Office of the Comptroller General
Practice Guideline 1

Public Private Partnerships

Ministry of Finance

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I. INTRODUCTION

The purpose of this Practice Guideline on Public Private Partnerships (P3) is to provide information to organizations within the Province of British Columbia’s reporting entity on the appropriate accounting treatment for P3 arrangements. The document is also intended to provide background information on P3s and direct users to other relevant resource material.

The Office of the Comptroller General (OCG) determined that there was a need to provide clarity to government organizations on the accounting for Public Private Partnerships for a number of reasons. There are currently no Canadian accounting standards that specifically address P3s. While certain international accounting standard setting bodies have begun to draft guidance for service concession arrangements, they are still under development. The Province of British Columbia has entered into a number of P3 arrangements and has established a policy of utilizing P3 arrangements for procuring infrastructure whenever feasible.

P3 projects are complex arrangements, each a unique arrangement negotiated independently of other projects involving different types of assets or services with varying degrees of risk or responsibility allocated between the private sector and public sector partner. It is important that the P3 arrangements that the province enters into are accounted for appropriately and consistently.

Before addressing the specific accounting issues, the guideline explores what a P3 is and how the substance of the arrangement influences accounting treatment.

Public Private Partnership or P3 is a term used to describe capital procurement and service delivery arrangements that are different than the traditional borrow and buy/in-house method of acquiring assets or services, and where significant risks are shared with the private sector. While the third “P” in P3 is “partnership”, the arrangement is usually in the form of service agreements or performance contracts, and a legal partnership is not formed between government and the private company.

P3s are a relatively new procurement method that transfers capital project risks from government to the private sector through fixed price agreements, guaranteed delivery dates, long-term warranties and guarantees of lifecycle and rehabilitation performance. Payments to the private sector “partner” are subject to meeting performance standards and may deduct penalties for sub-standard performance.

Under a public-private partnership contract, a private sector concessionaire usually constructs a capital asset specific to the service delivery needs of government and operates or maintains it for a term specified by the contract. In return, the provincial government either pays the concessionaire a unitary performance based payment or allows the concessionaire to charge a toll or fees to users of the asset. The payments by government, or the fees collected from users, cover both the cost of the capital asset plus...
the ongoing expenses over the term of the contract, including finance expense, maintenance, and rehabilitation or lifecycle costs.

A project may be particularly well suited to a P3 arrangement when a market for bidders can be identified or can be reasonably expected to develop and there is potential to transfer risk to the private sector. Projects where opportunities exist for private sector innovation in design, construction, service delivery and/or asset use and where opportunities also exist for the private sector partner to generate non-government streams of revenue, would be attractive to private sector bidders. It is also critical that clearly definable and measurable output specifications (i.e. service objectives) can be established, making the agreement suitable for payment on a services-delivered basis.

Every project undertaken by government carries an upside risk and a downside risk. Upside risks are those which, for example, could see a project being completed ahead of schedule, below cost or exceeding revenue estimates. With downside risk, the opposite of each of these examples could occur – completion delays, cost overruns and revenue shortfalls.

With projects that are fully funded and operated by the government, the public sector retains a greater portion of the risk. In a P3 arrangement, risks are shared between the public sector and the private partner. This sharing of risk creates opportunities for parties to be rewarded for upside risk outcomes and for downside risk outcomes to be absorbed by the responsible party.

It is the Province of British Columbia’s policy that a public private partnership/alternative service delivery arrangement will be considered the base case for procurement in a business case where the province would be contributing more than $50\(^1\) million to the capital cost of a project.

This policy applies to all ministries, Crowns and agencies of the province, as well as any municipal capital projects where the province’s contribution is $50 million or more.

Other procurement options may be supported by a value for money analysis.

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\(^1\) Prior to November 2008, P3s were to be the base case where the province’s contribution was $20 million or more. Effective November 2008, the threshold was changed to $50 million or more.
THE P3 PROCESS

The following is a brief description of components of the P3 procurement process. For detailed description of the steps in the P3 process, refer to the Ministry of Finance’s Capital Asset Management Framework (CAMF) at http://www.fin.gov.bc.ca/tbs/camf.htm Further information on the procurement process in government can be found in the Purchasing Handbook at http://www.pc.gov.bc.ca/data/docs/PurchasingHandbook.pdf

Business Case
A case for a P3 project may be prepared in response to a need identified in an agency’s service plan, or to explore a new service delivery opportunity.

A clearly defined business need or opportunity is critical to the development of a business case. The business case communicates the business need or opportunity, the alternatives considered and the estimated cost of the options including status quo. The level of analysis required, including the number of business case elements addressed and the depth of analysis in each, depends on the project’s size, complexity and risk.

Risk Analysis
Agencies examining P3 options need to identify and analyze the risks inherent in a project. This information will be used to develop strategies for risk management and as a basis for allocating risk between the public and private partners in a proposed P3 arrangement.

The optimal allocation of risk between the partners should result in the potential for downside risks to be minimized. Partnerships British Columbia Inc. (Partnerships BC) has developed a publication entitled “Introduction to Risk Management in a P3” dated July 2006. This document can be found at: http://www.partnershipsbc.ca/pdf/risk-management-ppp-28-jul-06.pdf

Project approval
The evaluation of a project's feasibility includes the business case analysis and the determination of whether the project meets its objectives within the estimated cost structure. The project is generally the subject of a cabinet decision.

Procurement Process
The procurement process can be broken into three basic stages: Solicitation, Evaluation/Negotiation and Contract Award. Solicitation includes preparing and issuing documents such as Requests for Expressions of Interest (REOIs), Requests for Qualifications (RFQs) and Requests for Proposals (RFPs). Next, is the evaluation of qualified proponents and their proposals against measurable, clearly defined criteria and subsequent negotiation with the preferred proponent. The contract award is the process of awarding the contract to the successful bidder.
Treasury Board approval may be required at the solicitation and/or contract award stage depending on the complexity, risk and cost of the project.

Partnerships BC has prepared a guideline called “Procurement Related Disclosure for Public Private Partnerships”. The document can be found at:  

Disclosure, in the context of public sector procurement practices, refers to the type, amount and timing of information related to procurement decisions that is made public.

**Contract Management**

Once the contract award is made, the focus shifts to managing the contract which includes monitoring the construction of the asset and later, monitoring performance of the asset and/or service.

An adequately resourced contract management team must be established well before the final contract is executed. The team should initially have members who were, or currently are members of the procurement team. This is aimed at promoting a continuity of working relations with the private sector personnel, as well as maintaining a thorough understanding of what the project is seeking to achieve.

Over time, the membership of the contract management committee should change to reflect the movement of the project from infrastructure construction to service delivery and asset management. Access to relevant specialist expertise, as and when required, is extremely important.

Further guidance on contract management is available in the Core Policy and Procedures Manual (CPPM) at:  http://www.fin.gov.bc.ca/ocg/fmb/manuals/CPM/CPMtoc.htm

A post-completion evaluation is required on every contract over $50,000 to provide a record of the contractor's performance and to assist in future contracting activity.

The post-completion review should highlight both the positive aspects and potential areas for improvement associated with the project. The lessons learned will enable future projects to be improved through better planning, construction, implementation and management.

Given the long term nature of most P3 arrangements, it is recommended that a post-completion review be conducted once the infrastructure asset is substantially complete, not just at the end of the contract term.

For P3 projects, the cost of building and operating the public facility and the benefits to taxpayers over the life of the agreement are reported on in a Value for Money Report, typically prepared by Partnerships BC.
II. THE SUBSTANCE OF THE ARRANGEMENT

A P3 project usually involves the construction of an infrastructure asset, and a long term operations or maintenance contract. Certain aspects of the agreement may relate to the capital project and others to ongoing operations of the asset, even though there may be a blended unitary performance-based payment plan.

The contract terms and conditions provide an understanding of the overall substance of the arrangement. The substance of the arrangement is more important than the legal form of the documents when determining the appropriate accounting treatment. A number of indicators, including the allocation of risks and responsibilities in the agreements, will inform us of the substance of certain core issues such as control of the organization, ownership of the constructed assets, and obligation for liabilities.

For instance, a new organization, or “special purpose entity” (SPE) may be created by the private sector partner, with the intention of being independent of government, to oversee the construction of an asset and/or delivery of services. However, certain details of government’s relationship with the SPE, such as involvement in day-to-day operations, financial guarantees of operating shortfalls, restrictions on activities, or approving budgets may indicate government effective control over the organization. If government has effective control of an organization, it must be consolidated into the government reporting entity (GRE). All P3 contracts and agreements must be analyzed on the basis of the substance of the arrangement to determine:

- whether government controls the SPE;
- which organization (public or private) bears the risks and rewards of ownership of the infrastructure asset under development;
- whether the arrangement contains the lease of an asset;
- whether any associated leases are operating or capital in nature; and
- at what point liabilities are incurred by government.

The results of these analyses are critical to the determination of the appropriate accounting treatment for the project. More information on each of these analyses is included in the Accounting Guidance section of the guideline.

The substance of the arrangement prevails for budgeting, accounting and reporting purposes. Some examples of circumstances where the substance of an arrangement may differ from its form are:

1. A contract may be titled “Operating Lease”; however, the details of the agreement indicate that it is not really an “operating lease” because the lessee bears the risks and rewards of asset ownership.
2. A private sector service provider acquires or builds a specialized asset specifically to deliver services under contract to government and the asset is not readily adaptable to other uses. In this case, there may be more than just a contract for services, but may also be an underlying lease of the specialized asset that needs to be assessed.
3. Certain concession arrangements may be based on tolls or fees collected directly by a concessionaire and retained as payment for the contracted work. The substance of the arrangement is that tolls collected on the province’s asset, belong to the province and must be reported as the province’s revenue. The operations and maintenance, rehabilitation and financing costs associated with the agreement must also be recorded by the province – even though paid for through foregone revenue. It was the province’s choice to forgo the revenue in exchange for the infrastructure and service provided for in the contract. The total cost of the project would be the full amount of the forgone revenue plus any other payments the province may be required to make.
III. FUNDING ANALYSIS

The business case is intended to explore viable options to address a clearly defined business need. According to the CAMF, capital business cases should include financial information, including a year-by-year breakdown of forecast costs, revenues and funding sources for the asset’s full, risk-adjusted life cycle. This section of the business case is typically called the Funding Analysis.

Partnerships BC and the sponsoring entity work together to develop a comparative quantitative analysis that forms part of the business case and Treasury Board Submission. This comparative analysis will inform decision makers on the potential financial impacts of the proposal. Decision makers must rely on estimated cost calculations when granting approval for a contract. It is not until a contract is awarded, after a competitive bidding process and much negotiation, that the contracted project cost is available. The decision to embark on a project and issue an RFP is based on estimated amounts. The two bases of comparison utilized throughout the approval and procurement process are the Shadow Bid Model and the Public Sector Comparator.

The Shadow Bid Model is an estimate of how much the bids from the private sector are expected to be. Prices are calculated based on delivery of the project by the private sector. Costs include risk, insurance, taxes, debt servicing and profit. The shadow bid analysis can be useful for negotiators and decision makers in evaluating bids that come in from the private sector.

The Public Sector Comparator (PSC) estimates the cost where the private partner constructs the asset and the public sector provides facility maintenance, rehabilitation and financing. A PSC is an estimate of the costs and financial impacts of procuring a project, similar to the one under consideration for a P3 where the public sector retains substantially all management responsibility and exposure to risk. A PSC provides a benchmark against which a Shadow Bid, and eventually a P3 proposal, can be evaluated. A PSC should capture the costs of assets, services, staff and other elements required to deliver the project to the same standards as anticipated under a P3 arrangement.

The Shadow Bid and the Public Sector Comparator for the various options or proposals should each report costs as explained below in Cost Determination and Accounting Treatment for the purposes of consistency, comparability and providing the best available information to the decision makers. The negotiated contract will be accounted for in the same manner.

IV. COST DETERMINATION AND ACCOUNTING TREATMENT

P3 arrangements usually contain costs relating to capital assets, operations and maintenance, lifecycle or rehabilitation and financing. Each of these types of costs are accounted and budgeted differently, so it is important to identify the different types of costs in the project financial model.
OCG has worked with key stakeholders including ministries, Treasury Board staff (TBS), and Partnerships BC to define a consistent methodology for determining the cost of the main components of P3 arrangements, capital cost, operations, maintenance, lifecycle or rehabilitation costs, and other financing charges attributed to either capital or operating components. The objective has been to establish a consistent basis of reporting the financial characteristics through the planning, approval and implementation phases. The methodology provides for a full accounting of P3 project costs and is intended to be applied to all government P3 projects.

The main benefit of this approach is certainty and consistency in accounting, as well as comparability between projects throughout a project’s life. If the estimated cost of a project changes between the approval stage and completion of the RFP, a consistent approach will allow the changes to be directly reconciled and fully disclosed.

**Contract Financial Model**

The valuation of major components of P3 projects uses the information available in the project detailed financial model, which forms part of the contract between the government and the private sector partner, to attribute specific amounts to the broad categories of capital and operating costs.

The financial model is prepared by the P3 private sector partner and represents the various costs of the project as agreed to by the province. The performance payments from the province, as detailed in the contract, are shown in the revenue section of the contract financial model’s income statement. The details of the concessionaire’s planned financing arrangements, whether through debt or equity, are independent evidence of the province’s finance costs associated with the project.

The financial model details the expected financing charges to the concessionaire by lenders and return on equity to investors. No matter how the concessionaire chooses to finance the project, from government’s perspective, both concessionaire’s interest on debt and return to equity holders is the cost of financing the project.

**Government’s Accounting Entries**

Even though the financial model in the contract details the cost elements of the project, and the contract terms provide the periodic payment calculation, the information necessary for government to account for each payment to the concessionaire is not readily available.

Payments are made to the concessionaire according to the terms of the contract and are based on the concessionaire meeting certain performance criteria. Although the payments are performance based, a determination needs to be made as to what the payments have purchased – whether it is part of an asset, operations and maintenance
services, rehabilitation or lifecycle costs, financing costs, or the reduction of a liability already recognized.

Whether the concessionaire is paid through a performance based payment structure or through the collection of tolls or user fees, the accounting treatment for the costs of the project is the same.

The government entity responsible for the P3 agreement must take the applicable cost elements from the financial model in the contract and create its own model from which it can derive its journal entries. The model created by the government entity must include the following information:

- Amounts and timing of planned additions to the work in progress assets and corresponding liability. The asset and liability amounts must be recorded in the government’s accounting system, even though payments to the concessionaire may not start until substantial completion. The asset and liability amounts will increase over the period of construction.
- Amounts and timing of accrual of interest during construction (IDC). IDC is the portion of the total finance charges that are allocated to the construction period. The accrual of IDC increases the work in progress asset accounts and the corresponding liability, over time, until substantial completion. It should be noted that the IDC is based on the province’s overall cost of financing the project, not merely the concessionaire’s cost of financing during the construction period.
- Planned payments to the concessionaire (including revenues collected and retained by the concessionaire), which usually commence at substantial completion of the asset, require analysis by the responsible ministry to determine how much of each periodic payment applies to:
  i) Contracted operating and maintenance expense;
  ii) Lifecycle or rehabilitation costs;
  iii) Current period operating (non-capitalized) finance charges – at the province’s imputed rate of interest; and
  iv) Reduction of the liability incurred for the asset and IDC as calculated in the debt repayment schedule discussed below.
- A debt repayment schedule based on the obligation incurred for the asset and IDC, the imputed interest rate for the province on the debt to the P3 partner applied over the term of the agreement, and the portion of the periodic payments that is available to service and reduce the debt.
- Amortization of the asset – over the term of the concession agreement or asset’s useful life, whichever is appropriate based on the policies of the responsible government entity.
- Recognition of any other direct costs of the responsible government entity that are not captured in the payment to the concessionaire.

A discussion of each of the types of project costs follows.

**Determining the Asset Cost**
The cost of a tangible capital asset includes direct construction or development costs (such as materials and labour) and overhead costs directly attributed to the acquisition, construction or development of the asset.

Tangible capital assets should be recorded at cost. The Core Policy and Procedures Manual of government chapter I.2 sets out what elements of the concessionaire’s financial model can be included as part of the capital cost of the P3 asset. Link to CPPM Chapter I

Asset costs include capitalizable P3 planning costs, concessionaire bid costs, insurance during construction, contingency fees, administrative fees, direct financing costs such as credit rating fees, finder’s fees, Letter of Credit fees, and interest during construction (IDC) based on government’s imputed interest rate for the agreement.

Costs of a general nature, such as expenditures for feasibility studies, post implementation reviews, training, training materials, etc., are never capitalized. If in doubt whether a cost should be capitalized, please contact the sponsoring ministry’s senior financial officer.

The contract financial model must be analyzed to assess the cost items. During the construction period the capital asset cost will be determined using the percentage of completion method even if the government entity does not obtain title to the asset until the completion of construction. Generally, information regarding the percentage of completion can be obtained from project progress reports over the construction period.

Professional judgement will be used to determine whether the costs obtained from the financial model reliably represent the value of the underlying activity.

**Determining the Operations and Maintenance Expense**

Operating costs of government related to the P3 arrangement may include payments or commitments for operations and maintenance, lifecycle or rehabilitation costs, and any costs that do not meet the definition of an asset. The annual operations and maintenance expenses related to the P3 agreement are found in the contract financial model. The planned lifecycle or rehabilitation costs are also detailed in the contract financial model.

Depending on the nature of the rehabilitation work, the province will either account for the costs as an expense of the period incurred or, if the cost meets the definition of an asset, capitalize and amortize the cost over time.

**Assessing Financing Costs**

The financing expenses contained in the contract financial model (interest on debt plus return on equity and direct financing fees) need to be recognized through the term of the
agreement and allocated between the amount that is attributable to the construction of the asset and the amount that is attributable to the operating period of the contract.

Direct finance costs in a P3 arrangement may be upfront finance fees (such as financing arrangement fees, credit rating fees, finders’ fees, letter of credit fees, etc). Certain of these finance costs, specifically related to the construction of the P3 asset, may be included in the asset cost up to the point of substantial completion. Finance costs not related to the construction of the asset, or incurred after the asset is in service, are likely to be expenses of the period incurred.

The other financing expenses (whether in the form of debt interest or return to the concessionaire) are attributed to capital and operating on a rational basis to reflect the province’s interest cost inherent in the agreement over the project life (the imputed interest rate). The amount that is attributable to the construction of the asset is capitalized as interest during construction.

It should be noted that the IDC calculated in the P3 partner’s contract model is not the same as the IDC of the province. The financing costs and return to shareholders for a specific period within the contract term (such as the construction period) does not represent the overall cost for the province of financing the project for the term of the contract through the P3 arrangement. The imputed interest rate for the province, which is similar to the internal rate of return (IRR) of the project, is the appropriate rate to calculate IDC and finance expense for the province.

IDC is applied to the asset cost by the province as the asset is constructed and is based on the province’s imputed interest rate for the project. Over the rest of the term of the agreement, the imputed interest rate is applied to the balance of the province’s obligation to the concessionaire for the asset. The total interest or financing cost calculated for each year during the operating period is an expense of that year for the province.

**Recognition of Liabilities**

A liability is incurred by the government entity engaged in the P3 agreement as soon as an event occurs that obligates the government to pay the concessionaire.

Generally, the government entity is the owner of the asset under construction so the asset and corresponding liability are recognized over time as the construction progresses. The concession agreement will indicate at what point the government entity incurs a liability. If, for instance, the agreement compels the government to pay the concessionaire for certain costs, then the government entity must record a liability when the concessionaire incurs these costs.

The analysis of the government’s payment to the concessionaire will provide information on the liability reduction in a year. The payment would be recorded first as operations
and maintenance expense, rehabilitation, and imputed interest expense. The balance of the payment or forgone revenue, after covering operations, maintenance, rehabilitation costs and the finance expense for the province, would be available to reduce the liability for the asset.

It should be noted that if the payment is not sufficient to cover operations, maintenance, rehabilitation and the government’s finance expense for that year, then the outstanding liability would increase by the amount of the shortfall.

**P3 Planning Costs incurred by the government entity**

Where P3 planning costs are related to the acquisition or development of a capitalizable asset that will be owned by the province or one that will be a leased capital asset of the province, costs similar to those capitalized under traditional procurement should be capitalized. Only P3 planning costs incurred after the commencement of the preparation of a request for proposal, directly related to the acquisition or development of the asset, should be capitalized. Where the P3 planning costs relate to the acquisition of both a capitalizable asset of the province and future receipt of services, only the portion that relates to the acquisition of the asset are capitalized. The ratio between capital and operating costs in the concession agreement may be used to determine the allocation.

**Asset Amortization**

At the point of substantial completion of the asset\(^2\), the government entity responsible for the P3 contract will commence amortization of the capital asset over the term of the contract or the asset useful life, whichever is appropriate. The government must calculate the amortization expense independently of any amortization expense reflected in the contract financial model. The amortization expense (or Capital Cost Allowance) in the contract model will be based on an intangible asset, licence or right, acquired by the concessionaire as the asset is built and does not represent the asset amortization of the government entity.

**Revenues**

A P3 agreement may encompass certain revenues, including those collected by the concessionaire on behalf of the province, earned by the concessionaire from non-government sources according to the agreement, or innovation profit sharing.

Revenue collected under the concession agreement, either by the government entity or the concessionaire, must be reviewed to determine the substance of the arrangement and the

\(^2\) Amortization of the asset begins at substantial completion, even when there is a delay between substantial completion of the asset and the commencement of operations.
appropriate accounting treatment for the province, including amounts and timing of revenue or liability recognition.

In a tolling structure, for example, it is likely that it is government’s revenue when either of the following conditions is present:

1. The government has retained a legislative right to set and impose the tolls; or

2. The concession agreement sets out the conditions under which the concessionaire may impose and collect tolls on facility users.

When it is the government’s revenue, even when collected by the concessionaire, the government must report the gross toll revenue and record the asset, liability, and expenses as determined from the contract model.

Where there are ancillary sources of revenue in the contract model that the concessionaire has all rights to, these amounts may not be considered revenues of the government entity, in which case the associated revenues and costs are not reported by the government entity.

**Other P3 Agreement Provisions**

There can be several other provisions in a P3 contract that need to be accounted for in an appropriate manner, if and when certain events occur over the term of the agreement. Examples of these provisions are penalty deductions for non-performance, sharing of refinancing or innovation gains, holdbacks for end of term payments, and several events including events of default or early termination.

1. **Penalty Deductions**

   Where a concessionaire has not met conditions specified in the agreement according to the timing articulated in the contract, there may be penalties or deductions calculated into the payment made by government.

   In the interest of transparency and performance evaluation, penalties must be recorded in such a way that it is possible to readily determine the cumulative amount of penalties assessed against the concessionaire.

2. **Refinancing Gains**

   In certain agreements, the province may be entitled to receive a share of a refinancing gain arising from an approved refinancing by the concessionaire.

   The province may elect to receive its share of any refinancing gain at the time of refinancing or as a reduction in performance payments over the remaining
term of the agreement. Regardless of how the province collects the gain, the accounting treatment should reflect the economic substance of the transaction, whether that is a receipt of revenue or a reduction of future interest or finance expense.

3. Retention Account and End of Term Payment

Some P3 arrangements provide that the province will withhold amounts from performance payments that would otherwise be due to the concessionaire as security for the performance of its obligations, often referred to as end of term requirements. End of term requirements generally relate to the condition of the infrastructure asset at the end of the concession term.

The province may be required to establish a retention account either as a new account or as segregated funds within an existing account of the province.

If the concession agreement provides for an end of concession term payment, then the terms of the concession agreement must be reviewed to determine whether the end of term payment should be accrued over a number of years, with the recognition of an expense in each of those years, or as a single expense item in the year in which the end of term payment is paid. The appropriate accounting treatment will depend on the terms of the agreement and at what point a liability is incurred.

Note Disclosure

Note disclosure forms an integral part of an entity’s financial statements and is critical to the financial information presented in the Public Accounts. Note disclosure provides extensive information to make the financial statements more meaningful for the reader, such as: the accounting policies used by the entity; pertinent information on types and values of assets, liabilities, revenues and expenses; the bases for valuations of major components of the statements; and information on areas of measurement uncertainty, pending litigation and future commitments of the entity. It also informs readers of significant projects, acquisitions, expenditures and commitments.

Note disclosures are required by GAAP and by legislation such as BTAA, and are audited by an entity’s external auditor.

A P3 project is generally announced by government in a news release with details of the nature of the project, estimated completion date and forecast cost. There is a great deal of public interest in the actual costs and progress of the P3 projects. The following information on large P3 projects is included in the note disclosure of the Public Accounts:

1. Assets – the value of the asset (whether completed or in progress) may be included in a pool of similar tangible capital assets.
2. Liabilities – the value of the P3 liability at a given date may be included in a pool of similar liabilities.

3. Contractual obligation - the unperformed and unpaid amount of the concession agreement, less the amount recorded as a liability, must be recorded in the GRE entity’s and the province’s contractual obligation note.

4. If the province has made a guarantee to the concessionaire, this will be included in the guarantees’ note.

5. The concession agreement should be reviewed to determine if disclosure is required in any other notes.

**Reconciliation of Approved Budget to Actual and Forecast Expenditures**

It is imperative that the actual and forecast expenditures on a P3 project be reconciled with the project budget on an ongoing basis. The reconciliation serves many purposes including project monitoring, accountability, transparency, and meets reporting and disclosure requirements as well.

The reconciliation requirement reinforces the importance of budgeting for project costs in a manner consistent with the accounting for the actual expenditures of the project.
V. GUIDANCE AND GOVERNANCE (RULES AND ROLES)

Roles and Responsibilities

The roles and responsibilities of ministries, agencies, Treasury Board (TB) and central agencies are provided for in legislation and detailed in the Capital Asset Management Framework. For instance, Treasury Board approval of project business cases is required prior to proceeding with the capital project.

Some of the major roles and responsibilities of government departments in the P3 process are listed below:

**Agency or Entity entering into the P3 (i.e. Health Authority or University)**

- Engage with Partnerships BC, ASD Secretariat or other firm to assist in the preparation of business cases
- Provide regular updates to information on project to government
- Request approval letter from sponsoring ministry
- Purchase the asset and or service included in the P3 arrangement.

**Sponsoring Ministry**

- Request TB approval of the business case prior to an agency proceeding to the procurement process of the capital project
- Active involvement with agency in the procurement process
- Keeps central government apprised of progress and issues
- Develops the accounting entries for government
- Cabinet Submission
- TB Submission letter to Ministry of Finance.

**Partnerships BC**

- May act as the P3 advisor to the agency or entity engaging in P3 procurement.
- Review options analysis in each business case and make recommendations to Treasury Board
- Included in steering committee for all P3s to facilitate sound governance and application of best practices
- Prepare value for money report.

**Ministry of Finance**

Treasury Board Staff (TBS)
- Reviews the project agreement and arranges for assessment of funding requirements for the province.
• TBS needs to see an early draft of the agreement and be continually apprised of changes to the Project Agreement in order to assess potential impact on estimates.
• A copy of the final contract is required before signing to provide TBS’s final recommendations to TB.
• Treasury Board Decision letter to sponsoring ministry.

Risk Management Branch (RMB)
• Reviews and arranges for approval of indemnities in the project agreement.
• RMB needs to see an early draft of the agreement and be continually apprised of changes to the Project Agreement in order to assess potential impact on indemnities.
• A copy of the final contract is required before signing.

Provincial Treasury (PT)
• Reviews the financing agreement and arranges for assessment of the financing for the province.
• PT needs to see the following from the preferred proponent once selected: the financial model, term sheet for the bank debt, fee letter, commitment letter, Confidential Information Memorandum (CIM), and to be continually apprised of changes to these documents and the financing in order to assess potential impacts to the province.
• PT is available to support project sponsors in assessment and transacting the financing component of a P3.

Office of the Comptroller General (OCG)
• Reviews the project agreement and assists with the assessment of accounting treatment for the province.
• OCG needs to see an early draft of the agreement, draft contract model, as well as the sponsoring ministry’s accounting model, and to be continually apprised of changes to the Project Agreement in order to assess potential impact on accounting treatment.
• A copy of the final contract is required to provide OCG’s final recommendations on accounting treatment.

Accounting Guidance

1. P3 Structure

Each P3 agreement is unique and needs to be considered individually. Concession agreements entered into by the province typically include the following elements. There is a special purpose entity (SPE) that exists between the government and the construction and maintenance company/companies, and the SPE’s financiers. The SPE is owned by its equity contributors (the
government is not an equity contributor) who provide the residual equity financing for the proposed project and who assume the risks associated with the agreement. The agreement requires the government to make performance payments commencing at the end of the construction period and continuing for the duration of the contract. There are usually penalties in the contract for non-performance or shortfalls in maintenance of assets. Contracts exist between the SPE and the construction and maintenance contractor, and with the SPE’s financiers. The government is not a party to these contracts.

2. Special Purpose Entity (SPE) Control

If the concessionaire creates a special purpose entity (SPE) to deliver the P3 and significant risk is not transferred to the private sector, then the SPE may be considered to be controlled by government and needs to be consolidated into its Public Accounts. Each SPE must be evaluated to determine if it is controlled by government.

A number of factors are considered to determine whether government exerts control over an organization. Some factors include: responsibility for losses, revenue control, approval of business plans, day-to-day management and decision-making discretion of the organization. Any specially created SPE must be evaluated to determine whether it is controlled by government. If it is controlled by government, it must be fully consolidated by the sponsoring government organization and thereby, included in the government reporting entity.

Guidance on the assessment of control of an organization is found on the Ministry of Finance website at:
http://www.fin.gov.bc.ca/OCG/fras/docs/GRE_Control_Template.doc

An SPE that is considered to be a joint arrangement, or where government does not fully control the entity, may need to be accounted for according to either CICA Handbook section 3055 Joint Ventures or Public Sector Handbook section 3060 Government Partnerships, depending on whether the entity prepares its statements according to the CICA Handbook or the Public Sector handbook. A joint arrangement with the private sector is highly unlikely to ever qualify as a government partnership.

In Summary

The following GRE evaluations must be performed:

a. When the sponsoring organization prepares its accounting records according to the Public Sector Handbook:
   • Public Sector Handbook section 1300 GRE review;
   • Public Sector Handbook section 3060 government partnership review.
b. When the sponsoring organization prepares its accounting records according to the private sector handbook:
   • CICA Handbook Section 1590 subsidiaries;
   • CICA Handbook Section 3055 joint venture review; and
   • CICA Handbook Accounting Guideline 15 variable interest entity review.

c. When evaluated based on the CICA Handbook (as in b. Above) the Public Sector Handbook sections PS 1300 and PS 3060 reviews must also be performed to determine whether a policy adjustment will be required for reporting in the Summary Financial Statement consolidation process.

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3. Leased Capital Assets

P3 agreements for the provision of infrastructure assets result in the acquisition of an asset for the government. If title to the asset does not transfer to the province until the end of a contract term, then it may be that the province is acquiring the asset through a capital lease.

Leases are classified into two main types for accounting purposes: capital and operating. An agreement may contain both an operating lease component and a capital lease component.

**Capital leases**

A lease is considered capital in nature when the lessee bears substantially all the risks and rewards of ownership of the leased asset.

Guidance in the CICA Handbook states that a transfer of substantially all the risks and benefits of ownership to the lessee occurs when, at the beginning of the lease, one or more of the following conditions exist:
There is reasonable assurance that the lessee will obtain ownership by the end of the lease when the terms result in ownership transfer, or there is a bargain purchase option.

The lease term is the major portion (usually 75% or more) of the asset’s economic life.

The present value of the minimum lease payments is substantially all (usually 90% or more) of the cost, or fair value at inception.

Even if the lease does not technically meet any of the three tests, if the lease transfers substantially all of the benefits and risks of ownership to the lessee, the transaction should be accounted for as an acquisition of an asset and an incurrence of a liability by the lessee; that is, treated as a capital lease.

Under Public Sector Accounting Board (PSAB) guidance there are further factors that cause a lease to be considered a capital lease, such as:

If the leased property is used to provide an essential service (e.g., schools, prisons, roads and highways, utilities systems) and the asset is specialized such that there is no alternative asset readily available to the government, it is likely that ownership of the asset will be transferred to the government, or the government will need to renew the lease at the end of the lease term.

**Operating leases**

Leases that do not transfer substantially all the risks and rewards of ownership to the lessee are operating leases. An operating lease generally does not transfer ownership to the lessee, has a lease term of less than 75% of an assets useful life, and the present value of the minimum lease payments is not substantially all of the cost or fair value at inception

Leases of land, however, are always reported as operating leases unless there is reasonable assurance of ownership transfer to the lessee. Even if the present value of the minimum lease payments is substantially all of the cost or fair value, ownership of the land must transfer to the lessee to be considered a capital lease.

**Evaluation of Lease arrangements – Capital or Operating**

The following steps should be taken to evaluate a lease:

a. When the organization prepares its accounting records according to the Public Sector Handbook, the entity will use Public Sector Guideline 2 Leased Tangible Capital Assets to determine if the concession agreement contains a leased capital asset.

b. When the organization prepares its accounting records according to the private sector handbook the entity will use the CICA Handbook section
3065 leases to determine whether the concession agreement contains a leased capital asset.

c. There may be occasions when the section 3065 lease analysis does not indicate that a leased asset has been acquired, but Public Sector Guideline 2 would indicate that capital lease treatment is appropriate. It is necessary to review the agreement in light of PSG 2 to determine whether an adjusting entry is required when the organization is consolidated into the Summary Financial Statements and the Public Accounts are prepared.

Service Agreements that may, in substance, contain a lease

Certain arrangements between government and the private sector may be in the form of a service agreement; however, for the private sector to deliver the service they must acquire or build a specialized asset. Where that asset is not readily adapted to other uses, or the government contract will consume a significant portion of the asset’s service potential, it may be determined that there is an underlying lease of the asset to government.

Following, is an example of an arrangement where the substance may differ from the form of the agreement. Rather than the contract representing merely the procurement of services, the government may bear the risk and rewards of ownership of the asset used to provide the services.

- A service contract for data management, where the private sector party develops a system including programming and databases that is specific to government’s needs.

The system in the example above would require significant modification to adapt its use to another customer and the duration of the contract with government is expected to have expended its service potential.

The following steps should be taken to determine if an arrangement contains a lease:

a) Agreements must be reviewed in light of the guidance in the CICA Handbook called EIC 150, Determining when an Arrangement Contains a Lease.

b) If a service agreement is determined to contain a lease according to EIC 150, then CICA section 3065 or PSG 2 must be consulted to determine whether the lease is capital or operating in nature.

c) If an implicit lease is determined to be capital in nature, then the substance of the service concession for the province is the acquisition of an asset.
VI. GLOSSARY OF ACRONYMS

ASD – Alternative Service Delivery
BBMAA – Balanced Budget and Ministerial Accountability Act
BTAA – Budget Transparency and Accountability Act
CAMF – Capital Asset Management Framework
CICA – Canadian Institute of Chartered Accountants
CIM – Confidential Information Memorandum
CPPM – Core Policy and Procedures Manual
EIC – Emerging Issues Committee – guidance under CICA
FAA – Financial Administration Act
FIA – Financial Information Act
GRE – Government Reporting Entity
IDC – Interest during construction
IRR – Internal rate of return
OCG – Office of the Comptroller General
PBC – Partnerships British Columbia
PSAB – Public Sector Accounting Board
PSC – Public Sector Comparator
PSG2 – Public Sector Guideline number 2 – guidance under PSAB
PT- Provincial Treasury
P3 – Public Private Partnership
REOIs – Requests for Expressions of Interest
RFPs – Requests for Proposal
RFQs – Requests for Qualifications
RMB – Risk Management Branch
SPE – Special Purpose Entity
TB – Treasury Board
TBS – Treasury Board Staff
Appendix - Relevant Legislation

Capital asset management in British Columbia is governed by a range of statutes, including the:

**Financial Administration Act (FAA)**
The *FAA* establishes the government’s responsibility and accountability for managing public money across all program and service areas. It is the principal authority for capital financial management and administration. The *FAA* authorizes Treasury Board and the Minister of Finance to provide central direction on capital management to government and government bodies, including Crown corporations and the broader public sector.

It is the FAA that legislates that ministers are responsible for proper financial administration of their respective ministries under the guidance of Treasury Board and the Minister of Finance.

**Financial Information Act (FIA)**
The *FIA* sets out authorities for the Minister of Finance or the minister responsible to obtain financial information – including capital-expenditure related information as set out in the *FAA* – from a corporation. The *FIA* also empowers the government to audit Crown corporations.

**Balanced Budget and Ministerial Accountability Act (BBMAA)**
The *BBMAA* prohibits annual budget deficits as of fiscal 2004-05. It also establishes a salary holdback for ministers and the Premier, paid out on the achievement of annual expenditure and performance targets.

**Budget Transparency and Accountability Act (BTAA)**
The *BTAA* requires public agencies to produce annual service plans as part of a provincial accountability framework. It also requires agencies to publish financial and other information on major capital projects with provincial contributions over $50 million.

**Other Legislation**
Crown corporations and local agencies are also subject to a variety of agency-specific legislation that affects capital management.