Truth in Accounting

September 8, 2017

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Bean:

Project: 3-30

Thank you for the opportunity to provide comments on the Governmental Accounting Standards Board (GASB) exposure draft Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements. Truth in Accounting’s mission is to “To educate and empower citizens with understandable, reliable, and transparent government financial information.” We believe this exposure draft can help open an important door for citizen access to critical financial issues facing their governments.

Bank lending to state and local governments has been growing rapidly since the 2007-2009 financial crisis. This development can be seen in aggregate data provided by banking regulators as well as regulatory reports for individual banking institutions. It is not, however, readily or easily understood in the financial statements and footnotes for many state and local governments.

In “Money and Banking” finance courses, textbooks often stress how banks help solve “asymmetric information” problems, providing a credit channel for borrowers (many of them smaller borrowers) with restricted access to securitized financing. This advocated role for banks emphasizes how banks can keep valuable information private, and in the interest of the owners of borrowing firms as well as economic growth more generally.

For state and local government borrowers, however, credit channels like these can help hide blooming financial problems, and in areas where taxpayers and citizens, unlike the owners of privately-held firms, lack access to valuable “private” information.

Going forward, we encourage the GASB to provide standards leading to the clearest and fullest disclosure for bank debt possible. This should include leasing as well as other forms of borrowing (including bank investment in municipal bonds) in at least footnote disclosure. Historical data is critical for understanding trends and current conditions, and we also recommend disclosure on a common basis going back at least to 2005.

History has taught us to be watchful if not leery of rapid bank lending growth. The boom in real estate lending leading to the massive 2007-2009 financial crisis is our latest and greatest example. But the flowering of the savings and loan crisis in the 1980s is also instructive, in important part because of the critical role that false regulatory accounting principles played in masking the financial condition of failed but growing S&Ls.
Here are some related observations from an FDIC booklet titled “History of the Eighties: Lessons for the Future:”

The period from year-end 1982 to year-end 1985 was characterized by extremely rapid growth, as the industry responded to the new regulatory and legislative climate. Total S&L assets increased from $686 billion to $1,068 billion, or by 56 percent more than twice the growth rate at savings banks and commercial banks (approximately 24 percent). … Reported capital was further augmented by the use of regulatory accounting principles (RAP) that were considerably more lax than generally accepted accounting principles (GAAP).

That pamphlet was written in 1997. Unfortunately, many of those lessons went unlearned leading up to the 2007-2009 financial crisis.

Let’s not do this to ourselves again.

Taxpayers and citizens are exposed to risk in municipal government banking relationships in a number of ways, including risks to their governments (with taxing authority), as well as exposure via the diversion or application of new public money for banks facing future related credit losses.

New governmental accounting standards have offered a tardy but valuable recognition of massive debts long excluded from the debts on state and local government balance sheet. More complete disclosure of bank borrowing by governments is also moving in the right direction.

The public should be aware that lending from banks may be one element of a blooming crisis in state and local governments. The public deserves full disclosure of the relationships leading to the risks facing taxpayers and citizens.

Sincerely,

Bill Bergman

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