

Governmental Accounting Standards Series

EXPOSURE DRAFT

Proposed Statement of the Governmental Accounting Standards Board

Accounting and Financial Reporting for Service Concession Arrangements

This Exposure Draft of a proposed Statement of Governmental Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 30

Comment Deadline: September 30, 2009



Governmental Accounting Standards Board
of the Financial Accounting Foundation

ACCOUNTING AND FINANCIAL REPORTING FOR SERVICE CONCESSION ARRANGEMENTS

Notice of Public Hearing and Request for Written Comments

Public hearing. A public hearing is scheduled during the Board's regular meeting on October 6, 2009, beginning at 1:00 p.m. in Norwalk, CT. Although interested participants may attend in person, individuals or organizations also may participate in the public hearing by telephone. Details regarding their participation will be provided after the GASB receives a notice of intent to participate.

Deadline for written notice of intent to participate in public hearing: September 18, 2009

Basis for hearing. The GASB has scheduled a public hearing to obtain information from interested individuals and organizations about the issues discussed in this Exposure Draft. The hearing will be conducted by one or more members of the Board and its staff. Interested parties are encouraged to participate at the hearing and through written response.

Public hearing oral presentation requirements. Individuals or organizations that want to make an oral presentation in person or by telephone at the public hearing are expected to provide, **by the deadline for written notice of intent to participate**, a written notification of that intent and a copy of written comments addressing the standards proposed in the Exposure Draft. The notification and written submission should be addressed to the Director of Research and Technical Activities, Project No. 30, and emailed to director@gasb.org or mailed to the address below. The notification should indicate a preference for participating in person or via telephone. The public hearing may be canceled if sufficient interest is not expressed by the deadline.

The Board intends to schedule all respondents who want to make oral presentations and will notify each individual or organization of the expected time of the presentation. The time allotted each individual or organization will be limited to about 30 minutes—10 minutes to summarize or elaborate on the written submissions, or to comment on the written submissions or presentations of others, and 20 minutes to respond to questions from those conducting the hearing.

Observers. Observers are welcome at the public hearing and are urged to submit written comments.

REQUEST FOR WRITTEN COMMENTS

Deadline for submitting written comments: September 30, 2009

Requirements for written comments. Any individual or organization that wants to provide written comments but does not intend to participate in the public hearing should provide those comments **by September 30, 2009**. Written comments may be submitted

through an Internet-based form at www.gasb.org/survey/cgi-bin/sca.html. Alternatively, comments may be addressed to the Director of Research and Technical Activities, Project No. 30, and emailed to director@gasb.org or mailed to the address below.

OTHER INFORMATION

Public files. Written comments will become part of the Board's public file and will be available for inspection at the Board's offices. Copies of those materials may be obtained for a specified charge.

Orders. Any individual or organization may obtain one copy of this Exposure Draft on request without charge until September 30, 2009, by writing or phoning the GASB Order Department. For information on prices for additional copies and copies requested after September 30, please contact the Order Department. The Exposure Draft may be downloaded from the GASB's website at www.gasb.org/exp.

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Notice to Recipients of This Exposure Draft

The Governmental Accounting Standards Board is responsible for developing standards of state and local governmental accounting and financial reporting and other accounting and financial reporting communications that will (1) result in useful information for users of financial reports and (2) guide and educate the public, including issuers, auditors, and users of those financial reports.

The due process procedures that we follow before issuing our standards and other communications are designed to encourage broad public participation in the standards-setting process. As part of that due process, we are issuing this Exposure Draft setting forth a proposed Statement on accounting and financial reporting for service concession arrangements (SCA).

We invite your comments on the following issues, as well as on all other matters in this proposed Statement. Because this proposed Statement may be modified before it is issued as a final Statement, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe we should consider.

All responses are distributed to the Board and to staff members assigned to this project, and all comments are considered during the Board's deliberations leading to a final Statement. When the Board is satisfied that all alternatives have adequately been considered and modifications, if any, have been made, a vote is taken on the Statement. A majority vote is required for adoption.

Issue 1

This Exposure Draft proposes financial reporting requirements for recognition of an up-front payment or installment payments from an operator to a transferor associated with an SCA in which the transferor *does not* meet all the control criteria set forth in paragraph 7. Paragraphs 11 and 12 would require that such up-front payments or present value of installment payments be recognized currently as revenue or a gain, rather than deferred and amortized over the term of the SCA, as would be required if the transferor *does* meet the control criteria in paragraph 7. Paragraphs 53 and 54 provide the Board's basis for that conclusion. The Alternative View, discussed in paragraphs 63 and 64, would require that the up-front payment or present value of installment payments initially be deferred and amortized as revenue in a systematic and rational method over the term of the agreement.

Question: How should up-front or installment payments be reported when a transferor does not control the facilities subject to an SCA? Please state why you support this position.

Issue 2

This Exposure Draft proposes financial reporting requirements for recognition of a residual interest by a transferor in a facility subject to an SCA for which the transferor does not meet all the control criteria set forth in paragraph 7. Paragraph 11 provides that if the facilities are purchased, constructed, or materially improved upon by the operator, the transferor would recognize its entitlement to the residual interest as an asset measured at fair value at the commencement of the SCA and a deferred inflow of resources. The deferral would be recognized as revenue when the facility reverts to the transferor at the end of the arrangement. Paragraph 56 provides the Board's basis for that conclusion. The Alternative View, discussed in paragraph 65, provides that the transferor would recognize an asset and a corresponding deferred inflow of resources at the commencement of the SCA. The deferral would be amortized and revenue would be recognized over the term of the arrangement.

Question: How should a transferor's residual interest in a facility subject to an SCA be reported when the transferor does not control the facility? Please state why you support this position.

Summary

The objective of this proposed Statement is to establish accounting and financial reporting requirements for service concession arrangements (SCAs), which are a type of public-private or public-public partnership arrangement. As used in this proposed Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental) 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”) and (2) the operator collects fees from third parties.

The primary issue for accounting and financial reporting for SCAs by transferors is determining whether the transferor should report the facility subject to an SCA as its capital asset. This proposed Statement would apply specific criteria to determine whether a transferor has control over the facility. If the transferor meets all control criteria, it would report the facility as its capital asset, subject to existing guidance for capital assets. Existing facilities would be reported at their current carrying amount; new or improved facilities would be reported at fair value along with a corresponding liability that would be amortized in a systematic and rational manner over the term of the arrangement.

If the transferor does not meet the service-related control criteria, it would derecognize any existing facility and report only a residual interest in the facility. The amount of the residual interest in an existing facility would be determined based on its carrying amount, but the amount of the residual interest in a new or improved facility would be determined based on its fair value. If the SCA requires the operator to provide the transferor with up-front or installment payments, the transferor would consider these payments in determining the gain or loss on derecognition of the facility.

This proposed Statement also provides guidance for governments that are operators in an SCA. The governmental operator would report an intangible asset at cost for its right to access the facility and collect third-party fees; it would amortize the intangible asset over the term of the arrangement in a systematic and rational manner. For existing facilities, a governmental operator’s cost may be the amount of an up-front payment. For new or improved facilities, a governmental operator’s cost may be its cost of improving an existing facility or constructing or acquiring a new facility.

This proposed Statement would require that, for revenue sharing arrangements, governmental operators report all revenues and expenses, unless they are functioning as an agent for the transferor.

This proposed Statement would require disclosures about an SCA, including a general description of the arrangement and information about the associated assets and liabilities, the rights granted and retained, and guarantees and commitments.

The requirements of this proposed Statement would be effective for financial statements for periods beginning after June 15, 2011. The provisions of this proposed Statement generally would be required to be applied retroactively for all periods presented.

How the Changes in This Proposed Statement Would Improve Financial Reporting

The requirements of this proposed Statement would improve financial reporting by establishing recognition, measurement, and disclosure requirements for SCAs for both transferors and governmental operators, thereby improving comparability of financial statements. It would alleviate the confusion that arises when determining whether and, if so, what existing guidance would apply in complex circumstances that are not specifically addressed by standards. The provisions of this proposed Statement would promote accountability in financial reporting by applying control criteria to determine whether transferors should report facilities subject to an SCA. This proposed Statement would contribute to the assessment of interperiod equity by reporting up-front payments or the present value of installment payments associated with facilities meeting the control criteria as liabilities, representing the obligation to provide access to the facility. The provisions of this proposed Statement would result in a faithful representation of a governmental operator's rights under SCAs by reporting rights to access SCA facilities as intangible assets. This proposed Statement also would improve the usefulness of financial reporting by requiring that specific relevant disclosures be made by transferors and governmental operators about SCAs.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 5 discusses the applicability of this Statement.

Proposed Statement of the Governmental Accounting Standards Board

Accounting and Financial Reporting for Service Concession Arrangements

June 30, 2009

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Proposed Statement of the Governmental Accounting Standards Board

Accounting and Financial Reporting for Service Concession Arrangements

June 30, 2009

INTRODUCTION

1. This Statement addresses service concession arrangements (SCAs), which are a type of public-private or public-public partnership (PPP) arrangement. 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.

2. Entering into SCAs may be seen as beneficial from the point of view of the government for a variety of reasons. An SCA may provide the government with the ability to leverage existing infrastructure and other public assets to generate additional available resources in the form of up-front payments from an operator for the right to operate such assets. SCAs may be used to facilitate construction and financing of new infrastructure and other public assets and transfer the risks associated with their construction and maintenance to a private entity. Risks associated with the building, financing, and operation of the infrastructure or other public assets are often shared between the government and the private sector entity. SCAs may be used to provide services to the general populace in a more efficient and cost-effective manner. Determining the accounting and financial reporting for SCAs involves the evaluation of several issues, including the application of the definitions of financial statement elements and communication methods and consideration of governmental accountability for infrastructure and other public assets and the services that are provided.

3. The objective of this Statement is to establish accounting and financial reporting requirements for SCAs. This Statement will improve consistency in reporting these types of arrangements, thereby enhancing the comparability of the accounting and financial reporting of such arrangements among state and local governments.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

4. This Statement establishes guidance for accounting and financial reporting for SCAs. As used in this Statement, an SCA is an arrangement between a government (the

transferor) and an operator¹ in which (a) the transferor conveys to the operator the right and related obligation to provide services through the use of infrastructure or another public asset (a “facility”²) and (b) the operator collects fees from third parties. SCAs include, but are not limited to:

- a. Arrangements in which the operator will design and build a facility and will obtain the right to collect fees from third parties (for example, construction of a municipal complex for the right to lease a portion of the facility to third parties)
 - b. Arrangements in which the operator will provide an up-front payment or a series of payments in exchange for the right to access an existing facility (for example, a parking garage) and collect fees from third parties for its usage
 - c. Arrangements in which the operator will design and build a facility (for example, a new tollway), finance the construction costs, provide the associated services, collect the associated fees, and return the facility to the government at the end of the arrangement.
5. The provisions of this Statement should be applied in financial statements of state and local governments that are prepared using the economic resources measurement focus.
6. This Statement amends NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments*, paragraph 11, to exclude arrangements meeting the definition of an SCA from the scope of that Statement.

Transferor Accounting and Financial Reporting for Facilities and Related Payments from an Operator

7. Accounting and financial reporting for a transferor is determined by whether the transferor controls the use of the facility associated with an SCA. For financial reporting purposes, a transferor controls the use of the facility if both of the following criteria, either explicitly or implicitly, are met:
- a. The transferor determines or regulates all of the following:
 - (1) What services the operator is required to provide
 - (2) To whom the operator is required to provide the services
 - (3) The price ranges or rates that can be charged for the services
 - b. The transferor is entitled to—through ownership or otherwise—significant residual interest in the service utility of the facility at the end of the arrangement.

¹An operator may be a governmental entity (governmental operator) or a nongovernmental entity. References to operators include both governmental and nongovernmental entities. References to *governmental* operators include only governmental entities.

²Facilities may include infrastructure, such as roads, bridges, and tunnels, and also may include equipment, buildings, and other structures.

Arrangements in Which All Control Criteria Are Met

8. If the facility associated with an SCA is an existing facility and the criteria in paragraph 7 are met, the transferor should continue to report the facility as a capital asset.

9. If the facility associated with an SCA is a new facility, purchased or constructed by the operator, or an existing facility that has been improved by the operator and the criteria set forth in paragraph 7 are met, the transferor should report (a) the new facility or the improvement as a capital asset at fair value when it is placed into operation with (b) a corresponding liability. After initial measurement, the capital asset is subject to existing requirements for depreciation, impairment, and disclosures. The corresponding liability should be amortized in a systematic and rational manner over the term of the arrangement beginning when the facility is placed into operation.

10. If an SCA requires up-front or installment payments from the operator and the transferor controls the facility associated with the SCA based upon the criteria in paragraph 7, then the transferor should report the up-front payment or present value of installment payments as a liability to be amortized in a systematic and rational manner over the term of the arrangement beginning when the facility is placed into operation.

Arrangements in Which Not All Control Criteria Are Met

11. For SCAs in which any criterion in paragraph 7 is not met, the transferor should not report the facility as a capital asset. If the facility was recognized by the transferor prior to the SCA, then the transferor should derecognize the facility and report a gain or loss upon commencement of the arrangement to reflect the transfer of the facility to the operator. If the transferor only has control over the residual interest in the facility at the end of the arrangement (that is, one or more criteria in paragraph 7a are not met), the transferor should, upon commencement of the arrangement, report an asset for the residual interest in the facility. The residual interest for an existing facility that is a depreciable capital asset should be reported at its proportionate historical cost. The remaining net cost of the facility (carrying value less estimated salvage value) should be allocated between (a) the period that the facility will not be controlled by the transferor and (b) the subsequent residual interest period. The proportionate historical cost of the residual interest is the sum of the remaining net cost allocable to the residual interest period and the estimated salvage value. The amount reported for the residual interest should be considered in determining the gain or loss to be recognized upon the transfer and derecognition of an existing facility. The residual interest for an existing facility that is accounted for using the modified approach³ or is inexhaustible should continue to be reported at the carrying value of the facility. The residual interest for a newly acquired or built facility or an improvement to an existing facility should be reported at fair value with a corresponding deferred inflow of resources at the commencement of the SCA. The deferred inflow of

³The requirements for the modified approach are included in paragraphs 23–26 of Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*.

resources should be recognized as revenue when the facility reverts to the transferor at the end of the arrangement.

12. If an SCA requires up-front or installment payments from the operator and the transferor does not control the facility associated with the SCA based upon the criteria in paragraph 7, the transferor should report the up-front payment or present value of installment payments as a gain, generally reported as a special item based on the criteria in paragraph 56 of Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*. If the facility is an existing facility, the gain is reduced by the amount of the existing facility derecognized in accordance with paragraph 11.

Governmental Operator Accounting and Financial Reporting for the Right to Access Facilities and Related Payments to a Transferor

13. A governmental operator should report an intangible asset⁴ for the right to access the facility and collect third-party fees from its operation at cost (for example, the amount of an up-front payment or the cost of construction of or improvements to the facility). The intangible asset should be amortized over the term of the arrangement in a systematic and rational manner.

14. Some arrangements require a facility to be returned in a specified condition. If information that is prominent—that is, conspicuous or known to the governmental operator—indicates the facility is not in the specified condition and the cost to restore the facility to that condition is reasonably estimable, a liability to restore the facility should be reported. Governmental operators are not required to perform additional procedures to identify potential condition deficiencies beyond those already performed as part of their normal operations or those that may be required by the arrangement.

Accounting for Revenue Sharing Arrangements

15. Some SCAs include provisions for revenue sharing. Except as provided in paragraph 16, a governmental operator that shares revenues with a transferor should report all revenue earned and expenses incurred—including the payment of the shared revenues to the transferor—that are associated with the operation of the facility. In this circumstance, the transferor would report only its portion of the shared revenue.

16. If the governmental operator is entitled only to retain a fixed dollar amount per customer transaction regardless of the amount paid by a customer or may only retain a stated percentage of the amounts charged to customers (that is, the governmental operator is in substance acting as an agent for the transferor), the governmental operator should recognize as revenue only the fixed amount or percentage to which it is entitled. A governmental operator should recognize the remainder of the net revenues (the remaining

⁴The intangible assets referred to throughout this Statement are not subject to the provisions of Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, and should be reported outside of the capital asset classification.

revenues associated with the SCA, less any related expenses) as a liability to the transferor. In this circumstance, the transferor should report all revenue earned and expenses incurred (including reporting the retention of the shared revenues by the operator as an expense) that are associated with the operation of the facility, as well as an asset (receivable) for unpaid amounts due from the operator.

Disclosures Related to Service Concession Arrangements

17. The following information should be disclosed in the notes to financial statements of transferors and governmental operators for SCAs:

- a. A general description of the arrangement in effect during the reporting period, including management's objectives for entering into it and, if applicable, the status of the project during the construction period
- b. The nature and amounts of assets and liabilities related to an SCA that are recognized in the financial statements
- c. The nature and extent of rights retained by the transferor or granted to the governmental operator under the arrangement, which may include rights to residual ownership by the transferor or access to the facility by the governmental operator.

18. Some arrangements may include provisions for guarantees and commitments. For example, a transferor may become responsible for paying the debt of the operator in the event of a default, or the arrangement may include a minimum revenue guarantee to the operator. For each period in which a guarantee or commitment exists, disclosures should be made about specific guarantees and commitments, including identification, duration, and significant contract terms of the specific guarantee or commitment.

19. Governments should include the information required by paragraphs 17 and 18 in the notes to the financial statements. Disclosure information for multiple SCAs may be provided individually or in aggregate.

EFFECTIVE DATE AND TRANSITION

20. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. Earlier application is encouraged. In the first period that this Statement is applied, changes made to comply with this Statement should be treated as an adjustment of prior periods, and financial statements presented for the periods affected should be restated. If restatement is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning net assets for the earliest period restated. In the period this Statement is first applied, the financial statements should disclose the nature of any restatement and its effect. Also, the reason for not restating prior periods presented should be explained.

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

Appendix A

BACKGROUND

21. Arrangements, sometimes referred to as public-private or public-public partnerships, between governments and private entities or other governments have become more prevalent as governments have sought alternative ways to provide services to their constituencies on a more efficient and cost-effective basis. These arrangements often result in a government transferring existing or newly constructed facilities and the obligation to provide certain services to an external entity.

22. Existing guidance applicable to these arrangements includes the lease accounting provisions found in NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments*, and the financial reporting entity provisions found in GASB Statement No. 14, *The Financial Reporting Entity*, as amended by Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. Governments have asked questions about whether these standards adequately addressed the variety of partnerships that have been formed or that have been explored. This issue was discussed with the Governmental Accounting Standards Advisory Council (GASAC) in July 2006. The potential project received strong support from the GASAC. As a result of the perceived need for additional guidance and the feedback from the GASAC, a project on public-private partnerships was added to the GASB's research agenda in August 2006.

23. The International Public Sector Accounting Standards Board (IPSASB) added a project on SCAs, a type of public-private partnership, to its agenda in November 2006. Due to a mutual interest in this topic, the staffs of the IPSASB and GASB worked together to conduct research regarding the nature and extent of the use of public-private partnerships around the world, as well as potential accounting and financial reporting issues related to these arrangements. GASB staff also served as the lead staff on the IPSASB's project until March 2008, when the Consultation Paper, *Accounting and Financial Reporting for Service Concession Arrangements*, was issued.

24. Based on the research findings and GASAC feedback, the project was moved to the GASB's current agenda in April 2008, and deliberations began in May 2008.

25. A task force was assembled comprising 15 persons broadly representative of the GASB's constituency. The task force members reviewed and commented on papers prepared for the Board's deliberations and on drafts of this Statement.

Appendix B

BASIS FOR CONCLUSIONS AND ALTERNATIVE VIEWS

26. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

Scope and Applicability

27. The term *public-private partnership* (PPP) has been applied to a wide variety of arrangements between a transferor and an operator that may include one or more of the following circumstances:

- An operator provides direct services or management services either to the transferor or to third parties (for example, a contract to provide janitorial services or a contract to provide counseling services to qualifying individuals)
- An operator is awarded the right to operate a concession in conjunction with infrastructure or another public asset (for example, a concession to sell food and beverages at a city park or collect tolls on a toll road)
- An operator designs, builds, and finances construction of a facility, such as a prison, hospital, or highway
- An operator operates and maintains a facility, such as a prison, hospital, or highway
- An operator takes ownership of a facility.

In considering the scope of this project, the Board viewed a PPP as an arrangement for placing a service with an operator for a specific period of time. The project scope was narrowed to focus on services that benefit the general public and are subject to a PPP, rather than benefiting the government itself. For example, if a government is required to provide waste management services and enters into an arrangement through which an operator is obligated to provide those services to the citizenry, this arrangement would be considered a PPP; however, an arrangement in which the operator provides cleaning services for the government's offices would not be considered a PPP. Initially, the Board included in the scope of this Statement all PPPs that placed a service benefiting the general public with an operator for a specified period of time.

28. As the Board evaluated the nature of arrangements that some might consider to be PPPs and the potential accounting provisions for various circumstances, it determined that arrangements in which a third party only designs and builds a capital asset for the transferor, service and management arrangements (SMAs), arrangements in which the government (rather than users) pays the operator for services, and privatizations, as described below, should not be included in the scope of this Statement.

Arrangements in Which a Third Party Designs and Builds a Capital Asset

29. Using traditional procurement methods, the design and construction elements are bid separately. There are arrangements for construction projects in which both the design and construction aspects are contracted together to a third party. A design and build arrangement is entered into for the purpose of obtaining a service (construction). However, the service is not being provided to the general public but rather to the government itself. Therefore, the Board concluded that these arrangements should not be included in the scope of this Statement. Existing provisions for construction of capital assets are sufficient to provide guidance for these transactions.

Service and Management Arrangements

30. The Board recognized that accounting for SMAs is not a principal issue. Existing guidance for accounting for expenses is adequate for these purposes. The potential issue with 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. Because some governments have a large number of SMAs, the number of arrangements potentially subject to a disclosure requirement could be voluminous. As a result, users of financial statements could be overwhelmed by a large volume of information that may hold little or no decision utility and could obscure information that is essential for their understanding of the financial statements. Because the Board was not aware of specific concerns about the need for additional disclosure requirements related to SMAs, the Board concluded that SMAs should be excluded from the scope of this Statement.

Arrangements in Which the Transferor Makes Payments to the Operator

31. Some PPP arrangements involve an operator constructing and operating a facility owned by the transferor, with the operator receiving payment for these construction and operations services from the transferor, rather than from user fees. When considering guidance for accounting for these arrangements, the Board determined that regardless of whether the stated payment terms explicitly identify the construction and the operations elements, the arrangements are in essence a combination of these two elements. Consequently, payments required under the terms of the arrangement should be allocated between the two elements so that they can be accounted for according to their nature. Payments related to the construction element should be reported as construction in progress and at completion as a capital asset subject to existing guidance for capital assets. The operations portion of the arrangement is an SMA, and payments related to the operations elements should be accounted for according to existing guidance for expenses. Because existing guidance is sufficient for both elements of these arrangements, the scope of this Statement was modified to exclude arrangements involving construction and operations payments made by the transferor to the operator.

Privatization

32. A privatization occurs when a government permanently transfers infrastructure or another public asset to an operator, generally through sale. The transferor divests itself of responsibility for the facility and the related delivery of services (other than possible regulatory authority). Privatization through the sale (or transfer) of capital assets should be reported similar to any other capital asset sale or transfer. Existing provisions for sales and transfers of capital assets are sufficient to provide guidance for these transactions. Therefore, the Board concluded that privatizations should not be included in the scope of this Statement.

Governmental Operators

33. Through the research conducted regarding the variety of PPP arrangements, it became clear that these arrangements often are between a government and a private entity, but sometimes they are between two governments. The accounting and financial reporting will not vary for the transferor regardless of whether the operator is a private entity or another government. Because governments sometimes participate as the operator in these arrangements, the Board concluded that accounting and financial reporting for governmental operators should be included in the scope of this Statement.

Governmental Fund Accounting and Financial Reporting

34. The Board determined that guidance for accounting and financial reporting in governmental fund financial statements should be excluded from the scope of this Statement. For some aspects of the reporting of SCAs by transferors, such as reporting capital assets, residual interests, and revenue sharing, existing guidance for governmental funds is clear. Capital assets, including residual interests, are reported in governmental funds as expenditures when purchased. Consequently, capital assets associated with existing facilities would have been reported as expenditures when purchased, and no additional reporting is needed at the time the existing facility becomes subject to an SCA. Acquisition of capital assets and residual interests associated with new or expanded facilities would not be reported in governmental funds because there is no flow of current financial resources associated with their acquisition. Reporting of fund revenue from revenue sharing arrangements would be the same as in financial statements prepared using the economic resources measurement focus to the extent that the revenues are available.

35. The Board deliberated appropriate accounting for the receipt of up-front or installment payments received by transferors. Ultimately, the Board decided to not provide guidance in this Statement because the Board is currently considering issues of recognition in financial statements prepared using the current financial resources measurement focus in its conceptual framework project on recognition and measurement attributes. The Board concluded that it would be premature to provide specific guidance for accounting for up-front or installment payments until the recognition concepts are finalized. The Board also recognized that the circumstances in which up-front or installment payments would be reported in governmental funds would be limited because

the scope of this Statement is limited to arrangements involving collection of user fees, which most frequently are reported in proprietary funds. Until new guidance is provided for arrangements reported in governmental funds, governments should consider the disclosure guidance in Accounting Principles Board Opinion No. 22, *Disclosure of Accounting Policies*.

36. Guidance for financial reporting in governmental fund financial statements of governmental operators also was excluded from the scope of this Statement. The Board believes that the activities of governmental operators will meet the criteria that require the use of enterprise funds in paragraph 67c of Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, because “the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).” If that criterion is met, governmental operators should report SCA activities in enterprise funds.

Control Criteria

Approach to Determining Whether the Transferor Reports the Facility

37. A principal accounting and financial reporting issue related to SCAs is determining whether the transferor or the operator should report the facility subject to an SCA. The Board considered a number of potential approaches to addressing this issue, including (a) applying existing guidance pertaining to leases, (b) applying a risks and rewards approach that has been used by some other standards setters, (c) applying a rights and obligations approach that has been considered by other standards setters, and (d) applying a control-focused approach similar to that expected to be proposed by another standards setter.

Lease Accounting

38. Because some SCAs are described as leases and some may meet the definition of a lease, the Board considered whether existing lease guidance, or perhaps an interpretation of existing lease guidance, would be sufficient for accomplishing its objective of reducing inconsistencies in accounting for these types of arrangements and enhancing the comparability of financial reporting for them. The Board concluded that lease guidance was not sufficient because some types of SCAs would not meet the definition of a lease, for example, arrangements that do not require payments from the operator to the transferor. Additionally, some would question whether arrangements in which the operator builds, owns, and operates the facility during the term of the arrangement would meet the definition of a lease, because the transferor does not own the facility during that period. An additional concern with application of lease guidance is that the criteria for determining lease classification focus entirely on the economic aspects of a capital asset and do not incorporate aspects of accountability for provision of services to the citizenry, which is a significant feature of SCAs. Another concern with the application of lease guidance is that the GASB’s lease guidance in NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments*

(which is to apply the guidelines in Financial Accounting Standards Board [FASB] Statement No. 13, *Accounting for Leases*, as amended and interpreted), is currently being reconsidered as part of a FASB and International Accounting Standards Board joint project on lease accounting.

A Risks and Rewards Approach

39. Some standards setters have taken a risks and rewards approach to determining which party—the transferor or the operator—should report a facility that is subject to an SCA as an asset. Under a risks and rewards approach, the entity that bears the majority of economic risks and rewards related to the facility associated with an SCA should report that facility as an asset. Examples of risks and rewards include demand risk, construction risk, obsolescence risk, changes in operating costs, existence of third-party revenues, and residual value. Evaluation of the economic risks and rewards determines constructive ownership of the facility.

40. One concern with a risks and rewards approach is that it focuses on economic aspects of the facility without adequate consideration of a government’s accountability for providing services to the citizenry. Paragraph 8 of Concepts Statement No. 4, *Elements of Financial Statements*, defines assets as “resources with present service capacity that the government presently controls.” Service capacity is one of the primary features of an asset and is a primary feature of the types of facilities subject to an SCA—infrastructure, such as roadways and bridges, and other public capital assets, such as water treatment plants. From the perspective of the transferor, the economic benefit generated by these assets through cash inflows from user fees generally is secondary to their service-related benefit because those cash inflows usually serve to defray the cost of providing services as opposed to earning a profit.

41. Another concern with a risks and rewards approach is whether criteria could be established such that the application of the approach would produce consistent results. In some circumstances, some criteria may be able to be determined with a sufficient degree of objectivity. However, it is inevitable that some criteria, perhaps the most significant criteria, would require a subjective evaluation of the arrangement. It would be possible to make different subjective assessments of the criteria and arrive at different conclusions regarding which entity should report the facility.

A Rights and Obligations Approach

42. A rights and obligations approach incorporates the notion that property ownership can be viewed as ownership of a “bundle of rights.” In an SCA, some of the ownership rights will be retained by the transferor and some of the ownership rights will be transferred to the operator. In a rights and obligations approach, the transferor and the operator would report as assets only their rights under the arrangement, not necessarily the entire facility. The transferor or operator also would report their respective obligations under the arrangement. This approach may be appealing conceptually because it reflects the nature of an SCA that is a sharing of risks and rewards related to a facility and provision of services. The Board’s primary concern with this approach is that it focuses

solely on the economic aspects of the arrangement, similar to the risks and rewards approach, and does not incorporate aspects of accountability. For a transferor, it is critical to consider whether or not the responsibility for the provision of services has been effectively transferred to the operator. An additional concern is that a determination of the rights and obligations, particularly for a transferor, may be subjective. Consider, for example, an arrangement involving the transfer of the right to operate an existing facility for some portion of its remaining useful life in exchange for an up-front payment. Some might believe the transferor has the right to access the facility subsequent to the conclusion of the SCA. Others might believe the transferor has the right to the facility for its entire life but also an obligation to permit the operator to access the facility during the term of the arrangement.

A Control-Focused Approach

43. A control-focused approach examines which party to the arrangement controls the overall use of the facility by establishing broad control criteria. However, within those criteria, the operator may determine numerous aspects of operating the property that could affect both the financial success of the arrangement for the operator and the level of service desired by the transferor. These aspects of operations may include the hiring and deployment of personnel, the development of specific operating policies and procedures, and the timing and execution of property maintenance. Nevertheless, those factors do not affect the determination of the party that has overall control of the use of the facility. If the transferor meets the control criteria, it can be viewed that the transferor retains accountability for provision of services to the citizenry. Controlling (a) what services are required to be provided through the property, (b) to whom the services are provided, and (c) the rates that may be charged for such services is tantamount to controlling the core of the service capacity of the facility. The operator essentially operates the facility for the transferor and, thus, is a service provider to the transferor. The economic risks and rewards assumed by the operator through the SCA are different from the risks and rewards associated with ownership of the property.

44. The Board acknowledges that a control-focused approach does emphasize the service aspects of a facility to the exclusion of consideration of the economic risks and rewards. However, the Board considered that for transferors, the primary feature of the types of facilities associated with SCAs is the services that they provide to the public. Although economic aspects of the facility may be of primary importance to operators, from the perspective of a government, whose mission is to provide services to the public, the Board believes the service aspect should prevail.

45. A key question to be answered in determining whether the transferor should report the associated facility as an asset is which party is responsible for providing the related service. The Board believes that the most effective way to address that question is through determining control over the use of the facility rather than assessing risks and rewards. If a transferor retains control over the use of the facility associated with an SCA, it preserves its objectives for public use of the property and retains a level of accountability for those services. Application of a control-focused approach is consistent with the aspects of the definition of an asset in Concepts Statement 4 and the objective of financial reporting

found in paragraph 79 of Concepts Statement No. 1, *Objectives of Financial Reporting*, to assist users in assessing the level of services that can be provided by the governmental entity.

Determination of Control Criteria

46. The Board concluded that the basic control criteria proposed in the IPSASB's Consultation Paper are conceptually sound for determining control over use of the facility. These criteria are control over (a) what services the operator is required to provide, (b) to whom the services are provided, and (c) the price ranges or rates that can be charged for services, as well as (d) retention of a significant residual interest in the facility at the end of the arrangement. The combination of control over the service provided by the facility during the arrangement and control over the facility at the end of the arrangement preserves the objectives for public use of the facility both during and after the SCA.

47. Inclusion of the control criterion—that the transferor should be entitled to a significant residual interest in the facility subject to an SCA—also serves to separate SCAs from privatization or regulatory arrangements. In the latter arrangements, the operator has control over the use of the facility for all of its useful life. In most cases, a significant residual interest in the underlying facility will exist at the end of an SCA because of the long-lived nature of the underlying facility and the frequent inclusion of a contractual requirement for the operator to return the property in good condition at the end of the arrangement. In instances in which the contract does not require this return of the facility at a stated condition level, fulfillment by the operator of maintenance requirements throughout the term of the arrangement ensures that the property is in operational condition at the end of the SCA. Given the fact that the facility is in operational condition at the end of the SCA, it would have future service potential or economic benefit and, therefore, has a significant residual value. Assessment of whether the residual value is significant should be made based on the service utility of the facility at the end of the arrangement rather than using a fair value notion. Because of the long duration of many of these arrangements, application of a discounting technique to estimate fair value may produce the inappropriate result that a residual interest is insignificant even when the facility is returned with substantial remaining service utility. If the residual interest is insignificant (for example, cases in which the entire useful life of the facility is exhausted during the term of the arrangement), the transferor is left with an asset that provides no service benefit, and the arrangement was in substance a privatization. Therefore, if control over residual interest is required to be present to establish control for financial reporting purposes, the residual interest also should be significant for this criterion to be meaningful.

Transferor Accounting for Facilities in Arrangements in Which All Control Criteria Are Met

48. For existing facilities that become subject to an SCA, the Board determined that if the control criteria are met, a transferor should continue to report the facility as its capital asset. Entering into an SCA and providing an operator access to the facility do not constitute a transaction that would give rise to a change in the current carrying value of

the facility. Permitting an operator access to the facility when the transferor maintains control, regardless of whether or not the transferor receives an up-front payment or will receive installment payments, does not constitute a sale of the facility. Furthermore, there has been no event or change in circumstance that would affect the remaining service potential of the facility.

49. For new facilities or improvements to existing facilities, the Board determined that transferors should report those that meet the control criteria at fair value. Purchases of capital assets are reported at historical cost. For facilities included in SCAs within the scope of this Statement, the transferor does not bear a cost for acquiring the facility; the operator receives user fees that are intended to compensate the operator both for its cost of constructing or improving the facility and for operating it during the term of the SCA. The Board acknowledged that the fair value of the facility is conceptually equivalent to what the transferor might have paid to have the facility constructed for it.

50. The Board did not include guidance for the transferor regarding reporting of a new facility or an improvement to an existing facility during the construction period. The Board recognized that a transferor may not have specific information about the extent of progress at the end of a reporting period necessary to estimate a fair value and that this estimate of fair value of construction in progress may have little decision utility for users of financial statements. For these cost-benefit reasons, this Statement does not require transferor governments to report an asset for construction in progress on new or improved facilities subject to an SCA.

Transferor Accounting for Up-Front or Installment Payments Related to Facilities That Are Reported as Capital Assets

51. The Board determined that if a transferor is required to report the facility as a capital asset by this Statement, the up-front payment or the present value of installment payments received or to be received by the transferor pursuant to an SCA should be reported as a liability because the payments meet the definition of a liability as discussed in Concepts Statement 4, paragraph 17. That paragraph states that, “liabilities are present obligations to sacrifice resources that the government has little or no discretion to avoid.” Generally, in SCAs featuring up-front or installment payments received from the operator, the consideration provided by the transferor in exchange for the up-front or installment payments is the right for the operator to operate the property underlying the SCA. These payments represent a liability because the transferor has sacrificed a right to financial or other use of the facility underlying the SCA during the term of the arrangement and is actively involved in fulfilling the contractual responsibilities. Pursuant to the SCA agreement, the transferor is obligated to permit the operator to access the facility that is being reported as a capital asset and to fulfill other responsibilities so that the services can be provided to the government’s citizens. This obligation is a present obligation when the transferor is entitled to receive the up-front or installment payments.

52. The Board concluded that transferors should amortize the liability arising from up-front or installment payments in a systematic and rational manner. This liability is an obligation for the transferor to provide access to the facility subject to the SCA. The

amortization of the liability should be proportionate to the access and use of the facility. Given the wide variety of SCAs and facilities subject to SCAs, the Board determined that application of professional judgment in selecting an amortization method is appropriate, and this Statement only limits the methods that may be selected to those that are systematic and rational.

Transferor Accounting When Not All Control Criteria Are Met

53. If the control criteria of paragraph 7a are not met, the transferor should not report the facility subject to an SCA but should report a residual interest. In circumstances involving new facilities, the transferor would recognize only the residual interest. In circumstances involving existing facilities, the amount of carrying value exceeding the residual interest should be derecognized, similar to a privatization. Proceeds of up-front payments or the present value of installment payments, if applicable, should be netted with the amount derecognized to determine the gain or loss from the transaction. The Board deliberated whether the up-front payment or present value of installment payments and gain (or loss), if applicable, should be recognized currently or deferred and recognized over the length of the arrangement. Up-front or installment payments related to a new facility are not associated with services to be provided in the future that are controlled by the transferor and, therefore, should not be deferred. If the transaction involving an existing facility were to be viewed as a sale of future revenues, the gain (or loss) should be deferred using the approach in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. However, the Board does not view the substance of SCAs in this instance as a sale of the cash flows from future revenues but, rather, as a transaction in which the government has relinquished control of a revenue-generating capital asset for a specific period of time. Consequently, current recognition of the associated gain or loss is appropriate.

54. The Board concluded that recognition of a gain or loss at the commencement of the arrangement, as required by paragraphs 11 and 12, is not inconsistent with the concept of interperiod equity. The Board believes that the substance of the arrangement is that the transferor has relinquished control of the facility and is no longer providing the services for which the operator has assumed responsibility, pursuant to the SCA. They believe that reporting the extent to which interperiod equity has been achieved should not require a transferor to recognize annual revenue, sometimes for decades, for a service that it does not provide from a revenue-producing facility that it no longer controls. The Board believes that immediate gain recognition *does* reflect the extent to which “current period revenues were sufficient to pay for current period services,” as discussed in paragraph 77a of Concepts Statement 1. Furthermore, the Board believes that recognizing revenue into the future, for which there is no inflow of resources related to the provision of services is contrary to the concept of interperiod equity because it will overstate the extent to which current period revenues were sufficient to “pay for” current period services. The Board believes that a significant up-front payment should not be accounted for as an acceleration of future period revenues because that payment reflects the fair value of the facility that has been effectively sold to the operator. Therefore, the Board concluded that deferral and amortization is not representationally faithful to the substance of the arrangement and that the financial statement presentation that would result would not be decision useful.

Residual Interest

55. The manner in which a residual interest in a facility subject to an SCA is acquired affects the measurement attribute applied to that residual interest. For an existing facility, the value of the residual interest is based upon the historical cost and carrying value of the facility. The Board views retaining a residual interest in an existing facility as separating the facility between the years of service during which the operator has access to it and the years subsequent to the term of the SCA when full control and access to it have returned to the transferor. Consequently, the carrying amount of the facility should be allocated between these components. The portion associated with the years of service during which the operator has access to the facility should be derecognized pursuant to the arrangement, but the portion associated with the residual interest remains an asset of the transferor. The Board recognized that the estimated salvage value should be considered to be part of the residual interest. Consequently, the carrying value of the facility is reduced by the estimated salvage value before allocation to the period of the arrangement and the subsequent residual interest period. The Board determined that engaging in an SCA for some period during the life of a facility does not provide a basis for changing the carrying amount of the facility that is associated with the residual interest. For eligible infrastructure accounted for using the modified approach, the residual interest portion is equal to the current carrying value of the facility, and the service utility of the facility at the beginning and end of the SCA is the same. Consequently, no portion of the carrying value will be derecognized. For a new or improved facility, the transferor is recognizing a new asset. Therefore, the Board believes a current measurement attribute—that of fair value—is the appropriate measurement.

56. In circumstances when the residual interest is in a newly acquired or constructed facility or an improvement to an existing facility, the Board concluded that the residual interest should be reflected as an asset at the commencement of the SCA. The Board also determined that a deferred inflow of resources should be reported at that time. The deferred inflow of resources will be recognized as revenue when the facility reverts to the transferor. The Board considered recognizing revenue with the residual interest upon commencement of arrangement; however, it concluded that because the transferor did not realize an increase in net position at that point in the arrangement, revenue should not be reported at that time. The Board also considered amortizing the deferred inflow of resources over the life of the arrangement. However, because the deferred inflow of resources does not represent inflows of resources that can be used to provide services during those periods, the Board determined that this alternative would not be consistent with the concept of interperiod equity. The Board concluded that the transferor has not increased its net position until the date of reversion, the time at which the asset can be used to provide services to the citizenry and the deferred inflow of resources is recognized as revenue.

Governmental Operator Accounting

57. The Board considered whether a control-focused approach (the transferor approach) also was appropriate for accounting and financial reporting by a governmental operator, noting that accountability for provision of services to citizens is not as significant a feature for operators as it is for transferors. The objectives of the governmental operator primarily are economic in nature, collecting user fees and providing services to customers through its right to access the facility during the term of the arrangement. The Board determined that a control approach to governmental operator accounting that recognizes the rights and obligations (the alternate approach) is most appropriate because it best reflects the economic features of the arrangement. One of the concerns with the alternate approach when applied to transferors—that of ambiguity regarding the specific nature of the rights and obligations—is not present. It is clear that governmental operators have a right to access the facility pursuant to the term of the SCA. The Board also noted that the financial results of applying the alternate approach or the transferor approach would be similar (if taking the view that a residual interest liability would be netted with the cost of the facility). An asset of the same amount would be reported under both approaches. Under the alternate approach, this asset is considered an intangible asset. Under the transferor approach, this asset is considered a capital asset. The Board did not believe that this difference in presentation would affect the understandability of the financial position of the governmental operator.

58. The Board determined that the governmental operator should report an intangible asset at the cost incurred to acquire its right to access the facility. The governmental operator's cost is either the up-front payment or present value of installment payments paid or to be paid to the transferor for the use of a facility or the cost of construction for newly constructed or improved facilities. For existing facilities, up-front or installment payments are directly exchanged for the right to access the facility and, consequently, there is no other potential measurement basis to consider in the current financial reporting model. For newly constructed or improved facilities, some might view the element of constructing or improving a facility to be separable from the element of exchanging that newly constructed or improved facility for the right to access the facility. Therefore, they would argue that the latter exchange is a nonmonetary exchange that should be reported at fair value (perhaps the value that the governmental operator would have charged for constructing or improving the facility). The Board considered this alternative, but it ultimately determined that the act of constructing or improving the facility is not a separate transaction but rather is part of a more complex arrangement. The Board determined, therefore, that reporting the intangible asset at fair value and reporting an associated gain or loss arising from the revaluation would not be appropriate.

59. The intangible asset of a governmental operator, although it bears some relation to a capital asset, is not within the scope of Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. The scope of Statement 51 excludes intangible assets that meet the basic criteria of an intangible capital asset but were acquired or created primarily for the purpose of directly obtaining income or profit. The intangible asset of a governmental operator meets this exclusion. Consequently, additional guidance for

reporting in subsequent periods is provided. The Board determined that these intangible assets should be amortized in a systematic and rational manner, leaving to professional judgment the selection of the specific method that is most appropriate to the arrangement. Also, because these intangible assets are outside the scope of Statement 51, they should be reported outside the capital asset classification.

60. The Board recognized that SCAs that require the governmental operator to return the facility in a specified condition may give rise to a liability due to the fact that this condition requirement is imposed on the governmental operator by the transferor as a part of a contractual arrangement, not by the governmental operator itself. Thus, any deficiency between the current condition and the specified condition is required to be remedied before the facility is returned. The estimated cost to restore the facility to the specified condition meets the definition of a liability. For cost-benefit reasons, the Board determined that governmental operators should not be required to make an assessment as to whether the facility is at the specified condition level only for financial reporting purposes. Rather, the Board concluded that a liability only should be measured when information already known from the governmental operator's activities of managing the facility indicate that the condition of the facility is below the specified condition level. The Board also determined that a liability should be reported only when the amount necessary to restore the facility to the specified condition level can be reasonably estimated.

Revenue Sharing

61. In arrangements involving revenue sharing, the Board determined that only one of the parties to the arrangement—either the transferor or the governmental operator—should report the revenues and expenses for the service provided. That party should be the one that has accountability for the services. In most cases, this will be the operator, because it has access to the facility and physically provides services. However, the operator may have a limited financial risk associated with the provision of services. This would be the case if the operator retains only a fixed percentage or fixed dollar amount per customer. In these circumstances, the operator is acting in an agent capacity; thus, it is the transferor who is accountable for the operations and, therefore, should be reporting the revenues and expenses associated with the operation.

Guarantees

62. The Board concluded that specific guidance for guarantees and commitments did not need to be developed for this Statement because the current guidance in FASB Statement No. 5, *Accounting for Contingencies*, adequately addresses the accounting and disclosures for the guarantees and commitments of an SCA. The criteria in FASB Statement 5 are appropriate for determining when a commitment or guarantee should be accrued in the transferor's financial statements, and the disclosure required under this Statement would provide users of the financial statements with the appropriate information on the commitment or guarantee.

Alternative Views

63. Three Board members disagree with the total immediate gain recognition by the transferor, proposed in paragraphs 11 and 12 of this Exposure Draft believing instead that deferral and amortization of the gain in a systematic and rational manner over the term of the SCA is necessary to more appropriately reflect interperiod equity. These paragraphs provide for the recognition of a gain or loss on commencement of an SCA when the transferor does not meet the control criteria specified in paragraph 7a and receives up-front or installment payments.

64. These Board members believe the up-front payments that the transferor receives represent compensation for forgoing revenue resulting from use of the capital asset during the term of the SCA. The members believe that the effects of the up-front payments should be reported as a “deferred inflow of resources” in order to allocate the resources to the applicable periods as envisioned by paragraphs 34 and 35 of Concepts Statement 4. The reason is, as stated in paragraph 35 of Concepts Statement 4, “. . . the inflow is applicable to a future reporting period rather than to the current reporting period.” This deferral approach achieves substantively comparable reporting to what is proposed by paragraphs 9 and 10 of this Exposure Draft for up-front payments or installment payments when the transferor meets the control criteria for existing or new capital assets. In those cases, the transferor would initially report a liability for the up-front payment or present value of installment payments, which would be similarly amortized over the term of the SCA in a systematic and rational manner in order to reflect interperiod equity.

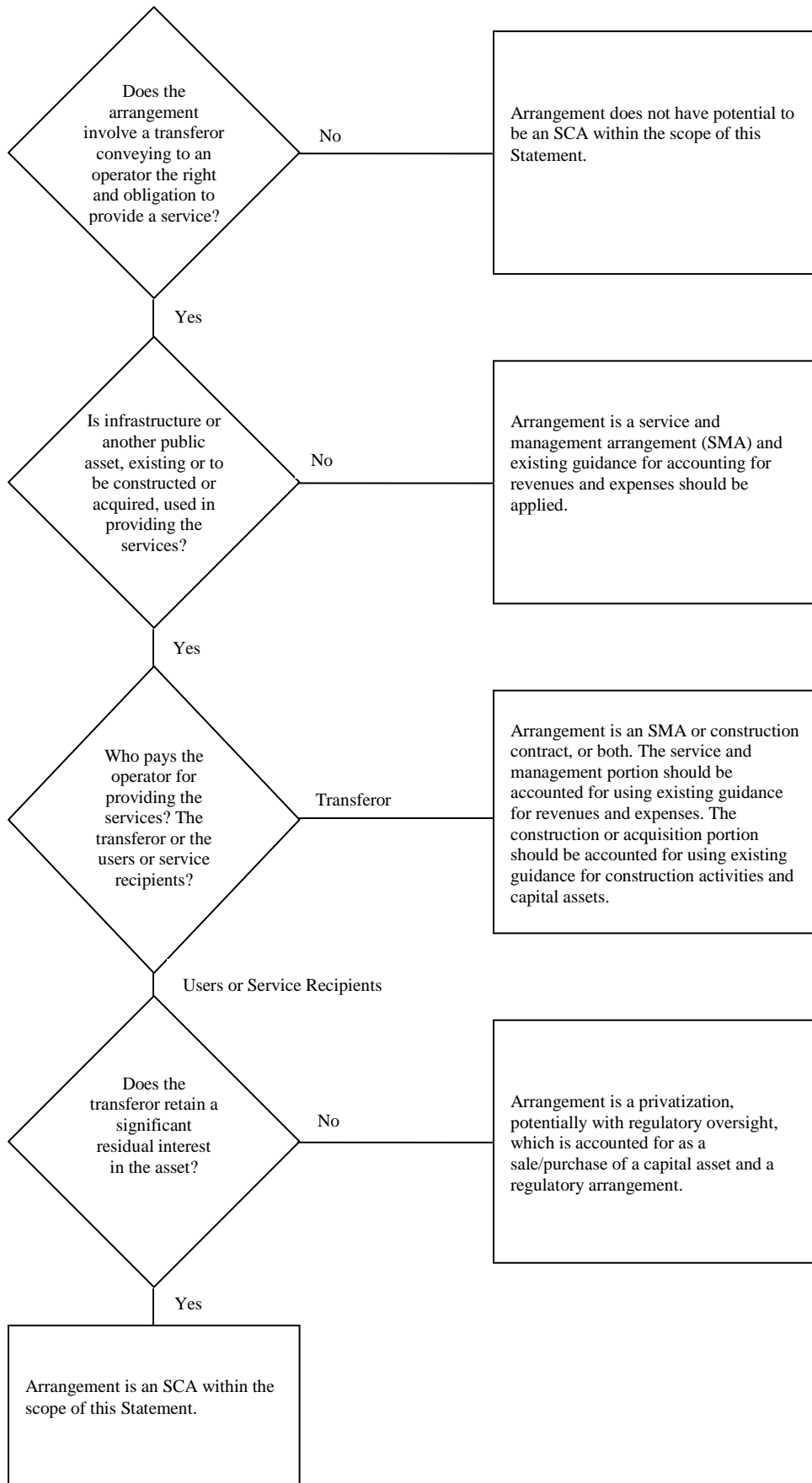
65. One Board member disagrees with the requirement in paragraph 11 that a deferred inflow of resources associated with reporting a residual interest in a newly acquired or built facility or an improvement to an existing facility should be recognized as revenue when the facility reverts to the transferor at the end of the arrangement. This Board member believes that a transferor should recognize a deferred inflow of resources equal to the residual interest at the commencement of the SCA and amortize it to recognize revenue on a systematic and rational basis over the term of the arrangement. The Board member believes this recognition approach is consistent with the concept of interperiod equity by reflecting the transferor’s entitlement to the residual interest as compensation for allowing the operator to charge fees for the use of the facility over the term of the arrangement, and accordingly, believes revenue should be recognized over that same period.

Appendix C

FLOWCHART FOR DETERMINING THE APPLICABLE ACCOUNTING AND FINANCIAL REPORTING GUIDANCE FOR VARIOUS PPP ARRANGEMENTS

66. The following flowchart is intended to aid in determining whether a PPP arrangement is within the scope of this Statement and, if not, what existing accounting and financial reporting guidance would be applicable. The flowchart is nonauthoritative and should not be used in place of the Statement itself.

Flowchart for Determining the Applicable Accounting and Financial Reporting Guidance for Various PPP Arrangements



Appendix D

ILLUSTRATIONS

67. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the approach illustrated. Application of the provisions of this Statement may require assessment of facts and circumstances other than those illustrated here. Existing standards may require disclosures in addition to those illustrated.

Illustration 1: Service Concession Arrangement Involving an Existing Tollway

Facts and Assumptions: A State, through its State Department of Transportation (SDOT), the transferor, enters into an SCA with the State Tollway Authority (STA), a government operator, involving the State Tollway, a capital asset currently being reported by the State at a carrying amount of \$1 billion. The SDOT receives an up-front payment of \$3 billion from the STA, in return for which the STA receives the right to operate the tollway and receive and retain toll revenues for a period of 75 years. The transferor meets the control criteria in paragraph 7a of this Statement. The SDOT has a significant residual interest in the tollway.

Accounting at commencement of the arrangement:

1. The State would continue to report the tollway as a capital asset because it meets the control criteria in paragraph 7. The State would recognize a liability in the amount of \$3 billion for the up-front payment received from the STA.
2. The STA would recognize an intangible asset in the amount of \$3 billion, the amount paid to SDOT for access to the tollway.

Illustrative Disclosures

(For the State)

Note X: Service Concession Arrangement for State Tollway

During the current reporting period, the State, through its State Department of Transportation (SDOT) entered into an agreement with the State Tollway Authority (STA), under which the STA will operate, maintain, and retain tolls from the State Tollway for the next 75 years. The STA is required to operate and maintain the tollway in accordance with the State Tollway Concession Contract; this agreement also regulates the rates at which tolls may be charged and increased. The SDOT received from the STA a lump-sum payment of \$3 billion. The SDOT plans to use the proceeds from the up-front payment to finance infrastructure investment throughout the state. The SDOT reports the tollway as a capital asset with a carrying amount of \$1 billion at year-end and reports a

liability to provide access to the tollway in the amount of \$3 billion at year-end pursuant to the service concession arrangement.

(For the STA)

Note X: Service Concession Arrangement for State Tollway

During the current reporting period, the STA entered into an agreement with the State Department of Transportation (SDOT), under which the STA will operate and collect tolls from the State Tollway for the next 75 years. The STA paid the SDOT a lump-sum payment of \$3 billion and is required to operate and maintain the tollway in accordance with the State Tollway Concession Contract. The STA entered into this agreement to secure a constant and reliable revenue stream from the tolls and related concession revenues. The STA has recognized an intangible asset in the amount of \$3 billion at year-end pursuant to the service concession arrangement.

Accounting in future years:

1. The State would continue to apply existing capital asset guidance, including depreciation, if applicable, to the tollway. If the State elects to use the straight-line method of amortization, it would recognize \$4 million (the up-front payment divided by 75 years) in revenue and amortize the related liability in the same amount each year of the arrangement.
2. If the STA elects to use the straight-line method, it would amortize the intangible asset and recognize expense in the amount of \$4 million (the up-front payment divided by 75 years). The STA also would recognize revenue and expenses for tollway operations based on applicable revenue and expense recognition guidance.

Both the State and the STA would continue to provide the disclosures required by paragraphs 17 and 18, as applicable.

Illustration 2: Service Concession Arrangement to Design, Build, and Operate a New Tunnel

Facts and Assumptions: A State, through its State Department of Transportation (SDOT), the transferor, enters into an arrangement with the Local Tunnel Authority (LTA), a governmental operator, in which the LTA has agreed to design, build, and then operate a tunnel, the Local Tunnel, for 40 years. The tunnel has a useful life of 100 years. During the term of the arrangement, the LTA is entitled to collect and retain tolls generated by the tunnel. The SDOT does not meet the control criteria in paragraph 7a of this Statement, but does have a significant residual interest in the facility. The cost to construct the tunnel is \$4 billion. The estimated fair value of the residual interest in the tunnel is \$3 billion.

Accounting at the commencement of the arrangement and completion of construction:

1. The State would recognize an asset and a deferred inflow of resources for the fair value of the residual interest in the tunnel, \$3 billion.
2. The LTA would recognize an intangible asset in the amount of \$4 billion, the cost to design and build the tunnel.

Illustrative Disclosures

(For the State)

Note X: Service Concession Arrangement for Local Tunnel

At the end of the current reporting period, construction was completed on the Local Tunnel pursuant to an agreement with the Local Tunnel Authority (LTA), under which the LTA designed, built, and for 40 years will operate the Local Tunnel. The LTA will be entitled to all toll revenues during the 40-year operations period. At the end of the arrangement, operation of the tunnel will be transferred to the SDOT. In order to satisfy the need to improve traffic flow for a major highway and reduce congestion on secondary roads, yet avoid the issuance of state debt, the department entered into this agreement with the LTA to construct and operate the tunnel. The State reports its residual interest in the tunnel as a capital asset with a carrying amount of \$3 billion at year-end and also reports a related deferred inflow of resources in the same amount.

(For the LTA)

Note X: Service Concession Arrangement for Local Tunnel

During the current reporting period, the LTA concluded construction and placed in service the Local Tunnel pursuant to an agreement with the State Department of Transportation (SDOT), under which the LTA designed, built, financed, and for 40 years will operate the Local Tunnel. The LTA will be entitled to all toll revenues during the 40-year operations period. At the end of the arrangement, operation of the tunnel will be transferred to the SDOT. The LTA has recognized an intangible asset for its right to access and operate the tunnel for 40 years in the amount of \$4 billion at year-end pursuant to the service concession arrangement.

Accounting in future years:

1. The State would recognize revenue in the amount of \$3 billion upon reversion of the facility (at the end of year 40) and would begin depreciating its \$3 billion residual interest in the tunnel over its remaining useful life or applying the modified approach, as applicable.
2. If the LTA elects to use the straight-line method of amortization, it would recognize expense in the amount of \$100 million each year (\$4 billion cost divided by 40 years). The LTA would recognize revenue and expenses on tunnel operations based on applicable revenue and expense recognition guidance.

Both the State and the LTA would continue to provide the disclosures required by paragraphs 17 and 18, as applicable.

Illustration 3: Service Concession Arrangement Involving an Existing Bridge

Facts and Assumptions: A State, through its State Department of Transportation (SDOT), the transferor, enters into a service concession arrangement with the County Bridge Authority (CBA), a governmental operator, involving the State Bridge, an asset currently recognized by the SDOT in the amount of \$50 million. The bridge has a remaining useful life of 50 years and no salvage value. SDOT receives an up-front payment of \$1 billion from the CBA, in return for which the CBA receives the right to operate the bridge and collect and retain toll revenues for a period of 20 years. The SDOT does not meet all of the control criteria in paragraph 7a of this Statement, but does have a significant residual interest in the facility. The proportionate historical cost of the residual interest in the bridge is \$30 million.

Accounting at the commencement of the arrangement:

1. The State would derecognize \$20 million of the carrying value of the bridge (total carrying amount of the bridge less the proportionate historical cost of the residual interest) and recognize cash of \$1 billion from the up-front payment and a gain of \$980 million.
2. The CBA would recognize an intangible asset in the amount of \$1 billion, the amount paid to the SDOT to access and operate the bridge.

Illustrative Disclosures

(For the State)

Note X: Service Concession Arrangement for State Bridge

During the current reporting period, the State, through its State Department of Transportation (SDOT), entered into an agreement with the County Bridge Authority (CBA), under which the CBA will operate, maintain, and retain tolls from the State Bridge for the next 20 years. The CBA is required to operate and maintain the Bridge in accordance with the State Bridge Concession Contract. SDOT received from the CBA a lump-sum payment of \$1 billion. The SDOT plans to use the proceeds from the up-front payment to finance infrastructure investment throughout the state. The State reports its residual interest in the bridge as a capital asset with a carrying amount of \$30 million at year-end and also reports a gain of \$980 million on the transfer of the State Bridge to the CBA pursuant to the service concession arrangement.

(For CBA)

Note X: Service Concession Arrangement for State Bridge

During the current reporting period, the CBA entered into an agreement with the State Department of Transportation (SDOT), under which the CBA will operate and collect tolls from the State Bridge for the next 20 years. The CBA paid the SDOT a lump-sum payment of \$1 billion and is required to operate and maintain the bridge in accordance with the State Bridge Concession Contract. The CBA entered into this agreement to secure a constant and reliable revenue stream for the tolls and related concession revenues. The CBA has recognized an intangible asset in the amount of \$1 billion at year-end pursuant to the service concession arrangement.

Accounting in future years:

1. Upon reversion of the facility (at the end of year 20), the State would resume depreciating its \$30 million residual interest in the bridge over its remaining useful life or resume applying the modified approach, as applicable.
2. If the CBA elects to use the straight-line method of amortization, it would recognize expense in the amount of \$50 million each year (\$1 billion cost divided by 20 years). The CBA would recognize revenue and expenses on bridge operations based on applicable revenue and expense recognition guidance.

Both the State and the CBA would continue to provide the disclosures required by paragraphs 17 and 18, as applicable.

Appendix E

CODIFICATION INSTRUCTIONS

68. The sections that follow update the June 30, 2008, *Codification of Governmental Accounting and Financial Reporting Standards*, for the effects of this Statement. Only the paragraph number of the Statement is listed if the paragraph will be cited in full in the Codification.

* * *

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND LEGAL COMPLIANCE

SECTION 1200

.115c [Update cross-references.]

* * *

REPORTING CAPITAL ASSETS

SECTION 1400

See also: [Add the following:] Section S30, “Service Concession Arrangements”

.122 [Update cross-references.]

[Insert new paragraph .124 as follows, and renumber remaining paragraphs.]

Capital Assets Related to Service Concession Arrangements

.124 Section S30, paragraphs .106–.108 and .110 and .111, provides guidance for accounting and financial reporting for infrastructure and other public assets that are subject to service concession arrangements.

* * *

NOTES TO FINANCIAL STATEMENTS

SECTION 2300

Sources: [Add the following:] GASB Statement XX

.106 [Update cross-reference in subparagraph k.]

.107 [Update cross-references in subparagraphs h and gg, and add new subparagraph kk as follows:] Service concession arrangements. (See paragraphs .124–.126, below.)

[Insert new paragraphs .124 and .126 as follows:]

Service Concession Arrangements

.124 [GASBS XX, ¶17]

.125 [GASBS XX, ¶18]

.126 [GASBS XX, ¶19]

* * *

**REPORTING ENTITY AND COMPONENT UNIT
PRESENTATION AND DISCLOSURE**

SECTION 2600

.117 [Update cross-references.]

* * *

CLAIMS AND JUDGMENTS

SECTION C50

.110 [Update cross-reference in subparagraph a.]

.125 [Update cross-reference.]

* * *

LEASES

SECTION L20

Sources: [Add the following:] GASB Statement XX

[Insert new paragraph .101 as follow, and renumber remaining paragraphs.]

Scope of This Section

.101 This section establishes standards of accounting and financial reporting for leases except for arrangements that meet the definition of a service concession arrangement in paragraph .103 of Section 30, “Service Concession Arrangements,” which should apply the guidance in that section. [NCGAS 5, ¶11, as amended by GASBS XX, ¶4 and ¶6]

* * *

POLLUTION REMEDIATION OBLIGATIONS

SECTION P40

.102 [Update cross-reference in footnote 4.]

.118 [Update cross-reference.]

* * *

[Create new section as follows:]

SERVICE CONCESSION ARRANGEMENTS

SECTION S30

Source: GASB Statement XX

.103–.118 [GASBS XX, ¶4–¶19, including headings and footnotes; change *Statement* to *section* and update cross-references.]