

Public-Private Partnerships

At your request, we have prepared a brief paper on the accounting for public-private partnerships. This paper is not intended to be authoritative guidance for all types of arrangements, nor is it intended to provide guidance on how to structure these type of arrangements.

Many colleges and universities have been entering into agreements known as public-private partnerships. These agreements are generally with private businesses and are used to deliver services to university students, faculty, and staff. Generally, the accounting (on/off books) for public-private partnerships is based on the specific agreement and the applicable accounting standards for the terms of those agreements. In an attempt to address many of these arrangements, the Government Accounting Standards Board (GASB) issued Statement No. 60, Accounting for Service Concession Arrangements. This paper discusses the specifics of Statement No. 60 and other types of arrangements with much of the text coming directly from Statement No. 60. In addition, Moody's Investors Service has issued guidance as it relates to the credit impact of public-private partnerships. This paper also quotes from a Moody's report.

According to Statement No. 60, a service concession arrangement (SCA) is an arrangement between a government (the transferor, or university) and an operator (or developer) in which all of the following criteria are met:

- a. The university conveys to the developer the right and related obligation to provide public services through the use and operation of a capital asset (facility) in exchange for significant consideration, such as an up-front payment, installment payments, a new facility, or improvements to an existing facility.
- b. The developer collects and is compensated by fees from third parties.
- c. The university determines or has the ability to modify or approve what services the developer is required to provide, to whom the developer is required to provide the services, and the prices or rates that can be charged for the services.
- d. The university is entitled to significant residual interest in the service utility of the facility at the end of the arrangement.

SCAs include, but are not limited to:

- a. Arrangements in which the developer will design and build a facility and will obtain the right to collect fees from third parties
- b. Arrangements in which the developer will provide significant consideration in exchange for the right to access an existing facility and collect fees from third parties for its usage

c. Arrangements in which the developer will design and build a facility for the transferor, finance the construction costs, provide the associated services, collect the associated fees, and convey the facility to the government at the end of the arrangement.

Accounting for SCA's is as follows:

If the facility associated with an SCA is an existing facility, the university should continue to report the facility as a capital asset.

If the facility associated with an SCA is a new facility purchased or constructed by the developer, or an existing facility that has been improved by the developer, the university should report (a) the new facility or the improvement as a capital asset at fair value when it is placed in operation, (b) any contractual obligations as liabilities, and (c) a corresponding deferred inflow of resources equal to the difference between (a) and (b).

A university should recognize a liability for certain obligations to sacrifice financial resources under the terms of the arrangement. Liabilities associated with the SCA should be recorded at their present value if a contractual obligation is significant and meets either of the following criteria:

- a. The contractual obligation directly relates to the facility. This obligation could relate to ownership of the facility or could arise from the university's responsibility to ensure that the facility remains fit for the particular purpose of the arrangement.
- b. The contractual obligation relates to a commitment made by the university to maintain a minimum or specific level of service in connection with the operation of the facility.

After initial measurement, the capital asset is subject to existing requirements for depreciation, impairment, and disclosures. The corresponding deferred inflow of resources should be reduced and revenue should be recognized in a systematic and rational manner over the term of the arrangement, beginning when the facility is placed into operation. If a liability is recorded to reflect a contractual obligation to sacrifice financial resources, the liability should be reduced as the university's obligations are satisfied. As obligations are satisfied, a deferred inflow of resources should be reported and the related revenue should be recognized in a systematic and rational manner over the remaining term of the arrangement. Improvements made to the facility by the operator during the term of the SCA should be capitalized as they are made and also are subject to requirements for depreciation, impairment, and disclosures.

If an SCA requires up-front or installment payments from the developer, the transferor should report (a) the up-front payment or present value of installment payments as an asset, (b) any contractual obligations as liabilities, and (c) related deferred inflow of resources equal to the difference between (a) and (b). Revenue should be recognized as the deferred inflow of resources is reduced. This revenue should be recognized in a systematic and rational manner over the term of the arrangement. A liability should be recognized if the university has contractual obligations.

Some SCAs include provisions for revenue sharing. If a university shares revenue with a developer, the university should recognize only its portion of the shared revenue when earned in

accordance with the terms of the arrangement. If revenue sharing arrangements contain amounts to be paid to the university regardless of revenues earned, then the present value of those amounts should be reported by the university and developer as if they were installment payments at the inception of the arrangement.

Other types of public-private partnerships that are not included in the scope of GASB Statement No. 60 may be SMAs, which are arrangements in which the university (rather than users) pays the developer for services, arrangements in which the third party only designs and builds a capital asset for the university; vendor arrangements; and privatizations. These arrangements are not included within the scope of GASB Statement No. 60 and follow different accounting guidance.

Arrangements in Which the University Makes Payments to the Developer

Some public-private partnership arrangements involve a developer constructing and operating a facility owned by the university, with the developer receiving payment for these construction and operations services from the university, rather than from user fees. When considering guidance for accounting for these arrangements, you need to consider 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.

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

These are arrangements for construction projects in which both the design and construction aspects are contracted together with a third party. A design and build arrangement is entered into for the purpose of obtaining a service (construction); the service is not being provided to the general public but, rather, to the university itself. Existing provisions for construction of capital assets are sufficient to provide guidance for these transactions.

Vendor Arrangements

These are arrangements in which a university contracts with vendors to provide ancillary services using a public asset, for example, vendors using a stadium as a venue to sell food or souvenirs. These are generally simple vendor related agreement and existing guidance for accounting for these contracts is adequate

Service and Management Arrangements

In a service contract, a university contracts with a separate entity for services it would otherwise have performed. For example, a university may enter into a service contract with another entity for the sweeping and snow removal from streets and sidewalks. These services generally are performed by the separate entity in accordance with requirements set by the university. A

management contract builds on a service contract by placing management responsibilities for the service with the separate entity. Using the previous example, in contrast to a service contract, a management contract would make the separate entity responsible for management functions associated with the operation of the service, such as hiring employees, interacting with other vendors, and preparing budgetary information related to the operation of the service, in addition to the actual sweeping and snow removal from streets. In both cases, the relationship between the university and the separate entity is similar to that of a purchaser and vendor, and the arrangements are generally short-term. Risk and responsibility for delivery of the service largely remains with the university. These arrangements may be referred to as *outsourced* or *contracted-out* services. These arrangements may or may not involve the use of a facility. In addition, a university may directly compensate the vendor for the services provided, or a university may compensate a vendor by allowing the vendor to collect and retain all or a portion of the fees from providing the service they are contracted to provide. Existing guidance for accounting for expenses is adequate for these purposes because the accounting for these types of arrangements can be viewed similarly to accounting for vendor or service contracts.

Privatization

A privatization occurs when a university permanently transfers a capital asset or service to an developer, generally through sale. The university 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 lease accounting requirements and provisions for sales and transfers of capital assets are sufficient to provide guidance for these transactions.

On/Off Credit (On/Off Debt Capacity)

Moody's Investors Service has published reports which address whether public-private partnerships are considered "on/off credit," which is synonymous with "on/off debt capacity." Their position is summarized in the Summary Opinion from the March 2010 Special Comment:

"This special comment updates Moody's treatment of privatized student housing projects as contingent liabilities of affiliated U.S. Universities. These types of projects always affect an affiliated university's credit position because student housing is a strategic core business of most U.S. universities—an integral part of a university's student market position, financial management, and capital strategy. The ultimate credit impact of a privatized financing on a university will vary depending on the project specifics, including the project's strategic importance and the university's involvement with the project. Our rating approach applies to all university affiliated privatized projects, including newer structures being used to finance these projects, such as equity-based models, subordinate debt, and pooled trust structures."

Summary

The above transactions are not meant to be all inclusive and there are other types of public-private partnership agreements. The GASB has tried to discuss many of the agreements in place

and the appropriate accounting for each. Since the accounting for public-private partnership arrangements will vary based on the structure of the agreement, each transaction will need to be reviewed to determine the proper accounting. However, in general, if projects are on campus and meet GASB 60 criteria, they would be recorded on the university's books and "on credit" per Moody's as noted above. If they don't meet GASB 60 criteria, they would generally be accounted for according to one of the methods described above and impact the university's financial statements, potentially as an asset and liability or an expense type item. Generally, if the projects are off campus, they would not be recorded as an asset or liability unless there is some ownership or contractual obligation and they would be "off credit" per Moody's. These relationships could still impact the university's financial statements as an expense.