Governmental Accounting Standards Board
of the Financial Accounting Foundation

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GASB Clarifies Difference between Sales and Borrowings

The Governmental Accounting Standards Board (GASB) has issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* to answer governments' questions about how to account for these types of transactions. Although such transactions (for example, those related to delinquent property tax receivables or future tobacco settlement receipts) have become more prevalent, no single standard previously existed to guide how to account for them and report them to the public.

Statement 48 makes a basic distinction between sales of receivables and future revenues, on the one hand, and the pledging of receivables or future revenues to repay a borrowing (a collateralized borrowing), on the other. The answer to the question of whether a transaction is a sale or a collateralized borrowing is important because the cash received from a sale may be recorded as revenue in some cases, but the cash from a borrowing is not—instead, the borrowing results in a liability on a government's financial statements.

The most significant factor distinguishing sales from borrowings is the continuing involvement of the government doing the selling or borrowing. Statement 48 establishes that a transaction is a collateralized borrowing *unless* it meets criteria that demonstrate that the government is no longer actively involved with the receivables or future revenues it has transferred to the other party. The new standards set forth the criteria for determining whether a government continues to be involved. For instance:

- Neither the government nor the buyer can cancel the sale
- The government cannot limit in any significant way the buyer's ability to subsequently sell or pledge the receivables or future revenues
- The government no longer has access to the receivables, future revenues, or the cash collected from them.

For a sale of receivables, the government cannot substitute for or reacquire specific receivables without the buyer's consent. For a sale of future revenues, the government is not actively involved in the future generation of the revenues. In other words, the revenues cannot be the product of goods or services provided by the government or a tax, fee, or charge that the government has to impose. In addition, if the revenues derive from grants or contributions, they cannot depend on the government subsequently submitting applications or meeting performance provisions to maintain eligibility to receive the revenues.

Accounting for Collateralized Borrowings

As noted earlier, if a transaction does not meet the criteria to be a sale, the government pledging the receivables or future revenues should report the proceeds it receives as a liability, not as revenue. It continues to report pledged receivables as assets and pledged revenues as revenues, as appropriate under generally accepted accounting principles (GAAP). The liability is reduced as cash is collected from the pledged receivables or revenues and transferred to the other party.

If the other party to the transaction—the “lender”—also is a government, then it reports a receivable in the amount of the proceeds it gave to the pledging government. The receivable is reduced as it receives the payments from the pledging government.

Accounting for Sales

Receivables that are sold should be removed from the assets in the selling government’s financial statements. If there is a difference between the proceeds received by the selling government and the amount of the receivables reported on its financial statements (the *carrying value*), the difference is reported as a gain or loss in the accrual-based financial statements (and as revenue in the modified-accrual-based governmental fund financial statements). Rather than being reported as revenue right away, the proceeds from the sale of a future revenue source generally will be reported as deferred revenue and spread over the life of the sale agreement. In each year of the agreement, a portion of the proceeds would be recognized as revenue.

If the buyer of a receivable is a government that is not a part of the selling government’s financial reporting entity, it adds a receivable to its financial statements equal to the purchase price and recognizes an equivalent expense. For the sale of future revenues, the purchasing government (as long as it is not a component unit of the selling government) realizes receivables and revenue when the recognition criteria under GAAP are met—the revenue stream now belongs to the purchasing government.

Intra-Entity Transactions

If the purchasing government is a part of the same financial reporting entity as the selling government, then the sale is an *intra-entity* transaction and the rules are different. For example, a state government might sell receivables to one of its component units, such as a public authority. In this case, the public authority purchasing the receivables should recognize assets equal to the carrying value they had for the state that sold them. The difference between the purchase price and the carrying value would be accounted for as a revenue, expense, or expenditure by the public authority in its separately issued financial statements. However, in the financial statements of the state’s reporting entity (of which both the state and the authority are a part), these amounts would be reported as transfers or subsidies between the two governmental entities to avoid double-counting.

In the case of a sale of future revenues between parts of the same reporting entity, the buyer does not add an asset to its financial statements because no carrying value would have been reported by the seller. Assets and revenues would not be reported by the purchasing government until appropriate under GAAP. The purchasing government would report the amount it paid as a deferred charge that would be spread over the life of the sale agreement—each year a portion of the charge would be recognized as an expense or expenditure. The selling government likewise defers the revenue.

Required Disclosures

Governments are generally required by Statement 48 to present disclosures in the notes to the financial statements about the revenues they pledge to collateralize debt, until the debt is fully repaid, including:

- Identification of the pledged revenue source, the amount pledged, and the percentage of the total revenue stream that has been pledged (if it can be estimated)
- Identification of the debt and its purpose
- The length of the pledge
- A comparison of the pledge revenues recognized during the year with the required debt service payments for the year.

The following information should be disclosed about sales of future revenue streams:

- Identification of the revenue sold and the approximate amount
- The period of the sale
- The percentage of the total revenue stream that has been sold
- A comparison of the proceeds of the sale with the present value of future revenues
- Significant assumptions made to approximate the amount of revenue sold and the calculation of its present value.

Implementation Date

Statement 48 should be implemented beginning with fiscal years ending December 31, 2007, though governments may apply the standards earlier. Because the requirements to defer revenues, expenses, and expenditures related to sales of future revenues differ from guidance provided by GASB Technical Bulletin No. 2004–1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues,* governments may apply those provisions prospectively and do not have to adjust the accounting for sales of future revenues completed prior to the implementation date or to restate previous years' financial statements.