Federal Accounting Standards Advisory Board

April 13, 2012

Memorandum

To: Members of the Board

From: Domenic N. Savini, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: **Status Report: Public-Private Partnerships – Tab H-4**[1]

MEETING OBJECTIVES

To provide an update on activities undertaken by staff on the Public-Private Partnerships project. This material is being provided for informational purposes only and will not be discussed at the April meeting unless specifically requested by one or more board members.

BRIEFING MATERIAL

The transmittal memorandum includes the following briefing material:

1. **Attachment 1 - Various Definitions for Public-Private Partnerships**
2. **Attachment 2 - Types of Public-Private Partnership Arrangements**
3. **Attachment 3 - Sample Public-Private Partnership Arrangement**

If you require additional information please contact me as soon as possible. If you have any questions or comments, please contact me by telephone at 202.512.6841 or by e-mail at savinid@fasab.gov

[1] The staff prepares board meeting materials to facilitate discussion of issues at the board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

BACKGROUND

This project was added to the agenda because federal agencies have increasingly turned to public-private partnerships (e.g., PPPs, P3s) to accomplish goals. Budget pressures are likely to further increase the use of P3s. Making the full costs of such partnerships transparent would be the overall objective of the project. As stated in our report to stakeholders[2], a detailed project plan along with active work on this project would not begin until FY2013 with final standards following a two to three year effort.

Specific objectives could include:

1. Defining terms (e.g., service concession arrangements, P3s)
2. Providing guidance for the recognition and measurement of:
   - assets and liabilities
   - revenues and expenses
3. Considering implications for other arrangements related to P3s (sale-leaseback or other long-term arrangements).

The Board expects to benefit greatly from the work of Governmental Accounting Standards Board (GASB) and the International Public Sector Accounting Standards Board (IPSASB).

The use of P3's in this country dates back to the colonial period. In 1742 Benjamin Franklin helped sponsor the first medical school in America that was supported by the Pennsylvania House of Representatives. Although the founders at the Constitutional Convention in 1787 believed (educational and scientific) activities should be independent of direct national governmental control, they felt that the national government should remain an influential force exerting its influence through indirect rather than direct means. Thomas Jefferson is credited with ushering in a more direct role for the government in the area of science by sponsoring the Lewis and Clark research expedition in 1803. The 1800's saw rapid P3 growth in response to medical emergencies (1822 cholera epidemic), establishment of universities and institutions (1824 Rensselaer Polytechnic Institute and 1829 Smithsonian Institution), and direct funding of applied science (1838 Samuel Morse telegraph). During the 20th century both world wars brought about increased pressure to advance scientific and technical advancements. For example, President Woodrow Wilson was advised by the *National Academy of Sciences* to create a *National Research Council* to coordinate efforts between government, industry and the academic communities to reach common national goals. In 1940 President Franklin D. Roosevelt established the *National Defense Research Committee* whose purpose was to organize scientific and technological resources toward enhancing national defense. After World War II there was an imbedded belief that scientific and technological advancements are fundamental for economic growth, and that the government has an important supporting role—both direct and indirect—to ensure such growth. As recent as President William J. Clinton who led efforts to transfer publicly funded technology to the private sector and President George W. Bush who advocated making tax policy (use of credits) P3 friendly, the use of these arrangements can be clearly seen throughout most of government.[3]

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[2] Federal Accounting Standards Advisory Board, *Report to Stakeholders: FASAB Three-Year Plan* dated January 11, 2012, page 22.

[3] Albert N. Link, "The History of Public-Private Partnerships from: *Public/Private Partnerships, Innovation Strategies and Policy Alternatives*", ISBN 978-0-387-29774-3 (2006), Chapter 2,

STAFF ANALYSIS AND RECOMMENDATIONS

Staff has conducted the following initial research:

1. Reviewing relevant GASB and IPSASB accounting standards,
2. Conducting a preliminary literature review,
3. Assessing domestic and European perspectives,
4. Reviewing selected agency financial reports,
5. Consulting with Financial Accounting Standards Board research staff, Federal program managers, and a public policy expert, and
6. Analyzing P3 arrangements in light of existing FASAB guidance (gap analysis).

At this time, staff believes many issues may be addressed through the standards under consideration in the reporting entity and leases projects. At a minimum, staff believes standards for P3s should be consistent with standards developed in these areas. Therefore, staff recommends deferring this effort until more progress has been made on these standards. Doing so would provide for consistency while allowing for consideration of implementation guidance in lieu of a standard. Staff recommends the following project objectives should the Board decide to proceed:

1. **Issuance of a Technical Bulletin.**

   Because fairly robust FASAB guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses, staff advises the Board to consider issuing a Technical Bulletin. Such bulletins provide guidance for applying FASAB Statements and Interpretations and resolving accounting issues not directly addressed by either the Statements or Interpretations. The following kinds of guidance may be provided in the Technical Bulletin:

   a. Guidance to clarify, explain, or elaborate on an underlying Statement or Interpretation, and

   b. Guidance to address areas not directly covered by existing Statements or Interpretations.

   Technical Bulletin procedures provide for both due process (more limited in scope and within a tighter minimum time frame than provided for Statements and Interpretations) and review by FASAB members.

   Generally, a Technical Bulletin can provide guidance if the problem can be resolved within the following guidelines:

   a. The guidance is not expected to cause a major change in accounting practice.

   b. The administrative cost involved in implementing the guidance is not expected to be significant to most affected entities.

   c. The guidance does not conflict with a broad fundamental principle or create a novel accounting practice.

2. **<u>In lieu of defining terms, characteristics of P3 arrangements should be identified.</u>**

   As recently experienced in the development of SFFAS 40[4], defining terms which are intended for uniform and general application across the federal government is an extremely laborious and time consuming process. However, identifying the more common characteristics of P3's which are generally accepted throughout government would significantly reduce staff time and agency burden and provide a sound basis for any subsequent accounting standard. Some of the more commonly agreed to P3 characteristics include: contractual agreements, shared risks, shared rewards, shared skills and expertise, and shared financing.

3. **<u>P3 structural arrangements and implications should be evaluated against federal entity requirements.</u>**

   Fairly robust FASAB guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses. However, attention should be given to the accounting implications raised by the formal or informal formation of P3 arrangements (i.e., legal or economic) that could include: special purpose vehicles (SPV) or special purpose entities (SPE) such as trusts, partnerships, and joint ventures to include variable interest entities (VIE)[5].

   For example, P3 arrangements should be evaluated against core, non-core, and related party definitions and criteria so that appropriate reporting objectives can be satisfied. Specifically, an analysis of ownership and control criteria should be conducted to evaluate if P3's that are material to an entity would be treated as "off balance sheet" or sufficiently included within the federal reporting entity or model.

   P3 arrangements not meeting either the ownership or control criteria could be reported as a related party.

4. **<u>P3 contractual arrangements and implications should be evaluated against federal capital lease requirements.</u>**

   P3 arrangements that do not involve the formation of a separate legal or economic entity should be evaluated against federal capital lease requirements. Please note that we currently have a Leases project underway. Current FASAB standards addressing leasing transactions include Statement of Federal Financial Accounting Standard (SFFAS) 5, *Accounting for Liabilities of the Federal Government* [pars. 43 – 46] and SFFAS 6, *Accounting for Property, Plant, and Equipment* [pars. 20 & 29]. These lease standards were originally developed from FASB lease standards effective at that time. The joint FASB/IASB project is expected to issue a revised Exposure Draft during the second half of 2012.

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[4] SFFAS 40; *Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment.*
[5] VIE control (controlling interest) is not based on majority ownership.

5. **Federal accounting guidance should not be limited to service concession arrangements.**

   Both GASB and IPSASB limit public-private partnership guidance to service concession arrangements directly benefitting the general public. As a result, P3 arrangements that provide services to the government entity or grantor are excluded. GASB refers to these as “service and management arrangements” or SMA’s.

   As previously mentioned, because sufficient guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses, it can be effectively used for the accounting of service concession arrangements.

   Additionally, P3 arrangements whether benefitting the general public directly or providing services to the government entity or grantor fall within the remit of the federal financial reporting objectives.[6] Specifically, budgetary integrity and operating performance are directly impacted as are, stewardship and systems and control. Refer to Figure 1.0 on the next page for an analysis.

6. **Other Matters**

   Intellectual Property – Staff has identified this area for potential research. SFFAS 1, *Accounting for Selected Assets and Liabilities and* SFFAS 6 *Accounting for Property, Plant and Equipment* do not discuss intangible assets. Staff has come across P3 arrangements where patents are jointly created and owned. Additional research would be required to assess the accounting implications for the accounting for intangibles.

   Privatization – The basic question is at what point could a P3 arrangement result in a de facto privatization? Also, P3 arrangements could be an entity’s initial step into a privatization program. In both cases the appropriate accounting treatment and classification for assets/liabilities and revenues/expenses would need to be considered. For example, should assets being held for privatization be separately classified on the balance sheet? Another accounting issue could be the treatment of employee legacy costs and/or service contract termination costs.

[6] Statement of Federal Financial Accounting Concepts 1: *Objectives of Federal Financial Reporting.*

Figure 1.0

Public-Private Arrangements and their Relationship To Federal Reporting Objectives

<table>
<tr><th colspan="2">By subjecting <u>all</u> P3 activities to FASAB reporting requirements we meet the following reporting objectives:</th></tr>
<tr><td colspan="2"></td></tr>
<tr><td>Budgetary Integrity
1. How budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization.</td><td>Example:
1. Identifying the full costs of P3s to enable comparison of these costs with budgetary resources.</td></tr>
<tr><td>Operating Performance
1. The costs of providing specific programs and activities and the composition of, and changes in, these costs.</td><td>Example:
1. In some cases costs and related liabilities are understated. For example, some P3 arrangements may not involve any lease payments and to the contrary, involve a revenue stream flowing to the government in exchange for offering low cost leases of government property, committing to future purchases, or transferring assets to the P3.</td></tr>
<tr><td>Stewardship
1. The government’s financial position improved or deteriorated over the period.
2. Future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.
3. Government operations have contributed to the nation’s current and future well-being.</td><td>Discussion:
1. Not reflecting all asset/liabilities on the balance sheet makes this more difficult and could skew results.
2. Revealing the full costs may facilitate consideration of future budgetary resource needs.
3. Assessing the full cost of P3s is important in considering the benefits.</td></tr>
<tr><td>Systems and Control
1. Transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards.
2. Assets are properly safeguarded to deter fraud, waste, and abuse.</td><td>Discussion:
1. Excluding organizations from coverage may make it difficult to assess compliance. Not reflecting all asset/liabilities on the balance sheet makes this difficult if not impossible to accomplish and could mislead readers or users of the financial statements.
2. Not reflecting all asset/liabilities on the balance sheet makes this difficult if not impossible to accomplish and could mislead readers or users of the financial statements.</td></tr>
</table>

Attachment 1 - Various Definitions for Public-Private Partnerships

Organization	Definition or Description
1. The National Council for Public-Private Partnerships http://www.ncppp.org/howpart/index.shtml#define	A Public-Private Partnership (PPP) is a contractual agreement between a public agency (federal, state or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility.
2. General Accountability Office Glossary GAO/GGD-99-71, April 1999	Under a public-private partnership, sometimes referred to as a public- private venture, a contractual arrangement is formed between public and private-sector partners. These arrangements typically involve a government agency contracting with a private partner to renovate, construct, operate, maintain, and/or manage a facility or system, in whole or in part, that provides a public service. Under these arrangements, the agency may retain ownership of the public facility or system, but the private party generally invests its own capital to design and develop the properties. Typically, each partner shares in income resulting from the partnership. Such a venture, although a contractual arrangement, differs from typical service contracting in that the private-sector partner usually makes a substantial cash, at-risk, equity investment in the project, and the public sector gains access to new revenue or service delivery capacity without having to pay the private-sector partner.
3. U.S. Department of Transportation Report to Congress on Public-Private Partnerships www.fhwa.dot.gov/reports/pppdec2004/pppdec2004.pdfSimilar December 2004	A contractual agreement formed between public and private sector partners, which allows more private sector participation than is traditional. The agreements usually involve a government agency contracting with a private company to renovate, construct, operate, maintain, and/or manage a facility or system. While the public sector usually retains ownership in the facility or system, the private party will be given additional decision rights in determining how the project or task will be completed. The term public-private partnership defines an expansive set of relationships from relatively simple contracts (e.g., A+B contracting), to development agreements that can be very complicated and technical (e.g., design-build-finance-operate-maintain). In the context of this report, the term public-private-partnership is used for any scenario under which the private sector would be more of a partner than they are under the traditional method of procurement. Further, the broad definition used for public-private partnerships includes many elements that are applied fairly regularly on appropriate projects.
4. General Service Administration January 2012	An agreement between a public and private sector entity in which a private entity would provide the investment and expertise to develop or renovate property for government use. The private entity assumes development risk; in almost all cases, the public sector ends up owning developed real estate, significantly reducing leasing costs over the long term.

Attachment 1 - Various Definitions for Public-Private Partnerships

Organization	Definition or Description
5. Congressional Budget Office, H.R. 2573 Cost Estimate, Public Private Partnership Act of 2003 http://www.cbo.gov/doc.cfm?index=4632&type=0 October 15,2003	Most of the projects undertaken by these agencies have involved forms of project financing. Project financing is backed by the cash flows or asset value of a particular economic unit or asset rather than the financial resources of the owner, operator, or sponsor. Project financing typically involves a series of contracts and agreements that serve two functions: creating an entity that will act on behalf of the sponsors to implement the project (including obtaining financing) and protecting lenders from the credit risk associated with the project's development or operations. Many of the government projects financed by the private sector have made a federal agency the sole or primary beneficiary of a special-purpose entity (SPE) that is created to implement the project. Agencies usually have retained significant control over the decisions made by the SPE, including the project development and management agreements. The SPEs associated with previous federal projects have taken different legal forms, including trusts and limited-liability companies, some of which involve direct government ownership. Most projects have been rated as investment grade by credit rating firms, largely because of their strong federal support. The types of commitments backing the cash flow of federal projects have varied, ranging from explicit obligations (e.g., lease or purchase agreements) to indirect measures that mitigate the credit risk (e.g., covenants or economic incentives for an agency to voluntarily extend its use of an asset). CBO has concluded that many of the projects characterized as public-private ventures involve significant government control and use, and therefore, should be treated in the budget as governmental entities.
6. Standard & Poor's PPP Credit Survey 2005	Any medium-to-long term relationship between the public and private sectors, involving the sharing of risks and rewards of multi-sector skills, expertise and finance to deliver desired policy outcomes.
7.* PriceWaterHouseCoopers, Delivering the PPP promise: *A review of PPP issues and activity. November 2005	The term "public-private partnership" ("PPP") has been in general use since the 1990s. However, there is no widely agreed, single definition or model of a PPP. Different types of PPPs tend to share some common characteristics. These include contracting between the public and private sectors for the delivery of services, often involving infrastructure development and management, where risks are shared between the parties. Risks are allocated to the party which is best able to manage them, i.e. reduce their impact and/or absorb their consequences. Appropriate risk allocation should therefore minimize the cost of risks. The need to utilize private sector management and experience, and not only the capability of raising finance, is also key.

ATTACHMENT 2 – Types of Public-Private Partnership Arrangements

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
1. Build-Own-Operate (BOO)	Under a BOO transaction, the contractor constructs and operates a facility without transferring ownership to the public agency. Legal title to the facility remains in the private sector, and there is no obligation for the public agency to purchase the facility or take title. A BOO transaction may qualify for tax-exempt status as a service contract if all Internal Revenue Code requirements are satisfied.	If the public agency decides to: **Lease** – Capital lease requirements are covered in SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Purchase** – Asset recognition is covered in SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26[iii].
2. Build/Operate/Transfer (BOT) or 3. Build/Transfer/Operate (BTO)	Under the BOT option, the private partner builds a facility to the specifications agreed to by the public agency, operates the facility for a specified time period under a contract or franchise agreement with the agency, and then transfers the facility to the public agency at the end of the specified period of time. In most cases, the private partner will also provide some, or all, of the financing for the facility, so the length of the contract or franchise must be	**Asset transfer** – can be accomplished either via a lease or a purchase. Capital lease requirements are covered in SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. Asset recognition is covered in SFFAS 6, *Accounting for Property, Plant, and*

[7] Source: Government Accountability Office (GAO) Glossary, GAO/GGD-99-71, *Public-Private Partnerships, Terms Related to Building and Facility Partnerships,* dated April 1999 and Congressional Budget Office (CBO) Report , *The Budgetary Treatment of Leases and Public/Private Ventures*, dated February 2003.

[8] Any of the 19 listed Public-Private Partnership types could be part of an arrangement that establishes a Special Purpose Entity (SPE), Special Purpose Vehicle (SPV, Trust or some type of Variable Interest Entity (VIE); where the public agency holds a controlling interest that is not based on the majority of voting rights. Such arrangements would come under the Federal Entity principles which as of the date of this analysis include the following inclusion principles: (a) in the budget, (b) majority ownership interest, (c) control with expected benefits of risk or loss, (d) misleading to exclude. Also, non-core disclosure objectives include relationship, relevant activity and future exposures.

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
	sufficient to enable the private partner to realize a reasonable return on its investment through user charges. At the end of the franchise period, the public agency can assume operating responsibility for the facility, contract the operations to the original franchise holder, or award a new contract or franchise to a new private partner. The BTO model is similar to the BOT model except that the transfer to the public owner takes place at the time that construction is completed, rather than at the end of the franchise period.	*Equipment,* paragraph 26[iii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].
4. Buy-Build Operate (BBO)	A BBO transaction is a form of asset sale that includes a rehabilitation or expansion of an existing facility. The public agency sells the asset to the private sector entity, which then makes the improvements necessary to operate the facility in a profitable manner.	**At Sale** - SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 38[v] and SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraph 36e – 47[vi]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].
5. Operations and Maintenance	A public agency (federal, state, or local government agency or authority) contracts with a private partner to operate and/or maintain a specific service. Under the	**At Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraph 19[vii].

ATTACHMENT 2 – Types of Public-Private Partnership Arrangements

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
	private operation and maintenance option, the public agency retains ownership and overall management of the public facility or system.	
6. Operations, Maintenance, and Management	A public agency (federal, state, or local government agency or authority) contracts with a private partner to operate, maintain, and manage a facility or system providing a service. Under this contract option, the public agency retains ownership of the public facility or system, but the private party may invest its own capital in the facility or system. Any private investment is carefully calculated in relation to its contributions to operational efficiencies and savings over the term of the contract. Generally, the longer the contract term, the greater the opportunity for increased private investment because there is more time available in which to recoup any investment and earn a reasonable return. Many local public governments use this contractual partnership to provide wastewater treatment services.	**At Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraph 19[vii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].
7. Design-Build-Operate (DBO)	In a DBO project, a single contract is awarded for the design, construction, and operation of a capital improvement. Title to the facility remains with the public agency unless the project is a	**At Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraph 19[vii]. **At Build** – SFFAS 6, *Accounting for*

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
	design/build/operate/transfer or design/build/own/operate project. The DBO method of contracting is contrary to the separated and sequential approach which involves one contract for design with an architect or engineer, followed by a different contract with a builder for project construction, then followed by the owner's taking over the project and operating it. A simple design-build approach creates a single point of responsibility for design and construction and can speed project completion by facilitating the overlap of the design and construction phases of the project. On a public project, the operations phase is normally handled by the public agency or awarded to the private sector under a separate operations and maintenance agreement. Combining all three phases into a DBO approach maintains the continuity of private sector involvement and can facilitate private-sector financing of public projects supported by user fees generated during the operations phase.	*Property, Plant, and Equipment,* paragraph 34[viii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv]. **Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47[ix].
8. Developer Financing	Under developer financing, the private party (usually a real estate developer)	**Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,*

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
	finances the construction or expansion of a public facility in exchange for the right to build residential housing, commercial stores, and/or industrial facilities at the site. The private developer contributes capital and may operate the facility under the oversight of the public agency. The developer gains the right to use the facility and may receive future income from user fees. While developers may in rare cases build a facility, more typically they are charged a fee or required to purchase capacity in an existing facility. This payment is used to expand or upgrade the facility. Developer financing arrangements are often called capacity credits, impact fees, or exactions. Developer financing may be voluntary or involuntary depending on the specific local circumstances.	paragraph 23[iv]. **Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47[ix].
9. Enhanced Use Leasing (EUL)	An EUL is an asset management program in the Department of Veterans Affairs (VA) that can include a variety of different leasing arrangements (e.g., lease/develop/operate, build/develop/operate). EULs enable the VA to long-term lease VA-controlled property to the private sector or other public entities for non-VA uses in return for receiving fair consideration (monetary or in-kind) that enhances VA's mission or	**Lease** – SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47[ix].

ATTACHMENT 2 – Types of Public-Private Partnership Arrangements

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
	programs. (See 38 U.S.C. § 8161, et seq.)	
10. Lease/Develop/Operate (LDO) or 11. Build/Develop/Operate (BDO)	Under these partnership arrangements, the private party leases or buys an existing facility from a public agency; invests its own capital to renovate, modernize, and/or expand the facility; and then operates it under a contract with the public agency. A number of different types of municipal transit facilities have been leased and developed under LDO and BDO arrangements.	**Lease** – SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Sale** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraph 36e – 47[vi]. **Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47[ix]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].
12. Lease/Purchase	A lease/purchase is an installment-purchase contract. Under this model, the private sector finances and builds a new facility, which it then leases to a public agency. The public agency makes scheduled lease payments to the private party. The public agency accrues equity in the facility with each payment. At the end of the lease term, the public agency owns the facility or purchases it at the cost of any remaining unpaid balance in the	**Lease** – SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].

TYPE[7]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[8]
	lease. Under this arrangement, the facility may be operated by either the public agency or the private developer during the term of the lease. Lease/purchase arrangements have been used by the General Services Administration for building federal office buildings and by a number of states to build prisons and other correctional facilities.	
13. Sale/Leaseback	A sale/leaseback is an arrangement in which the owner of a facility sells it to another entity, and subsequently leases it back from the new owner. An innovative application of the sale/leaseback technique is the sale of a public facility to a public or private holding company for the purposes of limiting public agency liability under certain statutes. Under this arrangement, the public agency that sold the facility leases it back and continues to operate it.	**Sale** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraph 36e – 47[vi]. **Purchase** – SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 26[iii]. **Lease** – SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[iii].
14. Tax-Exempt Lease	Under a tax-exempt lease arrangement, a public agency finances capital assets or facilities by borrowing funds from a private investor or financial institution. The private partner generally acquires title to the asset, but then transfers it to the public agency either at the beginning or end of	**Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv]. **Asset transfer** – can be accomplished either via a lease or a purchase. Capital lease requirements are covered in

TYPE[7]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[8]
	the lease term. The portion of the lease payment used to pay interest on the capital investment is tax exempt under state and federal laws. Tax-exempt leases have been used to finance a wide variety of capital assets, ranging from computers to telecommunication systems and municipal vehicle fleets.	SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. Asset recognition is covered in SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26[iii].
15. Turnkey	Under a turnkey arrangement, a public agency contracts with a private investor/vendor to design and build a complete facility in accordance with specified performance standards and criteria agreed to between the agency and the vendor. The private developer commits to build the facility for a fixed price and absorbs the construction risk of meeting that price commitment. Generally, in a turnkey transaction, the private partners use fast-track construction techniques (such as design-build) and are not bound by traditional public agency procurement regulations. This combination often enables the private partner to complete the facility in significantly less time and for less cost than could be accomplished under traditional construction techniques. In a turnkey transaction, financing and ownership of the facility can rest with	**Purchase** – SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 26 [iii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23 [iv]. **Risk assumption** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i].

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
	either the public or private partner. For example, the public agency might provide the financing, with the attendant costs and risks. Alternatively, the private party might provide the financing capital, generally in exchange for a long-term contract to operate the facility.	
16. Concession Benefits	Concession benefits are rights to receive revenues or other benefits for a fixed period of time. (Also see franchising.)	**Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47[ix].
17. Cooperative Agreements	A cooperative agreement as set forth in 31 USC 6305 is the legal instrument an executive agency uses to reflect a relationship between the U.S. public agency and a state, a local public agency, or other recipient when (1) the principal purpose of the relationship is to transfer a thing of value to the state, local public agency, or other recipient to carry out a public purpose of support or stimulation authorized by U.S. law, and (2) substantial involvement is expected between the executive agency and the state, local public agency, or other recipient in carrying out the activity contemplated in the agreement.	**Asset transfer** – can be accomplished either via a lease or a purchase. Capital lease requirements are covered in SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. Asset recognition is covered in SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26[iii]. **Risk Assumption** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraph 19[vii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,*

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
		paragraph 23[iv].
18. Franchising	Under the franchising of external services, the public agency grants a concession or privilege to a private-sector entity to conduct business in a particular market or geographical area—for example, operating concession stands, hotels, and other services provided in certain national parks. The public agency may regulate the service level or price, but users of the service pay the provider directly.	**Lease** – SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47[ix].
19. Lease – Leaseback	In an arrangement called lease-leaseback, the public agency leases an asset long-term (i.e. for 50 years) to a private-sector entity or a special-purpose entity created for that purpose and then leases the asset back for a shorter period (i.e.,20 years or about half of the asset's useful life). The private-sector entity or special-purpose entity pays for their long-term lease with a one-time, upfront payment, while the public agency spreads its leaseback payments over the (shorter) lease period. Such transactions generate up-front cash for the public agency allowing it to avoid seeking either budgetary appropriations or	**Lease** – SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].

TYPE[7]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[8]
	issuing additional bonds to finance its investments. In effect, the private-sector entity or special-purpose entity borrows on behalf of public agency. The private sector partner obtains financing through the sale of pass-through certificates which the public agency may or may not explicitly guarantee. However, these certificates are usually fully backed by the public agency's contractual commitment to make lease payments. The public agency entity benefits from some of the tax advantages that the private sector partner enjoys in the form of lower lease payments.	

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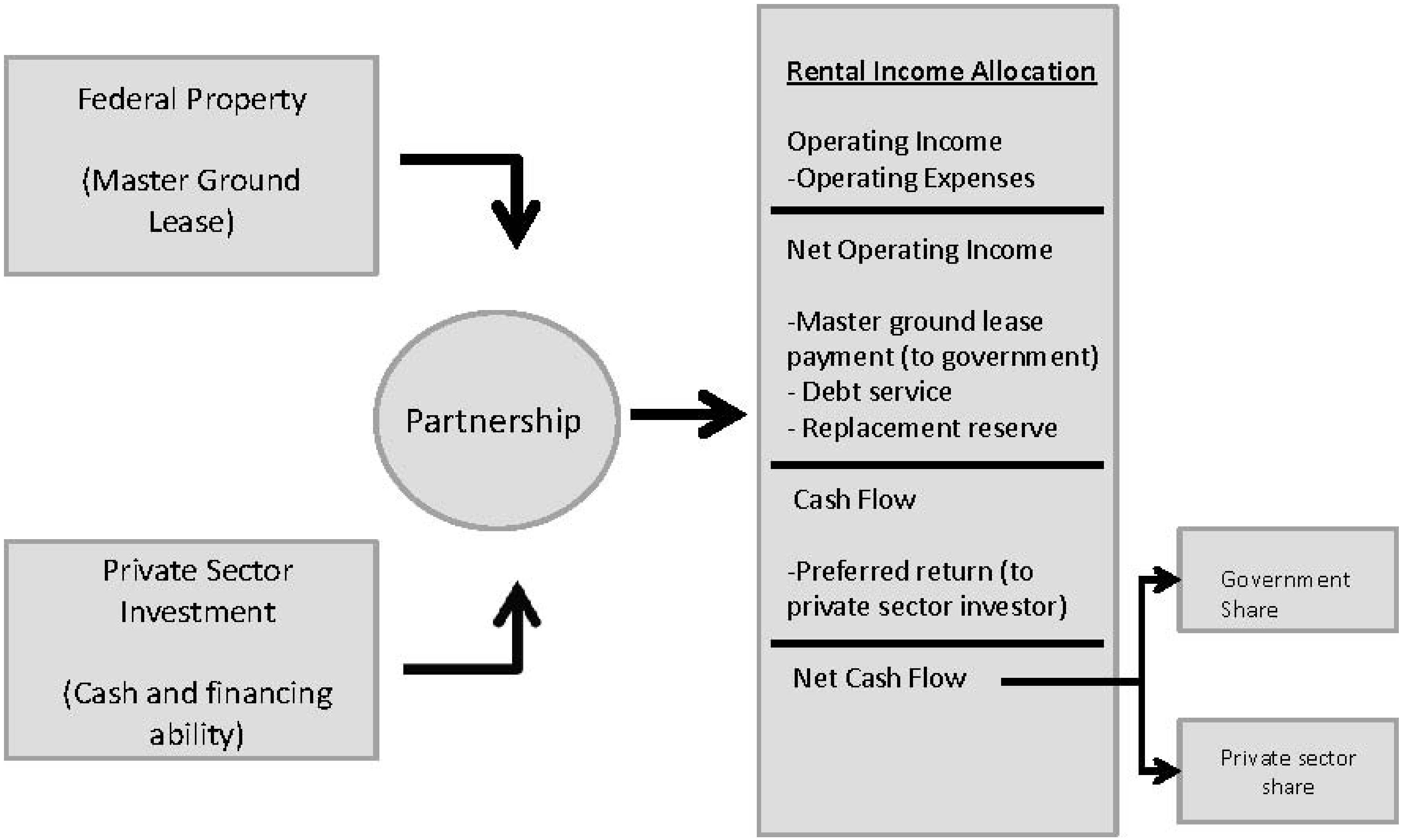
ATTACHMENT 3 –Sample Public-Private Partnership Arrangement



ATTACHMENT 2 - END NOTES

[i] 43. Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.

44. The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor.20
However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.

45. The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.

46. During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability.

[ii] 20. Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life9 of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executor cost, equals or exceeds 90 percent of the fair value of the leased property. The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

[iii] 26. All general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- transportation charges to the point of initial use; • handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid.

[iv] Post-1991 Loan Guarantees. 23. For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

[v] 38. In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized30 shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service.

[vi] 36. Revenue from specific types of exchange transactions should be recognized as follows: (e) When an asset other than inventory is sold, any gain (or loss) should be recognized when the asset is delivered to the purchaser.

37. When advance fees or payments are received, such as for large-scale, long-term projects, revenue should not be recognized until costs are incurred from providing the goods and services (regardless of whether the fee or payment is refundable). An increase in cash and an increase in liabilities, such as “unearned revenue,” should be recorded when the cash is received. “Unearned revenue” should also be recorded if an agency requests advances or progress payments prior to the receipt of cash and records the amount.

38. The measurement basis for revenue from exchange transactions should be the actual price that is received or receivable under the established pricing arrangements.

39. When cash has not yet been received at the time revenue is recognized, a receivable should be recorded. An appropriate allowance for estimated bad debts should be established.

40. To the extent that realization of the full amount of revenue is not probable due to credit losses (caused by the failure of the debtor to pay the established or negotiated price), an expense should be recognized and the allowance for bad debts increased if the bad debts can be reasonably estimated. The amount of the bad debt expense should be separately shown.

41. To the extent that realization of the full amount of revenue is not probable due to returns, allowances, price redeterminations, or other reasons apart from credit losses, the revenue that is recognized should be reduced by separate provisions if the amounts can be reasonably estimated. The amounts of such provisions should be reflected as revenue adjustments, rather than costs of operations, and should be separately shown.

42. The recognition and measurement of revenue and credit losses due to direct loans and loan guarantees is determined by SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees. Appropriate allowances should be established as determined by those standards.

43. Exchange revenue should be recognized in determining the net cost of operations of the reporting entity during the period. The exchange revenue should be recognized regardless of whether the entity retains the revenue for its own use or transfers it to other entities. Gross and net cost should be calculated as appropriate to determine the costs of outputs and the total net cost of operations of the reporting entity. The components of the net cost calculation should separately include the gross cost of providing goods or services that earned exchange revenue, less the exchange revenue earned, and the resulting difference. The components of net cost should also include separately the gross cost of providing goods, services, benefit payments, or grants that did not earn exchange revenue. The U.S. government-wide financial statements need not break out gross costs of providing goods, services, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned exchange revenue.

44. The net amount of gains (or losses) should be subtracted from (or added to) gross cost to determine net cost in the same manner as exchange revenue is subtracted. Exchange revenue that is immaterial or cannot be associated with particular outputs should be deducted separately in calculating the net cost of the program, suborganization, or reporting entity as a whole as appropriate. Nonexchange revenues and other financing sources should not be deducted from the gross cost in determining the net cost of operations for the reporting entity.

45. Under exceptional circumstances, such as rents and royalties on the Outer Continental Shelf, an entity recognizes virtually no costs (either during the current period or during past periods) in connection with earning revenue that it collects.

45.1 The collecting entity should not offset its gross costs by such exchange revenue in determining its net cost of operations. If such exchange revenue is retained by the entity, it should be recognized as a financing source in determining the entity's operating results. If, instead, such revenue is collected on behalf of other entities (including the U.S. Government as a whole), the entity that collects the revenue should account for that revenue as a custodial activity, i.e., an amount collected for others.

45.2 If the collecting entity transfers the exchange revenue to other entities, similar recognition by other entities is appropriate.

a. If the other entities to which the revenue is transferred also recognize virtually no costs in connection with the Government earning the revenue, the amounts transferred to them should not offset their gross cost in determining their net cost of operations but rather should be recognized as a financing source in determining their operating results.

b. If the other entities to which the revenue is transferred do recognize costs in connection with the Government earning the revenue, the amounts transferred to them should offset their gross cost in determining their net cost of operations.

45.3 Because the revenue is exchange revenue regardless of whether related costs are recognized, it should be recognized and measured under the exchange revenue standards.

DISCLOSURES AND OTHER ACCOMPANYING INFORMATION

46. Each reporting entity that provides goods or services to the public or another Government entity should disclose the following:
(a) differences in pricing policy from the full cost or market pricing guidance for exchange transactions with the public as set forth in OMB Circular No. A-25, User Charges (July 8, 1993), or in subsequent amendments in circulars that set forth pricing guidance; (b) exchange transactions with the public in which prices are set by what extent, the quantity demanded was assumed to change as a result of a change in price. law or executive order and are not based on full cost or on market price; (c) the nature of intragovernmental exchange transactions in which the entity provides goods or services at a price less than the full cost or does not charge a price at all, with explanations of the amount and reason for disparities between the billing (if any) and the full cost; and
(d) the full amount of the expected loss when specific goods are made to order under a contract, or specific services are produced to order under a contract, and a loss on the contract is probable (more likely than not) and measurable (reasonably estimable).
The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements.

47. When making the disclosures called for by (a) and (b) in paragraph 46, cautionary language should be added to the effect that higher prices based on full cost or market price might reduce the quantity of goods or services demanded and, therefore, the difference between revenue received and such higher prices does not necessarily provide an indication of revenue foregone. If a reasonable estimate is practicable to make, the entity should provide as other accompanying information the amount of revenue foregone and should explain whether, and to what extent, the quantity demanded was assumed to change as a result of a change in price.

[vii] Definition And General Principle For Recognition Of A Liability

19. A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.

[viii] 34. PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity. In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E.

[ix] RECOGNITION AND MEASUREMENT OF EXCHANGE REVENUE

34. Revenue from exchange transactions should be recognized when goods or services are provided to the public or another Government entity at a price.

35. When a transaction with the public or another Government entity at a price is unusual or nonrecurring, a gain or loss should be recognized rather than revenue or expense so as to differentiate such transactions.

36. Revenue from specific types of exchange transactions should be recognized as follows:

(a) When services are provided to the public or another Government entity (except for specific services produced to order under a contract), revenue should be recognized when the services are performed.

(b) When specific goods are made to order under a contract (either short- or long-term), or specific services are produced to order under a contract (either short- or long-term), revenue should be recognized in proportion to estimated total cost when goods and services are acquired to fulfill the contract. If a loss is probable (more likely than not), revenue should continue to be recognized in proportion to the estimated total cost and costs should continue to be recognized when goods and services are acquired to fulfill the contract. Thus, the loss should be recognized in proportion to total cost over the life of the contract.