March 5, 2018

Mr. David Bean
Director of Research and Technical Activities, Project No. 9-5
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Accounting for Interest Cost during the Period of Construction Exposure Draft
Project No. 9-5

Dear Mr. Bean:

The City of Chicago (the City) Department of Aviation (CDA) appreciates the opportunity to provide comments on the Governmental Accounting Standards Board (GASB) Exposure Draft concerning the Accounting for Interest Cost during the Period of Construction (Project 9-5). CDA encourages the GASB to reconsider the proposed statement for reasons described in this letter.

CDA operates O’Hare International and Midway International Airports, which are both large-hub airports as defined by the FAA. O’Hare, located 18 miles northwest of the City’s central business district, is the primary commercial airport for the City and the region and serves as an important transfer and connecting point for numerous domestic and international flights. It is a hub in networks of United Airlines and American Airlines and is one of the busiest airports in the world. O’Hare served nearly 80 million passengers in 2017. Midway, located eight miles southwest of the City’s central business district, is the largest airport in the Southwest Airlines system in terms of passengers and operations. In 2017, Midway served over 22 million passengers.

The City has undertaken significant capital programs at both airports in recent years. At O’Hare, the City is nearing completion of one of the largest airfield capital programs in the world. This program, with an estimated cost of $5.5 billion, consists of the development of one new runway, the relocation of three existing runways, and the extension of two existing runways at the airport. In addition, the City recently announced an $8.5 billion capital program that includes a major terminal expansion. At Midway, a Terminal Development Program was completed in 2001 which included a new terminal for the airport

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1 Large-hub airports enplane at least 1.0 percent of total annual passenger boardings in the U.S.
and in 2015 the City began a $248 million capital program that included an expansion of the concession facilities, the terminal parking garage, and security checkpoints.

**Rate Setting Methodology**

O’Hare and Midway International Airports are accounted for as two distinct self-supporting enterprise funds of the City. The City maintains the books, records and accounts of the airports in accordance with generally accepted accounting principles and as required by the provisions of the airport use agreements, bond ordinances and bond indentures. The airport use agreements for O’Hare and Midway specify a residual rate-making methodology for the calculation of airline rates and charges. Under this methodology, total operating and maintenance expenses and debt service (including coverage) are calculated for each cost-revenue center and offset by non-airline revenues. The airport use agreements provide that the aggregate of airport fees and charges paid by the airline parties must be sufficient to pay for the net cost of operating, maintaining and developing the respective airports including the satisfaction of debt service coverage, deposit and payment requirements of the bond ordinance and indentures. O’Hare and Midway each sets fees and charges in this manner which generally include landing fees and terminal rental rates charged to the airlines on a landing tonnage and per square foot basis, respectively.

Although the rate-making methodology allows for the inclusion of debt service in the calculation, per the terms of the airport use agreements, CDA is prohibited from including costs associated with capital projects in the airline rate calculations until the date of beneficial occupancy of the project. The rates established pursuant to the airport use agreements do not include debt payments for assets until a project is complete. Due to the residual nature of the airport use agreements at O’Hare and Midway the airports do not have discretionary funds available in the amounts needed to pay interest accrued during the construction of large, multi-year programs such as those described in this letter and contemplated under the proposed exposure draft. The practice of capitalizing interest during construction appropriately captures the benefit of future cash flows as required by the airline use agreement and is in line with the Federal Aviation Administration’s (FAA’s) Policy Regarding Airport Rates and Charges and the International Civil Aviation Organization (ICAO) 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 depreciation costs in the cost for user charges.” Changing the accounting of interest cost during the construction period will create a material difference between the airport financial statements and the purpose of rate making and does not support the Exposure Draft’s objective to “enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period”.

**Definition of an Asset**

In addition, CDA does not agree with separating the interest cost during the construction period from the asset. As stated in the Exposure Draft, assets are defined as “resources with present service capacity that the government presently controls” and present service capacity is defined as an “existing capability to enable the government to provide services, which in turn enables the government to fulfill its mission”. CDA contends that interest costs incurred during construction are not a financing activity separate from the capital asset, but, in fact, are inseparable from the capital asset as the capital asset could not be built without incurring interest costs during construction. Therefore, interest is a planned and necessary component of the value and cost of the project. Bonds are issued by the City for specific
assets that are part of the capital program and beneficial occupancy dates are used to determine the capitalized interest during construction. The terms of the bonds are also set with consideration of the useful lives of the assets and are equal to or less than the estimated useful lives of the assets. Financial statements for O'Hare and Midway accurately include the capitalization of interest during construction to reflect the full value of the capital assets at the airport. The proposed change to remove this component from capital assets would understate the value of those assets.

**Accounting Considerations**

Accounting for interest during construction as a period cost could have a material, and misleading impact on the net financial position of the airports. Large capital programs take several years to construct and a significant amount of interest is incurred during construction. By changing interest from a capitalized asset to a period expense, the net financial position will decline because a period expense will be incurred without a corresponding revenue offset. An alternative would be to defer accounting of the interest to align with the offsetting revenue given that airports will be recovering the interest through future charges. If the interest expense is not deferred, the financial statements would present a misleading impression of a reduced net position during construction and even with no change to the underlying economics of the airport, this has the potential to negatively impact bond ratings and the interest rates on bonds.

**Consistency**

Airports have a broad base of stakeholders from an international perspective and consistency with international accounting guidance is important to enhance the comparability and relevance of information. Airports in Canada (as well as in the rest of the world), capitalize interest during construction as well as 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. Divergence from the current practice will diminish comparability of capital assets and financial reporting amongst airports.

In summary, CDA believes the current standard of accounting for interest costs during construction is most relevant and is the best approach to provide consistency and comparability. We encourage the GASB to reconsider the proposed statement. If the GASB determines a change in the treatment of interest during construction is necessary, we encourage consideration of deferring the cost and recording it as a deferred outflow in order for it to be recognized with offsetting revenue.

Thank you for the opportunity to provide comments on this Exposure Draft. Please let me know if any additional information would be useful to further support the current standards remain in place.

Sincerely,

Reshma N. Soni
Chief Financial Officer
Chicago Department of Aviation