

Governmental Standards Board (GASB) Statement No. 70 (GASB No. 70), Accounting and Reporting for Non-Exchange Financial Guarantee

Recognition and Measurement of Nonexchange Financial Guarantees

GASB No. 70 improves accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. As part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity or the individual that issued the obligation does not fulfill its payment requirements. In addition, the government may have its obligation(s) guaranteed by a legally separate entity.

What is Nonexchange Financial Guarantee?

GASB No. 70 paragraph 4, states “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 legally separate entities may include any other government, nonprofit organization, private entity or individual.

A nonexchange financial guarantee occurs when the State guarantees to make payments on the obligations (bond, loan, contract, agreement, etc.) of a legally separate entity to the holder of that obligation, but generally receives little or no compensation in return. In addition, the State may have its obligation(s) guaranteed by a legally separate entity. In general, the State or the legally separate entity guaranteeing the obligation agrees to make payments to the holder of the obligation if the entity that issued the obligation is unable to fulfill its obligation or in the event of default.

Examples:

1. School district receives a nonexchange financial guarantee from the State Department of Education for the district’s debt service payments on construction bonds it has issued.
2. Small business receives a nonexchange financial guarantee from the Governor’s Office of Business and Economic Development through the Small Business Loan Guarantee Program.

State Government Extending Financial Guarantees

GASB No. 70 requires a guarantor government to recognize a liability when qualitative or historical factors indicate that it is **more likely than not** that the guarantor government will actually be required to make payments as a result of the guarantee agreement. “**More likely than not**” is greater than 50 percent possibility.

Qualitative factors relevant to legally separate entities or individuals that receive the guarantee include, but are limited to the following:

Governmental Standards Board (GASB) Statement No. 70 (GASB No. 70), Accounting and Reporting for Non-Exchange Financial Guarantee

- Initiation of a bankruptcy process into bankruptcy or financial reorganization
- Breach of debt covenant or terms and conditions by the guaranteed entity (such as failure to meet rate covenants, failure to meet coverage ratios, or default or delinquency in interest or principal payments)
- Indication of significant financial difficulty which may include:
 - Failure to make payments to paying agents in timely manner
 - Draw on reserve funds for debt service payments
 - Concessions from debt holders
 - Significant investment losses
 - Loss of major revenue source
 - Significant increase in non-capital disbursements related to operating revenues
 - Commencement of a financial supervision by another government.

The historical factors include past experience with similar transactions and/or similar entities.

When the State department/agency extends similar type of nonexchange financial guarantees to more than one entity or individual, applicable qualitative factors and relevant historical data (default frequency) should be considered to assess the likelihood the State department/agency will have to make payment in relation to those guarantees.

Accounting Treatment

If you are a party to a nonexchange financial guarantee, please contact SCO policy section. Once confirmed, you will be required to submit GAAP adjustments each year to recognize the guarantee liability and the expense/revenue.

Recognition under Economic Resource Measurement Focus (Proprietary and Trust Funds)

The State department/agency that report their financial statements using the economic resources measurement focus, if the qualitative and historical factors indicate that it is **more likely than not** that the State government will be required to make payment, the State department/agency should recognize a liability discounted at present value and an expense for those nonexchange financial guarantees.

The amount of the liability recognized by the State department/agency should be the best estimate of the discounted present value of the future outflows expected to be incurred as a result of the guarantee. If no best estimate is available then the amount of the liability should be based on the discounted present value of the minimum amount within a range of available estimated future outflows.

Governmental Standards Board (GASB) Statement No. 70 (GASB No. 70), Accounting and Reporting for Non-Exchange Financial Guarantee

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

Recognition under Current Financial Resources Measurement Focus (Governmental Funds)

For the State department/agency that report using the current financial resources measurement focus for their financial statements, if the qualitative and historical factors indicate that it is **more likely than not** that the State department/agency will be required to make payment, the State government should recognize a liability and an expenditure to the extent that is expected to be liquidated with expendable available financial resources when payments are due and payable (within 12 months after the year-end) on the guaranteed obligations.

State Government Issuing a Guaranteed Obligation

Under both economic resources measurement focus and current financial resources measurement focus, if a State department/agency is required to repay an external guarantor for the payments actually made on the State department/agency behalf under nonexchange financial guarantee, the State department/agency should reclassify that portion of its previously recognized liability as a liability to the guarantor. The State government will continue to report its liability on any unpaid guaranteed obligation until the payment has been made by the guarantor and the liability is released.

Intra-Entity Nonexchange Financial Guarantees Involving Blended Component Units

When the State government that extends a nonexchange financial guarantee recognizes a liability and expenditure/expenses related to the guarantee, the State government issuing the guaranteed obligation should also recognize a matching receivable and revenue simultaneously, if the State government issuing the guaranteed obligation is one of the following:

1. A blended component unit of that State government
2. A primary government that includes the State government that extended the guarantee as a blended component unit within its reporting entity or,
3. Within the same reporting entity and both issuer and guarantor government are blended component units of the same primary government.

Disclosure Requirements

If it is confirmed that a nonexchange financial guarantee exists, you will be required to provide annual disclosure information that includes the following:

Governmental Standards Board (GASB) Statement No. 70 (GASB No. 70), Accounting and Reporting for Non-Exchange Financial Guarantee

Governments That Extend Nonexchange Financial Guarantees

The State governments that extend nonexchange financial guarantees should disclose the following information, regardless of the likelihood of a payment being required:

- Description of the nonexchange financial guarantee identifying:
 - Legal authority and limits for extending the guarantees and types of obligations guaranteed
 - The relationship to the entity or entities issuing the obligations that are guaranteed
 - Arrangements for recovering payments from the issuers of the obligations that are guaranteed
 - Length of time of the guarantees.
- The total amount of all guarantees extended that are outstanding at the fiscal year end.

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

- 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:
 - Beginning of year balances
 - Increases, including initial recognition and adjustments increasing estimates
 - Guarantee payments made and adjustments decreasing estimates
 - End of year balances.
- Cumulative amounts of indemnification payments that have been made on guarantees extended that are outstanding at the fiscal year end.
- Amounts expected to be recovered from indemnification payments that have been made during the fiscal year.

State Governments That Issue Guaranteed Obligations

The State governments that have outstanding obligations at the fiscal year end that have been guaranteed by another entity as part of a nonexchange transaction should disclose the following information:

- The name of the entity providing the guarantee

Governmental Standards Board (GASB) Statement No. 70 (GASB No. 70), Accounting and Reporting for Non-Exchange Financial Guarantee

- The amount of the guarantee
- The length of time of the guarantee
- The amount paid, if any, by the entity extending the guarantee on obligations of the government during the current fiscal year
- The cumulative amount paid by the entity extending the guarantee on outstanding obligations of the government
- A description of requirements to repay the entity extending the guarantee
- The outstanding amounts, if any, required to be repaid to the entity providing the guarantee.

The State governments that issued a guaranteed obligation for which the guarantor (entity that extended the guarantee) has made payments during the fiscal year, and the obligation is no longer outstanding at the fiscal year end, should disclose the following information:

- The amount paid by the entity that extended the guarantee on obligations of the State government during the current fiscal year
- The cumulative amount paid by the entity that extended the guarantee on outstanding obligations of the State government
- A description of requirements to repay the entity that extended the guarantee
- The outstanding amounts, if any, required to be repaid to the entity that provided the guarantee.