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September 7, 2012

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

Dear Sir/Madam,

Thank you for the opportunity to comment on the Exposure Draft (ED), *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions* document. The Wisconsin State Controller's Office is responsible for annually preparing the State of Wisconsin's Comprehensive Annual Financial Report (CAFR). We have reviewed the ED and concluded GASB should not issue the proposed statement.

We are concerned with the introduction of the new "more likely than not" concept in paragraph 9. Use of this term is not consistent with the existing literature of GASB 62 that uses "probable" to measure the likelihood of loss contingencies. While we agree with the need to report or disclose loss obligations at the point they become probable, use of the more than 50 percent concept is excessively conservative. We believe it will result in misleading information in GAAP-based financial statements that would be detrimental to the governmental reporting entity and users of those financial statements. Further, we believe there may be other unintended consequences that may result.

As used in the ED, the term more likely than not means a likelihood of more than 50 percent. However, this concept is not consistent with GASB Concepts Statement No. 4 which defines liabilities as "present obligations to sacrifice resources that the government has little or no discretion to avoid". As preparers of the State's financial statements, *we cannot reasonably defend that there is little or no discretion in assuming another entity's liability if there is up to a 50 percent likelihood it will not occur.* Rather, we agree with the alternative view expressed in paragraphs 53 and 54 of the ED. Consistent with that view, we believe the probable and reasonably estimable conditions stated in para. 102 of GASB 62 already provide a rational approach for reporting loss contingencies. Further, the loss contingency conditions of GASB 62 are more consistent with, and defensible under, the provisions of Concepts Statement No. 4. GASB 62 offers no "bright line" such as that offered by the greater than 50 percent likelihood included in the ED. Given the legal, operational and political complexities of assuming the liabilities of another entity, we believe professional judgment is crucial in GAAP reporting and cannot be adequately replaced by the attempted bright line offered in the ED.

Has GASB considered the correlating problem with revenue recognition in the event a guarantor does not end up paying a liability already reported in their financial statements? This would occur, presumably, in increasing instances because of the reporting of liabilities that are not probable. Would guarantors report revenue over the same timeframe as the receiver's liability payment schedule? Or, could guarantors report a revenue for the entire amount of the liability once qualitative and historic factors indicated there was a greater than 51 percent likelihood the liabilities were unlikely? Existing guidance suggests revenue would be recognized on the same timeframe as the receiver's payment schedule. This does not seem equitable to either entity because of the potential unintended consequences of reporting another entity's liabilities or having another entity reporting your liabilities.

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Further, we are concerned with a reporting entity guaranteeing their own liabilities. Paragraph 25 of the ED concludes that, "because Statement No. 14, the Financial Reporting Entity, as amended, stipulates that a component unit should be a legally separate entity from a primary government, both blended and discretely presented component units should be considered separate entities for the purpose of applying this Statement." This paragraph is in conflict with GASB 61, para. 43 which states blended component units are so intertwined with the primary government that they function much like a fund or department of the primary government. In this case, a financial guarantee to a blended component unit is similar to a government providing a financial guarantee to itself. This also leads to problems with double counting of liabilities.

Under the ED, double counting of liabilities would occur when a time lag exists between when a guarantor reports a liability and when a receiver recognizes revenue. This is not as much of a problem when the receiver is not included in the guarantor's financial statements. However, we are concerned with the treatment of component units, in particular blended component units, when the primary government would be reporting the same liability twice as well as guaranteeing its own liability. Because of the structure of the financial statements established by GASB 34, it would be misleading, and the integrity of the financial statements diminished, if both a component unit (blended or discrete) and the primary government reported the same liability.

To demonstrate the misleading and damaging impact on an entity's financial statements we share the following illustration: In recent years, a state entity included a blended component unit with \$1.3 billion of outstanding debt in its CAFR. Under the proposed ED, if that state had guaranteed the debt of the component unit and there was a 51 percent likelihood of having to assume that debt but no actual on-behalf payments had been made, the entity's liabilities would have been overstated by \$1.3 billion in the audited financial statements. Based on our understanding of the ED, the outstanding debt would have been reported by both the primary government and the blended component unit. We believe this approach would be harmful to the reporting entity and users of the financial statements. In addition, the receiver would also be harmed due to the unintended, but negative, consequences of having another entity reporting their liabilities as though they had defaulted.

We question whether there may be other unintended consequences. For example, does a guarantor reporting a liability in its financial statements before it is probable they must assume that liability encourage the receiving entity to default? Does it provide an incentive for the receiver to stop trying to find a way to meet their obligations? Would it change the receiver's decision making?

Placing a liability in a financial statement is a powerful message, with long-term consequences, that we believe is best reserved for circumstances that fully warrant it. We do not believe a situation with only a greater than 50 percent likelihood warrants such reporting. Further, that liability should not be intentionally overstated.

Finally, existing GASB standards are in place to sufficiently report financial guarantees. These standards do not result in over-aggressive reporting of liabilities, duplication of liabilities in audited financial statements, or other significant reporting issues.

As an alternative to issuing the proposed statement, GASB could consider modifying disclosure requirements for guarantees of the indebtedness of others when evidence suggests risks are increasing. Otherwise, if GASB wishes to include the concept of "more likely than not" in their standards, they should undertake a separate project to address all contingencies, not just financial guarantees.

We appreciate this opportunity to provide our comments to the GASB. Please contact Cindy Simon at (608) 266-3052 or Kip Zellmer at (608) 267-6958 if you need additional information.

Sincerely,



Stephen Censky, CPA
State Controller