Federal Accounting Standards Advisory Board

October 3, 2014

Memorandum

To: Members of the Board

From: Domenic N. Savini, Assistant Director

Through: Wendy M. Payne, Executive Director

Subject: **Project Plan Update for Phase 2: Public-Private Partnerships (P3)[1] – TAB D**

OBJECTIVE

To **review information** pertaining to this project's second phase, recognition and measurement, **so that members can decide on the option to include in** the *Annual Report and 3-Year Plan* **and provide phase 2 guidance to staff** as appropriate.

EXECUTIVE SUMMARY

If the Board believes staff support is needed on a higher priority project such as the budget to accrual reconciliation, then staff recommends presentation of the Lengthened Timeline option in the three-year plan. This option helps maximize efficiency and effectiveness. Also, staff believes the Board should use the three-year plan to seek comment on the Lengthened Timeline option assuming this would allow staff to focus on a higher priority project. Staff further recommends addressing major P3 accounting issues/gaps comprehensively through a single project and the use of Technical Bulletins where practicable. This approach helps ensure that principles are uniformly applied, aiding in consistency and comparability while making efficient and effective use of staff resources.

BRIEFING MATERIAL

A *Project Plan Update for Phase 2* is included in this transmittal memorandum. In addition, details concerning *Leasing and Other Arrangements* are provided at Attachment 1. You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

BACKGROUND

At the August meeting staff was asked to consider phase 2 options and report back to the Board in October. During the Board's review of its *Annual Report and 3-Year Plan* at that meeting,

[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.

members reviewed and discussed the following options for the P3 project's next phase scheduled to address recognition and measurement issues:

- **Defer** - some members noted that deferring the next phase allows the Board to study implementation issues and resulting disclosures, thus providing additional insight into how best to proceed with the second phase.
- **Not Defer** - other members expressed a need to proceed directly to the recognition and measurement phase. These members noted that the prevalence of P3s and their apparent increase in use makes the next phase highly important. In addition, potential interaction with other projects such as leases and reporting entity, illustrates a need to proceed directly to the next phase.
- **Lengthened Timeline** - to accommodate the divergent views, some members suggested lengthening the P3 project's time frame so that additional research and feedback initiatives can continue uninterrupted in the short-run, while any residual staff resources can be directed to other priorities.

MEMBER FEEDBACK

Please contact staff as soon as possible to convey your questions or suggestions or if you require additional information. 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. Communication before the meeting should help make the meeting more productive. Therefore, feel free to 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: *Leasing and Other Arrangements*

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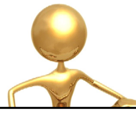
Public-Private Partnerships

PROJECT PLAN UPDATE – PHASE 2

Recognition & Measurement

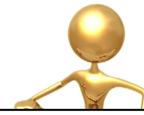
October 2014



Why

Why is phase 2 on Public-Private Partnerships needed?

- To address recognition and measurement issues.
- To identify potential gaps in existing guidance and recommend appropriate amendments.
- To assist preparers and auditors in implementing existing FASAB guidance.
- To stay abreast of recognition and measurement issues as they arise due to anticipated increased use of P3s in light of budgetary pressures.



What

What questions / issues does this project plan to address?

- Making the full costs of P3s transparent continues to be the overall project goal.
- This phase will address how best to communicate guidance; e.g., technical bulletins, amendments or new standards.
- 17 major P3 accounting practice issues have been identified for analysis.
- Areas include: balance sheet valuation and asset capitalization, capital leases, interests in SPVs, non-monetary exchanges and in-kind contributions, and deferred revenue.

Project Plan Update for Phase 2

Project Objectives

The primary objective of phase 2 will be to identify accounting gaps. Accounting gaps can be primarily addressed by use of Technical Bulletins or if required, amendments to existing standards. This is because existing FASAB guidance addresses many of the recognition and measurement issues staff has so far identified. For related comments please refer to the *Summary Analysis of Major P3 Accounting Gaps* on page 5.

Option 1: Current Timeline

April / May 2015 – December 2015

- Convene Task Force to confirm, analyze and address major P3 accounting practice issues requiring guidance.
- Coordinate progress and results with the *Reporting Entity*, *Leases* and *Risk Assumed* Project Managers

January 2016 – June 2016

- Develop and Issue Exposure Draft(s)

July – December 2016

- Finalize Guidance or Standards

Option 2: Deferred Timeline[2]

April / May 2018 – December 2018

- Convene Task Force to confirm, analyze and address major P3 accounting practice issues requiring guidance
- Coordinate progress and results with the *Reporting Entity*, *Leases* and *Risk Assumed* Project Managers
- Review entity P3 Disclosures

January 2019 – June 2019

- Develop and Issue Exposure Draft(s)

July – December 2019

- Finalize Guidance or Standards

[2] Phase 1 on Disclosure Requirements becomes effective for reporting periods beginning October 1, 2017 or Fiscal Year 2018. Results will be available during the last quarter of calendar year 2018.

Option 3: Lengthened Timeline [3]

April / May 2015 – December 2015

- Continue P3 research focusing on Leases and PP&E

January 2016 – June 2016

- Conduct initial agency visits and fact-finding sessions

July 2016 – October 2016

- Convene Task Force to confirm, analyze and address major P3 accounting practice issues requiring guidance.
- Coordinate progress and results with the *Reporting Entity*, *Leases* and *Risk Assumed* Project Managers

November 2016 – March 2017 [4]

- PROJECT RECESS

April 2017 – December 2017

- Conduct additional agency visits and fact-finding sessions
- Confirm findings from initial agency visits and fact-finding sessions

January 2018 – June 2018

- Develop and Issue Exposure Draft(s)

July – December 2018

- Finalize Guidance or Standards

Staff Recommendation

Staff recommends presentation of the Lengthened Timeline option in the three-year plan. This option helps maximize efficiency and effectiveness. Also, staff believes the Board should use the three-year plan to seek comment on the Lengthened Timeline option assuming this would allow staff to focus on a higher priority project. Project deferral is not advised primarily because (1) lost momentum will result in greater start-up costs later, (2) loss of the community's attention, and (3) unnecessarily delayed technical assistance to the community.

[3] The lengthened timeline assumes a 2 year "stretch" of the P3 project to allow staff time to work on another project.

[4] An approximate 4/5 month break would allow staff and the Board to focus solely on developing an Exposure Draft / Standard on the other project.

Summary Analysis of Major P3 Accounting Gaps

Staff Recommendation – Staff recommends addressing these issues comprehensively in a single project. As shown below, phase 2 mostly affects PP&E, liability, and revenue recognition and measurement issues. Although a few of these issues can be addressed in the leases project such as issues 2, 6, 7, 8, and 11, the majority will need specific project coverage or staff focus. Please refer to the Detailed Analysis of Major P3 Accounting Gaps beginning on page 12.

Gap - Accounting Practice Issue	SFFAS 5 Liabilities	SFFAS 6 PP&E	SFFAS 7 Revenue	SFFAS 15 MD&A	New or Other Standard
1. Balance Sheet Valuation		X			
2. Capital Leases	X	X			
3. Interest in an SPE/SPV				X	
4. Single or Unitary Payments	X	X			
5. Fair Value				X	
6. Minimum Lease Payments	X	X			
7. Discount Rate(s)	X				
8. Inception of Lease		X			
9. Asset Capitalization		X			
10. Reversionary or Residual Interests		X			
11. Capitalization of Interest		X			
12. Non-monetary exchanges		X	X		
13. In-kind Consideration		X	X		
14. Asset Re-measurement		X			X
15. Unearned Revenue			X		
16. Intellectual Property					X
17. Privatization		X			

P3 Touch-Points among Projects

Staff Recommendation - As stated above, staff recommends addressing these issues in a single project because there are no bright-line distinctions[5] of the P3 relationships that exist among the various projects. Effectiveness is maximized primarily as a result of addressing the relevant accounting issues or gaps comprehensively and not in piecemeal fashion. This helps ensure that principles are uniformly applied aiding in consistency and comparability.

P3 Touch-Points among Projects

P3	Reporting Entity	Leases	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		
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				

[5] As the United Kingdom's Association of Chartered Accountants have stated, *"Partnership is an ideal to be aspired to rather than a description of the actual working relationship between public and private contracting parties…"* Staff notes that the risk-sharing ideal embodied in P3s cuts across both projects and accounting standards.

P3 Accounting Issues and Case Studies

Staff Note – The following P3 case study illustrates a "land-for-energy" exchange or swap. Seven accounting issues are identified based on available information. Three of the issues are P3 specific whereas 4 are Leases specific.

National Aeronautics and Space Administration (NASA)

NASA and Florida Power & Light (FPL) the state's largest electric utility signed an agreement in June 2008 that will cut reliance on fossil fuels and improve the environment by reducing greenhouse gas emissions.

The agreement will permit FPL to lease 60 acres of NASA Kennedy Space Center's approximately 140,000 acres for a solar photovoltaic power generation system. The facility will produce an estimated 10 megawatts of electrical power, which is enough energy to serve roughly 3,000 homes. The solar power facility will be built and maintained by FPL.

As part of the agreement, FPL will build a separate one megawatt solar power facility at Kennedy that will support the electrical needs of the center. It will also help NASA meet its goals for use of power generated from renewable energy. In addition to generating electricity, the facility will provide an opportunity for NASA engineers and technicians to gain experience in energy production. It also may serve as a test bed for solar power technology that could be used on the surface of the moon and other planetary bodies.[6]

7 Relevant Accounting Issues – 2, 5, 6, 7, 8, 12, 13

P3 Issues = 5, 12, 13

Leases Issues = 2, 6, 7, 8

P3 Specific		Leases Specific	
5.	**Fair Value**	**2.**	**Capital Leases**
12.	**Non-monetary exchanges**	**6.**	**Minimum Lease Payments**
13.	**In-kind Consideration**	**7.**	**Discount Rate(s)**
		8.	**Inception of Lease**

[6] http://www.nasa.gov/centers/kennedy/news/releases/2008/release-20080625b.html

Staff Note – The following P3 case study illustrates a federal matching-funds program involving the use of in-kind contributions and/or donated assets or services. Three accounting issues are identified based on available information all of which are P3 specific.

Department of Commerce (DoC) – Brand USA

In 2010 Congress established the Corporation for Travel Promotion which conducts business as Brand USA, a nonprofit public-private partnership to promote international travel to the United States. Brand USA's annual budget consist of private sector cash and in-kind contributions, with federal matching funds. Commerce reviews Brand USA's requests for federal matching funds and directs Treasury to disburse the funds. For fiscal year 2012, Brand USA received about $50 million in private-sector funding and $100 million in federal matching funds.

Brand USA and the Department of Commerce established the in-kind contributions policy in November 2011 and have revised it three times since then, most recently in March 2013. However, GAO found that Brand USA and Commerce disagree regarding whether certain types of in-kind contributions that are eligible under the policy qualify for federal matching funds. Brand USA returned nearly $1.1 million in federal matching funds that Commerce had previously approved, but Brand USA noted that it reserved the right to resubmit these types of contributions. GAO's recent work on organizations that receive both federal and nonfederal resources found that formalizing and documenting a process for resolving disagreements between partners, such as Brand USA and Commerce, can enable productive interactions and facilitate collaboration.[7]

3 Relevant Accounting Issues – 1, 5, 13

P3 Issues = 1, 5, 13

P3 Specific	
1.	**Balance sheet valuation**
5.	**Fair Value**
13.	**In-kind Consideration**

[7] Brand USA GAO-13-705 *Brand USA Needs Plans for Measuring Performance and Updated Policy on Private Sector Contributions*

Staff Note – The following P3 case study illustrates a lease arrangement where the private party finances, builds or renovates and operates military housing. Nine accounting issues are identified based on available information. Four of the issues are P3 specific, 4 are Leases specific, and 1 is Reporting Entity specific.

Department of Defense (DoD) Military Housing

Congress established the Military Housing Privatization Initiative (MHPI) in 1996 as a tool to help the military improve the quality of life for its service members by improving the condition of their housing. The MHPI was designed and developed to attract private sector financing, expertise and innovation to provide necessary housing faster and more efficiently than traditional Military Construction processes would allow. The Office of the Secretary of Defense has delegated to the Military Services the MHPI and they are authorized to enter into agreements with private developers selected in a competitive process to own, maintain and operate family housing via a fifty-year lease.[8]

9 Relevant Accounting Issues – 1, 2, 3, 4, 5, 6, 7, 8, 9

P3 Issues = 1, 4, 5, 9

Leases Issues = 2, 6, 7, 8

Reporting Entity = 3

P3 Specific	Leases Specific	Reporting Entity Specific
1. Balance sheet valuation	**2. Capital Leases**	**3. Interest in an SPE/SPV**
4. Single or Unitary Payments	**6. Minimum Lease Payments**	
5. Fair Value	**7. Discount Rate(s)**	
9. Asset Capitalization	**8. Inception of Lease**	

[8] http://www.acq.osd.mil/housing/

Staff Note – The following P3 case study illustrates an energy savings arrangement where project savings will be used to repay the private partner's investment. Three accounting issues are identified based on available information all of which are P3 specific.

Architect of the Capitol (AOC)

In July 2009 it was reported that the Office of the Architect of the Capitol (AOC) entered into a partnership with NORESCO, LLC, for an Energy Savings Performance Contract in the House Office Buildings. The project includes nearly $34 million in facility infrastructure upgrades in the Rayburn, Longworth, Cannon, and Ford House Office Buildings, as well as the House Page Dormitory.

Through this energy savings performance contract, NORESCO, under the direction of the Architect of the Capitol, will invest private funds to carry out a pre-approved set of energy conservation projects in the selected buildings. NORESCO will guarantee minimum energy savings for each project and will be repaid for their investment from the verified savings.[9]

3 Relevant Accounting Issues – 1, 5, 9

P3 Issues = 1, 5, 9

P3 Specific	
1.	**Balance sheet valuation**
5.	**Fair Value**
9.	**Asset Capitalization**

[9] http://www.aoc.gov/press-room/aoc-enters-public-private-contract-save-energy-capitol-hill

Staff Note – The following P3 case study illustrates only a portion of the overall arrangement and is one of the most complicated arrangements reviewed by staff. There are eleven accounting issues identified primarily based on an Inspector General (IG) report and an IG fact-finding meeting conducted by staff. Seven issues are P3 specific whereas 4 are Leases specific.

Veterans Administration (VA) Cleveland Medical Center

The Enhanced Use Lease (EUL) executed on October 27, 2009 included three service agreements. Under the EUL authority, VA leased the entirety of the Brecksville campus to VetDev, a private partner in exchange for $2 million in cash and in-kind consideration of not less than $4 million. In addition to the building space and parking spaces provided as consideration for the EUL, the service agreements included additional building space, parking spaces, and domiciliary services that VA would pay for at negotiated rates. The IG specifically noted difficulty with valuing the In-Kind contributions and determining an appropriate market-based discount rate.[10]

11 Relevant Accounting Issues – 1, 2, 4, 5, 6, 7, 8, 10, 12, 13, 15

P3 Issues = 1, 4, 5, 10, 12, 13, 15

Leases Issues = 2, 6, 7, 8

P3 Specific	Leases Specific
1. Balance sheet valuation	**2. Capital Leases**
4. Single or Unitary Payments	**6. Minimum Lease Payments**
5. Fair Value	**7. Discount Rate(s)**
10. Reversionary or Residual Interests	**8. Inception of Lease**
12. Non-monetary exchanges	
13. In-kind Consideration	
15. Unearned Revenue	

[10] VA IG report, *Review of the Enhanced Use Lease between the Department of Veterans Affairs and Veterans Development, LLC,* Report No. 12-00375-290 , dated September 28, 2012 and a Fact-finding meeting conducted on February 27, 2013.

Detailed Analysis of Major P3 Accounting Gaps

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:

Gap - Accounting 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.	**TBD - To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment*** **and/or** • **Establish new standards for assets embodied in P3s.**

Gap - Accounting 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***

Gap - Accounting 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 – Reporting Entity Standard. (Tab C, August 2014)** The Reporting Entity Standard provides for disclosure of related party relationships of such significance that it would be misleading to exclude information. Organizations are considered to be related parties if the existing relationship or one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions. Although guidance is provided, judgment will be required to identify relationships that warrant disclosure as related parties.	**TBD - To Be Done** The task force will review the *Reporting Entity* guidance and address "Significant influence" for the purposes of determining if supplemental P3 guidance is needed. Also, because MD&A should provide a clear and concise description of the reporting entity and its mission and activities as well as other information, SFFAS 15 may need to be amended to ensure that readers are informed of activities being done via P3 arrangements/transactions.	• **Establish a protocol for evaluating Related Parties consistent with Reporting Entity standards.** • **Amend SFFAS 15, Management's Discussion and Analysis**

Gap - Accounting 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.	**Reference - 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	**TBD - To Be Done**	• **Amend SFFAS 5, *Accounting for Liabilities of the Federal Government*** • **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Gap - Accounting 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[11] 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**

[11] 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.

Gap - Accounting 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.	**TBD - To Be Done**	• **Amend SFFAS 5, *Accounting for Liabilities of the Federal Government*** • **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Gap - Accounting Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
7. Discount Rate(s)[12]	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 that attempt to lower a	**<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 the P3. The same could not	**TBD - To Be Done**	• **Amend SFFAS 5, *Accounting for Liabilities of the Federal Government***

[12] 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.

Gap - Accounting Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
	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.	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.		

Gap - Accounting 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	**<u>Reference</u> - Leases Project and SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 17[13] and 20[14].** 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	**TBD - To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

[13] 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.

[14] 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.

Gap - Accounting 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?		

Gap - Accounting 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	**TBD - To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

Gap - Accounting 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.[15] 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	**TBD - To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

[15] 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.

Gap - Accounting 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***

Gap - Accounting 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***

Gap - 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 <u>carrying amount</u> 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.	**<u>Reference</u> - 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. **<u>Potential issue</u>** – 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***

Gap - 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.	**Potential issue** – how to value contributions when parties are related.		

Gap - Accounting Practice Issue	Explanation	Observation	Task Force Review	If required: Recommended Guidance
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, "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."	**Reference - SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 20** **Potential issue** - how to value and report contributed financial resources such as stocks, bonds, etc., subsequent to year of acquisition/recognition.	**TBD - To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment*** • **Amend SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use***

Gap - Accounting 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***

Gap - 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.	**TBD – To Be Done**	• **Amend SFFAS 6, *Accounting for Property, Plant, and Equipment***

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Questions for the Board

1. **Does the Board agree with the staff recommendation to present the Lengthened Timeline option in the three-year plan and use the three-year plan to seek comment on the Lengthened Timeline option?? If not, what changes would the Board advise be made?**

   The Lengthened Timeline option continues project momentum helping to maximize efficiency by keeping the staff and task force engaged on the relevant accounting issues/gaps. Effectiveness is maximized primarily as a result of addressing the issues/gaps in a holistic manner and not piecemeal and the timely issuance of guidance. Project deferral is not advised primarily because (1) lost momentum will result in greater start-up costs later, (2) loss of the community's attention, and (3) unnecessarily delayed technical assistance to the community. Refer to the *Project Plan Update for Phase 2* beginning on Page 1 and the *P3 Accounting Issues and Case Studies* beginning on page 7.

Does the Board agree with the staff recommendation to present the Lengthened Timeline option in the three-year plan and use the three-year plan to seek comment on the Lengthened Timeline option? If not, what changes would the Board advise be made?

2. **Does the Board agree with the general project direction and staff's recommendation to begin this phase with the 17 Major P3 Accounting Gaps thus far identified? If not, what changes would the Board advise be made?**

   The primary objective of phase 2 will be to identify accounting gaps while making the full costs of P3s transparent will continue to be the overall project goal. This phase will address how best to communicate guidance; e.g., technical bulletins, amendments or new standards. Seventeen major P3 accounting practice issues/gaps have been identified for analysis. Areas include: balance sheet valuation and asset capitalization, capital leases, interests in SPVs, non-monetary exchanges and in-kind contributions, and deferred revenue. Refer to the *Summary Analysis of Major P3 Accounting Gaps* on page 5 and P3 *Touch-Points among Projects* on page 6 for details.

Does the Board agree with the general project direction and staff's recommendation to begin this phase with the 17 Major P3 Accounting Gaps thus far identified? If not, what changes would the Board advise be made?

Questions for the Board

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3. **Staff advises that where no significant accounting gaps exist, the Board consider issuing Technical Bulletins to assist practitioners in implementing existing FASAB guidance. Does the Board agree with this recommendation?**

   For example, 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 in consultation with the Leases project. Refer to Attachment 1*, Leasing and Other Arrangements* beginning on page 36 for details.

Staff advises that where no significant accounting gaps exist, the Board consider issuing Technical Bulletins to assist practitioners in implementing existing FASAB guidance. Does the Board agree with this recommendation?

To review information pertaining to this project's second phase, recognition and measurement, so that members can decide on the option to include in the Annual Report and 3-Year Plan and provide phase 2 guidance to staff as appropriate.

Please contact staff as soon as possible to convey your questions or suggestions or if you require additional information. 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. Communication before the meeting should help make the meeting more productive. Please contact me by telephone at 202-512-6841 or by e-mail at savinid@fasab.gov with a cc to paynew@fasab.gov.

Attachment 1

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Attachment 1: Leasing and Other Arrangements

Staff advises the Board to consider issuing guidance via Technical Bulletins for the 19 arrangements identified by CBO and GAO beginning on the next page. The majority of the arrangements are either discrete leases or involve aspects of leasing in the overall arrangement. As such, because fairly robust FASAB guidance exists, Technical Bulletins would be an effective and economical way to issue recognition and measurement guidance.

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.

Attachment 1: Leasing and Other Arrangements

Types of Public-Private Partnership Arrangements Identified by CBO and GAO And Relevant FASAB Standards

TYPE[16]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS[17]** **(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 (BOT)	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

[16] 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.

[17] 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.

TYPE[16]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[17] (all end notes can be found at the very end of this Memorandum)
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[16]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[17] (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 agency unless the project is a design/build/operate/transfer	**At Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Public agency,* paragraph 19[vii].

TYPE[16]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[17] (all end notes can be found at the very end of this Memorandum)
	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.	**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 agency. The developer gains the right to use the facility	**Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23[iv].

TYPE[16]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[17] (all end notes can be found at the very end of this Memorandum)
	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 municipal transit facilities have been leased and developed	**Sale** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 36e – 47[vi]. **Fees** - SFFAS 7, *Accounting for*

TYPE[16]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[17] (all end notes can be found at the very end of this Memorandum)
	under LDO and BDO arrangements.	*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 it back from the new owner. An innovative application of the	**Sale** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and*

TYPE[16]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[17] **(all end notes can be found at the very end of this Memorandum)**
	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.	*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 Equipment,* paragraph 26[iii].

TYPE[16]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[17] (all end notes can be found at the very end of this Memorandum)
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 Budgetary and Financial Accounting,* paragraphs 34 – 47[ix].

TYPE[16]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[17] (all end notes can be found at the very end of this Memorandum)
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 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	**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,*

TYPE[16]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS[17]** (all end notes can be found at the very end of this Memorandum)
	directly.	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. The public agency entity benefits from some of the tax advantages that the private sector partner enjoys in the form of lower 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].

End Notes: Leasing and Other Arrangements

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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.