



September 20, 2012

David Bean, Director of Research and Technical Activities
Project No. 19-18
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

RE: GASB Exposure Draft – *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions*

Dear Mr. Bean:

We appreciate the opportunity to respond to the Exposure Draft (ED) *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions*.

We generally support the proposed statement that establishes reporting and disclosure requirements for governments that extend nonexchange financial guarantees and governments that receive nonexchange financial guarantees. However, we do have specific concerns regarding the inclusion of *blended* component units and the *more likely than not* threshold as discussed below.

1. Paragraph 4, 9 and 25. It is our understanding from the scope of the ED and the Basis for Conclusions and Alternative View that if a state provided a nonexchange financial guarantee to one of its *blended* or *discrete* component units that the state (and the component unit) would be required to disclose the guarantee in the footnotes to the financial statements and, if applicable, record a liability for the guarantee in the state's financial statements. While we agree with this approach for *discrete* component units, we do not understand the logic behind applying this to *blended* component units. Per GASB Statement No. 14, blended component units should be reported as part of the primary government. If one department within the state guaranteed an obligation of another department, this guarantee would not be recorded in the financial statements or footnotes because the departments are both within the primary government. Additionally, footnotes do not present blended component unit information separate from the state's departments. Why treat a blended component unit (reported as part of the primary government) different than a department of the state in this situation?

Example: Assume the state's general fund provided a nonexchange financial guarantee to a component unit that is blended as a special revenue fund in the CAFR. And, also assume that the state determines it is more likely than not (greater than 50 percent) that the state would have to make payments on this guarantee. Not only would the governmental activities of the state report the liability for the debt the blended component unit holds, but the governmental activities would be required, under this ED, to report a

liability for an estimate of the discounted present value of the future outflows expected to be incurred by the general fund as a result of the guarantee. We believe this is misleading to report a liability (and expense) for nonexchange guarantees extended to blended component units because there is potential to double up the amount of the liability in the governmental activities for the same debt, as in this example.

2. Paragraph 4 and 25. The Basis for Conclusions and Alternative View specifically discusses the Board's opinion regarding whether blended and/or discrete component units are separate entities for purposes of applying *this* statement. This is key information to the standard that is somewhat buried in the Basis for Conclusions and Alternative View. We would suggest including this in a footnote to paragraph 4.
3. Paragraph 9 and 53. The standard requires that when it is *more likely than not* (more than 50 percent) that a government will make a payment on nonexchange financial guarantees it extended, the government should recognize a liability and an expense in financial statements prepared using the economic resources measurement focus. However, per GASB Statement No. 62, paragraphs 100-102, an estimated loss from a loss contingency should be accrued only if it is *probable* that a liability had been incurred. We agree there is a need to report a liability and expense; however, we agree with the Alternative View in paragraph 53 that it would be more appropriate to recognize a liability and expense when it is *probable* that a payment will be made. This would be consistent with GASB Statement No. 62. We do not understand the logic behind treating the contingent liability for a nonexchange financial guarantee differently than all other contingencies. We believe the requirement to record a liability by the guaranteeing government when it is *more likely than not* that government will make a payment on the debt is much too low of a threshold.

If you have questions or need additional information regarding this response, please do not hesitate to contact Kim Knight at (515) 281-6523.

Sincerely,

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