



August 28, 2009

Mr. David R. Bean
Director of Research and Technical Activities
No. 25-17
Governmental Accounting Standards Board (GASB)
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Advancing
Government
Accountability

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Dear Mr. Bean:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB or the board) appreciates the opportunity to provide comments to the Governmental Accounting Standards Board (GASB) on its exposure draft of a proposed statement on *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. The FMSB, comprising 21 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

The proposed statement would establish financial reporting requirements for recognition and measurement of the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs. The approach the GASB has taken in the proposed statement is to attempt to take a middle of the road approach and to try to reconcile two competing approaches, the accounting (paragraph 6) and the 'economic' (paragraph 7). This does not appear to have been entirely successful.

The valuation of the debt is a problem. The economic approach would always value the debt discounted by the current rate, so if interest rates rise, the entity would recognize a gain and vice-versa for a decline in interest rates. However, that would make the financial statement volatile, and if an entity is not floating a bond issue that year, the determination of a current interest rate is subjective. The accounting approach is to use historic values unless they materially misstate the economic reality, so any gains or losses from fluctuating interest rates would stay off the books; the reader of the financial statements would simply know that, say, a 2% rate is really low or a 5% rate really high in the current economic climate.

Some of the opinions given show the economic approach: a restructuring of the debt should result in a gain or loss based on the discounted value using the original interest rate. The accounting approach would only recognize a gain or loss if the amount of the principal or interest already accrued is adjusted. The wrinkle here is that this takes place after a legal action that has accounting implications (unlike revaluing based on prevailing rates as described in the previous paragraph). Given that the entity has gone through the effort of going to court to get a change made to the debt terms, it only makes sense to assume that any change in those terms gives value to the Agency at the present time, even when the decision only affects future outflows.



The recommendation by GASB is a mixed approach: use the accounting standard (historic only) for changes that definitely affect principal or interest, but use the economic standard (discounted value) if it's not clear how much of the adjustment is to principal and how much is to interest. The economist wing of GASB, in paragraph 55 and 56, argues the approach should be consistent and always use discounted value. The accounting wing of GASB, in paragraphs 51-54, say that even if the Court doesn't specify, we should assume it is the interest that is adjusted and only adjust the principal if not doing so would cause the interest rate to become negative.

We find the inconsistency between paragraphs 6 (accounting approach) and 7 (economic approach if unclear) most disconcerting. Given that a court ruling has taken place and has provided economic relief to the Agency, we would use the economic approach in all cases (effectively, use paragraph 7's approach, which is to say we agree with paragraphs 7, 55 and 56).

Specifically, our answers to the question posed in the exposure draft are:

Issue 1

Question: How should these payment reductions that result from a Chapter 9 bankruptcy be measured and reported? Please state why you support this position.

We think that future payments should be reported at their discounted present value using the original interest rate. The rationale for our opinion is indicated above.

Issue 2

Question: How should payment reductions that result from a Chapter 9 bankruptcy be measured and reported? Please state why you support this position.

We think that the carrying amount of the liabilities should be measured based on the discounted present value of the new payments using the original interest rate. The rationale for our opinion is indicated above.

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. No member objected to its issuance. If you have questions concerning the letter, please contact Anna D. Gowans Miller, CPA, AGA's director of research and staff liaison for the FMSB, at amiller@agacgfm.org or 703.684.6931 ext. 313.

Sincerely,



Robert L. Childree, Chair
AGA Financial Management Standards Board

cc: William A. Morehead, Ph.D., CPA, CGFM
AGA National President

**Association of Government Accountants
Financial Management Standards Board**

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