

Financing Procedures Checklists

Internal Disclosure Programs for Issuers, a two-part article authored by Robert Doty, American Governmental Financial Services Company, that appeared in the October and November DEBT LINE newsletter, discussed the concept of municipal securities issuer internal diligence and disclosure programs. The article made reference to the Financing Procedures Checklists available in an exposure draft from the International Municipal Lawyers Association (IMLA).¹

The following are among IMLA's checklist items:

A. Employment of Professionals

- √ Use written contracts directly with professionals.
- √ Comply with state procurement laws.
- √ Seek independent advice. Be careful about conflicts of interest when professionals change roles.
- √ Be aware that legal and financial professionals participating in the transaction are relying upon your jurisdiction for information.
- √ Be aware that legal and financial professionals participating in the transaction, unless contractually obligated or otherwise undertaking to do so, may not consider they are responsible for rendering advice to your jurisdiction.
- √ Your jurisdiction's official statement should be prepared by experienced professionals having direct contractual relationships with your jurisdiction.
- √ Be aware of limitations of disclosure opinions.
- √ A disclosure opinion is best rendered by a professional with whom your jurisdiction has a direct contractual relationship.

B. Reliance on Advice of Legal & Financial Professionals

- √ Your jurisdiction, as issuer, is considered to have a "primary" responsibility and "ultimate" liability for disclosure.
- √ Do not rely blindly upon professionals. Your jurisdiction may know more than they do.

¹ The Checklists, which serve as guides to issuers in the design and administration of diligence and disclosure programs, are available from IMLA on their website at www.imla.org, by contacting them at 7910 Woodmont Avenue, Suite 1440, Bethesda, Maryland 20814, or by phone at (202) 466-5424.

√ If your jurisdiction is seeking to rely upon professional advice, ask well-formulated formal written questions, obtain written answers, and satisfy the SEC's requirements for such reliance.

√ Read everything that your jurisdiction is signing.

√ If you do not understand something (keeping in mind that you are not an expert), ask questions until you do.

C. Reliance on Specialized Experts

√ Your jurisdiction should employ, have written contracts with, and pay experts, such as feasibility consultants, appraisers, auditors (with reimbursement from private parties, as appropriate).

√ Review expert reports carefully and completely.

√ Experts should identify their assumptions in their reports, and should state in their reports that the assumptions are reasonable.

√ Expert work products should be addressed to your jurisdiction.

√ Satisfy yourself as to an experts' independence, competence, appearance of performance, applicable industry standards, compliance with those standards, and access to information. Expert reports should speak to such matters.

√ Obtain written consents from experts as to use of their names and work products in official statements and to your jurisdiction's reliance upon them as experts.

Experts: Experts in a municipal securities offering may be feasibility analysts, property appraisers, market analysts, auditors, lawyers or a variety of other parties with specialized expertise who prepare, as their work products, opinions, reports, studies or other analyses that assist in the financing process.

D. Internal Informational Due Diligence Procedures

√ Review carefully the entire official statement.

√ Ask for reviews of specific categories of information by potentially knowledgeable sources within your jurisdiction as to material accuracy and completeness and review potentially relevant source documents.

√ Review outdated ("stale") financial statements, expert reports and other information with special care. Update that information, as appropriate, even if it results in a delay.

√ Ask for a complete review of the official statement at a high executive or administrative level within your jurisdiction.

- √ Avoid overstatement and other casually framed language.
- √ Deliver the final versions of official statements to the members of your jurisdiction's governing body a sufficient time prior to their action in approving the document to accommodate their careful review.
- √ Explain to your jurisdiction's executive or administrative officials and governing body members why it is important for them to review the official statement carefully.
- √ Follow your jurisdiction's established internal financing guidelines or checklists, or ask your governing body to make findings as to why that is not done.

Materiality: In general, information is considered to be “material” under the federal securities laws, if it would affect the investment judgment of a reasonable investor. That is, as to an omitted fact, the fact is “material,” if the “omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”²

Due Diligence: In general, “due diligence” is the careful process of conducting a sufficient affirmative investigation of information used in an official statement to gain a reasonable basis for belief that material misstatements are not made and that material information is provided in the document.

E. Representations & Certifications

- √ Read carefully all agreements, representations and certifications your jurisdiction is signing in the transaction. As necessary, consult with other officials of your jurisdiction for their review of particular provisions.
- √ Ask for explanations of any agreement, representation or certification you do not understand.
- √ Correct any agreement, representation or certification that is erroneous.
- √ Ensure that the agreements, representations and certifications are fair to your jurisdiction.
- √ Do not let your jurisdiction represent or certify, in an unqualified manner, anything that it does not know of its own knowledge.

F. Use of Third Party & Public Information

- √ Do not use information in an official statement unless you consider the source reliable.

² *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976); *Basic Inc. v. Levinson*, 485 U.S. 224, 232, 108 S.Ct. 978, 983, 99 L.Ed.2d 194 (1987).

- √ When information used in an official statement comes from third parties, explicitly attribute the information in the official statement to those parties.
- √ When third parties providing information are interested in the transaction, segregate their information as much as possible in a separate section or appendix of the official statement.
- √ Obtain the third parties' written authorization for use of and approval of their information and their signatures in the segregated portion of official statement.
- √ Your jurisdiction should not approve that interested third party information.
- √ The third parties should certify to your jurisdiction the material accuracy and completeness of the information they provide.

Conduit Offering: A conduit securities offering is one in which your jurisdiction acts in an accommodating role to assist a nonprofit corporation or private business in obtaining funds. Your jurisdiction is not the principal party with a substantive interest in a conduit transaction.

G. Private Placements

- √ Provide private placement investors with materially accurate and complete information, even if in a less formal format than an official statement.
- √ Be aware that even documents in such transactions appearing to be form documents actually are negotiable.
- √ Consider seeking a professional review of the documentation.
- √ If desired, especially (but not solely) when a private placement is conducted due to special transactional risks, limit the ability of the investors to subdivide the financing documentation into certificated form and to sell it into the broader market or to unsophisticated investors.
- √ Obtain disclosure to your jurisdiction of all fees paid in private placements to “lease brokers” and others.
- √ Consider placing transactional costs in private placements into principal, rather than higher interest rates, and negotiate more flexible prepayment provisions.
- √ In transactions involving significant risks, consider obtaining an “investment letter” from private placement investors stating that they understand risks, have received the information they need, and are conducting their own investigations, and agreeing to restrict resales.
- √ Ask whether “lease brokers” or others serving in similar roles are registered as broker-dealers, and if not, why not.

Private Placement: In order to reduce issuance costs, an increasing number of local governments have begun to look to private placements, usually (but not always) to a single investor. That occurs especially as to small negotiated “lease” financings for equipment or smaller structures, such as approximately \$3 million or less, although larger private placements also occur. Private placements also may be utilized in transactions entailing special risks inhibiting effective sale in the broader securities market. The desire to reduce costs may lead to less formal legal or financial procedures, such as more casual financing document preparation and avoidance of an official statement or other formal disclosure documentation. While saving costs is a laudable goal, you should consider the extent to which your jurisdiction is adequately protected in such a transaction, and how to enhance those protections.

H. Continuing Disclosure

- √ Continuing disclosure occurs in most municipal securities offerings. Exceptions include short-term or floating rate securities and private placements. The documents are filed with national repositories.
- √ Continuing disclosure occurs pursuant to undertakings or agreements into which your jurisdiction enters in securities transactions in accordance with SEC Rule 15c2-12.
- √ It is important for your jurisdiction to file continuing disclosure reports in timely manner. Those reports are filed with designated national repositories.
- √ An easy, inexpensive method of, but not the sole alternative for, filing a continuing disclosure report is through the central post office maintained at DisclosureUSA. Some private services will undertake the required filings in conjunction with other services they provide for a fee.
- √ Similar investigative and review procedures to those used in the preparation of official statements apply as to the information contained in a continuing disclosure report.
- √ If additional material information is relevant to the subject matter of the required continuing disclosure information, it is best to include the additional information in the continuing disclosure report.
- √ CUSIP numbers (which should be contained in the official statement) should be placed on the cover of each continuing disclosure report to simplify filing, record keeping by the repositories, and access by interested parties.
- √ Continuing disclosure reports should be filed as single documents in PDF or other electronic formation.
- √ With respect to investor inquiries to your jurisdiction, because investors may seek information from disparate sources within your jurisdiction, appoint a knowledgeable person to serve as a central contact in order to coordinate responses and avoid investor misinformation.

√ If material information is identified in connection with investor inquiries, make it available through an appropriate means to the market.

I. Websites

√ Be aware that investors may use your jurisdiction's website as a source of information.

√ Websites, if properly used and maintained, can be a useful form of communication with the investment community for the benefit of your jurisdiction. If not properly managed, however, websites can be problematic.

√ Appoint a knowledgeable person to be in charge of website oversight with respect to investor information.

√ Consider seeking professional advice regarding your jurisdiction's website's operation and, as appropriate, particular information that may be placed thereon.

√ Identify information for investors and segregate it from other website information that serves nondisclosure purposes.

√ Review website investor information for material accuracy and completeness with respect to the subject matters included on the website

√ Keep investor information materially current, and identify it as to date.

√ Outdated ("stale") information should either be removed from the website or clearly identified as such in a segregated, clearly identified archive.

√ Be careful of links to the websites of other parties. Inform users of your jurisdiction's website that they are leaving the website and that your jurisdiction does not warrant the accuracy or completeness of the information on those other websites.