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DEPARTMENT OF TREASURY
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Issued By:	Local Audit and Finance Division (LAFD) Bureau of Local Government and School Services
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2002-08	Accounting and Reporting Infrastructure Assets Local Water and Sewer Systems and County Drains[i]
Intended Audience:	Local Units of Government and Certified Public Accountants

COMMON SCENARIOS INVOLVING LOCAL WATER AND SEWER SYSTEMS AND COUNTY DRAINS

The following guidance addresses the accounting for several common scenarios involving Water and Sewer Systems. These scenarios involve instances where the county is involved in issuing debt associated with a local Water and Sewer System. This guidance also addresses the accounting for scenarios involving Drainage Districts where there is an apportionment of a long-term debt assessment for the construction of a new drain. This statement is not intended to cover all types of arrangements that may exist. Further, it should be noted that arrangements can be labeled as "leases" that may not meet the definition of a lease under GASB Statement No. 87. Although we outline certain specific accounting recommendations, the facts and circumstances associated with each individual arrangement should be evaluated.

Water and Sewer Systems:

A county issues debt in its name (generally under Act 185 and 342; sometimes Chapter 20 is used for sanitary sewage systems). There is a lease with the local unit whereby the local unit agrees to lease the asset over the life of the bonds (often the lease payment is equal to debt service requirements of the county bonds). These scenarios assume that the arrangement does not meet the definition of conduit debt in GASB Statement No. 91.

Common variations of this scenario are as follows:

1. The county issues the debt and turns the proceeds over to the local unit; the local unit constructs, operates, and controls the system.

2. The county issues the debt and constructs the system; the local unit operates the system. Typically, in this scenario, the local unit takes ownership of the system after the agreement ends.

3. The county issues the debt, constructs the system, and operates it on behalf of the local unit.

For the full-accrual statements, the accounting treatment would be as follows:

Scenario 1

Accounting by the County:

The first item that should be considered is whether this constitutes a lease as defined by GASB Statement No. 87. In this case, there is no underlying asset of the county that is being used by the local unit given that the local unit operates and controls the system; therefore, it should not be considered a lease as defined by GASB Statement No. 87 because the agreement does not convey control of the right to use another entity's nonfinancial asset (GASB 87, para 4). Rather, this transaction appears to be a financed purchase of the underlying asset. The county should reflect the long-term debt as well as a long-term receivable from the local unit upon the transfer of the debt proceeds.

Accounting by the Local Unit:

The local unit would establish an enterprise fund to account for the water or sewer system. The enterprise fund would initially record the long-term payable to the County along with the related debt proceeds.

The local unit's enterprise fund would record the operations of the system.

Scenario 2

Accounting by the County:

This guidance is assuming the local unit takes ownership of the system after the agreement ends. If the fact pattern is different, the guidance that follows may be different. The first item that should be considered is whether this constitutes a lease as defined by GASB Statement No. 87. In such a situation, this would meet the definition of a contract that transfers ownership in accordance with GASB Statement No. 87, paragraph 19, and, based on that guidance, should be reported as a financed purchase of the underlying asset by the lessee (local unit) or sale of the asset by the lessor (County). Accordingly, the County should reflect the long-term debt when issued as well as a long-term receivable from the local unit.

Accounting by the Local Unit:

The local unit would establish an enterprise fund to account for the water or sewer system. The enterprise fund would initially record the long-term payable to the County and cash held by the county. Cash held by the county would be reduced as the county constructs the asset, with the offset to CIP as the project progresses.

The local unit's enterprise fund would record the operations of the system.

Scenario 3

Accounting by the County:

The county should determine whether this arrangement meets the definition of a public-public partnership (PPP) under GASB Statement No. 94. Because the County is operating the system, this arrangement would not qualify as an availability payment arrangement. As each arrangement may have unique facts and circumstances, they should each be considered individually.

The following would indicate a PPP:

- The transaction must represent an exchange or exchange-like transaction for a period of time where the local unit contracts with the county to provide public services by conveying control of the right to operate the system

- The transaction may represent a PPP that is also a service concession arrangement (SCA) if all of the following criteria are met:
  - The local unit is receiving significant consideration in exchange for the county operating the system (such as up-front payments, installment payments, a new capital asset, or improvements to an existing capital asset)
  - The county collects and is compensated by fees from the users of the system
  - The local unit determines or has the ability to modify or approve which services the county is required to provide, to whom the county is required to provide the services, and the prices or rates that can be charged for the services
  - The local unit is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement

Assuming the transaction meets the definition of a PPP, the county would account for the PPP in accordance with paragraph 38 of Statement 94 if it is also an SCA or paragraph 39 of Statement if it is not also an SCA.

<u>Accounting by the Local Unit</u>:

Assuming the transaction meets the definition of a PPP, the local unit would account for the PPP in accordance with paragraph 15 of GASB Statement No. 94 if the arrangement is also a service concession arrangement or paragraph 16 of GASB Statement No. 94 if the arrangement is not a service concession arrangement.

Drains and Drainage Districts

Various chapters of the Drain Code are used to authorize issuance of debt to construct or maintain storm drains, including Chapters 4, 8, 20 and 21. The county drain commissioner either directly or through a drainage district, which is a separate legal entity is responsible for constructing and maintaining the drains, and for allocating those costs. In general, the costs are apportioned between the following four parties: the State, the county (to the extent that the improvement benefits roads), the local unit (to the extent that the improvement benefits the general health and welfare) and specific benefited property owners.

In general, any written agreements by the county or local unit to pay some or all of the drain debt is not viewed as leases to the county or local units under GASB Statement 87, because the agreements do not convey control of the right to use the drains and do not provide the right to determine the nature or manner of use of the drains (paragraphs 4 and 5 of Statement 87).

The accounting guidance below is intended to be applied to arrangements described above where there is an apportionment of a long-term debt assessment for the construction of a new drain. It is not intended to be applied to annual maintenance assessments that are apportioned. Typically, these arrangements are financed via a special assessment levied by the drainage district to the benefiting units.

<u>Accounting by the Drainage Districts</u>: Drainage districts are separate legal entities that are reported as discretely presented component units of the county. If the arrangement is financed via a special assessment, GASB Codification S40, paragraphs .121-.123 indicate that special assessment revenue and receivables should be recognized on the accrual basis of accounting, as well as the capital asset (cost of improvements) and debt. They should also record any contributions from third parties (the state, county, local unit and special assessment property owners) as an asset (cash

or receivable) and a "program" revenue (capital grants and contributions). There is no applicable GASB guidance to indicate whether the drainage district should record this revenue as received or if the district should record the revenue over time based on the ability to use the capacity of the drain. The MCGAA feels that recording the revenue over time is most appropriate under GAAP, but an argument exists that it could be treated as a capital contribution.

Accounting by the County and Local Units: In this scenario, both the county and local units are users being assessed. To the extent that the county or local unit has been assessed, it should record a liability (or reduce cash, if appropriate). The costs should be allocated over the useful life of the improvement, by recognizing a noncurrent intangible asset ("flowage rights"), and amortizing the asset over its useful life.

If you need further assistance please call (517) 335-7469 or write our office: Michigan Department of Treasury, LAFD, P.O. Box 30728, Lansing, Michigan 48909-8228 or email our office at TreasLocalGov@michigan.gov.

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[i] June 2002 – Original letter

(Revised Date June 24, 2025) – This statement was updated to numbered letter. Updated formatting changes, updated accounting standards references, revised common scenarios, and updated terminology and structure improvements.