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Proposed Statement of the Government Accounting Standards Board:

Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions

*Response by the State of Arkansas Department of Finance and
Administration, Office of Accounting*

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To the Director of Research and Technical Activities

RE: Project 19-18, Proposed Statement on Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions

We appreciate the opportunity to present our comments on the preliminary views of the Governmental Accounting Standards Board. The information needs of decision-makers and users of financial information require careful study and input from preparers.

In general, we do not agree that a separate accounting and financial reporting standard is required for nonexchange financial guarantee transactions.

The only identifiable difference between a nonexchange financial guarantee and an exchange or exchange-like financial guarantee is the provision of value by the recipient of the financial guarantee. In all other respects, a financial guarantee is the same regardless of whether value is given in return.

As stated in paragraph 23, "a financial guarantee should require a guarantor to perform an action under specified conditions." Thus, a key element in determining if a liability should be recorded for a financial guarantee by the guarantor is that the guarantor must "perform the action." The action required to be performed is payment pursuant to the financial guarantee. This requirement is the same for all financial guarantees, whether it is a nonexchange transaction or an exchange transaction. Thus, there is no substantial difference that would require or allow different standards for recognition of a liability. Having a different standard for nonexchange financial guarantees would decrease consistency and comparability with financial guarantees arising from exchange transactions.

We also disagree with the threshold that would trigger recognition. The term "more likely than not" is defined in footnote 1 as the likelihood that making a payment on the guarantee is greater than 50%. While this threshold does indicate that payment is likely, certain events that are objectively determinable must occur before payment is required. The analysis of qualitative factors is subject to the perspective of the determining party.

In this matter, we agree with the alternative view that the contingent liability requirement of “probable” is sufficient for recognition of a liability. As stated in paragraph 102b of Statement 62, “It is implicit in this condition that it should be probable that one or more future events will occur confirming the fact of the loss.” A financial guarantee meets the definition of a contingency because it involves “uncertainty as to possible gain ... or loss ... that will ultimately be resolved when one or more future events occur or fail to occur.” (Paragraph 96 of Statement 62)

Thus, a sufficient standard has already been provided for the recognition of a liability with regards to a nonexchange financial guarantee transaction. We see no demonstrative difference to warrant a separate, specialized standard for recognition of a liability. We agree with the alternative view that the Board should reexamine contingent liability reporting as a whole if it has concerns about how the contingent liability recognition standard is being applied. We advise the Board to not issue piecemeal standards but consider a more general standard that promotes consistency in reporting transactions with similar characteristics.