



Exposure Draft

July 30, 2018

Comments Due: November 2, 2018

Proposed Statement
of the Governmental Accounting Standards Board

Conduit Debt Obligations

This Exposure Draft of a proposed Statement of Governmental Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 26-6

Governmental Accounting Standards Board

CONDUIT DEBT OBLIGATIONS WRITTEN COMMENTS

Deadline for submitting written comments: November 2, 2018

Requirements for written comments. Comments should be addressed to the Director of Research and Technical Activities, Project No. 26-6, and emailed to director@gasb.org.

OTHER INFORMATION

Public hearing. The Board has not scheduled a public hearing on the issues addressed in this Exposure Draft.

This Exposure Draft may be downloaded from the GASB's website at www.gasb.org.

Public files. Written comments will become part of the Board's public file and are posted on the GASB's website.

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Notice to Recipients of This Exposure Draft

The Governmental Accounting Standards Board (GASB) is responsible for (1) establishing and improving standards of state and local governmental accounting and financial reporting to provide useful information to users of financial reports and (2) educating stakeholders—including issuers, auditors, and users of those financial reports—on how to most effectively understand and implement those standards.

The due process procedures that we follow before issuing our standards and other communications are designed to encourage broad public participation in the standards-setting process. As part of that due process, we are issuing this Exposure Draft setting forth proposed standards that would define conduit debt obligations for accounting and financial reporting purposes, establish recognition and measurement criteria for liabilities related to conduit debt obligations, and improve required note disclosures for conduit debt obligations.

We invite your comments on all matters in this proposed Statement. Because this proposed Statement may be modified before it is issued as a final Statement, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe the GASB should consider.

All responses are distributed to the Board and to staff members assigned to this project, and all comments are considered during the Board's deliberations leading to a final Statement. In deciding on changes in accounting and financial reporting standards, the GASB also takes into consideration the expected benefits to users of financial statements and the perceived costs of preparing and reporting the information. When the Board is satisfied that all alternatives have adequately been considered, and modifications have been made as considered appropriate, a vote is taken on the Statement. A majority vote is required for adoption.

Summary

The primary objectives of this proposed Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with additional commitments extended by issuers, arrangements associated with conduit debt obligations, and related note disclosures. This proposed Statement would achieve those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is a liability of the third-party obligor, not the issuer; establishing standards for accounting and financial reporting of additional commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

A conduit debt obligation would be defined as a debt instrument having *all* of the following characteristics:

- There are at least three parties involved: (1) an issuer, (2) a third-party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third-party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).
- The issuer's commitment related to the debt service payments is limited.

An issuer would not recognize a conduit debt obligation as a liability. However, an issuer would recognize a related liability and expense or expenditure if the recognition criteria are met. While a conduit debt obligation is outstanding, the issuer would evaluate at least annually whether those criteria are met.

This proposed Statement also would address arrangements—often characterized as leases—that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired from the proceeds of a conduit debt obligation and used by third-party obligors in the course of their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangements, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

Issuers would not report those arrangements as leases, nor would they recognize a liability for the related conduit debt obligations or a receivable for the payments related to those arrangements. In addition, the following would apply:

- If the title passes to the third-party obligor at the end of the arrangement, an issuer would not recognize a capital asset
- If the title does not pass to the third-party obligor and the third party has exclusive use of the entire capital asset during the arrangement, the issuer would not recognize a capital asset until the arrangement ends and the conduit debt obligation is paid off
- If the title does not pass to the third-party obligor and the third party has exclusive use of only portions of the capital asset during the arrangement, the issuer, at the inception

of the arrangement, would recognize the entire capital asset and a deferred inflow of resources. The deferred inflow of resources would be reduced, and revenue would be recognized in a systematic and rational manner over the term of the arrangement.

This proposed Statement would require issuers to disclose general information about their conduit debt obligations, organized by type of commitment(s), including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment(s). Issuers that recognize liabilities related to conduit debt obligations also would disclose information about the amount recognized and how the liabilities change during the reporting period.

Effective Date and Transition

The requirements of this proposed Statement would be effective for reporting periods beginning after December 15, 2020. Earlier application would be encouraged.

How the Changes in This Proposed Statement Would Improve Financial Reporting

The requirements of this proposed Statement would improve financial reporting by eliminating the existing option for issuers to report conduit debt obligations as their own liabilities, thereby ending significant diversity in practice. The clarified definition would resolve stakeholders' uncertainty as to whether a given financing is, in fact, a conduit debt obligation. Requiring issuers to recognize liabilities associated with additional commitments extended by issuers and to recognize assets and deferred inflows of resources related to certain arrangements associated with conduit debt obligations also would eliminate diversity, thereby improving comparability in reporting by issuers. Revised disclosure requirements would provide financial statement users with better information regarding the commitments issuers extend and the likelihood that they will fulfill those commitments. That information will inform users of the potential impact of such commitments on the financial resources of issuers and help users assess issuers' roles in conduit debt obligations.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 3 discusses the applicability of this Statement.

Proposed Statement of the Governmental Accounting Standards Board

Conduit Debt Obligations

July 30, 2018

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Proposed Statement of the Governmental Accounting Standards Board

Conduit Debt Obligations

July 30, 2018

INTRODUCTION

1. To provide financing for specific governmental or nongovernmental third-party obligors, some governments issue conduit debt obligations bearing the government's own name. Debt service payments generally are made by third-party obligors directly to debt trustees or, in private placements, directly to debt holders. In many cases, the issuer assumes no responsibility for debt service payments of a conduit debt obligation beyond the resources provided by the third-party obligor.

2. The objective of this Statement is to better meet the information needs of financial statement users by enhancing the comparability and consistency of conduit debt obligation reporting and reporting of related transactions and other events by state and local government issuers. This Statement also is intended to improve the relevance, reliability, and usefulness of information about conduit debt obligations, as well as related transactions and other events.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

3. This Statement defines conduit debt obligations for accounting and financial reporting purposes and establishes related standards for recognition, measurement, and disclosure for issuers. The requirements of this Statement apply to the financial statements of all state and local governments.

4. This Statement supersedes Interpretation No. 2, *Disclosure of Conduit Debt Obligations*, and *Implementation Guide No. 2015-1*, Question 7.22.14. This Statement amends Statement No. 34, *Basic Financial Statements— and Management's Discussion and Analysis— for State and Local Governments*, footnote 48; Statement No. 79, *Certain External Investment Pools and Pool Participants*, paragraph 31; Statement No. 87, *Leases*, paragraph 8; National Council on Governmental Accounting Interpretation 6, *Notes to the Financial Statements Disclosure*, paragraphs 4 and 5; and *Implementation Guide 2015-1*, Questions 2.27.1, 7.22.18, and Z.12.1.

Definition of a Conduit Debt Obligation

5. For accounting and financial reporting purposes, a conduit debt obligation is a debt instrument issued in the name of a state or local government but is for the benefit of a third

party that is primarily liable for the repayment of the debt instrument. A conduit debt obligation has *all* of the following characteristics:

- a. There are at least three parties involved: (1) an issuer, (2) a third-party obligor, and (3) a debt holder or a debt trustee.
- b. The issuer and the third-party obligor are not within the same financial reporting entity.
- c. The debt obligation is not a parity bond¹ of the issuer, nor is it cross-collateralized with other debt of the issuer.
- d. The third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- e. The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (hereinafter referred to as *debt service payments*).
- f. The issuer's commitment to support the debt service payments is limited to the commitments discussed in paragraph 6.

Limited and Additional Commitments Extended by Issuers

6. An issuer's commitment to support the debt service payments of a conduit debt obligation can vary. Generally, an issuer makes a commitment limited to resources provided by the third-party obligor. However, an issuer can extend *additional commitments* of its own resources beyond those provided by the third-party obligor. Under an additional commitment, an issuer agrees to support debt service payments in the event the third-party obligor is, or will be, unable to do so. Examples of additional commitments by an issuer to support debt service payments include, but are not limited to, the following types:

- a. Extending a moral obligation pledge
- b. Extending an appropriation pledge
- c. Extending a guarantee
- d. Pledging its own property, revenue, or other assets as security
- e. Requesting appropriations without a moral obligation pledge or appropriation pledge.

Recognition and Measurement

7. An issuer should not recognize a conduit debt obligation as a liability. However, an issuer should recognize a related liability and expense or expenditure if the recognition criteria in paragraphs 8–12 are met. While the conduit debt obligation is outstanding, the issuer should evaluate at least annually whether those criteria are met.

¹A parity bond is a bond with equal rights to the collateral as other bonds issued under the same parity bond indenture.

Recognition and Measurement in Financial Statements Prepared Using the Economic Resources Measurement Focus

8. An issuer should recognize a related liability and an expense in financial statements prepared using the economic resources measurement focus if qualitative factors indicate that it is *more likely than not*² that the issuer will support debt service payments for a conduit debt obligation.

9. Qualitative factors to assess whether it is more likely than not that an issuer will support debt service payments include, but are not limited to, the following:

- a. A third-party obligor initiating the process of entering into bankruptcy or financial reorganization
- b. A third-party obligor breaching a debt contract in relation to the conduit debt obligation, such as failure to meet rate covenants, failure to meet debt service coverage ratios, or default or delinquency in debt service payments
- c. A third-party obligor experiencing significant financial difficulty, such as failure to make payments to paying agents or trustees on a timely basis; drawing on a reserve fund to make debt service payments; initiation of a process to intercept receipts to make debt service payments; debt holder concessions; significant investment losses; loss of a major revenue source; significant increase in noncapital disbursements in relation to operating or current revenues; or commencement of financial supervision by another government, if the third-party obligor is a government
- d. Termination of the project that was to be the source of funding for debt service payments
- e. Litigation that would negatively affect the project
- f. The issuer's concern that a defaulted conduit debt obligation could affect its access to capital markets
- g. The issuer's history of fulfilling its additional commitments to support debt service payments for other conduit debt obligations, including voluntarily supporting debt service payments
- h. The issuer's ability or willingness to support debt service payments.

10. The amount recognized for the liability and expense should be measured as the discounted present value of the best estimate of the future outflows (that is, payments to support debt service) expected to be incurred. If there is no best estimate of the future outflows expected to be incurred but a range of estimated future outflows can be established in which no amount within that range appears to be a better estimate than any other amount, the discounted present value of the minimum amount in that range should be recognized.

Recognition and Measurement in Financial Statements Prepared Using the Current Financial Resources Measurement Focus

11. An issuer should recognize a fund liability and an expenditure, to the extent that the liability is normally expected to be liquidated with expendable available financial resources,

²The term *more likely than not* means a likelihood of more than 50 percent.

if qualitative factors, discussed in paragraph 9, indicate that it is more likely than not that the issuer will support debt service payments for a conduit debt obligation.

12. A fund liability is normally expected to be liquidated with expendable available financial resources when a payment to support a conduit debt obligation is due and payable.

Arrangements Associated with Conduit Debt Obligations

General Attributes

13. Issuers of conduit debt obligations may enter into certain arrangements with third-party obligors associated with conduit debt obligations. Generally, those arrangements are characterized as leases and have the following attributes:

- a. The construction or acquisition of the capital asset is financed with the proceeds from the conduit debt obligation.
- b. The issuer retains the title to the capital asset from the beginning of the arrangement.
- c. The payments from the third-party obligor are to cover the debt service payments and are made to the debt holder or debt trustee.
- d. The payment schedule of the arrangement coincides with the debt service repayment schedule.

14. Issuers should *not* report the arrangements described in paragraph 13 as leases. Generally, those arrangements can be classified into one of the following three categories. Those arrangements should be recognized consistent with the provisions in paragraphs 15–18.

- a. The issuer relinquishes the title to the capital asset at the end of the arrangement, at which time the conduit debt obligation generally has been paid off. (See paragraph 15.)
- b. The issuer does not relinquish the title to the capital asset. The third-party obligor has exclusive use of the entire capital asset until the end of the arrangement. (See paragraph 16.)
- c. The issuer does not relinquish the title to the capital asset. The third-party obligor has exclusive use of only portions of the capital asset until the end of the arrangement. (See paragraphs 17 and 18.)

Issuer Relinquishes Title at the End of the Arrangement

15. In an arrangement as described in paragraphs 13 and 14a, the issuer should *not* recognize (a) a liability for the conduit debt obligation, (b) the capital asset, or (c) a receivable for the payments related to the arrangement.

Issuer Retains Title and Third-Party Obligor Has Exclusive Use of the Entire Capital Asset

16. In an arrangement as described in paragraphs 13 and 14b, at the inception of the arrangement, the issuer should *not* recognize (a) a liability for the conduit debt obligation, (b) the capital asset, or (c) a receivable for the payments related to the arrangement. When

the arrangement ends, at which time the conduit debt obligation generally has been paid off, the issuer should recognize the capital asset at *acquisition value*, as defined in paragraph 79 of Statement No. 72, *Fair Value Measurement and Application*.

Issuer Retains Title and Third-Party Obligor Has Exclusive Use of Portions of the Capital Asset

17. In an arrangement as described in paragraphs 13 and 14c, the issuer, at the inception of the arrangement, should recognize the entire capital asset (rather than only the portions of the asset for which the third-party obligor has nonexclusive use) at acquisition value. The issuer should *not* recognize either (a) a liability for the conduit debt obligation or (b) a receivable for the payments related to the arrangement.

18. In that arrangement, when the issuer recognizes the capital asset, the issuer also should recognize a deferred inflow of resources for the same amount. The deferred inflow of resources should be reduced, and revenue should be recognized in a systematic and rational manner over the term of the arrangement.

Notes to Financial Statements

19. Issuers should disclose information about conduit debt obligations in the notes to financial statements. The disclosures required by paragraphs 20 and 21 should be organized by the type of commitment(s) the issuer has extended, as described in paragraph 6.

20. The disclosures of conduit debt obligations should include:

- a. A general description of the issuer's conduit debt obligations
- b. A general description of the issuer's commitment(s)
- c. The aggregate outstanding principal amount of all conduit debt obligations that share the same type of commitment(s) at the end of the financial reporting period.

21. If an issuer has recognized a liability in accordance with paragraphs 7–12, it should disclose the following information:

- a. A brief description of the timing of recognition and measurement of the liability and information about the changes in the recognized liability, including the following:
 - (1) Beginning-of-period balances
 - (2) Increases, including initial recognition and adjustments increasing estimates
 - (3) Decreases, including payments made and adjustments decreasing estimates
 - (4) End-of-period balances
- b. Cumulative amounts of payments that have been made on the recognized liability at the reporting date, if any
- c. Amounts expected to be recovered from those payments, if any.

EFFECTIVE DATE AND TRANSITION

22. The requirements of this Statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.

23. Changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. If restatement for prior periods is not practicable, the cumulative effect, if any, of applying this Statement should be reported as a restatement of beginning net position (or fund balance or fund net position, as applicable) for the earliest period restated. In the first period that this Statement is applied, the notes to financial statements should disclose the nature of the restatement and its effect. Also, the reason for not restating prior periods presented should be disclosed.

**The provisions of this Statement need
not be applied to immaterial items.**

Appendix A

BACKGROUND

A1. The GASB first addressed conduit debt obligations in Interpretation 2, issued in 1995. Interpretation 2 described conduit debt obligations as follows:

The term *conduit debt obligations* refers to certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing capital financing for a specific third party that is not a part of the issuer's financial reporting entity. Although conduit debt obligations bear the name of the governmental issuer, the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued. [Paragraph 2; footnote omitted.]

A2. Conduit debt obligations generally are tax exempt, provided that they conform to relevant portions of the Internal Revenue Code. Thus, those financings are a way for not-for-profit organizations—for example, hospitals, nursing home facilities, and educational institutions—to secure financings at tax-exempt rates. Borrowers (third-party obligors) also may be for-profit entities or other governments. This structure is often used when the issuer is considered to have financing expertise and can take advantage of economies of scale (for example, a state finance authority). Many issuers receive a fee for arranging conduit debt financings, and some are government agencies organized solely to issue conduit debt obligations. Third-party obligors are identified in debt documents, such as offering statements and bond indentures. Based on the GASB's pre-agenda research, users generally consider information about conduit debt obligations to be important for assessing issuers' roles in those debt obligations.

A3. Interpretation 2 required a government issuer to disclose information about its conduit debt obligations in the notes to financial statements, including: (a) a general description of the conduit debt obligations, (b) the aggregate amount of all conduit debt obligations outstanding at the date of financial statements, and (c) a clear indication that the issuer has no obligation for the debt beyond the resources provided by related leases or loans. Under Interpretation 2, issuers that were reporting their conduit debt obligations as liabilities on their financial statements, along with related assets, were permitted to continue doing so.

A4. Before adding a Conduit Debt Obligations project to its current technical agenda, the GASB conducted pre-agenda research. That research found that even though Interpretation 2 provided a description of conduit debt obligations, confusion still existed among stakeholders in determining whether a specific financing would meet that description. Application of Interpretation 2 has been inconsistent, and many financial statement users believe there should be more information provided by issuers in their note disclosures. The research also considered the Board's work on its conceptual framework. Since the issuance of Interpretation 2, the Board has addressed note disclosures in Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain*

Basic Financial Statements, and elements in Concepts Statement No. 4, *Elements of Financial Statements*. Prior to this project on conduit debt obligations, the provisions of Interpretation 2 had not been evaluated in light of those Concepts Statements.

A5. In June 2017, the members of the Governmental Accounting Standards Advisory Council (GASAC) were consulted to identify practice issues related to applying the existing standards. Issues associated with conduit debt obligations were among those ranked with the highest priorities identified by GASAC members. The Board added the Conduit Debt Obligations project to its current technical agenda in August 2017 as a practice issue project. Board deliberations began in September 2017. Throughout the Board's due process, the GASAC and other stakeholders provided feedback on the project.

Appendix B

BASIS FOR CONCLUSIONS

Introduction

B1. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

Scope and Applicability

Definition and Characteristics of Conduit Debt Obligations

B2. In establishing the definition and characteristics of conduit debt obligations for accounting and financial reporting purposes, the Board considered the issues identified through its pre-agenda research. The Board noted that despite the issuance of Interpretation 2 in 1995, many of the technical inquiries received by the GASB staff relating to conduit debt obligations continue to deal with the fundamental question of what should be considered a conduit debt obligation. The Board found that there are some characteristics that stakeholders generally agree would distinguish conduit debt obligations from an issuer's nonconduit debt obligations. In developing the definition in this Statement, the Board considered all the potential characteristics identified in the pre-agenda research.

B3. Many stakeholders participating in the pre-agenda research noted that conduit debt obligations involve at least three parties: (a) a government that issues the debt to finance a project; (b) a third-party obligor that receives the proceeds from the debt issuance, carries out the project, and makes debt service payments; and (c) a debt holder (for privately placed loans) or a debt trustee (for publicly sold bonds) that receives the debt service payments from the third-party obligor. Based on those findings, the Board decided that the "three-party" aspect should be a defining characteristic of conduit debt obligations.

B4. Paragraph 2 of Interpretation 2 describes conduit debt obligations as debt instruments "for a specific third party that is not a part of the issuer's financial reporting entity" (footnote reference omitted). In addition, Question 7.22.18 in Implementation Guide 2015-1 expands on that characteristic and highlights that a debt obligation between governments in the same reporting entity is not conduit debt. In the GASB's view, if a debt issuer and a third-party obligor are within the same financial reporting entity, the debt should be recognized by the issuer. Many financing authorities at the state and local levels are established as component units of a primary government. The financing authorities' sole purpose is to issue debt to finance projects for their primary governments and other component units. The Board believes that if debt that is issued by a component unit for the benefit of the primary government or another component unit were to be treated as a conduit debt obligation, that treatment would not be a faithful presentation of the debt. As a result, the Board concluded

that another defining characteristic of conduit debt obligations should be that the issuer and third-party obligor are not within the same reporting entity.

B5. In identifying the characteristics of conduit debt obligations, the Board considered housing financing agencies, associations, or authorities that issue housing-related debt to finance (a) single-family mortgage loans for the benefit of lower income first-time homebuyers or (b) multifamily mortgage loans for the construction, acquisition, or rehabilitation of multifamily housing for the benefit of tenants with incomes below certain thresholds. The Board noted that some of that housing-related debt possesses the characteristics of conduit debt obligations discussed in paragraphs B3 and B4. However, the Board also noted that if a debt obligation is a parity bond of the issuer, it will be subject to a parity bond indenture. Consequently, unspent bond proceeds, properties and revenue pledged, and other security relative to each parity bond issued under the same indenture can be used for any individual bond issued under the same parity bond indenture. Accordingly, under a parity bond indenture, the government becomes both the issuer and the obligor for all the bonds issued. A similar mechanism applies to cross-collateralization. In addition to housing-related financings, during the Board's deliberations it also was noted that parity bonds and cross-collateralization may appear in other areas including student loan financings and revolving loan programs. The Board believes that if a debt obligation is a parity bond of the issuer or is cross-collateralized with other debt of the issuer, such a debt obligation should not be considered a conduit debt obligation but, rather, the issuer's own debt obligation. Therefore, the Board concluded that another defining characteristic of conduit debt obligations should be that the obligation is neither a parity bond of the issuer nor cross-collateralized with other debt of the issuer.

B6. Pre-agenda research and outreach conducted throughout the project also indicate that the third-party obligor or its agent, not the issuer, ultimately receives debt proceeds from conduit debt obligations. The Board believes that the term *ultimately* is important to describe this aspect of conduit debt obligations. There may be financings in which an issuer initially receives debt proceeds and then passes the proceeds to the third-party obligor through a debt trustee. Without specifying the *ultimate* recipient, the issuer may be viewed as the recipient of the debt proceeds, even though it is the third-party obligor that ultimately receives the debt proceeds. Similarly, the Board also believes it is important to include the third-party obligor's agent as a party that can ultimately receive the debt proceeds. The Board noted that there may be financings in which a third-party obligor designates its agent as the recipient of the debt proceeds. For example, an architectural engineering firm may be contracted by a charter school to build an auditorium. The charter school as a third-party obligor, designates the firm as the recipient of the proceeds from the related conduit debt obligation. In this case, the architectural engineering firm is acting as an agent of the charter school; therefore, the charter school in substance receives the debt proceeds. The Board believes that whether the third-party obligor or its agent ultimately receives the debt proceeds does not change the economic substance of a conduit debt obligation. As a result, the Board concluded that another defining characteristic of conduit debt obligations should include both the third-party obligor and its agent as the ultimate recipients of the debt proceeds.

B7. Pre-agenda research and outreach also suggest that for what stakeholders believe are conduit debt obligations, the third-party obligor is primarily obligated for the debt service payments. The issuer may support debt service payments if the third party is, or will be, unable to pay because the issuer has extended an additional commitment to the conduit debt obligation, including when the issuer decides to voluntarily support the debt service payments. However, despite the issuer's additional commitments, the primary obligation for debt service payments still resides with the third-party obligor. Therefore, the Board concluded that this aspect of the financing should be another defining characteristic of conduit debt obligations.

Limited and Additional Commitments Extended by Issuers

B8. Paragraph 2 of Interpretation 2 stated that “. . . the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued.” However, the pre-agenda research indicates that an issuer sometimes may extend additional commitments of its own resources that are beyond the resources provided by the third-party obligor. In those instances, an issuer agrees to support debt service payments in the event the third-party obligor is, or will be, unable to pay. Several examples of the types of those additional commitments were identified, including situations in which an issuer (a) extends a moral obligation pledge; (b) extends an appropriation pledge; (c) extends a guarantee; (d) pledges its own property, revenue, or other assets as security; or (e) requests appropriations without a moral obligation pledge or an appropriation pledge. In considering examples that could demonstrate a moral obligation, the Board rejected situations in which a government official makes a public statement implying that the government would support debt service payments. The Board believes such an assertion is the statement of an individual and not an additional commitment of the government. The last type of additional commitment identified as an example by the Board, shown as (e) above, are voluntary payments by an issuer to support a conduit debt obligation in the event the obligor is unable to pay. The Board believes, any voluntary payments, in substance, should be viewed as an additional commitment. The Board concluded that when associated with conduit debt obligations, issuers' additional commitments comprise contingent obligations that are not fundamentally different from similar commitments made by issuers for other types of debt. That is, the presence of an additional commitment does not, by itself, transfer the liability for the debt from the third-party obligor to the issuer. Accordingly, the Board believes the presence of any type of additional commitment(s) does not alter the “conduit” nature of conduit debt obligations.

B9. To determine whether an issuer's additional commitments would affect the definition of a conduit debt obligation in this Statement, the Board considered two possible approaches. The first approach would be to develop a broad definition that is not affected by an issuer's additional commitments, provided that all other characteristics of a conduit debt obligation are met. The second approach would narrowly define a conduit debt obligation to include only those in which an issuer's commitment is limited to resources provided by the third-party obligor, as initially defined in Interpretation 2.

B10. The Board decided that the first approach—the broader definition—was more appropriate. The Board is not convinced there is a conceptual difference between a conduit

debt obligation with a commitment that is limited to resources provided by the third-party obligor and a conduit debt obligation with additional commitments that extend beyond those resources. The broader definition would provide comprehensive guidance for debt obligations that meet all characteristics of a conduit debt obligation. The pre-agenda research indicated that there are different stakeholder views regarding whether a conduit debt obligation could include an issuer's additional commitment, such as those described in paragraph 6 of this Statement. The Board believes that a broad definition that encompasses such additional commitments would bring clarity to stakeholders and improve consistency and comparability in financial reporting.

Recognition and Measurement

Issuer Should Not Recognize a Conduit Debt Obligation as a Liability

B11. Paragraph 3 of Interpretation 2 required all conduit debt obligations to be disclosed in the notes to financial statements of the issuers. As noted in Appendix A of this Statement, Interpretation 2 permitted, but did not require, issuers to report certain conduit debt obligations as liabilities, along with related assets, on the face of their financial statements. As a result, recognition of liabilities for conduit debt obligations differed from government to government. In the Basis for Conclusions of Interpretation 2, the Board stated that "its decision [on reporting conduit debt obligations] should be reconsidered after a definition of a governmental liability is developed" (paragraph 14).

B12. Concepts Statement 4 provides the definition of a liability. Paragraph 7 of Concepts Statement 4 describes the relationship of the definition of an element and its recognition in financial statements: "For an item to be recognized in a financial statement, it should meet all relevant criteria. These criteria include meeting the definition of an element, as well as meeting recognition and measurement criteria." In addition, paragraph 17 defines liabilities as "present obligations to sacrifice resources that the government has little or no discretion to avoid." Paragraph 22 elaborates that, "For an obligation to be a liability, it should be a present obligation. The event that created the liability has taken place. This distinguishes the item from a commitment that may become a liability in the future when the event giving rise to the liability occurs. The government may be able to withdraw from or avoid the commitment until a future event giving rise to the liability occurs."

B13. The Board believes that the definition of a liability in Concepts Statement 4 leads to the conclusion that a conduit debt obligation is not a liability of an issuer and should not be recognized in the issuer's financial statements. Based on the definition of conduit debt obligations in this Statement, it is the third-party obligor, not the issuer, that has the primary obligation for the debt service payments. Because the issuer is not the obligor, the issuer does not have a "present obligation to sacrifice resources" to support debt service payments. An issuer's additional commitment is its promise to support debt service payments with its own resources in the event the third-party obligor is or will be unable to make payments in the future. The future event that would create a potential liability for the issuer has not taken place at the time a conduit debt obligation is issued. In other words, even if an issuer makes an additional commitment, the conduit debt obligation does not represent a present

obligation of the issuer to sacrifice resources. Therefore, the Board concluded that an issuer should not recognize a conduit debt obligation as a liability.

Recognition and Measurement of Liabilities Resulting from an Issuer's Additional Commitments

B14. Although a conduit debt obligation is not a *present* obligation and, therefore, does not meet the definition of a liability for an issuer, additional commitments extended by an issuer represent contingent obligations. An obligation is defined in paragraph 18 of Concepts Statement 4 as “a social, legal, or moral requirement, such as a duty, contract, or promise that compels one to follow or avoid a particular course of action” (footnote reference omitted). When an issuer extends an additional commitment associated with a conduit debt obligation, the issuer agrees to support debt service payments with its own resources, if the third-party obligor is or will be unable to make such payments. Whether a specific additional commitment would rise to the level of a present obligation and be required to be recognized as a liability depends on whether the recognition criteria are met.

B15. Recognition criteria are not addressed in the existing conceptual framework. Recognition refers to *when* an element—such as a liability—should be reported in a financial statement. The Board believes the most relevant existing guidance for recognition criteria for those types of commitments is (a) recognize a liability when payment is *probable*, as provided in paragraphs 96–113 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, and (b) recognize a liability when payment is more likely than not, as provided in paragraphs 9 and 10 of Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*.

B16. The Board's main concern is that using probable as the recognition threshold may cause recognition by an issuer to be delayed, resulting in an understatement of liabilities and expenses. That concern is based on anecdotal evidence that indicates that applying a probable threshold in practice often delays recognition until a payment becomes imminent. Conversely, if more likely than not is used as the recognition benchmark for liabilities resulting from an issuer's additional commitments associated with conduit debt obligations, consistency, comparability, and timeliness of recognition would be enhanced. Therefore, the Board decided the recognition criteria for a liability resulting from an issuer's additional commitments in conduit debt obligations should be when the likelihood of the issuer making a payment to support debt service is more likely than not, as defined in Statement 70.

B17. The Board believes that, in addition to the recognition criteria in Statement 70, it would be equally appropriate if the measurement guidance in Statement 70 is adopted for the transactions and other events addressed in this Statement.

Qualitative Factors in Assessing Whether It Is More Likely Than Not an Issuer Will Support Debt Service Payments

B18. The Board acknowledges that the evaluation of the likelihood of whether an issuer may support debt service payments for a conduit debt obligation can be difficult.

Statement 70 provides a list of qualitative factors as examples that may indicate when a guarantor's payment for a nonfinancial guarantee is more likely than not. The Board concluded that similar and comparable guidance should be provided to assist issuers in evaluating whether it is more likely than not that they will support debt service payments of a conduit debt obligation.

B19. Statement 70 addresses nonexchange guarantees, which is one type of commitment. This Statement, however, expands the definition of a conduit debt obligation to include those with additional commitments that are not limited to guarantees. Therefore, the Board decided other qualitative factors are needed to help issuers evaluate whether it is more likely than not that they will support debt service payments of a conduit debt obligation.

Arrangements Associated with Conduit Debt Obligations

B20. In some cases, governments issue conduit debt obligations to finance the construction or acquisition of capital assets for third-party obligors—usually private-sector entities—to use in the third parties' operations, even though the issuers retain the titles to the capital assets. Generally, the capital assets financed by conduit debt obligations are pledged as collateral for the benefit of debt holders. The payments from those arrangements—frequently characterized as leases, are structured to cover debt service payments on the conduit debt obligations and are made by the third-party obligors to debt holders or debt trustees. However, there are differences within those arrangements that are significant enough to warrant distinguishing three separate categories.

B21. In the first category of arrangements, as described in paragraph 14a of this Statement, an issuer holds the title to the capital asset until the arrangement ends, at which time the title is transferred to the third-party obligor (generally when the debt is paid off). In the second and third categories of arrangements, as described in paragraphs 14b and 14c of this Statement, respectively, the issuer does not transfer the title to the capital asset to the third-party obligor, even after the arrangement ends. Although similar, there is a significant difference between the categories described in paragraph 14b and paragraph 14c. In paragraph 14b, the third-party obligor has exclusive use of the entire capital asset during the length of the arrangement. In paragraph 14c, the third-party obligor has exclusive use of only *portions* of the capital asset during the length of the arrangement.

B22. Some respondents to the Exposure Draft of Interpretation 2 believed that, at a minimum, liabilities should be recognized for those conduit debt obligations that finance facilities on property owned by the issuer and for which no transfer of ownership to the third-party obligor occurs. That approach would require an issuer to recognize a liability in the arrangements described in both paragraphs 14b and 14c of this Statement. However, Interpretation 2 did not address recognition of liabilities for conduit debt obligations in general. As previously noted, the Board decided, at that time, that “questions relating to accounting recognition for conduit debt transactions should be reconsidered after further progress is made” on the conceptual framework project that would address the definition of elements of financial statements, including liabilities (paragraph 12 of Interpretation 2).

B23. Those additional arrangements associated with conduit debt obligations also are excluded from the scope of Statement 87. Specifically, Statement 87 excludes from its scope “leases in which the underlying asset is financed with outstanding conduit debt, unless both the underlying asset and the conduit debt are reported by the lessor” (paragraph 8e). In the Basis for Conclusions of that Statement, paragraph B16 explains that those arrangements are excluded because of the accounting complexities associated with those transactions and the then on-going pre-agenda research activity to reexamine conduit debt obligations.

B24. Given the history and complexity of the issue, the Board concluded that specific guidance should address the accounting recognition issues resulting from such arrangements associated with conduit debt obligations. The Board believes the existence of those arrangements in any of the three categories described in paragraph 14 of this Statement does not change the nature of the associated conduit debt obligations. In substance, the payments from the third-party obligors are not “lease payments” but, rather, debt service payments to debt holders or debt trustees. Consequently, the Board concluded that, for all three categories, an issuer should *not* recognize (a) a liability for the related conduit debt obligation, (b) a receivable for the payments related to the arrangement, or (c) the arrangement as a lease.

B25. The Board also considered potential recognition of the capital assets financed with the conduit debt obligations and analyzed each of the three categories independently. Paragraph 8 of Concepts Statement 4 defines assets as “resources with present service capacity that the government presently controls.” As previously noted, in the first category, the issuer has the title to the capital asset but relinquishes it to the third-party obligor at the end of the arrangement, at which time the conduit debt obligation generally is paid off. From the issuer’s perspective, at no point is there present service capacity associated with that capital asset. Therefore, the Board concluded in that case, that the issuer should not recognize the capital asset as its own at any time.

B26. In the second category of arrangements, the issuer retains the title to the capital asset. The third-party obligor has exclusive use of the *entire* capital asset until the end of the arrangement. The issuer does not relinquish the title to the capital asset to the third party at the end of the arrangement. As previously noted, paragraph 8 of Concepts Statement 4 defines assets as “resources with present service capacity that the government presently controls.” Although the issuer has the title, there is no present service capacity associated with the capital asset from the issuer’s perspective as long as the third-party obligor has exclusive use of it. The issuer cannot use the present service capacity of the capital asset to fulfill its mission to provide public services. Furthermore, the payments made pursuant to the arrangement do not go to the issuer but rather to debt holders or debt trustees. Thus, from the issuer’s standpoint, the capital asset is not an income-producing asset and does not provide present service capacity in the form of economic benefits. Therefore, the Board concluded that in the second category of arrangements, the issuer should not recognize a capital asset during the additional arrangement. However, when the additional arrangement ends, at which time the third-party obligor will no longer have exclusive use of the capital asset, the issuer not only will retain the title to the capital asset but also will have access to the present service capacity of that capital asset. Therefore, in that case, the Board concluded that the issuer should, at the end of the arrangement, recognize the capital asset.

B27. In the third category of arrangements, the issuer retains the title to the capital asset. The third-party obligor has exclusive use of only *portions* of the capital asset until the end of the additional arrangement. The other portions of the capital asset may be used by the issuer or the general public. Because the third-party obligor does not have exclusive use of the entire capital asset, the Board believes that the capital asset taken as a whole possesses present service capacity for the issuer.

B28. The Board considered whether the issuer should divide the capital asset into two separate units of account, based on the relative proportions of exclusive and nonexclusive uses. The Board recognizes the conceptual basis of this approach, as the application of *unit of account* would allow an asset to be divided and accounted for separately. However, if separation is required, an issuer would recognize the asset and related depreciation only for the portions of the capital asset that are for nonexclusive use. For practical reasons, the Board concluded that separation of the asset should not be permitted. That conclusion is similar to that reached by the Board in Statement 87. That Statement does not allow separating the capital asset underlying a lease, rather, the lessor cannot derecognize the capital asset. The Board believes that from a practical standpoint, the effort associated with separating the underlying asset does not appear to be cost-beneficial. Therefore, the Board concluded that in the third category of arrangements, the issuer should recognize the entire capital asset rather than only the nonexclusive-use portions.

B29. The Board also considered alternatives for recognition of the credit when an issuer recognizes the capital asset in the arrangement described in the third category. Statement No. 65, *Items Previously Reported as Assets and Liabilities*, provides the “approach that established a hierarchy for applying the definitions of the elements in Concepts Statement 4” (paragraph 45). Based on that approach, the Board first evaluates an item as a potential asset or liability as defined in Concepts Statement 4. If it does not meet one of those definitions, the item should be tested against the definition of a deferred outflow of resources or a deferred inflow of resources. Finally, if the item does not meet the definition of a deferred outflow of resources or a deferred inflow of resources, it should be considered for recognition as an outflow of resources or an inflow of resources.

B30. The Board applied that approach when considering what the credit should be when an issuer recognizes the capital asset in category three. Because the Board had previously determined that an issuer should not report a liability for the related conduit debt obligation that finances the capital asset in those arrangements, the Board considered whether the potential credit meets the definition of a deferred inflow of resources. The Board believes that an issuer’s position in that category is comparable to a transferor’s position in the arrangements described in Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (paragraphs 9 and 12). In Statement 60, when a facility under a service concession arrangement is newly constructed or purchased by the operator, the transferor should report the new facility as a capital asset and a corresponding deferred inflow of resources. In category three, the Board concluded that even though the issuer should not report a liability for a conduit debt obligation, recognition of a capital asset and a deferred inflow of resources still is appropriate. Therefore, to be consistent with the Statement 60 guidance, the Board decided the appropriate credit when the issuer recognizes the capital asset should be a deferred inflow of resources.

Disclosure Requirements of This Statement

B31. In addition to the concepts set forth for the notes to financial statements in Concepts Statement 3 and the feedback from GASAC members and subject-matter experts, the Board considered the disclosures required by Statements 62 and 70 and Interpretation 2. Because each of those pronouncements provides guidance for transactions that are relevant to conduit debt obligations, the Board decided to develop the disclosure requirements for conduit debt obligations based on those standards rather than create a new set of disclosures. The Board believes that providing consistent and comparable disclosures for conduit debt obligations is practical and will reduce costs.

B32. The pre-agenda research indicated that stakeholders generally find the disclosures required by paragraph 3 of Interpretation 2 to be valuable for making decisions and assessing accountability. The Board believes that those disclosures offer users important insights into items that may not be on the face of the financial statements, one of the guiding principles for note disclosures found in Concepts Statement 3. The Board concluded that those disclosure requirements should be incorporated into this Statement.

B33. The disclosure requirements from Interpretation 2 were revised to conform to the broad definition of a conduit debt obligation in this Statement, which encompasses all issuers' commitments. With the conforming edits, the disclosure of outstanding conduit debt obligations is organized by the type of commitment(s) and includes a general description of each type of commitment(s). The pre-agenda research found that variation in the types of commitments issuers extend creates uncertainty about finance-related consequences to issuers, because it may be unclear whether those commitments will compel an issuer to sacrifice its own resources to support the debt service payments. The Board concluded that the required disclosures would provide essential information about conduit debt obligations and give additional insights into potential outflows of resources from issuers.

B34. This Statement provides that if an issuer has recognized a liability related to its conduit debt obligations or has made payments related to its conduit debt obligations during the reporting period, it should disclose the information required by paragraph 21. The Board concluded that those disclosures provide essential detail about the amounts recognized in the financial statements, especially considering the Board's decision that conduit debt obligations can carry additional commitments of an issuer's own resources beyond those provided by the third-party obligor. The Board believes that for situations in which a related liability results from those additional commitments, that information will allow users to better understand the issuer's ongoing financial responsibilities related to conduit debt obligations.

Disclosures Considered but Not Required

B35. The pre-agenda research indicated that some stakeholders believe that information about the identity, credit rating, and payment history of the third-party obligor would help them assess the issuer's potential obligations. Some stakeholders also believe that disclosures of project information—such as whether (a) a conduit debt obligation satisfies

the financial needs of the program it is financing, (b) taxpayers get benefits from the program financed by the conduit debt obligation, and (c) the conduit debt financing is the lowest cost of borrowing and most expeditious way to finance the project—may be useful to assessing the issuer’s accountability and transparency. The Board acknowledges the potential interest in those disclosures but believes such information is not essential for users’ understanding of the financial aspects of the conduit debt obligations. Essentiality is one of the criteria required by Concepts Statement 3 to be met before any information is included in the notes to financial statements. The Board noted that the potential disclosures about third-party obligors would require disclosures of that information for each individual conduit debt obligation, which may be burdensome for issuers, especially those with many conduit debt obligations. The Board also noted that gathering information on the associated projects could require significant efforts that may not be justified by the usefulness of the information. Therefore, the Board concluded that disclosure of information about third-party obligors and the projects associated with the conduit debt obligations should not be required.

B36. This Statement does not require an issuer to recognize a liability for additional commitments related to a specific conduit debt obligation unless it is more likely than not that the issuer will make a payment to support the third-party obligor’s debt service. In addition, the issuer is required to disclose information about a recognized liability. However, there may be instances in which an issuer’s additional commitment for each individual conduit debt obligation does not meet the recognition criteria, but when all such commitments are considered in the aggregate, it becomes more likely than not that some additional commitment will be honored. In those situations, an issuer may need to consider the disclosure requirements in paragraph 107 of Statement 62, as amended, when no liability is recognized for a loss contingency. The Board considered adding a specific requirement in this Statement for such a disclosure because some preparers may not realize that the disclosure requirement in Statement 62 would apply to conduit debt obligations in the situation described above. However, the Board believes that the loss contingency literature in Statement 62 is well-known to preparers and already provides sufficient guidance for reporting loss contingencies. Therefore, the Board decided that including a reference to disclosures that may be required by other loss contingency literature is not necessary.

Considerations Related to Benefits and Costs

B37. The overall objective of financial reporting by state and local governments is to provide information to assist users (the citizenry, legislative and oversight bodies, and investors and creditors) in assessing the accountability of governments and in making economic, social, and political decisions. One of the principles guiding the Board’s setting of standards for financial reporting is the assessment of the expected benefits and perceived costs. The Board strives to determine that its standards (including disclosure requirements) address a significant user need and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit.

B38. Present and potential users are the primary beneficiaries of improvements in financial reporting. Persons within governments who are responsible for keeping accounting records

and preparing financial statements, as well as managers of public services, also benefit from the information that is collected and reported in accordance with GASB standards. The costs to implement the standards are borne primarily by governments and, by extension, their citizens and taxpayers. Users also incur costs associated with the time and effort required to obtain and analyze new information to meaningfully inform their assessments and decisions.

B39. The Board's assessment of the expected benefits and perceived costs of issuing new standards is unavoidably more qualitative than quantitative because no reliable and objective method has been identified for quantifying the value of improved information in financial statements. Furthermore, it is difficult to accurately measure the costs of implementing new standards until implementation has taken place. Nonetheless, the Board undertakes this assessment based on the available evidence regarding expected benefits and perceived costs with the objective of achieving an appropriate balance between maximizing benefits and minimizing costs.

B40. Practice was inconsistent, and the conceptual framework project was pending when Interpretation 2 was issued. The Board decided then that liability recognition of conduit debt obligations would be reconsidered after a definition of a governmental liability was developed. As previously noted, since the issuance of Interpretation 2, the GASB has addressed the definition of liabilities through Concepts Statement 4. Before this Statement, the provisions in Interpretation 2 had not been evaluated in light of the conceptual framework with regard to whether or when conduit debt obligations should be reported as an issuer's liability. The Board believes that this Statement will provide consistency in recognition of a conduit debt obligation by requiring recognition only when an additional commitment meets the conceptual definition of a liability and the recognition threshold of more likely than not. The Board also believes that eliminating the option to recognize a liability for a conduit debt obligation under Interpretation 2 and providing specific guidance on additional commitments and arrangements associated with conduit debt obligations will resolve the inconsistencies in current practice and improve the comparability of financial reporting.

B41. The Board gathered information on the expected benefits of improving the conduit debt obligations standards primarily through input from pre-agenda research, the GASAC, and outreach with stakeholders. The feedback indicated that users need additional information beyond the disclosures required by Interpretation 2. For example, some users expressed the concern that existing disclosures do not provide sufficient information related to an issuer's risk in the event of a third-party obligor's default. Some users indicated the importance of knowing different commitments that issuers extend. Some users, including financial community analysts, believe there is a benefit in understanding the additional commitments issuers have made on conduit debt obligations and the potential impact of such commitments on the resources of the issuers. The Board believes that the recognition criteria and disclosure requirements organized by type of commitment(s) of this Statement are responsive to the needs expressed by the users.

B42. The Board considered the anticipated costs in two categories: costs of applying the guidance similar to existing standards and costs of applying the recognition, measurement,

and additional disclosure requirements for issuers' conduit debt obligations that rise to the level of liabilities. For the disclosure guidance in this Statement that is similar to the existing disclosure requirements in Interpretation 2, most governments are not expected to have a large incremental burden to comply. The pre-agenda research indicates that governments either already have this information available or the information is easily accessible. When an issuer's commitment rises to the level of a liability, the recognition, measurement, and additional disclosure guidance in this Statement will apply. However, the Board believes that, based on the research conducted, it is unlikely that a substantial portion of issuers' commitments associated with conduit debt obligations would be recognized as liabilities by issuers, because many conduit debt obligations do not have issuer-extended additional commitments. Also, the disclosure requirements for liabilities arising from conduit debt obligations are based on Statement 70 with conforming edits. Many preparers and auditors already should be familiar with the disclosures required by that Statement. The Board believes that those factors would mitigate implementation and ongoing costs. In addition, the transition provisions discussed in paragraphs B45 and B46 are intended to mitigate costs of implementation.

B43. The Board also considered the aggregate expected benefits and perceived costs associated with the entirety of the requirements in this Statement. Although the Board recognizes that it is difficult to accurately measure the costs of implementing new standards, the Board believes that the costs of implementing this Statement will be low in most cases. Also, stakeholders will derive substantial benefits from the significantly improved information on conduit debt obligations. The Board believes that the intended benefits that will result from the information provided through implementation of this Statement are significant and justify the perceived costs of implementation and ongoing compliance.

Effective Date and Transition

B44. The provisions of this Statement are effective for reporting periods beginning after December 15, 2020. The Board believes the effective date is appropriate because most issuers of conduit debt obligations currently report or can readily determine the amount of outstanding conduit debt obligations and related information to be disclosed. The Board acknowledges that implementation will be more difficult for governments with many conduit debt obligations. The Board concluded that the effective date allows adequate time for the financial statement preparers to plan for transition and implementation. Some governments may wish to implement earlier than that date, which this Statement encourages.

B45. The Board believes that this Statement should be applied retroactively to encourage consistency and comparability. However, the Board considered the potential for the lack of readily available information for the restatement of all prior periods and for similar disclosure requirements. Accordingly, the Board recognized that it may not be practicable to restate all prior periods.

B46. The phrase *if practicable* has been used in other GASB standards in a similar context as used in this Statement with respect to transition provisions that require restating the

financial statements for all prior periods presented. The Board believes that reasonable efforts should be employed before a government determines that restatement of all prior periods presented is not practicable. In other words, *inconvenient* should not be considered equivalent to *not practicable*.

Appendix C

ILLUSTRATIONS

C1. This appendix illustrates certain requirements of this Statement. The examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown. Application of the provisions of this Statement may require assessment of facts and circumstances other than those illustrated here. Disclosures set forth in other GASB pronouncements, in addition to those shown in Illustration 2, are required, if applicable.

Illustration 1—Application of the Definition of a Conduit Debt Obligation

The following are examples of application of the guidance in this Statement to determine whether a debt obligation is a conduit debt obligation.

Example 1—Bonds That Meet the Definition of a Conduit Debt Obligation

Facts and Assumptions

An economic development agency issues industrial development bonds on behalf of a company to finance construction of a manufacturing facility for the company.

The manufacturing facility is pledged as collateral for the debt, and the bonds are payable solely from the payments received from the company on a mortgage on the manufacturing facility. No other collateral, security, or commitment is provided by the economic development agency to support the debt service payment of the bonds.

The bonds are not parity bonds of the economic development agency, nor are they cross-collateralized with other debt of the economic development agency.

The company, through the debt trustee, receives the debt proceeds to pay for the cost of construction of the manufacturing facility. The company makes debt service payments to the debt holders through the debt trustee until the bonds are paid off.

Determination

The industrial development bonds meet the definition of a conduit debt obligation. The bonds are issued in the name of a local government (the economic development agency) for the benefit of a third-party obligor (the company). The bonds also have the required characteristics in paragraph 5 of this Statement:

- a. At least three parties are involved in the obligation: an issuer (the economic development agency), a third-party obligor (the company), and a debt trustee.

- b. The economic development agency and the company are not within the same financial reporting entity.
- c. The bonds are not parity bonds of the agency, nor are they cross-collateralized with other debt of the economic development agency.
- d. The company, not the economic development agency, ultimately receives the proceeds of the bonds.
- e. The company, not the economic development agency, is primarily obligated for the debt service payments of the bonds.
- f. The economic development agency's commitment related to the debt service payments is limited to the payments made by the company on the mortgage on the manufacturing facility.

Example 2—Bonds That Do Not Meet the Definition of a Conduit Debt Obligation

Facts and Assumptions

A state housing finance authority issues multifamily housing bonds. The bonds' proceeds are made available to various developers, enabling them to participate in the authority's affordable multifamily housing developments.

The bonds are issued under a parity bond indenture that is cross-collateralized with multiple series of multifamily housing bonds of the authority. All the bonds under that same parity bond indenture carry the same security pledge of the authority.

The bond proceeds are received by the developers through the debt trustee to finance the construction of the multifamily housing developments. The developers make debt service payments to the debt holders through the debt trustee until the bonds are paid off. The mortgage loan revenue and investments provide the security pledge and cross-collateralization for the bonds and are the sources for the debt service payments.

Determination

The multifamily housing bonds are *not* conduit debt obligations. Although they meet most of the criteria in paragraph 5 of this Statement, they do not meet the specific criterion in paragraph 5c because they are parity bonds of the authority and are subject to cross-collateralization.

Illustration 2—Disclosures

As previously noted, this illustration includes only note disclosures required by this Statement. Existing standards may require disclosures in addition to those illustrated. Those disclosures are not related to the examples in Illustration 1 for the determination of whether a debt obligation meets the definition of a conduit debt obligation.

Example 1—An Issuer Makes a Commitment Limited to Resources Provided by the Third-Party Obligor

Facts and Assumptions

To further economic development in the County, the County Development Authority has issued bonds that meet the definition of a conduit debt obligation. Those bonds have provided private-sector entities with access to capital for the acquisition and construction of industrial and commercial facilities. The bonds are secured by the property they finance and are payable solely from payments received from the private-sector entities on the underlying mortgage or promissory notes. The County Development Authority has not extended any additional commitments for the debt service payments of the bonds beyond the collateral and the payments from the private-sector entities on the underlying mortgage or promissory notes. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$37.5 million, none of which was recognized as a liability by the County Development Authority.

Illustrative Disclosure in the County Development Authority’s Financial Statements

Note J. Conduit Debt Obligations

To further economic development in the County, the County Development Authority has issued bonds that provide capital financing to private-sector entities for the acquisition and construction of industrial and commercial facilities. The properties financed are pledged as collateral, and the bonds are payable solely from payments received from the private-sector entities on the underlying mortgage or promissory notes. The bonds are not liabilities of the County Development Authority. In addition, no commitments beyond the collateral and the payments from the private-sector entities were extended by the County Development Authority for any of those bonds. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$37.5 million.

Example 2—An Issuer Makes an Additional Commitment beyond the Resources Provided by the Third-Party Obligor for Some Conduit Debt Obligations and Does Not Meet the Criteria for Recognizing a Liability Associated with the Additional Commitment

Facts and Assumptions

The City has issued education facilities bonds that meet the definition of a conduit debt obligation to finance the construction of new buildings by several charter schools. The schools are not component units of the City. The buildings financed by the bond proceeds are pledged as collateral for the bonds. The charter schools are the obligors of the underlying mortgage loans for those buildings. The bonds are payable solely from payments received from the charter schools on the mortgage loans. The City has not extended any commitments for the debt service payment of those bonds beyond the collateral and the

payments on the mortgages from the charter schools. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$48.5 million.

To further economic development in the City, the City also has issued industrial development bonds that meet the definition of a conduit debt obligation. The bonds provided capital financing for a third-party manufacturer to construct a new factory in the City's redevelopment district. The factory is pledged as collateral for the bonds and the bonds are payable from payments received from the manufacturer on an underlying mortgage. If the manufacturer defaults, a request will be made of the City Council to appropriate the amount of the deficiency from the City's resources. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$19.5 million.

The City has not issued other conduit debt obligations to which it extends any additional commitments.

Illustrative Disclosure in the City's Financial Statements

Note K. Conduit Debt Obligations

Conduit Debt Obligations with Commitments Limited to the Resources Provided by the Third-Party Obligor

The City has issued education facilities bonds that finance the construction of new buildings by several charter schools. The buildings are pledged as collateral for the bonds. The charter schools are the obligors of the underlying mortgage loans for those buildings. The bonds are payable solely from payments received from the charter schools on those mortgages. The bonds are not liabilities of the City. In addition, no commitments beyond the collateral and the payments from the charter schools were extended by the City for any of those bonds. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$48.5 million.

Conduit Debt Obligations with the City's Appropriation Pledge

To further economic development in the City, the City has issued industrial development bonds to provide capital financing for a third-party manufacturer. Bond proceeds were used by the manufacturer to construct a new factory in the City's redevelopment district. The factory is pledged as collateral for the bonds. The manufacturer is the obligor of the underlying mortgage loan. The bonds are payable solely from payments received from the manufacturer on an underlying mortgage. The bonds are not liabilities of the City. However, if the manufacturer defaults, the City Council will appropriate the amount of the deficiency from the City's own resources. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$19.5 million.

Example 3—It Is More Likely Than Not That an Issuer Will Make Payments as a Result of an Additional Commitment

Facts and Assumptions

On December 1, 20X1, a State issued \$10 million of 10-year higher education facility bonds that meet the definition of conduit debt obligations. The proceeds from the bonds were used to finance construction of dormitories of a private college. The bonds mature annually, beginning December 1, 20X2 through December 1, 20Y1, with semiannual interest payments. The dormitories are pledged as collateral for the bonds. There are underlying mortgage loans on those dormitories. The bonds are payable from payments received from the private college on those mortgages. The State made a moral obligation pledge in that if the private college defaults, a request will be made of the State's General Assembly to appropriate the amount of the deficiency from the State's capital reserve fund.

In the second half of its fiscal year 20X7, the private college started to encounter financial difficulties. A significant decline of its tuition and dormitory revenue in the fall semester of 20X8 resulted in a violation of revenue coverage requirements contained in the bonds' covenants. The private college made its required June 1, 20X8 interest payment; however, it had to use a significant portion of the resources in a bond reserve account to do so. The use of those resources brought the balance of the private college's bond reserve account below its required level and constituted another violation of a bond covenant.

Based on the financial difficulties encountered by the private college and the concern that the defaulted conduit debt could affect the State's access to capital markets, the State determined at June 30, 20X8, that it is more likely than not that it will honor its moral obligation pledge and make a request to the General Assembly to appropriate the State's resources to replenish the private college's bond reserve account to its required level, thereby supporting the remaining debt service payments. The State determined that the present value of the future outflows of its moral obligation pledge was \$3.05 million at June 30, 20X8.

The State replenished the private college's bond reserve account to its required level on November 28, 2018, which then was used to make the December 1, 20X8 principal and interest payments. Total payments for the fiscal year ending June 30, 20X9, were equivalent to the debt service payments of the \$1 million in principal and \$175,000 in interest. The State determined that it was more likely than not that it will continue to replenish the private college's bond reserve account so that the remaining debt service payments will be made as scheduled, until the bonds are paid off.

Illustration: Fiscal Years Ending June 30, 20X2 through June 30, 20X7

Accounting for the additional commitment

The State does not record a liability related to its moral obligation pledge extended on the December 20X1 issuance of the conduit debt in the financial statements for the years ending June 30, 20X2–20X7.

Illustrative disclosures: fiscal year ending June 30, 20X2

Note L. Conduit Debt Obligations

In December 20X1, the State issued higher education facilities bonds to provide capital financing for a private college to construct dormitories. The dormitories are pledged as collateral for the bonds. There are underlying mortgage loans on those dormitories. The bonds are payable from payments received from the private college on those mortgages. The bonds are not liabilities of the State. The State made a moral obligation pledge that if the private college defaults, a request will be made of the State's General Assembly to appropriate the amount of the deficiency from the State's capital reserve fund pursuant to the State's moral obligation pledge. At June 30, 20X2, the conduit debt obligation has an outstanding principal amount payable of \$10 million.

Illustration: Fiscal Year Ending June 30, 20X8

Accounting for the additional commitment

In its financial statements prepared using the economic resources measurement focus as of June 30, 20X8, the State records a related liability and an expense in the amount of \$3.05 million, the present value of the expected future outflows of its moral obligation pledge.

Illustrative disclosures: fiscal year ending June 30, 20X8

Note L. Conduit Debt Obligations

In December 20X1, the State issued higher education facilities bonds to provide capital financing for a private college to construct dormitories. The dormitories are pledged as collateral for the bonds. There are underlying mortgage loans on those dormitories. The bonds are payable from payments received from the private college on those mortgages. The bonds are not liabilities of the State. The State made a moral obligation pledge that if the private college defaults, a request will be made of the State's General Assembly to appropriate the amount of the deficiency from the State's capital reserve fund pursuant to the State's moral obligation pledge.

As a result of the private college's financial difficulties, as well as the State's concern that defaulted conduit debt could affect the State's access to capital markets, the State determined that it is more likely than not that it will honor its moral obligation and make a request to the General Assembly to appropriate funds to replenish the private college's bond reserve account to its required level, thereby supporting the remaining debt service payments. The amount of the State's related liability recognized for its moral obligation pledge is the best estimate of the discounted present value of the future outflows expected to be incurred as a result of this additional commitment.

The liability recognized by the State related to its moral obligation pledge at June 30, 20X8, is as follows:

<u>Beginning of Year</u>	<u>Increases</u>	<u>Decreases</u>	<u>End of Year</u>
\$ 0	\$ 3,050,000	\$ 0	\$ 3,050,000

Illustration: Fiscal Year Ending June 30, 20X9

Accounting for the additional commitment

In its financial statements prepared using the economic resources measurement focus as of June 30, 20X9, the State records a reduction in the liability related to its moral obligation pledge. The reduction includes the payments made by the State to replenish the private college's bond reserve account that supported the \$1 million of principal payments and \$175,000 of interest payments during that fiscal year. The State also records a \$170,000 increase in the related liability to reflect an increase in the present value of the related liability due to the passage of time.

The State also reports the cumulative payments to replenish the private college's bond reserve account that supported the principal and interest payments of \$1,175,000 as expenditures in its financial statements prepared using the current financial resources measurement focus.

Illustrative disclosures: fiscal year ending June 30, 20X9

Note L. Conduit Debt Obligations

In December 20X1, the State issued higher education facilities bonds to provide capital financing for a private college to construct dormitories. The dormitories are pledged as collateral for the bonds. There are underlying mortgage loans on those dormitories. The bonds are payable from payments received from the private college on those mortgages. The bonds are not liabilities of the State. The State made a moral obligation pledge that if the private college defaults, a request will be made of the State's General Assembly to appropriate the amount of the deficiency from the State's capital reserve fund pursuant to the State's moral obligation pledge.

As a result of the private college's financial difficulties as well as the State's concern that defaulted conduit debt could affect its access to capital markets, the State determined that it is more likely than not that it will fulfill its moral obligation pledge and make a request to the General Assembly to appropriate funds to replenish the private college's bond reserve account to its required level, thereby supporting the remaining debt service payments. The amount of the State's liability related to its moral obligation pledge is the best estimate of the discounted present value of the future outflows expected to be incurred as a result of this commitment.

On November 28, 20X8, the State began making payments to replenish the private college's bond reserve account that would support the remaining debt service payments. Those payments were used to cover the \$1 million in principal and \$175,000 in interest of the debt service payments on the bonds through June 30, 20X9. There also was a \$170,000 increase

in the State's related liability resulting from its moral obligation pledge, reflecting an increase in the present value of the future outflows expected to be incurred.

The liability recognized by the State related to its moral obligation pledge at June 30, 20X9, is as follows:

<u>Beginning of Year</u>	<u>Increases</u>	<u>Decreases</u>	<u>End of Year</u>
\$ 3,050,000	\$ 170,000	\$ 1,175,000	\$ 2,045,000

Appendix D

CODIFICATION INSTRUCTIONS

Codification of Governmental Accounting and Financial Reporting Standards—December 2020 Update

D1. The instructions that follow update the June 30, 2018 *Codification of Governmental Accounting and Financial Reporting Standards* (Codification) for the effects of this Statement. Only the paragraph or footnote number of the Statement is listed if the paragraph or footnote will be cited in full in the Codification.

* * *

[Update cross-references throughout.]

* * *

REPORTING CAPITAL ASSETS

SECTION 1400

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

* * *

REPORTING LIABILITIES

SECTION 1500

Sources: [Remove GASBI 2; add GASBS XX.]

.126 [Replace with the following:] Section C65 provides disclosure guidance for issuers of conduit debt obligations. Issuers should recognize liabilities when the criteria in paragraphs .104–.109 of that section are met. [GASBS XX, ¶7–¶12]

[Delete Question .715-1.]

* * *

NOTES TO FINANCIAL STATEMENTS

SECTION 2300

.106d [Replace the parenthetical reference with the following:] (See Section 1500, “Reporting Liabilities,” paragraph .125, Section C50, “Claims and Judgments,” paragraphs .115, .161–.164, .167, and .168, and Section C65, “Conduit Debt Obligations,” paragraphs .116–.118.)

[Revise current paragraph .107y as follows:]

.107y [Replace the parenthetical reference with the following:] (See paragraphs .116–.118 of Section C65.)

* * *

CASH FLOWS STATEMENTS

SECTION 2450

.707-14 [In the question, replace *conduit debt* with *a conduit debt obligation*.] [GASBIG 2015-1, Q2.27.1, as amended by GASBS XX, ¶5]

* * *

SEGMENT INFORMATION

SECTION 2500

[Replace footnote 1 with the following:]

¹Segment reporting is not required when an individual fund both is a segment and is reported as a major fund. [GASBS 34, fn48, as amended by GASBS XX, ¶5]

* * *

CLAIMS AND JUDGMENTS

SECTION C50

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

* * *

CONDUIT DEBT OBLIGATIONS

SECTION C65

Sources: [Remove GASBI 2; add GASBS XX.]

[Replace paragraphs .101–.103, including headings and footnotes, with the following:]

.101 [GASBS XX, ¶3, including heading]

.102–.118 [GASBS XX, ¶5–¶21, including headings and footnotes]

[Replace Question .701-1 with the following:]

.701-1 Q—A component unit of a state government issues debt that has some characteristics of a conduit debt obligation, as discussed in paragraphs .102 and .103 of this section. However, the proceeds are used to finance construction of capital assets for the state (the primary government). Should the issuance be classified as a conduit debt obligation for financial reporting purposes?

A—No. To be classified as a conduit debt obligation for financial reporting purposes, one of the characteristics identified in paragraph .103 of this section is that the issuer and the third-party obligor cannot be within the same financial reporting entity. In this case, the component unit (the issuer) and the state (the third-party obligor) are within the same reporting entity.

[GASBIG 2015-1, Q7.22.18, as amended by GASBS XX, ¶5 and ¶6]

[Replace Question .701-2 with the following:]

.701-2 Q—A county government issues bonds for the construction of a convention center. Although the bonds are in the county’s name, debt service will be from a county hotel and motel tax. The center will be owned and operated by a tourist board, an organization that will be reported in the county’s financial statements as a discretely presented component unit. Has the county issued a conduit debt obligation?

A—No. In order to be considered a conduit debt obligation, the issuer and the third-party obligor cannot be within the same reporting entity (paragraph .103 of this section). In this case, the county (the issuer) and the convention center (the third-party obligor) are within the same reporting entity.

[GASBIG 2015-1, QZ.I2.1, as amended by GASBS XX, ¶5]

[Delete Question .702-1.]

* * *

NONEXCHANGE FINANCIAL GUARANTEES

SECTION N30

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

* * *

**SALES AND PLEDGES OF RECEIVABLES AND
FUTURE REVENUES AND INTRA-ENTITY
TRANSFERS OF ASSETS AND FUTURE REVENUES**

SECTION S20

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

* * *

INVESTMENT POOLS (EXTERNAL)

SECTION In5

.131d [Replace with the following:] A conduit debt obligation as described in paragraphs .102 and .103 of Section C65, “Conduit Debt Obligations,” should be considered to be

issued by the third-party obligor related to the obligation rather than the governmental issuer. [GASBS 79, ¶31, as amended by GASBS XX, ¶5 and ¶6]

* * *

Codification—December 2019 Update

D2. The instructions that follow update paragraph C1 of Statement No. 87, *Leases*, for the effects of this Statement. Statement 87 is effective for reporting periods beginning after December 15, 2019.

* * *

LEASES

SECTION L20

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

.106e [Replace with the following:] Arrangements, characterized as leases, that meet the definition of additional arrangements in paragraph .111 of Section C65. [GASBS 87, ¶8, as amended by GASBS XX, ¶13 and ¶14]

* * *

***Comprehensive Implementation Guide*—June 2019 Update**

D3. The instructions that follow update the June 30, 2018 *Comprehensive Implementation Guide* for the effects of this Statement.

* * *

2.27.1. [In the question, replace *conduit debt* with *a conduit debt obligation*.] [GASBIG 2015-1, Q2.27.1, as amended by GASBS XX, ¶5]

[Delete Question 7.22.14.]

[Replace Question 7.22.18 with the following:]

7.22.18. Q—A component unit of a state government issues debt that has some characteristics of a conduit debt obligation, as discussed in paragraphs .102 and .103 of this section. However, the proceeds are used to finance construction of capital assets for the state (the primary government). Should the issuance be classified as a conduit debt obligation for financial reporting purposes?

A—No. To be classified as a conduit debt obligation for financial reporting purposes, one of the characteristics identified in paragraph .103 of this section is that the issuer and the third-party obligor cannot be within the same financial

reporting entity. In this case, the component unit (the issuer) and the state (the third-party obligor) are within the same reporting entity.

[GASBIG 2015-1, Q7.22.18, as amended by GASBS XX, ¶5 and ¶6]

[After Question Z.77.14, insert new heading and question as follows:]

Z.XX Statement No. XX, *Conduit Debt Obligations*

Z.XX.1. Q—A county government issues bonds for the construction of a convention center. Although the bonds are in the county’s name, debt service will be from a county hotel and motel tax. The center will be owned and operated by a tourist board, an organization that will be reported in the county’s financial statements as a discretely presented component unit. Has the county issued a conduit debt obligation?

A—No. In order to be considered a conduit debt obligation, the issuer and the third-party obligor cannot be within the same reporting entity (paragraph .103 of this section). In this case, the county (the issuer) and the convention center (the third-party obligor) are within the same reporting entity.

[GASBIG 2015-1, QZ.I2.1, as amended by GASBS XX, ¶5]

[Delete Question Z.I2.1 and associated heading.]