



Australian Government

Australian Accounting
Standards Board

AASB 13-14 July 2011
Agenda paper 18.3

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14 July 2010

Ms Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
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CANADA

Dear Stephenie,

IPSASB Exposure Draft 43 Service Concession Arrangements: Grantor

The Australian Accounting Standards Board appreciates the opportunity to comment on the International Public Sector Accounting Standards Board's proposals concerning the accounting treatment by the grantor for service concession arrangements. The AASB acknowledges the significance of the work undertaken by the IPSASB on this topic, which has been an important issue in Australia for many years.

Australian grantors and operators have embraced service concession arrangements as a way of developing infrastructure and delivering infrastructure-related services. Participants are exposed to major risks and benefits for long periods of time associated with billions of dollars of investments in toll roads, airports, ports, railways and water treatment facilities (for example). Therefore, there is considerable interest in Australia in the accounting by grantors for service concession arrangements.

Accordingly, the AASB issued an Exposure Draft (ED 194) in April 2010 to publicise the IPSASB's proposals and to seek the views of Australian constituents. The comments received from constituents have been taken into account by the AASB in preparing this submission. The comment letters received are published on the AASB's website (www.aasb.gov.au).

In general, the AASB supports the proposals in ED 43 and encourages the IPSASB to continue its work on this important project. Our main concerns or comments regarding the proposals are noted below.

Service Concession Arrangements

The AASB notes that there is no explicit definition of 'service concession arrangement' in the proposed Standard. However, the AASB considers that the description of typical service concession arrangements in paragraph 2, combined with the requirements in paragraph 7, will

be sufficient to ensure that the appropriate arrangements are captured. For example, the references in paragraph 7 to the operator being obliged to provide the public services and to arrangements not involving the delivery of public services being outside the scope of the Standard will appropriately mean that arrangements that result only indirectly in the provision of public services would not be covered by the Standard.

Scope of the Proposed Standard

The scope of the Standard proposed in the Exposure Draft reflects the requirements of IFRIC Interpretation 12 *Service Concession Arrangements*. Therefore, the scope of the proposals are effectively limited to service concession arrangements where the underlying service concession assets are controlled by the grantor during and after the concession period (or just during the concession period, in respect of 'whole-of-life' service concession assets) in accordance with the grantor control criteria set out in paragraph 10. The AASB believes that there should be consistency across the accounting by operators and by grantors, and is keen to see the project progress on a timely basis, and therefore agrees with the limited scope of the proposals.

However, the degree of consistency achieved in practice may depend upon the assessment of regulatory arrangements by grantors in applying the grantor control criteria.

Scope of Regulation

Paragraph AG6 indicates that the regulation contemplated by those criteria could be through a third-party regulator. Paragraph AG8 states that the term 'regulate' is not intended to convey the broad sense of the power of government to regulate the behaviour of entities. It is uncertain, therefore, whether the reference to 'regulate' is intended to cover regulators that have been established by a government as independent regulators (i.e. independent of direct government administration). The government may be able to apply its legislative powers to change the parameters within which an 'independent' regulator works, but unless and until it does just that, it is not clear whether such powers should be ignored as merely part of the broad sense of government power referred to in paragraph AG8.

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. This potentially will result in inconsistent accounting between grantor and operator, since from the operator's perspective the nature of the source of regulation is irrelevant. This may result in significant service concession assets not being recognised by either the operator or the grantor.

GBEs as Grantors

As per paragraph 5 of the ED, the proposed Standard would apply to all public sector entities, other than Government Business Enterprises (GBEs). Although GBEs could be grantors in service concession arrangements, the AASB does not support extending the scope of the proposed Standard, given the IPSASB's general exclusion of GBEs from the scope of its Standards.

The present scope of the proposed Standard would exclude both GBEs and any private sector grantors. Such grantors would be likely to look to the Standard by way of analogy under the

requirements of international or national Standards corresponding to IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BOOT Arrangements

The AASB notes 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. For example, paragraph 8(b) states that a grantor may have access to existing assets of the operator (which may or may not be owned by the operator) for the purposes of a service concession arrangement, and that the grantor therefore would recognise the assets if the grantor control criteria in paragraph 10 are satisfied. The Standard could usefully make the point that control of an asset is the critical factor, not ownership.

The AASB considers that BOOT arrangements should be identified in the proposed Standard or its Basis for Conclusions as a type of BOT (build-operate-transfer) arrangement and thus covered by the requirements. The Implementation Guidance table of typical types of arrangements and the relevant Standards (see page 32 of the ED) refers to BOT and BOO (build-own-operate) arrangements, but not BOOT arrangements, which don't fall neatly into any of the columns due to asset ownership by the operator but the residual interest being held by the grantor.

Residual Interest in Service Concession Assets

The grantor control criterion specified in paragraph 10(b) of the ED addresses grantor control of 'any significant residual interest' in the asset at the end of the term of the service concession asset. This is a change from the preceding Consultation Paper, which referred instead to 'the residual interest'. The approach in the ED is consistent with IFRIC 12.

In responding to the Consultation Paper, the AASB supported such a change to ensure that insignificant residual interests could not affect the assessment of control over service concession assets, and also that assets used in a service concession arrangement for their entire useful lives would be appropriately covered by the proposals. Accordingly, the AASB welcomes and supports the IPSASB's reference to 'any significant residual interest' in paragraph 10(b) of the ED and the coverage of whole-of-life service concession arrangements.

Grantor Recognition of Assets Constructed by the Operator

The ED (paragraph AG20) proposes requirements for the timing of initial recognition by grantors of assets constructed or developed by the operator for the purpose of a service concession arrangement. The proposed requirements distinguish the timing according to whether the operator or the grantor bears the construction risk. In the former case, recognition by the grantor would occur when the asset is placed into service, and in the latter case, as the construction takes place – provided the grantor has reliable cost information.

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. In the context of significant, long-term service concession arrangements, it is normally 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. An operator is unlikely to enter into a service concession arrangement if the grantor can simply refuse to pay for the construction work where there is some defect in the constructed asset – or else defer payment until some minor aspect has been resolved. Therefore, the reliance upon construction risk does not seem to be justified for service concession arrangements.

Indeed, the last sentence in paragraph AG20 seems somewhat at odds with the rest of the paragraph. It is not clear what cases are being referred to. In any case, the grantor's obligation for construction costs prior to completion of construction should give rise to an asset for the grantor, and it is not clear why this could not be a service concession asset. The control criteria in paragraph 10 do not apply explicitly only to service concession assets that are presently operating: the grantor's control of the services, recipients and pricing might only be *exercised* in the future, from when the assets are placed into use, but the grantor already controls the assets in the requisite manner in that case.

Recognition of Performance Obligations

While accepting the IPSASB proceeding with the recognition of performance obligations, the AASB encourages the IPSASB to consider the impact of related research (for example, on leases) by the IASB and FASB as it develops its Standard. There are a number of aspects concerning performance obligations in the ED that need to be clarified.

First, it appears that the amount of the performance obligation 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.

The AASB expects that in most (if not all) service concession arrangements, the grantor would have a performance obligation to the operator to continue to provide the granted service concession rights during the concession period. Therefore, it does not seem appropriate for the grantor to recognise a performance obligation only to the extent that the grantor does not have a payment obligation to the operator. If the performance obligation exists, it should be treated similarly in all cases, regardless of whether the grantor has a payment obligation. However, if the IPSASB retains its existing proposal, the AASB requests that it clarify why a performance obligation should be recognised only to the extent that the grantor's payment obligation (financial liability) falls short of the fair value of the service concession assets.

Secondly, it is 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 in accordance with paragraph 12. Paragraph AG29 (corrected) explains the nature of the obligation as requiring the grantor to 'provide' the asset to the operator. This seems equally applicable to existing assets of the grantor to which the grantor gives the operator access for the purpose of a service concession arrangement. The AASB considers that all service concession assets should be treated in the same way in this respect, regardless of whether they are new or existing assets of the grantor.

Finally, the AASB questions whether the performance obligation approach is proposed essentially as a means of deferring revenue recognition by the grantor. If this is the case, the IPSASB should address revenue recognition directly instead of via partial application of the notion of performance obligations.

Disclosure Requirements

While supporting the disclosure requirements proposed in the ED, the AASB thinks that it would also be useful to require separate (rather than combined) disclosure of:

- (a) service concession assets recognised during the period; and
- (b) existing assets of the grantor that have been reclassified as service concession assets during the period.

As presently drafted, paragraph 27(c)(iii) of the ED does not require separate disclosure of these amounts, even though paragraph 12 appears to suggest that that is intended.

Transitional Requirements

ED 43 proposes prospective application when an entity has not previously recognised service concession arrangements. However, the AASB recommends 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 also 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, and defer the achievement of comparability between entities in respect of the financial reporting of service concession arrangements.

Other Matters

The AASB considers that the structure of the proposed Standard could be improved. At present, there is considerable detail and 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. Some paragraphs such as paragraph AG19 merely duplicate the requirements in the main part of the Standard and should be deleted.

Some additional, less significant matters are noted in the attached Appendix. An editorial review of the proposed Standard is also required to identify and correct numerous problems, such as references to “grantor” instead of “operator” in paragraphs 14(b), AG22(b) and AG29 (and perhaps others), missing parentheses and incorrect punctuation.

If further information or clarification is required regarding any matters in this submission, please contact me or Clark Anstis, Senior Project Manager (e-mail: canstis@aaasb.gov.au).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K. M. Stevenson', with a long, sweeping flourish extending to the right.

Kevin M. Stevenson
Chairman

APPENDIX – ADDITIONAL MATTERS

These additional comments address some less significant issues arising from the proposed Standard. Some of these are concerned with the wording used in the proposed Standard, but an editorial review will be needed to identify numerous other necessary changes.

The proposed Standard

Paragraph 7 – the footnote text can be added to the end of the paragraph to simplify the presentation of the paragraph and make it more readable.

Paragraph 15 – the meaning of ‘original’ service concession asset is unclear, and should be clarified by referring instead to an asset recognised in accordance with paragraph 10 or 11.

Paragraph 18 – this is already covered by paragraph 13. Paragraph 12 already covers the subsequent accounting in the case of existing grantor assets reclassified as service concession assets.

Paragraph 21 – the references in the third sentence to ‘allocate the payments to the operator’ and ‘service portions’ are unhelpful, and the sentence should be amended to refer to identifying the components of the payments according to their substance as a reduction of the liability, a finance charge or the cost of services, and accounting for them accordingly.

Paragraph 23 – seems odd here to be referring to the operator compensating the grantor when all the other requirements are in terms of the grantor compensating the operator. It would seem better for the last sentence of paragraph 23 to be simply added to paragraph 19 and the rest of paragraph 23 deleted.

Paragraph 25 – this paragraph should be amended to allow for the possibility of the finance charge being capitalised as a borrowing cost. An amendment of IPSAS 5 *Borrowing Costs* on this point is proposed in Appendix B on page 25 of the ED.

Application Guidance

Paragraph AG3(a) – the relevant description of IFRIC 12 requirements would appear to be the operator’s recognition of a financial asset, rather than the revenue and derecognition aspects noted.

Paragraph AG6 – the last part of the first sentence is not helpful as it refers to circumstances in which the grantor buys all, some or none of the output; there are no other cases.

Paragraph AG23 – it is not the arrangement that may be separable, but the asset and service components can be separately identified.

Paragraphs AG33-AG36 – the requirements for determining the finance charge when the grantor makes payments to the operator seem very permissive, as there is a long list of possible interest rates that might be applied in determining the finance charge. Better to state the principle first, that the interest rate should be appropriate to the terms of the service concession arrangement, and then discuss how that rate might be determined in practice.

Amendments to Other IPSASs (Appendix B)

Three Standards are proposed to be amended: IPSASs 5, 13 and 17. However, only IPSAS 17 is proposed to have a new paragraph identifying the effective date of the amendment and the requirements for early application. This difference in approach between the Standards does not seem justified.

IPSAS 13, paragraph 25 – the present last sentence referring to a public sector entity leasing infrastructure from a private sector entity is likely to be confusing in conjunction with the proposed additional sentence regarding service concession arrangements and should be deleted.

IPSAS 13, paragraph 27 – a service concession arrangement is ‘described’, not ‘defined’, in ED 43.

Basis for Conclusions

Paragraph BC7 – the explanation for the lack of formal definitions seems weak: different nature of the Standard? A Standard is a Standard, whatever its provenance. Best to delete the first sentence and commence the paragraph simply by stating that although the Standard does not include formal definitions, the IPSASB has instead provided guidance on terminology, etc. In substance, some of the guidance amounts to definitions anyway.

Paragraph BC11 – the correlation of risks and rewards with economic benefits and of control with service potential is too stark. In Australian Accounting Standards, economic benefits and service potential are inseparable aspects of assets. A different justification for choosing the control basis should be identified.

Implementation Guidance

Accounting framework flowchart – the third box on the right-hand side of the flowchart refers to the grantor continuing to account for an asset as a leased asset. However, this is not acknowledged in the second point of the last box of the flowchart or indeed in the proposed Standard proper, which refers only to IPSAS 17 and IPSAS 31 in various paragraphs, and never to IPSAS 13.

Illustrative Examples

Table 2.3 in Example 2 – in note 4, ‘CU 135’ is incorrect and should be ‘CU 149’ instead. The other amounts in the note are correct.
