Letter of Comment No. 31
File Reference: CapInt
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Mr. David Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Project 9-5 — Exposure Draft — Accounting for Interest Cost during the Period of Construction

Dear Mr. Bean:

Deloitte & Touche LLP is pleased to respond to the Governmental Accounting Standards Board's (GASB) exposure draft (ED) on *Accounting for Interest Cost during the Period of Construction*. We commend the GASB for its efforts to enhance comparability in financial reporting of capital assets and simplify accounting for interest cost. We appreciate the GASB's efforts to follow the hierarchy; to apply the definition of assets under Concepts Statement No. 4, *Elements of Financial Statements*; and to apply consistency to governmental and business-type activities in the treatment of interest costs during construction.

However, there are implications in the implementation of this proposed standard and inconsistencies between other standards and frameworks that we believe require further consideration.

Interest as Part of Construction Cost

The basis for conclusions in the ED indicates that "regardless of whether interest is incurred during the construction period, the asset will have the same ability to provide services." However, the basis for conclusions fails to explore whether the asset would have been constructed if not for financing. The basis for conclusions indicates that interest costs can be considered separable from the cost of the assets and evaluated as to whether they provide present service capacity in and of themselves. However, generally, the cost of financing large and multiyear projects is inseparable from all other project costs. Large project plans are contingent upon financing and cannot proceed without the foundation of financing. Similar to large-scale developments in which developers generally secure financing, governments simply do not fund significant enterprise projects with their own resources. They do not have their own cash to expend on these assets. Such projects are generally multiyear, multiphase, and bond-funded projects, often supported by the revenue

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stream of the proprietary fund. Therefore, interest is a planned and necessary component of the value and cost of the project where financing is sought.

Other Construction Costs

The GASB considered in the ED that interest is different than other costs of construction, such as freight, transportation, or other ancillary costs. Though the ED includes some discussion as to the Board's considerations of the differences between interest and other ancillary costs, which are believed to be part of the constructed assets, this discussion is brief and should be better explained and enhanced for better understanding by the user. It is unclear as to how the Board concluded that certain ancillary charges add to the present service capacity and interest cost does not. Also, it is unclear how the Board came to the decision that interest is a clearly separable cost from the asset while other ancillary costs are not.

Regulated Operations

In the basis for conclusions of the ED, the GASB explained that business type activities that meet the criteria in in GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraphs 476-500, *Regulated Operations*, may continue to apply the provisions in reporting qualifying interest as a regulatory asset. However, there is no background as to how the Board concluded that, for the entities that elect to apply the provisions of GASB Statement No. 62 paragraphs 476-500, interest ***is*** part of the cost of an asset, but for other entities, qualifying interest is ***not*** part of the cost of an asset as defined by Concepts Statement No. 4.

This inconsistent treatment of interest cost may cause entities, specifically those who report as stand-alone business-type activities, such as airports and certain utilities, to make the election to report under the provisions of paragraphs 476-500 of GASB Statement No. 62, provided they meet the criteria set forth in GASB Statement No. 62. Because such costs are so significant to these entities, it is possible that they may prefer to make changes to their accounting and reporting over making changes to operations and rate structures.

Should alternative treatments not be provided for in the final standard, it is possible that the change in accounting may be so significant to certain entities that they may be forced to decide between changing their accounting and reporting a regulatory asset or revising their operations and rate structure to account for the expensing of interest.

Donated Capital Assets

GASB Statement No. 72, *Fair Value Measurement and Application*, requires that donated capital assets be measured at acquisition value. In general-purpose governments, the most valuable donated capital assets are infrastructure assets donated by developers. Large-scale developments, whether commercial or residential, are usually financed. The infrastructure donated to the government and measured at acquisition value can generally be assumed to have an interest component, as neither the developer nor the government, if constructing themselves, would construct without financing.

GASB Statement No. 62 currently provides that assets qualifying for interest capitalization include assets being donated or gifted to other entities. Therefore, if a government receives infrastructure or other assets that have been constructed by another government, the asset value currently includes interest incurred during the construction period. While this will be amended under the proposed standard, these costs are being incurred and are a part of the gifted asset during the construction period. We believe this is an appropriate treatment and should not be revised.

By eliminating the ability to capitalize interest in proprietary funds, similar capital assets constructed by private sector entities and donated to the government would be valued differently. This proposed accounting treatment may cause inconsistencies between funds and between entities. We believe that the GASB should consider the impact on comparability in relation to donated assets.

Consistency with Financial Accounting Standards Board (FASB) and International Accounting Standards Board

When providing the guidance related to interest capitalization on qualifying assets in GASB Statement No. 62, the GASB incorporated guidance included in FASB Statements No. 34 and 62 (now codified in Accounting Standards Codification ASC Topic 835-20, *Capitalization of Interest*). It is also consistent with International Financial Reporting Standards, International Accounting Standard No. 23, *Borrowing Costs*. By having similar baseline guidance, users of both private- and public-sector entities have a basic understanding of the types of costs, including interest, that can be expected to be included in the capital assets of business enterprises of those entities. The nature of business-type activities and proprietary funds is that they operate more like a private sector entity, and therefore, some similarity and familiarity between the entities should be expected. Removing interest from the value of capital assets as proposed in the ED further divides comparability. A shift away from what has been adopted by the other primary reporting frameworks will put governments in a place of incomparability. We recommend that the GASB consider whether the divergence from all other reporting frameworks that report under full accrual accounting is necessary.

We understand that the GASB's revised definition of an asset is ultimately driving this change. However, we suggest that the GASB consider allowing governments' alternate accounting treatments, such as the presentation of other items similar to regulatory assets or deferred outflows (allowing for amortization as in current practice), to provide governments an option other than expensing interest during construction as a period cost, the effect of which may be impactful to financial statement comparability, debt covenants, and the near-term bottom line.

Implementation Date

The proposed implementation date of the ED is reporting periods beginning after December 15, 2018. While governments may be able to implement the proposed standard as written from a financial accounting and reporting standpoint by the suggested implementation date, the larger impact on debt covenants may require a longer lead time. We recommend that the GASB consider extending the implementation date by no less than one additional year to provide governments sufficient time to evaluate the impact on debt covenants, rates, and other operations and make any necessary revisions.

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If you have any questions concerning our responses, please contact Mike Fritz at +1 614 229 4806.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl