GOVERNMENTAL ACCOUNTING STANDARDS BOARD

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# GASB Statement Provides Accounting and Financial Reporting Guidance for Nonexchange Financial Guarantees

The GASB recently issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. That Statement provides new recognition, measurement, and disclosure guidance for state and local governments that extend or receive nonexchange financial guarantees.

## What Are Nonexchange Financial Guarantees?

A *nonexchange financial guarantee* occurs when a government guarantees a financial obligation but generally receives little or no compensation in return.

On the other hand, under an *exchange financial guarantee,* a government issuing debt typically pays a market-based fee to a credit enhancement company to insure the outstanding balance. Exchange financial guarantees are already addressed in the GASB authoritative literature and are not discussed in Statement 70.

Under a nonexchange financial guarantee, the government guaranteeing the debt (the *guarantor*) agrees to make payments to the holder of the debt if the entity that issued the debt (the *issuer*) is unable to fulfill its obligation independently. For example, a state government might guarantee the debt of all local school districts. If a local school district in that state became unable to pay, the state would step in to make the payment. Guarantor governments generally enter into these types of guarantees to allow smaller governments within their jurisdiction to obtain better interest rates when issuing debt than they would be able to otherwise.

To the guarantor, the guarantee represents the possibility of claims on the government's resources. To the issuer, a nonexchange financial guarantee represents potential resources that can be drawn upon to make the required payment. A variety of different types of state and local government entities issue and receive financial guarantees, including general purpose governments and governmental entities that engage in business-type activities, like a public electric utility or water district.

## Why Did the GASB Issue This Guidance?

Statement 70 focuses on nonexchange guarantees because, in the absence of an exchange of financial resources between the guarantor and the issuer, the existence of the guarantee can easily be overlooked as a part of the financial reporting process. Stated another way, nothing is entered into a government's accounting system because, in many situations, no money changes hands under a nonexchange financial guarantee. Consequently, in many cases, nothing is reported about the guarantee. Statement 70 requires that governments plainly disclose that these relationships exist in their financial statements.

## Has the GASB Addressed This Issue Before?

Although some relevant accounting and financial reporting guidance for nonexchange financial guarantees does exist within GASB literature, it comes from multiple sources, most notably No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. Having guidance appear in various places can lead to uncertain or inconsistent application, which can impair the comparability of the reported information.

Statement 70 provides a single source of recognition and disclosure guidance specifically intended for governments. This is particularly valuable considering that nonexchange financial guarantees are more common in the government environment and can lead to significant claims.

## What Does Statement 70 Require?

Statement 70 requires a guarantor government to recognize a liability when qualitative factors indicate that it is *more likely than not* that it will actually be required to make a payment as a result of the guarantee agreement.

These qualitative factors might include such events as the issuer experiencing the loss of a major revenue source, initiating the process of entering into bankruptcy protection proceedings or a financial reorganization, or other significant financial hardship.

When a guarantor government extends groups of similar guarantees, Statement 70 requires that government to assess both qualitative factors and existing historical data regarding the frequency of default in relation to the group of guarantees rather than for each individual agreement.

The amount of the liability recognized by the guarantor government should be the best estimate of the costs expected to be incurred expressed at present value—in other words, the value of the liability considering the passage of time, expressed in today's dollars. When a best estimate cannot be determined, but a range of estimates can, the government recognizes a liability equal to the minimum amount within the range.

Statement 70 requires an issuer government to continue to report a liability until it is legally released as an obligor. If that issuer is required to repay a guarantor for guarantee payments that have been made on the issuer's obligation, the issuer is required to report a liability to the guarantor until legally released. When the issuer is released from those liabilities, it recognizes revenue as a result.

## What about Disclosures?

Taken together, the aim of the disclosures described in Statement 70 is to provide users with the essential information they need to recognize and understand the risks and potential claims on a guarantor government's resources related to nonexchange financial guarantees provided. The Statement also requires disclosure of information by an issuer government that has its obligations guaranteed by another government about the potential resources available to it as the recipient of a financial guarantee.

A guarantor government should disclose certain information, by type of guarantee, for all nonexchange financial guarantees, regardless of the likelihood of a payment being required. This includes a description of the nonexchange financial guarantee and the total amount of all guarantees outstanding at the reporting date.

A guarantor government that recognizes a nonexchange financial guarantee liability, or has made payments during the reporting period on nonexchange financial guarantees extended, should disclose additional information including:

- A brief description of the timing of recognition and measurement of the liabilities and information about the changes in recognized guarantee liabilities
- Cumulative amounts of indemnification payments made on guarantees outstanding at the reporting date
- Amounts expected to be recovered from indemnification payments made through the reporting date.

In cases involving an issuer 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, that government should disclose the identity of the guarantor, as well as the amounts, duration, and other details about the guarantee. In cases in which payments have been made on the obligation but the obligation is no longer outstanding at the reporting date, an issuer government also should disclose information regarding the payments made.

## When Will Governments Implement Statement 70?

The requirements of the Statement are effective for periods beginning after June 15, 2013 (in other words, fiscal years ending June 30, 2014, and later). Governments are encouraged to implement earlier.

## Obtaining Statement 70

The full text of Statement 70 is available to download free from the GASB website (www.gasb.org).

- Printed copies of Statement 70 are available in the GASB Store
- Read the news release
- Read the media advisory