

June 24, 2025

Mr. Alan Skelton
Director of Research and Technical Activities
Project No. 3-31
Governmental Accounting Standards Board
801 Main Avenue, P.O. Box 5116
Norwalk, CT 06851

Via email to askelton@gasb.org

RE: Governmental Accounting Standards Board's Preliminary Views, *Severe Financial Stress and Probable Dissolution Disclosures*

Dear Mr. Skelton:

The National Federation of Municipal Analysts (NFMA) is pleased to respond to the Governmental Accounting Standards Board's (GASB) Preliminary Views, *Severe Financial Stress and Probable Dissolution Disclosures* (PV).

The NFMA is a not-for-profit association with nearly 1,200 members in the United States, comprising a broad range of municipal bond analysts from the buy-side, sell-side, rating agencies, and bond insurers. The mission of the NFMA is to enhance the professional development and analytical contributions of municipal market participants through best-in-class educational programs, networking opportunities, and targeted advocacy that supports improved disclosure to benefit the industry. The NFMA has published an extensive library of Best Practices in Disclosure and White Papers that are available on our website, www.nfma.org.

The NFMA supports the GASB's efforts to improve the transparency and quality of financial information available to help users of financial statements more accurately evaluate the credit attributes, trends, and fiscal health of governmental entities. The comments that follow are made in recognition of the clear alignment of interests that exists between the GASB's mission of good financial disclosure to users and our professional needs as analysts of municipal credit risk.

The NFMA generally agrees with the proposals in the PV. The following outlines our reasons for supporting the proposals, as well as our concerns and recommendations related to certain aspects.

Chapter 2—Relationship between Severe Financial Stress and Probable Dissolution

We agree that governments should separately assess whether they are exposed to severe financial stress and whether dissolution as a separate legal entity is probable. Although disclosure about a government potentially ceasing to exist is valuable to our members, it is of greater importance to



know about circumstances in which a government is experiencing severe financial stress. Disclosures about by a government meeting the severe financial stress condition directly inform key factors in our evaluation of the creditworthiness of municipal issuers. It is vital that municipal analysts receive such information from governments when financial difficulties arise, well before dissolution is even a consideration. Because many governments cannot cease to exist, legally or practically, regardless of the severity of their financial condition, the financial statements may never directly address the existence of severe financial stress under existing standards. This proposal would therefore address a major shortcoming in financial reporting at present.

Chapter 3—Assessment of the Severe Financial Stress Condition

We agree that disclosure should be required when a government meets the definition of severe financial stress: “near or at the point of insolvency.” However, we are uncertain about the proposal to assess severe financial stress as of the financial statement date (in general, fiscal year-end). We understand the conceptual and practical reasons for this decision but believe it will be difficult to apply to a condition that is inherently time related.

This is evident in the proposed definition of insolvency as “generally...not paying its liabilities as they come due or is unable to pay its liabilities as they come due.” It is possible that a government may routinely make payment on its liabilities after their due date and not be experiencing severe financial stress. Consequently, the implications of “as they come due” for determining whether the severe financial stress condition is met are unclear. Clarity may be needed as to the point at which one would conclude that a government is not paying or is unable to pay its liabilities, such as a significant period (perhaps 90, 120, or 180 days) without payment. Alternatively, the severity of nonpayment might be expressed as a significant divergence (perhaps 10 or 20 percent) over multiple years from a government’s historical average number of days before payment. Ultimately, we recommend either reflecting the severity of the lateness of payment in the definition or removing “as they come due.”

Another concern related to assessing severe financial stress as of the financial statement date rather than as of the date the financial statements are available for issuance (as proposed for possible dissolution) involves events or changes in circumstances after fiscal year-end that could lead to a different conclusion. For example, if a government determines that it meets the severe financial stress condition as of the end of the fiscal year but events after fiscal year-end resolve the key factors that led to that determination, we would expect those events to be disclosed under the standards for subsequent events; however, that disclosure would not say that the government was no longer experiencing severe financial stress. On the other hand, a government that did *not* meet the severe financial stress condition at fiscal year-end but subsequently experienced events that would result in it meeting the condition might disclose them separately as subsequent events but would not be required to state that they are now experiencing severe financial stress.

Additionally, we believe some clarity may be needed as to whether the severe financial stress condition encompasses both chronic long-term financial stress and periodic acute financial stress. We are aware of governments that have been in seemingly perpetual dire financial straits for



lengthy periods. The proposed disclosures would be valuable when analyzing such a government, but it is unclear whether the disclosures, repeated annually for many years by an individual government, would be as meaningful as for a government that is newly facing severe financial stress.

We agree that the example indicators of being near insolvency in paragraph 22 generally are appropriate. However, we believe that one of the indicators should more explicitly address *liquidity*, which is a key concern of our members and has been shown to be a central factor in municipal bankruptcies. Although liquidity may be implicit in some of the proposed indicators—such as consistent working capital deficiencies and increased reliance on short-term borrowings—we believe it to be sufficiently important to be cited separately. Such an indicator might be described as “declining liquidity, such as due to the rapid depletion of cash.”

We recommend that some of the other indicators be clarified in a manner that more clearly reflects that they are uncommon and severe. For example:

- A school district closing school buildings due to unused space may be considered a reduction in service by some but an improvement in efficiency and reduction of unnecessary costs by others.
- Growth in the amount borrowed short term may be consistent with overall growth in a government's operating budget, as distinguished from short-term borrowing that increases substantially as a proportion of the operating budget.

We believe that issuers should consider all potential factors that may indicate severe financial stress. Therefore, we would prefer that the potential indicators identified in paragraph 26 be included in an evaluation as to whether the condition exists. For instance, we believe that “continuing negative operating cash flows from business-type activities” and “loss of a critical license or patent for a business-type activity” both may indicate a current condition of financial stress, if they have already occurred, and are “strong enough to indicate that a government may be near insolvency.” Additionally, although “government-wide labor force reduction” may be related to reducing services (paragraph 22b(1)), it is sufficiently distinct to be included as a separate indicator; broad-based layoffs may be utilized to avoid disproportionate reductions in specific services, to a degree that the “reduce services” indicator would not be applicable.

Chapter 4—Severe Financial Stress Disclosures

We agree that governments that meet the severe financial stress condition should make the disclosures proposed in paragraph 2 for the primary government, including its blended component units.

The proposed disclosure of “actions taken by the government in response to the SFS condition prior to the date the financial statements are available to be issued” may be helpful in addressing our previously stated concerns about assessing severe financial stress as of the financial statement



date. However, it does not avoid the potential confusion caused by a government disclosing it met the severe financial stress condition at fiscal year-end, despite having taken actions that result in the condition no longer being met by the time the financial statements are issued.

If the definition of severe financial stress is amended as we recommend above to include in indication of the magnitude of late payment or nonpayment, we recommend that the required disclosures include information about the lateness of payments (for example, the average number of days beyond the due date).

Regarding the disclosure of “the known effects of the SFS condition,” we recommend adding “significant difficulty accessing credit markets” and “the cost of borrowing or security provisions become prohibitive” as examples.

We also agree with the disclosures proposed in paragraphs 5 and 7 for governments that made the severe financial stress disclosures in the preceding reporting period. We recommend that governments that continue to meet the severe financial stress condition also be required to disclose that they met the condition in the preceding period (or periods, if more than two years consecutively).

Chapter 5—Evaluation of Probable Dissolution

We agree that disclosure should be required when it is probable that a government will cease to exist as the same legally separate entity within 12 months of the date the financial statements are available to be issued. We recommend that this guidance indicate that probable means “likely to occur,” as is done elsewhere in GASB standards.

Chapter 6—Probable Dissolution Disclosures

We agree that governments that are probable of ceasing to exist (as defined in chapter 5) should make the disclosures proposed in paragraph 2 for the primary government. However, it is unclear why disclosure of the probable dissolution of a blended component unit is relevant when the primary government will continue to exist. Therefore, we recommend that disclosures regarding the primary government’s blended component units should be limited to circumstances in which dissolution of a blended component unit (1) is a relevant factor in concluding that dissolution of the primary government is probable or (2) will have significant financial ramifications for the primary government (for instance, because the component unit constitutes a sizeable proportion of the primary government, or because the component unit issues debt for which the primary government would be responsible, regardless of the component unit’s size relative to the primary government).

Regarding the proposed disclosure of “information about the recoverability or classification of reported asset amounts or the amounts or classification of liabilities,” we recommend that this disclosure specifically address whether and which assets of a blended component unit that is probable to dissolve would revert to the primary government, and whether and which liabilities



would be assumed by the primary government. We also recommend that the disclosure indicate whether the recoverability, classification, or amounts are subject to ongoing legal proceedings.

We also agree with the disclosures proposed in paragraphs 5 and 7 for governments that made the probable dissolution disclosures in the preceding reporting period. We recommend that governments that continue to make the probable dissolution disclosures also be required to disclose that they met the condition in the preceding period (or periods, if more than two years consecutively).

We thank you for the opportunity to provide our comments on the Preliminary Views and would be happy to discuss our feedback in follow-up communications. We have encouraged our members to consider participating in your planned public forums.

Sincerely,

/s/

Dean Michael Mead
NFMA Representative to GASAC

