



KPMG LLP
345 Park Avenue
New York, N.Y. 10154-0102

Telephone +1 212 758 9700
Fax +1 212 758 9819
Internet www.us.kpmg.com

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

Dear Mr. Bean:

We appreciate the opportunity to provide our comments on the Governmental Accounting Standards Board (GASB) Exposure Draft (ED), *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions*. In general, we are supportive of the notion of recognition of a liability by a government that extends a financial guarantee to a third party when the entity that issued the guaranteed obligation does not fulfill its requirements. While the *more likely than not* criteria maybe appropriate for nonexchange financial guarantee transactions, we believe the Board should undertake a more thorough review of similar transactions and consider if this criteria for recognition should also be applied. We also believe there are significant changes and clarifications that are needed before the ED can be issued as a final standard, which are detailed in the following section of this letter. The final section of this letter includes our other comments and recommendations.

Exclusion of Exchange Financial Guarantees from Scope

It is not clear to us why the Board chose to limit the standard to nonexchange financial guarantees. Paragraph 26 states that the Board concluded that amended guidance related to financial guarantees that are exchange transactions would be more appropriately addressed in re-examination projects related to the various types of exchange transactions associated with an extended guarantee. We believe there is a significant need for guidance in this area, especially for finance authorities which routinely receive fees in exchange for financial guarantees of loans and debt. Exclusion of exchange financial guarantees from the scope of the standard will lead to inconsistent recognition. Accordingly, we recommend the Board expand the scope to include exchange financial guarantees.



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Definition of Financial Guarantee

Paragraph 4 states, “As used in this Statement, a financial guarantee extended that is a nonexchange transaction is a guarantee of an obligation of a legally separate entity that requires the guarantor to indemnify a third-party entity, the obligation holder, under specified conditions.” Based on the examples and illustrations provided in the ED, it appears that guarantees of traditional debt issuances would be within the scope of the ED; however, we believe it is not clear whether guarantees of other obligations, such as derivatives, performance obligations, and letters of credit, are also within the scope of the standard. We recommend the scope be more clearly defined to apply to obligations other than debt. In addition, we believe the examples and illustrations be revised to incorporate guarantees of other obligations.

Recognition

Paragraph 7 of the ED provides examples of qualitative factors relevant in assessing the likelihood that a government will make a payment in relation to the guarantee. These examples appear to impose an implied requirement on governments to have a process to actively determine whether any of these conditions exist, as opposed to a “triggering event” when the government becomes aware. For many of the qualitative factors listed, the government would not have timely access to the information to assess in the normal course of business. For example, one of the qualitative factors in paragraph 73 is failure to transfer deposits from debt service funds to the paying agent or trustee. The government providing the guarantee may not have access to information on the transfer of funds to paying agents. Does this standard imply the government should verify timely payment? We recommend these factors be removed and the Board allow for the use judgment when determining the likelihood that a government will have to make a payment in relation to a financial guarantee.

Measurement

Paragraph 9 of the ED indicates the amount to recognize should be the best estimate of the discounted present value of the future outflows expected to be incurred as a result of the guarantee. If there is no better estimate of the future outflows expected to be incurred but a range of estimated outflows can be established in which no amount within the range appears to be a better estimate than any other amount, the minimum in the range should be recognized. We are supportive of the notion of using the best estimate to record the liability when one is available; however, in cases where no amount is a better estimate than any other within a range of all estimates, we believe that the expected cash flow



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approach should be used to estimate the liability as this is more indicative of the notion more likely than not.

Other Comments and Recommendations

Governments Receiving a Financial Guarantee

Paragraph 11 indicates a government should reclassify that portion of its liability for the guaranteed obligation as a liability to the guarantor when the government is required to repay the guarantor for payments made on the government's obligations. We assume the accounting treatment in the paragraph applies to financial statements prepared using the economic resources measurement focus. We recommend the basis of accounting be specifically stated. In addition, it does not appear there is guidance addressing how to record this transaction in financial statements prepared using the current financial resources measurement focus. We believe the Board should provide such guidance.

Intra-entity recognition

In paragraphs 43 and 44 of the Basis for Conclusions, the Board acknowledges it considered the application of the recognition and measurement requirements to nonexchange financial guarantees between entities within the same financial reporting entity. Paragraph 44 indicates the Board considered the affect of "doubling up" of the liability, but concluded that since each entity has a present obligation to sacrifice resources that they have little or no discretion to avoid, the accounting and financial reporting guidance for nonexchange financial guarantees should also apply to intra-entity nonexchange financial guarantees. This may be appropriate on a standalone basis, but when a component unit is blended with the primary government, we believe this could potentially over state the obligation of the government as a whole based on the nature of the way the blended component unit is included in the primary government's financial statements (i.e. consolidated or presented as a separate fund). We recommend the Board provide specific guidance related to intra-entity nonexchange financial guarantees.

Accounting for Obligations Not Recorded by Governments Receiving a Financial Guarantee

As previously discussed, we are unclear whether the standard covers obligations, such as performance obligations, that may *not* be recorded on the statement of financial position. If the standard is intended to cover such circumstances, the accounting guidance for receipt of guarantee (i.e. reclassify portion of liability to a liability to guarantor) does not appear to be appropriate.



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Discount Rate

Paragraph 9 requires the guarantor to recognize a liability and an expense in financial statements prepared using the economic resources measurement focus using the best estimate of the discounted present value of the future outflows expected to be incurred as a result of the guarantee. While we agree with the use of a discounted rate, we have concerns that without specifying a benchmark for the discount rate, there will be inconsistency in practice. For example, GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, requires the application of a discount rate without any specificity which has led to disparity in practice. We encourage the Board to specify the rate to be used for discounting purposes and recommend it be based on an index or benchmark such as a AA (or higher) municipal bond rate with a maturity that corresponds to the liability.

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If you have any questions or need additional information regarding our comments, please contact Mr. Jeffrey Markert at 212-909-5306 or jmarkert@kpmg.com.

Very truly yours,

KPMG LLP