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September 28, 2012

Mr. David Bean  
Director, Research and Technical Activities  
Governmental Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

**Re: Project No. 19-18 — Exposure Draft of Proposed GASB Statement *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions***

Dear Mr. Bean:

Deloitte & Touche LLP is pleased to comment on the exposure draft of a proposed GASB Statement, *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions*.

We support the Board's effort to improve the information available to users of government financial reports to assess a government's exposure to financial guarantees. Accordingly, we support the disclosure requirements under the proposal because they would improve the transparency of a government's exposure to nonexchange financial guarantees. However, we recommend that the Board address the following items before issuing a final Statement:

- *Scope* — The proposal's limited scope would result in different accounting for similar transactions (i.e., "exchange" and "nonexchange" financial guarantees). We recommend that the Board adopt a consistent accounting model (e.g., recognition threshold) for all financial guarantees and not limit the standard's scope to nonexchange financial guarantee transactions.
- *Recognition of intra-entity guarantees* — We disagree with the Board's conclusion that a reporting entity should be required to record a financial guarantee liability in its financial statements when the guarantor and the guaranteed party (e.g., a blended component unit) are both part of the entity being reported upon. Under the proposal, the reporting entity would be required to recognize the "intra-entity guarantee" (i.e., a "doubling up the liability"). However, such requirement does not faithfully represent the *reporting entity's* actual obligation (i.e., the reporting entity has only one obligation to an entity external to it).
- *Initial and subsequent measurement* — We recommend that the Board provide additional guidance on the initial and subsequent measurement of financial guarantees to avoid the potential for inconsistent application. For example, the Board should address how entities should determine the discount rate to use to measure the guarantee obligation and how subsequent changes in the measurement of the guarantee obligation should be accounted for.

The appendix below expands on these items and contains other recommendations to improve the clarity of the final Statement.

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Deloitte & Touche LLP appreciates the opportunity to comment on the proposed Statement. If you have any questions concerning our comments, please contact Adrian Mills at (203) 761-3208.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl  
W. Michael Fritz

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### **Appendix**

#### **Scope**

We do not support the scope of the proposed guidance because it would result in different accounting for similar transactions. For example, assume that a state governmental entity extends two guarantees to a municipal government within its jurisdiction. In exchange for the first guarantee, the municipal government gives the state government consideration equal to the initial value of the guarantee (e.g., \$10,000 is exchanged for a guarantee worth \$10,000 at inception). However, in exchange for the second guarantee, the municipal government gives the state government consideration that is less than equal value (e.g., \$8,000 is exchanged for a guarantee worth \$10,000 at inception). Although the first guarantee would fall outside the proposal's scope, the second would fall within it,<sup>1</sup> even though the state government's economic exposure under the contingent aspect of the two guarantees is the same. Thus, the entity would use a probable threshold to recognize the first guarantee but would apply the proposal's more-likely-than-not threshold to recognize the second.

We recommend that to avoid such accounting differences, the GASB expand the scope of the final Statement to include both "nonexchange" and "exchange" guarantees. The final Statement should also address how guarantors should account for consideration received in exchange for a financial guarantee (i.e., the noncontingent aspect of the guarantee).

In addition, we recommend that the GASB further consider the definition of a financial guarantee (i.e., the scope of the proposed Statement) in light of the scope of (and scope exceptions in) FASB Accounting Codification Topic 460, *Guarantees*. For example, the GASB should address whether indirect guarantees of indebtedness (see ASC 460-10-15-4(d)) are within the scope of the proposed Statement. We recommend that the final Statement include a scope exception for intra-entity guarantees<sup>2</sup> that is similar to the FASB's scope exception in ASC 460-10-25-1(g) for "a parent's guarantee of its subsidiary's debt to a third party." We do not support the proposal's concept of "doubling up" the liability within the reporting entity's financial statements because the reporting entity is not legally required to pay the obligation twice. In contrast, we do support the recognition of the guarantee obligation in the guarantor's stand-alone financial statements.

Lastly, the GASB should clarify whether joint-and-several obligations are within the scope of the proposed Statement. Whether a joint-and-several obligation is similar to a guarantee is currently the subject of an EITF issue.

#### **Initial Recognition**

We recommend that the GASB adopt a consistent recognition threshold for all financial guarantees. The current recognition threshold (i.e., "probable") is known to be operational and is already well understood by practitioners.

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<sup>1</sup> In accordance with paragraph 1 of the proposed Statement.

<sup>2</sup> Refer to paragraph 43 of the proposed Statement.

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### Initial Measurement

Although we generally support the initial measurement guidance, it should be clarified so that reporting entities apply it consistently.

The proposed Statement requires that the guarantee liability initially be measured as “the best estimate of the **discounted present value** of the future outflows expected to be incurred as a result of the guarantee” (emphasis added).<sup>3</sup> However, the final Statement should indicate how entities should determine the discount rate to use to measure the guarantee liability (e.g., a rate that reflects the government’s credit standing).

### Subsequent Measurement

The final Statement should provide further guidance on the following matters:

- *Discount rate to be used in the subsequent measurement of the guarantee liability* — As noted above, the proposal does not indicate the appropriate discount rate for entities to use to measure the guarantee liability. The final Statement should identify the appropriate discount rate to be used as well as whether and, if so, when the discount rate should be updated.
- *Accretion of guarantee liability after initial recognition* — The final Statement should address how accretion of the guarantee liability (i.e., changes in the value of the liability solely due to the passage of time) should be accounted for (e.g., as interest expense).
- *Favorable versus unfavorable changes in estimates* — The final Statement should address whether the reporting entity would be required to record both increases and decreases or only increases (until settlement) in any change in estimate of the recognized financial guarantee liability.

### Other Comments

The following table outlines other recommendations for improving the clarity of the final Statement:

<i>Other Recommendations</i>	
<b>Paragraph</b>	<b>Comment</b>
8	<p>Add the following language from ASC 310-10-55-5 (as modified) to the end of the paragraph:</p> <p>“However, the use of historical statistics alone would be inappropriate if the nature of the [guarantees] or current environmental conditions differ from those on which the statistics were based. Any [liability] that is recorded [must] be reasonably estimable and supported by an analysis of all available and relevant information about circumstances that exist at the balance sheet date.”</p>

<sup>3</sup> Refer to paragraph 9 of the proposed Statement.

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11	Clarify the last sentence of the paragraph as follows:  “Interest expense/expenditures <del>reported</del> accrued on the <u>guaranteed obligation</u> should be reduced by the interest- <del>related</del> payments made by the guarantor that <u>the government that issued the guaranteed obligation is not required to repay to the guarantor are not required to be repaid.</u> ”
13	Clarify what is meant by “type” of guarantee.  Consider whether requiring the guarantor to disclose the credit quality status of the guaranteed obligation would be helpful to financial statement users (see ASC 815-10-50-4K(a)(4)).
13(b)	Clarify the requirement to provide a “description of the timing of recognition and measurement.” On the basis of the illustrative examples, we understand that this disclosure would require a reporting entity to describe what qualitative considerations resulted in the initial accrual of the financial guarantee liability. However, it is not clear what the entity should disclose about the measurement (e.g., whether this is a requirement to disclose how the entity arrived at its best estimate).
13(c)	Clarify what is meant by “outstanding guarantees.” Does it refer to the total amount guaranteed at period-end (i.e., the total open exposure without consideration of whether there has been an accrual)? Or is it meant only to reflect the total amount guaranteed at period-end that has not been accrued for?
Illustrations	Add footnotes to help preparers calculate the accrued liability amounts and any related changes to the liability amount in subsequent periods.