Letter of Comment No. 2
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August 30, 2012

David Bean
Director of Research
Project No. 19-18
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Dear Mr. Bean:

On behalf of the Tennessee Department of Audit, we thank the GASB for the opportunity to comment on its proposed Exposure Draft (ED), *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions*.

We generally agree with the requirements of the ED and the bases for the requirements as explained in paragraphs 29, 32, 34, and 42. However, we have provided some suggestions for improvement to the proposed statement.

**Specific Comments**

For the disclosure requirement in ¶13a(2), we suggest that preparers be reminded that GASB 56 requires any related party transaction relationships to be disclosed which we believe could be probable with nonexchange financial guarantees extended. In addition, we recommend adding a disclosure requirement to ¶13 for the discount rate and the significant assumptions used in determining the discount rate (i.e., similar to the requirement in GASB 68 ¶111) because this could have a material impact on the determination of the liability balance. We believe this is an essential piece of information users would need to assess the reliability of the liability.

In regard to ¶25 (blended component units – "In this circumstance, the Board concluded that because Statement No. 14, *The Financial Reporting Entity*, as amended, stipulates that a component unit should be a legally separate entity from a primary government, both blended and discretely presented component units should be considered separate entities for the purpose of applying this Statement.), we believe the board's conclusion might conflict with the intent of GASB 61 ¶43 and GASB 48 ¶19-20). GASB 61 ¶43 clearly states that blended component units

are so intertwined with the primary government that they function much like a fund or department of the primary government. Furthermore, GASB 48 ¶57 emphasized a neutral impact on financial position and changes in financial position. The "doubling up" effect of this requirement in ¶25 appears inconsistent with that intent of intra-entity transactions. We would equate a financial guarantee to a blended component unit as the government providing a guarantee to itself, especially if the government had initially created the blended component unit (e.g., through legislation).

Finally, we do recognize that the board could have a dilemma based on the alternative view expressed in ¶53 ("This member believes that financial guarantees are not important or different enough from other contingencies to merit blazing a new contingent liability recognition trail just for them. If the Board has concerns about the appropriateness of the contingent liability recognition requirements in Statement 62, this member believes the Board should establish a separate project to readdress all aspects of governments' contingent liability reporting."). Establishing different GAAP here could result is similar transactions being treated differently based on two different standards (GASB 62 for all other transactions and this proposed statement). The board could consider that the "reasonably possible" criterion within GASB 62 (as related to FASB 5) would at least result in a note disclosure if the board was concerned (as expressed in ¶29) that liability recognition for a financial guarantee would occur "well after the point it is evident a liability has been incurred." The basis for conclusions does not explain why this option was not feasible. We also understand that note disclosure is no substitute for presentation.

Should you have questions or need clarification on any of our comments, please contact Gerry Boaz or me at (615) 747-5262.

Sincerely,

Arthur A. Hayes, Director
Division of State Audit