

University of California  
Governmental Accounting Standards Board (GASB) Statement No. 86,  
*Certain Debt Extinguishment Issues*



**Issues Resolution Memo No. 86-1**

Issued: May 2017

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**BACKGROUND**

GASB Statement No. 86, *Certain Debt Extinguishment Issues*, is effective for the University's fiscal year beginning July 1, 2017. This Statement is meant to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

**DEFINE ISSUES**

The University must determine whether GASB Statement No. 86 changes any existing financial reporting and disclosure requirements for any of the University's financial reporting entities.

**AUTHORITATIVE GUIDANCE AND APPROACH**

**In-Substance Defeasance of Debt Using Only Existing Resources**

When a government places cash and other monetary assets acquired with only existing resources with an escrow agent in a trust that meets the criteria below for an in-substance defeasance, the debt should no longer be reported as a liability in the financial statements using the economic resources measurement focus. Any difference between the reacquisition price and the net carrying amount of the debt, together with any deferred outflows of resources or deferred inflows of resources from prior refundings, should be recognized as a separately identified gain or loss in the period of the in substance defeasance.

In addition, payments to the escrow agent made from existing resources should be reported as debt service expenditures in financial statements using the current financial resources measurement focus. Further, governments that defease debt using only existing resources should provide a general description of the transaction in the notes to financial statements in the period of the defeasance. A general description of the transaction may include, for example, the amount of the debt, the amount of cash and other monetary assets acquired with existing resources placed with the escrow agent, the reasons for the defeasance, and the cash flows required to service the defeased debt. Lastly, in all periods following an in-substance defeasance of debt using only existing resources, governments should disclose the amount of that debt defeased in substance that remains outstanding, if any, at period-end. That amount may be combined with the amount of debt defeased in substance through refunding transactions that remains outstanding, if any.



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### Criteria for an in-substance defeasance:

Debt is considered defeased in substance for accounting and financial reporting purposes if the government irrevocably places cash and other monetary assets acquired with only existing resources 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.

### **Prepaid Insurance Related to Extinguished Debt**

Governments that extinguish debt, whether through a legal extinguishment or through an in-substance defeasance, should include the amount of any remaining prepaid insurance related to the extinguished debt in the net carrying amount of that debt for the purpose of calculating the difference between the reacquisition price and the net carrying amount of the extinguished debt.

### **Additional Disclosures for All In-Substance Defeasance Transactions**

In the period in which debt is defeased in substance, regardless of how the cash and other monetary assets were acquired, 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.



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In all periods following an in-substance defeasance, regardless of how the cash and other monetary assets were acquired, governments should disclose the amount of debt defeased in substance that remains outstanding, if any, for which the substitution discussed above is not prohibited. That amount should be disclosed separately from the total amount of debt defeased in substance that remains outstanding, which is required to be disclosed.

### ANALYSIS AND CONCLUSION

Implementation of GASB Statement No. 86 has no impact to the University's (including its Medical Centers') financial statements. GASB Statement No. 86 is only applicable to in-substance defeasance transactions in which cash and other monetary assets acquired with only existing resources – that is, resources **other than** the proceeds of refunding debt – are placed in an irrevocable trust for the purpose of extinguishing debt.

The University currently only uses proceeds refunding debt or cash with proceeds from debt issued (a crossover refunding transaction<sup>i</sup>) for these transactions. GASB Statement No. 86 limits the scope to transactions using only existing resources and certain related issues and does not include involve crossover refunding transactions. The University will continue to assess future impacts to the financial statements should circumstances change.

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<sup>i</sup> Discussed in item B9 (basis for conclusions) of GASB Statement No. 86