

**MEMORANDUM**

TO: File No. 4-610

FROM: Alicia F. Goldin  
Division of Trading and Markets

DATE: May 26, 2011

RE: Meeting with Richard Ciccarone, Merritt Research Services, LLC (Merritt)

On April 27, 2011, Richard A. Ciccarone, President and Chief Executive Officer of Merritt, met with Commissioner Elisse B. Walter; Cyndi Rodriguez and Lesli Sheppard from the Office of Commissioner Walter; David Sanchez and Alicia Goldin from the Division of Trading and Markets; and Amy Starr and William Hines from the Division of Corporation Finance, to discuss issues related to the municipal securities market, and in particular, the timeliness of financial reporting by municipal issuers. Mr. Ciccarone provided a copy of Merritt's study on the timeliness of annual governmental audits, entitled "Just How Slowly Do Municipal Bond Annual Audit Reports Waddle in after the Close of the Fiscal Year?" and a document providing recent data, both of which are attached to this Memorandum.

**Just How Slowly Do Municipal Bond Annual Audit Reports Waddle in after the Close of the Fiscal Year?**

By the time many annual governmental audits are received, many capital markets analysts and investors believe that they have lost significant value for assessing the current financial position of a municipal bond issuer. But the range in reporting time is huge among the slowest and fastest municipal bond borrowers when it comes to closing the books and providing the information to the public. Certain municipal bond credit sectors are also much better than others relative to the completion of their audits.

In our analysis of over 14,000 audits on more than 4,600 different municipal bond entities received by Merritt Research Services, LLC, spanning a three-year period, we found that the average time it takes for an audit document to be signed after the close of the fiscal year is about five months. While the time it takes to release the signed audit to the public was not a part of the study, our experience is that it can often take an additional month or more before the document is officially approved by a governmental body and made available to the general public.

While the Securities and Exchange Commission (SEC) requires corporate borrowers (depending on the size of their common equity outstanding) to file their annual audit reports (10-K) within 60 to 90 days after the close of their business year, municipal bonds are exempt from the requirement. The Municipal Securities Rulemaking Board (MSRB) recently requested but not required that annual reports be submitted to its Electronic Municipal Market Access (EMMA) data center within 120 days after the close of the fiscal year, but there are no enforcement penalties for non-compliance. The Government Finance Officers Association (GFOA) requires that documents be completed no later than six months after the government's fiscal year in order to receive its Certificate of Achievement for Excellence in Financial Reporting. The Governmental Accounting Standards Board (GASB), which establishes financial reporting standards for governmental bodies, has used the six-month time period as an unofficial minimum guideline but recently has been taking input from investors on their satisfaction relative to the timing of audits.

**Findings:**

- Looking at three years of audits covering the period from 2007 to 2009, the average time it takes for an audit letter to be signed after the close of the fiscal year for 16

sectors studied was **146.6 days (4.9 months)**. The number of calendar days after the fiscal year end only comprises the time to complete the audit. It does not include the time spent after the audit is signed for a public body to review it, approve it (if necessary), and disseminate it to the public as well as the markets. Depending on the size of the oversight board and the sophistication of the entity and their speed to send out their documents, an additional 30 days or more may be added to the time lapse prior to the release of this document to the public .

- Large single-purpose wholesale electric agencies showed the speediest record as a group, with a median time of just slightly over three months from the end of the fiscal year. On the other end of the spectrum, state governments were the slowest group to release their audits, which took a median time of just under six months.
- While municipal market participants often anticipate a six-month time span before the audit is completed, the range can vary dramatically by sector and by individual governmental bodies or agencies. For example, the fastest city had its audit completed and signed in 64 days while the slowest took 367 days – even though both were located in the state of New York. Hospitals ranged from as late as 380 days to as fast as 38 days. States took as long as 402 days in Tennessee to as short as 115 days in New York. No state would have passed the SEC corporate requirement of 60 to 90 days.
- Credit quality was not necessarily a factor in how fast or slow the audit was completed; however, weaker or more distressed credits were often more likely to be found on the list of late audits.

### **Fastest and Slowest Credit Sectors by Reporting Time**

- Wholesale electric utilities, which showed the best three-year median time to get their audit done (92 days), cover large federally created utilities and regional joint action agencies. There were 348 annual reports counted in the sector over the three-year period belonging to about 115 different entities. For the most recent fiscal year (2009), the five best and worst reporters were:
  - **Best:** Bonneville Power Administration, OR, a federal power GSE (30 days), Associated Electric Co-operative, MO (39 days), Northern Municipal Power Agency, MN (47 days), Central Valley Financing Authority, CA (50 days) and Sacramento Power Authority, CA (50 days).

- **Worst:** West Texas Municipal Power Agency, TX (170 days), Northern California Power Agency (148 days), Alabama Municipal Electric Authority (141 days), Arkansas River Power Authority, CO (133 days) and the MSR Public Power Agency (132 days).
- The slowest reporting municipal credit sectors come from state and local governments themselves (excluding school and special districts) and not their agencies or authorities. States, counties and cities generally finished their audits in approximately six months. As is the case for all municipal sectors, this time span did not count any additional days subsequent to the audit signing before the documents were distributed to the public. Within these three important categories of municipal audits, covering a count of nearly 2,500 annual audits, there is a wide range of reporting times suggesting that more complicated accounting rules and complex activities are not necessarily an excuse for late audits. New York City, which is the largest and possibly the most complicated of all cities, was able to complete its audit in 115 days.
- In the governmental category, states **and territories took the most time to finish their audits.** As a group, the median time it took the states to get their audit signed in 2009 was 176 days (three-year average of 177.7 days), which was just short of six months. Hawaii, the Virgin Islands, and Puerto Rico state audits were not received by Merritt as of the date of this study. In 2008 and 2007, these governments were slow reporters.
  - **Best States in 2009 : Fastest States to Complete Audit (based on number of days after the end of fiscal year)**

<u>State</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
New York	115	116	114
District of Columbia	120	122	183
Utah	146	157	143
Michigan	150	92	89
South Carolina	157	135	138

- **Worst States in 2009: Slowest States to Complete Audit (based on number of days after the end of fiscal year)**

<u>State</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Tennessee	402	165	160
Illinois	365	375	361
Arizona	311	330	352
Ohio	304	459	300
Rhode Island	280	283	282

- **Counties** followed close behind the states. The median time spent by the counties to get their 2009 fiscal year audits signed was 170 days, while the three-year average was 172.3 days. Over 876 audits representing more than 250 counties were used in our study. The following best and worst results were found:

- **Fastest to complete audit in days after FY End 2009(based on number of days after the end of fiscal year):**

- Santa Barbara County, CA 59
- Manatee County, FL 65
- Sarasota County, FL 79

- **Slowest to complete audit in days after FY End 2009(based on number of days after the end of fiscal year):**

- San Joaquin County, CA 274
- Humboldt County, CA 274
- Clackamas County, OR 274

- **Cities** were slightly faster than states and counties but not by much. The median time to get their audits signed in 2009 was 166 days, while the three year average for cities was 167.7 days. Over 1403 audits for over 450 different cities were collected to compile these results.

- **Fastest to complete audit in days after FY End 2009(based on number of days after the end of fiscal year):**

- Perinton, NY 64

- East Tawas, MI 65
- Florence, KY 65
- **Slowest to complete audit in days after FY End 2009 (based on number of days after the end of fiscal year):**
  - Freeport Village, NY 367
  - Detroit, MI 332
  - Bayonne, NJ 321
- Most non-profit hospitals and private higher education organizations have managed to consistently complete their audits in less than four months, which is significantly below the 141-day average for all the municipal credit sectors included in the study. These two credit sectors are often considered among the riskiest in the municipal investment grade world.
  - Hospitals over the three-year time period as well as in 2009 achieved the second fastest reporting time of all municipal bond credit sectors. The average audit time for hospitals over the three-year study period was 106 days based on 3,148 audits received. For fiscal years 2008 and 2009, approximately 1,000 hospitals reported a median audit time of 107 days in both years. The fastest-reporting hospitals included organizations as small as the 35-bed Oak Valley hospital in California, which completed its audit report in 38 days, as well as large entities such as Memorial Healthcare, FL. and Mayo Clinic, MN, which signed their reports in 46 and 49 days, respectively. All three of these hospitals completed the job well within the SEC required timeline for public corporations.
    - **Fastest Hospitals to complete audit in days after FY End 2009(based on number of days after the end of fiscal year):**
      - Oak Valley Hospital District, CA 38
      - Memorial Healthcare Sys., FL 46
      - St. Claire Regional Med Ctr., KY 48
      - Mayo Clinic, MN 49
      - Keokuk Area Hospital, IA 49
    - **Slowest Hospitals to complete audit in days after FY End 2009(based on number of days after the end of fiscal year):**
      - Thomas Hospital, AL 380

- Sierra Kings Healthcare Dist., CA 328
  - Carilion Clinic Obl Group, VA 281
  - Baptist Hosp of Southeast Texas 262
  - John C Fremont Hlthcare Dist., CA 227
- Private colleges recorded a median time of 108 and 114 days, respectively, for 2008 and 2009 audits related to about 400 different colleges in the survey. The average audit time for private higher education over the three-year study period was 108 days based on 1,192 audits received. In this sector, smaller institutions tended to be slower reporters, however, exceptions were present such as for Alma College, MI which finished its audit in 58 days. The honors for getting its audit out fastest in its category went easily to Syracuse University, which was fastest in all three years of the study. In 2007, Syracuse University actually completed its financial report in 27 days.
- **Fastest Private Colleges to complete audit in days after FY End 2009 (based on number of days after the end of fiscal year):**
    - Syracuse University, NY 30
    - Alma College, MI 58
    - George Washington, DC 59
    - Marquette University, WI 72
    - St. Mary's College of California 72
  - **Slowest Private Colleges to complete audit in days after FY End 2009 (based on number of days after the end of fiscal year):**
    - Waldorf College, IA 263
    - Colleges of the Seneca, NY 254
    - Beloit College, WI 248
    - Stevens Inst. of Technology, NJ 245
    - Howard University, DC 241

### The Rest of the Credit Sectors

The remaining credit sectors included in the study are ranked below in the order of the best reporting times over the three-year period. The three fastest and slowest individual governmental entities shown are listed based on 2009 audit times only based on the number of days (shown in parenthesis after the government's listing) that have lapsed since the end of the fiscal year. The total number of audits in the study over the three-year time period for each sector is shown after the sector name in parenthesis.

<u>Sectors (total audits counted 2007-2009)</u>	<u>3-year average (in days)</u>
○ Tollways (134)	109.7
▪ <i>Best: Buffalo &amp; Fort Erie Public Bridge Authority, NY (41); Kansas Turnpike Authority, KS (60); Niagara Falls Bridge Commission, NY (65)</i>	
▪ <i>Worst: Cameron County International Toll Bridge System, TX (181); Connector 2000 Association Inc, SC (181); New Hampshire Turnpike System, NH (176)</i>	
○ Retail Electrics (1,362)	129.7
▪ <i>Best: Floresville Electric Light &amp; Power Sys, TX (29); Glencoe Light &amp; Power Commission, MN (35); Jonesboro City Water &amp; Light Plant, AR (36)</i>	
▪ <i>Worst: Freeport Village Electric Fund, NY (367); Flora Electric Fund, NY (307); Lusk Electric Fund, WY (267)</i>	
○ Public Higher Education (954)	136.7
▪ <i>Best: University of South Alabama, AL (44); Victoria County Junior College District, TX (46); Saginaw Valley State University, MI (51)</i>	
▪ <i>Worst: Univ. of North Carolina at Charlotte, NC (359); Hinds Community College District, MS (353); Brunswick Community College, NC (322)</i>	
○ Special Districts (64)	144.0
▪ <i>Best: Channahon Fire Protection District, IL (31); Lakeside Fire Protection District, CA (36); Castaic Lake Water Agency, CA (72)</i>	
▪ <i>Worst: Cook County Forest Preserve District, IL (181); Santa Clara Valley Water District, CA (181); Marion County Health &amp; Hospital Corp, IN (180)</i>	
○ Other Revenues (450)	144.7
▪ <i>Best: National Health Services, CA (45); Milwaukee World Festival, WI 50; UGAREF CCRC Bldg, GA (62)</i>	
▪ <i>Worst: Waukegan Motor Vehicle Parking Lot Fund, IL (379), Oregon Economic &amp; Community Dev. Dept (339), Ohio Administrative Knowledge System COPs (304)</i>	
○ Airport (346)	151.7
▪ <i>Best: Bishop International Airport, MI (49); Port Authority of NY and NJ, NY (57); Huntsville-Madison County Airport (59)</i>	
▪ <i>Worst: Ontario International Airport, CA (311); Burlington International Airport, VT (289); Los Angeles International Airport, CA (255)</i>	
○ School Districts (64)	152.0
▪ <i>Best: Maple Shade School District, NJ (24); Chester School District, NJ (31), Fairfield Independent School District, TX (32)</i>	
▪ <i>Worst: Oxnard Union H.S. District, CA (379); Pulaski County Special School District, AR (332); Richmond County Board of Education, GA (325)</i>	

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- Land Districts (324) 153.7
  - *Best: Boynton Beach Community Redevelopment Agency, FL (44); West Harris County MUD #10, TX (62); Detroit Local Development Finance Authority and Detroit Downtown Development Authority, MI (71)*
  - *Worst: Carson Redevelopment Agency, CA (307); Hemet Redevelopment Agency, CA (286); Compton Community Redevelopment Agency, CA (240)*
  
- Dedicated Tax (300) 154.3
  - *Best: Sarasota County Communications Services, FL (79); Ernest N Morial New Orleans Exhibition Hall, LA (82); Sioux Falls Sales & Use Tax Fund, SD (84); Allegheny Regional Asset District, PA (84)*
  - *Worst: Build Illinois Bond Retirement & Interest DS Fund, IL (365); Illinois Civic Center Bond Retirement & Interest DS Fund, IL (365); Metro Atlanta Rapid Transit Authority, GA (266)*
  
- Water Sewer (971) 157.3
  - *Best: Goleta Water District, CA (50); Johnson County Water District #1, KS (57); Contra Costa Water District, CA (58)*
  - *Worst: Tuckahoe Creek Service District, VA (336); Detroit Water Fund & Detroit Sewage Disposal Fund, MI (332); Madera Water & Sewer Fund, CA (324)*

*Richard A. Ciccarone  
President & CEO  
Merritt Research Services, LLC  
September 1, 2010*

*Background on Merritt Research Services, LLC*

*Merritt Research Services, LLC is an independent municipal bond data and research provider focused on credit information related to municipal bonds. Founded originally in 1985 as a part of Van Kampen Merritt Inc., it first began to collect municipal bond audits for its initial database software product called The Merritt System, which was launched in 1986. Ten years later, The Merritt System partnered with Investortools, Inc. to primarily release its data through Creditscope. In 2001, Merritt Research Services LLC was spun off from the Van Kampen Funds to become an independent municipal data research company. Today, Merritt Research, headquartered in Hiawatha, Iowa, collects municipal bond audits on over 8,000 municipal bond credits.*

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**MERRITT RESEARCH SERVICES AUDIT TIMING STUDY**  
 Time for Audits to be Completed by Municipal Sector (2007-2010 Preliminary)

	FY 2010	FY 2009	FY 2008	FY2007	4 YR Avg SECTOR AVERAGES	# REPORTS 2010	# REPORTS 2009	# REPORTS 2008	# REPORTS 2007	Total # of Audits Counted (last 4 yrs)
<i>AIRPORTS</i>	<i>140</i>	<i>152</i>	<i>158</i>	<i>154</i>	<i>151.0</i>	77.0	125	124	121	447
<i>CITIES</i>	<i>160</i>	<i>166.0</i>	<i>168.0</i>	<i>167.0</i>	<i>165.3</i>	365.0	680	628.0	594.0	2267
<i>COUNTIES</i>	<i>167</i>	<i>174.0</i>	<i>175.0</i>	<i>173.0</i>	<i>172.3</i>	142.0	371	381	354	1248
<i>DEDICATED TAX</i>	<i>145</i>	<i>156</i>	<i>159</i>	<i>151</i>	<i>152.8</i>	65.0	136	128	107	436
<i>HOSPITALS</i>	<i>103</i>	<i>108.0</i>	<i>107.0</i>	<i>105.0</i>	<i>105.8</i>	591.0	1179	1086	1104	3960
<i>LAND DISTRICTS</i>	<i>154</i>	<i>153.0</i>	<i>156.0</i>	<i>151.0</i>	<i>153.5</i>	97.0	138	125.0	109.0	469
<i>OTHER REVENUES</i>	<i>131</i>	<i>135.0</i>	<i>141.0</i>	<i>142.0</i>	<i>137.3</i>	139.0	239	214.0	173	765
<i>PRIVATE HIGHER EDU</i>	<i>111</i>	<i>114.0</i>	<i>107.0</i>	<i>102.0</i>	<i>108.5</i>	348.0	441	416	409	1614
<i>PUBLIC HIGHER EDU</i>	<i>128</i>	<i>141.0</i>	<i>140.0</i>	<i>138.0</i>	<i>136.8</i>	299.0	383	363.0	313	1358
<i>RETAIL ELECTRICS</i>	<i>125</i>	<i>133.0</i>	<i>138.0</i>	<i>129.0</i>	<i>131.3</i>	166.0	525	504.0	471.0	1666
<i>SCHOOL DISTRICTS</i>	<i>137</i>	<i>143.0</i>	<i>144.0</i>	<i>143.0</i>	<i>141.8</i>	936.0	1164	1049.0	881.0	4030
<i>SPECIAL DISTRICTS</i>	<i>108</i>	<i>140.0</i>	<i>141.0</i>	<i>173.0</i>	<i>140.5</i>	22.0	53	41	30	146
<i>STATES &amp; Territories</i>	<i>175</i>	<i>181</i>	<i>176</i>	<i>181</i>	<i>178.3</i>	48.0	51	53	54	206
<i>TOLLWAYS</i>	<i>116</i>	<i>116.0</i>	<i>109.0</i>	<i>106.0</i>	<i>111.8</i>	26.0	45	45.0	43.0	159
<i>WATER SEWER</i>	<i>152</i>	<i>154.0</i>	<i>158.0</i>	<i>155.0</i>	<i>154.8</i>	310.0	553	515.0	439.0	1817
<i>WHOLESALE ELECTR</i>	<i>90</i>	<i>90.0</i>	<i>96.0</i>	<i>88.0</i>	<i>91.0</i>	77.0	125	122.0	118	442
<b>Average for all sectors</b>					<b>139.5</b>	<b>3708</b>	<b>6208</b>	<b>5794</b>	<b>5320</b>	<b>21030</b>

Sectors in Red Font are slowest for audit to be completed

Sectors in Green Font are fastest for Audit to be completed

Source: Merritt Research Services, LLC, Hiawatha, Iowa

(2010 Data is in the process of being gathered. The number of total audits included to date represents about 60% of the 2009)

Data as of April 24, 2011

Additional Audits for 2010 will continue to be received after the data date of April 24.