

Advancing Government Accountability

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Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board (GASB)
PO Box 5116
Norwalk, CT 06856-5116

Re: Project 19-18

Dear Mr. Bean:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Governmental Accounting Standards Board (GASB or the Board) on the exposure draft (ED) entitled *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions*. The FMSB is comprised of 25 members (list attached) 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. Local AGA chapters and individual members are also encouraged to comment separately.

The FMSB has reviewed the exposure draft regarding accounting and reporting for nonexchange financial guarantee transactions and we agree with the position of the Board on many of the issues discussed in the ED. We agree that when a government extends a financial guarantee for an obligation to another government or nongovernmental entity for which equal value is not received in return for the guarantee, an obligation has occurred. This fulfills the definition of an obligation under Concepts Statement No. 4. The FMSB also concurs that not every obligation offered under such an arrangement will rise to the level of a liability and thus need to be recognized. For a liability to result from a guarantee, a subsequent event (or events) must occur that requires professional judgment be used to evaluate the impact of the new circumstances. The FMSB agrees that the evaluation of qualitative factors to determine if an obligation shall become a liability is an appropriate part of the process and that an assessment as to the probability that a payment shall be required must be made.

However, a majority of the FMSB members disagree with the Board's proposal to use the criteria of "more likely than not" (MLTN) rather than the criteria of "probable" as a factor for determining whether a liability should be recognized. The FMSB's majority has two areas of concern regarding the use of the MLTN criteria. As indicated in note 1 on page 2 of the ED, MLTN



means a likelihood of more than 50 percent. Thus a liability might be recognized where, in theory, an actual expenditure will be required slightly more than half of the time and not required in slightly less than half of the time. We recognize that professional judgments will be required in such determinations; however, we believe that the threshold for recognizing a liability has been set very low in this circumstance and thus may be premature. Among other issues, recognition of a liability at such an early stage may reduce the likelihood of the primary parties to this obligation resolving this matter without resorting to the guarantor.

The majority of the FMSB also agree with the opinion expressed in paragraph 53 of the ED regarding the similarities between this type of transaction and the transactions covered by Statement 62. Introducing the MLTN criteria into the recognition equation for this single class of contingent liability reporting will needlessly complicate matters. If the Board believes that contingent liability reporting is an area that should be addressed, we would also prefer a separate project to address this matter. In paragraph 28 of the ED, the Board expressed concern that using the criteria of "probable" will result in recognition of a liability at a date well after the point it is evident a liability has been incurred for these types of transactions. If there are similar concerns with other contingent liability situations, we believe that the matter should be addressed collectively.

In summary, the majority of the FMSB do not agree that the use of the MLTN criteria will improve reporting. They believe that in theory, the MLTN criterion can result in the recognition of a liability that has a little more than even chance of resulting in the guaranteeing government having to make a payment and nearly an equal chance of not occurring.

Similar to the Board's ED, the FMSB also has a minority view on the use of the MLTN criteria versus the probable criteria. The minority's view is that the MLTN criterion is an appropriate choice for several reasons. The MLTN criterion is employed extensively by FASAB in their statements and the FASB allows recognition at levels below the probable level in the establishment of loss contingencies. The minority view also believes that the approach outlined in the ED is similar to the approaches established in IPSAS 19 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS. IPSAS 19, paragraph 31 states that, "For a liability to qualify for recognition, there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits or service potential to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, the probability that the event will occur is greater than the probability that it will not. ..."

The FMSB minority view also wants to emphasize that even if a guarantor has determined that it was MLTN that it would be required to make good on its guarantee, the actual amount of its obligation must also be reliably measurable for a liability and expense to be recognized. Generally, by the time the amount of a guarantor's obligation can be reliably determined (whether whole or partial, i.e. what will be the extent and timing of outflow of its economic benefit or service potential) it is not only MLTN, it is at least sufficiently reliable. The FMSB minority view also wishes to point out that the ED allows that "when there is no best estimate of the future outflows expected to be incurred but a range of estimated future outflows can be established in which no amount within that range appears to be a better estimate than any other amount, the minimum amount in that range should be recognized [as a liability and expense]."

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. If there are any questions regarding the comments in this letter, please contact Steven E. Sossei, CPA, and AGA's staff liaison for the FMSB, at <a href="mailto:ssossei@agacgfm.org">ssossei@agacgfm.org</a> or at 518-522-9968.

Sincerely,

Eric S. Berman, CPA, Chair

AGA Financial Management Standards Board

cc: Evelyn A. Brown, CGFM-Retired AGA National President

## Association of Government Accountants Financial Management Standards Board

July 2012 – June 2013

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