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May 31, 2025

Governmental Accounting Standards Board
801 Main Avenue
Norwalk, CT 06856

RE: Comments on GASB Project No. 3-31, Preliminary Views – *Severe Financial Stress and Probable Dissolution Disclosures*

The Financial Management Standards Board (FMSB) of the AGA appreciates the opportunity to provide comments on the Governmental Accounting Standards Board's preliminary views. Our answers to the questions posed by the Board are as follows.

Question 1: Which of the proposals do you agree with?

We agree it would be beneficial to recognize probable dissolution as a separate assessment from severe financial stress. Governments have legal authority that can allow them to be insolvent without forcing them to dissolve, which can sometimes be confusing in practice if these two aspects of the extant going concern uncertainty are conflated. By bifurcating these assessments, it allows for both the evaluations and disclosures to be more understandable and precise.

Question 2: Which of the proposals do you disagree with?

Our group expressed concerns regarding the assessment of severe financial stress, in particular the term and criteria for "near insolvency." Those concerns revolve around understandability, judgment involved, and alignment with other GASB standards or audit standards. However, members differed on the degree and reasons for concern.

Question 3: Do you believe the proposed provisions would be operable and auditable?

Going concern uncertainty is highly important to financial statement users. However, reporting a going concern uncertainty is also a highly sensitive situation that may be subject to strong political or economic pressures and motivations. While this may be a judgment that preparers and auditors must make independently, it would benefit from the maximum possible clarity and precision. This not only makes for a more operable and auditable judgment, it also means that users will be able to have greater understanding and reliance on those definitions and criteria.

In Question 1 we describe how we see the bifurcation of severe financial stress from probable dissolution as an improvement to operability and audibility.



In Questions 6 and 10 we describe our concerns regarding the ambiguity of the “near insolvency” criteria and potential misalignment or ambiguous alignment of the severe financial stress assessment with other GASB standards and audit standards.

And in Question 8 we describe our suggestions for improving the examples of probable dissolution factors to make them more operable and auditable.

Question 4: What feedback do you have on Chapter 1 (Objective and Background)?

We agree that going concern uncertainty is an important topic and that there have been challenges and diversity in practice in applying it to the government environment. Compared to private sector entities, governments very rarely default on obligations or declare bankruptcy. And even in such cases, state and local governments have legal protections and authority that may allow them to continue operations even in an insolvent state, which can be a source of confusion for applying extant requirements. Therefore, we agree with the direction of the project.

We further agree with pre-agenda research that there is no consistently reliable set of predictive financial ratios or warning indicators. For this reason, we affirm that the subject of assessment and disclosure should be directly focused on the potential for insolvency and dissolution rather than indirectly focused on financial indicators.

Question 5: What feedback do you have on Chapter 2 (Relationship between SFS and PD)?

We agree that severe financial stress and probable dissolution are separate, but not mutually exclusive. We see benefit in separating these two concepts, since some of the confusion in applying extant going concern uncertainty guidance has to do with governments experiencing one but not the other. However, we would be concerned if GASB does not specifically identify how these two concepts align with the extant concept of going concern uncertainty. Given that preparers will often face strong motivations or pressures to avoid an audit conclusion of a substantial doubt about the ability to continue as a going concern, it is imperative that criteria and alignment with audit standards be as clear as possible.

Our group had mixed views on defining severe financial stress as a condition existing as of the financial statement date. Some members appreciated the idea of making the assessment a historical disclosure based on known information rather than a forward-looking one that may be based on estimated likelihood of future outcomes. Other members expressed concern about potential misalignment or ambiguous alignment with audit standards. Our group also had concerns about alignment between these assessments and other GASB standards, such as subsequent events, certain risk disclosures, troubled debt restructuring, bankruptcies and government combinations. We also noted potential concerns with alignment between assessments for severe financial stress and probable dissolution, since these are not mutually exclusive, yet are assessed as of different dates and for different time horizons. These linkages to audit standards and between areas of GAAP should be clear.

Question 6: What feedback do you have on Chapter 3 (Assessment of SFS)?

Our group discussed a variety of real and hypothetical scenarios and ended up without a clear consensus on how criteria would be applied. For example:

- Would it be possible to report a probable dissolution due to insolvency within 12 months of financial statement issuance, but not a severe financial stress disclosure because the government was not in that condition at the financial statement date?
- Would it be possible to report a certain risk disclosure that indicated likely insolvency within 12 months of financial statement issuance, but not a severe financial stress disclosure because the government was not in that condition at the financial statement date?
- If a government subsequently and unexpectedly loses a lawsuit or suffers a catastrophic event that leads to insolvency or consideration of bankruptcy, would it be possible for this to be a subsequent event disclosure but not a severe financial stress disclosure, since the government was not in that condition as of the financial statement date?
- How close to insolvency is “near?”
- If a special purpose government has little or no working capital and operates on a reimbursement basis or is otherwise reliant on revenues received just after fiscal year end, would it be considered “near” insolvency at year end because it is objectively “in close proximity to the level of stress represented by insolvency?” To this point, we note that consistent working capital deficiencies is an example indicator in paragraph 22(a)(2), and paragraph 20 explains that a government might be able to maintain itself in a severe financial stress condition without actually becoming insolvent. While our group is aware of many examples of these types of governments and do not consider them to be in severe financial stress, we were concerned that this conclusion seemed questionable under the criteria given in the preliminary views.
- Similarly, our group is aware of many examples of governments that have longstanding deficit unrestricted net positions that we would not consider to be in severe financial stress. However, this is also listed as an example indicator in paragraph 22(a)(1), and we were similarly concerned that a conclusion to the contrary would seem questionable given the ambiguity of “near.”
- How would subsequent events, the timing of expected future cash flows or expected resolution of plans or contingencies, or the rate at which a government’s condition might be projected to decline or improve affect the assessment of “near insolvency,” since the assessment is expressly limited to the financial statement date and without regard to a time horizon?

During these discussions, our group found it particularly difficult to discuss “near insolvency” without reference to a time frame for actual insolvency or financial impacts. In part, this difficulty was with the word “near” since it invokes the consideration of time. To this point, it would be preferable to use a word that does not include time in its common definition if this is not the Board’s intent, for example “nearly insolvent.” But ultimately, while we could individually speculate on potential answers to these questions, our overall concern was with the level of ambiguity to the criteria and how easily it was to make different judgments. This ambiguity was especially a concern given that governments may be highly incentivized to avoid disclosure, making clarity a critical factor for consistent and reliable reporting.

We agree that providing example indicators would be helpful to the assessment. However, different members expressed concerns about some of the indicators in paragraph 22 and how they would be applied. Specifically, (a)(1) and (a)(2) for reasons described above, all four items listed under (b) since these are common operational considerations and only in rare occasions are they related to severe financial stress, and (c)(1) and (c)(2) because we found the word “certain” to be too ambiguous. One member was also concerned about the ambiguity of example (b)(4) and suggested that it use the term “troubled debt restructuring” and be explicitly tied to existing guidance in GASB Codification D20.129-165 so as to avoid conflating severe financial stress with mere refunding or defeasance.

Another member pointed out that SEC Rule 15c2-12 requires certain continuing disclosures that might be associated with severe financial stress, and that it might be helpful to align these with examples in paragraph 22. This could be done by either using these continuing disclosures as example indicators or by including guidance that explains how they may be related to the severe financial stress assessment. Continuing disclosures that might be considered as indicators of severe financial stress would be:

- Payment delinquencies,
- Unscheduled draws on debt service reserves reflecting financial difficulties,
- Unscheduled draws on credit enhancements reflecting financial difficulties,
- Bankruptcy, insolvency, receivership or similar events, or
- Default, acceleration, termination, modification of terms, or other similar events for a financial obligation which reflect financial difficulties.

Question 7: What feedback do you have on Chapter 4 (SFS Disclosures)?

We agree with proposed disclosures. In particular, we appreciate the Board's preliminary views in paragraph 7 that a government previously disclosing a severe financial stress condition but no longer in that condition would disclose how the condition was alleviated. We thought this would provide meaningful information to users and be an appropriate means of resolving the matter.

Question 8: What feedback do you have on Chapter 5 (Evaluation of PD)?

We agree with the Board's preliminary views about the evaluation of probable dissolution. In particular, we appreciate that the time frame for assessment is converged with FASB, audit standards and other GASB standards such as subsequent events and certain risk disclosures.

We agree that providing example indicators would be helpful to the assessment. However, examples could be improved by focusing more on direct evidence about the probability of the event, rather than more indirect or speculative evaluation about whether the government's condition is viable or conducive to merger, acquisition or dissolution. It would also be helpful to make an explicit connection to the assessment of severe financial stress. To that end, we would suggest considering the following factors in lieu of those listed in paragraph 15:

- Legal processes by which the government could be dissolved, merged or acquired, and whether such processes are subject to dispute or legal challenge.

- Dissolution actions, such as governing body consideration, negotiations, or initiation of legal processes. This would include situations where such actions are described as part of a severe financial stress disclosure.
- Public statements or plans from the government and other relevant parties to support or oppose dissolution, merger or acquisition actions. This would include situations where such support or opposition is described as part of a severe financial stress disclosure.
- Potential for necessary legal processes to be completed within the time frame.

Question 9: What feedback do you have on Chapter 6 (PD Disclosures)?

We agree with the Board's preliminary views on probable dissolution disclosures. As with severe financial stress, we appreciate that resolution of a previously disclosed situation would be explained.

However, given that severe financial stress and probable dissolution are not mutually exclusive, we would prefer if requirements would be explicit as to how to organize disclosures to avoid unnecessary duplication in the event of both conditions. Also, while we appreciate the Board's consideration in paragraph 7 to align terms with GASB Codification Section Co10, we ask the Board to also consider whether the disclosures required in Co10.153-.156 will remain relevant, and if so, how these would be aligned with probable dissolution. Preparers may miss or confuse requirements if alignment does not occur. This may also be important for users, since labeling or describing a combined disclosure in terms of severe financial stress may give it different context than labeling or describing content in terms of probable dissolution or a government combination.

Question 10: What other feedback would you like to provide?

We expect GASB will work closely with AICPA and user groups to ensure alignment of accounting standards with audit standards and user expectations regarding going concern uncertainty. We are unsure how reasonable it might be to expect users to adjust their expectations or AICPA to amend audit standards to accommodate a fundamental variance in how going concern uncertainties might be assessed for state and local governments. While we acknowledge that GASB does not set audit standards and is not beholden to them, we would emphasize that this should be a cost-benefit consideration of new standards. Specifically, it would be of no advantage to preparers, auditors or users if the connection between preparer responsibilities and disclosure on this matter compared to audit responsibilities and reporting was left as an open question.

Sincerely,

A handwritten signature in black ink, appearing to read 'Scott DeViney', written over a light blue horizontal line.

Scott DeViney, CPA
Chair, Financial Management Standards Board



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AGA
Financial Management Standards Board

The FMSB comprises the following 22 members with accounting and auditing backgrounds in federal, state, and local government, as well as academia and public accounting. The FMSB reviews and responds to proposed standards and regulations of interest to AGA members. The purpose of the FMSB is to advocate for the improvement of accounting and financial reporting standards at all levels of government and thus advance government accountability. The views of the FMSB do not necessarily represent those of AGA. Local AGA chapters and individual members are also encouraged to comment separately.

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