Federal Accounting Standards Advisory Board

June 7, 2013

Memorandum

To: Members of the Board

From: Domenic N. Savini, Assistant Director

Through: Wendy M. Payne, Executive Director

Subject: **Project Plan Update: Public-Private Partnerships (P3) [1] – Tab B**

OBJECTIVE

The objective of this session is to **update the Board concerning progress** made on the project plan **and to address four questions** in the following areas: (1) general project direction, (2) suggested matters for technical bulletin guidance, (3) potential gaps in major P3 accounting practice issues, and (4) potential P3-Centric reporting characteristics/criteria.

BRIEFING MATERIAL

A Project Plan Update Summary is attached to this transmittal memorandum. In addition, there are End Notes containing reference material that provides additional information should you desire more details. You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

BACKGROUND

At the December 2012 the Board did not object to expanding the project scope beyond service concession arrangements. However, members noted that (1) the complexities involved may later require a re-focus to a more narrow scope, (2) we should look to establish uniform principles-based guidance to enhance comparability among agencies, (3) gaps in existing guidance should be highlighted, and (4) we should avoid duplicating guidance and standards-overload.

The Board briefly discussed the matter of whether to issue technical guidance to aid preparers and users or a separate set of P3 standards. Much will depend upon whether there are significant gaps in current guidance. Regardless of the form that the final deliverable may take, the Board was clear that forthcoming guidance must be consistently applied and grounded or covered by an overarching principle(s).

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

Consistent with overall project goals, staff has assembled a task force and conducted fact-finding meetings to identify and refine major P3 accounting issues that those familiar with P3's believe are most relevant to federal P3 arrangements. As a result, this update provides a summary of the preliminary findings, including suggested matters for technical bulletin guidance, potential gaps in major P3 accounting practice issues, and potential P3-Centric reporting characteristics/criteria.

MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-6841 or by e-mail at savinid@fasab.gov with a cc to paynew@fasab.gov.

Thank you.

Attachment 1: Project Plan Update Summary

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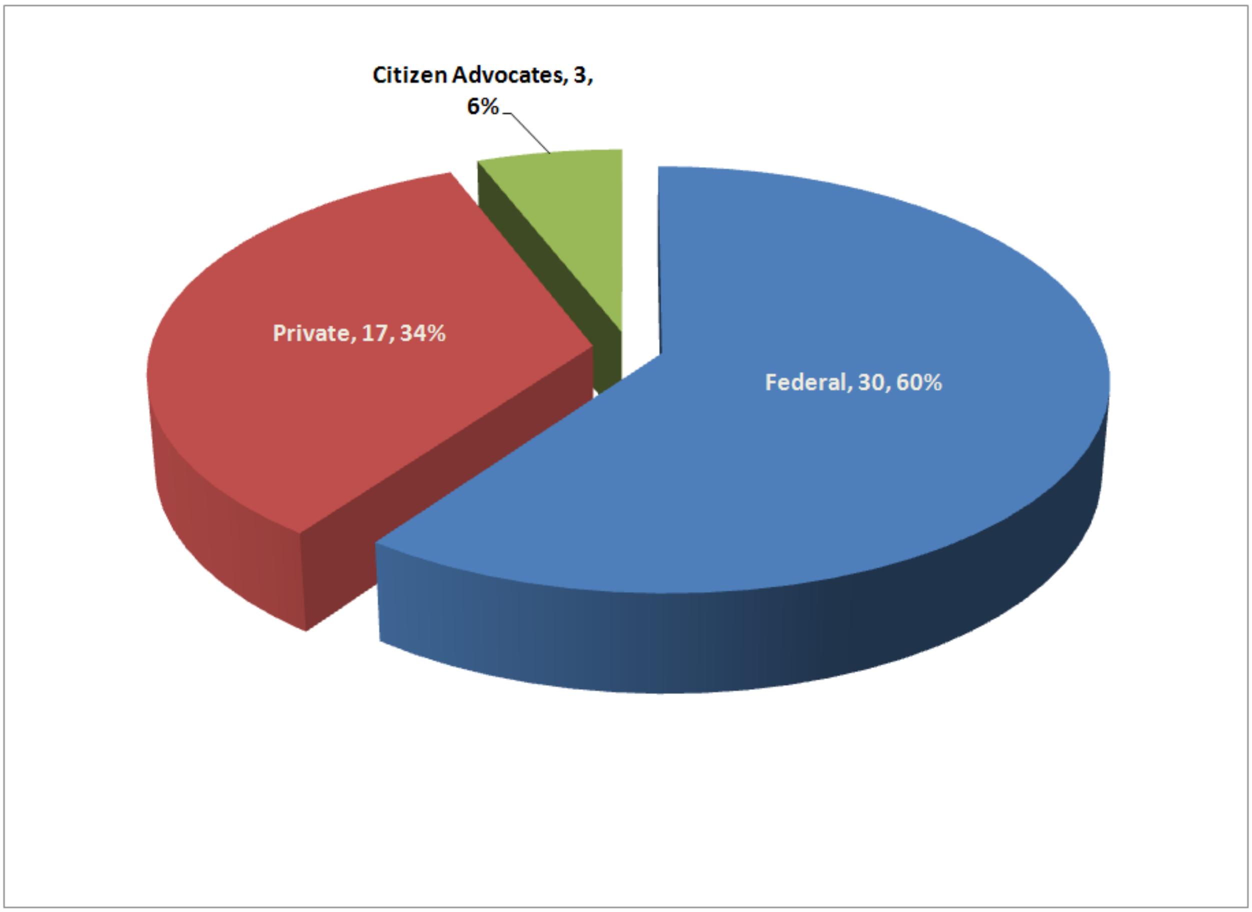
P3 Task Force Composition

We have received a significant amount of interest in this project from both federal and private communities. Fifty people have asked to either join the Task Force or become active followers of our work. We have had three meetings so far with active and lively participation.

Chart 1.0 provides a break-out of the P3 Task Force Representation, whereas Chart 2.0 shows the professional disciplines represented on the Task Force.

Chart 1.0

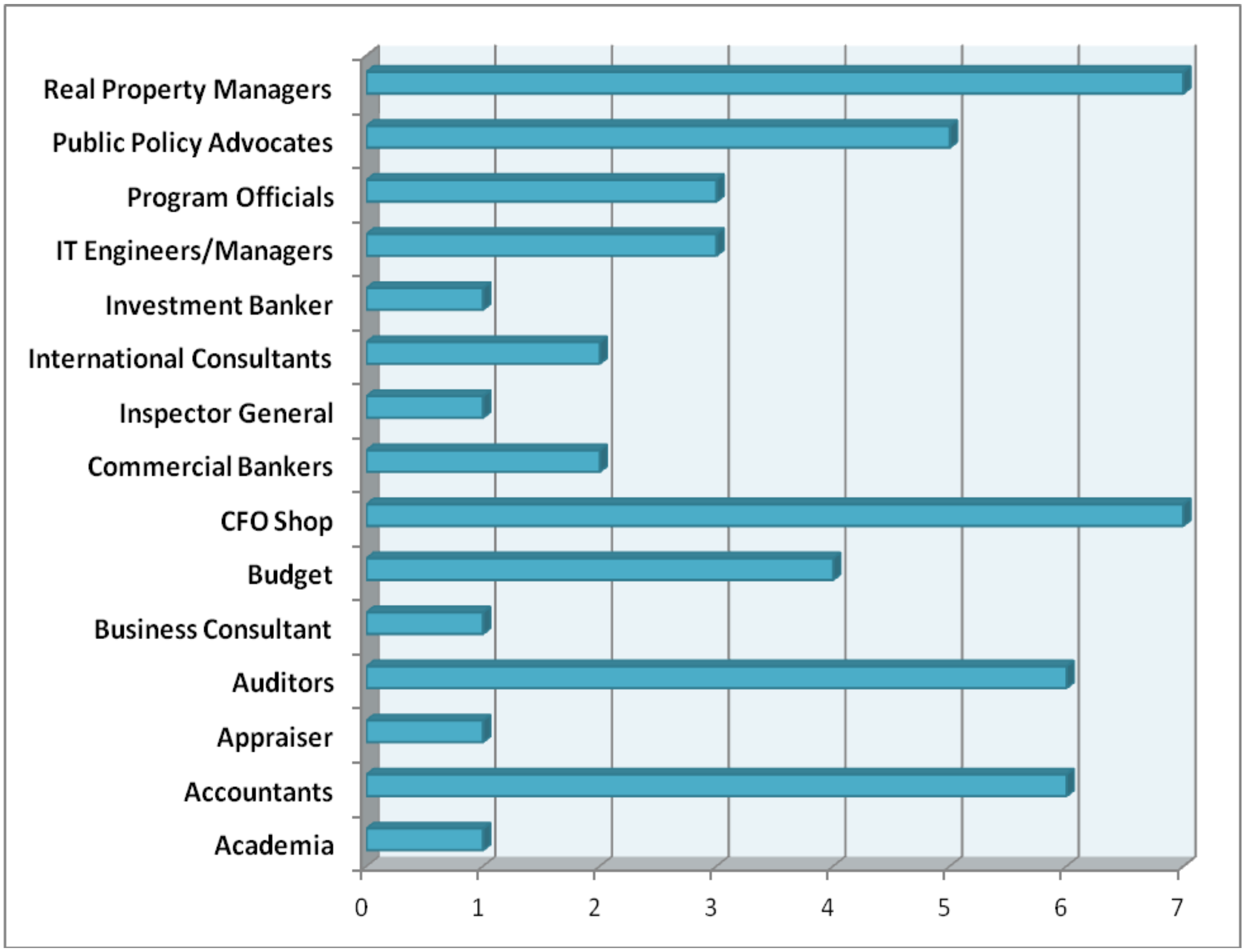
P3 Task Force Representation



P3 Task Force Composition

Chart 2.0

P3 Task Force Professional Disciplines



Fact-Finding Meetings Held To-date

To best meet our project objectives, in addition to task force discussions, staff initiated fact-finding meetings with experts both within and external to government. The goal of the fact-finding meetings was to better develop project scope by:

- Identifying the types of arrangements where part of the agency's risk profile has been transferred to (or shared with) the private partner,
- Noting current P3 issues being faced by the participant(s),
- Soliciting input/suggestions on potential P3-Centric financial reporting characteristics/criteria, and
- Analyzing arrangements for potential accounting policy issues.

Staff has met with federal agency representatives, public policy experts, consultants, private equity participants and an IT/Cloud software development firm. Please refer to Tables 1.0 and 2.0 respectively, for listings of the federal agencies visited or considered and the professionals or disciplines consulted.

TABLE 1.0

Fact-Finding Agencies Visited or Considered

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

* = No visit was made. GAO Congressional analysts provided information concerning a Department of Commerce P3 that is 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	

Common Fact-finding Themes and Other Matters

Common Themes

Common themes that existed among the agencies and participants consulted include:

- As a minimum, participants expect continued use if not growth in P3's,
- Value for Money[2] (VfM) analyses need attention,
- Uniform/required VfM method(s) could result in higher credit ratings for individual project financing resulting in lower project financing costs,
- Government employee legacy & relocation costs not presently considered in VfM analyses,
- Long-term nature of P3's accepted, but
  - Lack of transparency in the solicitation and award processes along with the lack of competition hinders accountability and fair & reasonable pricing
  - Not applying the Federal Acquisition Regulations[3] (FAR) increases government risk
  - Some P3's circumvent procurement administration
- In-Kind contributions are difficult to value or are overvalued and not always reported,
- P3-Centric financial reporting is generally supported but agencies and participants vary in the what, how and where
  - for example, relative to significant and material P3 arrangements, 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 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.

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[2] *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*.

With the Board's indulgence, a more bourgeoisie definition is that the 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.

[3] 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.

Other Matters

- **Asset capitalization.** Some say the entire P3 value[4], to include such things as ancillary services and in-kind contributions should be capitalized along with the core or "hard" asset. However, others say that ancillary services and in-kind contributions should be separately accounted for and not commingled with the core or "hard" asset.

- **Increased Risk to Citizens.** A few participants noted that P3's erode (1) the notion of public service (e.g., what is inherently governmental) and (2) in many cases, belief in good government. This increased risk is evidenced by those governments that:
  - purposefully avoid budget scoring
  - absorb "availability" risk absent sufficient private partner consideration
  - lose control of assets
  - lock into long-term arrangements that cannot be re-competed or re-negotiated
  - are constrained by contract modification restrictions
  - are constrained by proximity and/or right-to-compete restrictions
  - ignore government employee personnel (legacy) costs

- **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.

[4] In order to (a) reflect the comprehensive nature (i.e., inseparable bundling of assets and services) of a P3 arrangement and/or (b) not skew decision-making in favor of conventional delivery methods, Agencies' often develop business case justifications (i.e., costs versus benefits, value-for-money, net present value, etc) that include both direct and indirect costs in their analyses. Also, some of these allocations will include costs (fixed or sunk) that are typically treated as period expenses (e.g., M&R and G&A) or deemed irrelevant (e.g., depreciation), respectively. As a result, such P3 accounting could accommodate capitalizing such costs and allocating them over the life of the P3.

Matters for Technical Bulletin

Because fairly robust FASAB guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses, staff advises the Board to consider issuing guidance via Technical Bulletins for the nineteen (19) P3 types (identified by CBO and GAO) prioritized on the next two pages and detailed on pages 12-22. It is important to note that most of these P3 types are either discrete leases or involve aspects of leasing in the overall arrangement.

Technical Bulletins provide guidance for applying FASAB Statements and Interpretations and resolving accounting issues not directly addressed by either the Statements or Interpretations. The following kinds of guidance may be provided in a Technical Bulletin:

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

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

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

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

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

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

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

Because of the numerous touch-points that exist among other projects (please refer to page 26 for further details), staff advises that these matters be addressed after (1) substantial progress is made on our *Leases* Project and (2) the P3 Task Force completes its work on P3 risk (fiscal exposure).

Staff suggests that 10 of the 19 P3 types be considered “More Immediate” primarily because of their active use and focus on asset construction. They are as follows:

More Immediate	Type
P3 arrangements that:	
• **Are actively used** • **Involve Enhanced Use Leasing** • **Focus on asset construction** • **Either current or potential ownership interest** • **Have been identified by Task Force or Fact Finding**	9. Enhanced Use Leasing (EUL) 1. Build-Own-Operate (BOO) 2. Build/Operate/Transfer (BOT) 3. Build/Transfer/Operate (BTO) 4. Buy-Build Operate (BBO) 7. Design-Build-Operate (DBO) 8. Developer Financing 12. Lease/Purchase 14. Tax-Exempt Lease 15.Turnkey

Staff suggests that 9 of the 19 P3 types be considered "Less Immediate" primarily because they do not involve asset construction and ownership interest is not present. They are as follows:

Less Immediate	Type
P3 arrangements that:	
• **Are services oriented** • **No current or potential ownership interest** • **Are concession or franchise based** • **Are non-exchange asset transfers**	5. Operations and Maintenance 6. Operations, Maintenance, and Management 10. Lease/Develop/Operate (LDO) 11. Build/Develop/Operate (BDO) 13. Sale/Leaseback 16. Concession Benefits 17. Cooperative Agreements 18. Franchising 19. Lease – Leaseback

Matters for Technical Bulletin

Types of Public-Private Partnership Arrangements
And Relevant FASAB Standards

TYPE[5]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[6] **(all end notes can be found at the very end of this Memorandum)**
1. Build-Own-Operate (BOO)	Under a BOO transaction, the contractor constructs and operates a facility without transferring ownership to the public agency. Legal title to the facility remains in the private sector, and there is no obligation for the public agency to purchase the facility or take title. A BOO transaction may qualify for tax-exempt status as a service contract if all Internal Revenue Code requirements are satisfied.	If at the end of the lease the public agency decides to: **Continue Leasing** – Capital lease requirements are covered in SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Purchase** – Asset recognition is covered in SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26[iii].
2. Build/Operate/Transfer	Under the BOT option, the private partner builds a facility to the specifications agreed to by the public agency, operates	**Asset transfer** – can be accomplished

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

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

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(BOT) or 3. Build/Transfer/Operate (BTO)	the facility for a specified time period under a contract or franchise agreement with the agency, and then transfers the facility to the public agency at the end of the specified period of time. In most cases, the private partner will also provide some, or all, of the financing for the facility, so the length of the contract or franchise must be sufficient to enable the private partner to realize a reasonable return on its investment through user charges. At the end of the franchise period, the public agency can assume operating responsibility for the facility, contract the operations to the original franchise holder, or award a new contract or franchise to a new private partner. The BTO model is similar to the BOT model except that the transfer to the public owner takes place at the time that construction is completed, rather than at the end of the franchise period.	either via a lease or a purchase. Capital lease requirements are covered in SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. Asset recognition is covered in SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26[iii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].
4. Buy-Build-Operate (BBO)	A BBO transaction is a form of asset sale that includes a rehabilitation or expansion of an existing facility. The public agency sells the asset to the private sector entity, which then makes the improvements necessary to operate the facility in a profitable manner.	**At Sale** - SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 38[v] and SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraph 36e – 47[vi]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].

TYPE[5]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[6] (all end notes can be found at the very end of this Memorandum)
5. Operations and Maintenance	A public agency (federal, state, or local government agency or authority) contracts with a private partner to operate and/or maintain a specific service or facility. Under the private operation and maintenance option, the public agency retains ownership and overall management of the public facility or system.	**At Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraph 19[vii].
6. Operations, Maintenance, and Management	A public agency (federal, state, or local government agency or authority) contracts with a private partner to operate, maintain, and manage a facility or system providing a service. Under this contract option, the public agency retains ownership of the public facility or system, but the private party may invest its own capital in the facility or system. Any private investment is carefully calculated in relation to its contributions to operational efficiencies and savings over the term of the contract. Generally, the longer the contract term, the greater the opportunity for increased private investment because there is more time available in which to recoup any investment and earn a reasonable return. Many local public governments use this contractual partnership to provide wastewater treatment services.	**At Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraph 19[vii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv]. **Lease** – SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii].
7. Design-Build-Operate (DBO)	In a DBO project, a single contract is awarded for the design, construction, and operation of a capital improvement. Title to the facility remains with the public	**At Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,*

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	agency unless the project is a design/build/operate/transfer or design/build/own/operate project. The DBO method of contracting is contrary to the separated and sequential approach which involves one contract for design with an architect or engineer, followed by a different contract with a builder for project construction, then followed by the owner's taking over the project and operating it. A simple design-build approach creates a single point of responsibility for design and construction and can speed project completion by facilitating the overlap of the design and construction phases of the project. On a public project, the operations phase is normally handled by the public agency or awarded to the private sector under a separate operations and maintenance agreement. Combining all three phases into a DBO approach maintains the continuity of private sector involvement and can facilitate private-sector financing of public projects supported by user fees generated during the operations phase.	paragraph 19[vii]. **At Build** – SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 34[viii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv]. **Lease** – SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii].
8. Developer Financing	Under developer financing, the private party (usually a real estate developer) finances the construction or expansion of a public facility in exchange for the right to build residential housing, commercial stores, and/or industrial facilities at the site. The private developer contributes capital and may operate the facility under the oversight of the public	**Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].

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	agency. The developer gains the right to use the facility and may receive future income from user fees. While developers may in rare cases build a facility, more typically they are charged a fee or required to purchase capacity in an existing facility. This payment is used to expand or upgrade the facility. Developer financing arrangements are often called capacity credits, impact fees, or exactions. Developer financing may be voluntary or involuntary depending on the specific local circumstances.	
9. Enhanced Use Leasing (EUL)	An EUL is an asset management program that can include a variety of different leasing arrangements (e.g., lease/develop/operate, build/develop/operate). EULs enable certain agencies to long-term lease agency-controlled property to the private sector or other public entities for non-agency uses in return for receiving fair consideration (monetary or in-kind) that enhances an agency's mission or programs.	**Lease** – SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraphs 34 – 47[ix].
10. Lease/Develop/Operate (LDO) or 11. Build/Develop/Operate (BDO)	Under these partnership arrangements, the private party leases or buys an existing facility from a public agency; invests its own capital to renovate, modernize, and/or expand the facility; and then operates it under a contract with the public agency. A number of different types of	**Sale** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 36e – 47[vi].

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	municipal transit facilities have been leased and developed under LDO and BDO arrangements.	**Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47[ix]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].
12. Lease/Purchase	A lease/purchase is an installment-purchase contract. Under this model, the private sector finances and builds a new facility, which it then leases to a public agency. The public agency makes scheduled lease payments to the private party. The public agency accrues equity in the facility with each payment. At the end of the lease term, the public agency owns the facility or purchases it at the cost of any remaining unpaid balance in the lease. Under this arrangement, the facility may be operated by either the public agency or the private developer during the term of the lease. Lease/purchase arrangements have been used by the General Services Administration for building federal office buildings and by a number of states to build prisons and other correctional facilities.	**Lease** – SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].
13. Sale/Leaseback	A sale/leaseback is an arrangement in which the owner of a facility sells it to another entity, and subsequently leases	**Sale** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and*

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	it back from the new owner. An innovative application of the sale/leaseback technique is the sale of a public facility to a public or private holding company for the purposes of limiting public agency liability under certain statutes. Under this arrangement, the public agency that sold the facility leases it back and continues to operate it.	*Concepts for Reconciling Budgetary and Financial Accounting,* paragraph 36e – 47[vi]. **Purchase** – SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 26[iii]. **Lease** – SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[iii].
14. Tax-Exempt Lease	Under a tax-exempt lease arrangement, a public agency finances capital assets or facilities by borrowing funds from a private investor or financial institution. The private partner generally acquires title to the asset, but then transfers it to the public agency either at the beginning or end of the lease term. The portion of the lease payment used to pay interest on the capital investment is tax exempt under state and federal laws. Tax-exempt leases have been used to finance a wide variety of capital assets, ranging from computers to telecommunication systems and municipal vehicle fleets.	**Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv]. **Asset transfer** – can be accomplished either via a lease or a purchase. Capital lease requirements are covered in SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. Asset recognition is covered in SFFAS 6, *Accounting for Property, Plant, and*

TYPE[5]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[6] **(all end notes can be found at the very end of this Memorandum)**
		Equipment, paragraph 26[iii].
15. Turnkey	Under a turnkey arrangement, a public agency contracts with a private investor/vendor to design and build a complete facility in accordance with specified performance standards and criteria agreed to between the agency and the vendor. The private developer commits to build the facility for a fixed price and absorbs the construction risk of meeting that price commitment. Generally, in a turnkey transaction, the private partners use fast-track construction techniques (such as design-build) and are not bound by traditional public agency procurement regulations. This combination often enables the private partner to complete the facility in significantly less time and for less cost than could be accomplished under traditional construction techniques. In a turnkey transaction, financing and ownership of the facility can rest with either the public or private partner. For example, the public agency might provide the financing, with the attendant costs and risks. Alternatively, the private party might provide the financing capital, generally in exchange for a long-term contract to operate the facility.	**Purchase** – SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 26 [iii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23 [iv]. **Risk assumption** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i].
16. Concession Benefits	Concession benefits are rights to receive revenues or other benefits for a fixed period of time. (Also see franchising.)	**Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling*

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		Budgetary and Financial Accounting, paragraphs 34 – 47[ix].
17. Cooperative Agreements	A cooperative agreement as set forth in 31 USC 6305 is the legal instrument an executive agency uses to reflect a relationship between the U.S. public agency and a state, a local public agency, or other recipient when (1) the principal purpose of the relationship is to transfer a thing of value to the state, local public agency, or other recipient to carry out a public purpose of support or stimulation authorized by U.S. law, and (2) substantial involvement is expected between the executive agency and the state, local public agency, or other recipient in carrying out the activity contemplated in the agreement.	**Asset transfer** – can be accomplished either via a lease or a purchase. Capital lease requirements are covered in SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. Asset recognition is covered in SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26[iii]. **Risk Assumption** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraph 19[vii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].
18. Franchising	Under the franchising of external services, the public agency grants a concession or privilege to a private-sector entity to conduct business in a particular market or geographical area—for example, operating concession	**Lease** – SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Fees** - SFFAS 7, *Accounting for*

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	stands, hotels, and other services provided in certain national parks. The public agency may regulate the service level or price, but users of the service pay the provider directly.	*Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47[ix].
19. Lease – Leaseback	In an arrangement called lease-leaseback, the public agency leases an asset long-term (i.e. for 50 years) to a private-sector entity or a special-purpose entity created for that purpose and then leases the asset back for a shorter period (i.e.,20 years or about half of the asset's useful life). The private-sector entity or special-purpose entity pays for their long-term lease with a one-time, upfront payment, while the public agency spreads its leaseback payments over the (shorter) lease period. Such transactions generate up-front cash for the public agency allowing it to avoid seeking either budgetary appropriations or issuing additional bonds to finance its investments. In effect, the private-sector entity or special-purpose entity borrows on behalf of public agency. The private sector partner obtains financing through the sale of pass-through certificates which the public agency may or may not explicitly guarantee. However, these certificates are usually fully backed by the public agency's contractual commitment to make lease payments.	**Lease** – SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20[ii]. **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].

TYPE[5]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[6] (all end notes can be found at the very end of this Memorandum)
	The public agency entity benefits from some of the tax advantages that the private sector partner enjoys in the form of lower lease payments.	

Substance over Form - Potential Gaps in Major P3 Accounting Practice Issues

Some may believe that the central accounting question when addressing public-private partnerships is whether an asset and related liability should be recognized on either of the partner's balance sheet. Although this is a legitimate question that must be answered, it is not the most important question that the profession must address when dealing with P3's.

By their design, P3 partners share both risks and rewards and as a result, a government must understand how much 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 government sponsor. Such an analysis relies on a thorough understanding of the underlying guarantees, insurance and indemnification strategies as well as the existence and nature of any underlying capital buffer that might exist; i.e., debt and equity investors' participation.

As such, an entity's risk profile[7] directly relates to the following financial reporting objectives:

- Budgetary Integrity - Entities should demonstrate how budgetary resources have been obtained and used. For example, in some P3 arrangements/transactions entitiies take current appropriated funds and leverage them in the private capital markets. Also, there could be instances in which a P3 acquires assets or provides services outside the budget rules; not in accordance with an entity's legal authorization. P3's can actually affect the analysis of program costs by either deferring costs or burying them in the accounting detail making it hard to understand how the agency achieves mission. SFFAC 3, Management's Discussion and Analysis states that, "The discussion should describe major financing arrangements, guarantees, and lines of credit, including those not recognized in the basic financial statements."
- Operating performance - Related to budget integrity is the concept of program costs. SFFAC 3 states that current and potential users of federal financial information want information to help them assess how well the government is doing by answering such questions as, "How much do various programs cost, and how were they financed?

For financial reporting purposes, staff advises that we define P3 risk as being limited to an entity's *fiscal exposure*.[8] Specifically, P3 risk or more precisely, P3 fiscal exposure is deemed to be a sub-set of an entity's overall risk assumed[9] or risk profile and may not be always identifiable, measurable or quantifiable for financial reporting purposes.

[7] Risk profile can be defined as, "An evaluation of an entity's willingness to take risks, as well as the threats to which an organization is exposed. A risk profile identifies: (1) The acceptable level of risk an entity is prepared to accept. An organization's risk profile attempts to determine how the entity's willingness to take risk (or aversion to risk) will affect its overall decision-making strategy, and (2) the risks and threats faced by an organization. The risk profile may include the probability of resulting negative effects, and an outline of the potential costs and level of disruption for each risk. Adapted from: http://www.investopedia.com/terms/r/risk-profile.asp

[8] Fiscal exposures vary widely as to source, extent of the government's legal obligation, likelihood of occurrence, and magnitude. These exposures include items such as retirement benefits, environmental cleanup costs, and future social insurance benefits. Given this variety, it is useful to think of a spectrum extending from explicit liabilities to implicit promises embedded in current policy or public expectations. GAO Report No. GAO-03-213, *Improving the Budgetary Focus on Long-Term Costs and Uncertainties,* dated January 2003.

[9] Risk assumed is the possible or probable risk of future outflows that the federal government is expected to incur, in the judgment of a reasonable person, as a result of its mission, operations, and current or past actions. The population of risk assumed may be determined through a review of varied information, including, but not limited to,

For those governments that engage in significant P3 activity the most important accounting question that must be asked is,

> ***How has the government's fiscal exposure been changed as a result of its P3 arrangement or transaction?***

Strict adherence to conceptual accounting models may not effectively account for P3's because the underlying economics and assumptions of risk, ownership, control, rights, and obligations in many of these complex deals (1) are not always known at the time of the agreement, (2) change over the life of the agreement, and (3) are often cross-shared among the partners over the life of the agreement.

Because P3's can be highly complex and sophisticated risk-transfer systems, our traditional recognition accounting models of ownership and control and rights and obligations must be carefully reviewed in light of these risk-transfer systems so that "form" does not overtake "substance." If accounting form takes precedence over economic substance, accountants may fail in providing an accurate and faithful representation of an entity's fiscal exposure (risk).

For example, the related party definition[10] staff has proposed to the Board reads as follows:

> **Related parties:** Organizations are considered to be related parties if the existing relationship[46] or one party to the existing relationship **has the ability to exercise significant influence** over the other party **in making financial and operating decisions**. (Underscoring and bolding are added for emphasis)
>
> [46] Relationship as used in this context refers to material transactions or events involving both parties.

Assuming the existence of significant influence, if a sponsoring agency or agency party to a P3 did not have both financial and operating (significant) influence, the P3 relationship would be exempt from federal reporting as a related party.

Capital lease accounting provides another example of where form may take precedence over substance. Specifically, capital lease accounting requires that there be a substantial transfer of ownership risk to the lessee. However, as we all recognize, leasing strategies have evolved over time that have led to technical compliance with "form" - GAAP – absent representational faithfulness because the actual economic consequences of ownership are not reflected on the entity's balance sheet. This impact is significantly magnified when a government enters into a P3 arrangement or transaction because of the nature of the

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obligations incurred, commitments undertaken, contracts signed, agency policy, legislative history, economic projections, programmatic responsibility, and risk analysis. Risk assumed is generally measured by the present value of unpaid expected outflows net of associated inflows (e.g., premiums), if any, based on management's best estimate of the total risk assumed. Source: Staff Draft, April 2012, Tab H-1.

[10] Exposure Draft dated April 3, 2013 - *Federal Reporting Entity*- Related Party, page 31, paragraph 79.

assets involved and the long-term nature of lease agreements that in almost all cases cut across generations. In such cases, accountants must ascertain whether an entity's ownership risk has been substantially transferred when, for example, the government leases the asset back in a much improved state or retains either a residual or reversionary interest in the asset.[11]

Another example deals with the creation of special purpose vehicles (SPV's). Structurally complex, these entities can be under de facto government control in absolute and permanent terms from a P3's inception or sporadically and temporarily during different periods of a P3's life-cycle. Numerous and complicated agreements further complicate ownership and control assessments. As a result, traditional control indicators fall short in helping to identify a government's influence and control.

Moreover, a government's control may lay dormant and not be evidenced during the initial stages of a P3. For example, the government's ability to unilaterally restructure its loan terms with the P3 to help ensure success while taking ownership of various P3 assets may be an innocuous contractual term existing at the time of agreement or subsequently evolve into a legal agreement or mutual understanding.

All said, when dealing with P3's the use of traditional recognition criteria may lead to inaccurate financial statement reporting and significantly obscure an entity's risk profile. Users will not be able to fully rely on management's assertions or understand what future commitments may be made against an entity's resources. Due to the highly complex P3 arrangements and structures that exist and their potential for immense downside risks that affect future generations, it is paramount that "substance" prevail over "form" when accounting for P3's.

As a result, the Board is asked to consider "substance-over-form" in its deliberations as it strives to issue *guidance that must be consistently applied and grounded or covered by an overarching principle*.

[11] On May 16, 2013 the IASB clarified that service concessions are not within the scope of their Exposure Draft on *Leases* primarily because (1) service concession arrangements do not meet their definition of a lease and (2) leases may be but one element in a broader set of agreements with private partners to construct, own, operate and/or transfer assets.

P3 Touch-Points Among Projects - Major P3 Accounting Practice Issues

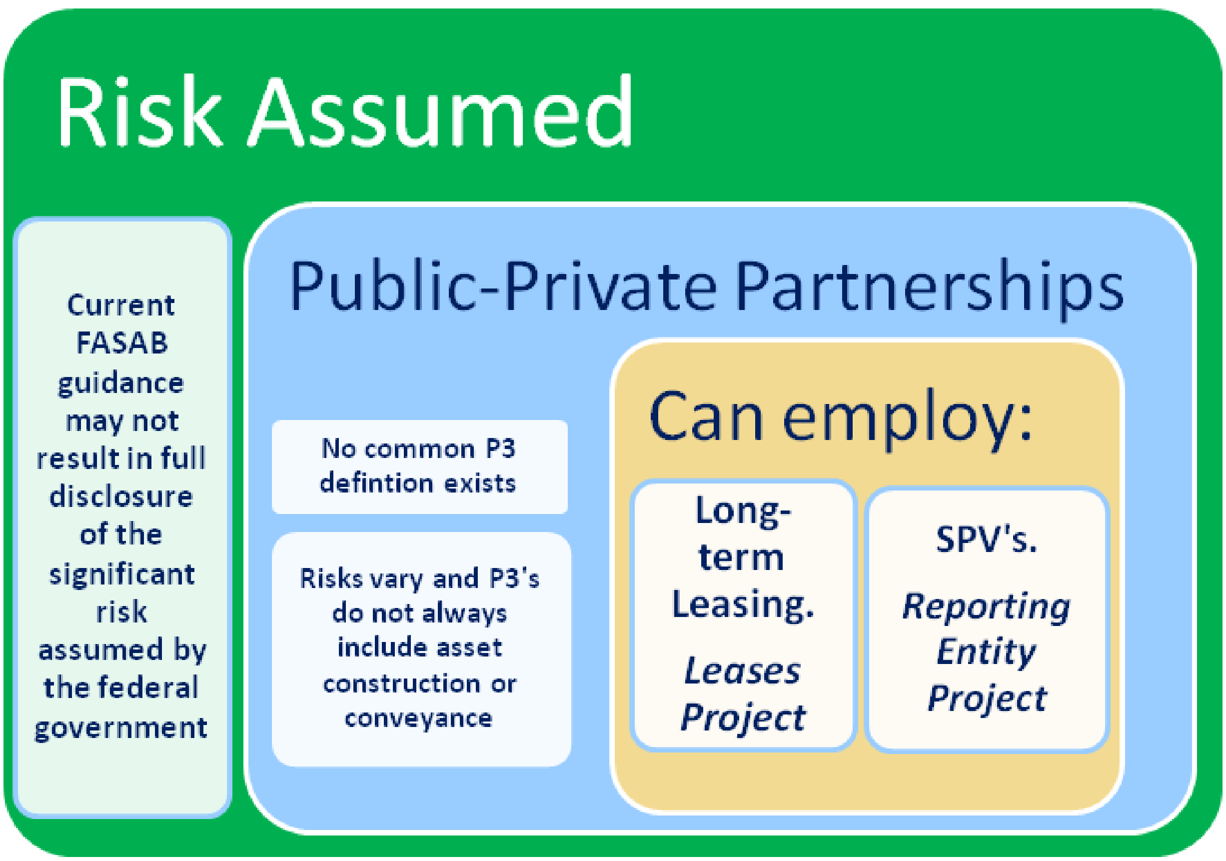
It is extremely important to note that however one defines P3 arrangements/transactions, as the United Kingdom's *Association of Chartered Accountants* have opined, *"Partnership is an ideal to be aspired to rather than a description of the actual working relationship between public and private contracting parties…"*[12] As such, there are no bright-line distinctions of the P3 relationships that exist among the various projects shown below. Nonetheless, staff has identified the various touch-points among projects for the Board's consideration.

To assist the Board in its deliberations, staff has (1) graphically depicted the P3 project in relation to the other active FASAB projects and (2) allocated the major P3 accounting practice issues identified in our work-to-date to those projects that would ordinarily include them in their scope. Staff's analysis follows and continues onto the next page:

Chart 3.0

P3 project in Relation to the Other Active FASAB Projects

Note: There are no bright line distinctions as issues overlap among projects



[12] Association of Chartered Certified Accountants (2004), "*Evaluating the Operation of PFI in Roads and Hospitals".* Research Report No. 84, page 8. *"Partnership is an ideal to be aspired to rather than a description of the actual working relationship between public and private contracting parties and has implications for monitoring and accountability relationships."*

P3 Touch-Points Among Active Projects - Major P3 Accounting Practice Issues

Board Guidance

P3 guidance must be consistently applied and grounded or covered by an overarching principle.

Note: There are no bright line distinctions as issues overlap among projects.

Each numbered issue is discussed in more detail beginning on page 29.

P3	Reporting Entity	Leases Note 1	Risk Assumed	Other
1. Balance sheet valuation. Should the Full value of the P3 be capitalized?	3. Interest in an SPE/SPV	2. Capital Leases	17. Other Matters - Privatization	16. Other Matters - Intellectual Property
4. Single or Unitary Payments		6. Minimum Lease Payments		14. Asset Re-measurement
5. Fair Value		7. Discount Rate(s)		
9. Asset Capitalization		8. Inception of Lease		

Note: There are no bright line distinctions as issues overlap among projects

P3	Reporting Entity	Leases Note 1	Risk Assumed	Other
10. Reversionary or Residual Interests		**11. Capitalization of Interest. Should financing be imputed?**		
12. Non-monetary exchanges				
13. In-kind Consideration (Donated assets)				
15. Unearned Revenue				

Note 1: Leases - It is noteworthy that under IFRS the IASB clarified that service concessions are not within the scope of their Exposure Draft on *Leases* (Topic 842) dated May 16, 2013. This is primarily because (1) service concession arrangements do not meet their definition of a lease and (2) leases may be but one element in a broader set of agreements with private partners to construct, own, operate and/or transfer assets.

In IFRIC Interpretation 12, *Service Concession Arrangements*, the IASB opined that although service concession arrangements are similar to leases inasmuch as rights are usually conveyed to the operator for a limited period of time, they do not meet the definition of a lease because the operator's right is different from that of a lessee. Specifically, the grantor retains control over the use to which the infrastructure is put by controlling or regulating what services the operator must provide, to whom it must provide them, and at what price. The grantor also retains control over any significant residual interest in the infrastructure throughout the period of the arrangement. Unlike a lessee, the operator does not have a right of use of the underlying asset but rather it has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

Analysis of Major P3 Accounting Practice Issues

Staff has identified seventeen (17) major P3 accounting practice issues that could be considered potential gaps in federal accounting guidance. Please refer to the below table for an explanation of each issue along with staffs' observations, task force status and type of guidance or action that may be required:

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
1. Balance sheet valuation. **Is the full value of the P3 inclusive of such costs as service costs and indirect expenses, an asset that should be capitalized?**	In order to (a) reflect the comprehensive nature (i.e., inseparable bundling of assets and services) of a P3 arrangement and/or (b) not skew decision-making in favor of conventional delivery methods, Agencies' often develop business case justifications (i.e., costs versus benefits, value-for-money, net present value, etc) that include both direct and indirect costs in their analyses. Also, some of these allocations will include costs (fixed or sunk) that are typically treated as period expenses (e.g., M&R and G&A) or deemed irrelevant (e.g., depreciation), respectively. As a result, P3 accounting could accommodate capitalizing such costs over the life of the P3.	<u>**Reference**</u> **- SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26*.*** Consistent with SFFAS 6 par. 26, identify or clarify which specific costs should be capitalized as part of the P3 arrangement.	**IN PROCESS**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment*** **and/or** • **Establish standards for assets embodied in P3 arrangements.**

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
2. Capital Leases	In a P3, assets and related liabilities are arranged and managed based on a risk and reward model. Therefore, the asset typically follows the party who can best manage risk and not necessarily the party who has control or right-of-use of the asset. Defaulting to capital lease treatment without fully considering the substance of the transaction – including the assumption of risks as well as asset control – could result in a misstatement of assets and/or liabilities. Please note that unlike a lessee, the private partner/operator does not always have a right-of-use of the underlying asset but rather, a right-to-operate or access-to-operate the asset so that public services can be provided on behalf of the government.	**<u>Reference</u> - SFFAS 6, *Accounting for Property, Plant, and Equipment, paragraph 20.*** By their very nature P3's are designed to transfer different types of risk to a private party with varying degrees of governmental control. Adopting the current FASB/IASB approach (one-size-fits-all) may not accurately reflect the risk-transfer of certain P3 arrangements. In coordination with the *Leases* project, FASAB guidance should be clarified so that P3 transactions are not automatically assumed to be a capital lease with a resultant capital asset.	**TBD - To Be Done**	• **Amend SFFAS 5, *Accounting for Liabilities of the Federal Government*** • **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Practice Issue	**Explanation**	**Observation**	**Task Force Review**	**If required: Recommended Guidance**
3. Interest in an SPE/SPV	In certain cases the government sponsor and/or private partner may establish a special purpose entity (SPE) or special purpose vehicle (SPV) to channel financing and/or conduct operations. These special vehicles or entities may take the form of a corporation, owner trust, partnership or unincorporated entity and are often created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of their governing board, trustee or management over the operations of the special purpose entity. Provisions may also specify that ongoing activities cannot be modified without approval from the creator or sponsor.	**Reference – Proposed Federal Entity Standard, *Identifying and Reporting upon Organizations to Include in General Purpose Federal Financial Reports.* (Tab C, October 2012)** The proposed standard provides three principles (i.e., in the Budget, majority ownership interest, and control with risk of loss or expectation of benefit) for determining which organizations or funds should be included (either consolidated or disclosed) in a federal entities' financial report. Furthermore, the proposed standard also requires inclusion of organizations if it would be misleading to exclude them; e.g. related party relationships of significant influence.	**IN PROCESS** **Potential issue** – Significant influence can exist even when an entity does not meet any of the three inclusion principles. However, because the proposed related party definition hinges upon one party to the existing relationship having the ability to exercise significant influence over the other party in making financial **and** operating decisions, certain P3 SPE's/SPV's may not meet the misleading to exclude disclosure requirement (underscoring and bolding are added for emphasis). The proposed standard makes it clear that related party "… *relationships are numerous and not all warrant disclosure*" and that judgment to identify relationships that warrant disclosure will be required.	• **Revise *Reporting Entity* if needed prior to finalization** • **Amend SFFAS 15, Management's Discussion and Analysis**

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
4. Single or Unitary Payments	Commonly, a single or unitary payment for both the capital (i.e., design, construction, financing, etc.) and operating and maintenance components is made to the private partner. Usually unique to each bidder, the single or unitary payment amount optimizes the mix of capital and operating inputs and includes a risk return amount (i.e., profit). In the eyes of the private partner they receive a singular payment for the delivery of a suite of services whereas the accountants for the public partner see a payment made up of capital and operating costs. If single or unitary payment cannot be split, asset and liability values become very difficult to reliably measure.	**<u>Reference</u> - Leases Project.** In consultation with Ms. Valentine, ensure that the Leases Project considers the various P3 lease arrangement/transactions that practitioners can be expected to address. This should include evaluation and revision as needed of lease-related definitions (see below) and lease recognition guidance in SFFAS 5, *Accounting for Liabilities of the Federal Government* and SFFAS 6, *Accounting for Property, Plant, and Equipment*. Specific to P3's, the terms that may require (further) definition or clarification include: i. Fair value ii. Minimum lease payments iii. Discount rate(s) iv. Inception of lease	**IN PROCESS**	• **Amend SFFAS 5, *Accounting for Liabilities of the Federal Government*** • **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
5. Fair Value	If a P3 transaction is to be recognized as a capital lease, it should be noted in the financial statements that there is a significant difference between the capital value of the asset created and the fair value of the transaction itself (refer to Issue 1 above). The difference results primarily from: • the services provided by the private partner that are "wrapped-around" the asset • the risk premium paid to the private partner • different discount rates used by each partner	**Reference - Leases Project and SFFAS 15, *Management's Discussions and Analysis*, paragraph 2.** Consistent with SFFAS 15 par. 2, if an entity's use of P3's is discussed in MD&A[13] as part of an entity's structure, mission, goals, performance, etc., readers should be advised that the fair value of the arrangement/transaction should not be assumed to be the same as the capital value of the asset as capitalized on the government's balance sheet. Two important matters should be noted: (1) the government's use of a "risk-free" rate results in an asset value higher than the value the private partner would assign and (2) there may not be either at present, or in the foreseeable future an active market for the P3 asset or arrangement.	**TBD - To Be Done**	• **Amend SFFAS 15, Management's Discussion and Analysis**

[13] To the extent that P3's lead to significant actions or proposals by top management or can be significant to oversight functions such as Congress, they should be included within MD&A.

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
6. Minimum Lease Payments	When lease accounting is followed for P3's, accountants often attempt to identify and capitalize a stream of minimum payments which the entity is likely to make in all circumstances. However, in practice it may be rare for a P3 to experience a guaranteed minimum payment which is not subject to non-performance costs; e.g., re-procurement costs, fines, penalties, etc. In addition to the uncertainty of these non-performance costs, accountants must often wrestle with the single or unitary payments issue discussed above (Issue 4). As such, some argue that the resulting minimum lease payment calculation is questionable and/or unreliable.	**Reference - Leases Project, SFFAS 5, *Accounting for Liabilities of The Federal Government,* paragraphs 43-46, *and* SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 20.** To avoid misrepresenting either the P3 arrangement/transaction or related asset/liability values, care needs to be taken in identifying a minimum lease payment stream in the majority of P3 arrangements/transactions and that, where this is considered both appropriate and permitted (refer to Issue 7 directly below for related comments), a risk-adjusted stream of payments should be calculated.	**IN PROCESS**	• **Amend SFFAS 5, *Accounting for Liabilities of the Federal Government*** • **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
7. Discount Rate(s)[14]	There are two questions here – first, should we use different discount rates to value the asset and/or project and second, which rates should be used. i. As discussed in the fair value discussion above (Issue 5), there is a significant difference between the capital value of the asset created and the fair value of the entire P3. As a result, there is sufficient justification to use different discount rates. ii. The government's rate for incremental borrowing is typically viewed as "risk-free" and is essentially a preferential rate that is unavailable to most private sector partners. Apart from elaborate financing and/or taxation schemes	**<u>Reference</u> - Leases Project, SFFAS 5, *Accounting for Liabilities of The Federal Government,* paragraph 45.** **Should different discount rates be used in valuing either P3 assets or projects?** Answer – Conceptually, yes. When a decision is made to value the project as a whole, then it may be appropriate to use the private partner's project Internal Rate of Return (IRR) or Weighted Average Cost of Capital (WACC) as the discount rate that reflects the overall project risk. This would seem appropriate especially for those arrangements/transactions that may have an active market or when the government does not participate in the financing of	**IN PROCESS**	• **Amend SFFAS 5, *Accounting for Liabilities of the Federal Government***

[14] OMB Circular A-94, "*Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*," provides the requirements under which a lease purchase or other capital lease has to be justified and the analytical methods that need to be followed. The Circular applies to projects which would result in a series of measurable benefits or costs extending for three or more years, specific applications include: (1) Benefit-cost or cost-effectiveness analysis of Federal programs or policies, (2) Regulatory impact analysis, (3) Analysis of decisions whether to lease or purchase, and (4) Asset valuation and sale analysis.

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
	that attempt to lower a private partner's cost of capital, most private partners will use an interest rate implicit in the lease. The implicit rate is calculated by adjusting the payment stream to back-out non-capital type costs and then by use of discounting techniques, setting this amount equal to the asset's fair value.	the P3. The same could not be said if we were to only value the asset even when having or expecting an active market because the risk assumptions or risk allocations would probably differ significantly between the asset and overall project. **Which rates should be used?** Answer – This would depend on such factors as; (a) whether to value the asset or the project as a whole, (b) existence or expectancy of an active market, (c) ability to reasonably split the single or unitary payment into capital and non-capital costs,(d) ability to reasonably calculate a minimum lease payment, and most importantly, (e) prevailing OMB Circular A-94 requirements.		

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
8. Inception of Lease	The timing and recognition of capital lease assets and liabilities can depend upon the interpretation of "inception." There is no uniform definition within FASAB literature for "inception" as it relates to leases. SFFAS 6 paragraph 20 which addresses capital leases states that capital leases are leases **that transfer substantially all the benefits and risks** of ownership to the lessee. The questions that arise are – When does a lease transfer substantially all the benefits and risks? And, what does such a transfer of risks and benefits look like? SFFAS 6 paragraph 17 defines PP&E in part as	**Reference - Leases Project and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 17[15] and 20[16].** In consultation with Ms. Valentine, explore if a P3 should be recognized at inception (however subsequently defined) or when the lease transfers substantially all the benefits and risks of ownership to the lessee (refer to Issues 2 and above for related comments). a. For example, inception can occur at different times: • At the signing of the P3 contract • When construction begins	**IN PROCESS**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

[15] Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria: they have estimated useful lives of 2 years or more; they are not intended for sale in the ordinary course of operations; and they have been acquired or constructed with the intention of being used, or being available for use by the entity.

[16] Capital leases transfer substantially all the benefits and risks to the lessee. If at lease inception a lease meets one or more of the following four criteria, it is a capital lease: (1) the lease transfers ownership of the property to the lessee, (2) the lease contains a bargain purchase option, (3) the lease term is equal to or greater than 75 percent of the property's economic life, or (4) the present value of the payments (excluding executor costs) equals or exceeds 90 percent of the fair value of the leased property. The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
	consisting of **tangible assets**, including land, that have been **acquired or constructed with the intention of being used, or being available for use by the entity**. Therefore, recognition of P3 assets (1) could depend upon the interpretation of "use" - e.g., what happens if the government only controls the asset, and (2) would be permitted for those assets under construction or work in progress prior to an actual "hand-off" (asset placed into service) date.	• When asset becomes available • When asset is placed in service b. What elements *constitute a transfer of substantially all the benefits and risks* of ownership? For example, in a government secured or loan guaranteed financing transaction, does a substantial transfer occur when the financing or loan guarantee are in place? What happens in the case where a P3 is deemed highly effective and the private partner assumes substantially all the risks?		

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
9. Asset Capitalization	There are two broad ways to identify and quantify the appropriate cost to be capitalized: the equivalent built (Design-Build contract) cost of the asset or the discounted stream of future government payments.	**<u>Reference</u> - SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26*.*** It may be impractical to specify which of the two methods should be used in all cases. For example, procurement information relative to the design and build costs may not be available and in cases where the private partner is the lessee, lease payment amounts may be considered company-proprietary. Lastly, as discussed above (Issue 4), splitting the single or unitary payment that commingles both the capital (i.e., design, construction, financing, etc.) and operating and maintenance components may be the government's only option. If an asset is capitalized practitioners should be given sufficient flexibility to value the asset using either the Design-Build contract method or splitting the single or unitary payment. Therefore, it may be appropriate to provide guidance using both	**IN PROCESS**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
		methods. To avoid inconsistencies and increase comparability, the Board may desire stipulating that once chosen for selected asset classes or P3 arrangements/transactions, methods should not be changed.		
10. Reversionary or Residual Interests	How do we value a P3 asset when it is handed back to the government at the end of the P3 term where the government has not made any <u>direct</u> payments for the asset? In deliberating SFFAS 6 (see paragraph 150) the Board was asked to address reversionary interests in PP&E.[17] The Board stated that in essence, these are contingent assets and should	**<u>Reference</u> - SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 20.** Accounting guidance may need to be issued on how to either disclose or properly recognize and value the government's reversionary interest in a P3 arrangement/transaction. For example, if it is probable that the government will	**IN PROCESS**	• ***Amend SFFAS 6, Accounting for Property, Plant, and Equipment***

[17] In some instances, the Federal Government provides grants to state and local governments for the acquisition of PP&E. If the state or local government decides that it no longer needs to use the PP&E there is often a provision that the PP&E must revert to Federal ownership. In these cases, the Federal Government maintains a reversionary interest in PP&E.

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
	not be recognized on the balance sheet. The Board elected to specifically exclude these items from PP&E.	reclaim or acquire a P3 asset, a present value estimate of the asset taking into account its age and anticipated condition could be reflected on the entity's balance sheet. Also, the treatment of depreciation (i.e., the asset's net book value) needs to be considered in those cases where an asset once held by the government is required to be returned in the same condition that existed at the time of transfer to the private partner was made.		
11. Capitalization of Interest **Should financing be imputed?**	Per SFFAS 6, all general PP&E shall be recorded at cost and such cost shall include material amounts of interest costs **paid**. The historical cost basis of assets includes those incurred costs necessary to ready the asset (i.e., condition and location) for its intended use. As such, the interest cost incurred during the period that the asset is being readied for its intended use (condition and location) would be capitalized thus	**Reference** - **SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 26.** Interest cost refers to any interest **paid** by the reporting entity directly to providers of goods or services related to the acquisition or construction of PP&E. **Reference** – **SFFAC 2, *Entity and Display,* paragraph 100, footnote 19**	**TBD - To Be Done** In discussing **Imputed financing** S**ources,** the Board noted two types: (1) amounts equal to the costs that have been incurred by the reporting entity but financed by another entity, e.g., retirement costs; and (2) amounts representing costs that are attributable to the reporting entity's activities but that do not	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
	becoming part of the historical cost of acquiring the asset.		require a direct out-of-pocket payment, e.g**., the interest costs associated with carrying inventory or investing in physical assets**. (emphasis added) Although the Board did not reach a decision regarding the recognition by individual entities of these types of costs, it stated that it planned to undertake a project on the interest cost associated with investing in operating assets.	
12. Non-monetary exchanges	Non-monetary exchanges are not specifically mentioned in SFFAS 7. Nonmonetary exchanges are reciprocal transactions that transfer the usual risks and rewards of ownership. In a P3 environment this usually involves nonmonetary assets such as PP&E. For example, an entity that (1) swaps land use for the placement of solar energy panels or satellite antennas or (2) allows the private partner to use a portion of the P3 asset for private profit.	<u>Reference</u> - **SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*** Generally, the accounting for nonmonetary exchanges: i. Is usually based on the <u>fair value</u> of the asset given up (thus becoming the cost of the asset acquired). ii. However, if the fair value of the asset given up is not readily determinable or if the fair value of the asset acquired is more clearly determinable,	**TBD - To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment*** • **Amend SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting***

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
		then its value is used to measure the transaction. iii. Gains and/or losses are recognized. iv. Also applies when a transaction includes a small monetary consideration (boot). v. Is based on the carrying amount of the asset given up when certain exceptions apply (i.e., when the exchange lacks commercial substance). In such cases, unless boot is received no gain is recognized.		
13. In-kind Consideration (Donated assets)	As a condition to drawing down or securing federal funds, some P3 arrangements require that the private partner must first raise funding from non-federal sources. Such matching programs allow for In-Kind contributions to be counted as part of the non-federal support. Also, cases may arise where contributions are made from related parties such as board members or officers.	**Reference - SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 20, FN 10.** SFFAS 6 defines "Fair value" as the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties. **Potential issue** – how to value contributed financial resources such as stocks, bonds, etc.	**TBD - To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment*** • **Amend SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting***

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
	In-kind consideration is mentioned in SFFAS 7, paragraph 62 in the context of Donated assets. Donations are defined as contributions to the government, i.e., voluntary gifts of resources to a government entity by a nonfederal entity Donations may be financial resources, such as cash or securities, or nonfinancial resources such as land or buildings. Revenue arising from donations should be recognized for those inflows of resources which meet recognition criteria for assets and should be measured at the estimated fair value of the contribution. SFFAS 6, paragraph 26 states that the cost of PP&E may include the fair value of facilities and equipment donated to the government.	**<u>Potential issue</u>** – how to value contributions when parties are related.		
14. Asset Re-measurement	Should such values be written down or revalued and if so, what period would be most appropriate to use; i.e., the asset's economic life, service life, or the P3 arrangement's life? Paragraph 20 states that,	**<u>Reference</u> - SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 20** **<u>Potential issue</u>** - how to	**TBD - To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment*** • **Amend SFFAS 44,**

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
	"Re-measurement updates a previously determined carrying amount to reflect a change in the economic value of an asset or liability that has occurred since the previous financial statement date."	value and report contributed financial resources such as stocks, bonds, etc., subsequent to year of acquisition/recognition.		***Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use***

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
15. Unearned Revenue	In cases where the P3 liability is significantly less than the P3 asset's recorded value, depending upon the nature of the arrangement/transaction, the difference could represent unearned revenue. Generally, such an amount could be determined as the fair value of the asset less financial liabilities.	**Reference - SFFAS 5, *Accounting for Liabilities of The Federal Government*, and SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*** **Potential issue** – Proper discernment of significant differences between P3 assets and liabilities need to be made before it is assumed that unearned revenue exists. For example, unearned revenue would exist in cases where the government is provided cash or other consideration in exchange for the private partner's right to use an asset or access to a facility over an established period. However, absent such a quid pro quo, the existence of cash or other consideration should not conclusively lead to recognition of an additional liability.	**TBD - To Be Done**	• **Amend SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting***

Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
16. Other Matters **Intellectual Property**	SFFAS 1, *Accounting for Selected Assets and Liabilities* and SFFAS 6 *Accounting for Property, Plant and Equipment* do not discuss intangible assets. Staff has come across P3 arrangements where patents are jointly created and owned.	**Potential issue** - Staff has identified this area for potential research. Primarily due to valuation concerns, additional research would be required to assess the accounting implications for the accounting for intangibles.	**TBD - To Be Done**	• **Create new SFFAS on Intellectual Property**
17. Other Matters **Privatization**	The basic question is at what point could a P3 arrangement result in a de facto privatization? As P3's could be an entity's initial step into a privatization program questions arise as to the appropriate accounting treatment and classification (i.e., de-recognition) for assets/liabilities and revenues/expenses. For example, should assets being held for privatization be separately classified on the balance sheet? Another de-recognition issue could be the treatment of employee legacy costs or service contract costs.	**Potential issue** - Staff has identified this area for potential research. Primarily due to classification and de-recognition concerns, additional research would be required to assess the accounting implications for the accounting for privatizations.	**IN PROCESS**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Potential P3-Centric Reporting Characteristics/Criteria

Purpose – To develop P3-Centric characteristics/criteria that could become potential reporting criteria that an agency can use in light of its materiality threshold to ascertain what P3's are reportable for financial statement purposes. The characteristics/criteria are intended to apply to all types of P3's; construction, housing, utilities, military depots, etc. These characteristics may be used as an agency filter that in connection with materiality tolerances would eliminate reporting P3 arrangements/transactions that pose no (1) financial recognition or de-recognition concerns, or (2) other risk that could lead to a liability. An agency would be expected to apply judgment and look at these criteria in connection with one another and not in isolation.

Source – In consultation with FASAB's P3 taskforce, a potential listing of criteria have been developed. The potential criteria are not in any order of importance nor did we consider assigning any weights to them at this time.

Scope – Staff developed a suggested list of potential characteristics based on: (1) a P3 literature review, (2) meetings with a diverse group of individuals from federal government, public policy groups, private partners, investment and commercial bankers, and accountants/auditors.

Conclusion – The task force (1) generally agreed with each of the proposed characteristics, (2) offered edits on some of the characteristics, and (3) suggested inclusion of additional characteristics. The results are loosely categorized by P3 project life-cycle components and are presented on the following page.

Potential P3-Centric Reporting Characteristics/Criteria

P3 Project General Life-cycle Components

Project Feasibility	Project Organization	Project Finance	Project Administration
1. Is a value for money or other similar cost-benefit analysis performed?	1. Is an SPE, partnership, trust, etc created?	1. Has the agency invested via an equity contribution 20% or more of the SPE/partnership, trust, etc, common-voting stock?	1. Is the principal arrangement exempt from FAR or other comparable language preserving and protecting the government's rights?
2. Is the principal arrangement NOT managed by an Administrative Contracting Officer (ACO) and/or Procurement Contracting Officer (PCO)?	2. Are significant work force duties, activities or knowledge cross-shared?	2. Is the agency an equity or long-term subordinated debt provider?	2. Is the principal arrangement NOT managed by an Administrative Contracting Officer (ACO) and/or Procurement Contracting Officer (PCO)?
3. Does the government rely on either the private partner or a third party determination of a P3's performance or return on investment/equity without performing its own verification?	3. Do contractual arrangements require the government to absorb a majority of residual losses (or receive a majority of residual returns)?	3. Is any debt or loan non-secured?	3. Is there a greater focus on collaboration and informal, real-time resolution processes as opposed to the more formal contractual administrative processes?
4. Has the arrangement resulted in the creation of an asset or liability?	4. Is the consideration or items given up in an arrangement not readily apparent?	4. Does a residual interest exist in any asset conveyed to the P3?	4. Are separate payments as opposed to a unitary payment, made to the private partner?
5. Is the arrangement considered long-term? That is, greater than 5 years.		5. Is the equity at risk not sufficient to absorb losses of the P3?	

Questions for the Board

1. **Does the Board agree with the general project direction and staff's recommendation to pursue risk (fiscal exposure) identification and subsequent disclosure? If not, what changes would the Board advise be made?**

   General Project Direction

   Because FASAB guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses, the primary objective of this project would be to consider the type of P3 guidance needed to (1) assist preparers in accounting for these highly complex arrangements and (2) identify and report the fiscal exposure (risk) related to material P3 arrangements. Guidance to assist preparers can be issued as a Technical Bulletin[18] which would build on evolving *Lease* and *Reporting Entity* standards, whereas guidance to identify and report fiscal exposure (risk) can be addressed via a SFFAS.

Does the Board agree with the general Project direction and staff's recommendation to pursue risk (fiscal exposure) identification and subsequent disclosure? If not, what changes would the Board advise be made?

2. **Staff advises that the Board consider issuing separate guidance, mostly in the form of amendments, regarding the potential accounting gaps identified on pages 29 – 47. Does the Board agree with the Staff's recommendation? If not, what changes would the Board advise be made?**

   As mentioned above in Question 1, FASAB guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses, therefore, staff recommends that amendments be made to existing standards to best address the fiscal exposure (risks) associated with federal P3's.

   Because P3's can be highly complex and sophisticated risk-transfer systems, our traditional recognition accounting models of ownership and control and rights and obligations must be carefully reviewed in light of these risk-transfer systems so that "form" does not overtake "substance." If accounting form takes precedence over economic substance, accountants may fail in providing an accurate and faithful representation of an entity's fiscal exposure (risk).

[18] Technical Bulletins provide guidance for applying FASAB Statements and Interpretations and resolving accounting issues not directly addressed by either the Statements or Interpretations.

Questions for the Board

Staff advises that the Board consider issuing separate guidance, mostly in the form of amendments, regarding the potential accounting gaps identified on pages 29 – 47. Does the Board agree with the Staff's recommendation? If not, what changes would the Board advise be made?

3. **Staff advises that the Board consider issuing Technical Bulletins, as needed regarding the types of P3 arrangements listed on pages 10 & 11 and more thoroughly discussed on pages 12 - 22 of this document. Does the Board agree with this recommendation? That is, would any of the P3's listed be better addressed in a separate accounting standard or before (1) substantial progress is made on our *Leases* Project and (2) the P3 Task Force completes its work on P3 risk (fiscal exposure)?**

   Staff has identified nineteen (19) different types of P3's that mostly involve leasing arrangements that can be addressed via the issuance of a Technical Bulletin.

   Because of the numerous touch-points that exist among other projects (please refer to pages 26-28 for further details), staff advises that these matters be addressed after (1) substantial progress is made on our *Leases* Project and (2) the P3 Task Force completes its work on P3 risk (fiscal exposure).

Staff advises that the Board consider issuing Technical Bulletins, as needed regarding the types of P3 arrangements listed on pages 10 & 11 and more thoroughly discussed on pages 12 - 22 of this document. Does the Board agree with this recommendation? That is, would any of the P3's listed be better addressed in a separate accounting standard or before (1) substantial progress is made on our *Leases* Project and (2) the P3 Task Force completes its work on P3 risk (fiscal exposure)?

4. **Does the Board generally agree with the P3-Centric characteristics/criteria so far identified on page 49? If not, what changes would the Board advise be made? Does the Board agree that the aforementioned characteristics can become selective criteria that an agency can use in identifying potential P3's for P3-Centric reporting?**

In consult with the Task Force and via fact-finding meetings held-to-date, staff has identified P3 characteristics that could become potential reporting criteria that an agency can use in light of its materiality threshold to ascertain which P3's within their portfolio should be subject to P3-Centric reporting.

For example, relative to significant and material P3 arrangements, 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 SFFAS 15's requirement to address the future effects of existing, currently-known demands, risks, uncertainties, events, conditions and trends, while others suggest reporting in both locations.

The criteria are intended to apply to all types of P3's; construction, housing, utilities, military depots, etc. These characteristics may be used as an agency filter that in connection with materiality tolerances would eliminate additional reporting for P3 arrangements that pose no (1) financial recognition or de-recognition concerns, or (2) other risk that could lead to a liability. An agency would be expected to apply judgment and look at these criteria in connection with one another and not in isolation.

Does the Board generally agree with the P3-Centric characteristics/criteria so far identified on page 49? If not, what changes would the Board advise be made? Does the Board agree that the aforementioned characteristics can become selective criteria that an agency can use in identifying potential P3's for P3-Centric reporting?

Questions for the Board

The objective of this session is to update the Board concerning progress made on the project plan and to address four questions in the following areas: (1) general project direction, (2) suggested matters for technical bulletin guidance, (3) potential gaps in major P3 accounting practice issues, and (4) potential P3-Centric reporting characteristics/criteria.

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-6841 or by e-mail at savinid@fasab.gov with a cc to paynew@fasab.gov.

Questions for the Board

1. **Does the Board agree with the general project direction and staff's recommendation to pursue risk (fiscal exposure) identification and subsequent disclosure? If not, what changes would the Board advise be made?**
2. **Staff advises that the Board consider issuing separate guidance, mostly in the form of amendments, regarding the potential accounting gaps identified on pages 29 – 47. Does the Board agree with the Staff's recommendation? If not, what changes would the Board advise be made?**
3. **3. Staff advises that the Board consider issuing Technical Bulletins, as needed regarding the types of P3 arrangements listed on pages 10 & 11 and more thoroughly discussed on pages 12 - 22 of this document. Does the Board agree with this recommendation? That is, would any of the P3's listed be better addressed in a separate accounting standard or before (1) substantial progress is made on our Leases Project and (2) the P3 Task Force completes its work on P3 risk (fiscal exposure)?**
4. **Does the Board generally agree with the P3-Centric characteristics/criteria so far identified on page 49? If not, what changes would the Board advise be made? Does the Board agree that the aforementioned characteristics can become selective criteria that an agency can use in identifying potential P3's for P3-Centric reporting?**

Illustration 1: P3 Business Models Share Risks and Rewards.

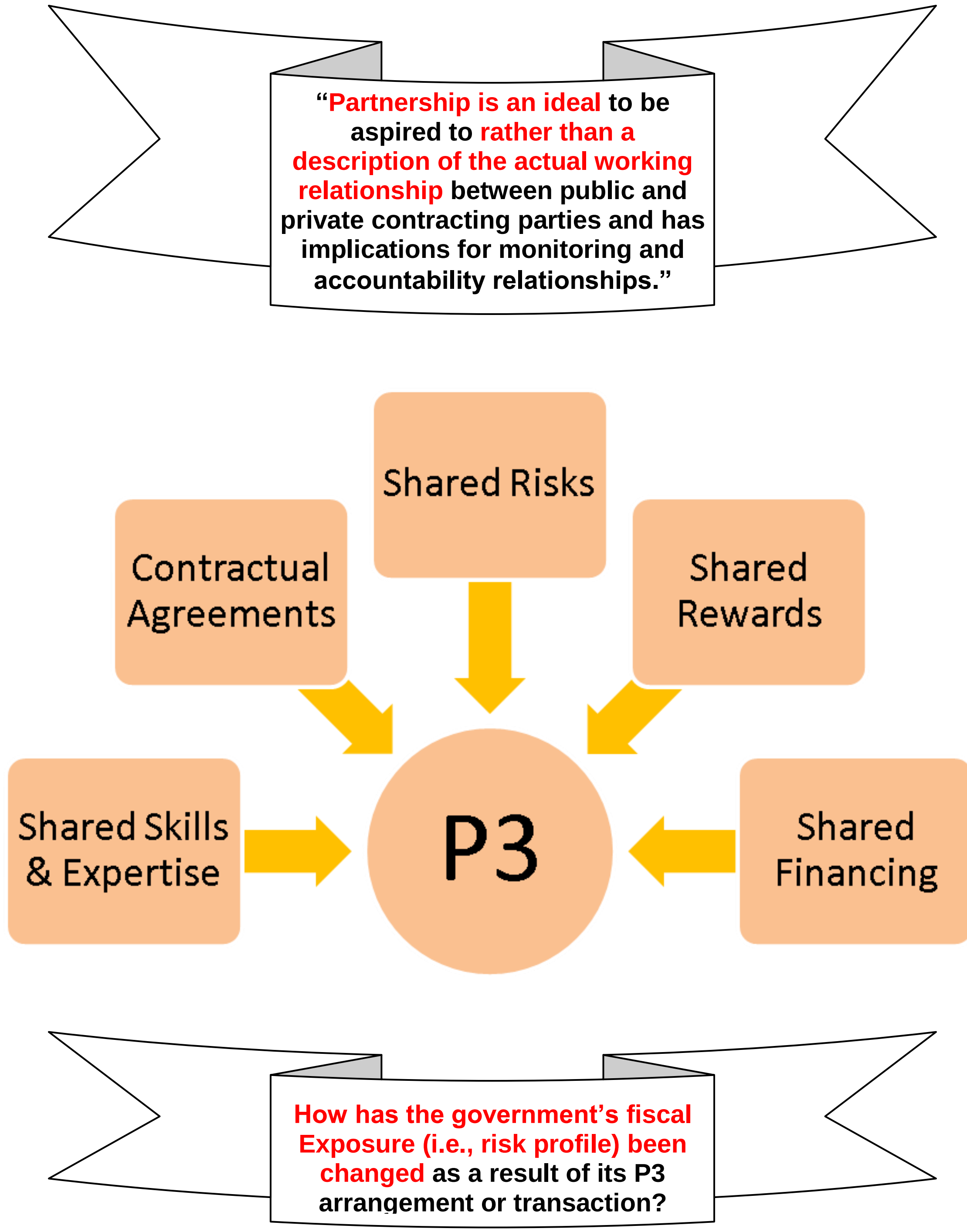
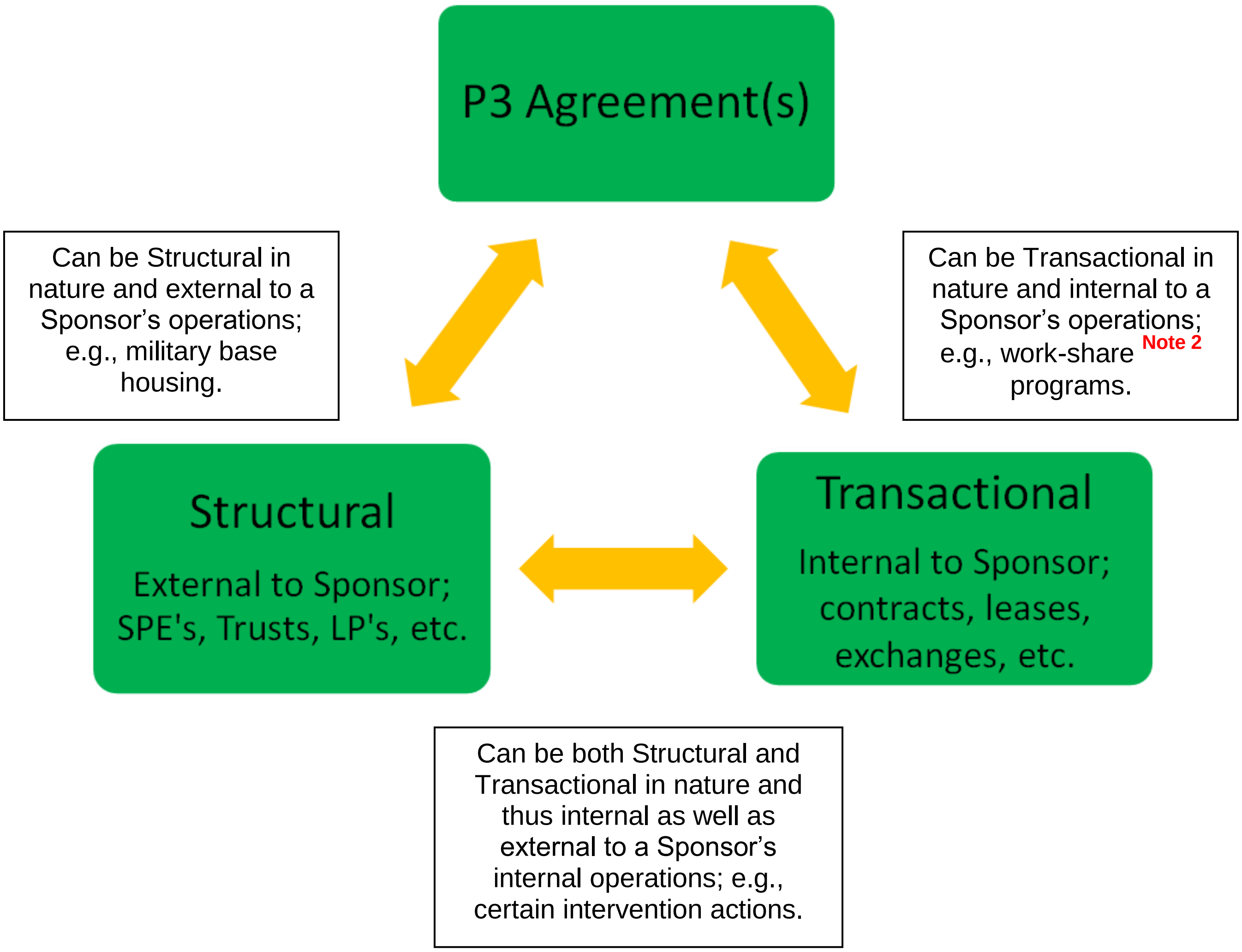


Illustration 2: Complex P3 Accounting – Structural and/or Transactional



Note 2: Work-share Programs - A partnership in which a government buying activity, in collaboration with a contractor and an organic product support activity determines the best mix of work capitalizing on each partner's capabilities. The workload is then shared between the contractor and the organic activity. The contractor is funded through a contract and the organic activity is funded through a project or work order. The partnering agreement between the contractor and organic activity focuses on the roles and responsibilities of each partner where they work jointly to accomplish the overall requirement. Funding is not exchanged between the partners under a work-share agreement; therefore, work-shares do not require specific legal authority.

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Attachment 1: Project Plan Update Summary

Public-Private Partnerships

PROJECT PLAN UPDATE

June 2013

Attachment 1: Project Plan Update Summary

Why

Why is a project on Public-Private Partnerships needed?

- Federal agencies have increasingly turned to public-private partnerships (P3s) to accomplish goals
- Budget pressures are likely to further increase the use of P3s

What

What questions / issues does the Public-Private Partnerships project plan to address?

- Making the full costs of such partnerships transparent would be the overall goal of the project

Project Plan Update Summary

Project Objectives

Because FASAB guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses, the primary objective of this project would be to consider the type of P3 guidance needed. Such guidance can be issued as a Technical Bulletin or SFFAS. Technical Bulletins provide guidance for applying FASAB Statements and Interpretations and resolving accounting issues not directly addressed by either the Statements or Interpretations.

Initial Timeline

October 2012

- Develop Project Plan and Begin Research

October 2013

- Develop and Issue Exposure Draft

October 2014

- Finalize Guidance or Standards

This initial timeline will change because of (1) the breadth and complexity of federal P3 arrangements, (2) refining the project scope wherein accounting issues will be paired with the most appropriate form of guidance (i.e., technical bulletin or standard), and (3) on-going task force research on open accounting issues.

Interim Results

The task force has had three meetings that primarily covered the following topical areas:

- **February 2013** – Agency interest in the use of P3's, types of federal P3's, and use of SPE's.
- **April 2013** – Analysis of various federal P3s, potential P3 characteristics and some accounting policy issues.
- **June 2013** – Analysis and refinement of potential P3 characteristics, further review of some accounting policy issues, and P3 risk discussions.

The task force notes that resources are best used in developing characteristics of P3's as opposed to developing a federal P3 definition. Nevertheless, in answer to the question of *what is a Federal Public-Private-Partnership*, the task force initially agrees that:

> *Federal P3's are arrangements between a public agency and a private sector entity to deliver a service or an asset for either government or general public use.*

End Notes:

End Notes:

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

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

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

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

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

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

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

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

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

- amounts paid to vendors;
- transportation charges to the point of initial use; • handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);

• engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
• acquisition and preparation costs of buildings and other facilities;
• an appropriate share of the cost of the equipment and facilities used in construction work;
• fixed equipment and related installation costs required for activities in a building or facility;
• direct costs of inspection, supervision, and administration of construction contracts and construction work;
• legal and recording fees and damage claims;
• fair value of facilities and equipment donated to the government; and
• material amounts of interest costs paid.

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

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

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

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

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

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

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

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

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

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

U.S. government-wide financial statements need not break out gross costs of providing goods, services, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned exchange revenue.

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

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

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

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

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

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

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

DISCLOSURES AND OTHER ACCOMPANYING INFORMATION

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

47. When making the disclosures called for by (a) and (b) in paragraph 46, cautionary language should be added to the effect that higher prices based on full cost or market price might reduce the quantity of goods or services demanded and, therefore, the difference between revenue received and such higher

prices does not necessarily provide an indication of revenue foregone. If a reasonable estimate is practicable to make, the entity should provide as other accompanying information the amount of revenue foregone and should explain whether, and to what extent, the quantity demanded was assumed to change as a result of a change in price.

vii Definition And General Principle For Recognition Of A Liability

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

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