NFMA

October 11, 2010

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

*Via electronic mail*

RE: *Project No. 30: Exposure Draft – Proposed Statement of the Governmental Accounting Standards Board: Accounting and Financial Reporting for Service Concession Arrangements*

Dear David:

The National Federation of Municipal Analysts (NFMA) welcomes this opportunity to comment on the *Exposure Draft – Proposed Statement of the Governmental Accounting Standards Board: Accounting and Financial Reporting for Service Concession Arrangements.*

The NFMA is an organization comprised primarily of research analysts who evaluate credit and other associated risks of securities in the municipal bond market. Established in 1983, the NFMA has over one thousand members who represent, among others, broker-dealers, institutional investors, and rating agencies.

As users of financial and operational information provided by municipal issuers, the NFMA typically supports measures that improve the quality and timeliness of that information. GASB's proposal to improve accounting and financial reporting related to Service Concession Arrangements (SCAs) of state and local government is, in general, consistent with NFMA's goal of better disclosure.

In recent years, state and local governments have turned increasingly to Service Concession Agreements as a means to maximize the value of government infrastructure projects, as well as a way to generate financial resources for use in non-related government services. In light of continued economic and financial stress, these issues are not likely to abate, and will probably expand in the next decade. As a result, it is important that government accounting principles establish a consistent standard for users of financial statements for issues that will grow in importance in future years.

With that overall goal in mind, we would like to share the following comments and responses to the three issues and questions posed by GASB:

**Issue 1, Question 1:**
***Do you agree that the control criteria should be a factor in determining the scope and applicability of this proposed Statement? Why or Why not?***

NFMA agrees that the control criteria should be the main factor in determining scope and applicability of the proposed statement. The reasoning is simple: if the transferor government has ceded control and has no residual interest in the infrastructure project that has been converted into a Service Concession Agreement, then the transaction is a simple sale and transfer of assets, for which there are existing accounting rules and treatment. In those cases where control and ownership still lies with the transferor government, there needs to be a separate set of rules to handle the ongoing operations and financial results of the transaction on the financial operations of the transferor government. In any event, the financial statements of the transferor government should have a footnote clearly stating the status of its residual interest in the underlying project. The footnote should also state if the transferor is treating the concession transaction solely as a balance sheet asset or is accounting for the transaction on its income statement. The footnote should indicate if the concession agreement can be terminated at will, is annually renewable, terminable only upon default by either party to the transaction, and if the potential term of the concession agreement covers the estimated useful life of the underlying project asset(s).

**Issue 2, Question 2:**
***Do you agree that a transferor should report a deferred flow of resources, reduced by any liabilities incurred, for consideration received by an operator? Why or why not?***

This is a more difficult question to answer. From a pure accounting point of view, taking into account resources and the time over which they might be earned, NFMA would agree that the deferred inflow of resources approach would be correct for the government transferor. However, this approach will probably be viewed with alarm by governments that use this financing vehicle to balance general fund operating budgets. In those types of situations, some or all of the current proceeds from an SCA could be used as revenue to fund current expenses, but SCA receipts would only be accrued and earned over several years. The resulting transaction for that government's general fund would depict an operating deficit where annual revenue that year would be below expenditures as to this transaction, even though the transaction would have been undertaken by the government operator in order to eliminate a deficit.

Since all of the current proceeds from an SCA would be used as a revenue to fund current expenses, but the SCA receipts could only be accrued and spread over several years, the resulting transaction for that government's general fund would depict an operating deficit where annual revenue that year would be below expenditures as to this transaction, even though the transaction would have been purportedly been undertaken by the government operator for eliminating a deficit. Proper footnoting of the transaction (i.e., good description of the transaction) will help users of the government operator's financial statements to reconcile some of these accounting tensions.

**Issue 3, Question 3:**
***Do you agree that a governmental operator should report all revenue and expenses for the service provided, with the transferor recognizing only its portion of the shared revenue? Why or why not?***

NFMA agrees that when a government operator is responsible for the operation and maintenance of an infrastructure project, whose continued successful operation is necessary for the operator to be compensated for its operating the project, then the project's revenue and expenditures should be reported by the operator on its income statement, and not the transferor. The transferor would then only report its portion of the shared revenue on its income statement. This makes sense because the operator would need to be the entity (and is the most knowledgeable entity) to keep track of all expenses, depreciation and renewal and replacement costs that would be necessary to return a project in a condition as good or better than when it was transferred by the government transferor. This presumes the government operator is not the owner of the concession project (i.e., the government operator has no meaningful residual interest in the underlying asset). Somewhere in the government operator's footnotes should be an estimate of the useful life of the underlying asset and whether the government operator has the responsibility to maintain the underlying asset—as this could impose a long-term liability of the government operator despite it not technically owning the underlying concession asset.

The NFMA appreciates the efforts GASB is taking to improve the disclosure of financial and operating reports of municipal and other entities and welcomes the opportunity to discuss these comments further.

Sincerely,

/s/
Mark Stockwell
NFMA Chairman