Federal Accounting Standards Advisory Board

PUBLIC-PRIVATE PARTNERSHIPS
DISCLOSURE REQUIREMENTS

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by January 2, 2015

October 1, 2014

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Federal Accounting Standards Advisory Board

October 1, 2014

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards, entitled *Public-Private Partnerships: Disclosure Requirements*, are requested. Specific questions for your consideration appear on page 5 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by January 2, 2015.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to e-mail your responses, we encourage you to fax the comments to (202) 512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
441 G Street, NW, Suite 6814
Washington, DC 20548

We will confirm receipt of your comments. If you do not receive confirmation, please contact our office at 202.512.7350 to determine if your comments were received.

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft.

Notice of the date and location of any public hearing on this document will be published in the Federal Register and in the FASAB's newsletter.

Sincerely,

Tom L. Allen

Chairman

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

To ensure that the full costs of Public-Private Partnerships (P3s) are recognized in the reporting entity's general purpose federal financial reports (GPFFRs) and appropriate disclosures are included, the Board anticipates providing implementation guidance in two phases.[1] The first phase as covered by this proposal addresses disclosure requirements to aid users in understanding the nature of P3s and related fiscal exposures. To that end, this proposed Statement establishes a definition of P3s and identifies risk-based characteristics that need to exist before considering the proposed disclosure requirements. The second phase of the project is scheduled to cover measurement and recognition issues. Specifically, the Board has previously addressed various types of long-term arrangements in which the government participates (for example, leases, guarantees, etc.). Existing accounting standards provide for measurement and recognition of assets/liabilities and revenues/expenses as well as disclosures of certain risks (that is, fiscal exposure) in these long-standing types of arrangements or transactions. Still, the Board believes that there is a need for disclosure requirements specific to the fiscal exposures existing in P3s. The requirements herein would not replace existing disclosure requirements in other statements of federal financial accounting standards (SFFAS) for similar arrangements or transactions such as leases. P3s are complex and an entity would apply all applicable standards to report relevant information in the notes regarded as an integral part of the basic financial statements. One member has an alternative view that expresses concerns related to the proposed definition of P3s, the proposed disclosure requirement for remote risks, the disclosure threshold for risks, and the nature of certain risks proposed for disclosure This member's alternative view is presented at page 38.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

Given the increasing use of P3s, the Board has identified a need for disclosures regarding these complex arrangements or transactions. By addressing disclosure issues as a first step, the Board will provide a mechanism to disclose information regarding the nature of these complex arrangements or transactions and their risks. The Board also believes there is a need for clarity with respect to the (full) costs of P3s and will continue working with stakeholders to identify measurement and recognition issues pertinent to P3s. As such, future proposals may address additional measurement and recognition guidance for certain types of P3 arrangements or transactions.

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

[1] This is subject to the acceptance of the technical agenda. The Board routinely consults with the Executive Director to prioritize its potential projects. As a result, active projects may change based on periodic prioritization by the Board. Please note that all agenda decisions are made at Board meetings by oral polling with agreement of at least a majority of members polled required for approval. Source: FASAB Rules of Procedure, October 2010.

objectives are identified as being most important for P3 reporting.[2] P3 reporting is important to meeting these objectives because the federal government is accountable to citizens for the proper administration of its resources. 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 being managed and (b) the identification of the risks (that is, fiscal exposure) associated with P3s.

[2] SFFAC 1, *Objectives of Federal Financial Reporting*, September 2, 1993.

Operating Performance Objective

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine:

- the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- the efficiency and effectiveness of the government's management of its assets and liabilities.

Budgetary Integrity Objective

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations. Federal financial reporting should provide information that helps the reader to determine:

- how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization,
- the status of budgetary resources, and
- how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

Source: SFFAC 1

The benefits of developing this Statement include but are not limited to:

a. Developing terminology and guidance that is meaningful to federal agencies and users.

b. Improving consistency in definitions so that information is comparable among agencies.

c. Disclosing information helpful in meeting the reporting objectives.

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QUESTIONS FOR RESPONDENTS

The Board encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also welcomes your comments on other aspects of the proposed Statement. Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

> Wendy M. Payne, Executive Director
> Federal Accounting Standards Advisory Board
> Mailstop 6H19
> 441 G Street, NW, Suite 6814
> Washington, DC 20548

All responses are requested by January 2, 2015.

Q1. The Board proposes defining the term "public-private partnerships" as shown below:

> Federal public-private partnerships (P3s) are contractual arrangements 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).

Do you agree or disagree that the P3 definition proposed at paragraph 17 captures the most widely identified features of federal P3s (refer to paragraphs A7 – A9 for a detailed discussion and related explanations)? Please provide the rationale for your answer.

Q2. The Board's proposed definition at paragraph 17 is intended to help identify risk-sharing arrangements or transactions that possess significant risk (that is, fiscal exposure) to the entity. Such arrangements or transactions are commonly referred to as *Public-Private Partnerships* (P3s) but may also be referred to as *Alternative Financing Arrangements* or *Privatization Initiatives*. For example, informal arrangements or transactions that do not share risks or rewards and are solely designed to foster goodwill, encourage economic development, promote research and innovation, coordinate and integrate strategic initiatives, etc., would generally be exempt from applying this Statement. One member has an alternative view that expresses concern that the definition of P3s is not confined solely to P3 arrangements or transactions and is not sufficiently clear to facilitate consistent application of the standard (refer to paragraphs A31-A41 for the Alternative View).

a. **Do you agree or disagree that the P3 definition helps identify risk-sharing arrangements or transactions that could possess significant risk (that is, fiscal exposure) to the federal reporting entity (refer to paragraphs 17, 18, A7- A9, and A10 - A12 for related comments)? Please provide the rationale for your answer.**

b. **Do you agree or disagree that the P3 definition, while capturing P3s based on their most widely identified features, excludes contracts or other arrangements or transactions that are routine in nature and not generally identified as P3s for other purposes (refer to paragraphs 17, 18, A7- A9, and A10 – A12 for related comments)? Please provide the rationale for your answer.**

c. **Are there any features other than those identified in the proposed P3 definition that would assist entities in identifying risk-sharing arrangements or transactions that could possess significant risk (that is, fiscal exposure) to the federal reporting entity (refer to paragraphs 17, 18, A7- A9, and A10 - A12 for related comments)? Please provide the rationale for your answer.**

d. **The scope of the ED excludes those informal arrangements or transactions that do not share risks or rewards and for example, are solely designed to foster goodwill, encourage economic development, promote research and innovation, coordinate and integrate strategic initiatives, etc. Do you agree with the exclusion? Is it clear what would be excluded by this provision? If not, what features, if any, differentiate them from those arrangements or transactions that do possess significant risk (that is, fiscal exposure) to the federal reporting entity (refer to paragraphs 17, 18, A7- A9, A10 – A12, and A13 – A14 for related comments)? Please provide the rationale for your answer.**

e. **Do you agree or disagree with the one member's concern that the definition of P3s is not confined solely to P3 arrangements or transactions and is not sufficiently clear to facilitate consistent application of the standard (refer to paragraphs A31-A41 for the Alternative View)? Please provide the rationale for your answer.**

Q3. The Board has developed P3 risk-based characteristics (that is, conclusive and suggestive characteristics) to ascertain what P3s, if any, should be considered[3] for disclosure (refer to paragraphs A1 – A6 for related comments). The characteristics apply to all types of P3's; construction, housing, utilities, military depots, etc. These characteristics may eliminate the need to disclose P3 arrangements/transactions that do not possess significant fiscal exposure(s).

a. **Do you agree or disagree that only those P3s (identified pursuant to the above definition) possessing risk-based characteristics (that is, conclusive or suggestive characteristics) should be subject to the disclosure requirements proposed at paragraphs 21 – 24 (refer to paragraphs A13 – A14 for a detailed discussion and related explanations)? Please provide the rationale for your answer.**

b. **Do you believe that there are other arrangements or transactions besides P3s for which the risk-based characteristics are present and therefore disclosure should be required? Please provide the rationale for your answer.**

c. **Do you believe that when the final Statement becomes effective, the entities with which you are associated have P3s that are subject to disclosure pursuant to the proposed requirements (refer to paragraphs A1, A4, A6(a), A10 – A12 for a detailed discussion and related explanations)? Please provide the rationale for your answer.**

[3] Considering for disclosure would include further evaluation as stated in the referenced paragraphs and be made in light of the entity's materiality considerations; including qualitative and quantitative thresholds.

Q4. The Board proposes that the P3 risk-based characteristics be categorized as either: conclusive characteristics - where answering “Yes” to any one characteristic means the P3 arrangement or transaction should be considered for disclosure; or suggestive characteristics - where answering "Yes" to any one suggestive characteristic suggests that the P3 arrangement or transaction may be subject to disclosure but that preparers consider suggestive characteristics in the aggregate before reaching a final decision. Each conclusive characteristic is meant to be definitive whereas each suggestive characteristic will require entity judgment as each one is analyzed in connection with the other suggestive characteristics. The conclusive and suggestive characteristics are presented at paragraphs 19 to 20 and more fully discussed at paragraphs A15 – A16.

Do you agree or disagree with the risk-based characteristics, their related classification as either conclusive or suggestive, and their proposed application at paragraphs 19 and 20 (refer to paragraphs A15 – A16 for a detailed discussion and related explanations)? Please provide the rationale for your answer.

Q5. The Board proposes the following component reporting entity disclosures:

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.

Do you agree or disagree with the component entity report disclosures proposed at paragraph 23 (refer to paragraphs A25 – A27 for a detailed discussion and related explanations)? Please provide the rationale for your answer.

Q6. The Board believes that significant P3 risks, including those that may be deemed remote should be disclosed. One member has an alternative view that expresses concern that (1) disclosure of remote contingencies is not limited to the terms of contractual arrangements, (2) the concept of "significant exposure" is not sufficiently clear to result in consistent disclosures, and (3) risks related to entity operations or performance (referred to in the Alternative View as business risks) would be included in the risk disclosures (refer to paragraphs A31-A41 for the Alternative View). The Board's position is as follows:

> *Consideration should be given to those risks that management does not expect to be likely, but represent a significant exposure to the government if they were to occur. With this being said, the Board also notes that such remote risks may have a reasonably high materiality threshold. As such, remote risks should not be dismissed from disclosure without further consideration of user needs and the qualitative and quantitative characteristics when applying materiality.*

a. **Do you agree or disagree with the Board's position as stated above and included at paragraph A24 (refer to paragraphs A22 – A24 for a detailed discussion and related explanations)? Please provide the rationale for your answer.**

b. **Do you agree or disagree with the one member's concern that (1) disclosure of remote contingencies is not limited to the terms of contractual arrangements, (2) the concept of "significant exposure" is not sufficiently clear to result in consistent disclosures, and (3) risks related to entity operations or performance (referred to in the Alternative View as business risks) would be included in the risk**

disclosures (refer to paragraphs A31-A41 for the Alternative View)? Please provide the rationale for your answer.

Q7. The Board proposes that due to the relative complexity and potentially large number of P3s that an entity might be party to, the proposed disclosures would permit entities to provide broad summarized information instead of individual arrangement or transaction detail. For example, disclosures of P3 arrangements or transactions could be grouped by an entity's strategic objectives, departmental or bureau categorizations, program budget classifications, etc. In this way, users are presented with information that is comprehensive and material to an entity's financial statements without placing an undue burden on preparers to provide P3 specific or granular level information.

Do you agree or disagree that entities should be permitted to aggregate or group disclosures as proposed at paragraph 21 (refer to paragraphs A28 – A29 for a detailed discussion and related explanations)? Please provide the rationale for your answer.

Q8. The Board encourages respondents to not only provide input concerning any and all aspects of the proposed changes, including whether concepts are sufficiently clear and the proposed effective date, but also other matters which may not have been specifically addressed in this exposure draft. In addition, the basis for conclusions explains the Board's goals for this project (see comments beginning at paragraph A1) and also discusses other issues raised by task force members as well as experts and practitioners both within and external to government (as an example, see paragraphs A4 through A6). Respondents are asked to particularly note the Alternative View beginning at Paragraph A31.

Please provide any comments or suggestions you have regarding the goals for this project, other issues identified in the basis for conclusions, or areas which have not been addressed.

INTRODUCTION

PURPOSE

1. The requirements for effective government continue to expand despite shrinking or limited funding, human capital skill sets, and other resources. To meet that challenge, government is increasingly establishing risk-sharing arrangements or transactions[4] with the private sector to deliver infrastructure, facilities, goods, and services in a less costly and more operationally efficient manner. From the point of view of the governmental entity (entity), entering into these arrangements or transactions may be seen as beneficial and in some cases essential for a variety of reasons. To that end, entities may employ risk-sharing as a way of delivering public value that might otherwise not be achieved.

2. These risk-sharing arrangements or transactions are commonly referred to as **Public-Private Partnerships (P3s)**[5] but may also be referred to as Alternative Financing Arrangements, or Privatization Initiatives, some of which are extremely complex. For example, P3s may involve the use of appropriated funds, non-appropriated funds, third-party financing, or significant amounts of private capital or investment. Furthermore, P3s can (1) be so long-term in nature that costs along with the accompanying benefits may not be distributed equitably across generations, (2) exclude contractual protections afforded the government by the Federal Acquisition Regulation (FAR) such as, but not limited to: termination rights and obligations, contract by negotiation, cost accounting administration, and contract cost allowability, and (3) require the government to provide resources or absorb losses greater than other alternative procurement methods or competing in-house[6] performance. Lastly, P3s may involve the transfer of government assets, including intellectual property, into private hands for extended periods of time.

3. As a result, the Board recognizes the accounting and reporting issues related to risk-sharing can also be extremely complex, involving a wide array of assets and liabilities. P3s by their very design transfer or share various forms of risk among the P3 partners. Such risk allocation strategies are in essence the very incentives that serve as the foundation or building blocks for P3s. Therefore, an entity should understand how much (total) risk resides in an arrangement or transaction and how much of that risk has been (1) transferred to the private partner, (2) shared with the private partner, and (3) retained by the entity (that is, government sponsor). Such an understanding relies on a thorough analysis of the underlying contractual agreements, guarantees, insurance and indemnification strategies as well as the

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[4] 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.

[5] Terms defined in the Glossary are shown in bold-face the first time they appear.

[6] In-house refers to using Government facilities and personnel as opposed to relying on commercial sources to supply the products and services the Government needs.

existence and nature of any underlying private party capital buffer that might exist; that is, the extent of any debt (e.g., bonds, loans, notes, etc.) and equity (e.g., stocks, other securities representing an ownership interest, etc.) participation.

4. Entities can execute P3s via **structural arrangements** through the use of **special purpose vehicles (SPV's)** and/or directly as **program transactional arrangements**. Furthermore, many P3s are either discrete (long-term) leases or involve aspects of leasing.

5. The Board has previously addressed various types of long-term arrangements or transactions in which the government participates (for example, leases, guarantees, etc.). As such, accounting standards exist that provide for recognition and measurement of assets/liabilities and revenues/expenses as well as disclosures of certain risks in these long-standing types of arrangements or transactions. This Statement supplements existing guidance to help ensure adequate disclosure of those arrangements/transactions that either form the basis of or are part of a P3. Therefore, existing accounting standards that govern the various types of long-term arrangements/transactions continue to apply. The Board would address any implementation issues that may arise during this project's second phase. Moreover, the Board believes the more immediate need is for disclosure requirements specific to P3 risk-sharing.

6. To that end, the Board notes that there are risks associated with P3s. For example, risks (1) where actual costs will be greater than budgeted costs, (2) the entity may have to absorb part or all of the project's private debt, (3) the entity will not achieve expected returns on its investments in limited partnerships, (4) conditions may lead to a government-acknowledged event where an entity assumes financial responsibility for the event, and (5) the public purpose or public value will not be fulfilled or achieved. Because of the risks involved in entering into such long-term agreements, some of which involve government assets, specific disclosures regarding P3s are needed. Such disclosures foster accountability and improve understanding of (1) the general risks inherent in P3 arrangements by revealing their purpose, objective, funding, operational and financial structures; and (2) significant contractual risks such as early termination requirements. Disclosures should generally accompany the related asset and/or liability display contained within the financial statements.

7. A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. Some risks associated with P3s may result in the incurrence of losses and applying Statement of Federal Financial Accounting Standards 5 (SFFAS 5): *Accounting for Liabilities of the Federal Government* would be appropriate. For recognition of losses, SFFAS 5 requires that a past event has occurred for which a future outflow or other sacrifice of resources is probable and measurable. Disclosure should be provided for reasonably possible losses.

8. Due to their very nature, P3s are used to manage risks, some of which may be deemed remote but are nonetheless significant and should be considered for disclosure. For example, excluding contractual protections afforded the

government by the Federal Acquisition Regulation[7] (FAR) inherently increases the entity's risk as does a relationship with an industry or private partner that may require the government to provide resources or absorb losses beyond what was contemplated. It is the Board's opinion that significant remote risks that are material should be disclosed. Therefore, consideration should be given to those risks that management does not expect to be likely yet could represent a significant exposure to the entity. With this being said, the Board also recognizes that (1) certain remote risks may have a reasonably high materiality threshold, and (2) not all individual remote risks in a P3 arrangement or transaction need to be disclosed to satisfy the requirements of this Statement. As such, remote risks should not be dismissed from disclosure without further consideration of user needs and the qualitative and quantitative characteristics when applying materiality.

9. Disclosures comprise quantitative and qualitative information and not all P3 risks lead to fiscal exposure or can be readily or sufficiently measured. However, federal financial reports are most likely to meet reporting objectives and, therefore, user's needs when disclosures help readers understand complex arrangements or transactions and the associated risk. To this end, qualitative disclosures are as important as quantitative disclosures. Further, both quantitative and qualitative factors should be considered in assessing materiality as well as the nature and content of information to be disclosed.

10. Because the Board has identified the need for clarity with respect to questions that arise concerning the full costs, including risk (that is, fiscal exposure) of these complex arrangements or transactions, this Statement is a first step toward developing principles-based guidance and identifying potential gaps in existing guidance. The Board is working, and will continue to work closely with stakeholders interested in improving the accounting and reporting of these complex arrangements or transactions. By addressing disclosure issues as a first step, the Board will facilitate continued cooperation and greater interest in identifying areas requiring attention while minimizing preparer burden. It should be noted that the Board also plans to address measurement, recognition, and reporting issues through continued consultation with stakeholders. This could lead to the issuance of additional guidance and/or standards.

MATERIALITY

11. The provisions of this Statement need not be applied to immaterial items. However, materiality should be applied cumulatively or in the aggregate by the entity. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. Refer to paragraphs 8 and 9 above for related comments.

[7] For example, contractual protections afforded the government by the Federal Acquisition Regulation (FAR) include but are not limited to: termination rights and obligations, contract by negotiation, cost accounting administration, and contract cost allowability,

PROPOSED STANDARDS

SCOPE

12. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles*, including the Application of Standards Issued by the Financial Accounting Standards Board.

13. This Statement addresses P3s and this term is used to refer to a wide variety of service, management, operating, and research and development arrangements or transactions. Such arrangements and transactions may include contracts, grants, alternative financing arrangements, privatization initiatives, and other arrangements or transactions.

14. The Statement provides a general definition of P3s and related disclosure criteria. The arrangements or transactions that fall within the scope of this Statement should be assessed against the conclusive and suggestive characteristics to identify those considered for disclosure. These characteristics along with materiality considerations would determine whether reporting certain P3 arrangements/transactions are necessary.

15. Leases[8] that are not bundled[9]and are entered into using GSA-delegated authority are excluded from the provisions of this Statement. This Statement does not amend existing standards applicable to leases and those standards remain applicable to all such arrangements/transactions. Acquisition of supplies and services, including construction, research and development, and commercial items, made pursuant to the Federal Acquisition Regulation (FAR) *Simplified Acquisition Procedures* (FAR Part 13) are excluded from the provisions of this Statement.

16. This Statement does not alter financial measurement and recognition requirements but may result in changes in practice due to the establishment of the proposed P3 definition focusing attention on P3s.

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[8] Leases include both capital and operating leases, as defined under current FASAB standards. The Board is currently considering changes to existing distinctions between capital and operating leases through a separate project on lease accounting. Potential changes to existing lease distinctions are not expected to alter the Board's exclusion of certain leases as described in paragraph 15, from the provisions of this guidance.

[9] A bundled lease typically arises when parties to a leasing arrangement agree to include additional products or services in the leasing arrangement, some of which might be related or tied directly to the underlying leased product or services (for example, software updates, maintenance, etc.). Although these additional products or services are not always expressly identified in the underlying lease agreement and may be documented in other agreements, they are nonetheless considered "bundled" with the underlying lease agreement.

DEFINITION

17. Federal public-private partnerships (P3s) are contractual arrangements[10] 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).

18. 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 DISCLSOURE

19. 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.

Conclusive Characteristics	Rationale[11]
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	Entities such as SPVs, partnerships, trusts, etc., can be established for a variety of strategic

[10]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.

[11] The Rationale presented herein 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 are articulated in paragraph 23. Please refer to BFC Paragraph A-11a for related comments.

Conclusive Characteristics	Rationale[11]
Vehicle (SPV), partnership, trust, etc.	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.
4. The principal arrangement or transaction is exempt from the Federal Acquisition Regulation (FAR).	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.

[12] Federal contracts are normally for one year but can be extended to five years through agencies' use of options. Source: 48 C.F.R. § 17.204(e) "Unless otherwise approved in accordance with agency procedures, the total of the basic and option periods shall not exceed 5 years in the case of services, and the total of the basic and option quantities shall not exceed the requirement for 5 years in the case of supplies."

20. While meeting one of the suggestive characteristics implies there is some persuasive evidence that the information at paragraph 23 may need to be disclosed for the P3. each characteristic must be considered in the aggregate with the other suggestive characteristics before a final decision is reached. Each conclusive characteristic is definitive whereas each suggestive characteristic will require entity judgment as each characteristic is analyzed in connection with the other suggestive characteristics. P3 arrangements or transactions considered for disclosure should be further evaluated in light of the entity's materiality considerations; including, qualitative and quantitative thresholds.

Suggestive Characteristics	Rationale[11]
1. A **Value for Money**[13] (VfM) analysis is performed.	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.
2. The consideration or items given up in an arrangement/transaction or their value are not readily apparent.	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.

[13] The National Council of Public Private Partnerships has adopted the United Kingdom's, Her Majesty's Treasury Value for Money definition as contained in Her Majesty's Value Assessment Guide:

> "VfM is defined as the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirement. VfM is not the choice of goods and services based on the lowest cost bid. To undertake a well-managed procurement, it is necessary to consider upfront, and at the earliest stage of procurement, what the key drivers of VfM in the procurement process will be".

In other words, VfM is a much broader concept than typical cost-benefit analysis because it emphasizes "value" in more of a qualitative than quantitative manner. Quantitatively, some VfM models use a project's Internal Rate of Return (IRR) to help determine project acceptability. The VfM concept has drawn criticisms not only because of its subjectivity and lack of rigor in application, but because in some cases (1) cash flows can be easily managed to meet desired expectations and (2) VfM results are used as ex-post facto justifications for qualitatively made project and/or award decisions. It is important to note that the same criticisms can be made of the more traditional cost-benefit analyses used in management decision making.

Suggestive Characteristics	Rationale[11]
3. Significant work force duties, activities, or knowledge are cross-shared between public and private sector P3 parties.	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 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.
4. The focus is more on collaboration and informal, real-time, resolution processes than on formal, contractual, administrative processes.	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.
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.	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

Suggestive Characteristics	Rationale[11]
	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.

DISCLOSURE REQUIREMENTS

COMPONENT REPORTING ENTITY DISCLOSURES

21. The P3 disclosures at paragraph 23 below specify the inclusion of qualitative and quantitative information and may be aggregated or grouped by an entity's strategic objectives, departmental or bureau categorizations, program budget classifications, or other means.

22. Disclosures should generally accompany the related asset and/or liability display contained within the financial statements. Depending on the circumstances, some of the listed information may be disclosed due to other requirements. The resultant disclosures should be integrated so that concise, meaningful and transparent information is provided and information is not repetitive.

23. 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.

Financial Report of the US Government Disclosures

24. The U.S. government-wide financial statements should disclose the following information:

a. general description of P3 arrangements or transactions,

b. the consolidated amounts the government receives and pays 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, and

c. reference(s) to applicable component entity report(s) for additional information.

EFFECTIVE DATE

25. The requirements of this Statement are effective for reporting periods beginning after September 30, 2017. Early adoption is permitted.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

A1. As part of FASAB's technical agenda-setting process this project was added in April 2012 because federal agencies have increasingly turned to public-private partnerships to accomplish goals and in light of budget pressures likely to further increase their use. Although federal generally accepted accounting principles are fairly robust, the Board noted that due to the complex nature of P3s significant study would be required regarding a host of issues dealing with the definition, measurement, and recognition of P3s. In December 2012, the project plan was adopted with the overall goal of recognizing the full costs of P3s in the financial statements. In addition, the formation of a P3 task force began and its inaugural meeting was held in February 2013.

A2. With active work on this project beginning in FY2013, final standards or guidance are expected following a three year effort. Specific project objectives include:

a. Defining terms

b. Providing guidance (that is, identifying gaps) for the recognition and measurement of:

    i. assets and liabilities,

    ii. revenues and expenses, and

    iii. establishing disclosure requirements.

c. Considering guidance for other arrangements/transactions related to P3s (for example, sale-leaseback or other long-term arrangements)

A3. Early in its deliberations the Board was clear that forthcoming guidance must be consistently applied and covered by an overarching principle(s). Specifically, the Board noted that it should look to establish uniform, principles-based guidance to enhance comparability among agencies, identify gaps in existing guidance, and avoid duplicating guidance or creating standards-overload. The Board noted its concern is with the risks to which the government is exposed and related disclosures. As a result, members decided that because P3s often involve innovative operational and complicated accounting practices, accompanied by sophisticated financing agreements, these complexities necessitate the establishment of disclosure requirements as a first step to (1) developing uniform, principles-based guidance, and (2) identifying potential gaps in existing guidance. To that end, the Board decided that a broad P3 definition accompanied by risk-based characteristics should be pursued to establish a framework for determining which P3s should be disclosed.

A4. P3 task force meetings for this phase of the project were held between February 2013 and May 2014. All meetings were well attended with representation from federal agencies, commercial sector(s), and citizens. Participants came from diverse disciplines such as accounting, auditing, facilities management, financial reporting, housing, information technology (IT), commercial and investment banking, procurement, and program management. The majority of participants agreed that there is significant interest in P3s across the diverse disciplines represented. It was noted that conditions such as current budget constraints and capacity (that is, contingency) planning are driving some agencies to look at various P3 models to accomplish their missions. Both federal and private participants agreed there is strong pressure against the use of P3s noting that this probably arises from the “off balance sheet” or “off budget spending” stigma associated with these arrangements or transactions. To counter the stigma associated with the term *Public-Private Partnerships,* some entities have begun re-labeling their P3 initiatives as *Alternative Financing* and/or *Privatization Initiatives.* A citizen stated that absent empirical evidence supporting the notion that P3s in fact work, a citizen’s concern is that the government is assuming more risk than it would otherwise. In light of the fact that many private companies appear to possess large amounts of available capital to invest in P3 projects, the citizen suggested that this be an area of careful consideration calling for transparency and robust disclosure.

A5. To best meet the project goals and objectives, staff, in addition to engaging in task force discussions, initiated fact-finding meetings with experts and practitioners both within and external to government. Staff met with federal agency representatives, public policy experts, consultants, private equity participants and a private IT/Cloud/Software development firm. Please refer to Tables 1.0 and 2.0 respectively for listings of the federal agencies visited or analyzed and the professionals or disciplines consulted. The goal of the fact-finding meetings was to refine the project’s scope by:

a. identifying the types of arrangements/transactions where part of the agency’s risk profile has been transferred to (or shared with) the a private partner,

b. identifying current P3 issues being faced by the participant(s),

c. soliciting input/suggestions on potential P3 financial reporting characteristics/criteria, and

d. analyzing arrangements/transactions for potential accounting policy issues.

TABLE 1.0

Fact-Finding Agencies Visited or Analyzed

Executive Agency*
Agency for International Development
Department of Commerce *
Department of Defense
Department of State
Department of Transportation/FHWA
Department of the Treasury
National Aeronautics and Space Administration
National Science Foundation
Veterans Affairs

* = Department of Commerce - no visit was made. GAO Congressional analysts provided information concerning a Department of Commerce P3 that was currently under audit.

TABLE 2.0

Professionals/Disciplines Consulted

	Profession/Organization/ Discipline	Federal	Non-Federal
1.	International Business & Finance Consultants		2X
2.	Procurement Professionals		2X
3.	Public Service Employee Union		X
4.	World Bank Finance Director		X
5.	P3 Attorney-Consultants		2X
6.	IT/Cloud Program Manager		X
7.	Agency Inspector General	X	
8.	Agency Policy Accountants	2X	
9.	Agency RP/Utility Directors	2X	
10.	Agency Deputy CFO	X	
11.	Agency Risk Manager	X	
12.	GAO Congressional Analysts	X	
13.	Agency P3 Program Manager	X	

Table 2.0 Note: An “X” signifies a single interview whereas as “2X” signifies that two persons usually from different organizations were interviewed.

Common Themes and Other Matters

A6. The most common themes arising from task force and fact finding meetings considered in developing the Statement include:

a. At a minimum, participants expect continued use if not growth in P3s.

b. Government employee legacy & relocation costs are not presently considered in Value for Money (VfM)[14] analyses.

[14] *The National Council of Public Private Partnerships* has adopted the United Kingdom’s, Her Majesty’s Treasury Value for Money definition as contained in Her Majesty’s Value Assessment Guide:

> *VfM is defined as the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user’s requirement. VfM is not the choice of goods and services based on the lowest cost bid. To undertake a well-managed procurement, it is necessary to consider upfront, and at the earliest stage of procurement, what the key drivers of VfM in the procurement process will be.*

In other words, VfM is a much broader concept than typical cost-benefit analysis because it emphasizes “value” in more of a qualitative than quantitative manner. Quantitatively, some VfM models use a project’s Internal Rate of Return (IRR) to help determine project acceptability. The VfM concept has drawn criticisms not only because of its subjectivity and lack of rigor in application, but because in some cases (1) cash flows can be easily managed to meet desired expectations and (2) VfM results are used as ex-post facto justifications for qualitatively made project and/or award decisions. It is important to note that the same criticisms can be made of the more traditional cost-benefit analyses used in management decision making.

c. Long-term nature of P3s is accepted, but concerns include
   - lack of transparency in the solicitation and award processes along with the lack of competition hinders accountability and fair and reasonable pricing,
   - not applying the *Federal Acquisition Regulation*[15] (FAR) increases government risk, and
   - some P3s circumvent procurement administration.

d. In-Kind contributions are difficult to value or are overvalued and not always reported.

e. P3 financial reporting is generally supported but agencies and participants vary in the what, how and where of disclosures.
   - For example, relative to significant and material P3 arrangements/transactions, some believe that property, plant, and equipment (PP&E) note disclosure would be sufficient whereas others believe that MD&A discussion is more appropriate because of the SFFAS 15, *Management's Discussion and Analysis,* requirement to address the future effects of existing, currently-known demands, risks, uncertainties, events, conditions and trends, while others suggest reporting in both locations.

Other Matters

- **Increased Risk to Citizens.** A few participants noted that P3s erode (1) the notion of public service (for example, what is inherently governmental) and (2) in many cases, belief in good government. This increased risk is evidenced by those entities that:
  a. purposefully avoid capital acquisition budgeting requirements
  b. absorb "availability" risk[16] absent sufficient private partner consideration
  c. lose control of assets
  d. lock into long-term arrangements/transactions that cannot be re-competed or re-negotiated
  e. are constrained by contract modification restrictions
  f. are constrained by proximity and/or right-to-compete restrictions
  g. ignore government employee personnel (legacy) costs

[15] The FAR is the primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services with appropriated funds. It became effective on April 1, 1984, and is issued within applicable laws under the joint authorities of the Administrator of General Services, the Secretary of Defense, and the Administrator for the National Aeronautics and Space Administration, under the broad policy guidelines of the Administrator, Office of Federal Procurement Policy, Office of Management and Budget.

[16] Availability risks or project completion risks exist when for example, defects in construction or quality shortfalls within the control of the private partner occur that preclude the asset or service from being available for its intended use requiring the government sponsor to intervene.

- **Financing costs.** To enable private financing to work, P3's must be longer-term in nature to allow for sufficient time to liquidate debt and achieve return on investment targets. This is significantly different than traditional procurement contract periods that are typically 5 years or less.
- **Performance Metrics.** Financial reporting would be enhanced by incorporating performance metrics that could point to both risks and potential liabilities as they arise.

Definition: Public-Private Partnerships

A7. The Board believes that a definition should be established in order to best assist the preparer community with the accounting for and reporting of P3s. The Board desires establishing a definition that (1) reflects actual federal P3 practices, (2) covers the wide breadth and diverse scope of federal assets, and (3) focuses on the risk-sharing or risk transfer strategies that are the very essence of these complicated arrangements or transactions. The definition is intended for general application to be applied uniformly across the federal government.

A8. In reviewing the P3 definitions of other standard-setters, the Board notes that their guidance is largely focused on service concession arrangements (that is, a sub-set of P3s) that directly benefit the general public. The definition contained in this exposure draft is much broader primarily as a result of actual federal P3 practices reflecting the wide breadth and diverse scope of federal assets being managed. It is important to note that (1) federal preparers and auditors have identified accounting topics that extend beyond those typically found in service concession arrangements; for example, excess and/or underutilized infrastructure and facilities, in-kind consideration, non-monetary exchanges, and fair value, (2) oversight entities such as the Congressional Budget Office (CBO), Government Accountability Office (GAO), and inspectors general have defined and identified P3 arrangements or transactions to be more than just service concessions, and (3) service concession accounting guidance primarily reflects economic development initiatives such as new roads, toll roads, highways, airports, railways, hospitals, etc., whereas federal initiatives extend well beyond economic development such as the common defense and general welfare of the nation thus necessitating corresponding accounting guidance to best fit these federal initiatives.

A9. In developing the definition, the Board relied on the task force's review of existing definitions from several authoritative sources. The task force identified the more common characteristics of P3s which are believed to exist in the federal government. Some of the more common P3 characteristics identified include: existence of very long-term contractual agreements (for example, anywhere from five to 99 years), shared or transferred financing, agreements covering a significant portion of the project's or asset's life, shared risks, shared rewards, shared skills and expertise, conveyance or creation of real and personal property, and the use of special purpose vehicles (SPV's). Accordingly, a broad definition was developed to encompass the diverse characteristics. Therefore the definition is:

> Federal public-private partnerships (P3s) are contractual arrangements 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).

Scope, Applicability and Exclusions

Scope

A10. The Board recognizes that establishing a P3 definition reflecting the breadth and diverse scope of entity missions, operational strategies, available leasing authorities, and other variables might capture activities which are already being recognized or disclosed in the entity's financial statements. Specifically, this is because the Board has previously addressed various types of long-term arrangements/transactions in which the government participates (for example, leases and guarantees). As such, existing accounting standards provide for recognition and measurement of assets/liabilities and revenues/expenses as well as disclosures of certain risks in these long-standing types of arrangements or transactions. However, the Board believes that there is a need for disclosure requirements specific to the fiscal exposures existing in P3s for which there is no current accounting guidance. The requirements herein would not replace existing disclosure requirements in other statements of federal financial accounting standards (SFFAS) for similar arrangements or transactions such as leases. P3s are complex arrangements/transactions and an entity would apply all applicable standards to report relevant information in the notes.

Applicability

A11. To help ensure achievement of the federal reporting objectives while minimizing unwarranted disclosure of P3 arrangements or transactions, the Board has established filters at several decision points to aid preparers in this regard. The filters are categorized as follow:

a. Overarching Disclosure Principle: Significant Fiscal Exposure – The 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[17] involved in

[17] Projects typically contain a variety of inherent risks than can affect the entire project life cycle. For example, there are regulatory, procurement and financing risks affecting a project's development phase and changes in market conditions, maintenance and other operational risks that affect a project's construction and operations phases. Inherent risks could be assessed using such factors as: potential financial exposure, degree of complexity, nature and extent of the use of estimates and/or projections, and adverse impact to the entity's reputation.

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 this Statement.

b. Definitional Features Indicative of Risk (Fiscal Exposure) – After careful study, the Board has identified four major features of federal P3 arrangements or transactions that are embodied in the proposed definition: (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 SPV's. Therefore, those arrangements not possessing one or more of the four features would generally not be subject to the requirements of this Statement.

c. Risk-based Characteristics – The Board has identified certain key characteristics discussed later that reflect varying degrees of risk that exist in federal P3s. Therefore, should these characteristics be absent in a P3, the disclosure requirements of this Statement would generally not apply.

d. Materiality – As is the custom with all Statements issued by the Board, only those P3s that are material (qualitatively and quantitatively) in nature, more thoroughly discussed later, should be subject to the requirements of this Statement. The Board notes that because materiality assessments require both qualitative and quantitative judgments, specific guidance limiting preparer and auditor considerations of information would not be appropriate.

Exclusions

A12. The Board proposes excluding from the provisions of this Statement (1) acquisitions made using Simplified Acquisition Procedures (FAR Part 13) and (2) leases[18] meeting certain conditions. It is the Board's opinion that acquisitions of supplies and services, including construction, research and development, and commercial items using Simplified Acquisition Procedures are not within the intended scope of this Statement. Concerning leases, in consultation with the P3 Task Force and after careful consideration, the Board concluded:

a. to exclude non-Enhanced Use Leases[19] (EULs) that meet the following two conditions: a) they are not bundled, and b) they are entered into using GSA delegated authority. It is the Board's conclusion that such leases (1) have no significant P3 fiscal exposure (risks), (2) are already subject to existing FASAB guidance, (3) have well defined FAR-based contractual processes and remedies in place to address risks associated with landlord-tenant relationships, (4) have contractually capped payments for termination liabilities, and (5) have termination payments that are indemnified by GSA's Building Fund. It is the Board's conclusion that if a lease is either bundled or not entered into using GSA delegated authority, the provisions of this Statement should apply.

   i. Bundled Leases - A bundled lease typically arises when parties to a leasing arrangement agree to include additional products or services in the leasing arrangement, some of which might be related or tied directly to the underlying leased product or services (e.g., software updates, maintenance). Because these additional products or services are not always expressly identified in the underlying lease agreement and may be documented in other agreements, they are nonetheless considered "bundled" with the underlying lease agreement.

      – Examples of bundled equipment leases can range from leasing high-end, sophisticated medical equipment (inclusive of all software licenses, training, maintenance, and/or other supplies necessary to operate the equipment during the lease term) to a small-ticket, basic photocopier with maintenance for the term of the lease.

      – Examples of bundled facilities leases can include fees paid for professional services and fees related to the purchase and/or

[18] Leases include both capital and operating leases, as defined under current FASAB standards. The Board is currently working on a leases project that may make changes to existing distinctions between capital and operating leases. Potential changes to existing lease distinctions are not expected to alter the Board's exclusion of certain leases as described in paragraph A12, from the provisions of this guidance.

[19] EULs are typically long-term lease agreements that allow public or private entities to use an agency's property. Agency EUL programs have allowed entities to develop or occupy federal properties such as power plants, housing and healthcare facilities, office space, and parking facilities, and in return, federal agencies receive cash or in-kind consideration. Please note that there is no government-wide definition of EULs. Source: GAO-13-14 Federal Real Property: Improved Cost Reporting Would Help Decision Makers Weigh the Benefits of Enhanced Use Leasing, December 2012).

construction of the facility. Such costs can include appraisal, architectural, engineering, environmental testing, financing, legal fees, and other pre and post construction expenses.

– Costs that are bundled are sometimes referred to as soft costs and from an accounting perspective can be (1) typically indirect in nature and not part of the direct costs charged to a cost objective, and (2) inclusive of general & administrative expenses (G&A).

b. to not exclude Enhanced Use Leases (EULs) because they are more oriented towards P3s as a result of (1) possessing special authorities and not being subject to the FAR, (2) often operating under a risk-reward model as opposed to those entity leases that are basically a landlord-tenant relationship and not a risk-sharing partnership, and (3) possibly including ancillary services and in-kind consideration as part of the arrangement or transaction. Because the Board believes that EULs could be encompassed by this Standard, a determination should be made as to whether disclosures should be considered via the application of the risk-based characteristics.

Risk-based Characteristics

A13. Although federal P3s are varied and complex, the Board believes there are some common characteristics that can be used to identify those P3s that create risk (fiscal exposure) such that information should be disclosed. Because the Board is aware of the administrative burdens agencies face day-to-day and that some P3 portfolios might be voluminous, in addition to identifying those P3s that create significant fiscal exposure, the proposed risk-based characteristics can also be applied to assist a federal entity in determining which P3 arrangements or transactions do not require disclosure.

A14. The risk-based characteristics have been developed, refined, and categorized from an initial comprehensive list of characteristics that distinguishes federal P3s from traditional procurement actions. With the assistance of the task force, the Board further analyzed and then selected risk-based characteristics which indicate significant P3 risk or fiscal exposure. These risk-based characteristics are intended to: (1) apply to all types of P3s: construction, housing, utilities, military depots, and others, (2) assist a federal entity in ascertaining which P3 arrangements or transactions require disclosure. Once a P3 is identified for disclosure, such arrangements or transactions would then be evaluated in light of the entity's materiality considerations including quantitative and qualitative threshold(s).

Conclusive and Suggestive Characteristics

A15. The Board proposes establishing two categories of risk-based characteristics -- conclusive and suggestive. Conclusive characteristics are those that by answering "Yes" to any one characteristic means the P3 arrangement or transaction should be considered for disclosure. Answering "Yes" to any one of the suggestive characteristic implies there is some persuasive evidence that the P3 arrangement or transaction may need to be disclosed. This one characteristic should be considered in the aggregate with all the other suggestive characteristics before a final decision is made. Each conclusive characteristic is meant to be definitive whereas each suggestive characteristic requires entity judgment as each one is analyzed in connection with the other suggestive characteristics.

A16. If a P3 arrangement or transaction is considered for disclosure, it should be further evaluated in light of materiality considerations that include both qualitative and quantitative assessments in determining the information that should be presented regarding P3 arrangements or transactions.

Materiality

Considering User Needs

A17. As the standards-setting body for the federal government, the Board has stated that there are two fundamental values that provide the foundation for governmental accounting and financial reporting: “accountability” and its corollary, “decision usefulness.”[20] We have explained that “Because a democratic government should be accountable for its integrity, performance, and stewardship, it follows that the government must provide information useful to assess that accountability.” The Board believes that P3 disclosures are an essential element in establishing accountability.

A18. In applying the concept of materiality, the needs of the users of the annual financial report should be considered. Specific to P3s for example, users are interested in: (1) assessing the costs and related risks (that is, fiscal exposure) of entering into such long-term agreements; (2) assessing the efficiency and effectiveness of these risk-sharing agreements as well as the government’s management of its assets and liabilities; and (3) determining how financial resources, budgetary or otherwise, have been obtained and used and whether their acquisition and use were in accordance with the entity’s legal authorization. As a result, the Board believes that the P3 disclosures contained in the body of this Statement help answer these questions while achieving the associated reporting objectives.

Qualitative and Quantitative Assessments Require Judgment

A19. “Materiality” has not been formally defined in the accounting community; rather, it is a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. The determination of whether an item is material:

a. requires the exercise of considerable judgment, based on consideration of specific facts and circumstances, and

b. depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

The Board notes that while a P3 arrangement or transaction might not be considered material from a quantitative standpoint, it may be considered qualitatively material and subject to this Statement’s disclosure requirements if the disclosures would influence or change the judgment of the financial statement user. Exclusive reliance on certain quantitative benchmarks or thresholds to assess materiality should be avoided.

[20] SFFAC 1, par. 105 states, “The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. …Providing this information to the public, the news media, and elected officials is an essential part of accountability in government.”

Materiality Includes Probability Assessments

A20. Decisions whether to recognize or, in the case of this Statement, disclose a P3 arrangement or transaction may take into account considerations that include uncertainties. Uncertainties can be expressed as a measurement of an appropriate attribute (for example, historical cost, fair value, *expected value*, or some other attribute) which may include an assessment of the probability of future flows of economic benefits or services (emphasis added). Furthermore, uncertainties are often subjected to assessments of the materiality of the item, and the benefit versus the cost of recognition or in this Statement's case, disclosure.

A21. Statement of Federal Financial Accounting Standards 5 (SFFAS 5), *Accounting for Liabilities of the Federal Government,* states that "probable" refers to that which

a. can *reasonably be exp*ected, or

b. is *believed to be more likely than not* on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.

The Board notes that the concept of probability is imprecise and may be difficult to apply with respect to certain P3 activities such as economic stabilization payments, in addition to other matters that could arise during the life of the P3 arrangement or transaction. However, the "more likely than not" phrase in SFFAS 5 accommodates the assessment of the probability of those uncertainties often associated with P3s due to their long-term nature and project variability.

Risks that are Deemed Remote

A22. SFFAS 5 provides that contingencies deemed remote (that is, the chance that a loss has been incurred is slight) are not recognized as a contingent liability or disclosed.[21] However, SFFAS 5 requires that a contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred.

A23. The Board believes that some risks associated with P3s may be contingencies that arise because of an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. It is this uncertainty, or risk in other words, that prompts entities to seek private partners who can best manage and/or contain the effects of the uncertainty that could ultimately lead to

[21] Per SFFAS 5, paragraph 38, a contingent liability should be recognized when all of these three conditions are met:

- A past event or exchange transaction has occurred (for example, a federal entity has breached a contract with a nonfederal entity).
- A future outflow or other sacrifice of resources is probable (for example, the nonfederal entity has filed a legal claim against a federal entity for breach of contract and the federal entity's management believes the claim is likely to be settled in favor of the claimant).
- The future outflow or sacrifice of resources is measurable (for example, the federal entity's management determines an estimated settlement amount).

fiscal exposure. In applying SFFAS 5 some contingencies may be identified for which the degree of uncertainty is so great that no reporting (that is, recognition or disclosure) is required by that Statement. However, the Board notes that reporting such contingencies is not inconsistent with the provisions of SFFAS 5.

A24. Due to their very nature, P3s can also possess risks that may be considered remote but significant. For example, excluding contractual protections afforded the government by the Federal Acquisition Regulation (FAR) inherently increases the entity's risk as does a relationship with an industry or private partner that may require the government to provide resources or absorb losses beyond what was contemplated. The Board believes such P3 arrangements or transactions should be disclosed, subject to materiality, even though the inherent risks may be deemed remote. The Board further notes that enterprise risk management frameworks often focus on remote risks because of the magnitude of any potential adverse effects that might arise. Therefore, consideration should be given to those risks that management does not expect to be likely, but represent a significant exposure to the government if they were to occur. With this being said, the Board also notes that such remote risks may have a reasonably high materiality threshold. As such, remote risks should not be dismissed from disclosure without further consideration of user needs and the qualitative and quantitative characteristics when applying materiality.

Disclosure Requirements of P3s

A25. The task force conducted research and identified examples of disclosures surrounding P3s from a variety of international and national authoritative sources which address P3 information needs for different types of users. Additionally, the task force considered fact-finding meetings with public and private representatives regarding the types of information that diverse users believe are important. As a result, the task force overwhelmingly agreed with requiring disclosures concerning (1) why the government selects a P3 model to conduct business, (2) the solicitation and procurement processes used, (3) how the P3 is structured, (4) the expected benefits, and (5) the total amounts expected to be paid. Although it was noted that requiring a description of the solicitation and procurement processes is unusual in financial reporting, the task force reached that conclusion because P3s fall outside the routine way governments procure services and such disclosures reveal the potential risk (fiscal exposure) that governments assume that can ultimately lead to liability recognition.

A26. In analyzing the task force's recommendations the Board considered the federal financial reporting objectives. 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. The Board agreed that P3 reporting is important to meeting these objectives because the federal government is accountable to citizens for the proper administration of its resources. As such, the Board agreed with the majority of the task force's recommendations. However, requiring disclosure of an entity's solicitation and procurement processes falls outside the realm of financial reporting. Furthermore, the Board questioned the informational value of such a disclosure and concluded that its cost also exceeded potential benefits identified by the task force.

A27. P3s are a form of investment and 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 being managed and (b) whether the government's financial position improved or deteriorated over the period of the P3. P3s often involve innovative operational and complicated accounting practices, accompanied by sophisticated financing agreements. These complexities necessitate the establishment of disclosure principles as a first step to (1) developing uniform, principles-based guidance, and (2) identifying potential gaps in existing guidance. As a result of considering the overall financial reporting objectives, the Board further developed and refined the task force's recommendation to include the following disclosures:

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.

Aggregation

A28. Due to the relative complexity and potential voluminous nature of P3s that an entity might be party to, the Statement permits entities to aggregate disclosures by providing broad and summarized information instead of unique or discrete arrangement or transaction detail. However, entities would be permitted to disclose information related to individually significant P3 arrangements or transactions separately if entity management believed that such disclosure would better meet user needs.

A29. For example, disclosures of P3 arrangements or transactions could be aggregated by an entity’s strategic objectives, departmental or bureau categorizations, program budget classifications, or other means. In this way users are presented with information that is comprehensive and material to an entity’s financial statements without placing an undue burden on preparers to provide P3 specific or granular level information.

Reporting Period

A30. Disclosures should be provided for the initial period and all annual periods thereafter where an entity is party to a material P3 arrangement/transaction.

ALTERNATIVE VIEWS

A31. Individual members sometimes choose to express an alternative view when they disagree with the Board’s majority position on one or more points in a Statement. The alternative view would discuss the precise point or points of disagreement with the majority position and the reasons therefore. The ideas, opinions, and statements presented in the alternative view are those of the individual member alone. However, the individual member’s view may contain general or other statements that may not conflict with the majority position, and in fact may be shared by other members. The material following was prepared by Mr. Robert F. Dacey and is presented as an alternative view.

A32. While Mr. Dacey fully supports the disclosure of commitments and contingencies related to public/private partnership (P3) contractual arrangements and transactions, he has concerns that:

- The breadth of the general definition of P3 contractual arrangements and transactions in the Exposure Draft (ED) does not confine the scope of arrangements and transaction solely to P3's and the definition does not provide sufficient clarity to facilitate consistent application of the standard (see paragraphs A33 - A34 below and Question for Respondents number 2);

- The expansion of current reporting to include disclosure related to certain remote risks (risks that have a slight chance of occurrence) and to risks related to entity operations or performance that do not necessarily result in contingent losses (referred to in the Alternative View as business risks) could overwhelm or mislead users with extensive information related to (1) risks that have only a slight chance of occurrence and (2) business risks that do not necessarily affect the financial statements (see paragraphs A35 – A36 below and Question for Respondents number 6); and

- The disclosure threshold of "significant exposure" is not clearly defined to facilitate appropriate and consistent disclosures of risk related to P3 contractual arrangements and transactions (see paragraphs A37 – A38 below and Question for Respondents number 6).

A33. Mr. Dacey believes that it is especially important to establish clear and appropriate principles related to risk disclosures at this time, as the board considers establishing disclosures of other types of risks--such as insurance, etc.—to ensure that a solid foundation is built so that there is consistency in the nature and magnitude of risk disclosures across many areas. The application of the ED's risk disclosure concepts to other areas would likely result in a significant expansion of disclosures and would be subject to concerns similar to those expressed in this Alternative View.

A34. With regard to the breadth and clarity of the general definition of P3s, the ED defines federal P3s as "contractual arrangements 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)." (para 17). While the Board intended to provide an expansive definition of P3s, the definition in the ED may not be sufficiently narrow to confine the scope of arrangements and transactions solely to P3's. The definition appears to encompass (1) contracts that are not traditionally considered P3s and (2) arrangements and transactions that do not necessarily result in potential contingent losses to the entity. For example, the definition would include contracts that relate to standard procurements of capital assets under the Federal Acquisition Regulation[22], long-term contracts in which some financing is incurred

[22] The ED definition excludes acquisitions under Simplified Acquisition Procedure, which are typically smaller dollar acquisitions, but includes acquisitions under "standard" FAR.

by the private sector entity, leases that include any other services related to the lease (e.g., leases including maintenance services)[23], and arrangements or transactions where government skills are transferred to the private party. These examples would also likely meet the conclusive or suggestive criteria. Consequently, entities may expend resources developing and implementing processes to identify contracts and agreements that meet the definition, but are not true P3s and do not result in disclosures. The Financial Accounting Standards Board (FASB), Governmental Accounting Standards Board (GASB), and the International Accounting Standards Board (IASB) have issued standards and defined a more narrow significant subset of P3s, service concession arrangements. In addition, further clarity in the definition and the meaning of the terms used in the definition would result in more consistent application of the standard and foster agreement between preparers and auditors as to which arrangements and transactions meet the definition.

A35. A second concern is that the ED would significantly expand the disclosure requirements for contingent liabilities that are provided under SFFAS 5, Accounting for Liabilities of the Federal Government, by extending disclosure requirements to certain remote contingencies (para 8) and expanding disclosures to include business risks (e.g., comparative costs, skill transfers to the private sector, etc.). Such additional disclosures could overwhelm or mislead users with extensive information related to (1) risks that have only a slight chance of occurrence and (2) business risks that do not necessarily affect the financial statements.

A36. Currently, SFFAS 5 requires the recognition of a contingent liability when a past event or exchange transaction has occurred and the future outflows or other sacrifice of resources related to a contingency is deemed probable and measureable (SFFAS 5 para 38-39). In addition, SFFAS 5 requires disclosure of a reasonably possible contingency and a probable contingency that is not measureable (SFFAS 5 para 40-42). For example, under SFFAS 5, if an early termination of a P3 was deemed reasonably possible, the potential financial effects would be disclosed. If early termination was deemed probable, the related losses expected to result from the early termination would be recognized in the financial statements.

In addition, a contingency subject to recognition or disclosure as a P3 arrangement or transaction may be contractual (e.g. the contract may contain early termination clauses and minimum payment guarantees) and the contractual terms could specify the amount or the basis for determining the amount of any contingent loss. On the other hand, a contingency may result from circumstances not addressed in the contract and relate to other types of non-performance or other external events. The ED would seem to require disclosure of remote contingencies related to both types of contingent losses. For example, paragraph A11.a of the ED states that significant fiscal exposure may extend even beyond what may have been contractually contemplated.

[23] The ED definition includes bundled leases that include additional products or services in the leasing arrangement.

SFFAS 5 states that "contingencies classified as remote[24] need not be reported in general purpose federal financial reports, though law may require such disclosures in special purpose reports. If information about remote contingencies or related to remote contingencies is included in general purpose federal financial reports (e.g., the total face amount of insurance and guarantees in force), it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of a loss of that amount" (para 42.) To (1) determine whether a remote risk represents a significant fiscal exposure and (2) meet the disclosure requirements of paragraph 23.d(2) for the potential effect on cash flows if the risks were realized, an assessment of remote contingencies would necessarily require estimation of the maximum loss to the federal entity that might be incurred, assuming all potential adverse events with respect to the federal government were to occur, whether or not such events were contemplated in the contract. Such potential disclosures would represent the "maximum possible loss" to the federal government, even though there is only a remote or slight likelihood of such an outcome. As noted above, the federal government has some limited examples of remote contingencies where the maximum loss under the terms of contractual arrangements is reported. Specifically, credit reform programs report the face value of loan guarantees and insurance programs report insurance–in-force. In such instances, the entities are in the business of guaranteeing and insuring and the reported amount represents the estimated maximum exposure to losses under the terms of the insurance or guarantee contracts. In addition, to the extent that maximum losses in these programs would occur, they would generally have a substantial adverse financial impact on the entity.

A37. Another concern is that the disclosure threshold of "significant exposure" does not provide a clearly defined conceptual threshold to facilitate appropriate and consistent disclosures of risk related to P3 contractual arrangements and transactions. In the development of the ED, the Board discussed limiting disclosure of remote contingencies to those where the potential loss would exceed a threshold that is considered to be higher than "material", as the term "material" is currently implemented. The ED states that disclosures of remote contingencies should be provided if they would result in "significant exposure" to the entity, but does not define the term. Also, the term is not clearly linked to the discussion of materiality in paragraph 11 or included in the disclosure requirements or other authoritative sections of the standard. The ED does indicate that certain remote risks "may have a reasonably high materiality threshold", but does not indicate how that would be applied or whether certain remote risks could likewise have a low materiality threshold. While the meaning of the term "material" is supported by a definition and years of implementation experience, the term "significant exposure", without definition, is likely not sufficiently clear to result in consistent application. For example, some may perceive "significant" as something less than material. By illustration, as it relates to internal controls, a "material weakness" is by definition more severe that a "significant deficiency." In addition to defining the concept, a term other than "significant" may be appropriate. Also, it is unclear how the concept of "significant exposure" would be applied to commitments (e.g., future payments under paragraph 23.c.ii). Further, the term "fiscal exposure", used in the ED, may be confused with the same term

[24] SFFAS 5 defines remote as "the chance of the future event or events occurring is slight".

that has been used in GAO and other reports to define concepts which differ from that in the ED.

A38. As background, in 2010, the Financial Accounting Standards Board (FASB) proposed to extend its disclosure requirements related to loss contingencies to include remote contingencies that have a potential “severe impact” on the entity. FASB defined “severe impact” as “a significant financially disruptive effect on the normal functioning of an entity. Severe impact is a higher threshold than material.”[25] Most respondents objected to the proposal and raised concerns, including:

- The additional disclosures would overwhelm or mislead the users with extensive information that has only a slight chance of occurrence and would not improve the ability of users to understand potential future cash flows;

- The disclosures of remote contingencies that may not be realized for an extended period of time are not relevant;

- The definition of severe impact would be difficult to apply operationally or was not sufficiently clear to be applied without being highly judgmental; and

- The current requirements for contingencies were adequate to inform users about potential future losses (note--FASB contingency requirements are generally consistent with SFFAS 5, except that FASAB defines probable as “more likely than not”, while FASB’s “probable “is generally considered a much higher threshold).

Respondents raised additional concerns about its specific application to legal contingencies. FASB decided to no longer pursue the proposal. Similar concerns would seem applicable to the proposals in FASAB’s ED related to remote contingencies.

A39. Mr. Dacey supports narrowly defining the instances in which remote risks would be disclosed to minimize the possibility of excessive disclosures and avoid the negative consequences discussed in this Alternative View. Specifically, he supports (1) limiting the disclosure of remote contingencies to those that are included in the terms of contractual agreements and (2) developing and clearly defining a disclosure threshold that is higher than materiality as it is applied to other areas, consistent with earlier Board discussions. While paragraph 23d refers to the term “significant contractual risks”, that term is not defined and is not necessarily limited to the terms of contractual agreements. For example, it can be considered to be all risks (including business risks) that could arise related to the contract, whether included in the contract terms or not. As noted earlier, paragraph A11.a of the ED states that significant fiscal exposure may extend even beyond what may have been contractually contemplated. Specific suggestions to address this issue are included below.

[25] See http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=900000011071

A40. In addition, the ED appears to extend the reporting requirements to disclosure of exposures related to business risks (risks related to entity operations or performance that do not necessarily result in contingent losses), which is significantly beyond the current reporting requirements for contingent losses. For example, paragraph 6 discusses disclosure of the risks associated with P3s and provides several examples of business risks, including instances where (1) actual costs will be greater than budgeted costs, (2) the entity will not achieve expected returns on its investments, and (3) the public purpose or public value will not be fulfilled or achieved. Also, the suggestive criteria discuss certain business risks, including (1) the loss of governmental skill-sets that would lead to costlier contracting-out procurement options in the future and (2) instances where there is subjectivity in value for money analyses and potential that management's decision to enter the P3 arrangement was not justified. Further, the disclosure requirements and the discussion of "significant exposure" do not specifically exclude business risks and, based on the consideration of qualitative characteristics in applying materiality, disclosures could relate to business risks that are not quantitatively material. While information about business risks is relevant to management and possibly to performance reporting, requiring disclosure of business risks in the notes:

- extends significantly beyond current financial reporting requirements;
- would not necessarily reflect potential future losses to the entity;
- would seem to be highly subjective;
- would also present difficulties in determining whether the exposures meet the "significant exposure" disclosure threshold; and
- may cause confusion to users about the entity's finances.

Also, there would likely be challenges in auditing such business risk disclosures, particularly in determining whether all such business risks were considered and properly evaluated. Risks not affecting the financial statements are generally outside the scope of a financial statement audit-which focuses on the reliability of the financial statements. Further, if the underlying principle of disclosure of business risks were to be applied by the Board to other contracts or other areas, it could substantially increase the volume of disclosures in all financial statements. It is not clear that such additional information would add value, and may detract from the readers' ability to assess the entity's finances.

A41. Based on the above, the ED could be improved by:

- Narrowing the definition of P3s to more closely align with P3 arrangements, such as by adding additional exclusions for contractual agreements and transactions that likely have limited risk of contingent losses, and more clearly defining the terms used in the definition;
- Limit disclosure of remote contingencies to those that are included in the terms of contractual agreements and develop and clearly define a disclosure threshold that is higher than materiality as it is applied to other areas. For

example, paragraph 25d, which articulates required disclosures of risk, could be revised to language such as

> "Contingent payments that may be payable under the terms of the contractual arrangement or transaction (e.g., early termination requirements including related exit amounts and other responsibilities such as asset condition (hand-back) requirements, minimum payment guarantees, escalation clauses, other contingent payments, renewal options, etc.). Disclosures should discuss the nature of such contingent payments and the potential effect on cash flows if the contingent risks were realized. The potential effect may include a narrative discussion of the effect, the basis for determining the amount of the payments, and/or the amount of the contingent payments if measureable. Materiality used to determine whether to disclose contingent payments that have a remote likelihood of occurrence is necessarily higher than materiality, as it is applied to other areas, to (1) avoid overly extensive disclosures of remote contingencies that could lead to user misunderstanding of potential losses and (2) focus on those remote contingencies that would have a substantial effect on the entity's finances if they occurred. If remote risks are disclosed, an explanation should be included that avoids the misleading inference that there is more than a remote chance of a loss." and;

- Clearly exclude business risks from the scope of disclosures in the financial statements. This could be done by discussing "risk" and "significant exposure" in the ED in terms of potential impact on the financial statements and more clearly tying "significant exposure" to the disclosure requirements.

Also, the Board should clarify whether they anticipate that the concepts in the ED are or are not equally applicable to risk disclosures in financial reporting areas other than P3s.

APPENDIX B: ABBREVIATIONS

CFR	Consolidated financial report of the U.S. government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
OMB	Office of Management and Budget
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
VfM	Value for Money

APPENDIX C: GLOSSARY

Public-private partnerships - Federal public-private partnerships (P3s) are contractual arrangements 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).

P3 Structural Arrangement - P3s that are external to the government sponsor's or entity's operations and often involve the creation of an SPV, Trust, or Limited Partnership (LP), etc. For example, military base housing.

P3 Program Transactional Arrangement - P3s that are internal to the government sponsor's or entity's operations. For example, work-share programs not involving the creation of a SPV, Trust, or LP, etc.

Special Purpose Vehicles (SPVs) - also commonly called Special Purpose Entities (SPEs), are entities created for a specific, limited and normally temporary purpose. An SPV can be a corporation, trust, partnership, limited-liability company or some type of Variable Interest Entity (VIE). They are often an integral part of public private partnerships because of their risk-containment nature of isolating participating entities from financial risk.

Value for Money (VfM) - VfM is defined as the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirement. VfM is not the choice of goods and services based on the lowest cost bid. To undertake a well-managed procurement, it is necessary to consider upfront, and at the earliest stage of procurement, what the key drivers of VfM in the procurement process will be. In other words, VfM is a much broader concept than typical cost-benefit analysis because it emphasizes "value" in more of a qualitative than quantitative manner. Quantitatively, some VfM models use a project's Internal Rate of Return (IRR) to help determine project acceptability.

Task Force Member Agencies

Department of Agriculture, U.S. Forest Service

Department of Defense, Office of the Secretary of Defense

Department of Defense, Comptroller

Department of Labor, Office of the Inspector General

Department of State, Bureau of Overseas Buildings Operations

Department of the Treasury, Office of Financial Stability

Department of the Treasury, Office of the Fiscal Assistant Secretary

Department of Veterans Affairs, Office of Financial Policy

General Services Administration, Office of the Chief Financial Officer

National Aeronautics and Space Administration, Office of Strategic Infrastructure

Naval Audit Service, Financial Management and Comptroller Division

Task Force Member Firms

American Federation of State, County and Municipal Employees

Checco Communications

Claret Consulting, Llc

Cloud Nine Technologies

Cotton and Company

Dennis M. Giaimo, MBA

Douglas Bartlett, CPA

Duller Studios

Institute for Responsible Infrastructure Stewardship

KPMG

McKenna, Long and Aldridge

Moreland Advisors, Inc

National Contract Management Association

National Council for Public Private Partnerships

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