

Financial Reporting Standards for US State and Local Governments

Draft Working Paper: Marc Joffe, May 2023

The last two cities to file Chapter 9 bankruptcy petitions – [Fairfield, AL](#)¹ and [Chester, PA](#)² – were years behind in issuing audited financial statements at the time of their filings. This fact is illustrative of the failure of our current system of municipal financial reporting to help stakeholders predict and address municipal financial distress. The current system also inhibits government finance researchers and practitioners from conducting peer comparisons. Finally, it hinders reporting of aggregate public sector financial statistics, as evidenced by the 2–3-year lag in the Census Bureau’s publication of its Annual Survey of State and Local Government Finances.

In this paper, I will first describe the various shortcomings of municipal financial reporting, then I will consider in-progress reforms and objections before concluding with my own suggested policy solutions.

Problems

In this section, I list six shortcomings with municipal disclosure that limit its value for conducting credit analysis, oversight, and academic research. The municipal bond market includes approximately 36,000 bond issuers³ and 1.3 million outstanding bonds.⁴ Although these numbers may seem large, they are well within the capacity of modern data analysis tools. If fundamental municipal data were better organized, they could be readily analyzed with statistical packages and even electronic spreadsheets.

Lack of Effective and Freely Redistributable Standard Identifiers

In the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access (MSRB EMMA) system, individual bonds are identified by nine position CUSIP numbers. The first six positions of the CUSIP number are intended to uniquely identify the security issuer, the seventh and eighth positions identify the instrument, and the final position is a check-digit used for verification purposes.

The first six positions of the CUSIP often fail to uniquely identify a securities issuer. Because the seventh and eighth positions of the CUSIP allow for only about 1000 unique security identifiers, Global CUSIP Services is obliged to create additional CUSIP-6 codes for entities that have issued more than 1000

¹ Fairfield filed for bankruptcy on May 19, 2020. At the time, the city’s latest audited financial statements were for the fiscal year ending September 30, 2017 and are available at <https://emma.msrb.org/ES1156556-ES904477-ES1305726.pdf>. The bankruptcy case number is 20-01800-TOM9 in the Bankruptcy Court of the Northern District of Alabama.

² Chester filed for bankruptcy on November 10, 2022. At the time, the city’s latest audited financial statements were for the year ending December 31, 2018, and are available at <https://emma.msrb.org/P31427056-P31109013-P31519602.pdf>. The bankruptcy case number is 22-13032 in the Bankruptcy Court of the Eastern District of Pennsylvania.

³ Principles for Responsible Investment. ESG Integration in Sub-Sovereign Debt: The US Municipal Bond Market. 2021. United Nations Environmental Programme. <https://www.unpri.org/download?ac=14049>. As the authors note, the often-cited figure of 50,000 includes inactive issuers.

⁴ Based on search of OpenFIGI database. May 8, 2023.

<https://www.openfigi.com/search#!?marketSector=Muni&facets=maturity:..%5B2023-05-08T00:00:00Z%20TO%202099-12-31T00:00:00Z%5D&page=1>

instruments. At the extreme end, at least 29 CUSIP-6 identifiers have been assigned to the State of California and 42 have been assigned to the Dormitory Authority of the State of New York.⁵

Further, CUSIP numbers are not freely redistributable. The numbering system is operated by CUSIP Global Services, a business recently sold by Standard & Poor's to FactSet, on behalf of the American Bankers Association (ABA). EMMA's Terms of Use include the following language:

CUSIP Numbers and CUSIP standard securities descriptions are provided to the MSRB by the CUSIP Global Services. CUSIP Global Services and the ABA assert that the CUSIP Numbers and CUSIP standard securities descriptions are and shall remain valuable intellectual property of CUSIP Global Services and the ABA, and you acknowledge and agree that no proprietary rights are being transferred to you in such information. ... We are providing CUSIP Numbers and Securities Descriptions on the Website solely for the purpose of identifying municipal securities as an integral part of the trade price information provided on the Website and to which the official statements and advance refunding documents provided on the Website are related. No other use of CUSIP Numbers and Securities Descriptions is granted by us, Standard & Poor's, CUSIP Global Services or the ABA. You agree that you will not use the CUSIP Numbers and Securities Descriptions contained on the Website for any other purpose. You may not download CUSIP Numbers and Securities Descriptions from the Website.

MSRB enforces Global CUSIP Service's intellectual property claim by preventing EMMA users from copying and pasting CUSIP Numbers from the website into spreadsheets. MSRB also prohibits users from crawling EMMA (using computer software to emulate user keystrokes for the purpose of downloading large amounts of site content). Although MSRB does provide Primary Market and Continuing Disclosure services by subscription, it requires users to purchase a costly CUSIP license to use these services.⁶

In 2022, market participants filed two class action lawsuits against the ABA, Global CUSIP Services, FactSet, and S&P seeking to disqualify their intellectual property claims and establish free redistribution of CUSIPs.⁷ One of the complaints included the following argument:

The ABA's purported copyright over the CUSIP numbers themselves is thin as it covers purely factual information (i.e., strings of numbers and letters) that identify specific financial instruments, no different than a license plate serves to identify a vehicle someone else produced. The CUSIPs are trivial and nothing more than a random string of letters and numbers. Anyone can generate random numbers and letters in a string. Plaintiff's use of CUSIPs is also reasonable and fair as its use is proportional to the need to accurately identify specific financial instruments in connection with its analysis, purchase, sale, and monitoring of such securities.

⁵ Marc Joffe and Mark Campbell. Why is it so hard to access performance and financial data in munis? *The Bond Buyer*. November 13, 2019. <https://www.bondbuyer.com/opinion/its-time-to-fix-municipal-market-infrastructure>

⁶ Municipal Securities Rulemaking Board. CUSIP Global Services License Verification Form. November 3, 2022. <https://www.msrb.org/sites/default/files/2022-08/CUSIP-Global-Services-Confirmation-Form.pdf>

⁷ Marc Joffe. Class action lawsuits against CUSIP could improve government transparency. Reason Foundation. March 18, 2022. <https://reason.org/commentary/class-action-lawsuits-against-cusip-could-improve-government-transparency/>

Notably, defense counsel has stated that ABA does not assert a copyright on each individual CUSIP, but only on its full compilation of CUSIP data.⁸ If that is the case, perhaps it is no longer necessary for MSRB to prevent copying and pasting of individual CUSIPs.

Regardless of that, researchers and credit analysts sometimes need to download large numbers of securities records to conduct analysis. Unless and until ABA and CGS lose or settle the lawsuits in favor of data users, CUSIPs will remain a barrier to municipal securities research.

Late Filings

Municipal bond issuers typically commit to producing Annual Comprehensive Annual Financial Reports (ACFRs) within nine months of the end of their fiscal year.⁹ This lag compares poorly with corporate securities issuers which normally have 60-90 days to produce audited financial statements.

But many municipal bond issuers fail to file within the nine-month timeframe, and, in some cases, do not produce audited financial statements at all. As noted at the beginning of this paper, the bankrupt cities of Fairfield, AL and Chester, PA fell far behind their respective filing deadlines before entering Chapter 9. Both continue to be late at the time of this writing.

Larger entities also file late. The Commonwealth of Puerto Rico fell over two years behind during its financial crisis of the late 2010s.¹⁰ The nation's largest sub-sovereign government, the State of California, has missed five consecutive filing deadlines¹¹, producing its 2021 ACFR a full 21 months after fiscal year end, which is one year late.

The city of Compton, CA never produced audited financial statements for the 2015, 2016 and 2017 fiscal years.¹² When it resumed issuing ACFRs for the 2018 fiscal year, it could not provide a Statement of Activities because its Net Position at the start of the fiscal year had not been established by a prior year audit.¹³

⁸ US District Court. Southern District of New York. Dinosaur Financial Group v. S&P Global, American Bankers Association and FactSet Research Systems. Case Number 1:22-cv-1860-KPF. Memorandum of Law in Support of Defendants' Motion to Dismiss Second Amended Class Action Complaint. Feb. 14, 2022.

<https://storage.courtlistener.com/recap/gov.uscourts.nysd.576062/gov.uscourts.nysd.576062.91.0.pdf>

⁹ The nine month deadline applies to Single Audit filers complying with 2 CFR-200 (see [https://www.ecfr.gov/current/title-2/subtitle-A/chapter-II/part-200#p-200.507\(c\)\(1\)](https://www.ecfr.gov/current/title-2/subtitle-A/chapter-II/part-200#p-200.507(c)(1))). In the municipal bond market, SEC Rule 15c-2-12 does not specify a filing period but requires that newly issued bonds include a continuing disclosure agreement that specifies a timeline for providing audited financial statements (see <https://www.ecfr.gov/current/title-17/chapter-II/part-240/subject-group-ECFRc8401dcba174f73/section-240.15c2-12>). GFOA best practice recommends a six-month filing deadline: <https://www.gfoa.org/materials/understanding-your-continuing-disclosure-responsibilities>

¹⁰ The Commonwealth's audited financial statements for the fiscal year ended June 30, 2017 were filed on EMMA on September 1, 2020. <https://emma.msrb.org/P21402806-P21090667-P21499208.pdf>

¹¹ <https://www.cato.org/blog/california-misses-audit-deadline-5th-consecutive-year>

¹² California State Auditor. City of Compton: Financial Mismanagement and a Lack of Leadership Have Threatened Compton's Ability to Serve the Public. October 13, 2022. <https://www.auditor.ca.gov/reports/2021-802/index.html>. The 2014 financial statement is also unavailable. It was originally published but the auditor later withdrew its opinion after learning about embezzlement by the city's former deputy treasurer.

¹³ City of Compton, CA. Financial Statements with Independent Auditor's Report. June 30, 2018. <https://www.comptoncity.org/home/showpublisheddocument/6226/637986596074670000>

The city of Mt. Vernon, NY has also been seriously delinquent in producing financial statements. In a July 2022 filing on EMMA, the city advised that it had yet to complete financial statements for fiscal years back to the one ending on December 31, 2016.¹⁴ Earlier this year, the city produced its 2016 financial audit¹⁵, but remains five years delinquent.

It is likely that hundreds or even thousands of municipal issuers file statements late or not at all for any given fiscal year, but the exact number is difficult to determine given other limitations in municipal data discussed in this paper. We do know that in March 2023, S&P placed 149 municipal bond issuers on credit watch negative status because they had yet to produce FY 2021 ACFRs.¹⁶ Longer filing delays could result in the withdrawal of credit ratings, restricted market access, and higher financing costs.

Heterogeneous Accounting Standards

While all US corporations are expected to follow Generally Accepted Accounting Principles (GAAP) as promulgated by the Financial Accounting Standards Board (FASB), many governmental entities do not follow the corresponding GAAP principles stated by FASB's sister body, the Governmental Accounting Standards Board (GASB).

Several states, including New Jersey, Arkansas, Indiana, Iowa, and Nebraska, ask their local governments to use alternative accounting standards, which are typically cash-based rather than accrual-based. Entities scattered across multiple other states partially implement many GASB standards but fail to produce accrual-based governmentwide financial statements as prescribed under GASB Statement 34.

Analysts and researchers studying non-compliant local governments may find it difficult or impossible to ascertain entities' pension and other post-employment benefit liabilities.¹⁷ Failure to implement accrual accounting not only impacts credit research, but it invites mismanagement and corruption. As the International Federation of Accountants stated in a June 2021 release:¹⁸

By providing a comprehensive view of government finances, accrual reporting helps ensure that expenditure of public funds is transparent, public officials are held accountable, and future liabilities are recognized officially and planned for properly. With governments under more financial strain than ever following the huge levels of pandemic-related expenditure, understanding the overall picture and making the best use of the remaining resources is crucial to long-term recovery. In addition to the support of regional and international organizations, effective implementation of accrual accounting relies on the skills of public sector accountants to interpret the richer, more comprehensive data; as more governments move to accrual, the need for need for public sector accountants will increase correspondingly. "Accrual-based

¹⁴ <https://emma.msrb.org/P21589789-P21226779-P21649289.pdf>

¹⁵ <https://emma.msrb.org/P21688812-P21299706-P21730568.pdf>

¹⁶ Keeley Webster. S&P tells 149 issuers: provide timely financials or risk withdrawn ratings. *The Bond Buyer*. March 14, 2023. <https://www.bondbuyer.com/news/s-p-tells-149-issuers-provide-timely-financials-or-risk-withdrawn-ratings>

¹⁷ Some non-compliant entities report their pension and OPEB liabilities in financial statement notes even if these amounts are not recorded on the balance sheet. For local governments participating in multiemployer plans, pension and OPEB liabilities may be found on GASB 68 and GASB 75 disclosures issued by the plan sponsor.

¹⁸ International Federation of Accountants. Global Public Sector Shift to Accrual Accounting Forecast to Continue. June 16, 2021. <https://www.ifac.org/news-events/2021-06/global-public-sector-shift-accrual-accounting-forecast-continue>

accounting is essential in helping governments mitigate corruption, improve trust and transparency, and deliver desired outcomes that their communities deserve and need in the post-pandemic world,” said Rob Whiteman, Chief Executive of CIPFA.

Heterogeneous Classification Methods

If many entities follow a standard chart of accounts, analysts can perform more complete peer comparisons across these entities. The chart of accounts, when fully implemented, imposes a uniform method of classifying assets, liabilities, revenues, and expenditures. A researcher trying to determine how dependent various governments are on revenue from fines or the degree to which they prioritize law enforcement over other categories of expenditure will have the data needed to answer such research questions if governments are following a standard and sufficiently granular chart of accounts.

In the absence of a national standard chart of accounts, governments across the United States classify revenues, expenditures, current assets, and current liabilities in inconsistent ways. Some states, including Florida, impose a standard chart of accounts on local entities for state-level reporting but cities, counties, and special districts still do not use standard categories on their ACFRs.

Some foreign countries, including Spain¹⁹ and Israel²⁰, have developed and implemented nationwide charts of accounts for their local governments. Also, the US Census Bureau has a high-level classification system for revenues and expenditures that it asks state and local governments to use when responding to its Annual Survey of State and Local Government Finances.²¹ However, this survey has a large non-response rate and is published on a two-year delay.

Lack of a Comprehensive Data/Document Repository

All municipal issuers (or, more precisely, their financial agents) are required to file ACFRs and other continuing disclosures on EMMA. But entities that do not have outstanding bond issues face no such requirement. As a result, EMMA only has a subset of US local government financial disclosures.

Another large, but incomplete, repository of audited financial statements is the Federal Audit Clearinghouse, currently operated by the Census Bureau, but transitioning to the General Services Administration in late 2023. Any state or local government that expends more than \$750,000 of federal funds in a given year must file audited financial statements on this system.

Between EMMA and the FAC, users have access to the vast majority of state and local government audited financial reports, but some entities meet neither MSRB nor federal filing requirements, yet still produce audited financial statements for some other reason, such as a state-level filing requirement.

EMMA and the FAC use different file naming conventions and can be difficult to navigate. MSRB’s terms of use prohibit users from bulk downloading audited financial statements (or any other form of disclosure) unless they pay a license fee and possess a CUSIP license.

¹⁹ Spain’s Chart of Accounts can be seen at

<https://www.hacienda.gob.es/DocLeyes/repositorio%20normativa/19936.htm>

²⁰ For an example of an Israeli budget with standard account codes, see <https://haipo.co.il/wp-content/uploads/2021/10/הגשה-למועצת-העיר/ספר-התקציב-הרגיל-של-עיריית-חיפה-לשנת-2022-הגשה-למועצת-העיר.pdf>

²¹ https://www2.census.gov/programs-surveys/gov-finances/technical-documentation/questionnaires/historical-forms/2022/f28_22_blank.pdf

While many states (including Ohio and Michigan) provide comprehensive and relatively easy-to-navigate ACFR repositories, we still lack such a resource at the national level.

Even if we had a comprehensive directory of ACFRs, it would simply be a collection of 30,000-40,000 annual file submissions rather than a dataset (e.g., a comma delimited file) due to the limitation described in the next section.

PDF-Based Reporting

ACFRs are almost exclusively published in PDF form—a format uniquely resistant to parsing. Further, some entities continue to produce locked PDFs (which do not permit copying and pasting of data) or include scanned pages that are not searchable. Even unlocked, text searchable ACFR PDFs are challenging to parse because entities use a variety of page and table formats.

PDF parsing solutions are available but cannot automatically handle some of the complexities of ACFR tables. Most notable is the Statement of Activities which is often presented across two pages without row headers repeated on the second page. Also, column headers, especially those containing multiple lines of text, are difficult to fully identify and associate with the data entries underneath them.

Many regulators and oversight bodies require the use of structured text formats such as Inline eXtensible Business Reporting Language (XBRL) instead of PDFs to facilitate data extraction and analysis. Among the bodies that have switched to Inline XBRL are the US Securities and Exchange Commission for corporate financial disclosures and the European Securities and Markets Authority (ESMA) for all EU securities issuers. ESMA characterizes its Inline XBRL implementation known as the European Securities Electronic Format (ESEF) as “the electronic reporting format in which issuers whose securities are admitted to trading on EU regulated markets must prepare their annual financial reports to facilitate accessibility, analysis and comparability of annual financial reports.”²²

Potential Solutions

Federal implementation of the Financial Data Transparency Act (FDTA)²³ promises to address two of the issues listed above, at least for entities that have outstanding municipal bonds, but there appears to be no legislative or industry-led solution to the other shortcomings.

The FDTA requires the implementation of a standard, non-proprietary issuer identifier. This should result in the replacement of CUSIP-6 issuer identifiers with the Legal Entity Identifier or something comparable.

FDTA does not explicitly address security identifiers and thus replacement of the full nine position CUSIP IDs now found on EMMA is less likely. That said, an alternative, royalty-free issue identification system known as OpenFIGI has been developed by Bloomberg and the Object Management Group. Regulators could adopt this standard when implementing FDTA especially if ABA and Global CUSIP Services are unwilling to relax restrictions on CUSIP use and redistribution.

²² <https://www.esma.europa.eu/issuer-disclosure/electronic-reporting>

²³ The FDTA is a portion of the National Defense Authorization Act for Fiscal Year 2023, HR 7776, 117th Congress. See text starting at page 1027 of <https://www.congress.gov/117/bills/hr7776/BILLS-117hr7776enr.pdf>.

The other limitation that can be removed through FDTA implementation is the ongoing reliance on PDFs as a disclosure format. Interest in replacing PDFs with XBRL (or something similar) dates to at least 2002, shortly after XBRL's initial introduction.

That year, three academics discussed XBRL's applicability to government financial statements in *The Journal of Government Financial Management*.²⁴ Also in the early 2000s, the GASB established its Electronic Financial Reporting monitoring project, which involved staff following developments in this area.²⁵

In 2008, the Association of Government Accountants published a study by PriceWaterhouseCoopers entitled "XBRL for Public Sector Reporting" which included an application of XBRL to the State of Oregon's audited financial statements.²⁶ Around the same time, MSRB launched EMMA, and mentioned XBRL as a future direction for the platform.

In 2009, the Government Financial Officers Association (GFOA) issued a Best Practice document on Web Site Presentation of Official Financial Documents²⁷ that included the following language:

Electronic financial reporting language. Governments should monitor developments in standardized electronic financial reporting (e.g., extensible business reporting language [XBRL]) and apply that language to their electronic document process when appropriate.

But after that progress toward XBRL adoption largely ended. Since this author was not following the issue at the time, this paper can only speculate about the reasons. The years 2009-2012 were a period of widespread local government fiscal distress, leaving less bandwidth to develop reporting standards. Further, creating and implementing an XBRL taxonomy are non-trivial tasks, and no entity appears to have had either the authority or budget to take them on.

After 2012, further academic papers and shorter commentaries appeared advocating the use of XBRL for government financial reporting. This author published two such commentaries in 2013,²⁸ and, as a result became connected with others interested in this idea. Neal Snow and Dr. Jacqueline Reck produced an academic working paper in 2014 that included a more extensive pilot of XBRL with government financial data than the AGA/PWC study.²⁹

²⁴ Mohammad Abdolmohammadi, Jonathan Harris and Kenneth Smith. Government financial reporting on the Internet: The potential revolutionary effects of XBRL. *The Journal of Government Financial Management*. Volume 51, Issue 2 (Summer 2002): 24-31.

²⁵ <https://www.gasb.org/document/blob?fileName=TP-First-Third%202023-Background%20and%20Historical%20Material.pdf>

²⁶ <https://www.yumpu.com/en/document/read/30188233/xbrl-and-public-sector-financial-reporting-aga>

²⁷ Government Finance Officers Association. BEST PRACTICE: Web Site Presentation of Official Financial Documents (2009) (ALL). February 27, 2009.

<http://web.archive.org/web/20100922072719/http://gfoa.org/downloads/websitepresentation.pdf>

²⁸ <https://tabbforum.com/opinions/the-case-for-muni-xbrl-bringing-municipal-financial-disclosure-into-the-21st-century/> and <https://www.foxandhoundsdaily.com/2013/10/modernizing-california-city-financial-reporting-2/>

²⁹ Neal M. Snow and Jacqueline Reck, Developing a Government Reporting Taxonomy (November 1, 2015). *Journal of Information Systems*, 30(2), 49-81., Available at SSRN: <https://ssrn.com/abstract=2474922> or <http://dx.doi.org/10.2139/ssrn.2474922>

The current relatively high level of interest in the use of XBRL for government financial reporting started with the State of Florida's decision to fund an XBRL taxonomy in its 2018-19 budget and to migrate local government annual financial reports (distinguished from ACFRs) to XBRL by 2023.

Passage of that legislation was followed by the formation of a Standard Government Reporting Working Group under XBRL US, which is responsible for supporting the XBRL standard in the United States as a jurisdiction of XBRL International.

This progress also engendered resistance. GFOA removed the reference to XBRL from its Best Practices document and instead adopted a position opposing any mandates of reporting technology.³⁰ Municipal Market Analytics, a high-profile research firm in the municipal finance industry, released a paper arguing that XBRL implementation would cost issuers tens of billions of dollars.³¹

The situation at the national level remained largely static until passage of FDTA. At the state level, the University of Michigan's Center for Local, State and Urban Policy partnered with XBRL US to develop an ACFR taxonomy and apply it to the city of Flint, the township of Pine River and the County of Ogemaw.³²

In 2019, President Trump signed the GREAT Act, which, among other things, mandated the Office of Management and Budget and the Department of Health and Human Services to apply a machine-readable reporting standard (such as XBRL) to federal single audits. Although the legislation called for this standard to be implemented in 2023, no progress has been made to date. Once the General Services Administration takes over Single Audit report collection later this year, implementation may begin. GSA has implemented another facet of open government legislation which was the replacement of the proprietary DUNS number with the freely redistributable Unique Entity Identifier for entities that receive federal funds, including state and local grantees.

Objections

As mentioned in the previous section, the Government Finance Officers Association and Municipal Market Analytics came out against the application of XBRL to state and local financial reports in 2018. They stepped up their opposition to the Financial Data Transparency Act in 2022 recruiting several other organizations to sign onto opposition letters. Ultimately, they were unable to prevent the legislation from passing but GFOA lobbyists were able to switch the implementing body from the MSRB to the SEC.

Opponents continue to argue that, given the complexity of government financial reporting, the cost of FDTA implementation will be in the billions of dollars. This author has addressed these concerns in a January 2023 commentary.³³ One XBRL taxonomy can cover a range of filers, multiple taxonomies can be

³⁰ Government Finance Officers Association. Mandating Specific Technologies for Financial Reporting and Disclosure Purposes. September 2018. <https://www.gfoa.org/materials/mandating-specific-technologies-for-financial-reporting>

³¹ MMA has removed that study from its website, but I discussed it here in a post entitled Addressing Misperceptions About XBRL for Municipal Disclosure, Reason Foundation, December 14, 2018. <https://reason.org/commentary/addressing-misperceptions-about-xbrl-for-municipal-disclosure/>

³² University of Michigan Center for Local, State, and Urban Policy. Bar Codes and Financial Reporting: XBRL Case Study at the City of Flint. September 2022. https://closup.umich.edu/sites/closup/files/2022-09/MICHIGAN%20GFOA%20PRESENTATION_9_13_2022.pdf

³³ Marc Joffe. Machine-Readable Financial Reporting Is Less Scary than You Think. Cato Institute. January 4, 2023. <https://www.cato.org/commentary/machine-readable-financial-reporting-less-scary-you-think>

developed if necessary, and there is a competitive market of XBRL tool providers who will drive down compliance costs.

Rather than rehash technical issues here, it is worth considering the legal and constitutional considerations. SEC and MSRB lack the authority to directly regulate municipal bond issuers due to the 1975 Tower Amendment.³⁴ Instead, they regulate municipal market activity through their power to oversee financial advisors and underwriters.

This arrangement is distinct from the regulation of corporate securities market, but this distinction often comes without a difference. Governments rarely (if ever) issue bonds without the assistance of regulated financial-industry third parties, and these players would rather avoid being subject to enforcement actions.

Further, there have been cases in which the SEC has taken action against government entities and their employees involved with bond issuance. For example, in June 2022 the SEC filed suit against the City of Rochester and its former finance director in connection with misleading statements allegedly contained in the city's bond offering documents.³⁵

So, while the existence of the Tower Amendment creates an appearance of municipal bond issuer sovereignty from federal oversight, it does not always offer protection in practice. Nonetheless, it provides an ideological basis for opposing FDITA implementation and other commonsense reforms.

The players in the Tower Amendment's introduction are no longer with us, so we cannot be sure of why this provision was added to the 1975 securities legislation. But it is reasonable to assume that the thinking was at least implicitly rooted in the Tenth Amendment to the US Constitution, which states that powers not explicitly granted to the federal government are reserved by the States and the people.

Federalism has been an important strength of US governance, but it is less obvious that it should apply to municipal bond issuance and financial reporting in the 21st Century. Over time, the federal government has intervened in municipal finance often at the urging of state and local government officials.³⁶

From the implementation of the federal income tax in 1913, interest on state and local government bonds could be excluded from the bondholder's income, providing a large implicit subsidy to issuers especially during periods of high marginal income taxation (between 1944 and 1963, marginal tax rates topped out at over 90%).³⁷

³⁴ Former SEC Commissioner Luis Aguilar called for repeal of the Tower Amendment in a 2015 speech. See Luis A. Aguilar, February 13, 2015. Statement on Making the Municipal Securities Market More Transparent, Liquid, and Fair. <https://www.sec.gov/news/statement/making-municipal-securities-market-more-transparent-liquid-fair>

³⁵ US District Court, Western District of New York, SEC v, City of Rochester, Rosalind Brooks-Harris, et. al. Case No. 22-cv-6273. <https://www.sec.gov/litigation/complaints/2022/comp-pr2022-108-city-of-rochester.pdf>

³⁶ For example, the National League of Cities and National Association of Counties advocated federal rescue funds for local governments as part of the American Rescue Plan Act. See, for example, <https://www.nlc.org/wp-content/uploads/2021/01/Summary-of-Coronavirus-Relief-Provisions.pdf> and <https://www.naco.org/blog/president-biden-signs-executive-order-increase-federal-food-benefits-and-expedite-stimulus>.

³⁷ Tax Foundation, 2021. Historical U.S. Federal Individual Income Tax Rates & Brackets, 1862-2021. <https://taxfoundation.org/historical-income-tax-rates-brackets/>

In 1982, Congress narrowed the exemption to registered municipal securities only, excluding “bearer bonds” to which coupons are physically attached. The State of South Carolina filed suit to overturn this exclusion on Tenth Amendment grounds. But the Supreme Court upheld the provision ruling that “the federal imposition of a bond registration requirement on state and local governments does not violate the Tenth Amendment.”³⁸

Under the 2009 American Reinvestment and Recovery Act, Congress created a new type of taxable state and local government bond. Issuers of “Build America Bonds” received an explicit subsidy from the federal government offsetting a portion of their interest cost. BABs were popular because they could be more readily sold to investors who did not have tax considerations, while still being less costly to service than corporate bonds with comparable risk.

The federal government also added Chapter 9 to the Bankruptcy Code in 1934 making it easier for defaulting local bond issuers to adjust their debts through a court-supervised process.³⁹ In 1941, the federal government effectively bailed out the state of Arkansas which has been in a state of default since 1933.⁴⁰ Finally, in 2016, Congress extended a bankruptcy process akin to Chapter 9 to Puerto Rico and other US territories.

Federal involvement in municipal finance transcends the bond market. The federal government has been making payments to state and local governments or assuming a portion of their programmatic costs for decades.⁴¹ Today, most of these subsidies take the form of federal grants, which come with financial reporting requirements. Since the Single Audit Act of 1984 larger grantees have been required to prepare and submit audited financial reports to the federal government.

In Fiscal Year 2021, over 18,000 governmental entities filed federal single audits that include basic financial statements.⁴² The content of these statements is regulated by 2 CFR 200.510.⁴³ The Grant Reporting Efficiency and Agreements Transparency Act of 2019, mentioned earlier, requires that single audits be transitioned to machine-readable format.⁴⁴

³⁸ S.C. v. Baker, 485 U.S. 505, 108 S. Ct. 1355, 99 L. Ed. 2d 592, 1988 U.S. LEXIS 1873, 56 U.S.L.W. 4311, 88-1 U.S. Tax Cas. (CCH) P9284, 61 A.F.T.R.2d (RIA) 88-995 (Supreme Court of the United States April 20, 1988, Decided). <https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:3S4X-F780-003B-44H7-0000-00&context=1519360>.

³⁹ The Supreme Court struck down the 1934 Act due to Tenth Amendment considerations. Congress passed a second version of Chapter 9 in 1937 which the Supreme Court upheld the following year. See US Courts. Chapter 9 - Bankruptcy Basics. <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics>

⁴⁰ Joffe, Marc. "Provincial Solvency and Federal Obligations." (2012). Macdonald-Laurier Institute. <https://www.macdonaldlaurier.ca/files/pdf/Provincial-Solvency-October-2012.pdf>

⁴¹ One example is the Social Security Amendment of 1950 which provided federal matching payments for state health benefits and was a predecessor to Medicaid. See Medicaid and CHIP Payment and Access Commission, Putting the program in context. <https://www.macpac.gov/putting-the-program-in-context/#:~:text=In%201960%2C%20the%20Kerr%2DMills,of%20assistance%20with%20medical%20expenses.>

⁴² Author’s analysis of Federal Audit Clearinghouse data at <https://facdissem.census.gov/PublicDataDownloads.aspx>

⁴³ Code of Federal Regulations. § 200.510 Financial statements. <https://www.ecfr.gov/current/title-2/subtitle-A/chapter-II/part-200/subpart-F/subject-group-ECFRc3bd6ae97de5a40/section-200.510>

⁴⁴ Public Law No. 116-103 (12/30/2019) <https://www.congress.gov/bill/116th-congress/house-bill/150/text>

Given the large overlap between grantees and bond issuers in the state and local government sector, the Tower Amendment and Tenth Amendment concerns are largely moot. To the extent that state and local governments receive large explicit and implicit subsidies from federal taxpayers, they should be accountable to this constituency. Accessible financial reporting provided on a timely basis and adhering to Generally Accepted Accounting Principles is one method of providing this needed accountability.

Recommendations and Conclusion

The federal government should leverage its role as a funder of state and local government to implement more comprehensive financial reporting standards for grantees to ensure the availability of high-quality, timely and accessible financial information.

Specifically, the federal government should withhold a portion of future grants from entities that fail to file on a timely basis single audit reports that contain audited financial statements adhering to GASB standards. OMB and GSA should implement the GREAT Act by providing an XBRL reporting taxonomy for use by state and local governments and require grantees to migrate to this format. SEC and MSRB can then reuse this taxonomy when implementing the FDTA. Free filing options should be offered to smaller governments that do not have the resources to buy and master commercial XBRL filing solutions.

Federal imposition of a standard chart of accounts on all local governments across the fifty states would be a usurpation of state authority and thus seems to be a bridge too far. Instead, Congress should instruct the Census Bureau to work with state and local governments to develop a high-level set of reporting categories that would ultimately align with state charts of accounts and the categories now included in the Annual Survey of State and Local Government Finances.

Also beyond the immediate scope of these recommendations is the implementation of a comprehensive nationwide ACFR repository. Such a repository could be built by a university or non-governmental organization by crawling federal and state document repositories.⁴⁵ Once machine readable ACFRs are widely available this document repository could be supplemented or replaced by an Excel or CSV formatted dataset.

Finally, SEC should implement the identifier provisions of the FDTA by transitioning the municipal bond market to Legal Entity Identifiers. MSRB or a federal agency should develop and maintain a mapping between LEIs and the Unique Entity Identifiers (UEIs) now being issued through the GSA. Finally, SEC and MSRB should remove all specific references to CUSIP from municipal bond regulation, and, if Global CUSIP Services is unwilling to permit unlimited royalty-free redistribution of CUSIPs on EMMA, MSRB should replace CUSIPs with Open FIGI identifiers on its platform.

This set of reforms would finally usher municipal finance data into the 21st century opening new opportunities for credit monitoring, state and federal oversight, academic and public policy research, and citizen involvement. They would place EMMA on equal footing with EDGAR allowing individual investors in municipal securities to have the same access to data now afforded those who invest in corporate securities.

⁴⁵ This author posted a codebase to accomplish this task on GitHub at <https://github.com/govwiki/SingleAuditRepo> but the code is now stale.