

October 28, 2016

David R. Bean, CPA  
Director of Research and Technical Activities  
GASB  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

**Re: August 26, 2016 Exposure Draft of a Proposed Statement of the Governmental Accounting Standards Board, *Certain Debt Extinguishment Issues* [Project No. 19-25E]**

Dear Mr. Bean:

The American Institute of CPAs (AICPA) is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the Private Company Practice Section (PCPS) Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Exposure Draft (ED) and is providing the following comments for your consideration.

### **GENERAL COMMENTS**

TIC believes that the requirements of this proposed Statement would increase consistency in accounting and financial reporting for debt extinguishments by establishing uniform guidance for derecognizing debt that is defeased in substance, regardless of whether existing resources or refunding debt proceeds are placed in a trust for the purpose of extinguishing that debt. The requirements of this proposed Statement also would enhance consistency in financial reporting of prepaid insurance related to debt that has been extinguished. Essentially, if the substitution of essentially risk-free monetary assets with monetary assets that are not essentially risk-free is not prohibited,

governments would disclose that fact in the period in which the debt is defeased in substance.

TIC is commenting below on each of the three major areas covered in the ED. TIC does have some concerns about a potential conflict between paragraph 4 of the ED and paragraphs 10 and 11, which is discussed below in the last section titled, "Notes to the Financial Statements for In-Substance Defeasance Transactions."

## **SPECIFIC COMMENTS**

### Accounting and Financial Reporting for In-Substance Defeasance of Debt Using Only Existing Resources

GASB determined that existing guidance did not address situations where ONLY existing resources are used to extinguish debt. The ED suggests that when existing resources are placed in a trust that meets the criteria for defeasance, the same accounting treatment would apply as in other in-substance defeasance. TIC agrees with GASB's proposal on this.

### Prepaid Insurance Related to Extinguished Debt

GASB is clarifying in this ED that any amount of remaining prepaid insurance related to the extinguished debt be included in the carrying amount of that debt for the purpose of calculating the difference between reacquisition price and the net carry amount of extinguished debt. This would apply to all defeasance of debt, whether done by a refunding or with existing funds.

TIC believes the Basis for Conclusions in B15 nicely describes why this is needed. TIC believes that this treatment is reasonable and clears up confusion that may be occurring in practice.

### Notes to the Financial Statements for In-Substance Defeasance Transactions

One of the criteria for determining an in-substance defeasance is that the trust be limited to holding only monetary assets that are classified as being essentially risk-free. If the substitution of essentially risk-free monetary assets with monetary assets that are not essentially risk-free is not prohibited, governments would disclose that fact in the period in which the debt is defeased in substance. TIC members noted that they have never seen this situation occur in practice. In addition, TIC is concerned about the seemingly conflicting statements in the ED as described below.

Paragraph 4 of the ED indicates the following:

Debt is considered defeased in substance for accounting and financial reporting purposes if the government irrevocably places only existing resources—that is, resources other than the proceeds of refunding debt—with an escrow agent in a trust to be used solely for satisfying scheduled payments of both interest and principal of the defeased debt, and the possibility that the government will be required to make future payments on the debt is remote. The trust is restricted to owning only monetary assets that are essentially risk-free as to the amount, timing, and collection of interest and principal. The monetary assets should be denominated in the currency in which the debt is payable. For debt denominated in U.S. dollars, essentially risk-free monetary assets are limited to:

- a) Direct obligations of the U.S. government
- b) Obligations guaranteed by the U.S. government
- c) Securities backed by U.S. government obligations as collateral and for which interest and principal payments on the collateral generally flow immediately through to the security holder.

In addition, the monetary assets held by the trust are required to provide cash flows (from interest and maturity of those assets) that approximately coincide, as to timing and amount, with the scheduled interest and principal payments on the defeased debt. However, some securities described above can be paid before their scheduled maturities and so are not essentially risk-free as to the timing of the collection of interest and principal. As a result, they do not qualify for defeasance purposes.

In contrast, paragraphs 10 and 11 of the ED indicate the following:

In the period in which debt is defeased in substance, whether through a refunding transaction or through the use of only existing resources, governments should disclose the following risk, if applicable: substitution of essentially risk-free monetary assets with monetary assets that are not essentially risk-free is not prohibited.

In all periods following an in-substance defeasance, governments should disclose the total amount of debt defeased in substance that remains outstanding for which the risk of substitution discussed in paragraph 10 exists, if any. This amount should be disclosed separately from the amount of debt defeased in

substance that remains outstanding, which is required to be disclosed by paragraph 14 of Statement 7 and paragraph 8 of this Statement.

Paragraph 4 of the ED suggests that a defeasance does not exist where the trust assets are not essentially risk-free. It indicates that the trust is restricted to owning only monetary assets that are essentially risk-free as to the amount, timing, and collection of interest and principal. If the trust is required to be restricted to owning assets that are essentially risk-free in order to have a defeasance, then the risk of substitution as contemplated here does not seem possible. Therefore, the disclosure also would not be relevant. TIC members that have extensive experience and many Government clients have never run into this particular situation in practice and are concerned that it will create confusion in practice. TIC believes the GASB should reconsider how paragraph 4 is currently worded and whether it will create an unintended consequence of having governments not record a defeasance in situations where substitution is not expressly prohibited.

One option for the GASB to consider in order to provide some clarification might be to include an example immediately after paragraph 4 describing how that situation might occur when the trust assets are not essentially risk-free, albeit may be rare in practice. Another option that TIC discussed is to simply remove paragraphs 10 and 11.

#### **ADDITIONAL COMMENT**

TIC suggests making a few minor edits to paragraph 2 of the ED to add a comment about the substitution of essentially risk-free assets with those that are not risk-free to the scope paragraph. Our revised proposed language is below, with suggested additional language noted in bold text:

**This Statement addresses three accounting and reporting matters related to long term debt defeasance.** This Statement establishes standards of accounting and financial reporting for transactions in which only existing resources—that is, resources other than the proceeds of refunding debt—are placed in a trust for the purpose of extinguishing debt. This Statement also amends accounting and financial reporting requirements for prepaid insurance associated with debt that is extinguished. Finally, this Statement establishes an additional disclosure requirement related to debt that is defeased in substance **with no prohibitions against substituting essentially risk free assets with those that are not risk free.** The requirements of this Statement apply to financial statements of all state and local governments.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

A handwritten signature in black ink that reads "Michael A. Westervelt". The signature is written in a cursive, slightly slanted style.

Michael A. Westervelt, Chair  
PCPS Technical Issues Committee  
cc: PCPS Executive and Technical Issues Committees