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Sent: Tuesday, December 16, 2014 2:54 PM
To: Karen Secker; Savini, Domenic N
Cc: Kane, Daniel F. (CMS/OAGM)
Subject: FASAB Requests Comments on Public-Private Partnerships: Disclosure Requirements

Karen/ Domenic,

Per your request, attached is OAGMs (Dan Kane) response to the subject request. Please let us know if you need additional information or have any comments/questions.

Many thanks.

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Office of Acquisition and Grants Management
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Federal Accounting Standards Advisory Board (FASAB) draft entitled “*Public-Private Partnerships: Disclosure Requirements*”

OAGM Review and Comments

Background

Definition

Federal public-private partnerships (P3s) are contractual arrangements¹ or transactions between public and private sector entities to provide a service or an asset for either government or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions. Sharing of risks and rewards is evidenced by conditions such as (1) agreements covering a significant portion of the economic life of a project or asset, and/or lasting more than five years, (2) financing provided in whole or shared in part by the private partner, (3) conveyance or transfer of real property, personal property, or multi-sector skills and expertise, or (4) formation of special purpose vehicles (SPVs).

The above definition captures the most widely identified features of federal P3s. P3s should be assessed against the conclusive and suggestive characteristics presented below to identify those subject to the disclosure requirements.

Identification of P3’s Requiring Disclosure

If any one of the following conclusive characteristics is met, the P3 arrangement or transaction should be considered for disclosure. P3 arrangements or transactions identified for disclosure should be further evaluated in light of the entity’s materiality considerations; including qualitative and quantitative thresholds.

¹ Risk-sharing arrangements can be either structural or transactional. P3 Structural Arrangements are external to the government entity’s operations and often involve the creation of a Special Purpose Vehicle (SPV), Trust, or Limited Partnership (LP). For example, military base housing. P3 Transactional Arrangements are internal to the government entity’s operations. For example, work-share programs not involving the creation of a SPV, Trust, or LP

Conclusive Characteristics	Rationale ²
1. The arrangement or transaction results in the conveyance or creation of a long-lived asset or long-term financing liability	Not all P3s result in the conveyance or construction of an asset. However, in those that do, the government's risk may be significantly increased because of costs that accompany asset ownership or control. Further, some private partners may incur substantial financing liabilities in preparation for delivering services even if an asset is not created.
2. The federal entity participates in, helps sponsor, or is party to a Special Purpose Vehicle (SPV), partnership, trust, etc.	Entities such as SPVs, partnerships, trusts, etc., can be established for a variety of strategic and/or tactical reasons. Generally speaking, they are commonly considered risk-containment vehicles and are more often than not, purposefully not included in budgets or balance sheets. P3s can be or most often become borrowing arrangements/transactions or alternative financing mechanisms. Therefore, the risk rests in the fact that because the established entity (for example, SPV) facilitates funding/financing, an agency's explicit or implicit long-term debt or promise to pay, the established entity is not appropriately recognized in either budget or financial reports.
3. The term of the procurement or contract is longer than 5 years ¹² .	Those P3 procurement or contract arrangements/transactions greater than 5 years pose greater risk to the federal entity because there is often no re-procurement or re-negotiation opportunity for the agency. As a result, changed conditions that could warrant a fair and reasonable re-negotiation or re-competition cannot be exercised and increased costs that would otherwise be avoided are incurred for the duration of the arrangement/transaction.

² The Rationale presented explains why the Board believes there is significant fiscal exposure when the characteristic is present. The rationale discusses risk broadly and is not intended to create specific disclosure requirements. The disclosures and related applicability comments are articulated starting on page 5.

<p>4. The principal arrangement or transaction is exempt from the Federal Acquisition Regulation (FAR).</p>	<p>The FAR is the primary regulation that governs the administrative framework and includes procurement and legal requirements to help safeguard and protect taxpayer dollars by preserving and protecting specific government (contractual) rights. Therefore, those P3s exempt from FAR are at an increased-risk because well-established safeguards and contract resolution mechanisms are absent in favor of substitute contract terms and conditions and/or alternate contract dispute resolution venues. As a result, the increased exposure arising from the loss of such contractual protections are not appropriately recognized or disclosed.</p>
Suggestive Characteristics	Rationale²
<p>1. A Value for Money (VfM) analysis is performed</p>	<p>The term VfM is almost always used in connection with P3 arrangements or transactions. VfM analyses are broader in scope emphasizing qualitative factors as opposed to the more traditional quantitatively based cost-benefit analyses most often performed. If an entity conducts a VfM analysis it is likely that the project in question is a P3. VfM's are typically more subjective than traditional cost-benefit analyses and are sometimes prepared ex-post facto thus increasing potential risk to the agency.</p>
<p>2. The consideration or items given up in an arrangement/transaction or their value are not readily apparent.</p>	<p>Generally under common law, consideration from both parties is required in order to have what constitutes a binding contract. Some courts have ruled that in those cases where the exchange appears excessively one sided, no quid-pro-quo exists and the contract may be void by law. Therefore, in those cases where consideration or its value from either party is not readily apparent, such cases could lead to recourse or remedies that have adverse financial ramifications to the agency.</p>
<p>3. Significant work force duties, activities, or knowledge are cross-shared between public and private sector P3 parties.</p>	<p>As federal entities face under-utilization and skill retention issues, with Congressional approval, some entities are entering into P3 arrangements/transactions to put both infrastructure and government personnel to heightened work. However, there is a concern that the analyses used to justify these arrangements or transactions often exclude</p>

	<p>government personnel costs including legacy costs (for example, pensions, OPEB's, etc.). Therefore, increased risk exists in those cases where such costs are excluded because the government (1) is left absorbing these costs with no related activity base, (2) is exposed to potential liabilities arising from union and/or employee litigation and (3) may lose governmental skill-sets that would lead to costlier contracting-out procurement options.</p>
<p>4. The focus is more on collaboration and informal, real-time, resolution processes than on formal, contractual, administrative processes.</p>	<p>Due to their very nature, P3 arrangements/transactions involve risk-sharing and in some cases, issues such as contract disputes are resolved informally. However, such informal resolution processes could lead to potential liability when contracting, procurement, or legal personnel are not involved. Therefore, the risk rests in the potential liability arising from informal resolution of what otherwise would require more formal contractual administrative processes.</p>
<p>5. The government relies on either the private sector partner's or a third party's determination of a P3's performance or return on investment/equity, without performing its own verification of performance/return on investment/equity.</p>	<p>Agencies often rely on 3rd party experts to assist in performing VfM and/or cost-benefit analyses, return-on-equity calculations, asset appraisals, risk-transfer analyses, etc. However, it has been noted both at the federal and state levels that conflicts of interest often exist because there are only a few firms who practice in this highly sophisticated area. As a result, some firms have provided advisory services to both the private partner and government sponsor of a P3 arrangement/transaction. In addition, fees are often based on the dollar volume of the arrangement/transaction creating what some believe are self-serving incentives. Therefore, the risk in those P3 arrangements/transactions rests where an agency does not or cannot perform its own independent analysis thus relying solely on either the private partner or a third party determination of a P3's performance or return on investment/equity without performing its own verification. Such analyses may belie the actual risk or fiscal exposure the government has or will incur.</p>

Disclosure Requirements

Disclosures should be provided for the initial period and all annual periods thereafter where an entity is party to a P3 arrangement/transaction. The following information should be disclosed:

- a. The purpose, objective, and rationale for the P3 arrangement or transaction and the relative benefits/revenues being received in exchange for the government's consideration, monetary and non-monetary, and the entity's statutory authority for entering into the P3.
- b. The mix and amount of funding, federal and non-federal, used to meet mission requirements and service delivery needs to support the P3.
- c. The operational and financial structure of the P3 including the entity's rights and responsibilities, including:
 - i. A description of the contractual terms governing payments to and from the government over the life of the P3 arrangement or transaction to include:
 1. in-kind contributions/services and donations,
 2. the time periods payments are expected to occur, and
 3. whether payments are made directly to each partner or indirectly through a third-party, such as, military housing allowances.
 - ii. The amounts received and paid by the government during the reporting period(s) and the amounts estimated to be received and paid during each of the succeeding five years and in aggregate over the life of the P3.
- d. Identification of the significant contractual risks the P3 partners are undertaking that could materially change the estimated cash flows, including a description of (1) the risk and (2) the potential effect on cash flows if the risks were realized (for example, early termination requirements including related exit amounts and other responsibilities such as asset condition (hand-back) requirements, minimum payment guarantees, escalation clauses, contingent payments, renewal options, etc.).
- e. As applicable:
 - i. Associated amounts recognized in the financial statements such as gains or losses and capitalized items.
 - ii. Significant instances of non-compliances with legal and contractual provisions governing the P3 arrangement or transaction.
 - iii. Whether the private partner(s), including any Special Purpose Vehicle (SPV), have borrowed or invested capital contingent upon the entity's promise to pay whether implied or explicit.
 - iv. Description of events of termination or default.

Applicability

Overarching Disclosure Principle: Significant Fiscal Exposure – The FASB’s Board desires to limit disclosure to those P3s possessing significant fiscal exposure. Significant fiscal exposure can result from various perspectives. For example, a key indicator that significant fiscal exposure exists in a P3 arrangement or transaction is when a long-lived asset or long-term financing liability exists in the arrangement or transaction regardless of which party recognizes said amounts. This is because (1) the inherent risks involved in acquiring, financing, operating and maintaining long-lived assets such as Property, Plant and Equipment, (PP&E) and certain intangible assets such as Patents or Trademarks, and (2) the risk-sharing nature of P3s, over very long periods creates the potential for significant fiscal exposure to extend to either party. Such significant fiscal exposure may extend even beyond what may have been contractually contemplated. However, significant fiscal exposure can exist absent a significant long-lived asset or sizeable long-term financing liability. For example, another key indicator of significant fiscal exposure in a P3 arrangement or transaction is when government skills are effectively transferred to the private party. In addition to being left absorbing personnel legacy costs, the government is exposed to potential fiscal exposure and liabilities arising from the need to turn to costlier contracting-out procurement options and union and/or employee litigation, respectively.

Therefore, if a P3 arrangement or transaction does not possess significant fiscal exposure, it would not be subject to the requirements of the FASB’s Statement.

Public-Private Partnerships (P3s)

Of the four objectives outlined in Statement of Federal Financial Accounting concepts (SFFAC):, *1, Objectives of Federal Financial Reporting*, the operating performance and budgetary integrity objectives are identified as being most important for P3 reporting. Because P3s are a form of investment, they should be adequately disclosed in order to assist report users in determining: (a) the important assets of the U.S. government and how effectively they are managed and (b) the identification of the risks (that is, financial exposure) associated with P3s.

OAGM/DFS’ Comments/Input:

- In addition to the very valid risks identified in the RATIONALE listed above there are additional concerns already experienced by CMS in the transition of moving from agreements to FAR based contracts such as: Mergers and Acquisitions what legal entity would be responsible over the long term since these typically are of 5 years or greater duration; lack of internal controls with disclosed practices creating significant uncertainty of actual cost data much less accountability for unallowable costs; lack of consistent contract or in this case (agreement) terms and conditions sufficient enough to properly address all anticipated risks with such agreements; and finally what happens when the other party (private entity) no longer exists who is responsible for the outcome of an otherwise agreed upon P3?

- These arrangements are not covered under FAR; therefore, what controls will be in place to ensure compliance with mandatory FAR criteria such as small business/social economic programs, etc. in the P3 arrangements? The answer lies with how they are written and structured which is not defined and thus leaves a great deal of risk associated with the drafters and the terms of these agreements.
- Guidance and direction needs to be provided on establishing a risk disclosure framework – risks associated with P3s and the use of quantitative and qualitative disclosures.
- Guidance and direction needs to be provided on how to determine when information should be disclosed based upon its qualitative aspects and whether auditors can attest to that information, such as the rationale for entering in to the P3.

For instance, On May 16, 2013, the Financial Accounting Standards Board (FASB) issued an exposure draft on proposed changes to accounting standards regarding Leases. The new standards will change the way leases are reported on company financial statements. Currently, Generally Accepted Accounting Principles (GAAP) requires companies to recognize capital leases as both an asset and a liability in balance sheets, while operating lease payments only affect current operating income. Future leasing liabilities are disclosed only in the footnotes of the financial statements.

- Should the Government contact CFO/Accounting departments for their input since this disclosure relates to financial accounting and reporting U.S. government-wide financial statements?
- In conclusion, P3s are complex transactions, and determining that a P3 is likely to provide a better result than a conventional approach is not simple. Therefore, education and training programs need to be provided to help understand and navigate the different aspects of implementing P3 projects and the possibility of establishing Subject Matter Experts (SME's). Additionally, although there may be merits when these type of arrangements make sense to move from the FAR based contracting world to P3s should be only on a very limited acceptance basis and with the Government's eyes wide open to all of the potential risks involved.