

## Review of IPSASB Decisions (June 2011) re Service Concession Arrangements: Grantors

**Objective:** To review IPSASB decisions on grantor accounting to consider whether the concerns raised by the AASB in response to IPSASB ED 43 (AASB ED 194) have been appropriately addressed and whether there are outstanding issues of concern.

Issues Raised in AASB Submission	IPSASB ED 43 Proposals	Recent IPSASB Decision
<p><b>Definitions &amp; terminology</b></p> <p><b>Description of service concession arrangement</b></p> <p>The Board was not concerned by the lack of a definition, as the description of typical arrangements was suitable.</p> <p>Interpretation 12 contains a description rather than a formal definition.</p>	<p>A service concession arrangement typically involves an operator constructing or developing the asset used to provide the public service or upgrading an existing asset (e.g., by increasing its capacity) and operating and maintaining the asset for a specified period of time. The operator is compensated for its services over the period of the arrangement. (paragraph 2)</p> <p>To be within the scope of the Standard, an arrangement must be binding on the parties to the arrangement and oblige the operator to provide the public services related to the service concession asset to the public on behalf of the grantor. (paragraph 7)</p>	<p>Definitions will be included, on the grounds that the IPSASB is preparing a Standard rather than an Interpretation like IFRIC 12. (IPSASB does not issue Interpretations.)</p> <p><b>service concession arrangement:</b> a binding arrangement between a grantor and an operator in which the grantor (a) controls or regulates the services provided by the operator using a service concession asset, and (b) controls any significant residual interest in the asset at the end of the term of the arrangement. [to be modified to refer also to an operator constructing, developing or upgrading the asset]</p> <p><b>service concession asset:</b> an asset used to provide public services in a service concession arrangement that meets the conditions for recognition set out in paragraph 10 (or paragraph 11 for a whole-of-life asset), or for reclassification as set out in para 13.</p> <p><u>Staff view</u> – issue arises – the two definitions are circular, as each uses the other term in its own definition. Suggest that part (a) of the definition of service concession arrangement refer simply to an asset and not a service concession asset.</p>
<p><b>Scope of regulation</b></p> <p>It is uncertain whether the reference to ‘regulate’ is intended to cover regulators</p>	<p>The grantor control criteria refer to the grantor’s control or regulation of the services to be provided by the operator, the recipients and the pricing. (paragraph 10)</p>	<p>The guidance on regulators is not intended to refer to the broad understanding of public sector regulatory powers from the grantor’s point of view.</p> <p>The IPSASB proposes to amend para AG8 to state:</p>

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<p>that have been established by a government as independent regulators (i.e. independent of direct government administration).</p> <p>The AASB considers that governments are likely to conclude that independent regulators should not be factored into assessing the control or regulation specified in the grantor control criteria.</p> <p>NB Interpretation 12, para AG2, states: “If the grantor is a public sector entity, the public sector as a whole, together with any regulators acting in the public interest, shall be regarded as related to the grantor for the purposes of this Interpretation.”</p>	<p>The control or regulation referred to in paragraph 10(a) could be by a binding arrangement, including a contract or otherwise (such as through a third party regulator that regulates other entities that operate in the same industry or sector as the grantor) ... (paragraph AG6)</p>	<p>Many governments have powers to regulate entities operating in certain sectors of the economy either directly or through specifically created agencies. For the purpose of paragraph 10(a), the broad regulatory powers of governments, as described above do not constitute control. In this Standard, the term “regulate” is intended to be applied only in the context of the specific terms of the service concession arrangement.</p> <p>The revised wording is intended to ensure symmetry between the grantor and operator in assessing regulation – based on the specific arrangement.</p> <p><u>Staff view</u> – issue remains – under Interpretation 12, the operator does not consider only the specific arrangement. It is unclear in the IPSASB’s revised wording whether regulation by other government agencies needs to be explicitly referred to in the arrangement or else is implicitly incorporated.</p> <p>Operators and grantors potentially could apply differing views of regulation and reach differing conclusions on control of service concession assets, leading to asymmetric accounting.</p>
<b>Scope of the Standard</b>		
<p><b>BOOT arrangements</b></p> <p>The AASB noted that some concerns have been expressed in Australia as to whether BOOT (build-own-operate-transfer) arrangements would be covered by the proposed Standard. In its view, the reference to ownership is not a substantive matter, and BOOT arrangements could be identified as a type of BOT (build-operate-</p>	<p>Implementation guidance included a table of typical types of service concession arrangements, essentially the same as the table in Information Note 2 attached to Interp’n 12. The table refers to “build-operate-transfer” and “build-own-operate” types. The introductory text states that the list of types is not exhaustive and the table is intended to highlight the continuum of arrangements.</p>	<p>No specific reference to BOOT arrangements is required. The IPSASB staff suggested that there may be variations in BOOT arrangements such that a specific arrangement may or may not fall into the scope of a Standard, depending on its particular terms.</p> <p><u>Staff view</u> – issue remains, but not major – it has not been considered necessary to amend Interpretation 12 and its table to refer specifically to BOOT arrangements, so it seems unnecessary to do so for the</p>

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transfer) arrangement, which is covered.		IPSASB's Standard.
<p><b>Residual interest in service concession assets</b></p> <p>The AASB endorsed the grantor control criterion specified in paragraph 10(b) of the ED referring to grantor control of 'any significant residual interest' in the asset at the end of the term of the service concession arrangement. This was a change from the preceding Consultation Paper, which referred instead to 'the residual interest'.</p> <p>The approach in the ED is consistent with IFRIC 12. It means that 'whole-of-life' arrangements are covered, as these have no residual interest.</p>	<p>The grantor shall recognise a service concession asset ... if:</p> <p>(a) The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and</p> <p>(b) The grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the asset at the end of the term of the arrangement. (paragraph 10)</p>	<p>The grantor control criteria in paragraph 10 were confirmed. No change to the approach to whole-of-life arrangements.</p> <p><u>Staff view</u> – issue resolved – this was a major issue for the IPSASB at the Consultation Paper stage, and considerable argument was required to change the IPSASB's views.</p>
<b>Recognition of assets and liabilities</b>		
<p><b>Assets constructed by the operator</b></p> <p>The AASB believes that the grantor should recognise a service concession asset being constructed by the operator as construction takes place, irrespective of whether the construction risk is apparently borne by the grantor or by the operator. It would normally be unreasonable for the grantor to hold out that it has no obligation to the operator for its construction services until the grantor has accepted the constructed asset as suitable for its intended purpose or even until the asset is placed into use.</p>	<p>Where the operator bears the construction risk, the timing of initial recognition of the service concession asset by the grantor will normally be when the asset is placed into use. Where the grantor bears the construction risk, the recognition criteria may be met during the construction period, and, if so, the grantor will normally recognize the service concession asset (and related liability) during that period. (paragraph AG20)</p>	<p>The IPSASB decided that a grantor should recognise a work-in-progress service concession asset as it is being constructed by the operator when the grantor has little ability to avoid accepting the asset constructed so as to meet the specifications of the SCA. The application guidance will discuss the recognition criteria of probable future economic benefits and reliable measurement without reference to construction risk.</p> <p><u>Staff view</u> – issue resolved.</p>
<p><b>Performance obligations</b></p> <p>It appears that the amount of the</p>	<p>When the grantor recognizes a service concession asset in accordance with paragraph 10 (or paragraph 11 for a whole-of-life asset),</p>	<p>Where the grantor does not have a financial liability for compensation to the operator for the service concession asset that the grantor now controls, the</p>

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<p>performance obligation (to be recognised as a liability by the grantor) is the difference between the fair value of the service concession asset and any payment obligations of the grantor because the financial liability and the performance obligations must initially equate to the fair value of the asset. This means that a performance obligation is recognised by the grantor only to the extent that its payment obligation falls short of the fair value of the service concession asset.</p> <p>It is also not clear from the ED whether the grantor has a performance obligation in respect of its existing assets that are reclassified as service concession assets.</p>	<p>the grantor shall also recognize a liability. The liability recognized may be any combination of a financial liability and a performance obligation. (paragraph 19)</p> <p>The liability recognized in accordance with paragraph 19 shall be initially measured at the same amount as the service concession asset ... (paragraph 20)</p> <p>When the grantor compensates the operator by granting the operator the right to collect fees from users of the service concession asset or by granting the operator access to another revenue-generating asset for its use, the liability recognized in accordance with paragraph 19 is a performance obligation. (paragraph 22)</p>	<p>grantor is required to recognise revenue in accordance with the substance of the arrangement. The portion of such revenue that does not meet the revenue recognition criteria will be required to be recognised as a liability. [An AG paragraph will state that revenue is recognised over the term of the arrangement in a pattern that reflects the economic substance of the arrangement.]</p> <p>In other words, the reference to performance obligations has been removed.</p> <p>The IPSASB considered whether the credit should be recognised directly in equity instead, but rejected that approach.</p> <p><u>Staff view</u> – the specific issue resolved – but the issue now moves on to the grantor’s pattern of revenue recognition.</p>
<p><b>Recognition of revenue under grant of rights model</b></p> <p>[The ‘grants of rights to the operator model’ refers to the grantor compensating the operator by the grant of a right to charge users of the public service related to the service concession asset]</p> <p>The AASB questioned whether the performance obligation approach was proposed essentially as a means of deferring revenue recognition by the grantor. If so, the AASB suggested that the IPSASB should address revenue recognition directly instead of via partial application of the notion of performance obligations.</p>	<p>The grantor shall account for revenue from a service concession arrangement in accordance with IPSAS 9 <i>Revenue from Exchange Transactions</i>. (paragraph 24)</p> <p>... there may be more appropriate alternative methods for recognizing revenue ... that better reflect the operator’s consumption of their access to the service concession asset and/or the time value of money. For example, an annuity method that applies a compounding interest factor that more evenly recognizes revenue on a discounted basis ... may be more appropriate ... (paragraph AG46)</p>	<p>Paragraph 24 is to be amended to read “The grantor shall account for revenues from a service concession arrangement as they are earned in accordance with the substance of the arrangement.”, with an AG paragraph stating that revenue is recognised over the term of the arrangement in a pattern that reflects the economic substance of the arrangement. The principal text from paragraph AG46 remains.</p> <p>IPSAS 9 is no longer being referred to because of doubts that the proposed revenue recognition approach is a direct application of IPSAS 9. Instead, the Basis for Conclusions will note that the IPSASB regards an SCA as an exchange of dissimilar assets, which, by analogy with IPSAS 9, results in revenue. This is likely to be considered further by the IPSASB.</p> <p><u>Staff view</u> – issue remains – the difficulty with the</p>

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		<p>grantor’s accounting is due to the rights granted by the grantor to the operator not having been recognised as an asset by the grantor prior to accounting for the SCA. Conceptually, the grantor would recognise revenue if it were to recognise the ability to issue licences to charge users for using public services. However, the practical difficulty is that upfront revenue recognition is not generally accepted, and in responding to this view the IPSASB has gone as far as it can.</p>
<b>Transitional provisions</b>		
<p><b>Initial application of a Standard</b></p> <p>The AASB recommended retrospective application of the Standard when first applied by any entity, not just those that have previously recognised service concession arrangements. Such an approach would be consistent with the transitional requirements in IFRIC Interpretation 12. Allowing prospective application by some entities would permit the continued non-recognition of potentially significant service concession assets for many years into the future</p>	<p>An entity that has previously recognized service concession assets and related liabilities, revenues, and expenses shall apply this Standard retrospectively in accordance with IPSAS 3 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>. (paragraph 29)</p> <p>An entity that has not previously recognized service concession assets and related liabilities, revenues, and expenses and uses the accrual basis of accounting shall apply this Standard prospectively. However, retrospective application is permitted. (paragraph 30)</p>	<p>The IPSASB decided to require retrospective application by all entities applying the IPSAS, but to permit entities to elect to recognise a deemed cost for service concession assets as at the beginning of the earliest comparative period presented to ease any transitional difficulties.</p> <p>The deemed-cost exception is likely to feature in any general “first-time adoption of IPSASs” Standard.</p> <p><u>Staff view</u> – issue resolved.</p>
<b>Structure of the Standard</b>		
<p><b>Cross-referencing to application guidance</b></p> <p>The AASB considered that the structure of the proposed Standard could be improved. At present, there is considerable detail and</p>	<p>ED 43 included copious paragraph-to-paragraph cross-references.</p>	<p>No significant changes in the structure are to be made, however the cross-referencing between the body of the Standard and the application guidance is to be limited principally to sectional cross-references related to headings. This is intended to be similar to the</p>

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<p>cross-referencing in the Application Guidance, which is an integral part of the Standard. The complicated cross-referencing interferes with reading and understanding the requirements, and consolidation of the text into the main part of the Standard could improve the flow.</p>		<p>approach in IPSAS 29 <i>Financial Instruments: Recognition and Measurement</i>. This is the same approach as in IAS 39 and AASB 139.</p> <p><u>Staff view</u> – issue remains, but minor – it remains to be seen how well this can be done, since a complete draft of the proposed Standard has not yet been provided.</p>