

Is it a sale or a borrowing? GASB proposes clarifying standards

Governments with tight budgets are challenged to seek out new revenue streams or increase inflows to maintain cash balances. To generate additional cash in the short-run, some governments have turned to the sale of outstanding receivables (amounts owed to a government, such as unpaid property taxes and parking tickets) and the pledging of future revenues to repay amounts borrowed. When the time comes to account for such transactions, however, there is some confusion about how to determine whether a government's resources have been *sold*, or if the resources are in substance collateral against the repayment of resources provided to the government through a borrowing. This determination can significantly impact a government's financial statements—a sale is reported as *revenue*, but borrowing results in a *liability*.

The lack of a single accounting standard that specifically addresses this issue has led to considerable diversity in how these transactions are reported to the public and limited information has been disclosed about them in the notes to the financial statements. The Governmental Accounting Standards Board (GASB) proposes to address this issue with new guidelines for distinguishing sales from borrowings. In September 2005 the GASB published for public comment an Exposure Draft, *Sales and Pledges of Receivables and Future Revenues*, which would establish that these transactions generally should be reported as the pledging of collateral against borrowed resources. A government would report a liability, rather than recognizing the resources received as revenue, unless it can establish that the transaction meets certain criteria that would indicate an actual sale has occurred. At the heart of these criteria is a determination of the extent to which the government retains control over the receivables or future revenues.

No Continuing Involvement

Receivables. For a transaction to be considered a sale of receivables, a government's continuing active involvement with those receivables should be effectively terminated: the buyer is not limited in its ability to sell or pledge those receivables subsequently; the government selling the receivables cannot substitute for or reacquire specific accounts; the sale cannot be cancelled; and the receivables and cash collected on them in the future are *isolated* from the

government. The proposal sets forth criteria for assessing whether the receivables and cash have been isolated.

Future revenues. A transaction involving future revenues is considered a sale if: the government maintains no active involvement in the future generation of the revenues; the buyer is not limited in its ability to sell or pledge those receivables subsequently; the cash collected in the future is isolated from the government; the government is not prohibited from selling the revenues; and the sale cannot be cancelled. Active involvement on the part of the selling government includes actions such as: providing the goods or services that are exchanged for the revenues; levying taxes, fees, or charges to generate the revenues; or being required to submit applications for grants or contributions or to meet certain conditions in order to receive the revenues.

Accounting Guidelines

The proposed standards explain how sales and collateralized borrowings should be accounted for and reported in the financial statements. If a transaction does not meet the criteria to be treated as a sale, a government would continue to report its receivables as assets and its future revenues as revenues as it normally would, and would report a liability representing the amount it has to repay. The revenues or receivables collected and paid to the lender would reduce the liability.

If a transaction meets the criteria to be a sale of receivables, a gain or loss would be recognized that is equal to the difference between the proceeds received and the carrying value of the receivables, the latter of which would no longer be reported as assets on the financial statements. In a sale of future revenues, the proceeds generally would be reported as deferred revenue and recognized over the life of the sale agreement, rather than recognized immediately.

The Exposure Draft also proposes standards for several related issues, including: accounting for transactions between parts of the same financial reporting entity, which would differ in some respects from transactions with external parties; a government's residual interest in collections that exceed specified amounts; and transactions in which the proceeds are received by a separate unit of the seller government, such as a public authority, rather than the government itself.

Disclosure Requirements

The proposed standards would require governments engaging in these transactions to disclose new information in the notes regarding the unavailability of future revenues that have been pledged or sold. A pledging government should disclose: the specific revenue being pledged and, if determinable, the amount pledged; the proportion of the total revenue stream that has been pledged; the purpose of the debt; the length of the pledge; and a comparison of the pledged revenue with the interest and principal requirements of the debt. A selling government should identify the revenue stream being sold and, if determinable, the amount; the proportion of the total revenue stream sold; the period to which the sale applies; and a comparison of the proceeds with the present value of the future revenues, if determinable.

Effective Date

The proposed standards would be effective for periods beginning after December 15, 2006.

Public Comment Sought

The GASB is seeking public input on these proposed standards and has set a comment deadline of December 30, 2005. The Exposure Draft can be downloaded from the GASB's Web site, www.gasb.org. The GASB welcomes comments on some or all parts of its proposal. The GASB depends on the comments of those who prepare or audit financial statements for feedback on the conceptual soundness, technical accuracy, and appropriateness of its proposals. Additionally, comments from the users of financial statements are particularly helpful in understanding whether or not the information provided by the proposals is useful in fulfilling the needs of those who use governmental financial information. Many constituents submit comments when they do not agree with the GASB's proposals. However, it is equally important that the GASB know when constituents support a proposal. Furthermore, the GASB needs to understand *why* constituents support or oppose its proposals. One compelling comment can make a difference.