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# **Governmental Accounting Standards Series**

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Interpretation No. 2 of the  
Governmental Accounting  
Standards Board

**Disclosure of Conduit  
Debt Obligations**

**an interpretation of NCGA Statement 1**



**Governmental Accounting Standards Board**  
of the Financial Accounting Foundation

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## Summary

This Interpretation provides disclosure requirements for conduit debt obligations. Conduit debt obligations are certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing capital financing for a specific third party that is not a part of the issuer's financial reporting entity. Although conduit debt obligations bear the name of the governmental issuer, the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued.

The required disclosures include a general description of the conduit debt transactions, the aggregate amount of all conduit debt obligations outstanding at the balance sheet date, and a clear indication that the issuer has no obligation for the debt beyond the resources provided by related leases or loans.

The provisions of this Interpretation are effective for financial statements for periods beginning after December 15, 1995. Earlier application is encouraged.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments, public benefit corporations and authorities, public employee retirement systems, utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 2 discusses the applicability of this Interpretation.
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Governmental Accounting Standards Board  
of the Financial Accounting Foundation  
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# **Interpretation No. 2 of the Governmental Accounting Standards Board**

## **Disclosure of Conduit Debt Obligations**

### **an interpretation of NCGA Statement 1**

**August 1995**

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## **Interpretation No. 2 of the Governmental Accounting Standards Board**

### **Disclosure of Conduit Debt Obligations**

#### **an interpretation of NCGA Statement 1**

**August 1995**

### **INTRODUCTION**

1. Paragraph 158 of National Council on Governmental Accounting (NCGA) Statement 1, *Governmental Accounting and Financial Reporting Principles*, provides basic disclosure requirements essential to the fair presentation of a state or local governmental entity's financial statements. These disclosures include such matters as significant contingent liabilities and debt service requirements to maturity. These requirements, however, including subsequent amendments, do not specifically address disclosures for conduit debt obligations. This Interpretation requires the disclosure of information about such obligations.

### **INTERPRETATION**

#### **Scope and Applicability of This Interpretation**

2. This Interpretation clarifies the application of paragraph 158 of NCGA Statement 1, as amended by paragraph 63 of GASB Statement No. 14, *The Financial Reporting Entity*, to conduit debt obligations. The term *conduit debt obligations* refers to certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing capital financing for a specific third party that is not a part of the issuer's financial reporting entity.<sup>1</sup> Although conduit debt obligations bear the name of the governmental issuer, the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued. This Interpretation applies to all state and local governmental entities.

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<sup>1</sup>GASB Statement No. 14, *The Financial Reporting Entity*, establishes standards for defining and reporting on the financial reporting entity.

## Disclosure Requirements

3. Conduit debt obligations should be disclosed in the notes to the financial statements of the issuing entity.<sup>2</sup> The disclosures should include:
  - a. A general description of the conduit debt transactions.
  - b. The aggregate amount of all conduit debt obligations outstanding at the balance sheet date.<sup>3</sup>
  - c. A clear indication that the issuer has no obligation for the debt beyond the resources provided by related leases or loans.
4. Some issuers of conduit debt obligations currently report them as liabilities on their balance sheets along with related assets. This Interpretation does not alter that reporting or the reporting of future conduit debt obligations that are substantially the same as those already reported.

## EFFECTIVE DATE AND TRANSITION

5. The provisions of this Interpretation are effective for financial statements for periods beginning after December 15, 1995. Earlier application is encouraged.

<p><b>The provisions of this Interpretation need not be applied to immaterial items.</b></p>
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*This Interpretation was adopted by unanimous vote of the members of the Governmental Accounting Standards Board:*

Tom L. Allen, *Chairman*  
Robert J. Freeman  
Barbara A. Henderson  
Edward M. Klasny  
Paul R. Reilly

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<sup>2</sup>If a component unit (for example, an industrial development authority) that issues conduit debt does not publish separate financial statements, the disclosures required by this paragraph should instead be included in the reporting entity's notes to the financial statements. If the component unit does publish separate financial statements, the reporting entity should apply the disclosure guidance in paragraphs 62 and 63 of Statement 14.

<sup>3</sup>If the aggregate amount outstanding is not determinable or cannot reasonably be estimated, issuers may provide the aggregate original issue amount for conduit debt obligations issued prior to the implementation of this Interpretation. In this case, the information required should be segregated between conduit debt obligations with the original issue amount provided and those with the outstanding balance provided.



## Appendix A

### BACKGROUND INFORMATION

6. A governmental entity may issue certain debt bearing its name to lower the cost of borrowing for specific governmental or nongovernmental third parties. This debt is commonly referred to as conduit (or no-commitment) debt. Typically, the debt proceeds are used to finance facilities within the entity's jurisdiction that are transferred to the third party either by lease or by sale. The underlying lease or mortgage loan agreement, which serves as collateral for the promise of payments by the third party, calls for payments that are essentially the same as those required by the debt. Frequently, these payments are made by the third party directly to an independent trustee, who is appointed to service and administer the arrangement. Generally, the issuing government assumes no responsibility for repayment of this debt beyond the resources provided by the underlying leases or mortgage loans.

7. The 1994 American Institute of Certified Public Accountants' Industry Audit and Accounting Guide, *Audits of State and Local Governmental Units*, discusses conduit debt in Chapter 11, indicating that:

. . . For any no-commitment debt, because a default may adversely affect the government's own ability to borrow, practice supports display or disclosure of the existence of such debt in the financial statements. . . .  
[paragraph 11.32]

Chapter 15 of the guide, which discusses financing authorities, indicates that in certain conduit debt situations ". . . the debt and related capital lease receivable can be reported in the financial statements of the government or disclosed in the notes to the financial statements" (paragraph 15.24).

8. This project was added to the Board's technical agenda in December 1991 as a result of constituent inquiries requesting clarification of appropriate guidance for reporting conduit debt obligations. The emergence of public authorities as important municipal debt issuers and their increasing use of conduit debt financings have contributed to the significant growth of revenue bond issuances over the past two decades. In addition to the traditional industrial development activity, conduit debt issuances for hospitals, educational institutions, airports, and environmental facilities have taken place. Because relatively little guidance is provided in the existing literature, however, conduit debt

reporting has been inconsistent. Some entities recognize conduit debt obligations and related assets on their balance sheets. More often, the conduit arrangements are only disclosed in notes to the financial statements. Although some note disclosures are quantified and thereby inform readers of the significance of conduit debt obligations, more often they are not.

9. In February 1995, the Board issued an Exposure Draft (ED) of a proposed Interpretation, *Disclosure of Conduit Debt Obligations*. The Board received sixty-three comment letters on the ED, a majority of which supported its disclosure provisions. Certain changes have been made to this Interpretation, however, as a result of respondent recommendations.

## **Appendix B**

### **BASIS FOR CONCLUSIONS**

10. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Interpretation. Individual Board members gave greater weight to some factors than to others.

#### **Reporting of Conduit Debt Obligations**

11. Many of the inquiries received by the GASB staff relating to conduit (or no-commitment) debt and much of the reporting diversity deal with whether issuers of such obligations should recognize liabilities and related assets on their balance sheets. Some constituents believe that conduit debt is similar to revenue bond debt and that the issuing government should recognize the debt as a liability. Others believe that the issuing government should recognize a liability if the related assets are constructed on property owned by the governmental issuer, and there will not be a transfer of ownership of the property to the third-party beneficiary. Still others believe that conduit debt is a liability of the third-party beneficiary, not of the issuing government.

12. The Board concluded that issuers of conduit debt obligations should not be required to recognize a liability, but that such debt should be disclosed and quantified. The Board currently has on its agenda a conceptual framework project that will address the definition of elements of financial statements, including liabilities. Therefore, it has decided that questions relating to accounting recognition for conduit debt transactions should be reconsidered after further progress is made on that project. However, because existing disclosures of conduit debt transactions are inconsistent among issuers and often fail to adequately inform readers of these transactions' significance, the Board concluded that the standardized disclosure requirements set forth in this Interpretation will improve the level of readers' understanding of these transactions until recognition issues can be addressed. The Board further believes that these disclosures will provide useful information for potential investors in such instruments in the secondary market.

13. About half of the respondents to the ED agreed with the Board's conclusion that conduit debt obligations should be disclosed in the notes to the issuer's financial statements. Another large group of respondents, however, favored an alternative view in the ED that, as a minimum, proposed liability recognition for those conduit debt

obligations that finance facilities on property owned by the issuer and for which no transfer of ownership to the third-party beneficiary occurs.

14. The Board considered these comments; however, they continue to believe that conduit debt *recognition* questions should be reconsidered after further progress is made on the conceptual framework project. In addition, they are not persuaded that the location of the financed assets is relevant to the question of whether a liability exists for the governmental issuer. The Board notes that conduit debt is widely viewed both in the financial community and in law as a liability of the third-party beneficiary. (That is, typically, neither the parties to conduit debt transactions nor the financial community considers such debt to be a liability of the governmental issuer.) The government often is viewed merely as a facilitator for the financing of an asset and the incurrence of debt, both of which are attributable to the third-party beneficiary (hence the term *conduit* or *no-commitment debt*). Nevertheless, because practice is inconsistent and the conceptual framework project is pending, the Board concluded that its decision should be reconsidered after a definition of a governmental liability is developed.

#### **Definition of Conduit Debt Obligations**

15. Several respondents asked the Board to clarify the definition of *conduit debt obligations* proposed in the ED, noting, among other things, that it did not address such obligations issued for the benefit of *governmental* third parties. The Board acknowledges that governmental entities frequently are the beneficiaries of conduit debt issuances and has modified the definition accordingly. Further, the definition has been expanded to apply only to third parties that are *not a part of the issuer's financial reporting entity*. The Board notes that if the conduit debt issuer and the third-party beneficiary are in the same reporting entity, a liability and related asset should be displayed on the face of the reporting entity's balance sheet reflecting the capital lease arrangement in accordance with Statement 14, paragraph 58.

#### **Disclosure Requirements**

16. A majority of the respondents to the ED agreed that the specific disclosures proposed by the Board provide an appropriate level of information for financial statement users. A significant number of others, however, believed that certain of the requirements exceed what is essential for fair presentation of the issuer's financial statements. A third, smaller

group disagreed with the proposed requirements, believing the disclosures to be unnecessary.

17. Most of the respondents that believed the disclosures go beyond what is essential suggested that the information pertaining to major conduit debt issuances (that is, the specific third party, the final maturity date, and the outstanding amount) be eliminated. Many in this group also recommended deletion of the requirement for disclosing the aggregate amount of all conduit debt obligations outstanding at the balance sheet date. Several of these respondents suggested that, because the governmental issuer has no real or contingent liability for the debt (rather, only an obligation limited to the revenue stream provided by the underlying lease or loan), the foregoing disclosures are not particularly meaningful to financial statement users. Others cited cost-benefit considerations, noting that many conduit issuers will not have the required detail information readily available. They asserted that once conduit debt is issued, many entities do not account for specific debt issues on an ongoing basis. The Board was persuaded by respondent concerns questioning the usefulness of specific information relating to major conduit debt issuances and, accordingly, has deleted this requirement from the Interpretation.

18. The Board continues to believe, however, that conduit debt obligations in the aggregate should be quantified for disclosure purposes. The Board believes this is necessary to inform readers of the significance of such activity that, for many issuers, reflects the principal reason they were created. In response to suggestions from several respondents, however, and to facilitate issuer disclosure, the Board has modified this requirement to allow issuers to provide a *reasonable estimate* of the aggregate amount of conduit debt obligations outstanding if the actual amount is not determinable.

19. The Board notes that existing generally accepted accounting principle disclosures for long-term debt should continue to be made for conduit debt obligations that currently are reported on the issuer's balance sheet. These disclosures include the amount of debt outstanding (presented on the balance sheet) and a summary of debt service requirements to maturity (presented in notes to the financial statements).

## **Appendix C**

### **ILLUSTRATIONS OF DISCLOSURES**

20. This appendix illustrates disclosures required by this Interpretation. The facts assumed in these examples are illustrative and are not intended to modify or limit the requirements of this Interpretation or to indicate the Board's endorsement of the policies or practices shown. Existing standards may require disclosures and formats other than those illustrated here.

Illustration 1: Notes to the Financial Statements of a City That Issues Industrial Revenue Bonds That Are Not Recognized in the Financial Statements

Illustration 2: Notes to the Financial Statements of a County Airport Authority That Issues Special Facility Revenue Bonds That Are Not Recognized in the Financial Statements

**Illustration 1—Notes to the Financial Statements of a City That Issues Industrial Revenue Bonds That Are Not Recognized in the Financial Statements**

**Note J. Conduit Debt Obligations**

From time to time, the City has issued Industrial Revenue Bonds to provide financial assistance to private-sector entities for the acquisition and construction of industrial and commercial facilities deemed to be in the public interest. The bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Upon repayment of the bonds, ownership of the acquired facilities transfers to the private-sector entity served by the bond issuance. Neither the City, the State, nor any political subdivision thereof is obligated in any manner for repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the accompanying financial statements.

As of June 30, 1996, there were fourteen series of Industrial Revenue Bonds outstanding, with an aggregate principal amount payable of \$27.5 million.

*[If the aggregate amount outstanding is not determinable or reasonably estimable for conduit debt obligations issued prior to July 1, 1995, the following paragraph would be substituted for the immediately preceding paragraph:]*

As of June 30, 1996, there were fourteen series of Industrial Revenue Bonds outstanding. The aggregate principal amount payable for the three series issued after July 1, 1995, was \$5.5 million. The aggregate principal amount payable for the eleven series issued prior to July 1, 1995, could not be determined; however, their original issue amounts totaled \$37.5 million.

**Illustration 2—Notes to the Financial Statements of a County Airport Authority That Issues Special Facility Revenue Bonds That Are Not Recognized in the Financial Statements**

Note K. Conduit Debt Obligations

To provide for the construction of various concourses, terminals, and maintenance facilities at the airport, the Authority has issued three series of Special Facility Revenue Bonds. These bonds are special limited obligations of the Authority, payable solely from and secured by a pledge of rentals to be received from lease agreements between the Authority and various air carriers. The bonds do not constitute a debt or pledge of the faith and credit of the Authority, the County, or the State, and accordingly have not been reported in the accompanying financial statements.

At June 30, 1996, Special Facility Revenue Bonds outstanding aggregated \$250 million.



## Appendix D

### CODIFICATION INSTRUCTIONS

21. The sections that follow update the June 30, 1995, *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Interpretation. Only the paragraph number of this Interpretation is listed if the paragraph will be cited in full in the Codification.

\* \* \*

### NOTES TO FINANCIAL STATEMENTS

### SECTION 2300

[Revise current Codification paragraph .107 by adding a new subparagraph bb at the end of the paragraph:]

bb. Entity involvement in conduit debt obligations. (See Section C65, “Conduit Debt Obligations.”)

\* \* \*

[Add a new section as follows:]

### CONDUIT DEBT OBLIGATIONS

### SECTION C65

Source: GASB Interpretation 2

#### Scope and Applicability of This Section

.101 This section clarifies the application of Section 2300, “Notes to Financial Statements,” paragraph .102, to conduit debt obligations. The term *conduit debt obligations* refers to certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing capital financing for a specific third party that is not a part of the issuer’s financial reporting entity.<sup>1</sup> Although conduit debt obligations bear the name of the governmental issuer, the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued. This section should be applied to all state and local governmental entities. [GASBI 2, ¶2]

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<sup>1</sup>[GASBI 2, fn1; change cross-reference]

## **Disclosure Requirements**

.102–.103 [GASBI 2, ¶3–¶4]

## **NONAUTHORITATIVE DISCUSSION**

### **Illustrations of Disclosures**

.901 [GASBI 2, ¶20]