Federal Accounting Standards Advisory Board

December 7, 2012

Memorandum

To: Members of the Board

From: Domenic N. Savini, Assistant Director

Through: Wendy M. Payne, Executive Director

Subject: **Proposed Project Plan: Public-Private Partnerships [1] – Tab C**

OBJECTIVE

The objective of this session is to **approve the attached project plan** for the project on Public Private Partnerships **and provide feedback on the scope** (see questions on pages 15 through 20), **so that staff may take action on the next agreed-upon step**.

BRIEFING MATERIAL

The proposed Project Plan is attached to this transmittal memorandum. In addition, there are separate Appendices containing reference material that provides additional information should you desire more details. You may electronically access the briefing material (excluding the Appendices) at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

MEMBER FEEDBACK

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

Thank you.

Attachments:

Project Plan and Illustrations
Appendices

[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.

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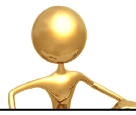
Public-Private Partnerships

PROJECT PLAN

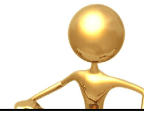
December 2012



Why

Why is a project on Public-Private Partnerships needed?

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



What

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

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

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PUBLIC-PRIVATE PARTNERSHIPS (P3s)

PROJECT PLAN

Purpose: This project was added to the agenda because federal agencies have increasingly turned to public-private partnerships (P3s) to accomplish goals. Budget pressures are likely to further increase the use of P3s. Making the full costs of such partnerships transparent would be the overall objective of the project. Active work on this project would begin in FY2013 with final standards or guidance expected following a two to three year effort.

Specific objectives could include:

Defining terms (e.g., service concession arrangements, P3s)

Providing guidance for the recognition and measurement of:

- assets and liabilities
- revenues and expenses
- establishing disclosure requirements

Considering guidance for other arrangements related to P3s (sale-leaseback or other long-term arrangements).

Applicability: This project applies to the federal government as a whole and all component entities that present general purpose federal financial reports in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles (GAAP), Including the Application of Standards Issued by the Financial Accounting Standards Board (FASB)*.

Objectives: Because FASAB guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses, the primary objective of this project would be to consider issuing either a Technical Bulletin or Standards. Technical Bulletins provide guidance for applying FASAB Statements and Interpretations and resolving accounting issues not directly addressed by either the Statements or Interpretations.

Assigned staff: Domenic N. Savini

Other resources: After a brief initial research phase, staff plans to utilize a multi-disciplinary task force, including sub-groups to address specific topics.

Preliminary Timeline:

January 2013 – December 2013

- Develop Project Plan, Begin Research, Develop Issues

February - June 2014

- Develop and Issue Exposure Draft

December 2014

- Finalize Guidance or Standards

PROPOSED APPROACH

I. Consider Existing Concepts, Standards, Other Guidance, and Legislation:

Both GASB and IPSASB limit public-private partnership guidance to service concession arrangements directly benefitting the general public. As a result, P3 arrangements that provide services to the government entity or grantor are excluded. GASB refers to these as "service and management arrangements" or SMA's.

As previously mentioned, because sufficient guidance exists regarding the recognition and measurement of assets/liabilities and revenues/expenses, it can be effectively used for the accounting of service concession arrangements.

Where applicable, the Board expects to benefit greatly from the service concession standards work of the Governmental Accounting Standards Board (GASB) and the International Public Sector Accounting Standards Board (IPSASB).

As noted at the April 2012 Board meeting, staff believes that FASAB guidance exists regarding the accounting issues raised by P3 arrangements; namely, the recognition and measurement of assets/liabilities and revenues/expenses. Accordingly, assisting the preparer community to apply current FASAB guidance to P3s is an important project objective.

Types of Public-Private Partnership Arrangements
And Relevant FASAB Standards

TYPE[2]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[3]
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 the public agency decides to: **Lease** – Capital lease requirements are covered in SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 43 – 46[i] and SFFAS 6, *Accounting for*

[2] 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.

[3] 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 reporting 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, and (d) misleading to exclude. Also, non-core disclosure objectives for disclosure entities include relationship, relevant activity and future exposures.

TYPE[2]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[3]
		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) or 3. Build/Transfer/Operate (BTO)	Under the BOT option, the private partner builds a facility to the specifications agreed to by the public agency, operates 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.	**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] **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23. [iv]

TYPE[2]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[3]
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]
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. 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 Government,* 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	**At Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraph 19. [vii] **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23. [iv]

TYPE[2]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS[3]**
	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.	
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 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 Contract** - SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraph 19. [vii] **At Build** – SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraph 34. [viii] **Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23. [iv] **Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47. [ix]

TYPE[2]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[3]
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 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.	**Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23.[iv] **Fees** - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* paragraphs 34 – 47.[ix]
9. Enhanced Use Leasing (EUL)	An EUL is an asset management program in the Department of Veterans Affairs (VA) that can include a variety of different leasing arrangements (e.g., lease/develop/operate, build/develop/operate). EULs enable the VA to long-term lease VA-controlled property to the private sector or other public entities for non-VA uses in return for receiving fair consideration (monetary or in-kind) that enhances VA's mission or programs. (See 38 U.S.C. § 8161, et seq.)	**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]

TYPE[2]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS**[3]
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 under LDO and BDO arrangements.	**Lease** – SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 20. [ii] **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 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	**Lease** – 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]

<u>**TYPE[2]**</u>	<u>**DESCRIPTION**</u>	<u>**RELEVANT ACCOUNTING STANDARDS[3]**</u>
	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.	<u>**Financing**</u> – 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/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.	<u>**Sale**</u> - SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 36e – 47. [vi] <u>**Purchase**</u> – SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 26. [iii] <u>**Lease**</u> – SFFAS 5, *Accounting for Liabilities of the Federal Government,* 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	<u>**Financing**</u> – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23. [iv] <u>**Asset transfer**</u> – can be accomplished either via a lease or a purchase.

TYPE[2]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[3]
	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.	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]
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	**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 Government,* paragraphs 43 – 46. [i]

TYPE[2]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS[3]**
	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.	
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]
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]

TYPE[2]	**DESCRIPTION**	**RELEVANT ACCOUNTING STANDARDS[3]**
		Risk Assumption - SFFAS 5, *Accounting for Liabilities of the Federal Government,* 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 directly.	**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]
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	**Lease** – 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]

TYPE[2]	DESCRIPTION	RELEVANT ACCOUNTING STANDARDS[3]
	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.	**Financing** – SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* paragraph 23. [iv]

II. Resources

At the August 2012 Board meeting members generally noted that P3s are complex and would require significant study to identify potential gaps in existing guidance. Consistent with overall project goals, staff would like to assemble a task force and consider establishing a sub-working group to identify and refine major P3 accounting issues that the preparer community may confront when working through existing FASAB literature. This effort will serve as a basis for preliminary recommendations to the Board.

III. Research Steps

Initial research steps include:

- Searching for and identifying relevant literature from other standards-setters
- Reviewing relevant Inspectors General, Congressional Budget Office, Government Accountability Office, and Congressional Research Service reports
- Consulting with academia and public-policy organizations
- Identifying relevant P3 topics and related accounting issues

POTENTIAL PROJECT MANAGEMENT CONCERNS

QUESTIONS FOR BOARD

1. Should the P3 project scope go beyond Service Concession Arrangements (SCAs)?

For reasons explained below,[4] both the IPSASB and GASB issued P3 guidance limited to service concession arrangements (SCAs). Such arrangements[5] are a sub-set (refer to Illustration 1 on page 22) of public-private partnerships where the partner acting on behalf of the government sponsor, provides a service to the public. Both Boards similarly concluded to exempt arrangements not involving the (direct) delivery of public services and those arrangements that involve service and management components (i.e., service management arrangements or SMAs). However, IPSASB conditioned its SMA exemption on whether the asset is controlled by the government. Refer to the bottom of page 25 (Illustration 2*)* for some examples of SCAs.

GASB excluded the following arrangements from the scope of its statement: (1) arrangements where the third-party <u>only</u> designs and builds an asset for the government, (2) vendor arrangements, (3) SMAs, (4) arrangements where the government (not the users) pays the operator, and (5) privatizations.

It is important to note that GASB was concerned with the potential for a burdensome level of disclosure. Accordingly, the GASB opined that due to the large number of SMAs in government, users could be overwhelmed by the large volume of information that would be potentially reported.

Limiting guidance to SCAs may have the following consequences in the federal space:

a. <u>Lack of consistency in accounting practices</u> – if standards only accommodate a narrow range of P3 arrangements or transactions, accounting for other types of P3s will lead to wide differences in interpretation and practice.

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[4] IPSASB opined (IPSAS 32, par. 6) that arrangements outside the scope of their Standard would be those that do not involve the delivery of public services and arrangements that involve service and management components where the asset is not controlled by the grantor (e.g., outsourcing, service contracts, or privatization).

GASB opined (GASBS 60, par. 33) that the potential issue with service management arrangements (SMAs) is whether it is essential for users of financial statements to be made aware through disclosure of what SMAs a government has engaged in. The Board was concerned with the potential for a burdensome level of disclosure and because it was not aware of specific concerns about the need for additional disclosure, it concluded that SMAs should be excluded from its Statement.

[5] GASBS 60 defines **a service concession arrangement** (SCA) as an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") <u>in exchange for significant consideration</u> and (2) the operator collects and is <u>compensated by fees from third parties</u>.

IPSAS 32, paragraph 8 defines **a service concession arrangement** as a binding arrangement between a grantor and an operator in which: (a) The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and (b) <u>the operator is compensated</u> for its services over the period of the service concession arrangement.

b. Many P3 accounting issues go unaddressed - by only accommodating a narrow range of P3 arrangements or transactions, several important accounting issues, some of which are unique to P3s, will go unaddressed.

c. Lack of transparency - to avoid additional reporting requirements management will be induced into selecting non-reportable P3 arrangements/transactions.

d. Lack of comparability – by establishing separate guidance, users will not be able to use the financial information in any meaningful manner such as comparing across similar types of P3 projects.

e. Inefficient use of P3 arrangements/transactions - establishing guidance which in effect creates “report” and “no-report” options, could lead to an inefficient use of P3’s as entities base their decisions on financial reporting rather than economic value.

f. Illusory changes – Governments seeking to reduce deficits may be tempted to replace spending cuts or tax increases with the use of off-balance-sheet P3s giving the illusion of deficit reduction.

Staff believes that it is critically important to assist the preparer community with implementation guidance relative to P3s[6] beyond just SCAs. The basis for this recommendation is predicated on (1) federal preparers and auditors have identified accounting issues that extend beyond those typically found in service concession arrangements/transactions; e.g., in-kind consideration, non-monetary exchanges, and fair value, (2) oversight entities such as CBO, GAO, and Inspectors General have defined P3s as including more than just service concession arrangements (refer to Illustration 1, page 22 for a hierarchy of P3 arrangements/transactions), (3) SCA accounting guidance primarily reflects economic development initiatives such as new roads, toll roads, highways, airports, railways, hospitals, etc., whereas federal initiatives extend well beyond economic development – common defense and general welfare of the nation,[7] and (4) increasing use of P3s by federal entities in dealing with excess and/or underutilized infrastructure and facilities.[8]

[6] Staff presumes that privatizations and service contracts would not be considered P3s for our purposes. Refer to Illustration 1: Hierarchy of P3 Arrangements/Transactions on page 22 and pages 22 and 23, respectively, for the related definitions of privatization and service contract.

[7] Statement of Federal Financial Accounting Concepts 1: *Objectives of Federal Financial Reporting.*

[8] In an August, 9, 2012 report the NASA IG reported that 9 of the 10 NASA centers have 430 leasing agreements that use a variety of arrangements such as easements, concessions, non-reimbursable and reimbursable agreements. Report No. IG-12-202, *NASA’s Infrastructure and Facilities: An Assessment of the Agency’s Real Property Leasing Practices.*

On June 22, 2011 the Congressional Research Service reported to Congress, that, “…*both Congress and the President have increasingly used hybrid organizations for the implementation of public policy functions traditionally assigned to executive departments*.” The analysis went on further to state that, *{t}he traditional tools for holding executive agencies accountable, such as the budget and general management laws, are inapplicable*…” Analysis RL30533 entitled, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics.*

Lastly, GAO reported in April 2003 that P3 usage at DoD increased from 19 to 93 between fiscal years 1998 and 2002. GAO-03-423, entitled, *Depot Maintenance: Public-Private Partnerships Have Increased, but Long-Term Growth and Results are Uncertain.*

Should the P3 project scope go beyond Service Concession Arrangements (SCAs)? If so, does the Board agree with staff's presumption that service contracts and privatizations would not be considered P3s for our purposes?

2. Should we require P3 accounting asymmetry (opposite-view accounting)?

Asymmetry or opposite-view accounting means that the same asset or liability may not be recognized by both participants in the partnership but must be recognized by one participant. Generally, accounting standards would be expected to have this result since to meet the asset or liability definitions certain conditions must exist in relation to the reporting entity which cannot also exist in relation to another reporting entity. Proponents for asymmetry or opposite-view accounting argue that establishing an explicit requirement for asymmetry would ensure that P3 items are reported in either the public sponsor's or private partner's balance sheet and not both. Their concern is that because some governments look to P3s as a way of avoiding debt ceiling limitations or improving debt-to-GDP ratios, that if asymmetry is not required and a private partner treats the arrangement/transaction as "off-balance-sheet", there is in effect no reporting of the P3 arrangement/transaction.

Opponents to asymmetry or opposite-view accounting counter-argue that there are valid reasons why a P3 item may not appear on a private-sector balance sheet and that this action alone should not require governments to take the view that the P3 arrangement/transaction must therefore be recorded on a government balance sheet. Precisely because each partner's reporting objectives, stakeholders, and fiduciary responsibilities are different, whether a P3 is consolidated or reflected on the private-sector balance sheet should not be taken as prima facie evidence that the transaction should or should not be reflected on government's balance sheet or somehow disclosed.

Staff does not believe that establishing an explicit requirement for asymmetry of accounting treatment between public and private partners should in itself be the sole basis for asset/liability recognition. In those cases where both the government and private partner elect not to recognize the asset/liability, requiring adequate disclosure of this fact should be sufficient.

Should we require P3 accounting asymmetry (opposite-view accounting)? If not, does the Board support requiring disclosure when neither the government nor the private partner recognize the asset/liability?

3. Should the project consider for those P3 entities that do not meet the reporting entity inclusion principles or qualify as a related party, recognition or disclosure criteria?

If a public entity were to determine that a P3 entity[9] did not meet the reporting entity inclusion principles or qualify as a related party, would there be a need to establish some level of accountability regarding P3s through disclosure?

For example, the project could consider the need for disclosures or Required Supplementary Information (RSI) related to:

a. Existence of P3s
b. Management's Discussion and Analysis (MD&A; in relevant/required sections)
c. Non-financial performance measures
d. Risk assumed
e. P3 entity going concern assessments

In the development of SFFAS 8, *Supplementary Stewardship Reporting*, par 133, some respondents requested that the standards provide for reporting additional information, such as the Federal Government's interest in property held by nonfederal entities or patents generated through Federal research and development funds, and foreign contributions to Federal programs. At paragraph 135 the Board opined that an entity may have other resources or obligations that were not specifically addressed in the stewardship standards, but if the entity believed that the reporting of the additional data would be useful and relevant to readers, and would provide a better indication of the resources and obligations of the entity, the Board would encourage such reporting.

Due to the structural complexity of many P3 arrangements that currently exist, certain P3s that would not meet either the control or ownership tests would be subject to a related party test. The related party definition[10] staff has proposed to the Board reads as follows:

> **Organizations are considered to be related parties** if the existing relationship[43] or one party to the existing relationship has the ability to exercise **significant influence over** the other party in making **financial <u>and</u> operating** decisions. (Underscoring and bolding are added for emphasis)
>
> [43] Relationship as used in this context refers to material transactions or events involving both parties.

[9] Public-Private Partnership entity types include corporations, general or limited partnerships, and trusts where each can be part of an arrangement that establishes a Special Purpose Entity (SPE), Special Purpose Vehicle (SPV), 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.

[10] Federal Reporting Entity- Related Party, page 31, paragraph 77. Ballot Draft document emailed 27 November 2012.

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

Does the Board wish to consider for those P3 entities that do not meet the reporting entity inclusion principles or qualify as a related party, recognition or disclosure criteria? If so, what types of recognition or disclosure would the Board consider most appropriate?

4. Does the Board wish to discuss any other matters not identified by Staff?

The objective of this session is to approve this project plan for the project on Public-Private Partnerships, so that staff may take action on the next agreed-upon step.

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

QUESTIONS FOR BOARD

1. **Should the P3 project scope go beyond Service Concession Arrangements (SCAs)? If so, does the Board agree with staff's presumption that service contracts and privatizations would not be considered P3s for our purposes?**
2. **Should we require P3 accounting asymmetry (opposite-view accounting)? If not, does the Board support requiring disclosure when neither the government nor the private partner recognize the asset/liability?**
3. **Does the Board wish to consider for those P3 entities that do not meet the reporting entity inclusion principles or qualify as a related party, recognition or disclosure criteria? If so, what types of recognition or disclosure would the Board consider most appropriate?**
4. **Does the Board wish to discuss any other matters not identified by Staff?**

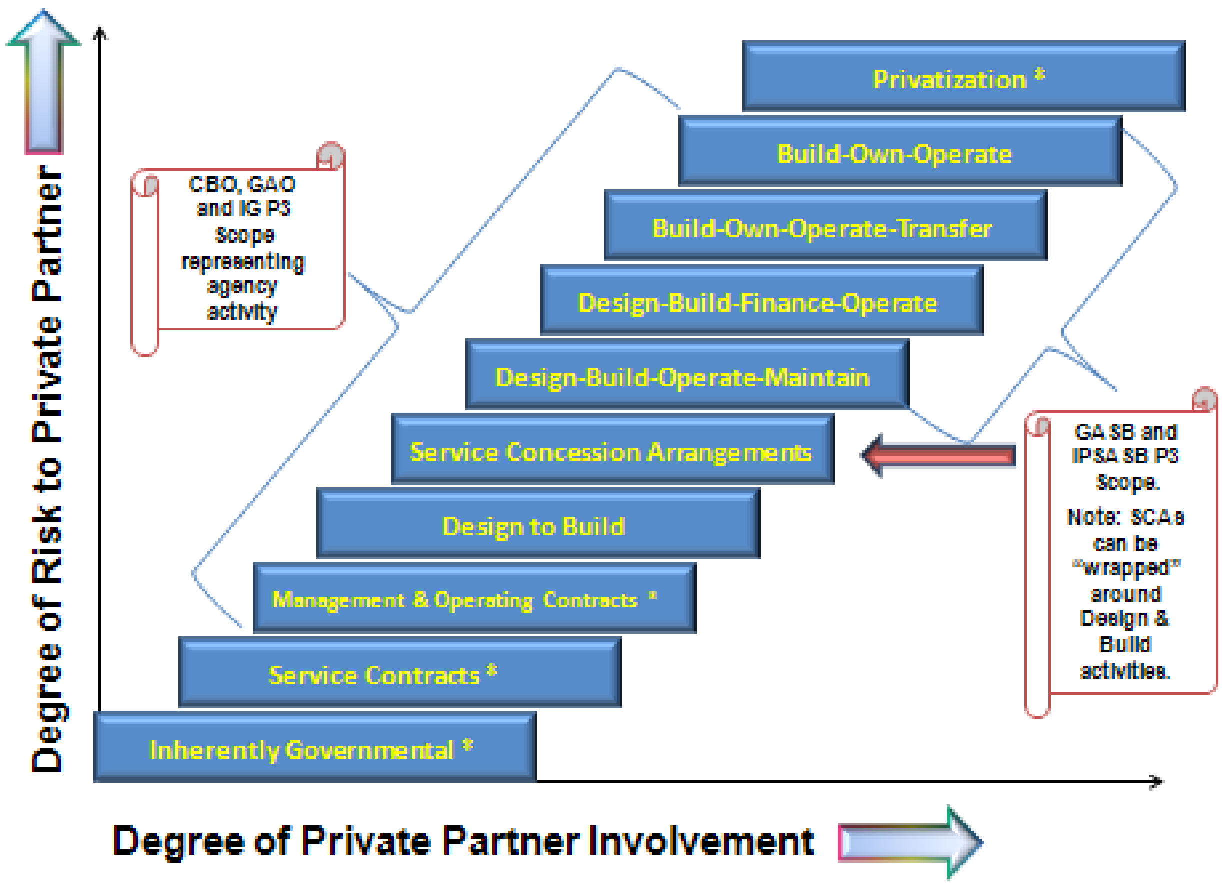
BACKGROUND

The use of P3s in this country dates back to the colonial period. In 1742 Benjamin Franklin helped sponsor the first medical school in America that was supported by the Pennsylvania House of Representatives. Although the founders at the Constitutional Convention in 1787 believed (educational and scientific) activities should be independent of direct national governmental control, they felt that the national government should remain an influential force exerting its influence through indirect rather than direct means. Thomas Jefferson is credited with ushering in a more direct role for the government in the area of science by sponsoring the Lewis and Clark research expedition in 1803. The 1800's saw rapid P3 growth in response to medical emergencies (1822 cholera epidemic), establishment of universities and institutions (1824 Rensselaer Polytechnic Institute and 1829 Smithsonian Institution), and direct funding of applied science (1838 Samuel Morse telegraph). During the 20th century both world wars brought about increased pressure to advance scientific and technical advancements. For example, President Woodrow Wilson was advised by the *National Academy of Sciences* to create a *National Research Council* to coordinate efforts between government, industry and the academic communities to reach common national goals. In 1940 President Franklin D. Roosevelt established the *National Defense Research Committee* whose purpose was to organize scientific and technological resources toward enhancing national defense. After World War II there was an imbedded belief that scientific and technological advancements are fundamental for economic growth, and that the government has an important supporting role, both direct and indirect, to ensure such growth. As recent as President William J. Clinton who led efforts to transfer publicly funded technology to the private sector and President George W. Bush who advocated making tax policy (use of credits) P3 friendly, the use of these arrangements can be clearly seen throughout most of government.[11]

At the August 2012 Board meeting members generally noted that P3s are complex and would require significant study to identify potential gaps in existing guidance. Consistent with overall project goals, staff would like to assemble a task force and consider establishing a sub-working group to identify and refine major P3 accounting issues that the preparer community may confront when working through existing FASAB literature. This effort will serve as a basis for preliminary recommendations to the Board.

[11] Albert N. Link, "The History of Public-Private Partnerships from: *Public/Private Partnerships, Innovation Strategies and Policy Alternatives*", ISBN 978-0-387-29774-3 (2006), Chapter 2,

ILLUSTRATION 1: HIERARCHY OF P3 ARRANGEMENTS / TRANSACTIONS



* = Definitions follow:

<u>Privatization</u> - A federal agency decision to change a government-owned and government-operated commercial activity or enterprise to private sector control and ownership. When privatizing, the agency eliminates associated assets and resources (manpower for and funding of the requirement). Since there is no government ownership and control, no service contract or fee-for-service agreement exists between the agency and the private sector after an agency privatizes a commercial activity or enterprise. Moving work from agency performance with government personnel to private sector performance where the agency still funds the activity is not privatization. *OMB Circular A-76 (REVISED), Performance of Commercial Activities; May 29, 2003.*

<u>Management and operating contract</u> - means an agreement under which the Government contracts for the operation, maintenance, or support, on its behalf, of a Government owned or -controlled research, development, special production, or testing establishment wholly or

principally devoted to one or more major programs of the contracting Federal agency.
Federal Acquisition Regulation (March 2005), Subpart 17.6 - Management and Operating Contracts.

Service contract - means a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to furnish an end item of supply. A service contract may be either a non-personal or personal contract. It can also cover services performed by either professional or nonprofessional personnel whether on an individual or organizational basis. Some of the areas in which service contracts are found include the following:

(1) Maintenance, overhaul, repair, servicing, rehabilitation, salvage, modernization, or modification of supplies, systems, or equipment.

(2) Routine recurring maintenance of real property.

(3) Housekeeping and base services.

(4) Advisory and assistance services.

(5) Operation of Government-owned equipment, real property, and systems.

(6) Communications services.

(7) Architect-Engineering (see Subpart 36.6).

(8) Transportation and related services (see Part 47).

(9) Research and development (see Part 35).

Federal Acquisition Regulation (March 2005), Subpart 37.1 - Service Contracts – General.

Inherently governmental - an inherently governmental activity is an activity that is so intimately related to the public interest as to mandate performance by government personnel. These activities require the exercise of substantial discretion in applying government authority and/or in making decisions for the government. Inherently governmental activities normally fall into two categories: the exercise of sovereign government authority or the establishment of procedures and processes related to the oversight of monetary transactions or entitlements. An inherently governmental activity involves:

(1) Binding the United States to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise;

(2) Determining, protecting, and advancing economic, political, territorial, property, or other interests by military or diplomatic action, civil or criminal judicial proceedings, contract management, or otherwise;

(3) Significantly affecting the life, liberty, or property of private persons; or

(4) Exerting ultimate control over the acquisition, use, or disposition of United States property (real or personal, tangible or intangible), including establishing policies or procedures for the collection, control, or disbursement of appropriated and other federal funds.

OMB Circular A-76 (REVISED), Performance of Commercial Activities; May 29, 2003.

ILLUSTRATION 2: SCA ACCOUNTING – SNAPSHOT COMPARISON OF GASB AND IPSASB GUIDANCE

Area	GASBS 60 Accounting and Financial Reporting for Service Concession Arrangements, November 2010	IPSAS 32 Service Concession Arrangements: Grantor, October 2011
Applicability	¶ 13 & 14 - Grantor and Operator ¶ Summary - Includes public operators ¶ Summary - This Statement also provides guidance for governments that are operators in an SCA. The governmental operator reports an intangible asset at cost for its right to access the facility and collect third-party fees; it amortizes the intangible asset over the term of the arrangement in a systematic and rational manner.	¶ 1 - Grantor only and excludes government business enterprises[12] ¶ BC7 – Excludes public operators ¶ AG1 - This Standard basically complements International Financial Reporting Interpretations Committee (IFRIC) 12, *Service Concession Arrangements*, which sets out the accounting requirements for the private sector operator in a service concession arrangement.[13]
Service Concession Arrangement (SCA) Definition	¶ 1 and 4a. An arrangement that is a type of public-private or public-public partnership[14]. Operator can be governmental as well as non-governmental.	¶ 8 A binding arrangement between grantor and operator. An operator is the entity that uses the service concession asset to provide public services subject to the

[12] Government Business Enterprises (GBS's) are required to follow IFRS.

[13] For arrangements falling within IFRIC 12's scope, infrastructure assets are not recognized by the operator as property, plant and equipment. Instead, depending on the terms of the arrangement the operator will recognize: (1) a financial asset (i.e., right to receive unconditional cash from grantor); or (2) an intangible asset (i.e., receipt of cash is contingent on extent that public uses the service); or (3) a hybrid or bi-furcated approach using both the financial asset and intangible asset approaches.

[14] GASBS 60, par. 1, states that, "*The term public-private partnership is used to refer to a variety of service arrangements, management arrangements, and SCAs. The terms of an SCA may include payments from the operator to the government for the right to build, operate, and collect user fees on infrastructure or other public assets and may provide for revenue sharing between the government and the operator during the term of the arrangement.*"

Area	GASBS 60 Accounting and Financial Reporting for Service Concession Arrangements, November 2010	IPSAS 32 Service Concession Arrangements: Grantor, October 2011
		grantor's control of the asset.[15]
SCA Criteria	¶ 4a. – 4d. 4 criteria must all exist: 1. An exchange 2. Operator collects and is compensated from 3rd party 3. Grantor can modify or approve services, to whom provided, and amounts that can be charged 4. Grantor is entitled to significant residual interest at end of arrangement	¶ 8 Criteria includes: 1. Operator uses the SCA asset to provide a public service on behalf of Grantor for a specified time 2. Operator is compensated over the SCA period
SCA Examples	¶ 28 lists: 1. Waste management services ¶ 65 Illustrations list: 2. Governmental operators such as Toll-way, Tunnel or Bridge Authorities. 3. Non-governmental operators.	¶ IE4 example: 1. A company that builds, maintains and operates a roadway
What is "arranged" in an SCA?	¶ 4a. – 4d. Grantor (transferor) conveys to operator the right and	¶ BC21 An exchange transaction.

[15] IPSAS 32, par. BC10 states that, *"The term "binding arrangement" had not been defined previously, but has been used in other IPSASs to describe arrangements that that confer similar rights and obligations on the parties to it as if they were in the form of a contract. The IPSASB concluded that this for the purposes of this Standard, this term should be defined to ensure consistent application of the Standard."*

Area	GASBS 60 Accounting and Financial Reporting for Service Concession Arrangements, November 2010	IPSAS 32 Service Concession Arrangements: Grantor, October 2011
	related obligation to provide services through the use of infrastructure or another public asset **in exchange for significant consideration** and the operator collects **and is compensated by fees from third parties**.	
Service Management Arrangement (SMA) Definition	¶ 33 GASB distinguishes between service contracts and management contracts. In a service contract, a government contracts with a separate entity for services it would otherwise have performed. For example, street sweeping and snow removal. Whereas a management contract makes the separate entity responsible for management functions associated with the operation of the service.	Not defined in standard or IPSASB Glossary.
SMA examples	¶ 28 lists: 1. Cleaning services for government offices	¶ IG4 lists 2 types of SMA's: 1. Debt collection 2. Facility management
Asset Recognition	¶ Summary, 9 and BC 37. Occurs when the Grantor "determines or has the ability to modify or approve" nature of services, recipients/customers, and charges. Generally follows existing measurement, recognition, and disclosure guidance for capital assets. Newly constructed or acquired	¶ 9. Occurs when the Grantor "controls or regulates" nature of services, recipients/customers, and charges.

Area	GASBS 60 Accounting and Financial Reporting for Service Concession Arrangements, November 2010	IPSAS 32 Service Concession Arrangements: Grantor, October 2011
	assets (including improvements) are booked at fair value.	
Liability Recognition	¶ Summary and 10. Occurs pursuant to the terms of the arrangement. Present value of significant contractual obligations imposed on the transferor and deferred inflows of resources.	¶ 14 and 15. Occurs when Grantor recognizes an asset. The liability is initially measured at the same amount of the asset and adjusted for “boot”.
Existing Assets	N/A	¶ 12 and 13. Reclassified and accounted for as a separate asset class.

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APPENDIX 1 - IPSAS 32, *Service Concession Arrangements: Grantor*.

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APPENDIX 2 - GASBS 60, *Accounting and Financial Reporting for Service Concession Arrangements*.

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End Notes:

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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 <u>Post-1991 Loan Guarantees.</u> 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.

ix RECOGNITION AND MEASUREMENT OF EXCHANGE REVENUE

34. Revenue from exchange transactions should be recognized when goods or services are provided to the public or another Government entity at a price.

35. When a transaction with the public or another Government entity at a price is unusual or nonrecurring, a gain or loss should be recognized rather than revenue or expense so as to differentiate such transactions.

36. Revenue from specific types of exchange transactions should be recognized as follows:

(a) When services are provided to the public or another Government entity (except for specific services produced to order under a contract), revenue should be recognized when the services are performed.

(b) When specific goods are made to order under a contract (either short- or long-term), or specific services are produced to order under a contract (either short- or long-term), revenue should be recognized in proportion to estimated total cost when goods and services are acquired to fulfill the contract. If a loss is probable (more likely than not), revenue should continue to be recognized in proportion to the estimated total cost and costs should continue to be recognized when goods and services are acquired to fulfill the contract. Thus, the loss should be recognized in proportion to total cost over the life of the contract.