

Memorandum

P3

April 24, 2024

To: Members of the AAPC
From: Domenic N. Savini, Assistant Director
Thru: Monica R. Valentine, Executive Director/ AAPC Chair
Subject: **Public-Private Partnerships (P3): Proposed Draft Guidance**

INTRODUCTION

In fiscal year 2012, Public-Private Partnerships (P3s) was added to the agenda because federal agencies were increasingly turning to these risk sharing arrangements or transactions to accomplish their goals, partly considering budget pressures. The overall objective of the project is to make the full costs of such partnerships transparent.

At the April 17, 2024, Board meeting, the majority of members continued to agree with the task force's direction, scope, and proposed plan to develop implementation guidance in the form of a technical release to assist preparers and auditors with implementing and complying with the SFFAS 49 disclosure requirements.

Specifically, the majority of members decided that it would be best to expose a technical release comprised of sample Q&As and a flowchart. The purpose would be to help address implementation challenges primarily dealing with the application of the risk-based characteristics, and aligning required SFFAS 49 supplemental disclosures to SFFAS 47, *Reporting Entity* and SFFAS 54, *Leases*.

Nevertheless, members made the following key points:

- Disclosures should be reviewed before moving forward in developing guidance;
- Concerns regarding reporting challenges specific to remote risk and cash flow estimates should be addressed;
- By issuing an exposure draft the Board will learn what (specific) impediments exist regarding P3 risk reporting;
- Case study illustrations may be best communicated as non-authoritative guidance;
- Training and outreach may be better venues to address the complex issues contained in some of the case studies; and
- Case study complexities could raise a myriad of questions best addressed via our Technical Inquiry process.

One member noted that consistent with the AAPC notes and previous meeting comments they had made, they would prefer first reviewing existing disclosures before moving forward in developing further guidance. Concerns regarding reporting challenges specific to remote risk and cash flow estimates should be addressed. However, some members were concerned that given the implementation issues faced by preparers and auditors, such a review is premature and that the Board should wait between 3 to 5 reporting cycles before reexamining the SFFAS 49 disclosures.

Another member expressed concern over the identification of material P3 risks, noting that practitioners may be struggling with how best to communicate those risks. In reply, another member suggested that by issuing an exposure draft, the Board will learn what (specific) impediments exist regarding risk reporting.

REQUEST FOR FEEDBACK BY MAY 6, 2024

Committee members are requested to review these materials in advance of the meeting. Although staff is not requiring technical feedback in advance of the meeting, members are encouraged to provide comments in advance to Dom as early as possible at savinid@fasab.gov with a cc to Monica at valentinem@fasab.gov.

Please review the attached material including attachments and respond to the three questions in Attachment 6 by **May 6, 2024**.

For additional information, questions, or suggestions, please contact Dom at savinid@fasab.gov with a cc to Monica at valentinem@fasab.gov.

ATTACHMENTS

1. Preliminary Guidance on Applying SFFAS 49 Risk Based Characteristics (RBCs)
2. Preliminary Guidance on Applying SFFAS 47, *Reporting Entity*
3. Preliminary Guidance on Applying SFFAS 54, *Leases*
4. Draft Decision Tree Flowchart to address SFFAS 47, *Reporting Entity* and SFFAS 54, *Leases* alignment
5. Proposed Next Steps
6. Questions for the Committee

ATTACHMENT 1: Preliminary DRAFT Guidance on Applying SFFAS 49 Risk Based Characteristics (RBCs)

1. Question - Agency analysis for P3s should include a review of contractual agreements, guarantees, insurance, and indemnification strategies, along with private partner debt and equity. What specific risks within these agreements might give rise to conclusive and suggestive risk characteristics described in Pars. 20-21 when considering the need for disclosures?

Answer - By nature, P3s are a form of investment that may also contain debt and equity and transfer or share various forms of risk among the P3 partners. Reporting entity management should have completed a comprehensive evaluation of the structure of each agreement and documented the reward and risk composition from each P3 relationship. The various forms of inherent risks documented could give rise to conclusive and/or suggestive risk characteristics requiring disclosure. Those inherent risks entities should evaluate might include, but are not limited to:

- Risks the entity may have to absorb part or all of the project's private debt;
- Risks the entity will not achieve expected returns on its investments in limited partnerships ;
- Risks from the transfer of government assets (including intellectual property) into private hands for extended periods of time;
- “Opportunity costs” (costs along with the accompanying benefits may not be distributed equitably across generations) (SFFAS 49, Par. 2), along with the financial costs of the public purpose or public value will not be fulfilled or achieved;
- “Opportunity cost” of procurement: “absorb losses greater than other alternative procurement methods or competing in-house performance”; and
- Risks that the federal government may have to absorb part or all of the project's private debt.

ATTACHMENT 2: Preliminary DRAFT Guidance on Applying SFFAS 47, *Reporting Entity*

- 1. Question - *If a private entity is consolidated and thus treated as being part of the overall reporting entity's general purpose federal financial reports, does SFFAS 49 apply?***

Answer – Yes. Consolidation of a private entity that meets the SFFAS 47 consolidation requirements does not extinguish the nature or character of the risk sharing relationship that may exist between the government entity and the private entity. To that end, if SFFAS 49 disclosure is required, supplemental disclosures should be provided in a manner which cross references SFFAS 47 so that concise, meaningful, and transparent information is provided and information is not duplicated.

- 2. Question - *Since consolidation basically results in a reporting entity treating another entity as part of its general purpose federal financial reports, does the consolidation process change a private entity into a public entity? If so, then wouldn't the SFFAS 49 requirements not apply?***

Answer - No. The consolidation process does not change the legal nature and character of the private entity. Component reporting entities' GPFFRs must include all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete.

- 3. Question - *If you have a P3 arrangement or transaction that meets the SFFAS 47 inclusion criteria (consolidated or disclosed) or is deemed a related party, which SFFAS 49 disclosures apply? That is, how do you align disclosures?***

Answer – Professional judgement will be required. Please refer to SFFAS 49, paragraph 24 for the complete list of disclosure requirements. SFFAS 47 and SFFAS 49 have similar disclosure objectives and requirements however, some SFFAS 49 supplemental disclosures could include:

- I. A description of federal and non-federal funding of the P3 over its expected life;
- II. Expected life determinations and identification of 3rd party payers;
- III. In-kind transactions and remote risks and donations;
- IV. Contractual risk of loss the P3 partners are undertaking, including remote risks and cash flow impacts;
- V. Identification of associated financial statement amounts;

ATTACHMENT 2: Preliminary DRAFT Guidance on Applying SFFAS 47, *Reporting Entity*

- VI. Private partner borrowings/investments based on government's promise to pay; and
- VII. Other contractual disclosures.

Therefore, to the extent that the SFFAS 47 disclosures do not provide the information specific to SFFAS 49, supplemental disclosures should be provided in a manner which is cross referenced so that concise, meaningful, and transparent information is provided and information is not duplicated.

4. *Question - I've identified a P3 and think it also meets SFFAS 47 because the partner seems to have the ability to exercise significant influence over the P3. How do I determine if the SFFAS 47 disclosure requirements for a related party also apply?*

Answer – Preparers should review the P3 guidance against the SFFAS 47 guidance, including paragraph 82 that discusses significant influence, and paragraph 85 that discusses related parties. Where a related party is determined, SFFAS 49 disclosure should be aligned with SFFAS 47 to provide supplemental information and reference.

1. Question - What are the required disclosures if a lease or lease component meets SFFAS 49?

Answer - The lease arrangements or transactions that have a lease component should be initially analyzed against SFFAS 54 definitions and criteria and secondly against SFFAS 49. Likewise, if a lease or lease component is identified as having P3 characteristics, the arrangement should then be also analyzed against SFFAS 49 criteria. For lease arrangements or transactions meeting P3 disclosure requirements, the lease should be disclosed under SFFAS 49 regardless of whether it is disclosed under SFFAS 54. Consistent with SFFAS 49 paragraph 23, if lease arrangements or transactions meet both the SFFAS 54 and SFFAS 49 reporting requirements, the resultant disclosures should be integrated so that concise, meaningful, and transparent information is provided and information is not repetitive. For example, entities may integrate disclosures and provide cross-references among separate disclosures. For lease arrangements not meeting P3 disclosure requirements, the arrangement should only be disclosed in accordance with SFFAS 54.

2. Question - I've identified a P3 that I believe may contain a SFFAS 54 lease. How can I tell if the P3 also contains a lease or lease component as opposed to another type of contract or arrangement that permits use of an asset similar to a lease?

Answer - Preparers should review the P3 arrangement against SFFAS 54, including paragraphs 2-4 and TR 20 paragraphs 4-19. First, ensure that the definition of a lease is met as defined by SFFAS 54 in paragraph 2, i.e., a contract or agreement is required to convey control of the right to use the underlying asset for a period of time in exchange for consideration. Also, evaluate the arrangement against other SFFAS 54 requirements and exclusions. For example, if a lease or contract allows a private party to use the reporting entity's property without consideration, the arrangement is not a lease (SFFAS 54, paragraph 2). For example, service concession arrangements generally provide access to contractors for operating or maintaining federal assets, but those contractors cannot deny or regulate access or otherwise control the right to obtain economic benefits and services from the use of the asset; they are merely contracted to operate or maintain the asset under the arrangement.

3. Question - What are some key characteristics to help distinguish a lease only meeting SFFAS 54 reporting requirements versus a lease meeting both SFFAS 54 and SFFAS 49 reporting requirements?

Answer - A lease identified to be a P3 will typically be a bundled lease (see paragraph 15.b. of SFFAS 49¹ for when unbundled leases are excluded). A lease meeting any one of the SFFAS 49 paragraph 20 conclusive risk characteristics and/or a lease meeting SFFAS 49 paragraph 21 suggestive risk characteristics in the aggregate may also be required to be disclosed under SFFAS 49.

4. Question - Are Energy Savings Performance Contracts and Utility Energy Service Contract leases and/or P3s?

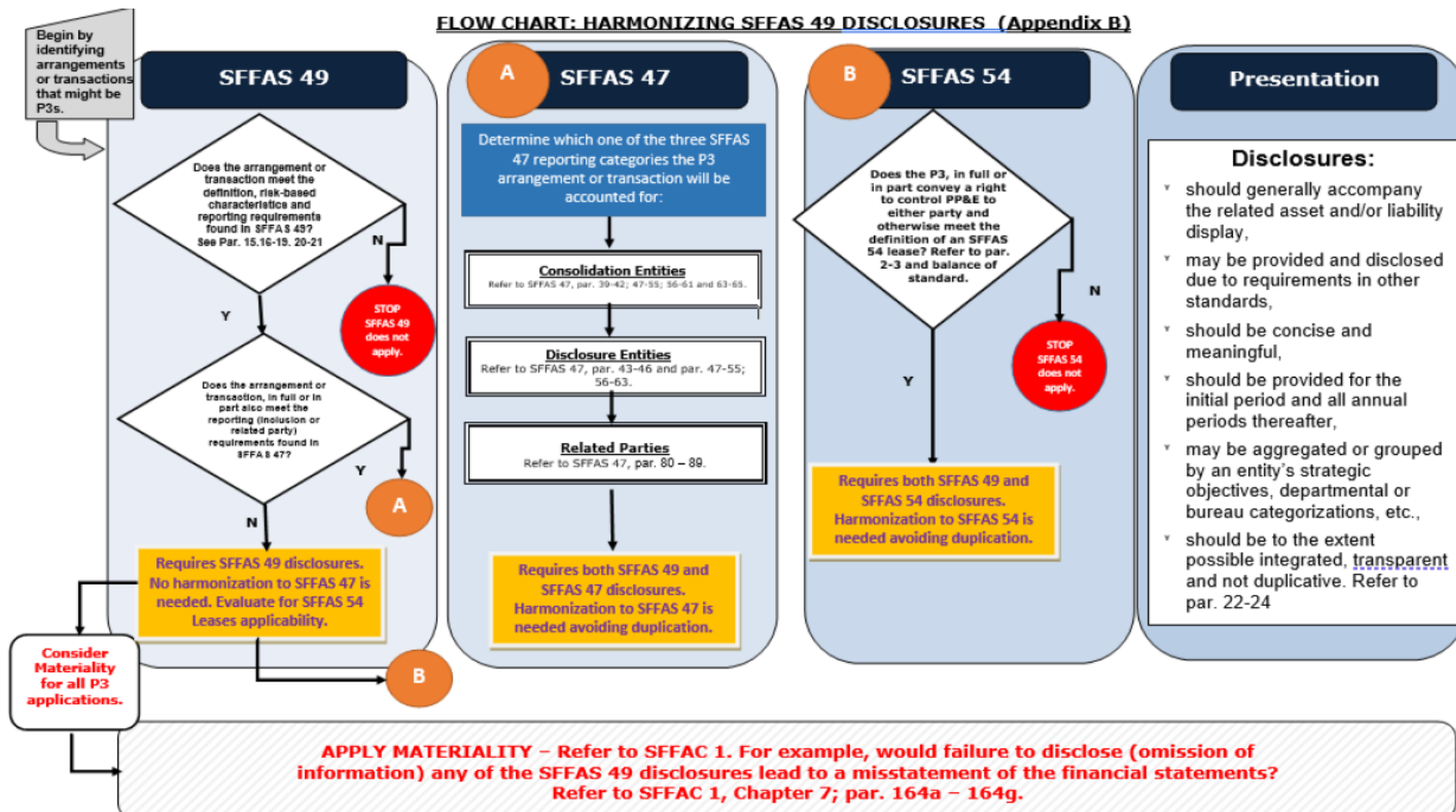
Answer - In those cases where energy savings performance contracts and utility energy service contracts meet the definition of a P3 (e.g., Conclusive Risk Characteristic 1 at paragraph 20), they will be required to meet the SFFAS 49 disclosure requirements. Such arrangements are not typically leases because the (1) government usually does not have the right to control access to the economic benefits or services of the underlying asset and (2) the private party is responsible for the construction and financing of the required equipment and the government usually has no obligation or risk during the construction period. Once the equipment and construction requirements have been accepted and approved by the government, liability and risk are shared with the private party. At the end of the contract period, the reporting entity usually purchases the equipment ending the liability and risk sharing arrangement or transaction. As a result, such contracts are alternative financing arrangements and generally would be subject to SFFAS 49.

¹ "...typically arises when parties to a multiple component arrangement agree to include additional non-lease products or services in the multiple component arrangement, some of which might be related or tied directly to the underlying leased product or services (for example, software updates or maintenance). Although these additional products or services are not always expressly identified in the underlying agreement and may be documented in other agreements, they are nonetheless considered "bundled" with the underlying lease agreement."

ATTACHMENT 4: Draft Decision Tree Flowchart

PROCESS FLOWCHART STEPS

1. First Step – Begin by identifying arrangements or transactions that might be P3s.
2. Second Step – Determine if SFFAS 47, Reporting Entity applies.
3. Third Step – Determine if SFFAS 54, Leases applies.
4. Last Step – Aligning Disclosures



ATTACHMENT 5: Proposed Next Steps

October 2023 — December 2023

- ~~Board reviews an overview of Task Force Technical results~~
- Brief AAPC as appropriate

January/February 2024 – April 2024

- Task Force Finalizes work per AAPC and Board guidance
- ~~Staff briefs Board on Task Force results~~
- ~~Board decides on how best to communicate results; e.g., SFFAS amendment; interpretation, Technical Bulletin and/or Technical Release.~~

May 2024 – Forward

- Task Force Finalizes work per AAPC and Board guidance
 - June and July – Receive AAPC input on Q&As and Flowchart
 - August – Brief Board and Review Technical Release Exposure Draft
 - October – AAPC and Board approve Technical Release Exposure Draft for release
 - November/December - Issue Exposure Draft

ATTACHMENT 6: Questions for the Committee

Question 1 – Sufficiency of the Sample Q&As

Are there any additional questions the Committee believes need to be addressed by the task force? If so, please provide them as well as any possible solutions, if any that should be explored and researched.

Refer to Attachments 1 through 3.

Question 1 – Are there any additional questions the Committee believes need to be addressed by the task force? If so, please provide them as well as any possible solutions, if any that should be explored and researched.

Question 2 – Sufficiency of the Draft Decision Tree Flowchart

Does the Committee have any suggested improvements to the draft Decision Tree Flowchart to address SFFAS 47, *Reporting Entity* and SFFAS 54, *Leases* alignment? If so, what specific changes or edits would the Committee like to propose?

Refer to Attachment 4.

Question 2 - Does the Committee have any suggested improvements to the draft Decision Tree Flowchart to address SFFAS 47, Reporting Entity and SFFAS 54, Leases alignment? If so, what specific changes or edits would the Committee like to propose?

Question 3 – Are there any other issues or concerns that the Committee would like for staff to consider? Please note in your response what changes you would recommend be made.

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