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NO. 337-B | APRIL 2013

# Governmental Accounting Standards Series

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Statement No. 70 of the  
Governmental Accounting  
Standards Board

Accounting and Financial Reporting for  
Nonexchange Financial Guarantees



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## Summary

Some governments extend financial guarantees for the obligations of another government, a not-for-profit organization, a private entity, or individual without directly receiving equal or approximately equal value in exchange (a nonexchange transaction). As a part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity or individual that issued the obligation does not fulfill its payment requirements. Also, some governments issue obligations that are guaranteed by other entities in a nonexchange transaction. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The amount of the liability to be recognized should be the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee. When there is no best estimate but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range.

This Statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to report the obligation until legally released as an obligor. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units.

This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees.

The provisions of this Statement are effective for reporting periods beginning after June 15, 2013. Earlier application is encouraged. Except for disclosures related to cumulative amounts paid or received in relation to a nonexchange financial guarantee, the provisions of this Statement are required to be applied retroactively. Disclosures related to cumulative amounts paid or received in relation to a nonexchange financial guarantee may be applied prospectively.

## **How the Changes in This Statement Will Improve Financial Reporting**

The requirements of this Statement will enhance comparability of financial statements among governments by requiring consistent reporting by those governments that extend nonexchange financial guarantees and by those governments that receive nonexchange financial guarantees. This Statement also will enhance the information disclosed about a government's obligations and risk exposure from extending nonexchange financial guarantees. This Statement also will augment the ability of financial statement users to assess the probability that governments will repay obligation holders by requiring disclosures about obligations that are issued with this type of financial guarantee.

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 4 discusses the applicability of this Statement.

Statement No. 70 of the  
Governmental Accounting  
Standards Board

# Accounting and Financial Reporting for Nonexchange Financial Guarantees

April 2013



**GOVERNMENTAL ACCOUNTING STANDARDS BOARD**

of the Financial Accounting Foundation

401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116

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# Statement No. 70 of the Governmental Accounting Standards Board

## Accounting and Financial Reporting for Nonexchange Financial Guarantees

April 2013

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# **Statement No. 70 of the Governmental Accounting Standards Board**

## **Accounting and Financial Reporting for Nonexchange Financial Guarantees**

**April 2013**

### **INTRODUCTION**

1. When a government extends a financial guarantee, it has agreed to indemnify a third party if the entity or individual that issued the guaranteed obligation does not fulfill its requirements under the obligation. Some governments guarantee financial obligations of other governments, nongovernmental entities, or individuals without receiving equal or approximately equal value in return—a nonexchange transaction. Generally, these types of guarantees are extended by governments as part of their mission to assist other governments, nongovernmental entities, or individuals within the government’s jurisdiction.

2. Similarly, a government may receive a financial guarantee for an obligation it has issued without providing equal or approximately equal value in return. For example, a school district may receive a financial guarantee from a state government for the district’s debt service payments on construction bonds it has issued without providing consideration to the state government.

3. The objective of this Statement is to improve the recognition, measurement, and disclosure guidance for state and local governments that have extended or received financial guarantees that are nonexchange transactions.

# STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

## Scope and Applicability of This Statement

4. This Statement establishes accounting and financial reporting standards for financial guarantees that are nonexchange transactions<sup>1</sup> (nonexchange financial guarantees) extended or received by a state or local government. As used in this Statement, a nonexchange financial guarantee is a guarantee of an obligation of a legally separate entity or individual, including a blended or discretely presented component unit, which requires the guarantor to indemnify a third-party obligation holder under specified conditions. The provisions of this Statement should be applied to financial statements of all state and local governments.

5. This Statement does not apply to guarantees related to special assessment debt within the scope of Statement No. 6, *Accounting and Financial Reporting for Special Assessments*.

6. This Statement amends NCGA Statement No. 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences*, paragraph 9; GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, paragraph 3; GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, paragraph 5; and GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraphs 98, 109, 110, and 124.

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<sup>1</sup>The scope of this Statement excludes both exchange and exchange-like transactions. The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a “pure” exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.

## **Recognition and Measurement of Nonexchange Financial Guarantees**

### **Governments Extending Nonexchange Financial Guarantees**

7. A government that has extended a nonexchange financial guarantee should consider qualitative factors in assessing the likelihood that the government will be required to make a payment in relation to the guarantee. Examples of such qualitative factors relevant to the entity or individual that has issued the guaranteed obligation include, but are not limited to, the following:

- a. Initiation of the process of entering into bankruptcy or financial reorganization
- b. Breach of a debt contract in relation to the guaranteed obligation, such as failure to meet rate covenants, failure to meet coverage ratios, or default or delinquency in interest or principal payments
- c. Indicators of 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.

8. Some governments extend similar nonexchange financial guarantees to more than one entity or individual. For example, a state government may guarantee debt issued by qualifying school districts within the state for construction of capital assets. If a government extends similar guarantees to a group, the government should consider applicable qualitative factors and relevant historical data, if any, in assessing the likelihood that the government will make a payment in relation to those guarantees. For example, a government that has historical data on the default frequency of a group of guarantees should consider those data in relation to its outstanding guarantees in assessing the likelihood that it will be required to make a payment on one or more of the guarantees within the group.

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

9. When qualitative factors and historical data, if any, as discussed in paragraphs 7 and 8, indicate that it is more likely than not<sup>2</sup> that a government will be required to make a payment related to the nonexchange financial guarantees it extended for liabilities of other entities or individuals, the government should recognize a liability and an expense in financial statements prepared using the economic resources measurement focus. The amount recognized should be the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee. 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. Classification of expenses related to nonexchange financial guarantees should be determined in the same manner as grants or financial assistance payments to other entities or individuals.

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

10. When qualitative factors and historical data, if any, as discussed in paragraphs 7 and 8, indicate that it is more likely than not that a government will be required to make a payment related to the nonexchange financial guarantees it extended for liabilities of other entities or individuals, the government should recognize a fund liability and an expenditure in financial statements prepared using the current financial resources measurement focus, to the extent the liability is normally expected to be liquidated with expendable available financial resources. Liabilities for nonexchange financial guarantees extended are normally expected to be liquidated with expendable available financial resources when payments are due and payable on the guaranteed

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<sup>2</sup>As used in this Statement, the term *more likely than not* means a likelihood of more than 50 percent.

obligation. Classification of expenditures related to nonexchange financial guarantees should be determined in the same manner as grants or financial assistance payments to other entities or individuals.

## **Governments Issuing a Guaranteed Obligation**

11. Under both the economic resources measurement focus and the current financial resources measurement focus, if a government is required to repay a guarantor for nonexchange financial guarantee payments made on the government's obligations, the government should reclassify that portion of its previously recognized liability for the guaranteed obligation as a liability to the guarantor. The government that issued the guaranteed obligation should continue to recognize its liability until that portion of the liability is legally released, such as when a Plan of Adjustment is confirmed by the court in the case of bankruptcy.

12. When a government that has issued an obligation that has received a nonexchange financial guarantee is legally released as an obligor from the obligation and from any liability to the guarantor, the government should recognize revenue to the extent of the reduction of its guaranteed liabilities.

## **Intra-Entity Nonexchange Financial Guarantees Involving Blended Component Units**

13. When a government that extends a nonexchange financial guarantee recognizes a liability for the guarantee in accordance with paragraph 9 or 10, the government that issued the guaranteed obligation should recognize a receivable equal to the amount of the liability recognized by the government that extended the guarantee, only if the government that issued the guaranteed obligation is one of the following:

- a. A blended component unit of that government
- b. A primary government that includes the government that extended the guarantee as a blended component unit within its reporting entity
- c. Within the same reporting entity and both parties are blended component units of the same primary government.

## Disclosures

### **Governments That Extend Nonexchange Financial Guarantees**

14. A government that extends nonexchange financial guarantees should disclose the following information, by type of guarantee, for all nonexchange financial guarantees, regardless of the likelihood of a payment being required:

- a. A description of the nonexchange financial guarantee, identifying:
  - (1) The legal authority and limits for extending the guarantees and types of obligations guaranteed
  - (2) The relationship of the government to the issuer or issuers of the obligations that are guaranteed
  - (3) The length of time of the guarantees
  - (4) Arrangements for recovering payments from the issuer or issuers of the obligations that are guaranteed
- b. The total amount of all guarantees extended that are outstanding at the reporting date.

15. A government that recognizes a nonexchange financial guarantee liability or has made payments during the reporting period on nonexchange financial guarantees extended should disclose the following information:

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

## **Governments That Issue Guaranteed Obligations**

16. A government that has one or more outstanding obligations at the reporting date that have been guaranteed by another entity as part of a nonexchange transaction should disclose the following information about the guarantee(s) by type of guarantee:

- a. The name of the entity providing the guarantee
- b. The amount of the guarantee
- c. The length of time of the guarantee
- d. The amount paid, if any, by the entity extending the guarantee on obligations of the government during the current reporting period
- e. The cumulative amount paid by the entity extending the guarantee on outstanding obligations of the government
- f. A description of requirements to repay the entity extending the guarantee
- g. The outstanding amounts, if any, required to be repaid to the entity providing the guarantee.

17. If a government has issued a guaranteed obligation for which payments have been made during the reporting period by the entity that extended the guarantee and that guaranteed obligation is no longer outstanding at the end of the reporting period, regardless of whether the government has any other outstanding guaranteed obligations at the end of the reporting period, it should disclose:

- a. The amount paid by the entity that extended the guarantee on obligations of the government during the current reporting period
- b. The cumulative amount paid by the entity that extended the guarantee on outstanding obligations of the government
- c. A description of requirements to repay the entity that extended the guarantee
- d. The outstanding amounts, if any, required to be repaid to the entity that provided the guarantee.

## **EFFECTIVE DATE AND TRANSITION**

18. The requirements of this Statement are effective for financial statements for reporting periods beginning after June 15, 2013. Earlier application is encouraged. In the period this Statement is first applied, changes made to comply with this Statement should be treated as an adjustment of prior periods, and financial

statements presented for the periods affected should be restated. If restatement of the financial statements for all prior periods presented is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning net position (or fund balance or fund net position, as appropriate) for the earliest period restated (generally the current period). Also, the reason for not restating prior periods presented should be explained. In the period this Statement is first applied, the financial statements should disclose the nature of any restatement and its effect.

19. The requirements for disclosure of cumulative amounts in paragraphs 15, 16, and 17 may be applied prospectively. If applied prospectively, the disclosure should state the date through which the cumulative amounts are determined.

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

*This Statement was issued by the affirmative vote of six members of the Governmental Accounting Standards Board. Ms. Taylor dissented.*

Robert H. Attmore, *Chairman*  
James E. Brown  
William W. Fish  
Michael H. Granof  
David E. Sundstrom  
Jan I. Sylvis  
Marcia L. Taylor

## Appendix A

### BACKGROUND

20. The current economic environment is such that investors in obligations are seeking additional credit enhancements and assurances, including financial guarantees, to minimize the possibility of nonpayment. Financial guarantees that are extended by governments can be associated with commitments related to debt issued or incurred by other governmental entities, not-for-profit entities, and, in certain cases, for-profit entities or related obligations of individuals. As part of many financial guarantee transactions, a government extends a financial guarantee, or receives a guarantee for an obligation that it has issued, without receiving or paying equal or approximately equal value. In many circumstances, these financial guarantees that are nonexchange transactions are extended with the anticipation that the entity or individual issuing the guaranteed obligation will fulfill its payment obligations and no payment will be required by the guarantor. However, a payment may be required due to future events or changes in circumstances.

21. Existing guidance applicable to state and local governments for financial guarantees primarily is found in GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraphs 96–113. That guidance requires governments that guarantee the indebtedness of others to recognize a liability related to the guarantee when (a) it is probable that the government will be required to make a payment as a result of the guarantee and (b) the amount of the loss can reasonably be estimated. That guidance was incorporated into Statement 62 from FASB Statement No. 5, *Accounting for Contingencies*, FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, and FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*. The objective of Statement 62 was to incorporate applicable pre-November 30, 1989 Financial Accounting Standards Board and American Institute of Certified Public Accountants guidance into state and local government accounting and financial reporting standards, including guidance for financial guarantee transactions. The provisions were modified, as appropriate, to recognize certain aspects of the governmental environment and the needs of governmental financial statement users, without Board reconsideration of all issues related to the guidance.

22. In April 2010, a project proposal on financial guarantees was reviewed with the Governmental Accounting Standards Advisory Council (GASAC). The GASAC members rated the potential project a high priority. As a result of the perceived need for guidance and the feedback from the GASAC, a project on financial guarantees was added to the Board's research agenda in April 2010.

23. Based on the research findings and further GASAC feedback on a project prospectus, the project was moved to the Board's current agenda in April 2011 and deliberations began in July 2011.

24. A task force composed of members broadly representative of the GASB's constituency was assembled. The task force members reviewed and commented on papers prepared for the Board's deliberations and on drafts of this Statement. In addition, further input was sought from the GASAC members at their meetings.

25. In June 2012, the Board issued an Exposure Draft, *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions*. The Board received 33 responses to the Exposure Draft. As discussed throughout the Basis for Conclusions of this Statement, the comments and suggestions from the organizations and individuals who responded to the Exposure Draft contributed to the Board's deliberations in finalizing the requirements of this Statement.

## **Appendix B**

### **BASIS FOR CONCLUSIONS AND DISSENT**

26. 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 of This Statement**

27. In considering the scope of this Statement, the Board studied a broad range of activities that could be classified as financial guarantees and concluded that a financial guarantee should require a government that has extended the nonexchange financial guarantee (guarantor) to perform an action under specified conditions. The Board believes the requirement of the guarantor to perform in accordance with the terms of the guarantee is the key element that provides value in the guarantee to the entity or individual holding the guaranteed obligation. The Board also concluded that the guarantor should be an entity separate from the entities or individuals involved in the underlying transaction being guaranteed. As a result, a financial guarantee would require the involvement of three separate entities. These entities are the holder of the obligation being guaranteed, the issuer of the obligation being guaranteed (issuer), and the entity extending the financial guarantee. The Board believes the involvement of three entities appropriately distinguishes a financial guarantee from the assurances provided by an entity or individual in relation to repaying its own creditors.

28. The Board also considered intercept only programs in which a government has the ability to withhold revenues that it collects for, or provides to, an issuer of an obligation to make payments on that obligation. In those circumstances, the Board concluded the withholding government has not provided a guarantee of the obligation that is within the scope discussed in the paragraph above. In essence, the withholding government is garnishing the issuing entity's own revenues, to the extent collected, to make the obligation payments.

29. The Board considered whether a primary government and its component units should be considered separate entities for purposes of determining whether three separate entities are involved in the guarantee transaction. In this circumstance, the Board concluded 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.

30. Some respondents to the Exposure Draft sought clarification on whether certain types of obligations should be considered nonexchange financial guarantees. Some respondents asked whether a government's pledge of revenue is a nonexchange financial guarantee. After considering the circumstances raised by these respondents, the Board concluded that a pledge of future revenues would not be considered a nonexchange financial guarantee for the purposes of applying the provisions of this Statement. A government recognizes a liability for the pledged revenue only when the pledged revenue meets the criteria for revenue recognition as required by Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. Other respondents sought clarification with regard to recognition of joint-and-several obligations potentially being nonexchange financial guarantees. The Board concluded that a government that enters into a joint-and-several obligation is not extending a guarantee for an obligation of another entity or individual. Instead, the Board concluded that the government is providing assurance of performance on its own obligations. Additionally, the Board concluded that obligations that are not legal obligations are not within the scope of this Statement.

31. During its initial deliberations, the Board determined that this project should be limited to nonexchange financial guarantees. The Board noted that because nonexchange financial guarantees generally do not result in the guarantor government receiving consideration, there is no initial accounting transaction that would result in ongoing analysis and reporting of these transactions. As a result, the Board concluded that providing accounting and reporting guidance for nonexchange financial guarantees was a higher priority. The Board also concluded that amending guidance related to financial guarantees that are exchange or exchange-like transactions would be more appropriately addressed in a separate reexamination project.

32. Some respondents to the Exposure Draft expressed the belief that the only difference between nonexchange financial guarantees and exchange or exchange-like financial guarantees is the value received for providing the guarantee. These respondents generally do not believe that the receipt of consideration should result in a different method to recognize a liability. As a result, some of these respondents requested that guidance for exchange and exchange-like financial guarantees also be included in this Statement. Other respondents requested that guidance for all contingencies be considered for this Statement as current recognition and measurement guidance for nonexchange financial guarantees is included in the guidance for contingencies. While the Board understands the desire by some for the GASB to provide consistent guidance for what may be perceived as similar transactions, the Board concluded that the need to provide timely guidance for nonexchange financial guarantees remained a higher priority. The Board continues to believe that guidance related to financial guarantees that are exchange transactions would be more appropriately addressed in a separate reexamination project. In addition, the Board notes that unlike many other types of transactions for which guidance for loss contingencies is applied, in most cases a government voluntarily enters into a nonexchange financial guarantee.

## **Recognition and Measurement**

33. Concepts Statement No. 4, *Elements of Financial Statements*, defines *liabilities* as “present obligations to sacrifice resources that the government has little or no discretion to avoid.” Concepts Statement 4 defines an *obligation* 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.” The Board believes the extension of a nonexchange financial guarantee by a government is an obligation of the government, but an event that would cause recognition of a liability has not necessarily occurred as many nonexchange financial guarantees are extended without the expectation of a payment ever being made.

34. The Board considered several recognition points at which a guarantor government should recognize a liability for payments that the government may be required to make. The Board initially considered recognition based on the eligibility requirements set forth in paragraphs 19 and 20 of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. However, for most nonexchange financial guarantees, the allowable costs would be principal and interest payments made; therefore, a government that extends a

guarantee would not recognize a liability until default occurred. Under the Statement 33 approach, the Board believes that recognition of a liability when default occurs may be well after it is evident that a guarantee payment is likely to be required. The Board also considered recognition of a liability as a result of extending a nonexchange financial guarantee when a payment is probable, as required for recognizing a liability for a loss contingency based on the provisions of Statement 62. Paragraph 100 in Statement 62 defines *probable* as “the future event or events are likely to occur.” Again, the Board was concerned that the recognition of a liability based on the probable criterion is likely to occur for a nonexchange financial guarantee at a date that may be well after the point it is evident that a guarantee payment is likely to be required.

35. The Board believes that determining whether a payment will be made as a result of extending a nonexchange financial guarantee requires a probability assessment. The Board concluded that recognition when a payment is *more likely than not* eliminates some of the concerns about the point at which a liability for the obligation is recognized. A more-likely-than-not criterion requires recognition in circumstances in which the probability that the guarantor will be required to make a payment as a result of a guarantee is greater than 50 percent. The Board recognizes that the determination of when a payment will more likely than not be required and when it is probable both require the application of professional judgment in assessing probability. However, the Board believes that the facts and circumstances surrounding a specific nonexchange financial guarantee, as discussed in paragraphs 37–39, will assist financial statement preparers in determining whether a liability should be recognized as a result of the guarantees extended.

36. Some respondents to the Exposure Draft expressed concern about the recognition point related to a liability for a nonexchange financial guarantee being different from the point currently required for an exchange transaction. These respondents generally believe that the recognition point of a nonexchange financial guarantee should not differ from the recognition point for a financial guarantee that is an exchange transaction. Other respondents expressed their belief that the recognition of a liability when a payment is more likely than not would result in a liability being recognized in situations for which a payment may never be made. After considering these views, the Board concluded that the more-likely-than-not provision should be retained. This conclusion was based primarily on the Board’s concerns that recognition of a liability for a nonexchange financial guarantee, if based on the probable criterion, may not occur until well after the point it is evident that a guarantee payment is likely to be required. Finally, the Board notes that under either

criterion, a liability is recorded based on an expectation of a future event. Under either the more-likely-than-not or probable approach, a liability may be recognized for a guarantee extended for which a payment will never be made. However, the Board notes that the more-likely-than-not approach is less subjective and therefore will result in a more consistent application of the standard.

## **Qualitative Factors to Indicate Recognition**

37. After initially considering several approaches, including the adoption of a more-likely-than-not recognition threshold without further clarifying guidance, the Board concluded that recognition of a liability resulting from a nonexchange financial guarantee should be based on the consideration of qualitative factors and, in certain situations, relevant historical data, if any. The Board believes the entity or individual that issued the guaranteed obligation experiences one or more predictive events prior to a guarantor being required to make a guarantee payment on that obligation. Those predictive events include negative economic events, violation of agreements related to the obligation, or initiation of the process of financial reorganization, including bankruptcy. The Board believes qualitative factors such as those will assist in assessing whether a payment will more likely than not be required as a result of the extension of the guarantee in most circumstances. Although the occurrence of these events may increase the likelihood that a payment will be required as a result of the guarantee, the Board believes that there generally will not be a specific point at which the government is certain that a payment will be required until the entity or individual issuing the guaranteed obligation fails to make its required payment. Accordingly, the Board believes that the conclusion that a future payment will more likely than not occur is a judgment based on facts and circumstances for each guarantee extended.

38. The Board believes that recognition of a liability from the extension of a nonexchange financial guarantee requires a two-step approach. First, a government considers qualitative factors and historical data, if any, as discussed in paragraphs 7 and 8, to determine whether the ability of the issuing entity or individual to repay the guaranteed obligation has diminished since the guarantee was extended. Second, the government uses that information to assess whether it is more likely than not that it will be required to make a payment.

39. Some respondents to the Exposure Draft requested guidance for recognition of a receivable for any expected recoveries by a government that has made a payment on a guarantee. In these circumstances, the Board believes that the specific guidance for gain contingencies, included in paragraph 112 of Statement 62, is appropriate.

## Measurement

40. To measure the liability, the Board considered (a) a fair value measurement approach that would measure the liability as the price required to exchange the liability in a deep and liquid market and (b) a cost accumulation approach that would measure the liability as the amount that the government expects to pay to settle the liability. The Board concluded the cost accumulation approach of expected future outflows associated with the nonexchange financial guarantee was more appropriate. Guarantors generally do not attempt to sell or transfer such guarantees to external entities.

41. The Board also considered two methodologies for measuring the liability using a cost accumulation approach. One methodology derives from paragraphs 102–104 of Statement 62 for accrual of a liability for loss contingencies. Following that guidance, a liability is measured using a reasonably estimable amount. If the amount of loss is only reasonably estimable within a range, a liability is measured using the best estimate within that range, or the minimum amount of that range if there is no best estimate within the range. The other methodology considered was an expected cash flow approach, as used in paragraphs 16 and 17 of Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. Following that guidance, a liability is measured as the sum of probability-weighted amounts from a range of possible estimated amounts.

42. The Board concluded that the measurement approach used in Statement 62 is more appropriate for measurement of a government's liability for a nonexchange financial guarantee. Unlike pollution remediation obligations, the Board could not identify a specific obligating event associated with nonexchange financial guarantees—other than the actual extension of the guarantee—that would serve as a basis for applying the expected cash flows approach. Because many nonexchange financial guarantees have unique characteristics, the Board was concerned that the application of the expected cash flows approach would not result in a faithful presentation of the guaranteeing government's liability.

43. The Board believes that when there is a best estimate of the amount a government will be required to pay, the government should recognize that amount as its liability. In cases in which there is no best estimate of the amount that a government will be required to pay, the Board believes the minimum amount within a range is the appropriate amount for the government to recognize, which is consistent with measurement guidance in other Statements.

## **Groups of Similar Guarantees**

44. The Board believes that if a government has a history of extending similar nonexchange financial guarantees, or a group of guarantees, the government should assess whether a payment will be required based on its relevant historical data as well as applicable qualitative factors relative to the group or significant individual issuers within the group. For example, the knowledge that 1 in 20 guarantees extended for a student loan program has historically required an indemnification payment may assist a government in evaluating whether a liability should be recognized when applying the more-likely-than-not recognition threshold. The Board believes that some governments extend groups of guarantees in which the probability of payment on any of the *individual* guarantees within the group is not more likely than not. However, historical data or experience may indicate that the probability of the guarantor government being required to make a payment on *at least one* of the guarantees within the group is more likely than not.

45. The Board believes that historical default experience for similar nonexchange financial guarantees of a group may indicate that a guarantee payment will be required as a result of extending the guarantees. As a result, the Board concluded that a government that extends a group of similar nonexchange financial guarantees should recognize a liability when consideration of historical data, if any, and qualitative factors indicates that it is more likely than not that a payment will be made on one or more of the guarantees within the group. Similarly, the measurement of the liability also should consider both historical data, if any, and applicable qualitative factors.

## **Recognition in Financial Statements Prepared Using the Current Financial Resources Measurement Focus**

46. For recognition in financial statements prepared using the current financial resources measurement focus, this Statement provides that a liability that results from extending a nonexchange financial guarantee should be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. This is consistent with the recognition guidance provided in Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, as amended, for liabilities that are claims against current financial resources. The Board specified that in relation to a nonexchange financial guarantee, an amount normally expected to be liquidated with expendable available financial resources refers to a guarantee payment that is due and payable as of the end of the reporting period.

### **Governments Issuing a Guaranteed Obligation**

47. As previously discussed for recognition and measurement issues for guarantors, sometimes the federal government, a state or local government, or another entity may extend a guarantee on an obligation of a state or local government in situations in which an indemnification payment for the guarantee is not likely. This result is anticipated because (a) indemnification payments are required only when the government issuing the guaranteed obligation does not make a required repayment in accordance with the terms of the obligation and (b) the guarantee is extended with the expectation that the government issuing the obligation will fulfill its repayment obligation.

48. The Board considered whether recognition and measurement guidance for governments that issue guaranteed obligations should be symmetrical with the recognition and measurement requirements for guarantors. Symmetry with the recognition requirements the Board has provided for guarantors would require a government that issued a guaranteed obligation to (a) derecognize its liability to the obligation holder or (b) recognize a receivable from the guarantor when it is more likely than not that the guarantor will make a payment on the guarantee. Based on this recognition approach, the receivable would be measured in the same way as the liability of the guarantor government.

49. The Board also considered that Statement 62 prohibits governments from recognizing gain contingencies prior to the realization of the gain. Based on that recognition approach, an issuing government would not recognize the payment to be made by the guarantor before it is realized, pursuant to paragraph 112 of Statement 62.

50. After analyzing both recognition approaches, except as discussed in paragraphs 51–53 for certain intra-entity guarantees, the Board concluded that a government that issues a guaranteed obligation should recognize a reduction in its liability for the obligation only when the guarantor has legally assumed all or a portion of the guaranteed obligation from the issuing government. Unlike the nonexchange transactions addressed in Statement 33 in which symmetry was based primarily on performance obligations, the Board believes the government issuing the guaranteed obligation still has a present obligation to sacrifice resources to the obligation holder that it has little or no discretion to avoid until a payment is made or the obligation is legally assumed. The Board also believes that another entity’s interpretation of the events that have occurred, or will occur, in this situation should not impact the assessment made by a government for its own financial reporting because the application of professional judgment may lead to different conclusions.

## **Intra-Entity Recognition and Measurement**

51. The Board considered the application of the recognition and measurement requirements for circumstances in which a government extends a nonexchange financial guarantee for an obligation of another government within the same financial reporting entity, such as when a primary government extends a guarantee for an obligation of one of its component units. When the recognition criteria in this Statement for issuers and guarantors are applied to an intra-entity guarantee, both the government that extended the guarantee and the government that issued the guaranteed obligation might recognize a liability within the financial statements of the reporting entity.

52. The Board believes that in certain circumstances, the timing of applying recognition criteria on intra-entity transactions should be symmetrical. As a result, the Board considered either (a) not recognizing a liability in the financial statements of the guaranteeing government to prevent both governments from recognizing a liability or (b) requiring the government that issued the guaranteed obligation to recognize a receivable in the amount of any liability recognized by the guarantor. However, the Board believes that both the government

that has guaranteed an obligation of another government within its reporting entity and the government that issued the guaranteed obligation have a present obligation to sacrifice resources that they have little or no discretion to avoid. The Board also initially believed that the government that issued the guaranteed obligation should not recognize a receivable for a guarantee payment prior to the guarantor making the payment. Therefore, the Board proposed that the accounting and financial reporting guidance for nonexchange financial guarantees extended by and received from entities outside of the reporting entity also should apply to intra-entity nonexchange financial guarantees.

53. Some respondents to the Exposure Draft expressed a concern that, for intra-entity guarantees, the financial statements for a reporting entity would recognize liabilities for both the guarantor and the government that issued the guaranteed debt. After further consideration of this concern, the Board still believes that both the guarantor government and the government that issued the guaranteed obligation have a liability in relation to the guarantee. The guarantor has a liability for the guarantee it extended, and the government that issued the obligation has a liability to the obligation holders. However, the Board recognizes that, as a consequence, the net position of a primary government will decrease in circumstances in which a liability has been recognized for a guarantee extended prior to the guarantee payment being made when (a) the guarantor is a primary government and the government issuing the guaranteed debt is one of its blended component units, (b) the government issuing the guaranteed debt is a primary government and the debt is guaranteed by one of its blended component units, or (c) the guarantor and the government issuing the guaranteed debt are both blended component units of the same primary government. After considering the comments made by respondents, the Board determined that, in these specific circumstances, the government that issued the guaranteed obligation should recognize a receivable in the amount of the liability recognized by the guarantor. Recognition of a receivable provides a mechanism by which the guarantee liability could be eliminated, to the extent the receivable is determined to be collectible as per paragraph 63 of NCGA Statement No. 1, *Governmental Accounting and Financial Reporting Principles*, when the financial statements of the components are aggregated. The Board concluded that this elimination would not be necessary for a guarantee involving a discretely presented component unit and, therefore, did not include a provision for a receivable to be recorded in that circumstance.

## Disclosures

54. Paragraphs 106–110 of Statement 62 require governments to disclose certain information about guarantees of the indebtedness of others. The Board believes the disclosure requirements in this Statement add to the disclosures required by Statement 62 and provide more detail to users of the financial statements about nonexchange financial guarantees extended and the underlying obligations being guaranteed. Statement 62 requires a government that guarantees the indebtedness of others to disclose the nature and amount of the guarantee, with consideration given to disclosing the value of any recovery that may result. The Board concluded that specifying that the nature of a guarantee includes (a) the legal authority and limits of the guarantee, (b) the relationship to the issuer or issuers of the guaranteed obligation, (c) the length of time of the guarantee, and (d) a description of arrangements for recovering guarantee payments and when those arrangements become effective. The Board believes these four disclosures are essential to understanding the risks associated with the guarantee. The Board also concluded that disclosure of (a) the amount of and changes in liabilities recognized related to guarantees in a schedule of changes, (b) the amount of obligations outstanding at the reporting date that have been guaranteed, and (c) the amounts of guarantee payments made and expected to be recovered provide essential detail on the amounts recognized in the financial statements and on amounts that do not meet the criteria for recognition. The Board believes this additional information will allow users to better understand the responsibilities that the guarantor has to the issuers of the obligations that are guaranteed in a nonexchange transaction. During its deliberations, the Board noted that significant commitments are required to be disclosed by paragraph 158 of NCGA Statement 1. Accordingly, the Board believes that disclosure requirement does not need to be repeated in this Statement. The Board also noted that many nonexchange financial guarantee transactions occur between related parties. Related party disclosures are addressed in GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. Accordingly, the Board concluded that applicable related party disclosure requirements do not need to be repeated in this Statement.

55. This Statement also requires disclosures by governments that issue obligations that are guaranteed in nonexchange transactions. The Board believes that the disclosures required by this Statement are essential to a user's understanding of the risk mitigation provided by the guarantees associated with obligations that are outstanding.

56. Some respondents to the Exposure Draft requested clarification on the requirement to make disclosures by “type of guarantee.” The Board concluded that selection of types of guarantees for disclosure should be left to the professional judgment of the financial statement preparers in relation to the facts and their own specific circumstances. For example, guarantees of student loans and guarantees of mortgage loans should not be aggregated.

## **Considerations Related to Benefits and Costs**

57. 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 standards setting for financial reporting is the assessment of expected benefits and the perceived costs. The Board strives to determine that standards (including disclosure requirements) address a significant user need and that the costs imposed through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit.

58. 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 conformity 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 information to meaningfully inform their assessments and decisions.

59. The Board’s assessment of the benefits and costs of issuing new standards is unavoidably more qualitative than quantitative because there is no reliable and objective method 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 actually taken place. Nonetheless, the Board undertakes this assessment based on the available evidence regarding benefits and costs with the objective of achieving an appropriate balance between increasing benefits while minimizing costs.

60. The Board believes the requirements of this Statement will enhance comparability of financial statements among governments by requiring consistent reporting by guarantors and requiring consistent reporting by governments that receive nonexchange financial guarantees. The Board also believes this Statement will improve the information disclosed about a government's obligations and exposure to risk from extending nonexchange financial guarantees. In addition, the Board believes this Statement will augment users' ability to assess the probability that governments will repay obligation holders by requiring disclosures about obligations that are issued with this type of financial guarantee. Based on research conducted as part of this project and feedback received from due process participants, the Board does not believe a government would incur significant costs to prepare this information. However, the Board did allow for governments that have made guarantee payments in the past in relation to outstanding guarantees extended to report cumulative payments on these guarantees prospectively at transition. The Board believes that this provision alleviates potential significant costs of preparing this information.

## **Effective Date and Transition**

61. The provisions of this Statement are effective for reporting periods beginning after June 15, 2013. The Board concluded that this effective date is appropriate because most guarantors and issuers of nonexchange financial guarantees can readily determine the amount of outstanding obligations related to nonexchange financial guarantees that they have extended or the amount of obligations they have issued that are guaranteed. Some governments may wish to implement earlier than that date, which this Statement encourages.

62. The Board believes that this Statement should be applied retroactively. However, the Board considered the potential for the lack of readily available information for the disclosure requirements of cumulative financial guarantee payments that have been made or received in prior reporting periods on outstanding guaranteed obligations by governments. Accordingly, the Board concluded that those disclosures may be provided prospectively.

## **Dissent**

63. Ms. Taylor dissents because she disagrees with the provision in paragraph 9 in which a liability will be recorded if the qualitative factors and historical data, if any, indicate that it is more likely than not that a government will be required to make a payment related to the nonexchange financial guarantees

that it has extended. Instead, she believes that the same contingent liability recognition point of probable, required for other exchange and nonexchange transactions under paragraphs 100–105 of Statement 62, should be used. She recognizes that the application of probable in practice has led to a lack of comparability; however, she does not believe that the introduction of another recognition approach solves this issue. She believes that the use of the more-likely-than-not approach will result in earlier and possibly premature recognition of nonexchange financial guarantee liabilities. She also is concerned that an impact of earlier expense recognition could result in the need for governments to subsequently recognize revenue in situations in which the more-likely-than-not recognition proves to be unwarranted.

## Appendix C

### ILLUSTRATIONS

64. The facts assumed in these 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. Existing standards may require disclosures in addition to those illustrated.

#### **Illustration 1—Nonexchange Financial Guarantee between Two Governments**

**Facts and assumptions:** The New Civic Center is a civic center district located within Any County, Any State. The New Civic Center and Any County are not part of the same financial reporting entity. The Any State Civic Center Act allows counties to extend nonexchange financial guarantees on bonds issued by civic center districts located within a county for improvements to civic center facilities. Both the New Civic Center and Any County have a fiscal year-end of June 30. On November 1, 20X1, the District Trustees of the New Civic Center voted and approved the issuance of \$10 million in general obligation bonds to be issued on December 1, 20X1, for facility improvements. The bonds mature annually beginning December 1, 20X2 through December 1, 20Y1, with semiannual interest payments. On November 4, 20X1, the County Board of Any County voted to extend a nonexchange financial guarantee on the planned issuance by the New Civic Center with no requirements for the New Civic Center to repay Any County if payments are made as a result of the guarantee. On December 1, 20X1, the New Civic Center issued the \$10 million in general obligation bonds with Any County's guarantee.

In the last half of fiscal year 20X8, the New Civic Center's revenue from concerts and promotions begin to decrease significantly due to the construction of a competing civic center in a neighboring county. The decrease in revenue resulted in a violation of revenue coverage requirements contained in bond covenants. The New Civic Center made its required June 1, 20X8, interest payment on the bonds; however, it had to use all of the resources in the bond reserve account to do so. The use of these resources resulted in another

violation of the bond covenants. Based on these indicators, Any County determined that at June 30, 20X8, it is more likely than not the New Civic Center will be unable to make any of the remaining required debt service payments on the bonds. Any County determined that the present value of the future outflows of the guarantee was \$4.020 million at June 30, 20X8. Beginning on December 1, 20X8, Any County was required to make a guarantee payment. Any County made the entire December 1, 20X8 payment for New Civic Center and also made the remaining required debt service payments on the guaranteed bonds until those bonds were paid.

## **Any County's Financial Statements, June 30, 20X2 through June 30, 20X7**

### ***Accounting for the Guarantee***

At June 30, [year], Any County does not record a liability related to the guarantee of the New Civic Center's December 20X1 issuance of general obligation bonds in the financial statements prepared using the economic resources measurement focus.

### ***Illustrative Disclosure***

In November 20X1, Any County guaranteed the 10-year, \$10 million December 20X1 general obligation bond issuance of the New Civic Center, a legally separate district located within Any County, in accordance with the Any State Civic Center Act. The bonds mature annually through December 1, 20Y1, with semiannual interest payments. In the event that the New Civic Center is unable to make a payment, Any County will be required to make that payment.

## **Any County's Financial Statements, June 30, 20X8**

### ***Accounting for the Guarantee***

At June 30, 20X8, Any County records a liability and an expense for the \$4.020 million present value of the expected future outflows for the guarantee of the New Civic Center's December 20X1 issuance of general obligation bonds in the financial statements prepared using the economic resources measurement focus.

### ***Illustrative Disclosure***

In 20X1, Any County guaranteed the 10-year, \$10 million December 20X1 general obligation bond issuance of the New Civic Center, a legally separate district located within Any County, in accordance with the Any State Civic Center Act. The bonds mature annually through December 1, 20Y1, with semiannual interest payments. In the event that the New Civic Center is unable to make a payment, Any County is required to make that payment. As a result of bond covenant violations that occurred in 20X8, Any County determined that it was more likely than not that the County would be required to pay the remaining portion of the New Civic Center's debt service payments based on this guarantee. The amount of the liability recognized is the best estimate of the discounted present value of the future outflows expected to be incurred as a result of the guarantee.

The liability recognized for nonexchange financial guarantees by Any County at June 30, 20X8, is as follows:

<u>Beginning of Year</u>	<u>Increases</u>	<u>Decreases</u>	<u>End of Year</u>
\$ 0	\$ 4,020,000	\$ 0	\$ 4,020,000

### **Any County's Financial Statements, June 30, 20X9**

#### ***Accounting for the Guarantee***

In Any County's June 30, 20X9 financial statements prepared using the economic resources measurement focus, Any County records a reduction in its guarantee liability for the outstanding balance of the New Civic Center's December 20X1 issuance of general obligation bonds for a \$1 million principal payment and \$175,000 of interest payments made by Any County during the fiscal year. The County also recorded a \$170,000 increase in its guarantee liability, reflecting an increase in the present value of the liability due to the passage of time. The County also reported the principal and interest payments as expenditures in its financial statements prepared using the current financial resources measurement focus.

### ***Illustrative Disclosure***

In 20X1, Any County guaranteed the 10-year, \$10 million December 20X1 general obligation bond issuance of the New Civic Center, a legally separate district located within Any County, in accordance with the Any State Civic Center Act. The bonds mature annually through December 1, 20Y1, with semiannual interest payments. In the event that the New Civic Center is unable to make a payment, Any County is required to make that payment. As a result of bond covenant violations that occurred in 20X8, Any County determined that it was more likely than not that the County would be required to pay the remaining portion of the New Civic Center's debt service payments based on this guarantee. On December 1, 20X8, Any County began making payments on the New Civic Center's bonds due to the New Civic Center failing to make payment. Any County has paid \$1 million in principal and \$175,000 in interest on the guarantee through June 30, 20X9. The amount of the liability recognized is the best estimate of the discounted present value of the future outflows expected to be incurred as a result of the guarantee.

The liability recognized for nonexchange financial guarantees by Any County at June 30, 20X9, is as follows:

<u>Beginning of Year</u>	<u>Increases</u>	<u>Decreases</u>	<u>End of Year</u>
\$ 4,020,000	\$ 170,000	\$ 1,175,000	\$ 3,015,000

### **New Civic Center's Financial Statements, June 30, 20X2 through June 30, 20X7**

#### ***Accounting for the Guarantee***

At June 30, [year], there is no impact on amounts reported on the New Civic Center's statement of net position or statement of activities as a result of the guarantee from Any County.

### ***Illustrative Disclosure***

On December 1, 20X1, the New Civic Center issued \$10 million in 10-year general obligation bonds. The bonds mature annually on December 1 with semiannual interest payments. All required payments on the bonds are guaranteed by Any County in the event that the New Civic Center is unable to make required payments.

## **New Civic Center's Financial Statements, June 30, 20X8**

### ***Accounting for the Guarantee***

At June 30, 20X8, there is no effect on amounts reported on the New Civic Center's statement of net position or statement of activities as a result of the guarantee from Any County.

### ***Illustrative Disclosure***

On December 1, 20X1, the New Civic Center issued \$10 million in 10-year general obligation bonds. The bonds mature annually on December 1 with semiannual interest payments. All required payments on the bonds are guaranteed by Any County in the event that the New Civic Center is unable to make required payments.

[The following illustrates disclosures required by NCGA Interpretation 6, *Notes to the Financial Statements Disclosure*, paragraph 4g, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, paragraph 9, and GASB Statement 62, paragraph 112.]

The New Civic Center is in violation of a bond covenant that requires the Center's adjusted operating income to be at least 125 percent of annual debt service requirements. On June 1, 20X8, the New Civic Center used the resources in the debt service reserve fund for the bonds to make the interest payment. The New Civic Center has decreased its operating expenses to attempt repayment to the reserve fund. However, as a result of declining revenues, the New Civic Center anticipates that Any County likely will make all future debt service payments based on this guarantee.

## **New Civic Center’s Financial Statements, June 30, 20X9**

### ***Accounting for the Guarantee***

On the New Civic Center’s June 30, 20X9 financial statements prepared using the economic resources measurement focus, the New Civic Center reports a reduction in its liability for the general obligation bonds and revenue in the amount of the \$1 million in payments made by Any County.

### ***Illustrative Disclosure***

On December 1, 20X1, the New Civic Center issued \$10 million in 10-year general obligation bonds. The bonds mature annually on December 1 with semiannual interest payments. All required payments on the bonds are guaranteed by Any County in the event that the New Civic Center is unable to make required payments. Any County has paid \$1 million in principal and \$175,000 in interest on the guarantee during the year ended June 30, 20X9. The cumulative amount that has been paid by Any County as of June 30, 20X9, is \$1,175,000.

[The following illustrates disclosures required by Statement 62, paragraph 112.]

As a result of declining revenues, the New Civic Center anticipates that Any County likely will make all future debt service payments based on this guarantee.

## **Illustration 2—Similar Nonexchange Financial Guarantees Extended by a Government to Multiple Entities**

***Facts and assumptions:*** Central State extends nonexchange financial guarantees for qualifying bonds issued by school districts within the State for construction of schools in accordance with the School Construction Act. Central State has determined based on historical experience and qualitative factors that 0.25 percent of the total amount of nonexchange financial guarantees extended eventually will require a guarantee payment to be made, and 50 percent of guarantee payments made are recovered from the school district. At July 1, 20X0, Central State has recognized liabilities of \$18.5 million related to \$14.6 billion in nonexchange financial guarantees outstanding with varying dates of

maturity through June 30, 2026. During the fiscal year ending June 30, 20X1, \$1.245 billion of the guaranteed obligations are repaid by the school districts that issued the obligations while Central State pays \$5 million on bond obligations of several school districts that did not make their required payments. Considering payments made during the current year in relation to the historical average of school districts that default, Central State estimates that its liability related to nonexchange financial guarantees will increase by \$1.875 million for nonexchange financial guarantees outstanding at June 30, 20X1. The increase in present value of the prior liability for the fiscal year ending June 30, 20X1, is \$1.5 million. In addition, during the fiscal year ending June 30, 20X1, Central State extends \$900 million in nonexchange financial guarantees on bonds issued for school construction with varying dates of maturity through June 30, 2027.

## **Central State's Financial Statements, June 30, 20X1**

### ***Accounting for the Guarantee***

On Central State's June 30, 20X1 financial statements prepared using the economic resources measurement focus, the State reports an increase in its liability related to nonexchange financial guarantees extended in the amount of \$1.5 million. This amount represents the present value of future outflows, \$2.250 million ( $\$900 \text{ million} \times 0.0025$ ). The State believes that this amount will more likely than not be required for the guarantees based on consideration of historical data and applicable qualitative factors (including negative economic events, violations of agreements, and initiation of the process of financial reorganization). In addition, Central State recognizes a decrease in its liability related to nonexchange financial guarantees extended of \$5 million for the payments made on nonexchange financial guarantees during the year. Also, Central State recognizes an adjustment to increase its liability in the amount of \$3.375 million. That amount is based on a historical analysis of current nonexchange financial guarantees outstanding (\$1.875 million) and an increase for adjustment in present value (\$1.5 million). Central State also reported the \$5 million in bond principal and interest payments made as expenditures in its financial statements prepared using the current financial resources measurement focus.

### ***Illustrative Disclosure***

In accordance with the School Construction Act, Central State has guaranteed outstanding bond obligations of school districts within the State in the amount of \$14.250 billion at June 30, 20X1. The guarantees extend through the maturity dates of the bonds with the last maturity date being June 30, 20Z7. In the event that a school district is unable to make a required debt service payment on a guaranteed bond, Central State is required to make the payment. Central State considered historic experience of defaults and qualitative factors in determining its guarantee liability.

The liability recognized for nonexchange financial guarantees by Central State at June 30, 20X1, is as follows:

<u>Beginning of Year</u>	<u>Increases</u>	<u>Decreases</u>	<u>End of Year</u>
\$ 18,500,000	\$ 4,875,000	\$ 5,000,000	\$ 18,375,000

For nonexchange financial guarantees outstanding at June 30, 20X1, Central State has paid \$32.675 million in debt service payments. Central State expects to recover \$16.485 million of this amount in future years.

## Appendix D

### CODIFICATION INSTRUCTIONS

65. The sections that follow update the June 30, 2012, *Codification of Governmental Accounting and Financial Reporting Standards*, for the effects of this Statement. Only the paragraph number of this Statement is listed if the paragraph will be cited in full in the Codification.

\* \* \*

#### NOTES TO FINANCIAL STATEMENTS

#### SECTION 2300

Sources: [Add the following:] GASB Statement 70

.107 [Add new subparagraph ggg as follows; add GASBS 70, ¶14–¶17 to sources.]

ggg. Nonexchange financial guarantees extended or received. (See Section N30, “Nonexchange Financial Guarantees,” paragraphs .111 through .113.)

\* \* \*

[Insert new section as follows:]

#### NONEXCHANGE FINANCIAL GUARANTEES

#### SECTION N30

Source: GASB Statement 70

##### Scope and Applicability of This Section

.101–.102 [GASBS 70, ¶14 and ¶15, including footnote; change *Statement to section* and update cross-reference.]

.103–.113 [GASBS 70, ¶17–¶17, including headings and footnote; change *Statement to section* and update cross-references.]

\* \* \*

**NONEXCHANGE TRANSACTIONS**

**SECTION N50**

See also: Section N30, “Nonexchange Financial Guarantees”

.103 [Insert the following at the end of the paragraph:] The provisions of this section do not apply to guarantees. Section N30 provides guidance for accounting and financial reporting for financial guarantees extended or received that are nonexchange transactions (nonexchange financial guarantees). [GASBS 33, ¶5, as amended by GASBS 70, ¶4]

\* \* \*

**CLAIMS AND JUDGMENTS**

**SECTION C50**

Sources: [Add the following:] GASB Statement 70

.103 [Replace *guarantees of the indebtedness of others* with *guarantees of the indebtedness of others in an exchange or exchange-like transaction.*] [GASBS 10, ¶3, as amended by GASBS 70, ¶4]

.150 [Replace *guarantees of the indebtedness of others* with *guarantees of the indebtedness of others in an exchange or exchange-like transaction.*] [NCGAS 4, ¶9, as amended by GASBS 10, ¶3, GASBS 34, ¶69, GASBS 59, ¶3 and ¶8, and GASBS 70, ¶4; NCGAS 4, ¶14, as amended by GASBS 62, ¶96–¶113]

.153 [Replace *Guarantees of indebtedness of others* with *Guarantees of indebtedness of others in an exchange or exchange-like transaction.*] [GASBS 62, ¶98, as amended by GASBS 70, ¶4]

.154 [Remove reference to footnote 20 from subparagraph g; add new subparagraph h, including footnote, as follows:]

h. Guarantees of indebtedness of others in a nonexchange transaction.<sup>20</sup>

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<sup>20</sup>[Insert current footnote 20 and add the following sentence to the end of the footnote:] The accounting and financial reporting standards for the risks of loss associated with item (h) are provided in Section N30, “Nonexchange Financial Guarantees.” [GASBS 62, fn38, as amended by GASBS 70, ¶4]

.164 [Replace the second and third sentences as follows:] The common characteristic of those contingencies is a guarantee in an exchange or exchange-like transaction, normally with a right to proceed against an outside party in the event that the guarantor is called upon to satisfy the guarantee. Examples include guarantees of indebtedness of others in an exchange transaction and guarantees to repurchase receivables (or, in some cases, to repurchase the related property) that have been sold or otherwise assigned. [GASBS 62, ¶109, as amended by GASBS 70, ¶14]

.165 [In the first sentence, replace *guarantees of indebtedness of others* with *guarantees of indebtedness of others in an exchange or exchange-like transaction*.] [GASBS 62, ¶110, as amended by GASBS 63, ¶18 and GASBS 70, ¶14]

\* \* \*

## **DEBT EXTINGUISHMENTS AND TROUBLED DEBT RESTRUCTURING**

## **SECTION D20**

.101 [Replace the first sentence as follows:] Paragraphs .102 and .103 apply to all extinguishments of debt, whether early or not, except debt defeased by a current or advanced refunding, debt that is extinguished through a financial guarantee payment that is a nonexchange transaction, and debt that is extinguished through a troubled debt restructuring. [GASBS 7, ¶1 and ¶7, as amended by GASBS 34, ¶82; GASBS 23, ¶3; GASBS 34, ¶16; GASBS 35, ¶5; GASBS 62, ¶124, as amended by GASBS 70, ¶12; GASBS 62, ¶128]

