those bills. We determined that a comparison of states' unfunded retirement liabilities, without consideration of states' other financial commitments and assets available to pay them, would be incomplete.

To bring truth and greater transparency to state budget processes Truth in Accounting has developed a budgeting system called "Full Accrual Calculations and Techniques". FACT based budgeting would require governors and legislatures to recognize expenses when incurred regardless of when they are paid.

November 15, 2013

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TOP 5
Sunshine States

1 Alaska
Assets Left After Bills Are Funded:
$10,611,198,000
Each Taxpayer's Surplus: $35,300

2 Wyoming
Assets Left After Bills Are Funded:
$8,540,591,000
Each Taxpayer's Surplus: $22,600

3 North Dakota
Assets Left After Bills Are Funded:
$4,073,085,000
Each Taxpayer's Surplus: $16,100

4 Utah
Assets Left After Bills Are Funded:
$1,802,072,000
Each Taxpayer's Surplus: $2,500

5 Nebraska
Assets Left After Bills Are Funded:
$1,179,500,000
Each Taxpayer's Surplus: $2,000

BOTTOM 5
Sinkhole States

46 Kentucky
Money Needed to Pay Bills:
$32,083,315,000
Each Taxpayer's Burden: $26,700

47 New Jersey
Money Needed to Pay Bills:
$104,664,421,000
Each Taxpayer's Burden: $34,200

48 Hawaii
Money Needed to Pay Bills:
$18,908,289,000
Each Taxpayer's Burden: $41,300

49 Illinois
Money Needed to Pay Bills:
$169,149,838,000
Each Taxpayer's Burden: $42,200

50 Connecticut
Money Needed to Pay Bills:
$58,570,015,000
Each Taxpayer's Burden: $46,000

Data derived from states' fiscal year ended 2012 financial reports and related actuarial reports.

SUMMARY OF 2012 FINDINGS

- By circumventing the intent of balanced budget requirements, elected officials have accumulated $1.3 trillion in state debt. As a result 42 states have dug financial holes for current and future taxpayers.
- More than $948 billions of unfunded retirement systems' liabilities are not reported on the face of state balance sheets.
- 

New Mexico received Truth in Accounting's first annual "Last Award" when the state issued its financial report 425 days after its fiscal year end. South Carolina and Illinois were also found to be "excessively tardy" in the release of their financial reports. These states took more than 300 days to issue their financial reports.

Sinkhole States

- Even though Connecticut's Taxpayer Burden decreased, the state remains the worst at $46,000. Connecticut's decrease is directly related to an $8.7 billion decrease in its unfunded retirees' health care liability. More than 50% of this reduction is related to changes in actuarial assumptions.
- Illinois and Hawaii are quickly closing in on Connecticut's position. Illinois' and Hawaii's Taxpayer Burdens grew to $42,200 and $41,300 respectively. These increases relate to dramatic rises in unfunded retirement liabilities and reported deficits.

Sunshine States

- Iowa and Tennessee have joined the ranks of Sunshine States that have Taxpayer Surpluses. The top five sunshine states are Alaska, Wyoming, North Dakota, Utah and Nebraska. South Dakota is the sixth sunshine state. Tennessee and Iowa now fall in seventh and eighth places.

See detailed discussions of these findings starting on page 11 of this report.

Introduction and Background

Truth in Accounting was formed in 2002 to encourage the federal government to issue financial information in a manner that allows the public and their elected officials to make informed and knowledgeable policy decisions. Truth in Accounting determined that recognizing the short term and long term financial consequences of public decisions would lead to a more sustainable government.

In 2005 Truth in Accounting supporters encouraged the organization to analyze budgeting and accounting practices in its home state of Illinois. Despite the state's constitutional requirement to balance the budget, this study exposed a reported cumulative spending deficit of (then) $20 billion. Truth in Accounting researchers also discovered that Illinois did not report all liabilities for public employees' pensions or other post-employment benefits such as health and dental care. When those liabilities were included, Truth in Accounting's analysis showed that in 2005 the state was actually more than $70 billion in the hole. To make matters worse, Illinois was continually delaying the issuance of its year-end financial report until after the next fiscal year's budget process had been completed. This prevented citizens and public officials from having the information they needed to make relevant decisions resulting in uninformed public policy decisions.

These findings called for a similar study of all 50 states' budgeting and accounting practices. This project investigated both the methods that states used to calculate their budgets and the accounting principles they used to create their Comprehensive Annual Financial Report (CAFR). Results from this study were published in February 2009 in "The Truth about Balanced Budgets – A Fifty State Study". Truth in Accounting researchers determined that every state except Vermont has a balanced budget requirement, yet almost all run annual deficits in the millions, and some cases, billions of dollars.

Truth in Accounting researchers found that states have deficient budgetary and accounting rules which tend to overstate revenues and understate expenses. States systematically ignore costs that are incurred in the current budget year but will not be paid until a later date. It was also determined the accounting principles available to states actually allowed for the omission of some direct liabilities from their balance sheets.[i]

Among the catalog of questionable budgeting and accounting techniques is the treatment of pensions and other post-employment benefits, such as retirees' health care benefits. Budgets, and the associated financial accounting, actively ignored the true costs of

[i] In state government accounting a "balance sheet" is called a "Statement of Net Assets."

compensating public sector workers. These costs were not considered nor were they reported in the states' primary accounting statements because state officials use antiquated accounting principles to calculate state budgets and financial reports. Truth in Accounting's study found under these principles states report balanced budgets while accumulating large debts and deferred liabilities.

All levels of government derive their just powers from the consent of the governed. This imposes a special responsibility on government officials to report their actions and the results of those actions in ways that are truthful and comprehensible to the electorate. Providing accurate, useful and timely information to citizens, the news media and other governmental officials is an essential part of that governmental responsibility.

The opaqueness of the financial information reported in state budgets and financial reports makes it difficult for state governments to meet this responsibility. Our state projects, which include the research completed for "The Truth about Balanced Budgets" and this study, have confirmed that view as well as the necessity of further investigation and analysis of the states' fiscal conditions.

This is the motivation and foundation for the non-partisan mission of Truth in Accounting: To compel governments to produce financial reports that are understandable, reliable, transparent and correct. Truth in Accounting is a non-profit, politically unaffiliated organization composed of business, governmental and academic leaders interested in improving public and private sector financial reporting. Truth in Accounting makes no policy recommendations beyond improvements to budgeting and accounting practices that will enhance the public's understanding of their government's financial matters.

2012 FINDINGS

Bottom 5 Sinkhole States

State	Taxpayer Burden 2012	Taxpayer Burden 2011	Increase (Decrease) In Taxpayer Burden
Connecticut	$46,000	$50,900	($4,900)
Illinois	$42,200	$38,500	$3,700
Hawaii	$41,300	$38,300	$3,000
New Jersey	$34,200	$37,000	($2,800)
Kentucky	$26,700	$26,300	$400

Connecticut Taxpayer Burden Remains the Highest

While the Connecticut Taxpayer [ii] Burden increased from $50,900 in 2011 to $46,000 in 2012, the state still ranks the highest of all of the 50 states.

Most of the decrease resulted from an $8.7 billion reduction in unfunded liability related to the State Employee Other Post Employment Benefit Plan (OPEB)[iii]. The majority of the reduction was due to changes in actuarial assumptions. Some of the changes were based upon claim experiences, while another portion was related to a change in the assumed rate of return on investments, up from 4.5% to 5%. The higher the rate of return, the lower estimated unfunded liability. [(2)] The state was allowed to increase this rate because the Governmental Accounting Standards Board (GASB)[iv] rules allow states to use a higher rate of return if the state has some funds invested to cover promised benefits. But GASB does not specific a minimum amount that needs to be set aside to take advantage of this higher rate of return. In Connecticut's case, $49.6 million of assets have been set aside to cover the $17.9 billion of promised benefits. This is less than a third of a percent.

[ii] *Based on the number of each state's 2010 federal tax filers with a tax liability adjusted by increase the rate of population since 2012 per census.gov.[(1)]

[iii]The bulk of OPEB are retirees' health care benefits.

[iv]Like Financial Accounting Standards Board (FASB) does for corporations, GASB sets Generally Accepted Accounting Principles for state and local governments.

The unfunded liabilities of Connecticut's major retirement plans as a percentage of covered payroll continue to be alarmingly high. For example, for the State Employee Other Post Employment Benefit Plan, this percentage is 459%. In other words to pay off this plan's unfunded liability, the state would have to stop paying all covered state workers for more than 4 1/2 years and divert all of the savings to the pension plan.

Plan	Unfunded Liability as % of Covered Payroll
State Employees' Retirement System	**396%**
Teachers' Retirement System	**305%**
State Employee OPEB Plan	**459%**

Illinois Taxpayer Burden Increases by $3,700 to $42,200

Illinois' shortfall rose to $169 billion. The increase is largely due to an $8.5 billion increase in the Teachers Retirement System unfunded liability. Actuaries revised their assumptions to more closely reflect actual performance and future expectations. The actuarial revisions changed the investment return from 8.5% to 8%. Inflation, salary increases, mortality and other actuarial assumptions, which were also revised to more closely reflect recent actual emerging experience and future expectations. [3]

The amount of unfunded retirees' health care liabilities did not change since 2011, because no actuarial valuations were completed for 2012. GASB does not require states to have actuarial valuations done every year. In 2011 Illinois' unfunded retiree health care liabilities were determined to be $44.9 billion. This represents a large portion of the state's shortfall (27%). Prudent financial management would recommend an annual actuarial valuation be completed.

The increase in Illinois' Taxpayer Burden can also be attributed to a spending deficit in excess of $2 billion reported on the state's 2012 income statement. This is despite the state's balanced budget requirement. This follows an **unprecedented spending deficit of $5 billion and $10 billion** in 2011 and 2010 respectively.

Hawaii's Taxpayer Burden Increases by $3,000 to $41,300

The rise in Hawaii's Taxpayer Burden is due to a spending deficit and an increase in its unfunded pension and retirees' health care liabilities from around $1 billion to more than $20 billion.

New Jersey's Taxpayer Burden Decreases by $2,800 to $34,200

The decrease in New Jersey's Taxpayer Burden is related to a reduction in the state's unfunded retirees' health care liability. The estimated unfunded OPEB liability was reduced by more than $10 billion from July 1, 2010 to July 1, 2011. Changes in the method used to manage retirees' prescription drug benefits, in conjunction with Medicare Part D and 2011 legislation that increased employee contribution requirements for some future retirees were the main factors responsible for the reduction. (4) A July 1, 2012 valuation was not available at the time of this analysis.

Top 5 Sunshine States

State	Taxpayer's Surplus 2012	Taxpayer's Surplus 2011	Increase (Decrease) In Taxpayer's Surplus
Alaska	**$35,300**	**$34,100**	**$1,200**
Wyoming	**$22,600**	**$21,500**	**$1,100**
North Dakota	**$16,100**	**$13,200**	**$2,900**
Utah	**$2,500**	**$2,800**	**($300)**
Nebraska	**$2,000**	**$2,100**	**($100)**

Two States Join the Sunshine States

Tennessee and Iowa now have money available to pay their bills moving them into the Sunshine State category. Tennessee and Iowa have Taxpayer Surpluses of $300 and $100 respectively.

The major reason for the improvement of Tennessee's financial position was a $925 million increase in tax revenues. The primary tax revenue increase was from an increase in sales and business tax collections. (5)

Iowa's financial report also indicates the reason for its financial position improvement was an increase in tax revenues. The report highlights this increase was a result of the continuing improvement in the state economy. (6)

Due to the small size of Tennessee's and Iowa's Taxpayer Burdens, it should be noted a large portion of each state's financial position is its unfunded retirement liabilities. These liabilities are calculated using actuarial assumptions such as projected payroll increases and investment rates of return. In this study, the unfunded retirement liabilities amounts are based upon the assumptions used by state retirement plans' actuaries.

A slight change in these actuarial assumptions can result in a large change in the states' unfunded retirement liabilities and financial position. Some argue that states use unrealistic rates of return in excess of 7%. If the rates were lower, the unfunded liabilities would increase dramatically. Taxpayer Burdens would likely exist in Tennessee, Iowa, and other Sunshine States if the rates of return were adjusted. In addition, the Taxpayer Burdens in other states would increase.

Alaska Remains the Top Sunshine State

In this study, Alaska ranks as the top Sunshine State. Some studies rank Alaska as the worst state because its pension funds have the country's lowest funding ratio (the ratio of plan assets to promised benefits). In addition to analyzing the state's funding ratios, this study considers the assets the state has outside the pension systems that could be used to cover the promised benefits. Ignoring these assets and focusing only on the unfunded liabilities is similar to someone being criticized for having a large credit card balance without considering the fact they have more than enough money saved to pay this balance.

In 2010 the state of Alaska catapulted to number one in Truth in Accounting's ranking, largely due to a dramatic increase in the rate of return used in the calculation of its unfunded retirees' health care plan. The rate of return is one of the actuarial assumptions used to measure the plan's accrued liabilities. Like Connecticut, Alaska was permitted by GASB to increase the rate of return because the state put money in the plan to fund future retirees' health care benefits. While Connecticut's amount of assets set aside is less than one percent of the related liabilities, the Alaska Public Employees and Teachers Retirees' Health Care Plans have assets available to pay almost 47% of related liabilities.

In 2012 the actuaries of the Alaska Public Employees' Retirement Systems calculated the unfunded retirees' health care liability using a 6.88% rate of return. Other Sunshine States' actuaries use at rate of return between 4.5% and 5% to calculate their unfunded retirees' health care liability. Alaska does disclose the calculation of unfunded liability using a rate of return of 4.25%. Using this rate the unfunded liability of this OPEB plan would increase from $4.5 billion to $9.4 billion. [(7)] If this unfunded liability amount was used in this analysis the state's Taxpayer Surplus would be reduced from $35,300 to $19,000. This would drop the state down from the best state to the 2nd best right below Wyoming, which has a Taxpayer Surplus of $22,600, and just above North Dakota, which has a Taxpayer Surplus of $16,100.

Wyoming and North Dakota Report Financial Surpluses

Wyoming's Taxpayer Surplus increased because the state financial statements reported financial surplus (positive change in net assets) of more than $1 billion. (8)

North Dakota also reported a financial surplus. The state's revenue rose 23% due in large part to increases in oil and gas production and oil prices. (9)

Utah and Nebraska experienced small decreases in their Taxpayer Surpluses.

State Data Lab Adds Context to Taxpayer Burden

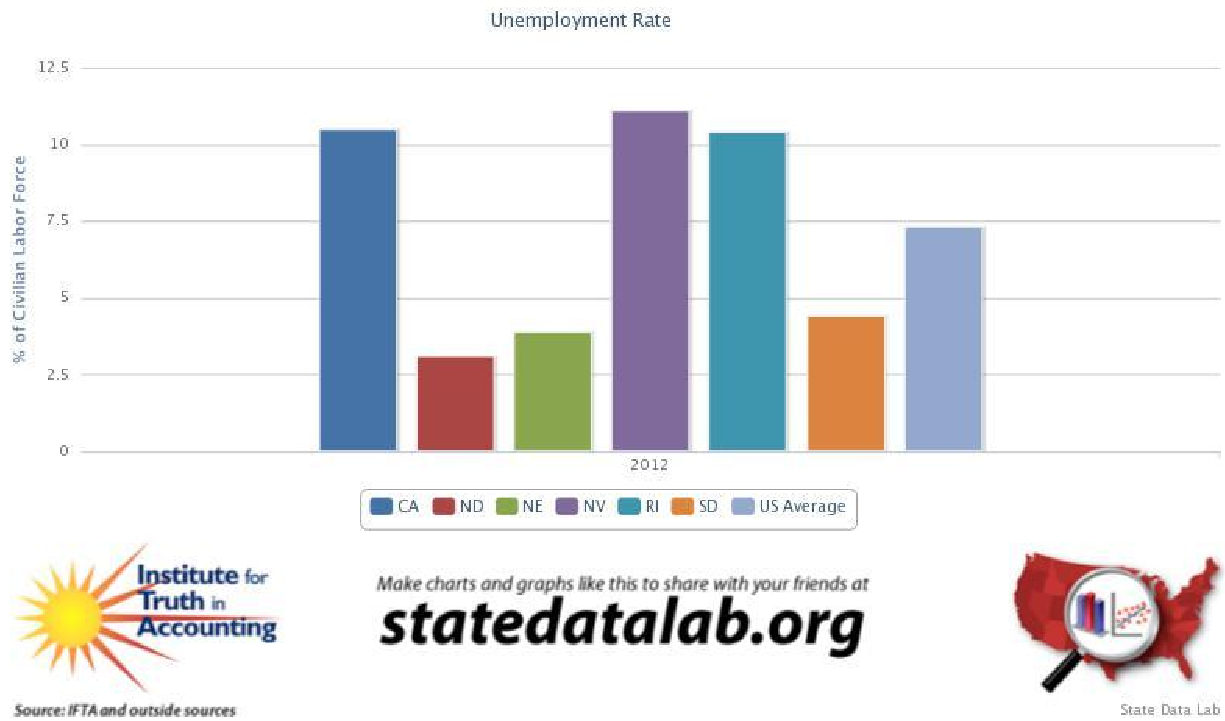
While Truth in Accounting ranks the states' financial conditions with a measure of the Taxpayer Burden or Surplus, those figures become more meaningful when put into context. To better communicate what the Taxpayer Burden or Surplus means in relation to other data points, Truth in Accounting developed State Data Lab (StateDataLab.org).

This new online tool allows users to view our analysis alongside additional financial, economic and demographic data. This website also gives users the ability to compare states' data points and share their findings with others.

The most powerful feature of the website is the ability for users to quickly and effortlessly create easy-to-read graphs and charts of financial, economic, and demographic data for all 50 states. State Data Lab also offers weekly charts, commentary and the ability to download raw data in Excel format from sources which include the U.S. Census, Bureau of Economic Affairs, United Van Lines and Truth in Accounting.

State Data Lab is the best source for updated figures on each state's assets and liabilities, including unfunded retiree pension and health care obligations, not found anywhere else. State Data Lab presents this data along with data from a number of government and private sources. State Data Lab provides citizens and reporters with valuable data and chart snapshots to include in their articles. The website also supplies legislators, think tanks and other political decision makers with the knowledge needed to develop policy solutions to budget and debt issues.

Below is an example of the easy to generate graphics users can create on State Data Lab.



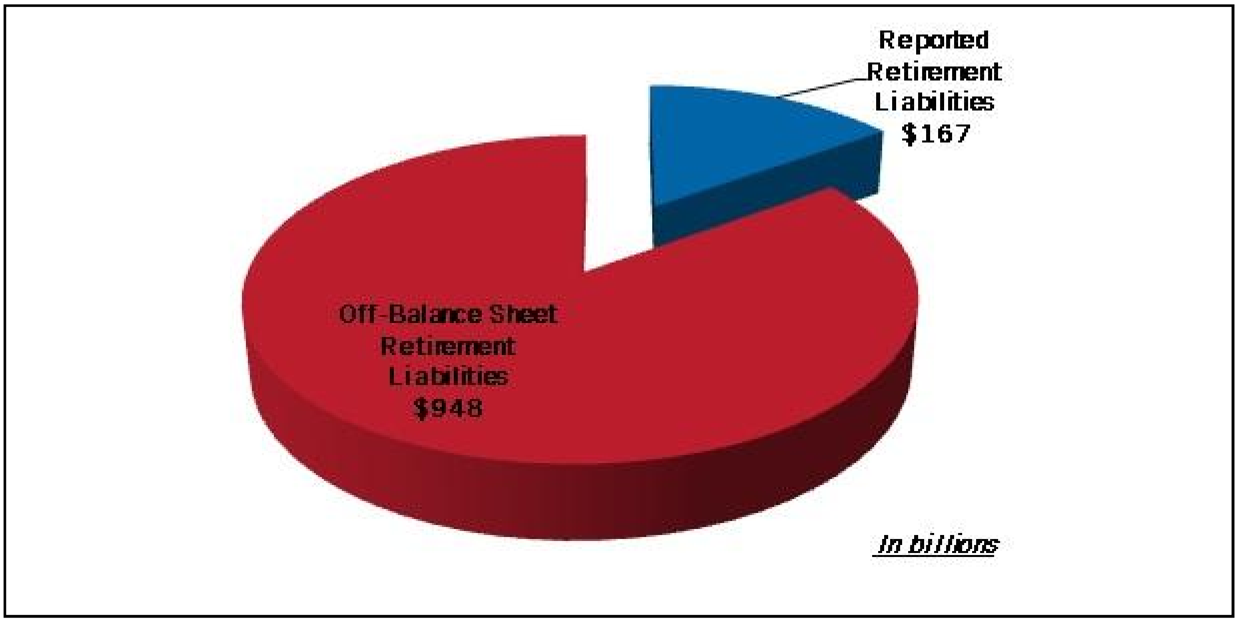
Billions of Dollars of Liabilities Are Maintained Off-Balance Sheet

Even applying the optimistic actuarial assumptions used by states to calculate their unfunded retirement liabilities, Truth in Accounting researchers found states have accumulated pension and OPEB liabilities totaling more than $1.1 trillion. This study determined only $167 billion of these liabilities are reported on state balance sheets. More than $948 billion of these retirement liabilities are maintained off-balance sheet.[v] This lack of transparency is due to the reporting requirements established by the GASB.

Truth in Accounting researchers found that <u>pension related liabilities of $485 billion do not appear on state balance sheets.</u> This means 89% of the states' unfunded pension liabilities are not reported on their balance sheets.

This study also found that <u>OPEB related liabilities of almost $463 billion do not appear on state balance sheets.</u> This means 85% of the states' OPEB liabilities are not reported on their balance sheets.

[v] See Appendix V – Schedule of Reported vs. Unreported Retirement Liabilities for detail by state.



The reasons why these retirement liabilities are not reported on state balance sheets are detailed in our 2010 report, which is available on the State Data Lab web site (StateDataLab.org).

For the most part states have not set aside money to pay OPEB benefits, relying on a "pay-as-you-go" system. Truth in Accounting's analysis of all 50 states found **only 4% of the promised retirees' healthcare benefits have assets set aside to cover them.**

Soon the Full Pension Liability Will Be on State Balance Sheets

On June 25, 2012, Truth in Accounting's CEO and founder, Sheila Weinberg, and others gave testimony before GASB which resulted in GASB approving amendments to accounting for pensions by employers. Soon states will be required to report their total "Net Pension Liability" on their balance sheets. The Net Pension Liability (NPL) will equal the total amount of accrued benefits net of the fair market value of the pension plans' assets. States are required to implement these amendments in their 2015 fiscal year financial statements.

States have the option of adopting these statements earlier. Truth in Accounting strongly urges the implementation of these amendments as soon as possible.

The amendments are based upon the principle that "[P]ensions are a form of compensation, like salaries, which governments provide in return for work." [10] GASB concluded from that observation that pension obligations should be recorded when earned, not when paid.

In the past most studies of states' unfunded retirement liabilities and financial conditions have allocated to each state all of the liabilities related to multi-employer, cost-sharing plans. GASB's amendments follow Truth in Accounting's lead of requiring states to calculate and put on their balance sheets only their share of the liabilities related to these plans. In the future states will also be required to report on their balance sheets the liabilities related to the pension plans' of their component units. Truth in Accounting includes these liabilities in its studies.

As noted above, the NPL will be based upon the fair market value of the pension plans' assets. Some people are concerned that the NPL will be volatile because of the fluctuation of the market value of plans' assets from year to year. However, this volatility will be a reflection of reality. The use of the fair market value of pension plans' assets will provide citizens and policy makers with information about the risks involved in financial markets and instruments used to fund their retirement plans.

Previously many states determined their contributions based upon the annual required contributions calculated according to GASB's pension standard. Whether states paid these annual contributions or not was the largest factor used in judging if states were adequately funding their pension plans.

Under the amended standards, no annual required contribution is required to be disclosed. The pension expense will not be an annual contribution or funding amount, rather a change in the NPL recognized from one year to the next. This provision will further highlight market risks.

The following are additional requirements of these statements: (11)

- The use of *The American Academy of Actuarial Standards of Practice* which will mostly likely mandate the use of more realistic discount rates to calculate retirement plans' accrued benefits and required contributions.
- A standardized method to calculate accrued benefits.
- A lower discount rate, based on a portfolio rate of municipal securities, should be used for the unfunded portion of the Net Pension Liability.
- A more realistic approach to the amortization of prior service costs that relates these costs to the expected remaining tenure of the employees concerned.
- Incorporation and recognition of accrued benefit changes and likely cost of living benefit increases at the time they are created.

Financial Data Is Not Released in a Timely Manner

Timely information is crucial during decision making processes such as the budget process. However, most states issue their financial reports long after their fiscal year ends.

Three States Excessively Tardy	Days to Release
New Mexico	426
South Carolina	342
Illinois	335

Five Most Timely States	Days to Release
Utah	111
Washington	138
Michigan	151
North Carolina	156
New York	157

A complete ranking of the timeliness of the release of state financial reports can be found in Appendix VII-Schedule of Timeliness of Financial Report Release.

New Mexico, Illinois and South Carolina are classified as “excessively tardy” because their financial reports were issued more than eleven months after their fiscal year ends. New Mexico received Truth in Accounting's first annual "Last Award" when the state issued its financial report 426 days after its fiscal year end.

Nineteen states are classified as “tardy” because their reports were issued after 180 days. Twenty eight states issued their financial reports within 180 days of their fiscal year end. According to the Government Financial Officers Association (GFOA) a government's financial report is considered timely if it is issued within 180 days of the fiscal year end.

Utah was the timeliest state, issuing its 2012 reports 110 days after its fiscal year end.

Our previous studies identified the following four main factors that are predictive of a timely CAFR:

- Commitment of governmental officials;
- Capacity of accounting systems;
- Adequate resources, including personnel; and
- The desire to receive the GFOA certificate.

You can find detailed discussions of each item in our 2010 report, which is available on the State Data Lab web site.

Actuarial Data Is Not Released in a Timely Manner

The most important information included in the CAFRs is the financial conditions of retirement plans. In most states, the related unfunded liabilities are the largest obligations. The calculations of these retirement plans' unfunded liabilities are based on actuarial valuations that are usually even more severely out of date than the audited financial reports. Many states, like Connecticut and Hawaii, do not obtain annual actuarial valuations of their retirement plans. GASB standards permit states to obtain an actuarial valuation of their retirees' health care plans every other year.

In today's volatile marketplace, the use of outdated retirement plan actuarial data is potentially very harmful. Estimates of current retirement plan balances, calculated using "smoothing" as discussed above, are artificially high given the current market conditions. Therefore current funding requirements based on these overly optimistic balance estimates will most likely be insufficient to cover future promises.

A Comprehensive Approach to Analyzing State Finances

To determine a state's financial condition Truth in Accounting researchers used a thorough, detailed approach comparing all of a state's bills, including those related to retirement systems, to all of a state's assets available to pay these liabilities. The results of that comparison are presented in the following "Financial State of the States" presentations.[vi]

Capital assets are not included in the Truth in Accounting analysis because it is not financially prudent to sell long term assets to pay for current liabilities. Because capital assets are not included in the analysis, the debt related to capital assets is also not included.

Other studies have reported dramatic unfunded pension and OPEB liabilities and related funding ratios. Others have reported sensationally high total state debt amounts per capita.

[vi] The electronic version of this document and of each state's detailed Financial State of the State can be found at: StateDataLab.org.

Appendix VI – Rankings Comparison Schedule of this report includes rankings according to the Truth in Accounting Taxpayer Burden (Surplus), Total State Debt per Taxpayer and Pension Percent Funded.

Truth in Accounting determined that a comparison of a state's unfunded retirement liabilities is incomplete without consideration of other obligations and the assets available to fund all liabilities.

Assessing a state's unfunded pension liabilities without considering other debt does not provide an accurate analysis because some states have issued pension bonds and other debt to fund plans' contributions. In those cases, improvement in the funding of pension plans is offset by increases in other state debt.

Such is the case in Washington State. As indicated in Appendix VI – Rankings Comparison Schedule, if ranked only by percentage of pension funded, the state ranks 6th best. However, the state ranks 23rd in our Taxpayer Burden ranking. This is because the Taxpayer Burden ranking takes into account all non-capital related debt. Washington issued debt to partially fund their pension plans, as made evident by the fact that 78% of Washington's debt burden *appears* to be unrelated to its unfunded retirement liabilities, compared to an average 51% across the 50 states.

Evaluating a state's unfunded pension and OPEB liabilities without analyzing the state's other liabilities is similar to judging a person's finances by only looking at one credit card with a $1,000 balance without considering the person used $10,000 from a second credit card to reduce the $11,000 balance on the first credit card.

Analyses of total state debt have been done by other organizations. Total state debt in this case included state liabilities, bonds and unfunded retirement obligations. Inclusive in the analysis of total state debt is debt related to capital assets. This analysis implies states should not issue debt to acquire long term assets. This is like saying an individual should not take out a mortgage to buy a house. Such an analysis does not recognize the value of the assets purchased with the related debt. While future taxpayers will be paying taxes to cover the payment of long term debt related to capital assets, those taxpayers will most likely receive benefits from those capital assets.

Furthermore, analyzing a state's debt without consideration of the assets (excluding capital assets) it has available to pay that debt is like judging a person's finances only looking at their $10,000 credit card balance without considering they have more than $20,000 in the bank to pay off this balance.

As indicated in Appendix VI our study ranks Alaska as the best in Taxpayer Burden (Surplus), but the state ranks the worst if only debt is considered. The difference is Alaska has $37.4 billion of assets available to pay $26.8 billion of bills.

Connecticut and Illinois have the dubious distinctions of ranking in the bottom five in the ranking of Taxpayer Burden, total state debt per taxpayer and percentage of unfunded pension liabilities.

State	Taxpayer's Burden (Surplus)	Ranking Based on Taxpayer's Burden	Debt Per Taxpayer	Ranking Based On Debt Per Taxpayer	Percent Unfunded Pensions	Ranking Based on Percent Unfunded Pensions
Connecticut	$46,000	50	$59,700	48	49.1%	48
Illinois	$42,200	49	$52,200	46	40.4%	50
Hawaii	$41,300	48	$68,300	49	59.2%	38
New Jersey	$34,200	47	$56,200	47	57.2%	43
Kentucky	$26,700	46	$41,200	43	46.8%	49

Ongoing Issues

A detailed discussion of the following ongoing issues can be found in our 2010 year's report, which can be found at StateDataLab.org

- Accounting rules have not kept up with growing state missions and associated costs.
- Antiquated budgeting rules and accounting standards used to calculate budgets result in artificially balanced budgets.
- The accounting standard requiring states to disclose their amount of contributions into multi-employer, cost-sharing pension plans; which include state and local governments, is being interpreted differently in various states.
- Current compensation costs are shifted to future taxpayers.
- The use of unrealistic assumptions results in the understatement of retirement systems' liabilities and the contributions needed to fund promised benefits.
- The financial information for state organizations, known as "component units", is not clearly disclosed in the financial reports of states.

RESULTS

Critical Decisions are Being Made with Inadequate Data

Truth in Accounting's research determined that states make critical financial decisions using data that is woefully inadequate in two ways:

- The data in state financial reports and budgets does not accurately recognize all the costs and liabilities associated with pensions and retirees' health care benefits. This means citizens cannot independently judge their state's true financial condition and elected officials' balanced budget claims.
- Prior year financial results are often reported too late to be used in current budget cycles. This study found that twenty two states' annual reports were not published until more than six months after the fiscal year end. Three states published reports more than 300 days after after their fiscal year ends.

BALANCED BUDGETS RESULT IN BILLS IN EXCESS OF ASSETS TOTALING ALMOST $1.3 TRILLION

This study determined that as of the 2012 fiscal year end states did not have the assets necessary to pay $1.3 trillion of their bills as they come due. As Appendix III indicates states have less than $1 trillion of assets available to pay nearly $2.3 trillion of bills as they come due. At that time states reported only $167 billion of retirement liabilities on their balance sheets. A detailed review of actuarial reports and other documents revealed the states' unfunded retirement liabilities totaled $1.1 trillion and more than $948 billion of these liabilities were maintained off-balance sheet.

A Taxpayers' Burden Exists in Forty Two States

A major intention of balanced budget laws is that state governments should not be able to shift the burden of paying for current-year services and benefits to future-year taxpayers. This is a significant part of accountability because it reduces the state's ability to incur costs without having an impact on the state's current budget calculations. Truth in Accounting's study found that forty two states have created financial burdens that will be the responsibility future taxpayers.

The main reason for these Taxpayer Burdens is that all compensation costs, especially related to earned retirement benefits, have not been included in prior budgets. Money that should have been put aside to provide for these costs was spent elsewhere. As a consequence future taxpayers will have to pay taxes for services and benefits that were received by prior taxpayers.

Evidence of these practices is illuminated in state annual financial reports. As indicated in Appendix IV, we identified $543 billion of unfunded pension and $573 billion of unfunded retirees' health care liabilities. But as indicated in Appendix V, only $167 billion of these liabilities were reported on the face of state balance sheets. Collectively more than $968 billion of the costs of pension and health care benefits earned and promised have not been included in prior state budgets and financial statements.[vii] Future taxpayers are responsible for ***all unfunded liabilities*** whether they appear on their state's balance sheet or not.

Taxpayers are also ultimately responsible for unfunded promises on the part of the federal and local governments. For citizens in Bridgeport, Connecticut; using the same methodology, our calculations show that amount to be $625,600 per taxpayer. Each and every Bridgeport taxpayer would have to write a check to their city for $29,600, to their state for $46,000 and to the U.S. Treasury for $550,000 [(12)] to cover government promises already made on their behalf.

Top 5 Sunshine States and Bottom 5 Sinkhole States Identified

In this report and the 2011 analysis Truth in Accounting identified the "Top 5 Sunshine States" as Alaska, Wyoming, North Dakota, Utah, and Nebraska. "Sunshine States" are identified as such because these states have taxpayer Surplus which represents each taxpayer's share of the assets their state has available to cover bills, including retirement obligations.

As in Truth in Accounting's 2011 analysis, the "Bottom 5 Sinkhole States" are Connecticut, Illinois, Hawaii, New Jersey, and Kentucky. These states are sinking in debts summarized by their Taxpayer Burden, the money required from each taxpayer to pay their state's outstanding

[vii] See Appendix IV - Schedule of Accumulated Bills and Appendix V - Schedule of Retirement Liabilities Not Clearly Disclosed for detail by state.

bills, including retirement obligations.

In the printed version of this document a one page summary of each state's Financial State of the State is located in Appendix VIII-Roll-Out of the States. This summary and a more detailed Financial State of the State for each state can be found in the online version of this document at: StateDataLab.org. Users of StateDataLab.org can click on any state on the website's map to find that state's summary and detailed Financial State of the State.

The detailed Financial State of the State includes a breakdown of the following:

- Asset Available to Pay Bills which is determined by subtracting Capital Assets and Restricted Assets from total assets, and
- Total Bills include State Bonds, Other Liabilities, Unfunded Pension Promises and Unfunded Retirees' Health Care Promises, minus Debt Related to Capital Assets.

RECOMMENDATIONS

To be informed participants in their governments, citizens must be provided with truthful and transparent information. States' efforts to begin digging out from their current financial holes must start with an honest accounting of their true fiscal conditions. Only then can alternatives to place the state on solid financial footing start to be developed and debated.

Recommendations to Elected Officials

Responsible budgeting requires accurate and timely data. Truthful budgetary accounting must incorporate all current compensation costs, including the portion of retirement benefits employees earn every year. Accurate accounting requires all real and certain expenses be reported in the state's budget and financial statements when incurred, not when paid. Therefore elected officials should:

- Use StateDataLab.org to develop a better understanding of their state's finances and to create graphs and charts to assist in the education of their constituents.
- Require the early implementation of the GASB amendments to the pension standard. These amendments require the inclusion of the state's unfunded pension liabilities on the face of its balance sheet.
- Take the first step to sound financial planning: determine the true financial condition of your state. We have demonstrated how to do this in each state's "Financial State of the State". See Appendix VIII-Roll-Out of the States.[viii]
- Start to follow the intent of your state's balanced budget requirement. Balanced budget requirements exist in state constitutions and/or statutes to prevent current legislatures and governors from passing current period costs onto future period taxpayers. This is a matter of equity; it is simply not fair for one generation to burden a future generation with costs for which no services or benefits are received.
- Recognize that responsible budgeting requires truthful data based upon sound accounting principles.
- Institute Full Accrual Accounting Calculations and Techniques (FACT) based budgeting which would include all costs when incurred not when paid. See the features of FACT based budgeting in 2010 report, which can be found at StateDataLab.org.
- Include in budget calculations the costs and obligations associated with pensions and retirees' health care benefits which, like salaries, are a form of current compensation.
- Leave actuarial assumptions to professional actuaries.

[viii]The electronic version of this document and of each state's detailed Financial State of the State can be found at: StateDataLab.org.

- Create no additional Taxpayer Burden and reduce the burden you have inherited as quickly as possible.
- Mandate the issuance of the state CAFR no more than 180 days after fiscal year end and prior to the budget negotiations for the next budgetary cycle.
- Provide the resources, including a centralized computer system and the personnel, needed to prepare the CAFR within 180 days.
- Require pension and retirees' health care plans' actuarial valuations be prepared using the same fiscal year end as the state CAFR and issued annually before the CAFR.
- For states that participate in multi-employer, cost-sharing plans, require the plans' actuaries to calculate and disclose each employer's share of the Unfunded Actuarially Accrued Liabilities and mandate the statecraft preparer to include this information in the financial report's notes. The CAFR of the Wisconsin Department of Employee Trust Funds for the year ended December 31, 2009 provides a good example of such disclosure. (13)

Recommendations To State Financial Report Preparers

- Encourage the early implementation of GASB's new pension standard.
- See additional recommendations in our 2010 report, which can be found at StateDataLab.org.

Recommendations to Accounting Standards Setters

Many of Truth in Accounting's concerns about pension liabilities reporting will be addressed when states implement GASB's amendments to pension reporting. Statements No. 67, Financial Reporting for Pension Plans, and No. 68, Accounting and Financial Reporting for Pensions, will improve the accounting financial reporting of pension information by state and local governments and pension plans. The provisions of these amendments should be extended to include the disclosure and reporting requirements for Other Post-Employment Benefits.

See additional recommendations in our 2010 report, which can be found at StateDataLab.org.

Recommendations to the Public and Public Interest Organizations

- Use StateDataLab.org to create a better understanding of your state's finances and to create graphs and charts to assist in the education of your fellow citizens.
- Encourage your governor and legislators to follow the intent of your state's balanced budget requirement by truthfully balancing the budget.
- Promote accountability of your elected officials by demanding that your state's financial burden not be increased and be reduced as quickly as possible.
- Encourage the early adoption of GASB's new pension reporting requirements.
- Until those changes are made, keep in mind that the liabilities reported on your state's balance sheet do not necessarily include all of the state's pension and retirees' health care liabilities.
- With that caveat, read your state's Comprehensive Annual Financial Report including all notes about retirement systems. To find a link to your state's financial report click on your state on the map at StateDataLab.org.
- Understand the financial condition of your state by reviewing its Financial State of the State. A link to your state's 2012 Financial State of the State can found in Appendix VIII and onStateDataLab.org. Each state's 2013 Financial State of the State will be available on StateDataLab.org when it is completed.
- Demand that state actuarial reports be readily available to outside analysts. This could be in the form of links in the electronic version of your state's CAFR and a note in the hard copy version. This will increase transparency regarding the assumptions used to calculate your state's retirement plans' unfunded liabilities and needed contributions and the employees' eligibility requirements.
- Let governmental officials know you expect them to implement the recommendations to CAFR preparers outlined in 2010 report.
- Educate legislators on the value of introducing and obtaining sponsors for an act to require truthful accounting in your state and local governments. A pro forma Truth in Accounting Act for Illinois is included in our 2010 report.

METHODOLOGY

To see detailed discussion of methodology go online at the bottom of StateDataLab.org and click on "About". On the right side of next screen click on "Accounting Methodology."