March 5, 2018

Mr. David Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

RE: Accounting for Interest Cost during the Period of Construction Exposure Draft (Project 9-5)

Dear Mr. Bean:

The Airports Council International – North America (ACI-NA) welcomes the opportunity to comment on the Exposure Draft of the Governmental Accounting Standards Board (“GASB”) on Accounting for Interest Cost during the Period of Construction.

The Airports Council International – North America (ACI-NA) is a non-profit organization that advocates policies and provides services that strengthen the ability of airports to serve their passengers, customers and communities. ACI-NA includes committees and working groups that support its mission and activities. The ACI-NA Finance Committee – Accounting and Financing Working Group (AFWG) advocates and supports Airport efforts to comment on and recommend a common position on accounting and financing standards. While our focus in these comments is on the airport industry, we believe the points in support of retaining the current standard for accounting for interest during the period of construction are also applicable and relevant to a majority of non-airport enterprise funds.

Commercial Service Airports in the United States are organized and operated under a variety of different legal entities and board structures, with varying degrees of independence and autonomy from state or local governments. Despite these differences, Airports are very similar with respect to business, financing and financial reporting perspectives.

Airports generally operate under Airline Use Agreements signed by commercial carriers that define financial and operational responsibilities for the carriers and airports, including the establishment of rates and charges, the recovery of costs, and infrastructure development and financing. The agreements, ratemaking, infrastructure and operations of the airport are heavily regulated by the Federal Aviation Administration. In addition, a vast majority of airports do not have taxing authority. These characteristics along with those discussed below require airports to report as enterprise funds using the economic resource focus with full accrual basis...
accounting. Consequently their financial reporting has a greater similarity to private sector financial reporting than it does to other governmental funds, including government-wide financial statements.

Relevance and comparability
The Exposure Draft (“ED”) provides two objectives for its proposed change in accounting for interest costs during construction. The first objective is “to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period...”. It is unclear from the ED how the proposed standard would enhance the relevance of information about capital assets and the cost of borrowing. We believe the current standard is the most relevant as it is consistent with ratemaking practice for debt service costs, including interest, when an airport capital asset is under construction. The long-standing practice of capitalizing interest during construction for enterprise funds appropriately captures the benefit of future cash flows as contained in airline/airport use agreements and by the Federal Aviation Administration’s (FAA’s) Policy Regarding Airport Rates and Charges. The International Civil Aviation Organization (“ICAO”) has issued global principles for the setting of airport charges that impact air carriers. ICAO states, “Once facilities are completed and commissioned, their capital costs are generally recovered by including associated amortization or depreciations costs in the cost for user charges.”

The ED argues that comparability will be enhanced by disallowing the current accounting treatment for enterprise funds since interest incurred during construction is currently not capitalized for governmental activities. The ED states if a building is constructed by a governmental fund and a similar building is built by an enterprise fund, there will be a difference in the historical cost of the building based on which fund was used to construct the building. Thus, the proposed statement presents this result as “misleading.” ACI-NA believes there is no basis for comparability to begin with, with or without the new standard. While the size of airports varies greatly, capital assets represent the greatest share of financially reported assets. In addition, airports are unique as these assets are required to carry out the entities’ purpose. There are no alternatives available.

We believe there are inherent differences between enterprise fund assets, airports in particular, that preclude financial reporting comparability under any circumstances. A billion dollar airfield system or a terminal complex is very different from an office building or a waste-water treatment facility, for example. Also, historical cost is only one facet of capital asset accounting, and a reasonable argument can be made that an asset’s carrying value or book value is more relevant, as it measures the expiration of its service capacity and the economic realities of an enterprise fund activity or industry when factors such as debt service and obsolescence are considered. An airport does not acquire runways, taxiways, and terminals. In most cases significant assets, such as infrastructure are constructed over long periods of time and are funded primarily through the issuance of debt.

Also, to take a position that comparability between government-wide financial statements and enterprise funds will be improved ignores the fundamental principle that there are important and substantial differences between individual statement and fund types. Consequently standards are established to uniquely identify and separate each. In the instance of enterprise funds, GASB Statement No. 34, states that a given activity must be accounted for in an enterprise fund if one of the following conditions is present:

1 GASB Statement No. 34, paragraph 67.
- there is outstanding debt backed solely by fees and charges,
- laws or regulations require that fees and charges be set to recover costs including capital costs (depreciation or debt service), and
- there is a pricing policy that fees and charges be set to recover costs, including capital costs (depreciation or debt service).

GASB’s statement that describes the difference in reporting for construction period interest as “misleading” is presented from an internally focused point of view related to comparability. ACI-NA believes that external considerations related to comparability are more relevant. The accounting for capital asset and interest during construction is more comparable to those within the private sector and global market. Thus, the GASB’s proposed reliance on internal comparability between two very different types of activities/funds is misplaced.

Comparing an airport to a governmental fund is not relevant or consistent with the purpose of enterprise funds. Airports in Canada (as well as in the rest of the world), capitalize interest during construction as do private sector entities who construct/own facilities at US airports. Both International Accounting Standard Board (“IASB”) and the Financial Accounting Standards Board (“FASB”) require capitalization of interest cost during construction. The ED’s divergence from the current accounting practice will diminish comparability of capital assets amongst airports.

The objective for a standard on the capitalization of interest during the period of construction should be how well it meets the objectives and fundamental principles that comprise the foundation for accounting for Enterprise Funds. Those principles are outlined in The National Council on Governmental Accounting Statement No. 1, which states that Enterprise Funds “…account for operations (a) that are financed and operated in a manner similar to private business enterprises – where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through use charges…”. Consequently, understanding that construction period interest is recovered in future periods through ratemaking and other cost recovery charges, the current standard providing for the capitalization of interest during construction is most appropriate.

Complexity
The ED’s second objective is to “simplify accounting for interest cost incurred during the period of construction.” ACI-NA believes that any simplification of this accounting treatment is significantly outweighed by the resulting impact of the change in financial statement reporting. It creates an artificial basis of accounting for an asset similar to differences created by book and tax basis treatment of the same asset. In this case the current standard reports on the same basis employed for cost recovery, which requires the capitalization of interest during construction, and is the basis used for airport ratemaking.

Rather than eliminating the current accounting for interest during construction for Enterprise Funds; ACI-NA suggests that GASB look at alternatives to simplify the current accounting requirements, such as identifying one requirement to apply to all capital assets (regardless of whether funded by tax exempt bonds). Also, we believe that simplification as a primary reason for a proposed accounting change seems arbitrary when you consider the overwhelming complexities resulting from the implementation of GASB 68 and those that will be required under GASB 87.
Interest as a component of an asset’s costs
The ED concludes that interest incurred during construction does not meet the definition of an asset because it is not a “resource with present service capacity.” The reality is that a large airfield system and terminal complex would not be possible but for the related interest costs incurred during construction of the asset. It is clearly more significant and relevant to the cost of an acquisition than ancillary costs that are necessary for an asset to be brought into service. In addition, if the concept of “resource with present service capacity” were extended to the construction of the asset itself, then construction-in-progress would not be included as a component of capital assets, although that is the current accounting treatment utilized.

Costs recovered through rates
GASB recognizes the unique accounting in a highly regulated industry, and provides for those circumstances in the GASB Statement No. 62 for Regulated Operations\(^2\) and are similar to the requirements for the use of Enterprise Funds in GASB Statement No. 34. Statement No. 62 requires that the rates be designed to recover the enterprises costs of providing service and that it is reasonable to assume rates will be set to recover such costs.

Similar to airline ratemaking in the United States, it is common for public sector utilities (similar to private sector counterparts), to establish rates to recover interest costs incurred during construction over the life of the related assets. GASB No. 62 recognizes that the ratemaking process may give rise to an asset in which future revenues are likely to be sufficient to recover costs. If the proposed change in accounting for construction interest is adopted by the GASB, it could lead more entities to change their accounting and follow regulatory accounting in order to be able to defer the recognition of interest cost during the construction period (rather than part of capital assets). The regulatory asset would be amortized over the period in which the related cost is recovered in rates.\(^3\) This accounting maintains consistency in rate treatment and the recognition of expense.

Non-Financial Reporting and Accounting Consequences
ACI-NA recognizes that the overall objective of financial reporting by state and local governments is to provide information to assist users (the citizenry, legislative and oversight bodies, and investors and creditors) in assessing the accountability of governments and in making economic, social, and political decisions. We do not see how a change in the current standard for construction period interest improves financial statement reporting consistent with this objective. However, the proposed standard could have unintended consequences that would impact a financial statement user’s conclusions about a government if interest is expensed during construction, as net position is reduced by the interest costs without any corresponding operating revenue recovery. In addition, bond ratings — and, correspondingly, interest rates -- may be negatively impacted by this change in net position. Ultimately, these unintended outcomes may impact total financing and asset costs, not only through less favorable borrowing terms, but also through higher costs that are associated with delays in or postponement of capital plans.

As a potential alternative to recording construction period interest as an asset, ACI-NA believes that airports should be provided an accounting treatment that provides for reporting interest during the construction period as a deferred outflow (and not recorded as a period cost)

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\(^2\) GASB Statement No. 62 (paragraphs 476 – 500) permits the recognition of Regulatory Assets due to the impact of regulation in the setting of rates to recover an entity’s costs.

\(^3\) The proposed statement on accounting on interest during construction makes no change in determination of a regulatory asset.
due to the ratemaking associated with airports in the United States. 4 Interest during construction could be treated as a deferred outflow, which would then be amortized and recovered through rates after construction has been completed.

Summary
For airports and many enterprise funds, interest during construction is an asset with future service capacity directly related to the service capacity of the underlying asset. It is a necessary cost of construction that may directly impact the ultimate design or utility of the asset, when factors such as finance market conditions, borrowing rates and other terms impact the amount that may be borrowed or the terms under which it is repaid. Ultimately financing affects how costs will be recovered in rates. There is no inherent foundation for comparability of assets between government-wide financial statement reporting and enterprise fund reporting; a significant amount of enterprise fund assets have no comparable counterpart in government-wide financials. In addition, even comparability across enterprise funds within different industries is limited by the unique nature of the assets required to conduct the activities of a particular enterprise fund. Even if simplification were a consequence of the new standard, it is significantly outweighed by the economic realities of accounting for capital assets within an enterprise fund.

The ratemaking process of airports will produce future revenues associated with interest during construction, and current accounting recognizes that ratemaking can create an asset. Alternatively, it is reasonable to view interest during construction as a deferred outflow since the airport is consuming a new asset today that would apply to the recovery in rates in future periods.

ACI-NA strongly encourages the GASB to re-consider its proposed statement by acknowledging that the primary objectives for its position are inconsistent with or inconsequential to enterprise fund activities and reporting, particularly for airports in the United States. We would also request that the Board hold a public meeting prior to its issuance of this ED as written. The efforts of the Governmental Accounting Standards Board and the opportunity to provide comments are greatly appreciated.

Sincerely,

Liying Gu
Vice President, Economic Affairs and Research
Airports Council International – North America

4 ACI-NA does not understand why interest during construction does not meet the definition of an asset but a regulatory asset representing the same cost with the same recovery in future rates is an asset.