

3. ACCOUNTING

3.4 Liabilities

3.4.12 Financial Guarantees

3.4.12.10 A non-exchange 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.

Example: A city (the guarantor) guarantees to pay the debt of a public facilities district in the event the district is unable to make payment.

3.4.12.20 Merely extending a guarantee does not create a financial statement liability for the guarantor. However, when it becomes more likely than not (a likelihood of more than 50 percent) that the guarantor will be required to make payment, a liability should be recorded.

3.4.12.30 When is it *more likely than not*? This is an assessment based on professional judgment. The government extending the guarantee should consider qualitative factors such as:

- The government that issued the debt has entered into bankruptcy or financial reorganization.
- The government that issued the debt is in violation of related debt covenants such as failure to meet rate covenants, failure to meet coverage ratios, or default or delinquency in interest or principal payments.
- The government that issued the debt has indicators of financial difficulty, such as failure to make payments 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 operations or current revenues, or commencement of financial supervision by another government, etc.

3.4.12.40 Note: a pledge of future revenues is not considered a non-exchange financial guarantee.

Guarantor Accounting

3.4.12.50 When it becomes *more likely than not* that the guarantor will be required to make a payment, the guarantor should recognize a liability (CR) and expense (DR) in its full-accrual financial statements. 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. The expense should be classified as a grant or financial assistance to the other entity.

3.4.12.60 In modified-accrual financial statements, the guarantor should recognize the amount currently due and payable. The expense should be classified as a grant or financial assistance to the other entity. The guarantor should not record a receivable for any expected recoveries from the other entity because the likelihood of realization is so uncertain. Recoveries should only be recognized when realized.

Original Issuer Accounting

- 3.4.12.70 The government that issued the debt continues to recognize the obligation in its financial statements until it is legally released from the debt.

If the government that issued the debt is required to repay the guarantor for any payments it made on its behalf, the government should reclassify that portion of the original obligation as a payable to the guarantor.

If the government that issued the debt is legally released from the obligation or from any liability to repay the guarantor it should recognize revenue to the extent of the reduction of the liabilities.

Blended Component Units

- 3.4.12.80 In order to address the “doubling-up” of liabilities in the financial statements where this situation occurs between a primary government and a blended component unit, the government that issued the debt should recognize in its financial statements a receivable equal to the amount of the liability recognized by the guarantor. The receivable and payable are eliminated at the government-wide level.

Note Disclosures

- 3.4.12.90 For requirements see [Note X – Financial Guarantees](#).
- 3.4.12.100 For a detailed discussion of the financial guarantees see [GASB Statement 70, Accounting and Financial Reporting for Nonexchange Financial Guarantees](#).