FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
October 23-24, 2013
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, October 23, 2013

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Chairman Allen, Messrs. Dacey, Reger, Smith, and Steinberg. Messrs. Granof, McCall, and Showalter attended the meeting via telephone. Mr. Dong was present on October 24th and attended a portion of the meeting via telephone on October 23rd. During his absence, Ms. Kearney represented him. The executive director, Ms. Payne, and general counsel, Ms. Hamilton, were present throughout the meeting.

- **Approval of Minutes**

The minutes of the August meeting were approved at the meeting.

- **Clippings**

Mr. Allen asked for comments on the news clippings. Mr. Showalter noted that transparency and simplicity are continuing themes. Mr. Granof referred to an article stating that the Board has proposed hybrid accrual standards. He indicated, however, that the author was seemingly unaware that the Treasury has long produced a report that was based on full accrual standards and that such report already reflected the obligations for social insurance programs that the article implied currently went undisclosed. He viewed this as another example of the lack of awareness of the existing standards and what is really in the annual report. Others referred to the efforts to pass the Inform Act requiring fiscal sustainability information and generational accounting.

Several members indicated these are signs that greater outreach to Congress may be needed. Mr. Allen noted the articles that indicated generational accounting is important and is not in our reports. He said he strongly agreed with that assessment. Mr. Steinberg disagreed; noting that he views some of the social insurance information as generational information. Mr. Granof pointed to support among economists for generational accounting. Mr. Dacey pointed out that there was another article in the clippings that expressed an alternative view that generational accounting is flawed. He recalled that the Board did consider generational information in the past. Ms. Payne agreed and noted that generational accounting focuses on relative tax burdens. Staff received feedback that such approaches do not assess relative benefits such as those from investments or support for potentially dependent family members.

Agenda Topics

- **Tax Expenditures**

Mr. Allen welcomed Donald Marron, the Director of Economic Policy Initiatives, Institute Fellow, Urban Institute; Director Emeritus of the Tax Policy Center. He previously served as a member of the President’s Council of Economic Advisers, as acting director of the Congressional Budget Office (CBO), and as executive director of Congress’s Joint Economic Committee. Before his government service, he taught economics and finance at the University of Chicago Graduate School of Business and served as chief financial officer of a health care software start-up. Dr. Marron was also a visiting professor at the Georgetown Public Policy Institute. Also, during his tenure at CBO, he was a member of FASAB.

Dr. Marron explained that people often view taxation as the way the government raises money. This is true but misses the fact that the government makes policy through the tax code. There is a debate about whether such policy is the moral equivalent to spending; in his opinion it often is. He explained that incentives are created and resources are reallocated. Either spending or tax policy can be used for these purposes.

Dr. Marron gave examples of tax provisions that substitute for spending programs. Following the economic distress in 2008-2009, some existing tax provisions stopped working. For example, the absence of profits caused some tax incentives to cease to work well. These tax incentives were converted to spending programs temporarily to provide incentives. In health reform, a large component of the subsidies is structured as a tax credit. In stimulus proposals, some stimulus could be provided through Social Security but this would not reach all seniors. For those not reached through Social Security, a tax credit was proposed that was economically equivalent to spending.

As a policy analyst, Dr. Marron expressed concern that tax preferences may not get the same attention and transparency as spending. Many tax provisions are permanent and do not get the annual attention that spending receives. There are rarely head-to-head comparisons between spending programs and tax policy. (He noted that he refers globally to 'tax preferences' because most but not all are equivalent to spending (expenditure) and others not. Using 'tax expenditures' as the global reference prejudges the question of whether a provision is equivalent to spending.)

There is no universal agreement regarding what provisions are tax preferences. To reach such an agreement one would need to identify a benchmark tax system. Given an ideal or benchmark system, tax preferences (expenditures) are deviations from that system. Judgments are inevitable in reporting on tax expenditures.

There is annual reporting on tax expenditures though. The Joint Committee on Taxation (JCT) and the Treasury have chosen to consider a broad-based individual income tax and a separate corporate income tax as normal. They have also incorporated as normal a progressive structure. These choices have affected what provisions are identified as 'tax expenditures.'

For example, the tax brackets allowing lower income earners to pay a lower rate than higher income earners are not identified as a preference. However, there are analysts who argue that this progressive rate structure is a preference rather than a feature of the normal tax system. The vast majority of analysts accept the progressive structure as normal.

Double taxation of corporate earnings, once through corporate taxes and again through individual taxes on dividends or capital gains, is also assumed to be part of the "normal tax system." The U.S. system has features intended to ameliorate double taxation. Because our normal tax system is identified as separate systems for individual and corporate taxation double taxation is "normal." Thus, features such as lower rates on dividends and capital gains are identified as tax expenditures and some would argue they are not (that is, a normal tax system would not tax earnings twice).

Political views influence judgments regarding the normal tax system. Because classification as a tax expenditure implies that the feature is 'spending' or a 'loophole', individuals on the right of the political spectrum have objected to reporting the lower rates on dividends and capital gains as tax expenditures.

Dr. Marron also noted there is a long-standing debate about whether it is best to tax consumption or income. The benchmark in the U.S. is an income tax. Some features of our tax system are designed to move in the direction of a consumption tax. For example, accelerated depreciation is designed to encourage investment. Therefore, there is controversy around treatment of such provisions as tax expenditures.

Payroll and excise tax expenditures are not tracked by JCT and are footnoted by Treasury. The largest income tax preference is exclusion of health care benefits provided by employers and this is exempt from payroll tax. Thus, there is a debate about whether these preferences should be included in reports.

Dr. Marron asked if members had any questions before he continued.

Mr. Allen asked whether tax expenditures could be measured in some consistent way from year to year and subject to audit. He noted that the Board rated this as an important project. He imagined there are a variety of ways to treat tax expenditures – disclosures, recognized amounts in the financial statements, or narrative in management's discussion and analysis. He asked about Dr. Marron's views on including the estimates.

Dr. Marron noted that the numbers currently focused on are the "net" amounts. That is, the amount the government has asserted a right to collect – perhaps 39% of total income – less the allowed deductions such as mortgage interest and charitable contributions. From a policy point of view, it is interesting to measure the size of government based on the gross actions rather than the net. He referred to the paper regarding the size of government provided in the briefing material (Marron and Toder).

Mr. Allen asked if the estimates could swing widely from year-to-year such that you would not have consistent agreement on the estimates.

Dr. Marron indicated that one decision point is whether it is a number or many numbers. There are about two hundred preferences. JCT and Treasury do not add the preferences together because of the effect of interactions and behavioral impacts. Many policy analysts do estimate them individually and then as a total. If you do all the itemized deductions together, the result is about 7% larger than if you run them individually. This difference is small and does not impact the usefulness of the discussion.

He noted a bigger issue is that the estimates may appear to represent what money you can raise by eliminating preferences. This would not be the case because of the interactions and behavioral impact if policy is changed. Behavioral responses may include decreasing charitable giving or paying down mortgage balances.

Mr. Showalter asked about the reason JCT and Treasury do not add them up. If the report is of the actual results of a prior year, is it more appropriate to total the preferences? Dr. Marron said that is a fair way to approach it but there may still be some interactions that affect estimates. He also noted that there are some differences between JCT and Treasury. One example is the value of the imputed rent you receive in income from owning a home. In concept, this is the equivalent of earnings on any durable asset you own. One set of estimates includes it and one does not. The question is whether this is a subsidy to housing and to be reported or not.

Mr. Dacey discussed a recent GAO report on tax expenditures. The report found that about half of the dollar value of reported tax expenditures comes from information that is not separately reported on line items on actual returns and he believes that they are derived statistically. There may be a challenge in auditing tax expenditures that are based on information that is not separately reported on tax forms.

Dr. Marron provided a few examples of preferences that must be estimated because they do not appear on returns. Mr. Dacey noted that some information comes from Statistics of Income reports prepared by the IRS and believes that such information is about two to three years in arrears. He thought this would pose some challenges to reporting.

Mr. Showalter asked if this would be a problem. He inquired whether we could audit at the total level rather than the individual preferences by considering total income and what the tax would be on that total. Mr. Dacey was uncertain if such an approach would be meaningful.

Dr. Marron acknowledged there is a lot of estimating that must go into this because it is not observable. He noted an additional issue this year. There was a tax law change late in calendar year 2012. Treasury was unable to estimate those changes in time for the estimates released in early 2013.

Mr. Allen asked about the value of health insurance provided by employers. He wondered how the value is reported or estimated. He thought the W-2 does not report that value. Dr. Marron noted a change brought by the Affordable Care Act is that the value of health insurance will be on the W-2. In addition, economists are estimating the value.

Continuing with his presentation, Dr. Marron noted there are six types of tax expenditures:

1. Deductions such as charitable contributions and accelerated depreciation (a timing shift)

2. Exemption of reported income such as tax-exempt interest and credit union income

3. Exclusion such as employer health insurance and imputed rental value of home

4. Credit such as child and research & experimentation

5. Deferral such as 401(k) and MNC foreign income

6. Preferential rates such as capital gains and dividends

Mr. Allen asked about separating those expenditures that are timing differences such as accelerated depreciation. Dr. Marron noted that the appropriate tax expenditure measure is the value of the timing benefit. This becomes more complicated to measure. For firms, accelerated depreciation is of greater value in periods of higher interest rates. There are many choices made in estimating these timing differences.

Dr. Marron noted that if you measure on a flow basis companies that made investments this year have a benefit and companies that did not make investments are not getting a benefit. The net effect of these behaviors is the expenditure for the government. The amount of timing that is shifted is much larger in 401Ks. Mr. Allen also noted that the tax rates may change before 401Ks reverse.

Mr. Showalter asked if Mr. Allen was suggesting that timing differences not be measured. Mr. Allen noted that may be an option.

Dr. Marron offered that there is a more complicated example. Income from foreign operations of multi-national firms is taxed but the tax is only paid when the income is returned (repatriated) to the U.S. So, when does the deferral become permanent?

Mr. Reger asked if that provides an incentive to not repatriate the income. Dr. Marron agreed. He referred to past "tax holidays." He also indicated there are active discussions of options to resolve this incentive. Generally, he said a net present value approach would be used but there are many choices to make regarding these estimates.

Dr. Marron noted the variety of tax credits that are available in the individual and corporate tax systems. There are both refundable and non-refundable tax credits. The refundable credits are paid even if the amount exceeds the taxpayer's liability and the non-refundable are paid up to the taxpayer's liability (that is, it only offsets taxes owed). In the budget, refundable tax credits are first offset against receipts and the amount paid to taxpayers is then recorded as spending. The total amount shows up as a tax expenditure.

Mr. Dacey asked if personal exemptions and standard deductions are treated as part of the normal tax system and not as tax expenditures. Dr. Marron indicated that they are but that is a choice and is not without controversy.

Mr. Dacey asked who the users of the data are. Dr. Marron noted that the tax reform debate includes discussion of eliminating certain tax expenditures and using the funds to lower the rate. He referred to the various deficit reduction commissions as well as the President's budget as users of the information.

Mr. Dacey asked what source CBO uses for its analyses. Dr. Marron indicated that JCT estimates are generally used.

Ms. Payne noted the discussion focused on policy makers. She asked if it is important for citizens to know about tax expenditures and, if so, all or some.

Dr. Marron noted it is important. He thought it would be useful to know about the magnitude of changes in tax law. He also thought the overall magnitude of tax expenditures in policy is important. He mentioned that the attention to tax preferences waxes and wanes. He noted that the mortgage interest deduction and Social Security are the two largest entitlements of the middle class but the latter gets much more press coverage.

Mr. Allen asked Dr. Marron's views regarding placement in the financial report – management's discussion and analysis, financial statements, note disclosures, or supplementary information. He also wondered if the information would enhance the financial report.

Dr. Marron indicated that one could simply take the Treasury numbers and report them as unaudited amounts. He was not certain that all readers of the financial statements already know that these large amounts are reallocated through the tax code. He noted it would be useful to identify the six largest programs on "auto-pilot" – whether they are spending programs like Social Security or tax policy like mortgage interest deductions. This would encourage people to weigh these policies in an equivalent manner.

Dr. Marron acknowledged you could do a gross revenue line as the first line of the income statement but he would not recommend it.

Mr. Dacey responded that he thought most people understand tax breaks. Mr. Steinberg disagreed. Dr. Marron noted that people view these breaks as "letting them keep their own money." Others view them as government money distributed through the tax system.

Mr. Reger pointed to the charts that show the projected receipts and expenditures. Those charts do not show all the revenue we are foregoing through tax expenditures since these are net revenues. Netting tends to hide aspects of the fiscal situation.

Mr. Steinberg added that reporting on tax expenditures would add information and the press might notice the information. It begins to educate the public about the budget and tax policy. He also noted that the information about the size of government is important to people.

Mr. Allen noted that a discussion of the fiscal challenges we face is incomplete unless tax expenditures are included. He thought tax expenditures ought to be mentioned. Ms. Kearney agreed that it would be informative but we must be very thoughtful about how it is presented. Showing it as "lost revenue" would be misleading. She thought some explanation of tax expenditures with a reference to Analytical Perspectives could be helpful.

Mr. Smith agreed it is important. He thought it was more complicated than simply “gross” versus “net” revenue reporting. It may need a statement to itself. He felt it was so meaningful that it should not be in a note. It should be more than one line and we should think about the whole picture. It is out of sight and out of mind but is a policy decision. It ought to have the same level of importance.

Mr. Showalter agreed. He noted that hospitals are already reporting gross revenue and then deducting what they do not anticipate collecting from Medicare and Medicaid.

Ms. Kearney noted that it would not be possible to remove all these preferences. So, it would be misleading to present this in a manner that suggests we could collect the whole amount.

Mr. Smith noted that the fact we cannot collect them is still a decision. These are the equivalent of entitlements. We cannot eliminate Social Security but we still report it.

Mr. McCall noted that he leaned toward a special statement, note or RSI. A schedule would help people understand that there are preferences for the middle class person as well as the corporate loopholes that get so much press.

Dr. Marron agreed. No one thinks they benefit from a loophole.

Mr. Steinberg noted the complexity of this project and the importance of a great task force. He thought we should begin by determining the point we want to get across and then determine the best way to convey that point.

Mr. Allen noted that there is a great deal of interest in the project. The project plan will be presented in March.

- **Annual Report and Three-Year Plan**

Ms. Payne explained that three members provided comments and a revised report had been provided. She also noted that Mr. Dacey had a suggestion. Mr. Dacey suggested that there was some repetition regarding staff resources. He offered that changes could be made to eliminate the repetition and asked if a revised draft, with such changes, could be provided to the Board for their review before the meeting resumed tomorrow. Ms. Payne agreed to provide a revised draft.

Ms. Payne explained that the Appointments Panel received the revised draft and any further comments they have will be available at the end of October. She will need to circulate the report one more time if other than editorial changes are suggested.

Members noted the need for updates on IPSASB and GASB activities. Messrs. Dacey and Granof agreed to provide the updates.

Mr. McCall asked that the objective of the reporting entity project be clarified. He thought the exposure draft provided clearer language.

Ms. Payne provided an update on the Congressional outreach. With GAO's assistance she learned of an informational session provided incoming members following each election. For that venue, she developed a draft informational tri-fold brochure. She provided it to members and asked for member comments.

Members asked about other outreach. Ms. Payne responded that her next step will be to contact the CPA Caucus and others. A white paper will also be developed.

The following morning, members were provided with a revised draft annual report with the following revisions:

1. Presentation of abbreviations for GASB, FASB, IPSASB, and G-PP&E upon first use.
2. Clarifications to the purpose of the reporting entity project objectives (pages 5 and 15)
3. Pages 9, 10 and 11 revised to streamline discussions of the staff vacancies and resource issues
4. Inclusion of FASB in our collaborative efforts in light of consultation on the insurance project (page 7)

Members approved the changes with one exception. Members identified a sentence that had been deleted from the resources section and asked that it be incoroporated in the performance section. Members thought minor edits would smooth the language. Ms. Payne agreed and suggested that members give the report a final review after the Appointments Panel comment period ends. She will provide the draft for review by email in early November.

Ms. Loughan provided a brief update regarding the reporting entity project. She explained that the topic was not on the agenda because of the furlough. The furlough shortened the amount of time members would have to review materials and prevented some members from being at the meeting in person. For these reasons, the topic was deferred until December.

- **Steering Committee Meeting**

The Steering Committee received a budget update and discussed the challenging budget environment. Members agreed to confer regarding resource issues as they unfold.

Adjournment

The Board meeting adjourned for the day at 3:30 PM.

Thursday, October 24, 2013

Agenda Topics

- **Reporting Model**

<u>Overview</u>

Since the Board's August 2013 meeting, FASAB staff has engaged a task force and the National Academy of Public Administration (NAPA) to help in developing an ideal reporting model. At the initial task force meeting, the participants discussed high-level features of an electronic, web-based model. However, while exploring the possibilities of various features, participants noted the challenge in discussing matters in abstract and suggested building a web-based mockup. Also, staff engaged NAPA to study financial and related information needs for managerial and reporting purposes. The study would inform and support the Board's reporting model and managerial cost accounting project.

The Board discussed the idea of building a web-based mockup and determined that additional information was needed at this stage of the project. Primarily, members believed that the project involves two aspects: (1) the what - what information should be provided given that there are different users with different information needs; and (2) the how - how should the information be presented, including the tools needed to provide access to the information. Members generally believed that it would be best to understand the 'what' before developing the 'how.' Accordingly, FASAB staff will focus on the 'what' for the December 2013 meeting. Details of the discussion follows.

<u>Discussion</u>

Mr. Simms noted that the task force conducted an initial meeting and discussed high-level features of an ideal reporting model. The discussion primarily focused on an electronic, web-based model with a number of features, such as a robust search capability. However, participants found that discussing features in abstract was somewhat challenging. As a result, they suggested building a web-based mockup of the ideal reporting model. A mockup would help with testing and determining possible designs, demonstrating features, and facilitating discussions.

Mr. Reger was concerned about whether we clearly understand what data and information users need and would look to financial reports to provide versus how to display the information and provide tools that might be used to obtain the data. He noted that a mockup may be needed at some point after the Board understands what data and information users need. Mr. Simms noted that staff has completed user needs research and could provide that information to the Board. Also, the NAPA will be conducting a study to determine what financial information program managers use and need. Ms. Payne added that the study looks beyond the financial statements and would address the challenges that may prevent users from having access to useful information.

Mr. Dong asked whether we were considering a one-size-fits-all approach and noted that there are different facets of users. For instance, agency leadership, mid-level managers, and appropriations committee staff will likely use different information. Mr. Simms noted that the research considered that different users were likely to want different information and different levels of aggregation. So, one idea was to provide aggregated information with drill-down capability while another approach was to provide disaggregated or more granular information and allow the different users to aggregate the information as needed for their analyses.

Mr. Showalter noted that the Board needs to decide who the recipient of the information is and for what purpose they need the information. If we try to satisfy all of the users we will not satisfy any of them.

Mr. Allen noted that the project should start with determining what questions users have. Next, determine what information is needed from financial statements at the government-wide level and agency level to answer those questions. Also, information for this analysis may already be available. Staff has researched users' information needs and the existing conceptual guidance discusses questions that financial statements should answer.

Mr. Reger noted that fundamentally the project should focus on what financial information, other than budgetary information, is valuable to program managers, Congress, and others. It is understood that users need budget information, but what accounting information should be made available at both the agency and government-wide levels? After determining what accounting information should be available, determining how the information can be accessed would be the next step.

Mr. Dong asked whether the purpose of the project is to design what could be a complete narrative of a program and its financial performance, trying to be exhaustive in terms of the information we are trying to present, or is there some minimal level of information that we should provide for all programs, not designed to be conclusive, but has some basic information that prompts further discussion and analysis. At the agency level, the most meaningful work comes from the data that prompts discussion, such as costs increasing over time. Trying to answer every possible question a user may have could result in a report that collapses under its own weight. Thus, the model should provide data that prompts further discussion rather than providing data that leads to a conclusion.

Mr. Steinberg noted that the Board does not set standards for budget information but when we look at accounting information, it should be in relation to the budget. Also, accounting information should serve the following purposes: demonstrate accountability to stakeholders, i.e., track how funds are being spent; inform the budget process, i.e., help those who are responsible for budgeting, know what was spent in the past; and drive performance improvement.

Mr. Smith wanted to better understand what we are trying to present in the model, what is it supposed to show. We could consider starting from the top and deciding how far down we go rather than trying to satisfy all the different users.

Mr. Dacey also wanted to better understand what we are trying to achieve with the model, but especially regarding the role of the Board. The Board has traditionally focused on GAAP-based financial statements, but it is not clear what role the Board would play in presenting nested levels of information.

Mr. Granof agrees that we need to address those basic questions - who are our users and what information they need.

Mr. McCall noted that staff is trying to accomplish what was summarized in the Board's annual report, such as provide information on the full cost of programs and on the budget while acknowledging that the public is relying on electronic media to obtain information. One way to envision how this could be accomplished is to consider that the government-wide financial statements cannot be everything to all users, but a financial statement could have links to other information. The statement of net cost that shows net cost by department could have links to each department's budget, performance report, audit report, and an area where citizens could provide comments. This approach would help prompt further discussions as Mr. Dong suggested. Also, the Board seems to know the elements that are needed, but it is not clear where they fit into the model. Performance reports have some good information beyond that presented in financial statements but we need to get users from the financial statements to those reports.

Mr. Allen noted that he envisions the project resulting in a concepts statement; therefore, the Board would not be constrained by today's circumstances. He noted that, for example, staff has done research on users' needs and determined that users want to know about the cost of programs. Although the research confirmed the Board's earlier conceptual guidance on the information that users seek, information on the cost of programs is not provided today. Regardless of today's practices, the Board could say that the ideal model provides information about the cost of programs and that is what it would like to work toward achieving in the long run. Also, by analyzing how to answer users' questions, we may determine that questions may be best answered by government-wide financial statements rather than agency financial statements.

Mr. Reger noted that financial statements provide more than historical information. The Board provides sustainability information that looks toward the future. Mr. Reger also noted that the federal government has budgetary reporting that, in general, agencies are accustomed to using; financial statements; reporting on procurements; reporting on assets and debts; and programmatic reporting practices that differ from program to program. However, there is no central location where all this information comes together. Proposed legislation such as the Data Act seeks to achieve some data consistency and the Board could help.

In addition, Mr. Reger discussed that the government has to find ways to do things more efficiently and more centrally. The question is what information should be provided to everyone? We know we have to provide budget information to support agency budget functions; financial information to represent financial condition of some nature; and performance information or operating information that users need to run their organization. Thus, as the government looks to improve efficiency and centralize, it is important to know what information should be provided and how the reporting model can help, recognizing that bodies other than FASAB would need to be involved. It would also be good if it could be determined what areas belong to whom.

Mr. Dacey noted that the International Public Sector Accounting Standards Board's (IPSASB) conceptual guidance emphasizes that there are general purpose reports, other than financial statements, that are available to users and that the IPSASB does not control what is presented in those reports. From a broad perspective, it is important to consider what information is provided, in addition to the information in financial statements, and who provides the information.

Mr. Allen noted that the reporting model could be built around the basic questions that users ask. He noted that when considering questions that citizens have asked, we could say that a particular question is not answered in the financial statements but could best be answered in another document such as the budget. Simply stating that other documents are available without guiding the user to a particular document for answers would not be helpful.

Members discussed the following views on what they would like staff to provide for the December 2013 meeting:

- Mr. Smith noted that, with respect to the model, it would be good to know what information would be reported at the top level and what drill-down information would be presented. Also, it would be good to know what questions the reported information is intended to answer. As a result, we would be able to explain the usefulness of the model because we would know what it will do and what it would not do.

- Mr. Dacey was not sure about building a model at this point. We could layout an overarching viewpoint of financial reporting and discuss that financial statements can refer users to other reports for additional information. We could start by looking at how agencies are linking financial statements to other reports today.

- Mr. Dong believed we need a strategy document that articulates: users' needs and the demand for information that is currently not being met; and how we plan to satisfy the demand for information that is not being met. We need to understand the users and their needs and determine what needs should be met by financial statements and what needs should be met by other means.

- Ms. Payne explained that we have a good sense of what users need, but how to provide that information is the challenge. Users have noted that financial statements should provide high level information that prompt deeper questions.

However, they would like the financial statements and other information integrated and the terminology used consistently. Also, when disaggregated dollar amounts are totaled, the amounts should agree with the totals in the financial statements. One challenge to achieving users' expectations is that different parts of the model are owned by different bodies. In addition, determining how to move from a world that uses Portable Document Formats (PDF) to a world where users can start at a PDF level of aggregation and drill down is a challenge as well.

- Mr. Reger noted that we need to concentrate on the topic of what information should be provided, ensure consistent definitions, and how to integrate this information. Also, Mr. Reger supports the NAPA study. The study would help us determine what information managers need to manage and have not historically used but is available in financials.

- Mr. Steinberg likes the idea of building a model because it would inform the Board on the topic of what information will be presented and the concepts statement. Also, the NAPA study will help determine what information is needed.

- Mr. Granof noted that he believes that the ultimate outcome of the project would be a data warehouse. He noted that the information provided in the existing set of financial statements remains relevant today and should not be disregarded. However, we should determine what additional information users want and how that information could be readily linked to the existing statements. As he envisions the model, a user could click on a line item in the existing financial statements and drill down to more detailed information or performance information. For example, one could click on an asset and drill-down to information on its condition. This would require understanding what information users would rank as a high priority and understanding that the project would be a work- in- process, taking years to develop as information is added gradually.

- Mr. McCall supports the NAPA study and is interested in knowing what information is provided to senior managers; what level of support is received from top management for cost data and performance management information; and to what extent the information is communicated and used within the agency. Mr. McCall also noted that we should work from the existing concepts statements, particularly Statement of Federal Financial Accounting Concepts 1, Objectives of Federal Financial Reporting, because the concepts provide a framework for determining where we should be with respect to this project.

- Mr. Showalter noted that we are struggling because we are not sure what we are building. We should have a strategy, stating what we are trying to achieve. Also, we need to be more clear on who are the users. The focus should be on those users who do not have access to information versus those that do. In addition, Mr. Showalter agreed with Mr. Granof in that the existing model should not be disregarded but we should build on what we have. Mr. Showalter would like to see a blueprint of the model rather than begin by focusing on various details.

Conclusions: For the December 2013 meeting, staff will focus on what information users need. The discussion will include: whether those information needs are reflected in the existing concepts; whether those needs are being addressed in the existing agency or government-wide model; and, if the needs are not being addressed in the existing models, are they being addressed in other reports.

- **Public-Private Partnerships**

Upon the Chairman's introduction of this agenda topic, Mr. Dacey requested clarification from staff concerning the structure of the project. Specifically, he understood that the draft definition was intended to be fairly broad and that this would be the starting point of the flowchart contained at Attachment 1. GASB and IPSASB focused on a sub-set of P3's, however, in theory the current proposal to the Board is that there are risks and exposures to a broader set of arrangements that need to be captured. He asked if this was a fair statement and staff replied that it was. Staff noted that both GAO and CBO have identified numerous types of P3s that go well beyond service concession arrangements. Furthermore, the federal government's privatization efforts involve a wide spectrum of assets and to staff's knowledge, very few service concession arrangements.

Mr. Allen then asked members to look at the flowchart noting that he liked the overall presentation. Mr. Allen noted that within the paper, staff indicated that there may be certain minimum disclosures that we would have about these P3 structures even if we create an asset or liability and they were reported somewhere else. The flowchart takes you first through the federal entity and, if you meet those requirements, you would stop there, then the flowchart progresses to whether an asset or liability is recognized or de-recognized. Mr. Allen then asked the members that if using the flowchart they could envision ever seeing any detail information concerning P3s given materiality constraints especially at agencies such as the Department of Defense.

He asked if it would be more appropriate that instead of saying "stop" that we would say "see additional disclosure requirements." Because these P3s are unique and complex and we don't know enough about them, it would seem that we might desire additional disclosures even if they are recognized through asset or liability standards or the federal entity standard.

Mr. Steinberg stated that he asked staff that very same question and that the response was that any additional disclosure requirements for P3s would need to be added to the federal entity standard as well as to the asset and liability standards.

At this point Mr. Allen called for a 15-minute recess.

After the recess, the Chairman asked Mr. Savini to begin the discussion by first introducing to the Board the invited P3 Task Force members[1] present at the table. Mr. Allen also invited them to share any comments they might have concerning the project.

Staff took the opportunity to thank three additional task force members who were present for their contributions to the task force; Maryla Engelking, Jerry Shea, and Ann Davis.

The invited Task Force members made the following opening comments:

Kevin McHugh[i]

Because the U.S. P3 market is developing very quickly, Mr. McHugh stressed the importance of protecting the best interests of the taxpayer by being nimble in providing guidance to avoid unnecessary P3 failures, inadequate or inappropriate asset valuations, and unfavorable contract terms. Once developed, this guidance should be shared with the media and citizens in an easy-to-comprehend manner so that increased accountability can be achieved. His biggest concern is that ill-advised and inconsistent guidance is coming from foreign consultants. Failing to properly address P3 accountability issues has adverse implications for current and future generations. Mr. McHugh believes that P3s are one of the most important issues facing the nation.

Bob Helwig[ii]

Mr. Helwig stated that he has two basic thoughts concerning P3s. First, as a program manager, he believes that P3s are a very good way of delivering public value that would otherwise not be achieved. Second, he believes P3s are not only about third party financing. Aside from financial capital, the private sector can effectively deliver targeted, less costly operational efficiencies which optimize the delivery of facilities and services. However, he cautioned that P3s must not be done in darkness and that we need to shed light on them by fostering accountability and sound accounting; i.e., capturing the important costs and risks. Some risks (that is, deviation from expectations) that the Board should consider addressing include: (1) what are the actual costs compared to those costs contained in the federal budget, (2) will the government have to absorb any of the project's private debt, (3) has the government's credit extended to the private partner in the form of direct loans and/or guarantees been properly reflected in the federal budget, (4) will the government achieve expected returns over the long-term on its investments in limited partnerships, (5) will the public purpose be fulfilled or public value achieved, (6) could unforeseen costs (e.g., environmental, litigation) that have not been budgeted create a liability, and (7) could political pressures necessitate incurrence of a liability that would not otherwise be a legal responsibility of the public agency.

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[1] Task Force member Ms. Anita Molino, Principal, *Bostonia Partners* & President of the *National Council of PPP's* was unable to attend due to unforeseen circumstances.

Ed Noble[iii]

Mr. Noble concurred with Mr. Allen's earlier comment that the flow at the end of each process stage was not a hard-stop, but really is meant to be an assessment of the appropriate minimum disclosure requirements. Mr. Noble then stated that he has a risk-assessment focus to this project and in particular, qualitative disclosures as opposed to quantitative. This is because one could easily justify that a quantitative disclosure is immaterial but the same is not always true with qualitative disclosures. To illustrate his point, Mr. Noble referred to the Conclusive and Suggestive Characteristics and in particular, the one addressing off-balance sheet risk via the creation or participation in an SPE. An agency's investment in an SPE might be considered too immaterial to disclose, but prior U.S. experience would suggest that qualitative disclosures would have been extremely beneficial to users of the financial statements.

Mr. Noble also indicated that the Task Force in their limited contact of market analysts believes that uniformity in disclosing P3 activity may decrease the inherent cost of financing as there is a perception that such uniform disclosures would provide order in the capital markets in an area that is both unique and complex. Mr. Noble will respond to a query from the Board as to whether or not debt associated with a P3 activity is exempt or not.

Larry Checco[iv] **-** Please refer to Attachment 1 for written statement

As the task force's citizen advocate, Mr. Checco looks at P3s through the prism of an investor and not just as a taxpayer. As such, he expects a return on taxpayer invested dollars. Too often we see that P3 arrangements involve less than honorable people leading to cost over-runs and wasted taxpayer dollars. Greater transparency and accountability are needed.

Mr. Checco emphasized these points concerning the nine disclosures that the task force has recommended:

1. Taken together, they form a "Trust but Verify" approach to P3s
2. No prudent private sector participant would not take each of these into consideration and as such, government agencies should be on equal footing by also considering these nine disclosures
3. Transparency would require that taxpayers be privy to these underlying considerations
4. Eliminating disclosures to facilitate auditing leads to auditing without context and a purposeless audit

Michael Fischetti[v] - Mr. Fischetti arrived shortly after the introductions were concluded.

Mr. Reger asked the Chairman if he could ask each of the task force members a question before reviewing the Tab D material with staff, to which the Chairman obliged. Mr. Reger thanked the entire panel for their voluntary contributions and expressed a sincere hope that the Board's effort would always reflect their contributions.

Mr. Reger asked Mr. McHugh about the asset values that he is requested to develop. Specifically, for assets like a state capitol building, does he take into consideration historical costs of the heritage asset or is there goodwill that is associated with the asset?

Mr. McHugh responded unlike a home for sale, where we go into a marketplace to ascertain a comparable value, with the state capitol building there is no such market. So, the first thing is to determine if the building is on a historical registry or if it has historical significance or if it is a modern office building. Based upon the results of this first step, he would then determine the proper valuation method. If it is a modern building, then he would use a replacement value from the building or if it was a historical building he would look at the reproduction costs. The building and land are estimated separately where the land is appraised using a vacant and available basis. There are three approaches to appraising property; cost, market and income approaches. So, for a historical building the market approach would not apply and unless there is a significant amount of retail income being generated from the state capitol building, the income method would not apply which would then leave you with the cost method. This cost method would be calculated using the depreciable amount and then that value in turn would be added to the land value. It is important to note that historical cost (i.e., book value) does not equal the fair market value of a building.

Mr. Reger asked Mr. Helwig if in his experience he had ever had a significant accounting issue.

Mr. Helwig recalled a somewhat arcane case having to do with making investments in the entities that own limited partnerships which actually own the privatized housing projects. The Department of Defense (DoD) can make an investment in those projects by statute. The government makes the subsidy characterized as an investment and because there are certain conditions set forth by statute, DoD managers work with the accountants to ensure that DoD is well within the percentage requirements that are allowed.

Mr. Reger asked Mr. Noble if financing arrangements that involve debt are considered tax exempt debt? In other words, do your clients consider that there is a full faith and credit of the United States behind the debt?

Mr. Noble noted that he believes there is an implicit understanding to that effect but would like to do additional research and get back to the Board.

Mr. Reger asked Mr. Checco if, from a citizen's point of view, he is interested in the financial arrangements from the government side, that this is public money, or if he is interested in the benefits to the private party to ensure that they are logical.

Mr. Checco said his interests are mostly from the taxpayer's point of view. His issue is one of efficiency of government rather than size of government. We could solve a lot of these polarized issues if we believed that every dollar we put into our common tax collection pot was used appropriately, but unfortunately a lot of people don't believe that.

Mr. Showalter explained that he communicated with staff prior to the meeting and clarifications were provided by staff. Regarding the first question in the staff memo, he had asked why the alternative definition was provided and favored the risk-reward (alternative) definition. Related to the characteristics, as well as all the other questions, his overall concern relates back to burden. The Chairman has stated that he doesn't believe many of these P3s will meet the materiality test but he questioned if one could conclude that without knowing what the population is. So, the concern is getting into circular logic wherein the client says that he has identified all P3s and the auditor challenges the client regarding the actual population. The question is this, because we've defined P3s so broadly, can we get a handle on the total population enough to conclude whether they are material or not? We need to have enough specificity for the preparer and the auditor to come to the same conclusion. He remains concerned about the unintended consequences and complexity about some of this.

Mr. Allen then stated that we should look at question three where the nine areas for disclosure were reduced to five.

Mr. Showalter asked, regarding the characteristics, whether we are certain that every characteristic adds to the pool of P3s as opposed to redefining what's already there. Further, in regard to the disclosures, he questioned whether ‘complexity’ means the same thing to each person involved. In his view, complexity usually increases risk and he wondered if we could fold complexity into the potential risk exposure characteristic.

Mr. Savini noted, as an auditor, his view is that just because something is complex doesn't mean its risk profile is increased and just the opposite could be true. For example, when we attempt to mitigate risk we might design a complex system to contain that risk.

Mr. Savini continued and noted that Mr. Showalter’s earlier observation is very important and Mr. Granof also touched on this in August. Specifically, the broader our definition is the more discrete our characteristics are going to be to help preparers identify P3s that should be reported. Conversely, the opposite is true. That is, if the Board took time over the next several months to develop a specific federal P3 definition that would inherently include many of the characteristics you now see broken out before you. So, there is a corollary between how we define the P3 and the resulting filtering effect of the characteristics. Concerning the burden or potential for excessive reporting of P3s, staff believes that the characteristics as shown actually would help the program manager identify not only material P3s but those which are significant.

Mr. Dacey also noted his concern with the breadth of the definition and agreed with Mr. Showalter. He thought some contracts would fit the definition of a P3 but he would not himself characterize them as P3s. He was also concerned that the proposed disclosures may seem rules-based rather than aligning with the principles to be established through the Risk Assumed project. He asked if there is a nexus between the two projects.

Mr. Smith asked Mr. Helwig, do you find it difficult to define what a P3 contract or transaction is?

Mr. Helwig said he finds it difficult to make fine gradations between what would be a very broad definition of a P3 compared to what is not. The very broadest definition can be a lawn-mowing service on some facility and clearly you do not want to attract this because it is an absurd extreme. What you're trying to get at as a program manager are those arrangements/transactions that bring concerns such as accounting, budgeting or otherwise that you want to have a spotlight shone on. This is what we are dealing with on the task force in trying to draw that particular line where you reach that tipping point where you need to have something disclosed.

Mr. Smith agreed that the lawn mowing service should not be a P3 disclosure item. However, he asked, when you look at the definition do you find it so vague or so difficult that complying with it would be tough? The concern being that these other contracts would be brought in under the umbrella definition.

Mr. Helwig conceded that it is difficult to say. In housing privatization, depending upon the audience he has to argue both ways. On even days, he argues that they are governmental and uneven days private. He has attributes on both sides that he shared with the task force. For example, who owns the asset and where it is located are questions he attempts to answer. The housing privatization program has a number of contractual-based and property-based relationships.

For example, in a privatization deal within the fence of a military installation we convey the improvements by fee title. However, the land is conveyed via a lease. This already shows an odd relationship of mixing a lease, which is a contractual relationship for the land, and an ownership model for the improvements. The revenue stream is based upon the service member’s housing allowance payment made to them by DoD and which they turn around and pay by allotment based upon their rank to their landlord as their rent. There are those that would argue that this is just the government revenue stream but then on even days he would argue “No”, that the revenue stream is private compensation to a military service member which he or she uses to pay rent the same way anyone does. In answering your question, understand that the answers are elusive and part of the challenge has been to identify those characteristics you’ve been presented. That's why we believe the methodology to get to the right level of disclosure is pretty good from what we've accomplished so far on the task force.

Mr. Savini explained that in the broadest sense the United States has been using P3s since the 18th century. Now, because there is no uniform definition, what is most critical is that we define those characteristics that we find relevant for federal reporting purposes. Although it is good to spend time on the definition, we should not get wrapped up in finding the ideal definition. We cannot specifically define P3s for each federal agency, each class of asset, or for each and every complicated arrangement.

This is why we need to go with the broad definition and then have a filtering process that is risk focused vis-à-vis the characteristics.

Mr. Dong asked if these are really P3 definitions then? That is, they are the first question that is asked to see whether the arrangements or transactions are eligible for disclosure.

Mr. Savini clarified Mr. Dong's statement by saying that these are not agency specific P3 definitions nor are they transaction or arrangement specific P3 definitions but they are general definitions inasmuch as they are trying to emphasize the new and novel ways of transferring and risk-sharing within these arrangements. As the English accountants have said, P3s are more of an ideal than an actual business practice. We have been sharing risk with contractors even before the Civil War. The European rubric has been introduced that has created turmoil here suggesting that the United States is behind the P3 power curve when in fact we are not.

Mr. Dong, coming back to Mr. Dacey's point, said your net is going to be cast very wide and you're going to be capturing arrangements and transactions that in the broadest sense can be defined as a P3 but then you apply more limiting criteria.

Mr. Savini agreed. We want to exclude as much as possible of the standard type procurements that we know exist that are not really P3s for our financial reporting purposes.

Mr. Dong noted that with either definition that is shown in TAB D, you're going to capture the type of contract activity that Mr. Dacey was talking about but then you screen it out later with your subsequent questions.

Mr. Savini agreed.

Mr. Dacey concurred that some P3 contracts pose serious risks that need to be disclosed. However, he thought that may also be true of many other different contracts that would not meet the filters. He was concerned that if we make the question so broad, we will cross over into the Risk Assumed project. He was unsure what the disclosures will be in that project versus the disclosures in this project.

Mr. Allen indicated that the Board acknowledged upfront that several projects may crossover such as this and Risk Assumed. He saw a need to go ahead with this project and do it as comprehensively as we can because it's ahead of our Risk Assumed project. By the time we get to the disclosures in that project, we might have to carve something out saying that we are dealing with selected disclosures elsewhere such as here in the P3 project.

Mr. Dacey said his concern is that the definition and filters may bring in a host of things that are not intended. He wondered if it is better to have a broader filter and come to similar risk disclosures for all risky arrangements. He did not yet have an answer.

Mr. Reger opined that the P3 draft did not seem to be limiting.

Mr. Allen stated that he likes the alternative definition because he prefers positive statements as opposed to negative statements. But it is still very broad and would need filters along with materiality. It seems that continuation of risk for the creation of assets and those of the things staff is suggesting will help delineate P3s from other contracts. He wondered whether you end up at the same place with both definitions.

Mr. Noble supported the view that standards need to cast the net broadly through a broad definition. What helps narrow it down is the last paragraph in both versions which contains language that specifically mentions that both definitions capture the most widely identified features but should be assessed against the conclusive and suggestive characteristics. He thinks this is a two-step process where we capture a lot of potential (contracts, arrangements, transactions) in the definition but then we eliminate or pare them down by virtue of the characteristics which are all risk driven.

Mr. Showalter commented the problem with that approach is that if the original net is flawed then the second level down is flawed.

Mr. Savini said he did not believe the definition is flawed and asked where it is flawed.

Mr. Allen asked Mr. Showalter for suggestions.

Mr. Showalter did not have specific suggestions. He again noted that if you cannot get any specificity in the definition to know the population then you will always have this question as to whether or not you captured all the P3s. You must make sure that we have the population identified in the first step. Then your second step is a subset of your first.

Mr. Dong thought the problem is not that you've captured too much, the problem is that you have captured those P3s possessing the risk characteristics that we would like to see disclosed.

Mr. Showalter said he is concerned with both – are we going to capture too much and how are we going to audit all of this. This is something we should ask as a question in our forthcoming exposure draft.

Mr. Savini asked Mr. Helwig if he could develop a single standard definition for his portfolio of DoD privatized housing.

Mr. Helwig stated that he would define his portfolio by the statutory authority DoD has been given to operate each program. That would be a broad definition. His program has over 100 deal structures and they have all been done as one-offs. They each have different characteristics and he could not categorize them all perfectly the same.

Mr. Showalter, addressing the Chairman, acknowledged that we prefer not to include negative standards. However, since the task force has done a good job capturing characteristics, he wondered if they found a common characteristic that does not make an arrangement or transaction a P3. In this way we could say if there is an arrangement or transaction that has this characteristic it would not be considered a P3 for financial reporting purposes.

Mr. Allen said the cascade approach does address this by first asking the question in regards to federal entity and then addressing the recognition of assets or liabilities. If an arrangement is captured in either of these two categories it doesn't have to be addressed as a P3. However, we do not have a unique characteristic that would automatically exclude an arrangement or transaction from P3 reporting.

Mr. Showalter understood that but asked if the experts in the room have an answer to that question.

Mr. Helwig noted if we start with the broadest definition possible, it would be “a relationship between a public sector entity and a private sector entity to accomplish a public purpose”. At that point everything is in and that is precisely what our definition does along with the characteristics.

Mr. Allen said we normally use terms in accounting such as arms-length transaction and if not, we talk about related parties. Do you believe that P3s are arm's-length transactions?

Mr. Helwig said he oversees three military services that use their authorizations each in their own unique manner. Two of those services have established limited partnership deal structures where the government becomes part of the formal partnership that owns the project and has a traditional common-law limited partnership role. However, the third service, the Air Force does not become a partner and as such, believes its deals are at arm's-length because they never entered into a formal limited partnership. Instead, the Air Force has a lessor-lessee or lender-guarantor, on a military base type relationship. He believes the Air Force has arm's-length deals whereas the Army and the Navy have partnership deals even though all three services would consider each of their deals to be partnerships.

Mr. Fischetti said with P3 arrangements there's an offer and consideration. In Federal Acquisition Regulations (FAR) based arrangements there is a plethora of laws and regulations that have been passed over the years to satisfy Congressional and OMB concerns, however at the end of the day a FAR based contract ensures that both parties have a stake in the outcome. He indicated that we're fooling ourselves that a P3 is not a contractual arrangement. He would say something to the effect that P3s are contractual arrangements which are not subject to the FAR. There are many agencies that are not subject to the FAR so this is not unusual.

Mr. Allen asked if there’s a continuing relationship other than typical long-term contracts that make P3’s different.

Mr. Fischetti said the nature of a P3 is that it is longer-term than the typical three-year or five-year government contract. The intent of these arrangements, for obvious reasons dealing with resources and returns, necessitate that they be long-term. You would not see a P3 for six months.

Mr. Allen asked if there are words that we can put into the definition that would give comfort to the auditors that the universe has been identified. For example, an entity with 10,000 contracts would need to know which ones were in fact P3s.

Mr. Dacey explained that the other standard setters also began very broadly and then they narrowed down to Service Concession Arrangements. It is difficult to deal with the broader issue of all P3s in the approach we are taking.

Mr. Smith noted that what brings these to the surface is that they are financing arrangements where there is risk. The contract is long term so that the other party has time to cover its costs and eliminate its risk. For example, in the alternative definition where we reference risk and reward, he did not see where the other party is at risk because the government is locked into a contract. The government's reward is receiving the asset at the end of the arrangement or whatever is left of the asset. This is ultimately a financing mechanism where the government is taking the risk. Unlike services contracts, many of these P3s involve significant amounts of capital and someone has to recover that cost of that capital or if the transaction is not successful, one of the parties will bear the loss.

Mr. Savini explained that not all P3s involve alternative financing. For example, services contracts arising at military depots where there is a sharing of overcapacity or the sharing of an industrial complex/facility, and even the sharing of actual government personnel. There is no financing involved but yet these are public-private partnerships. This is why it is very difficult to come up with a crisp and succinct definition. It is important to note that if we narrowed the definition, it would exclude many P3s and understate the government's potential risk and liability and do a disservice to the financial reporting objectives. He believes we should go broad with the definition.

Mr. Smith asked why we would be concerned with for example, a cafeteria type services contract where the government engages personnel to run operations. Unless the operator is charged with improvements or some other capital expenditures, why would we be concerned?

Mr. Savini explained that our labor union representative on the task force made the point that I have also been able to corroborate with other research, that there are legacy costs involved and potential lawsuits involved in some cases that pose a risk and liability to the government. So, this risk and liability do not arise from alternative financing schemes but from relationships that combine federal employees with private contractor managers as an example. Another example is if the P3 is used as a step towards privatization, and in the arrangement the government is left with the legacy costs to absorb, it bears the ultimate risk because there is no way to recover such costs.

Mr. Smith noted that these types of risks can be covered by a risk assumed contract. He emphasized that he is not saying that services contracts cannot be within P3 definition but we have to have some purpose of what we are trying to capture.

Mr. Savini asked Mr. Fischetti about the notion of excluding services contracts from the universe of P3s.

Mr. Fischetti said he could support that position because in those cases the government typically owns the assets and equipment. Should there be a change in contractors, the equipment remains with the government.

Mr. Checco asked if there is an underlying concern here that we are overburdening federal agencies. Is this the reason why we do not wish to cast such a wide net in the definition?

Mr. Allen responded that you can say it's overburdening in a way. However, the agencies must satisfy their independent auditors that they have captured all of the P3s. This is what has started the discussion - how do we satisfy the auditors that we have captured all of the P3s if the basic definition is very broad?

In following the previous discussion concerning services contracts, he pointed to the second conclusive characteristic[2] which he believe helps address that question and seems like the best screen. He did not think you can have the screen at a higher level but believes the screening takes place at the conclusive characteristics.

Ms. Hamilton offered to add some legal framework into the discussion. The FAR applies basically to everyone in the executive branch (not the legislative branch) and it covers the acquisition of goods and services. When I asked our GAO procurement law experts the question if they were aware of any service contracts that were P3s, their answer was yes. We see them in the information technology and computer environments.

Mr. Smith noted that is because you've outsourced IT because they are going to be putting in the system.

Ms. Hamilton responded that Mr. Smith was referring to the goods part and not to the services part. The services part entails upgrading and maintenance activities.

Mr. Smith added that is because you are incurring capital costs that need to be recovered over a longer term versus period costs. This is how as an auditor, I would make the distinction.

Mr. Fischetti thought this would be difficult because you could find an example that doesn't fit the current framework. There are probably services contracts that should be

[2] October 2013, TAB D, Page 7 Conclusive Characteristic #2 - *The federal entity is a party to an arrangement wherein the private sector partner or special purpose vehicle (SPV) has either borrowed or invested capital contingent upon the federal entity's promise, whether implied or explicit, to make future payments.*

reclassified to supply contracts and vice versa. At the Department of Energy there are management and operating (M&O) contracts that are specifically discussed in the FAR where contractors have been running facilities since World War II. There is only a very skeletal governmental crew to provide oversight. When these contracts are competed, essentially all of the employees, equipment and facilities are transferred to the new contract. In essence, what is truly competed are the 12 or so executives; e.g., the Oak Ridge Tennessee facility. There's a continuous debate as to whether or not this is the correct arrangement for the facility.

Mr. Smith said he sees these P3s and that the operator is required to replace and maintain the equipment. This is as a capital requirement and if the contract runs long enough so that the contractor recovers 100% of the costs there is no risk.

Mr. Allen asked staff what they need from us today in order to proceed to the next step.

Mr. Savini responded that there is a corollary at play between the definition and the characteristics. That is, the broader the definition the more discreet or specific the characteristics need to be. Conversely, the more narrow the definition, the fewer the characteristics we need because they would inherently be included within the more narrow or specific definition. With this being said, staff would like to know from the Board what it prefers doing. Should we spend time working the definition to become more precise or more narrow, or should we proceed along the path that staff recommends - going broad and focusing on characteristics?

Mr. Allen felt no one has really argued for the second or the alternative definition, but merely seeking clarification as to what the differences are from the first definition. Turning to the Board, Mr. Allen asked if any member would favor the second definition or more precisely, the second point made by staff that we in fact need a definition that is succinct enough and clear enough telling federal agencies which P3s should be included for financial reporting without the use or reference to the characteristics.

Mr. Dacey felt the definition is too broad and would prefer having a more restrictive definition identifying which P3s would be most directly relevant to financial reporting. He raised an additional concern with our Risk Assumed project. He asked what principal guides us in seeking information about risk. If we had a principle, we can then use judgment regarding whether certain contracts or arrangements result in financial exposure.

Mr. Smith noted one of the advantages of going with a definition and then the ensuing characteristics is that people are going to have arrangements or transactions that they believe are P3s, at least the broad definition ensures that from everyone's perspective that those arrangements or transactions are on the table for consideration. Then the characteristics are basically saying we are not trying to capture all of the P3s, as we’re only trying to capture those that we have identified as possessing risk or fiscal exposure. In this way we do not even have to get into the issue of whether this is the correct definition or not. For purposes of the standard, all we want are those arrangements or transactions that are relevant to federal financial reporting. We do not wish to disclose P3s that do not have significant or material amounts of risk. Therefore, he believes the broad definition with characteristics will make it easier to move this forward then trying to get definition perfect.

Mr. Dong concurred with Mr. Smith. He noted we will never get to a perfect definition.

Mr. Allen supported the concept of going broad along with the characteristics. He also asked staff and the task force to take a hard look at the characteristics because he believes that the draft conclusive characteristics are still too broad.

Mr. Reger added to Mr. Allen's comment that in the disclosures, we should state why the risk in the P3 is different from other risks and why we believe it is important to be disclosed. This will help us say why this is a reportable P3.

Mr. Steinberg agreed we need to narrow those arrangements and transactions that we want reported as P3s. However, he did not believe you can do this by narrowing the description. He believes that the cascade approach makes a lot of sense. Staff and the task force have done a pretty good job at coming up with the best description possible and one that is compact. Then, after reading and applying the definition we would use the cascade approach. In this way some of the arrangements or transactions may be assets, leases or reported as part of the federal entity.

He noted that he sent staff a list of questions concerning the characteristics asking for clarification and specificity and staff's response included examples to every one of my questions. These examples may need to go into the standard or in the basis for conclusions and they will further narrow down what we consider to be P3s.

Mr. McCall thought staff's definition in the first paragraph is a good summary of what we saw last time in light of the other definitions that are in use. He was concerned as to what a P3 is once we go beyond the definition. For the middle paragraph, he understood the alternative draft better. The first definition specifically mentioned the exclusion of contractual protections provided by the FAR but he is not familiar with those. He would like to know at the next meeting how significant this matter is.

Mr. Granof feared that we would not be able to write a perfect definition. So, he believes we should proceed with the broad definition and prefers alternative number two. He likes the idea about drilling down into the characteristics but they still need some work. He thinks they are generally right and this matter is what our attention should be focused to in the next meeting.

Mr. Allen indicated that it seems that we are headed in the direction Mr. Savini prefers.

Mr. Savini thanked the Board for its patience because this is a very complicated project. In addition, I would like to thank our panel task force members who are here, Ms. Anita Molino who was unable to join us today, as well as task force members Ann Davis, Maryla Engelking, and Jerry Shea for also being here today.

CONCLUSIONS: Staff will develop the definition, characteristics, and disclosures further based on member feedback. At the next meeting, staff will address the relationship between P3 disclosures and disclosures in other projects such as reporting entity and risk assumed.

Adjournment

The meeting adjourned at approximately noon.

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Attachment 1: Larry Checco's Prepared Statement

Report to the Federal Accounting Standards Advisory Board

Board of Directors

On the Need for Informative Disclosures over Public-Private Partnerships

A Citizen's Perspective

October 24, 2013

Introduction

My thanks to those who have provided me the opportunity to present to you today, especially Domenic Savini, Assistant Director of the Federal Accounting Standards Advisory Board (FASAB), who recruited me for this all-important Public-Private Partnership (P3) Task Force.

I greatly appreciate that he and others see the value in having people like me—ordinary, but concerned and involved citizen advocates—participate in what I perceive to be one of the most important government responsibilities, especially in this time of severely constrained financial resources; that being the oversight and protection of our taxpayer dollars. As we have experienced again and again, decisions made today have far-ranging and long-term implications and ramifications for the future well-being of our nation.

That's why I believe—or at least, hope—that I'm in the right place at the right time.

Taxpayers vs Investors

Let me begin by saying that I do not consider myself a taxpayer, but rather, through my taxpayer dollars, an investor in the future of America—as well as the ultimate future well-being of me and my family. And like all serious, conscientious investors, I am seeking a return on my investment.

For years, P3s have been employed to offset government costs in nations as far-flung and disparate as Great Britain, Australia, Canada, India and Russia, and are now beginning to gain traction in the United States.

Historically, however, there exists a common problem with P3 projects in that private partners and investors often are said to be sitting in the catbird seat when it comes to privatizing gains and socializing losses, meaning most—if not all—of the financial risk associated with a P3 project is borne by the public sector, i.e. taxpayers. Again, it is important to note that there are inter-generational consequences and burdens associated with privatizing gains and socializing losses where tomorrow's future taxpayers must rely on those of us today to make well-informed decisions that cut across generations.

Risk Disclosures

The website of the National Council for Public Private Partnerships (NCPPP) offers a testimonial on P3s which I believe helps put our task force issue into clear perspective:

> *"A partnership by definition involves two or more parties committed to a common task, sharing risk and yielding a reward to all the partners. The service goals need to be achieved more efficiently together than alone. And successful public-private partnerships enable both parties to do what they do best to achieve a common goal. In the end, it is as much about open honest communication as it is about money."*

For me, as a professional communicator, the operative statement in the above testimonial—above and beyond "sharing risk"—revolves around the fact that any P3 arrangement **"is as much about open honest communication as it is about**

money." In short, we're talking about transparency, which segues nicely into what I believe is the mission of this P3 Task Force, and that is to recommend transparent accounting disclosures that will bring clarity to the kinds of risk government agencies—using taxpayers dollars—face when they enter into these highly complex P3 agreements. Traditional forms of disclosure may fall short in helping reveal the underlying risks and rewards to these highly sophisticated and complex business arrangements.

When it comes to disclosing risk, I find it difficult to believe that any successful businessperson would overlook:

1. The nature of or reason he or she would be entering into a P3 agreement in the first place

2. The process used to qualify and select a legitimate, trustworthy partner

3. How the P3 is structured, including its terms and events that could lead to termination or default

4. Understanding completely his or her rights and obligations under the P3 arrangement/transaction

5. The benefits of engaging in a P3 arrangement contrasted against a more traditional approach to reaching his or her objectives

6. The relative benefits/revenues being received in exchange for his or her services

7. What significant risks P3 partners are undertaking in this arrangement

8. What obligations he or she can be reasonably expected to incur/pay over the life of the P3 arrangement or transaction

9. The ability to continually review the financial results of the P3, and how well the P3 arrangement/transaction is meeting its expected outcome(s).

So, if these are important enough for a business person to base a long-term inter-generational agreement on, why shouldn't the taxpayer also be on equal footing in regards to the risks or rewards that his or her government is exposing their families too?

For me, as a citizen representative to this P3 Task Force, the essential question for the task force is: **Why should the government act any differently than a successful businessperson trying to protect his or her personal interests or the interests of his or her investors—for the government that would be, we, the taxpayers—when entering into a public-private partnership?** Anything else would seem counterintuitive.

Accountability vs Auditing

I'd like to make one final point, if I may, and that is it is my understanding that the purpose of FASAB is to support the Treasury Department, the Office of Management Budget, as well as the GAO by providing the whole of the federal government with sound federal accounting standards.

I would like to point out, however, that the GA, in the acronym GAO, stands for **General Accountability, not General Auditing**. Speaking as a lay person, I find it difficult to understand (1) why disclosures would be limited to what an auditor may find easier to attest to and (2) how the GAO can hold the parties involved in a P3 agreement accountable without first providing each with a framework or understanding of what they need to be accountable for, especially when it comes to disclosing risks when entering into such an arrangement.

Thank you for giving me the opportunity to express my views.

Sincerely,

Larry Checco

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[i] **Kevin McHugh - Managing Director, Valuation & Financial Risk Management, Navigant Capital Advisors.**

Mr. McHugh focuses on providing valuable strategy, operations, fixed asset management and valuation solutions to the federal, state and local government as well as the higher education and healthcare communities throughout the United States.
Mr. McHugh brings more than 30 years of valuation consulting experience within these sectors, and focuses on service concessions, public/private partnerships, infrastructure valuation studies

(utilities, airport, roads, bridges, railways, tunnels, etc.), building componentization studies, pre/post BRAC readiness studies, asset impairment, intangible asset valuations, endowment and portfolio analysis and valuation, fixed asset inventory costing and valuation studies, real and personal property valuation studies and insurance valuation studies.
Mr. McHugh specializes in assisting clients to manage their financial reporting, asset stewardship and compliance requirements for various reporting standards as promulgated by the Office of Management and Budget (OMB), Governmental Accounting Standards Board (GASB), Financial Accounting Standards Board (FASB) and Federal Accounting Standards Advisory Board (FASAB). Prior to joining Navigant, Mr. McHugh was a Senior Vice President and National Managing Director with American Appraisal Associates.

[ii] **Bob Helwig, Deputy Director, Facilities Energy and Privatization, Office of the Secretary of Defense.**

Bob has been involved in the privatization of installation functions since 1996 when he joined the Department of Defense Housing Revitalization Office. Since that time he has been engaged in privatizing both military housing and utilities. Bob has been involved in all aspects of privatization, including concept development, contract solicitation, deal structuring, portfolio management, and financial analysis. His current responsibilities include development of policy and guidance, project analysis, program evaluation, military service oversight, budget scoring, and Congressional liaison. Bob has Bachelor degrees in Political Science and French from the California State University at Long Beach; a Master's degree in International Policy from the Monterey Institute of International Studies; and a Juris Doctor from George Washington University. He is a member of both the Maryland and Washington, D.C. Bars. He is currently a Doctoral Candidate in Public Administration at the University of Baltimore, writing his dissertation on P3s.

[iii] **Ed Noble, CPA – Partner, Reed & Associates.**

Mr. Noble has 39 years of experience in auditing and accounting which includes extensive experience in not-for-profit organizations and complex compliance and cost allocation issues. He has conducted forensic audits of non-profit organizations for the U.S. Attorney, the Federal Bureau of Investigation, Internal Revenue Service and the US Postal Service. In addition to his non-profit experience, Mr. Noble has extensive experience with performance and compliance audits of both commercial and government agencies, including the FDIC, U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services and the U.S. Department of Energy. Mr. Noble has also performed pre-award and contract close out audits of commercial entities and non- profits for various federal and state agencies. Mr. Noble is a Certified Public Accountant (CPA) a member of the New Jersey Society of Certified Public Accountants (NJSCPA) and a current member and past chair of the NJSCPA Nonprofit Interest Group. He is a speaker and class instructor for the AICPA on nonprofit and governmental accounting and auditing.

[iv] **Larry Checco – President, Checco Communications**

Larry is a nationally sought-after speaker on branding and leadership. He also serves as a consultant to both large and small organizations, companies, foundations and government

agencies. In addition, Larry conducts courses and workshops, and is a faculty member of the NeighborWorks® Training Institute—an adjunct of Southern New Hampshire University.
Larry's books, Branding for Success: A Roadmap for Raising the Visibility and Value of Your Nonprofit Organization, and Aha! Moments in Brand Management: Commonsense Insights to a Stronger, Healthier Brand have sold thousands of copies throughout the United States, Australia, Canada, South Africa, Sweden, Israel, Southeast Asia and elsewhere around the globe.
Larry has been recognized as a leading branding professional, and his articles on branding are cited and reprinted on countless websites.
Larry holds a degree in Economics from Syracuse University, as well as an MA in Journalism and Public Affairs from American University. - Please refer to Attachment 1 for written statement.

- **Michael Fischetti, Executive Director, National Contract Management Association**

Mr. Fischetti has held a number of senior leadership positions, including most recently Director, Acquisition Management and Support with the Office of the Assistant Secretary of Defense (Health Affairs)/TRICARE Management Activity; and Director, Office of Procurement and Assistance Policy with the Department of Energy.
Mr. Fischetti has 30 years of diverse acquisition experience, including leadership, management, policy, and contracting officer positions involving oversight, program management, and procurement operations of supplies and services in multiple government, civilian, and industry organizations.
Michael has an extensive record as a leader in the federal acquisition community and is widely recognized for his vision for the procurement and contract management profession.
He holds a Juris Doctorate (JD); an MS in national resource strategy from the National Defense University, Industrial College of the Armed Forces; an MA in business management from Central Michigan University; and a BA in economics and political science from the State University of New York at Buffalo. He is a certified professional contracts manager (CPCM), has attained Level 3 acquisition workforce certifications in contracting and program management with the DoD, and Level 3 contracting from the Department of Energy.