Letter of Comment No. 1 File Reference: 3-23E Date Received: 11/1/11

GASB Division of Research and Technology Activity: Project 3-23 Director@Gasb.org

Reporting Items Recognized As Assets and Liabilities Issued 8- 17- 2011 Comments By: Dr. Joseph S. Maresca CPA, CISA

Colleagues,

Thank you for the opportunity to critique this issuance.

Background:

The issuance applies to current refunds and advanced refundings resulting in a defeasance of debt reported by government, business activities and proprietary funds with differences between the reacquisition price and the net carrying amounts of the old debt. The resultant should be reported as deferred outflows or inflows of resources and recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or life of the new debt. #6/pp. 3

The adjustments of lease obligations to present value should be made using the effective rate for a revised agreement. #7/pp. 3 *I concur*.

Non-exchange transaction resources received or recognized as receivables before the time required but met under other eligibility requirements are a deferred outflow of resources by the provider and deferred inflow of the recipient. pp. 4 *Generally, I agree but how is transpaerency enhanced?*

Debt issuance costs include insurance costs, financing costs, printing legal and trustee costs. pp. 5 *I concur.*

The gain or loss on the sale of a property accompanied by leaseeback should be a deferred inflow of resources or deferred outflow and recognized in a systematic manner in proportion to the recognition of the leased asset. #18/pp. 5 *I concur.*

The loan origination fees are revenues in the period received. #21/ pp. 6 *I concur*.

Points received by the lender for a loan held for investment should be a deferred inflow of reources and revenues should be recognized systematically. #26/ pp. 7 *I concur.*

Critique:

The setting aside customarily by a borrower of cash or bonds sufficient to service debt of the borrower is a defeasance. The borrower's debt and the offsetting cash or bonds are taken off the balance sheet. In securities trading, a clearing house may become a counterparty to each side of a trade after concurrence on the trade and terms thereof. This is a condition precedent to facilitate netting, and reduce counterparty risk exposure.

The term defeasance has become popular recently, due to the growth of central counterparty clearing services in European bourses and cash or equities markets. A provision in a loan or bond removes it as a liability on the balance sheet if cash *or a portfolio* is set aside for debt servicing. Usually defeasance occurs when a borrower owns a portfolio of Treasury securities, *the coupons of which are used to service a debt*. When the borrower has set aside sufficient assets to cover the debt, the debt does not need to be recorded on a balance sheet. The more important question involves whether or not the valuation of the assets remains stable without a material variance.

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This is proper as long as transparency is ascertainable by investors and readers of the financial statements who rely.