COMPTROLLER

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SEP 16 2019

MEMORANDUM FOR ASSISTANT SECRETARIES OF THE MILITARY DEPARTMENTS (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Accounting and Reporting of Equity Investments in Military Privatized Housing Projects and Additional Disclosure Requirements for Direct Loans and Loan Guarantees for Military Privatized Housing Projects (FPM 19-04)

This memorandum prescribes the accounting method and entries to be used to account for and report investments and participation of the Military Departments in public-private partnerships, including Limited Liability Companies (LLCs) that manage and maintain privatized military housing. The Department of Defense (DoD) Military Housing Privatization Initiative (MHPI) equity investments in LLCs are considered public-private partnerships. The Standard Federal Financial Accounting Standard 49, "Public-Private Partnerships: Disclosure Requirements," defines public-private partnerships as "risk-sharing arrangements or transactions lasting more than five years between public and private sectors entities."

The attachments to this memorandum detail the new key policy elements. Attachment 1 defines the use of the equity method of accounting to record MHPI equity investments. Attachment 2 describes the documentation needed to properly record and support equity investment financial activities. Attachment 3 outlines the financial statement consolidation and disclosure requirements for financial statement reporting.

This policy change will be incorporated into the next update to the DoD Financial Management Regulation, Volume 4, Chapter 7; Volume 6B, Chapter 10; and Volume 12, Chapter 4. My point of contact is Ms. Kellie Allison. She can be reached at 703-614-0410 or kellie.r.allison.civ@mail.mil.

Mark E. Easton
Deputy Chief Financial Officer

Attachments:
As stated

cc:
Office of the Assistant Secretary of Defense for Energy, Installations, and Environment
General Counsel of the Department of the Department of Defense
Department of Defense Office of Inspector General

## Use of Equity Method of Accounting to Record MHPI Equity Investments

The Military Departments investments in limited partnerships and LLCs engaged in privatized military housing projects will be accounted for under the equity method of accounting. The Federal Accounting Standard Advisory Board (FASAB) currently has not issued specific accounting standards for this type of financial arrangement. Until FASAB issues specific guidance, DoD will apply a private sector accounting standard to account for DoD's investment/share of the public-private partnerships: Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 323 Investments – Equity Method and Joint Ventures. Furthermore, the DoD will treat such an investment/share as a consumption of budgetary resources, recording an obligation and an outlay in an amount equal to the equity investment. According to ASC 323, investments in limited partnerships generally should be accounted for under the equity method of accounting unless the investment is so minor that the limited partner may have virtually no influence over the partnership's operating or financial policies. In practice, investments of more than 3 to 5 percent are viewed as more than minor. The Military Departments and DFAS will use newly established accounting transaction codes in the DoD Transaction Library to record (1) the initial investments to include transfer of property to the LLC in exchange for an ownership stake in the LLC, (2) allocated portions of the LLC's profits and losses, (3) dissolution of the LLC (4) sale of government share of the LLC and (5) any other accounting transactions related to financial activities to DoD equity investments of this nature. Attachment 2 provides the primary accounting entries to be used to record equity investment transactions. These entries also record collections realized from the dissolution of the government's investment in an LLC that are not available for use without further Congressional action. Such balances require appropriation by Congress to become available for obligation.

### Documentation Needed to Properly Record and Support Equity Investment Financial Activities

All business events related to the financing of privatized military housing must be reported in the DoD financial statements, including relevant disclosures to help the user understand the financial condition of the projects. It is the Military Department's responsibility to monitor and properly report the financial condition and disclose significant risks of each of its equity investments in privatized military housing. Attachment 3 establishes policy effective immediately requiring the Military Departments provide DFAS with documentation necessary to record and support all business events that have a financial impact on the privatized military housing projects. Documentation should be furnished to DFAS on a real-time basis (within 3 business days of transactions occurrence). Chapter 7 of Volume 4 of the DoD Financial Management Regulation (FMR) is being updated to incorporate requirements set forth in Attachment 3. See also, DFAS' annual financial schedule and quarterly financial guidance for additional information including cut-off periods. Note that financial statement reporting should be based on the latest financial information for each LLC which may not be in line with the reporting periods for DoD's financial statement reporting. When an investor applies the equity method of accounting, the investor should record its share of the investee's earning or losses based on the most recently available financial statements from the investee, which may be on a lag.

## Financial Statement Consolidation for Privatized Housing Projects

When the federal government (directly or through its components) holds a majority ownership interest in an organization, it should be included as either a consolidation entity or a disclosure entity in the government-wide financial statements. Majority ownership interest exists with over 50 percent of the voting rights or net residual assets of an organization. If an entity is expected to assume more than 50% of another entity's expected losses or gains, it should consolidate that entity. An entity could effectively control another entity by making all of the investment decisions and obtaining a considerable portion of the economic benefits, but would not have been required to consolidate that investee if it was exposed to less than 50% of the investee's expected losses or gains.

Per SFFAS 47, an organization is considered a consolidation entity if, based on an assessment of the following characteristics as a whole, the entity is: (1) financed by taxes or other non-exchange revenue, (2) governed by the Congress and/ or the President, (3) imposing or may impose risks and rewards to the federal government and (4) providing goods and services on a market or non-market basis. Note, however, not all characteristics are required to be met or to be met to the same degree; classification is based on the assessment as a whole.

## Required Financial Statements Note Disclosures for Privatized Housing Projects

Disclosure requirements comprise quantitative and qualitative information to assist users in understanding the nature of public-private partnerships and direct loans and loan guarantees, to include related risks even those deemed remote. The Office of Management and Budget (OMB) Circular A-11, Section 185, *Federal Credit* and OMB Circular A-136, *Financial Reporting Requirements*, Section II.3.8.8 (Note 8 - Loans & Loan Guarantees, Non-Federal Borrowers), specify disclosure requirements for government direct loans and loan guarantees. OMB Circular A-136, Section II.3.8.41 (Note 41, Public-Private Partnerships (P3s)) governs disclosure requirements for public- private partnerships.  DoD's equity investments in LLCs for privatized military housing projects meets the Circular's P3 disclosure requirements.  See Attachment 3 for detailed note disclosure requirements for Military Privatized Housing Projects.

The DoD has incorporated OMB note disclosure requirements into the DoD Financial Management Regulation (FMR) Volume 6B, Chapter 10, Section 1011, Note 8 Direct Loan and Loan Guarantees.  Loan and loan guarantee disclosure-related requirements currently interspersed throughout Chapter 10 will be consolidated into a paragraph in an upcoming update to make them easier to identify.  The Attachment 3 is the pending change to Sections 101101 and 103101, and is effective immediately.

**SCENARIO 1 - YEAR 1 Initial Formation of LLC P3 Investment (Cash Only)**

DoD's initial investment in formation of LLC of cash only

Budgetary

Dr. 461000 - Allotments - Realized Resources

Cr. 480100 - Undelivered Orders - Obligations, Unpaid

Dr. 480100 - Undelivered Orders - Obligations, Unpaid

Cr. 490200 - Delivered Orders - Obligations, Paid

Proprietary

Dr. 169000 - Public-Private Partnership Investments

Cr. 101000 - FBwT

Dr. 310700 - Unexpended Appropriations - Used

Cr. 570000 - Expended Appropriations

(DoD invests cash in LLC)

**SCENARIO 2 - YEAR 1 Initial Formation of LLC P3 Investment (Cash and Property)**

DoD's initial investment in formation of the LLC of cash and conveys property to LLC - *In accordance with GAAP, a fair market value (FMV) for the property should be assigned at the inception of the LLC agreement, and for the purposes of P3 investment reporting, the FMV should be recorded as a gain or loss on disposition of the asset. If information on the fair market value of the property at point of contribution by the government to the LLC is not available, then value will need to be estimated.

Budgetary

Dr. 461000 - Allotments - Realized Resources

Cr. 480100 - Undelivered Orders - Obligations, Unpaid

Dr. 480100 - Undelivered Orders - Obligations, Unpaid

Cr. 490200 - Delivered Orders - Obligations, Paid

Proprietary

Dr. 169000 - Public-Private Partnership Investments

Cr. 101000 - FBwT

Dr. 310700 - Unexpended Appropriations - Used

Cr. 570000 - Expended Appropriations

(DoD invests cash as part of equity investment in LLC)

**AND**

Budgetary
No Budgetary Impact

Proprietary
Dr. 171900 - Accumulated Depreciation on Improvements to Land
Dr. 173900 - Accumulated Depreciation on Buildings, Improvements and Renovations
Dr. 169000 - Public Private Partnership Investments
Dr. *721000 Losses on Disposition of Assets - Other
Cr. 171100 - Land and Land Rights
Cr. 171200 - Improvements to Land
Cr. 173000 - Buildings, Improvements and Renovations
Cr. *711000 – Gains on Disposition of Assets - Other

(DoD also conveys Buildings and leases Land to LLC)

**SCENARIO 3 - YEAR 2 - Recognition of Periodic/Annual Decrease/Loss on P3 Investment Valuation**
DoD recognizes the amount of equity method earnings - based on the change in the investor claim on the investee's book value each reporting period

**Equity Method Loss**

Budgetary
No Budgetary Impact

Proprietary
Dr. 729000 - Other Losses
Cr. 169000 - Public-Private Partnership Investments

(To recognize equity method loss based on the change in the investor's claim on the investee's book value each reporting period.)

**SCENARIO 4 - YEAR 3 - Recognition of Periodic/Annual Increase/Gain on P3 Investment Valuation**
DoD recognizes the amount of equity method earnings - based on the change in the investor claim on the investee's book value each reporting period

**Equity Method Income**

Budgetary
No Budgetary Impact

Proprietary
Dr. 169000 - Public-Private Partnership Investments

Cr. 719000 - Other Gains
(To recognize equity method gain based on the change in the investor's claim on the investee's book value each reporting period.)

(carrying value of 1690 at end of YEAR 3 is 2,015,000)

**SCENARIO 5 - YEAR 4 - Net Loss on Dissolution of P3 Investment**

DoD dissolves all of its interest in the LLC - recognize $15,000 loss in valuation attributable to final year of P3 investment at time of dissolution. *Note – Any property interest acquired or reacquired in the dissolution of the LLC must be recorded at their FMV, not the LLC book value.

**Cash plus property transaction**

Budgetary

Dr. 426600 - Other Actual Business-Type Collections From Non-Federal Sources

Cr. 445000 - Unapportioned Authority

Proprietary

Dr. 101000 - FBwT

Dr. 171100 - Land and Land Rights

Dr. 171200 - Improvements to Land

Dr. 173000 - Buildings, Improvements and Renovations

Dr. *721100- Losses on Disposition of Investments

Cr. 169000 - Public-Private Partnership Investments

(To recognize a net loss upon dissolution of DoD's interest in LLC)

**SCENARIO 6 - YEAR 4 - Net Gain on Dissolution of P3 Investment**

DoD dissolves all of its interest in the LLC - recognize $61,000 gain in valuation attributable to final year of P3 investment at time of dissolution. *Note – Any property interest acquired or reacquired in the dissolution of the LLC must be recorded at their FMV, not the LLC book value.

**Cash plus property Transaction**

Budgetary

Dr. 426600 - Other Actual Business-Type Collections From Non-Federal Sources

Cr. 445000 - Unapportioned Authority

Proprietary

Dr. 101000 - FBwT

Dr. 171100 - Land and Land Rights

Dr. 171200 - Improvements to Land

Dr. 173000 - Buildings, Improvements and Renovations

Cr. *711100 - Gains on Disposition of Investments

Cr. 169000 - Public-Private Partnership Investments

(To recognize a gain upon dissolution of DoD's interest in LLC)

**New Paragraphs to Follow Existing Paragraph at Department of Defense Financial Management Regulation, Volume 4, Chapter 7, Last Update July 2015**

It is a Military Department's responsibility to monitor and report the financial condition of each of its equity investments in privatized military housing. A Fair Market Value (FMV) should be assigned for the property conveyed at the inception of the Public-Private Partnerships, and depreciation should be recognized for each accounting period thereafter. If information on the fair market value of the property at the point of contribution by the government to the LLC is not available, then the value will need to be estimated. The Military Department shall obtain the agreements and supporting documentation for its equity investments in LLCs managing privatized military housing to support the following business events:

1. Initial investment (equity interest) in the formation of the Public-Private Partnership including DoD assets and infrastructure conveyed to the limited partnership,

    - **LLC Operating Agreement --** governing document that contains the agreements set forth by the parties including the contributed cash and/or property balances and percent government ownership in the LLC.

    - **Lockbox Agreement --** addresses the flow of funds and order of priority for the project. The agreement is unique to each MHPI project.

    - **Revenue Agreement --** containing the priority for the flow of funds from the Revenue Account, and supporting documentation for understanding the flow of funds from the Revenue Account to the Construction Escrow Account prior to the completion of the Initial Development Period (IDP) and the percentage distribution to the Reinvestment Account and Owner after completion of the IDP.

    The agreements needed are those that provide the relevant information on the government's cash and asset contributions to the LLC, the government's ownership percentage of the LLC, the allocation of LLC cash flows to the various expense categories to be funded from the cash flows including the percentage split between the owner and a reinvestment account after payment of expenses. The Military Departments will work closely with DFAS and decide whether to provide the entire agreements or only the parts to determine financial transactions. The Military Departments will also provide to DFAS information on disbursements made for loans and loan guarantees.

2. Recognition of equity method income or loss during each reporting period for the life of the limited partnership agreement,

    - **Annual audited financial statements --** issued by the LLC's Independent Public Accountant firm provides the equity income / loss for each reporting period.

    - **Other agreements --** as needed to understand and support the accounting transactions for the LLC's management of the privatized military housing.

The purpose of providing these agreements is to allow DFAS to determine the LLC's gain or loss for the period in order to account for the government's investment in the LLC under the Equity Method of accounting. Audited financial statements of the LLCare to include the standard financial statements including the balance sheet, statement of operations (income statement), cash flows, and members' equity.

3. Dissolution of the investment at a gain or loss, property conveys back to DoD.

   The purpose of providing the dissolution agreement and supporting information is to allow DFAS to account for the government's gain or loss upon termination of the LLC agreement. The conveyed property should be valued at its Fair Market Value (FMV) at that point of dissolution.

The Military Departments shall provide DFAS any other transaction with a financial impact that is not listed above and footnote disclosures required, such as the equity method income or loss and description of events of termination or default, and the associated documentation supporting the Military Department's determination for the disclosure.

To record transactions currently missing from the financial statements the Military Departments must furnish to DFAS the needed documentation by March 25 to record transactions in 2$^{nd}$ Quarter Financial Statements. Volume 4, Chapter 7, of the "Department of Defense Financial Management Regulation" (DoD FMR) will be modified to incorporate changes to submit supporting documents for equity investments in LLCs owning privatized military housing.

**Revisions to the Department of Defense Financial Management Regulation: Financial Statement Consolidation and Disclosure Requirements for Financial Statement Reporting**

**Equity Investments Disclosures**

**Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, Section 103101, last update November 2018**

Disclosures should be provided for the initial period and all annual periods thereafter where an entity is party to a Public-Private Partnership (P3) arrangement/transaction. The following information should be disclosed as specified in SFFAS 49, paragraph 24:

1. The purpose, objective, and rationale for the P3 arrangement or transaction and the relative benefits/revenues being received in exchange for the government's consideration, monetary and non-monetary; and the entity's statutory authority for entering into the P3.

2. A description of federal and non-federal funding of the P3 over its expected life, including the mix and, where available, the amounts of such funding. For any amounts that are not available, the disclosures should indicate such.

3. The operational and financial structure of the P3 including the reporting entity's rights and responsibilities, including:

    a. A description of the contractual terms governing payments to and from the government over the expected life of the P3 arrangement or transaction to include:
        - Explanation of how the expected life was determined
        - The time periods payments are expected to occur
        - Whether payments are made directly to each partner or indirectly through a third-party, such as, military housing allowances
        - In-kind contributions/services and donations.

    b. The amounts received and paid through the government during the reporting period(s) and the amounts estimated to be received and paid in aggregate over the expected life of the P3.

4. Identification of the contractual risks of loss the P3 partners are undertaking

    a. Identification of such contractual risks of loss should include a description of (1) the contractual risk and (2) the potential effect on cash flows if the risks were realized (for example, early termination requirements including related exit amounts and other responsibilities such as asset condition (hand-back) requirements, minimum payment guarantees, escalation clauses, contingent payments, or renewal options.

b. Disclosure of remote risks of loss should be limited to those included in the terms of the contractual P3 arrangements or transactions. If remote risk of loss are disclosed, an explanation should be included that avoids the misleading inference that there is more than a remote chance of loss.

5. Other Disclosures as Applicable:

   a. Associated amounts recognized in the financial statements such as gains or losses and capitalized items

   b. Significant instances of non-compliances with legal and contractual provisions governing the P3 arrangement or transaction

   c. Whether the private partner(s), including any Special Purpose Vehicle (SPV), have borrowed or invested capital contingent upon the reporting entity's promise to pay whether implied or explicit

   d. Disclose events and changes in economic conditions, other risk factors, legislation, credit policies, and assumptions that have had a significant and measurable effect on the project's revenue stream or financial condition. The discussion should include events and changes that have occurred and are more likely than not to have a significant impact even if the effects are not measurable at the reporting date. Changes in legislation include changes possibly affecting the project's revenue stream.

## Direct Loans and Loan Guarantees Disclosures

**Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, Section 101101, last update November 2018**

Disclosures. Required financial disclosures for direct loans and loan guarantees must be supplemented by narrative that includes a description of the characteristics of the loan programs; events having a significant and measurable effect on subsidy rates, subsidy expense and subsidy reestimates; the nature of modifications; and the number of and restrictions on foreclosed property, per OMB Circular A-136, *Financial Reporting Requirements*, Section II.3.8.8.

1. ***OMB Circular A-136***, "*Financial Reporting Requirements*," Note 8 requires providing other information related to direct loan and loan guarantee programs, as appropriate, including a description of the characteristics of the loan programs, any commitments to guarantee, management's method for accruing interest revenue and recording interest receivable, and management's policy for accruing interest on non-performing loans.

   Disclose events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy reestimates. The disclosure should include events and changes that have occurred and are more likely than not to have a significant impact even if the effects are not measurable at the reporting date. Changes in legislation or credit policies include changes in borrowers' eligibility, the levels of fees or interest rates charged to borrowers, the maturity terms of loans, and the percentage of a private loan that is guaranteed.

If modifications were made, the disclosure should include the nature of the modifications, the discount rate used in calculating the expense, and the basis for recognizing a gain or loss related to the modification. Also, if appropriate, disclose the subsidy expense resulting from reestimates that is included in the financial statement, but not reported in the budget until the following year.

With respect to the foreclosed property reported, the following information should be disclosed:

- Changes from prior year's accounting methods, if any
- Restrictions on the use/disposal of the property,
- Number of properties held and average holding period by type or category, and
- Number of properties for which foreclosure proceedings were in process at the end of the period.