Wednesday's News You Can Use

J. Chris Hollifield & John Holden

Rushton & Company | Growing futures.

GASB 70, Accounting and Financial Reporting for Nonexchange Financial Guarantees

Carl Vinson Institute of Government
The University of Georgia

GGFOA
Georgia Government Finance Officers Association

Learning Objectives

At the end of this session, participants should be able to –

- Understand the reporting requirements for governments that guarantee obligations of other organizations
- Recognize qualitative factors when determining if a payment on a guarantee is more likely than not to be required
- Recall disclosure requirements about the amounts and nature of nonexchange financial guarantees

GASB 70

The GASB has issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*.

This Statement is effective for periods beginning after 6/15/2013 (6/30/2014 year-ends and later). Earlier application is encouraged.

GASB 70

The provisions of GASB 70 are required to be applied retroactively, except for disclosures related to cumulative amounts paid or received in relation to a guarantee, which may be applied prospectively.

GASB 70

- If it is not practical to restate all prior periods presented for the effects of GASB 70, the beginning net equity for the earliest period restated (usually the current period) should be restated for the cumulative effect of applying this Statement.
- The reason for not restating earlier periods should be disclosed.

Application of Statement

This Statement applies to governments who guarantee the financial obligations of others in a nonexchange transaction.

Those other entities may include governments or authorities, not-for-profits, private companies, and individuals.

Those other entities may also include blended or discretely presented component units.

Nonexchange Transactions

A nonexchange transaction is one in which the government extending the guarantee does not directly receive an equal or approximately equal value in exchange.

Guarantee of Obligations

As part of the guarantee, the government agrees to assume liability for the outstanding obligation in the event the entity or individual that issued the obligation does not meet its payment requirements (defaults).

Guarantee of Obligations

This Statement also applies to governments whose obligations are guaranteed by another entity in a nonexchange transaction.

This could create a receivable on the statements of the government issuing the debt.

Special Assessment Debt

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

Special assessment debt would be, for example, bonds issued to pay for sidewalks in a certain community and that community is assessed an additional tax to repay the bonds.

Question 1

- GASB 70 applies to your government if your government guarantees an obligation of another in a nonexchange transaction?
    - True
    - False

Recognition and Measurement

In financial statements using the economic resources measurement focus (government-wide and proprietary fund types), the government should recognize a liability and expense when qualitative factors and historical data indicate it is *more likely than not* that the government will be required to make a payment related to a guarantee.

Recognition and Measurement

For the purposes of Statement No. 70, "more likely than not" means a greater than 50% likelihood.

Qualitative Factors of Guarantees

Qualitative factors to be considered in the evaluation of the likelihood that the government will be required to make a payment in relation to a guarantee of an obligation include, but are not limited to:

Continued on next slide

Qualitative Factors of Guarantees

- Initiation of bankruptcy or financial reorganization

- Breach of debt contract
  - Delinquency or default of payments
  - Failure to meet debt covenants such as coverage ratios

Continued on next slide

Qualitative Factors of Guarantees

- Indicators of significant financial difficulty
  - Drawing on reserve funds to make debt service payments
  - Significant investment or major revenue source losses
  - Significant increase in noncapital disbursements (expenses)

Recognition and Measurement

The amount to be recognized is the discounted present value of the future outflows (all payments, including interest) required under the guarantee.

The government should use its best estimate of the outflows under the guarantee.

Recognition and Measurement

If there is no one best estimate of the expected outflows, but a range of outflows can be estimated, the minimum amount of the range should be used to calculate the discounted present value for recognition in the financial statements.

Recognition and Measurement

The expense reported in the financial statements should be classified similarly to grants or financial assistance payments to other entities or individuals.

For example, report the expense the same way you might report a grant paid out to another entity. An example might be "Grants (payments) on behalf of X entity".

Recognition and Measurement

In financial statements using the current financial resources measurement focus (governmental fund types), the government should recognize a liability and expenditure if the liability is expected to be paid with expendable available financial resources.

Recognition and Measurement

The amount of the liability expected to be paid with expendable available financial resources will be the amount due and payable at the end of the reporting period.

For example, delinquent payments.

Blended Component Units

The blended (not discretely presented) component unit issuing the guaranteed debt will record a receivable equal to the liability recorded by the guarantor government if the issuing component unit is:

Continued on next slide

Blended Component Units

- A blended component unit of the guarantor government. (This is the most common.)

- A blended component unit of a primary government for which the guarantor government is also a blended component unit. (Both are blended component units of the same primary gov't)

Blended Component Units

This treatment is required to prevent both the guarantee liability and the guaranteed debt decreasing the net position of the primary government. Must eliminate the intra-government transactions upon consolidation.

This treatment does not extend to discretely presented component units as they are a separate opinion unit.

Question 2

- Both blended and discretely presented component units issuing debt would record a receivable equal to the primary government's guarantee liability on the same debt.

  - True
  - False

Disclosures for Government Extending the Guarantee

The notes to the financial statements of governments extending guarantees should disclose:

Continued on next slide

Disclosures for Government Extending the Guarantee

- The legal authority and limits for extending guarantees and the types of debts guaranteed
- The relationship of the guarantor to the issuing entity
- The period covered by the guarantees
- Any arrangements to recover payments made under the guarantees
- The total amount outstanding for all guarantees extended

Note: These disclosures are required regardless of whether a liability has been recognized or not.

Disclosures for Government Extending the Guarantee

If the guarantor has recorded a guarantee liability or made payments required by a guarantee during the report period, the notes to the financial statements should disclose:

Continued on next slide

Disclosures for Government Extending the Guarantee

- The beginning balance of outstanding guarantee liabilities
- Increases, include recognition of liabilities and adjustments to liabilities
- Decreases, including payments made and adjustments
- The ending balance of outstanding guarantee obligations

Continued on next slide

Disclosures for Government Extending the Guarantee

- The cumulative amounts paid on outstanding guarantee obligations
- Amounts expected to be recovered on amounts paid from the issuing entity

Disclosures for Government Issuing the Debt

If a government has issued debt guaranteed by another government, the notes to the financial statements should include:

Continued on next slide

Disclosures for the Government Issuing the Debt

- The name of the guarantor
- The amount of the guarantee
- The period covered by the guarantee
- Any current year amounts paid by the guarantor on issued debt
- The cumulative amounts paid by the guarantor

Continued on next slide

Disclosures for the Government Issuing the Debt

- A description of any repayment arrangements
- Any amounts outstanding that are required to repaid to the guarantor

These disclosures are required regardless of whether there are any other guaranteed debt issues outstanding at the end of the reporting period.

Examples

Scenario #1 - Question 3 FACTS:

- In 2010, City X guaranteed 10 year, $5 million bonds issued by the Convention Center Authority (CCA), a discretely presented component unit, with a nonexchange financial guarantee. Annual principal payments are due May 1 each year; semi-annual interest payments due May 1 and November 1.

Examples

Scenario #1 – Question 3 FACTS, continued

- The CCA made all required payments through November 2014.
- In December 2014, the City determines that the CCA will be unable to make the required remaining principal and interest payments; the City will make the required payments in compliance with the guarantee.

Examples

Scenario #1 – Question 3 FACTS, continued

- At December 31, 2014, the City calculates the discounted present value of the remaining $3,360,000 debt service payments (principal and interest) to be $3,060,000.

Question 3

- What is the amount the City would record as an expense and liability for 2014?

A) $3,360,000

B) $3,060,000

C) $0

Answer

Scenario #1, Question 3

At December 31, 2014, City X will record a liability and expense of $3,060,000 for the beginning balance of the obligation under the guarantee. The City will also disclose the guarantee and the obligation reported under the guarantee.

Examples

Scenario #1 – Question 4 FACTS, continued

- During 2015, the City makes debt service payments of $610,000 ($500,000 principal, $110,000 interest).
- The City recalculates the discounted present value of the remaining obligation at December 31, 2015 to be $2,550,000, not $2,450,000 ($3,060,000-$610,000).

Examples

Scenario #1, Question 4 FACTS, continued

- For 2015, the City will decrease the obligation by $610,000 for the debt service payments made. The City will also recognize current expense of $100,000 for the change in the discounted present value of the guarantee. The City will disclose the guarantee and the debt service payments made.

Question 4

- What is the amount the discretely presented component unit, CCA would record as a receivable for 2014?

A) $3,360,000

B) $3,060,000

C) $0

Answer

Scenario #1, Question 4

- At December 31, 2014, there is no effect on the financial statements of the CCA since it is a discretely presented component unit. The CCA will disclose the guarantee and the City's obligations under the guarantee.

- Note that if the CCA was a blended component unit, the CCA would record a receivable for the amount of the guarantee liability.

Continued on next slide

Answer

Scenario #1, Question 4

- For 2015, the CCA will decrease bonds payable by $500,000 and recognize intergovernmental revenue for the principal payment made by the City. The CCA will also disclose the guarantee and the debt service payments made.

Examples

Scenario #2 - FACTS

- The facts regarding the debt issue and guarantee are the same as Scenario #1, except the City is not certain it will have to make all the remaining payments.

Examples

Scenario #2 - FACTS, continued

- In December 2014, City X determines that it will be required to make the debt service payments for 2015 and 2016.
- It is also determined that it is equally likely that the CCA or the City will make the debt service payments for 2017 through 2020.

Examples

Scenario #2 , conclusion

- Since it is equally likely that the City will make 2 years and equally likely that they could make up to 6 years of debt service payments, the City will calculate the discounted present value of only the 2015 and 2016 debt service requirements (lessor of the range) and record the liability under the guarantee obligation.

Continued on next slide

Examples

Scenario #2, conclusion

- The City should continue to evaluate the likelihood that it will be required to make future debt service payments and record an additional obligation if necessary.

Examples

Scenario #3 - FACTS

- The facts regarding the debt issue and guarantee are the same as Scenario #1, except the obligation was determined in 2013 (before GASB 70), rather than 2014.

Examples

Scenario #3 - FACTS, continued

- At December 31, 2013, the City calculates the discounted present value of the remaining $3,360,000 debt service payments (principal and interest) to be $3,060,000.

Examples

Scenario #3 - FACTS, continued

- The City makes debt service payments of $610,000 ($500,000 principal, $110,000 interest) during 2014.
- The City recalculates the discounted present value of the remaining obligation at December 31, 2014 to be $2,550,000, not $2,450,000 ($3,060,000-$610,000).

Examples

Scenario #3, conclusion

- At December 31, 2013, assuming not early adopting, City X will disclose the guarantee and the obligation reported under the guarantee.

- At December 31, 2014, City X will record a liability and a prior period adjustment of $3,060,000 for the beginning balance of the obligation under the guarantee. The City will also disclose the guarantee and the obligation reported under the guarantee.

Continued on next slide

Examples

Scenario #3, conclusion

- For 2014, the City will decrease the obligation by $610,000 for the debt service made. The City will also recognize current expense of $100,000 for the change in the discount present value of the guarantee. The City will disclose the guarantee and the debt service payments made.

Summary

- Nonexchange guarantee of an obligation of another
- Liability for PV of estimated future outflows (all payments)
- Liability must be reevaluated annually
- Blended Component Units issuing the debt would record a receivable
- Detailed note disclosures

GASB 70

Questions?

RUSHTON & COMPANY | Growing futures.

J. Chris Hollifield
chollifield@rushtonandcompany.com

John Holden
jholden@rushtonandcompany.com