

Governmental Accounting Standards Board (GASB) Statement No. 91

Conduit Debt Obligations

In May 2019, the Governmental Accounting Standards Board (GASB) issued Statement No. 91, *Conduit Debt Obligations* (GASB 91). GASB 91 provides guidance on the accounting and financial reporting for conduit debt obligations as well as commitments and arrangements associated with conduit debt obligations.

The requirements of GASB 91 as amended by GASB 95 are effective for reporting periods beginning after December 15, 2021. This is applicable to the State's Annual Comprehensive Financial Report for the year ended June 30, 2023.

Definition

GASB 91 defines a conduit debt obligation as a debt instrument having all of the following elements:

1. There are at least three parties involved: an issuer, a third-party obligor, and a debt holder or a debt trustee.
 - a. The *issuer* is the State of California
 - b. *Obligors* are borrowers that make debt service payments.
 - c. *Debt holders* and *debt trustees* are investors (typically large financial institutions) that purchase debt and receive payments.
2. The issuer and the third-party obligor are not within the same financial reporting entity. The *financial reporting entity* consists of the primary government of the State and its component units.
3. The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
 - a. A *parity bond* is a bond with equal right to collateral as other bonds issued in a common bond indenture.
 - b. A *bond indenture* is a trust agreement or contract containing the terms of the bonds and other agreements.
 - c. *Cross-collateralization* occurs when collateral for one bond is used to secure other bonds.
4. The third-party obligor or its agent, not the issuer, *ultimately* receives the proceeds from the debt issuance. The issuer may initially receive the proceeds from the bond sale before passing them on to the obligor.
5. The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

Issuer Commitments

Per GASB 91, a conduit debt obligation is not a liability of the issuer. However, the bond indenture could contain additional commitments which could potentially require the issuer to report a liability.

Limited Commitments

At a minimum, the issuer makes a *limited commitment* to maintain the issue's tax-exempt status. The issuer may also agree to facilitate debt service payments from the obligor to the debt holders. With a limited commitment, the issuer assumes no responsibility for debt service payments.

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The issuer should not report a liability. The conduit debt obligation should only be disclosed in the notes to the financial statements.

Additional Commitments

Under an *additional commitment*, the issuer agrees to support debt service payments only in the event the obligor is, or will be, unable to do so.

Examples of additional commitments:

- Extending a moral obligation pledge
- Extending an appropriation pledge
- Extending a financial guarantee
- Pledging its own property, revenue, or other assets as security.

If qualitative factors indicate that it is *more likely than not* (a likelihood of more than 50 percent) that the issuer will support one or more debt service payments of the obligor, the issuer should report a liability and related expense in the financial statements.

Qualitative factors that should be assessed include, but are not limited to:

- The obligor initiates the process of entering bankruptcy or financial reorganization.
- The obligor breaches a debt contract related to the conduit debt obligation - fails to meet rate covenants, fails to meet debt service coverage ratios, or default or delinquency in debt service payments.
- The obligor experiences significant financial difficulty - failure to make payments to paying agents or trustees 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 operating or current revenues; or commencement of financial supervision by another government.
- Termination of the project that was to be the source of funding for debt service payments.
- Litigation that would negatively affect the project.
- The issuer's concern that its access to capital markets could be affected by a third-party obligor's default on an outstanding conduit debt obligation.
- The issuer's history of fulfilling its additional commitments to support debt service payments for other conduit debt obligations, including voluntarily supporting debt service payments.
- The issuer's ability or willingness to support debt service payments.

Voluntary Commitments

Under a *voluntary commitment*, the issuer voluntarily decides to make debt service payments or request an appropriation for debt service payments in the event the obligor is, or will be, unable to do so.

If an event or circumstance occurs which more likely than will require the issuer to support debt service payments, a liability and related expense should be reported in the financial statements. Thereafter, the issuer should re-evaluate the liability at least annually.

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Arrangements Associated with Conduit Debt Obligations

Issuers of conduit debt obligations may enter into arrangements (agreements) associated with the obligations. These arrangements have all of the following attributes:

- The construction or acquisition of the capital asset is financed with the proceeds from the conduit debt obligation.
- The issuer retains the title to the capital asset from the beginning of the arrangement.
- The payments from the third-party obligor are to cover the debt service payments.
- The payment schedule of the arrangement coincides with the debt service repayment schedule.

These arrangements can be classified into one of the following three categories:

1. *Issuer relinquishes title at the end of the arrangement*

The issuer should not recognize a liability for the debt obligation, the capital asset, or a receivable for the payments related to the arrangement.

2. *Issuer retains title and third-party obligor has exclusive use of the entire capital asset*

At the beginning of the arrangement, the issuer should not recognize a liability for the debt obligation, the capital asset, or a receivable for the payments related to the arrangement. When the arrangement ends, the issuer should recognize the capital asset at acquisition value, as defined in paragraph 79 of Statement No. 72, *Fair Value Measurement and Application*, and an inflow of resources.

3. *Issuer retains title and third-party obligor has exclusive use of portions of the capital asset*

At the beginning of the arrangement, the issuer should recognize the entire capital asset at acquisition value and a deferred inflow of resources. Over the term of the arrangement, the deferred inflow of resources should be reduced, and an inflow of resources should be recognized in a systematic and rational manner.

Disclosure Requirements

GASB 91 requires disclosure of the following information in the notes to the financial statements:

- A general description of the issuer's conduit debt obligations.
- A general description of the issuer's limited, voluntary, and additional commitments, including the legal authority and limits for extending the commitments, the length of time of the commitments, and any arrangements for recovering payments from the obligor.
- The aggregate outstanding principal amount of all conduit debt obligations grouped by commitment type.

If a liability associated with voluntary or additional commitments is reported, the following information should also be disclosed:

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- A brief description of the timing of recognition and measurement of the liability and information about the changes in the recognized liability including beginning-of-period balances, increases, decreases, and end-of-period balances.
- Cumulative amounts of payments that have been made on the recognized liability at the reporting date, if any.
- Amounts expected to be recovered from those payments, if any.

For additional information regarding conduit debt obligations, please contact the State Controller's Office, State Accounting and Reporting Division, State Government Reporting, Policy Section. We may be contacted at SARDStatePolicy@sco.ca.gov.

GASB 91: Conduit Debt Obligations

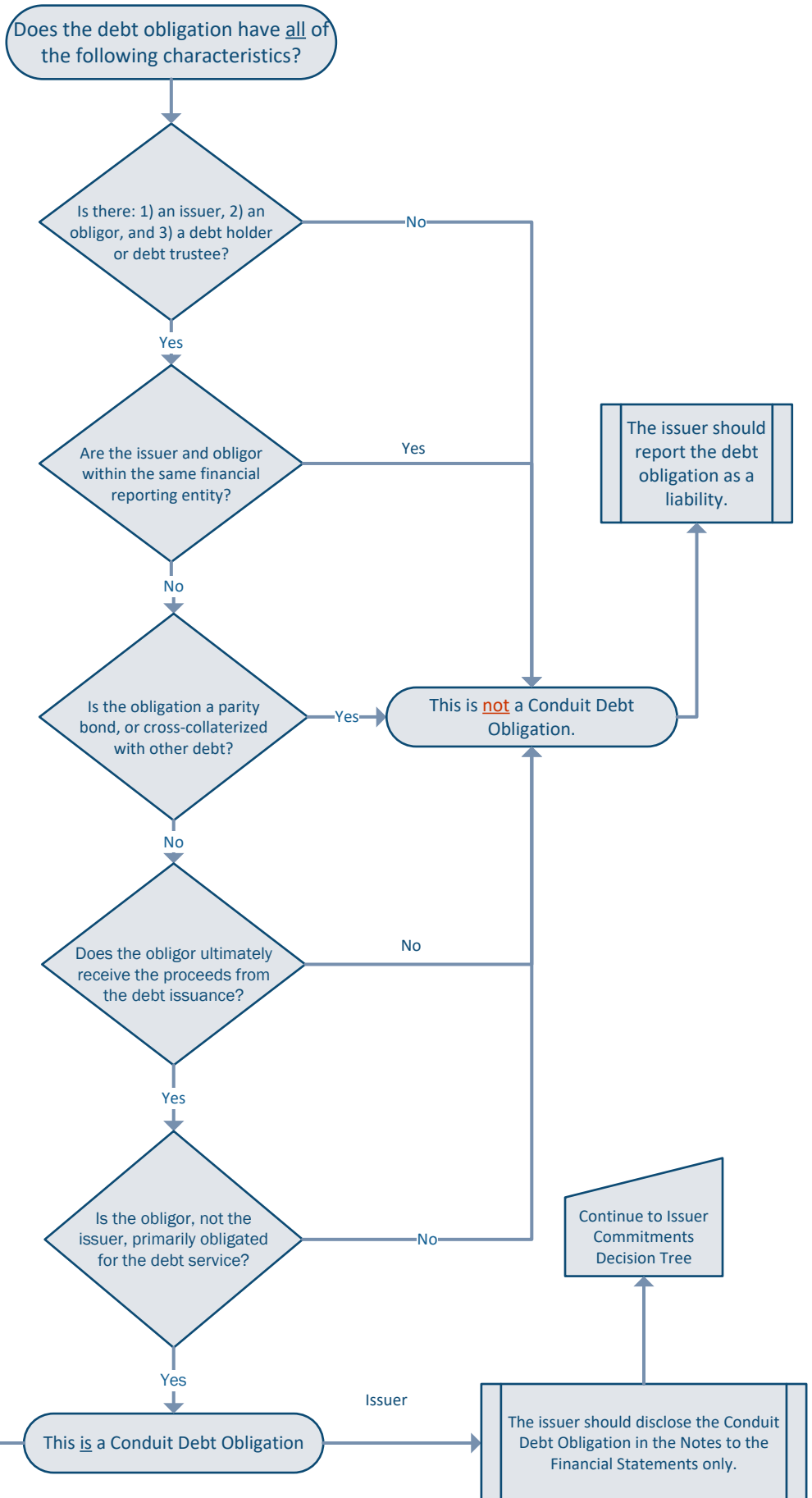
Conduit Debt Obligations Decision Tree

Issuer: State of California
 Obligor: third party making debt service payments.
 Debt holder/debt trustee: investors that purchase debt and receive payments.

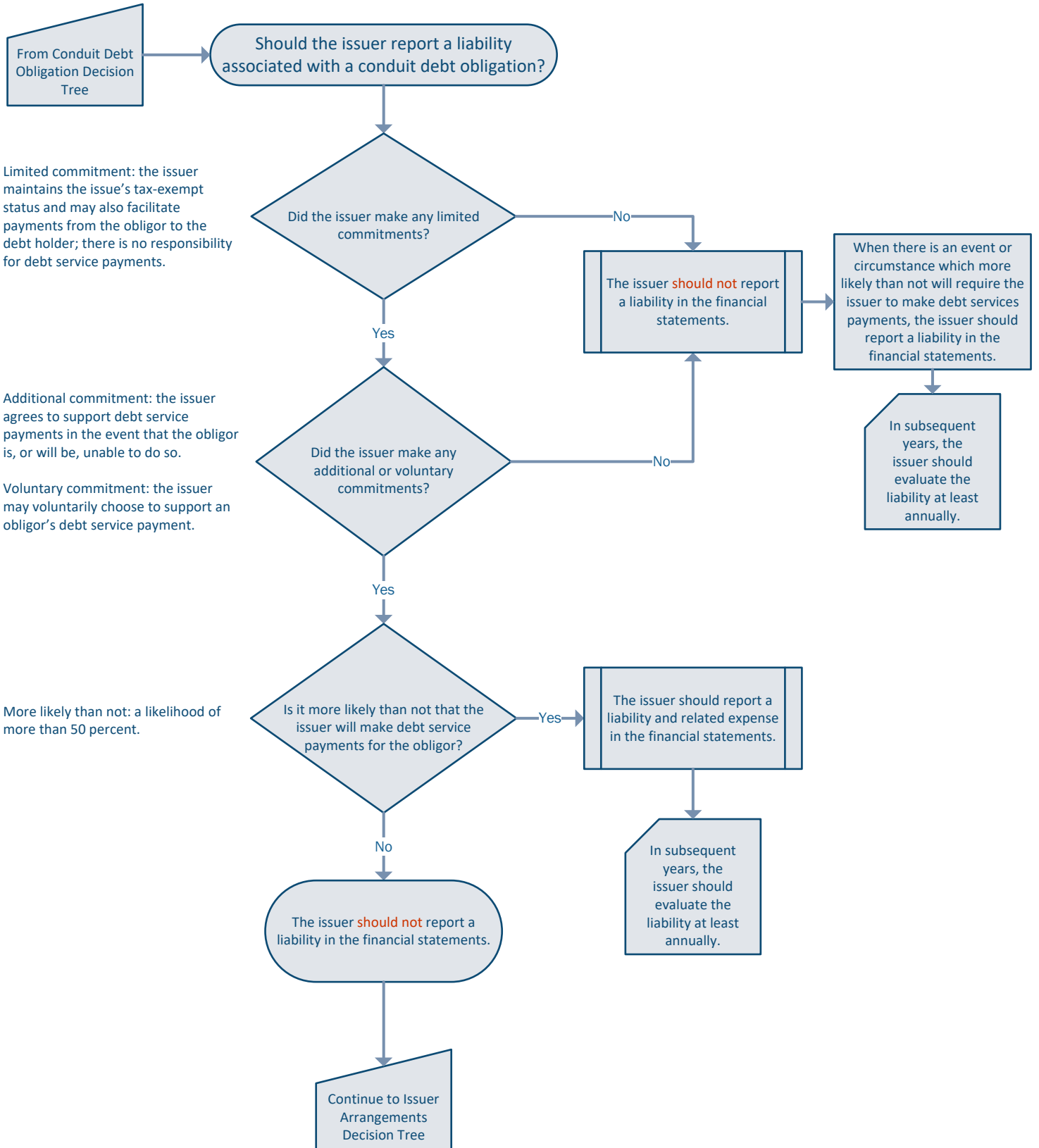
Financial reporting entity: the primary government of the State and its component units.

Parity bond: a bond with equal rights to the collateral as other bonds issued under a common bond indenture.
 Cross-collateralization: when collateral for one bond is used to secure other bonds.

The issuer could initially receive the proceeds before passing them on to the third-party obligor.



GASB 91: Conduit Debt Obligations Issuer Commitments Decision Tree



GASB 91: Conduit Debt Obligations Issuer Arrangements Decision Tree

From Issuer Commitment Decision Tree

Should the issuer report (a) a liability, (b) capital asset, or (c) a receivable associated with an arrangement?

Arrangement Attributes

1. Construction or acquisition of the capital asset is financed with the proceeds of the conduit debt agreement.
2. The issuer retains the title to the capital asset from the beginning of the arrangement.
3. The payments from the obligor are to cover the debt service payments.
4. The payment schedule of the arrangement coincides with the debt service repayment schedule.

Does the arrangement have all four of the attributes listed under Arrangement Attributes?

No

The issuer should not report a liability in the financial statements.

Yes

Does the arrangement meet the definition of a service concession arrangement (SCA) in paragraph 6 of GASB 94?

Yes

Follow guidance for service concession arrangements (SCAs) in GASB 94.

No

Does the issuer relinquish title at the end of the arrangement?

Yes

The issuer should not report (a) a liability, (b) the capital asset, or (c) a receivable for the payments related to the arrangement in the financial statements.

No

Does the obligor have exclusive use of the entire capital asset?

No

Yes

At the inception of the arrangement, the issuer should report the entire capital asset at acquisition value and a deferred inflow of resources.

The issuer should not report a (a) liability or (b) a receivable for payments related to the arrangement.

At inception of the arrangement, the issuer should not report (a) a liability, (b) the capital asset, or (c) a receivable for the payments related to the arrangement.

When the arrangement ends, the issuer should report the capital asset at acquisition value and an inflow of resources.

Acquisition value: price to acquire an asset of equivalent service potential at the acquisition date.