3. **ACCOUNTING**

3.4 **Liabilities**
3.4.X **Public-Private and Public-Public Partnerships PPP**

3.4.X.XX **Public-Private and Public-Public Partnership (PPP) Introduction**
Below is a summary of the accounting guidance for PPP arrangements. Additional guidance can be found in GASB Codification Section P90 – *Public-Private and Public-Public Partnerships*.

3.4.X.XX **PPP Definition**

A PPP is an arrangement in which a government (the transferor) contracts with an operator to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction.

Service Concession Arrangement (SCA) Definition

Some PPPs are service concession arrangements (SCAs). An SCA is a PPP arrangement between a transferor and an operator in which all of the following criteria are met:

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

3.4.X.XX **PPP Term**

The PPP term includes:

- The period during which the operator has a non-cancelable right to use the underlying PPP asset
  - plus periods covered by the operator's **or** transferor's option to extend the PPP (if reasonably certain the option will be exercised)
  - and periods covered by the operator's **or** transferor's option to terminate the PPP (if reasonably certain the option will not be exercised)
- PPP term **excludes** periods for which both the operator and transferor each have the option to terminate or both parties must agree to extend.

Determining whether an extension or termination option is reasonably certain of being exercised requires professional judgement and should take into consideration the specific facts and circumstances at your government. Examples of items to consider in this analysis:

- A significant economic incentive, such as contractual terms and conditions for the optional periods that are favorable compared with current market rates.

- A significant economic disincentive, such as costs to terminate the PPP and sign a new PPP arrangement (for example, negotiation costs, relocation costs, abandonment of significant underlying PPP asset improvements, costs associated with returning the underlying PPP assets in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty).
- The history of exercising options to extend or terminate.
- The extent to which the underlying PPP asset is essential to the provision of government services.

3.4.X.XX **Discount Rate**

The PPP payments should be discounted using the rate the transferor charges the operator. This may be a rate stated in the contract (if it's a reasonable rate) or the implicit rate can be estimated. Governments are also allowed to apply GASB Statement 62, paragraphs 173 – 187 for imputation of interest, but are not required to. If the implicit rate is not determinable, the operator's estimated incremental borrowing rate may be used.

The incremental borrowing is the interest that a borrower would have to pay to finance an asset of that same type, over a similar term, in the current economic environment, and of a similar amount. This is the borrowing rate at the margin for new debt, and not necessarily the rate of other previously negotiated debt which may have a dissimilar borrowing profile.

Governments should use professional judgment to determine their best estimate for the interest rate, maximizing the use of observable information to get a base rate (a starting point). For example, a prime rate would be a reasonable starting place for determining the incremental borrowing rate. Another example would be reviewing a local bank's website for their published interest rates.

If the government determines that they could finance an asset at that base rate (the prime rate, or another reasonable starting point), then that base rate should be used. However, if there are economic factors that would make that rate unobtainable, then the base rate should be adjusted accordingly. It is up to governments to determine the most appropriate discount rate.

3.4.X.XX **Remeasurement**

Operators and transferors are required to remeasure (recalculate) the liability for installment payments (operator) or receivable for installment payments (transferor) in the following circumstances:

Circumstance	Operator	Transferor
Change in the PPP term	X	X
Change in likelihood of residual value guarantee	X	
Change in estimated amounts for payments already included in the PPP liability	X	
Change in the interest rate the transferor charges the operator (if used as the discount rate)	X	X
Contingency for variable payments is resolved	X	X

If the PPP liability is remeasured for any of the changes above, the index or rate used for variable payments and the discount rate should also be updated. However, the liability/receivable does not need to be remeasured solely for a change in the index or rate used for variable payments or a change in the incremental borrowing rate (if used as the discount rate).

For operators, the right-to-use PPP asset should generally be adjusted by the same amount as the PPP liability. If the change reduces the carrying value of the right-to-use PPP asset to zero, any remaining amount should be reported as a gain.

For operators, if applicable, the liability for the underlying PPP to be transferred (when a new asset is purchased/constructed and the arrangement is **NOT** an SCA), should be remeasured if there is a change in the PPP term or if there is a PPP modification or termination.

For transferors, the deferred inflow should generally be adjusted by the same amount as the receivable. If the change reduces the deferred inflow to zero, any remaining amount should be reported as an expense.

For transferors, if applicable, the receivable for the underlying PPP asset (when a new asset is purchased/constructed and the arrangement is **NOT** an SCA), should be remeasured when there isa PPP modification or termination.

3.4.X.XX Transferor Accounting – Full Accrual

There are three different scenarios that can impact the accounting.

(1) The underlying PPP asset is an existing asset of the transferor.
(2) The underlying PPP asset is a new asset purchased or constructed by the operator and the PPP meets the definition of an SCA.
(3) The underlying PPP asset is a new asset purchased or constructed by the operator and the PPP does **not** meet the definition of an SCA.

Under full-accrual accounting (government-wide and proprietary fund financial statements), transferors will recognize the following:

Type of PPP	Financial Element	Measured at
1. Underlying PPP asset is existing asset of transferor	Improvements made to existing asset	Acquisition Value when improvements are placed into service
2. Underlying PPP asset is purchased/constructed by operator & is an SCA	Asset for the new purchased/constructed underlying PPP asset	Acquisition Value when asset is placed into service
3. Underlying PPP asset is purchased/constructed by operator & is **NOT** an SCA	Receivable for new purchased/constructed underlying PPP asset	Operator's estimated carrying value as of expected date of transfer
All types	Receivable for installment payments (if any)	Present value of PPP payments expected to be received during the PPP term, net of estimated uncollectible amounts
All types	Deferred inflows	All items above (improvements, assets, receivables) + PPP payments received from the operator at or before the start of the PPP term

3.4.X.XX **Improvements made to existing asset**

A transferor should measure improvements made by the operator to an underlying PPP asset at acquisition value when the improvements are placed into service. A transferor should apply all other accounting and financial reporting requirements relevant to the improvements to the underlying PPP asset, including depreciation and impairment.

3.4.X.XX **Asset for new purchased/constructed asset (if SCA)**

A transferor should initially measure the underlying PPP asset at acquisition value when the asset is placed into service. The transferor should apply all other accounting and financial reporting requirements, including depreciation and impairment, to the PPP asset. However, if the PPP arrangement requires the operator to return the underlying PPP asset in its original condition, the transferor should not depreciate the asset during the PPP term.

3.4.X.XX **Receivable for new purchased/constructed asset (if <u>not</u> SCA)**

A transferor should measure a receivable for the underlying PPP asset based on the operator's estimated carrying value of the underlying PPP asset as of the expected date of the transfer in ownership from the operator. The receivable for the underlying PPP asset should be remeasured if there is a PPP modification or a PPP termination.

3.4.X.XX **Receivable for installment payments (all PPPs)**

The initial PPP receivable is measured at the present value of installment payments expected to be received during the PPP term, reduced by any provision for estimated uncollectible amounts. The receivable should include the following:

- Fixed payments
- Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the PPP term
- Variable payments that are fixed in substance
- Residual value guarantee payments that are fixed in substance
- Residual value guarantee payments that are **not** fixed in substance if (a) the payment is required and (b) the amount can be reasonably estimated.

As the operator makes payments, the transferor will recognize a reduction in the PPP receivable and interest revenue. The PPP receivable must be amortized using the interest method.

3.4.X.XX **Deferred inflows (all PPPs)**

Deferred inflows includes the following:

- All PPPs – The amount of initial measurement of the receivable for installment payments (if any)
- All PPPs – PPP payments received from the operator at or before the start of the PPP term
- Existing PPP asset – The amount of initial measurement for improvements to the underlying PPP asset
- New asset in SCA – The amount of the initial measurement for the underlying PPP asset
- New asset & <u>not</u> SCA - The amount of the initial measurement of the receivable for the underlying PPP asset

The deferred inflow is amortized in a systematic and rationale manner over the PPP term. GASB does not specify a required amortization method, so transferors may choose which method they use (for example the interest method or straight-line).

3.4.X.XX **Transferor Accounting – Modified Accrual**

Under modified accrual accounting (governmental fund financial statements), transferors should recognize a receivable for installment payments (if any), and a deferred inflow. The deferred inflow will be measured at the initial value of the receivable for installment payments, plus the amount of any payments received at or before the start of the PPP term.

The receivable must be amortized using the interest method. The deferred inflows can be amortized using any systematic and rationale manner (for example the interest method or straight-line).

3.4.X.XX **Transferor Accounting – BARS Codes**

The transferor records PPP revenue and interest revenue. The interest revenue from PPPs should be recorded to BARS Code 361.4P which is a non-operating revenue code.

The PPP revenue should be recorded to BARS Code 34P.PP (Charge for Services code) or 362. In a proprietary fund, use BARS Code 362 for non-operating PPP revenue, and 34P.PP for operating revenue. In a governmental fund, use BARS Code 362 for PPPs that are not tied to a specific operation or function or for PPPs that are infrequent in nature.

The "P" stands for prescribed numbers that are related to the function of the PPP activity. Review your chart of accounts to identify the applicable function and determine the full BARS Code.

There are also required note disclosures. See template note at Note X – PPP (Transferors).

3.4.X.XX **Operator Accounting – Schedule of Liabilities (Schedule 09) Reporting**

The operator will report PPP liabilities on the Schedule of Liabilities (Schedule 09). In the year of implementation, any existing PPP contracts should report a beginning balance on the Schedule 09. The beginning balance reported should be the amount calculated for the implementation of GASBS No. 94. In subsequent years, the beginning balance should match the prior year ending balance.

Any new PPP contracts entered during the year will be reported as an addition on the Schedule 09. The addition will be the liability calculated to add the PPP to your financial statements.

Reductions are the amount the PPP liability is reduced during the year, which is typically the principal portion of payments made.

If the PPP liability is remeasured for any of the items in Section 3.4.X.60, the change in the PPP liability should be reported as either an addition or reduction on the Schedule 09.

See Schedule 09 reporting instructions.

There are also required note disclosures. See template note at Note X – PPP (Operators).

3.4.X.XX **Operator Accounting – Full Accrual**

There are three different scenarios that can impact the accounting.

(1) The underlying PPP asset is an existing asset of the transferor.
(2) The underlying PPP asset is a new asset purchased or constructed by the operator and the PPP meets the definition of an SCA.
(3) The underlying PPP asset is a new asset purchased or constructed by the operator and the PPP does **not** meet the definition of an SCA.

Under full-accrual accounting (government-wide and proprietary fund financial statements), operators will recognize the following:

Type of PPP	Financial Element	Measured at
1. Underlying PPP asset is existing asset of transferor & 2. Underlying PPP asset is purchased/constructed by operator & is an SCA	Right-to-use PPP asset	Liability for installment payments + Payments made to transferor + initial direct costs + costs of improvements (if existing asset) + cost of purchased/constructed asset (if SCA)
3. Underlying PPP asset is purchased/constructed by operator & is **NOT** an SCA	Asset for the new purchased/constructed underlying PPP asset	Actual cost
3. Underlying PPP asset is purchased/constructed by operator & is **NOT** an SCA	Liability for the underlying PPP asset to be transferred to the transferor	Operator's estimated carrying value as of expected date of transfer
3. Underlying PPP asset is purchased/constructed by operator & is **NOT** an SCA	Deferred outflow of resources for the underlying PPP asset to be transferred to the transferor	Operator's estimated carrying value as of expected date of transfer
All types	Liability for installment payments (if any)	Present value of PPP payments expected to be received during the PPP term, net of estimated uncollectible amounts

3.4.X.XX **Right-to-use PPP asset (Existing asset or new asset in SCA)**

An operator should initially measure the right-to-use asset when the underlying PPP asset is placed into service and include:

- The amount of the initial measurement of the liability for installment payments (if any)
- PPP payments paid to the transferor at or before the start of the PPP term
- Initial direct costs to place the right-to-use asset into service
- Existing asset – Cost of improvements to existing underlying PPP asset
- New asset in SCA – The cost of the purchased/constructed underlying PPP asset

A right-to-use asset should be amortized in a systematic and rational manner over the shorter of the PPP term or the useful life of the underlying PPP asset. GASB does not specify a required amortization method, so operators may choose which method they use (for example the interest method or straight-line).

3.4.X.XX **Asset for new purchased/constructed asset (if <u>not</u> SCA)**

An operator should recognize the underlying PPP asset until ownership of the underlying PPP asset is transferred to the transferor, if applicable. An operator should continue to apply other accounting and financial reporting requirements relevant to the underlying PPP asset, including depreciation and impairment.

3.4.X.XX **Liability & deferred outflow for new purchased/constructed asset to be transferred (if <u>not</u> SCA)**

If the operator is required to transfer the underlying PPP asset to the transferor during or at the end of the PPP term, the operator should measure the liability based on the estimated carrying value of the underlying PPP asset as of the expected date of the transfer in ownership to the transferor.

The operator should also recognize a deferred outflow in the same amount. This deferred outflow is amortized in a systematic and rationale manner over the PPP term. GASB does not specify a required amortization method, so transferors may choose which method they use (for example the interest method or straight-line).

3.4.X.XX **Liability for installment payments (all PPPs)**

The operator's initial PPP liability is measured at the present value of installment payments expected to be paid during the PPP term. The liability should include any of the following:

- Fixed payments
- Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the PPP term
- Variable payments that are fixed in substance
- Amounts that are reasonably certain of being required to be paid under residual value guarantees
- Payments for penalties for terminating the PPP, if the PPP term reflects the operator exercising (1) an option to terminate the PPP or (2) a fiscal funding or cancellation clause
- Any other payments reasonably certain to be made to the transferor

As payments are made, the operator will recognize a reduction in the liability and interest expense. The PPP liability must be amortized using the interest method.

3.4.X.XX **PPP Accounting – Modified Accrual**

Governmental funds do not report an operator PPP asset or PPP liability. Instead, the operator would record a Capital Outlay Expenditure (debit) and an Other Financing Source for PPP (credit). As the operator makes payments, they would record a Debt Service Principal Expenditure (debit), Debt Service Interest Expenditure (debit), and reduce cash (credit).

3.4.X.XX **Operator Accounting – BARS Codes**

In a full accrual fund, the revenue and expense accounts used are interest expense and amortization expense.

592.PP.80	Recording interest expense payments
501.PP.00	Recording amortization expense on PPP asset

In a modified accrual fund, there is no PPP asset or PPP liability, so the accounts used are different.

594.PP.60	Recording the capital outlay expenditure at the start of the PPP term
391.70.00	Recording the “other financing source” at the start of the PPP term
591.PP.70	Recording debt principal payments
592.PP.80	Recording interest expense payments

The “P” stands for prescribed numbers that are related to the function of government that the PPP is supporting. Review your chart of accounts to identify the applicable function and determine the full BARS Code.