

SERVICE CONCESSION ARRANGEMENTS

ISSUES PAPER – ISSUES FOR SUBMISSION TO IPSASB?

This Issues Paper addresses the principal issues that the staff consider should or might be addressed in the AASB's submission to the IPSASB on its ED 43 *Service Concession Arrangements: Grantor*. AASB members are requested to consider whether the issues raised should be addressed, and if so, whether the staff views noted are supported.

1 Applicability of the Proposed Standard to GBEs

The Exposure Draft is stated as applicable to all public sector entities, other than Government Business Enterprises (see paragraph 5 of ED 43). Three of the four submissions received suggested that either the resulting Standard should encompass GBEs (HoTARAC and ACAG) or that the IPSASB and IASB should work together to address GBEs as grantors (the Accounting Bodies).

The proposed applicability would cover any for-profit public sector entities that were not GBEs, although that could be a very small subset of service concession grantors.

AASB Staff View

Expanding the applicability of the ED to include GBEs would make the accounting requirements certain, and the AASB could choose to do this even if the IPSASB felt constrained by its general policy that GBEs should comply with IFRSs. If the applicability was not expanded, GBE grantors may choose to apply a public-sector Standard on service concession arrangements under the hierarchy for the selection of accounting policies.

<p>Q1 Do Board members wish to address in a submission to the IPSASB the issue of the application of the proposed Standard to GBEs?</p>
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2 Scope of the Proposed Standard

The key to the scope of the proposed Standard is the grantor control criteria in paragraph 10 of the Exposure Draft. ED 43 sets out the proposed accounting in respect of service concession assets that satisfy those criteria. This contrasts with the IPSASB's 2008 Consultation Paper, which addressed the accounting for service concession arrangements where neither of the grantor control criteria were satisfied or else one or the other was satisfied.

Mirror of IFRIC 12 Scope

As the HoTARAC submission indicates, 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). This reflects the scope of IFRIC Interpretation 12 *Service Concession Arrangements* in relation to the accounting by operators.

This scope has the potential to result in significantly different accounting for similar service concession arrangements, depending on whether the grantor control criteria are satisfied. This is illustrated in the HoTARAC submission (see page 11 – “Consistency and comparability are not achieved”). However, this conclusion is subject to one’s judgement of the degree of similarity of service concession arrangements depending on whether they do or do not satisfy particular parts of the grantor control criteria.

BOOT Arrangements

Australian discussions of service concession arrangements have often referred to both BOO (build-own-operate) and BOOT (build-own-operate-transfer) arrangements. The Implementation Guidance table of typical types of arrangements and the relevant Standards (see page 32 of the ED) refers to BOT (build-operate-transfer) and BOO arrangements, but not BOOT arrangements.

HoTARAC suggests that it is unclear whether BOOT arrangements are covered by the ED and that guidance for them would be useful in Australia. Considering the application of substance rather than form could lead to a conclusion that mere ownership of an asset by the operator should not affect the accounting (as control of the asset is the more important factor), in which case a BOOT arrangement may simply be a type of BOT arrangement, and thus covered by the ED.

Staff note that the table in the ED is prefaced with the statement that the table is not intended to convey the impression that bright lines exist between the accounting requirements for various types of arrangements. Perhaps it should also be regarded as not suggesting bright lines between the various types of arrangements. Furthermore, this table corresponds with that in Information Note 2 in IFRIC 12. The issue of application to BOOT arrangements is relevant also to Interpretation 12, but does not appear to have been a significant issue.

AASB Staff View

Ideally, the proposed Standard should address the requirements for all service concession arrangements, whether all or some or none of the grantor control criteria are met. Application guidance on BOOT arrangements would also be useful.

Q2 Should the AASB submission address these matters or accept and support the present scope of the proposals?

3 Grantor Control Criteria

The grantor control criteria are set out in paragraph 10 of the ED: (a) the grantor controls or regulates the services the operator must provide with the service concession asset, to whom it must provide them, and the price; and (b) the grantor controls any significant residual interest in the service concession asset at the end of the term of the arrangement. These criteria are also included in Interpretation 12 for application by operators.

These criteria essentially require the grantor to assess control of service concession assets based on control over the use of the assets. This approach to control distinguishes control over the use of an asset from mere access to use an asset within the operating or policy parameters set by the controlling party. This distinction was introduced in IFRIC Interpretation 4 *Determining whether an Arrangement contains a Lease* but has not been more widely adopted.

HoTARAC argues that the grantor control criteria lack a conceptual foundation and are rules-based, open to manipulation depending on the detailed requirements (or lack thereof) of service concession arrangements and lacking neutrality in that they address whether the grantor controls the service concession asset rather than also considering operator control directly. Similarly, ACAG notes that the control criteria relate to service provision rather than the underlying asset.

Alternative Approaches to Assessing Control

The grantor control criteria are not the only potential approach to determining whether the grantor controls the underlying service concession asset. Alternative approaches include assessing the control of an asset based on the existing definition in Standards¹, applying a risks and rewards model, and applying a components or rights and obligations approach. Typically, a risks and rewards model has been used to determine whether all or none of an asset should be recognised by an entity (for example, in lease accounting, to distinguish finance and operating leases). A rights and obligations approach can result in various parties recognising different parts of an asset, which is seen as a bundle of future economic benefits that may be divided amongst a number of entities.

These alternatives were raised in submissions to the IPSASB on its Consultation Paper, including the AASB's submission. The IPSASB has considered these and noted its response in paragraphs BC11-BC14. It concluded that a control-based approach should be used, and that it should be consistent with IFRIC 12, in order to minimise the possibility of a service concession asset being recognised by both grantor and operator, or by neither party (paragraphs BC14 and BC2). However, as noted in the HoTARAC submission (page 6), differences between IFRIC 12 and ED 43 in terms of the scope of "regulation" could result in neither party recognising a service concession asset.

AASB Staff View

Staff consider that the arguments in paragraphs BC11-BC14 are not particularly convincing. For example, the correlation in paragraph BC11 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 not regarded as separate aspects of assets.

Q3 Do Board members agree that the IPSASB should be encouraged to reconsider such a fundamental aspect of the Exposure Draft?

4 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 arrangement. 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.

The AASB supported such a change in its submission on the Consultation Paper, to ensure that insignificant residual interests could not affect the assessment of control over the service

¹ AASB 138 *Intangible Assets* (paragraph 13) – An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* (paragraph 7) – Control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.

concession asset, and also that assets used in a service concession arrangement for their entire useful lives would be appropriately covered by the proposals.

Paragraph AG9 explains the consequences of the grantor's control of any significant residual interest in a service concession asset: restricting the operator's ability to sell or pledge the asset, and giving the grantor a continuing right of use throughout the term of the arrangement. No issue with the first point, but the second is problematic, since the operator has the right to access (and use) the asset during the arrangement. Instead, the grantor may have the power to control the use of the service concession asset during the term of the arrangement, based on the grantor control criterion in paragraph 10(a).

The reference to a continuing right of use for the grantor based on control of the residual interest has come from the Consultation Paper, which sought to reconcile notions of control and how the grantor could remain subject to service potential risks and rewards throughout the term of an arrangement even if the operator was subject to the significant economic risks and rewards. The reference no longer appears to be necessary and could be deleted to avoid confusion.

AASB Staff View

Support for the change to "any significant residual interest" and the coverage of whole-of-life service concession arrangements should be reiterated in a submission. Paragraph AG9 should be revised.

Q4 Do Board members agree that these residual interest aspects should be included in an AASB submission?

5 Grantor Recognition of Assets Constructed by the Operator

The Exposure Draft (paragraph AG20) proposes requirements for the timing of the initial recognition by grantors of assets constructed or developed by the operator for the purpose of a service concession arrangement. The requirements distinguish the timing according to whether the operator or the grantor bears the construction risk. In the former case, recognition by the grantor should 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 HoTARAC submission notes the asymmetrical accounting that would result if a grantor recognises a constructed service concession asset only when it is ready for use, since the operator would recognise a receivable as the construction proceeds.

However, although international and Australian Standards exist for the accounting by construction contractors for their activities, there is no corresponding requirement for the timing of the recognition of the constructed asset by the customer. Thus in the general construction-contract circumstances, any asymmetry in constructor and customer accounting has been allowed to continue.

AASB Staff View

The accounting on this point by grantor and operator is a particular case of the accounting by constructor and customer. It may be more appropriate to address the issue generally in another project rather than specifically in relation to service concession arrangements. The

requirements proposed in paragraph AG20 could set a general precedent without the benefit of views from many parties interested in the general question but not service concession arrangement accounting.

Q5 Should the AASB submission support or oppose the proposals for grantor recognition of constructed assets?

6 Recognition of Performance Obligations

ED 43 proposes that when a grantor recognises a service concession asset, it should also recognise a liability, which may be any combination of a financial liability and a performance obligation. The liability is initially measured at the same amount as the asset, which is measured at its fair value.

Under the proposals, a financial liability is recognised when the grantor compensates the operator for the service concession asset by making payments. In contrast, a performance obligation is recognised when the grantor compensates the operator by granting the operator the right to collect fees from users of the asset or by granting the operator access to another revenue-generating asset. The performance obligation is to be accounted for subsequently in accordance with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

It appears that 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 only to the extent that the payment obligation falls short of the fair value of the service concession asset.

Nature of the Performance Obligation

Staff expect 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 to recognise a performance obligation only to the extent that the grantor does not have a payment obligation. If the performance obligation exists, it should be treated similarly in all cases, regardless of whether the grantor has a payment obligation. The performance obligation should either be recognised in full or not at all, rather than recognising it only in some circumstances.

In addition, ED 43 states that the performance obligation obligates the grantor to provide the asset to the operator (paragraph AG29, corrected). However, it is unclear whether the performance obligation relates to the operator's right to earn revenues (a licence) or the operator's right to access the service concession asset or to access or use another asset provided by the grantor for the operator's use (a physical asset) or both. Perhaps the performance obligation is a kind of reverse stand-ready obligation – an obligation on the grantor not to do anything to upset the operator's quiet enjoyment of the asset, rather than an obligation to take specified action if required.

Paragraph 18 of IPSAS 19 defines liabilities as “present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential”. It is questionable whether the grantor would have any continuing performance liability over the service concession period as both the licence and the physical asset made available to the operator at the start of the

concession period would seem to have settled any present obligation of the grantor. Once the licence has been granted and/or the physical asset made available to the operator, no further economic benefits (service potential) would be required to flow from the grantor. In addition, a performance obligation does not appear to qualify as a provision, defined in IPSAS 19 as “a liability of uncertain timing or amount”, because the timing and amount of the performance obligation are determinable.

Furthermore, staff question whether the performance obligations approach is proposed essentially as a means to deferring revenue recognition by the grantor. If this is the case, the IPSASB should address revenue recognition directly.

IASB and FASB Consideration of Performance Obligations

Staff also note that the IASB and the FASB are contemplating performance obligations in their Leases and Revenue Recognition projects. In the Leases project, the IASB and the FASB have tentatively decided that under the performance obligation approach a lessor would recognise, in addition to the asset subject to the lease:

- (a) an asset representing its right to receive rental payments from the lessee (a lease receivable); and
- (b) a liability representing its performance obligation under the lease – that is, its obligation to permit the lessee to use one of its assets (the leased item). The lessor would satisfy that performance obligation (and hence would recognise revenue) over the lease term.

However, there are some suggestions that a significant number of IASB members are now questioning this approach.

In relation to the Revenue Recognition project, the IASB and the FASB propose a model requiring an entity to:

- (a) identify the contract with a customer;
- (b) identify the separate performance obligations in the contract;
- (c) determine the transaction price;
- (d) allocate the transaction price to the separate performance obligations; and
- (e) recognise revenue when a performance obligation is satisfied.

Moreover, staff note that the AASB and the FRSB jointly issued AASB ED 180/ FRSB ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)* in June 2009. The ED was based on IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* with few changes being proposed to the requirements of that Standard. In March 2010, the Boards commenced their review of the submissions on the ED, focusing particularly on comments received on the timing of income recognition by recipients. The Boards tentatively decided to explore departing from the ED’s proposal that a liability (other than an advance receipt) arises from a non-exchange transaction when and only when the transfer gives rise to both a performance obligation and a return obligation. The Boards decided to explore an approach in which:

- (a) an enforceable performance obligation is of itself sufficient for a liability to exist, and any related return obligation should be treated as an indicator of the enforceability of the performance obligation;
- (b) the principles for identifying an enforceable performance obligation are based on those being developed by the IASB and the FASB in their joint project on Revenue Recognition; and
- (c) when a transferor in a non-exchange transaction imposes an enforceable performance obligation on the transferee, the transferor is regarded as the ‘customer’.

AASB Staff View

The staff propose that performance obligations be raised in the submission to the IPSASB as an important issue. Staff recommend that the AASB's submission should oppose the present approach and encourage the IPSASB to further explore performance obligations in view of the IASB and the FASB projects on Leases and Revenue Recognition.

Q6 Do Board members agree with the views presented on performance obligations, and that the issues should be raised in the submission to the IPSASB?

7 Disclosure Requirements

The disclosure requirements set out in paragraphs 27 and 28 of ED 43 are based on the requirements in SIC Interpretation 29 *Service Concession Arrangements: Disclosures* and appear to be comprehensive. Interpretation 29 applies to both operators and grantors.

However, it would be useful to require the separate disclosure of (i) service concession assets recognised during the period and (ii) existing assets of the grantor that have been reclassified as service concession assets during the period. At present, these amounts could be combined in the one disclosure required by paragraph 27(c)(iii), even though paragraph 12 appears to suggest that separate disclosure is intended.

Q7 Are there any additional disclosures that should be specified?

8 Transition Requirements

The proposed transition requirements in paragraph 30 specify that an entity that has not previously recognised service concession arrangements should apply the (resulting) Standard prospectively, unless it elects to apply it retrospectively.

It would be helpful for the Standard to clarify whether the prospective application refers to an entity applying the Standard only to service concession arrangements entered into once the Standard is applied by the entity, or to both new and existing arrangements from the reporting period to which the Standard is first applied. If the latter is intended, then the application guidance might need to address measurement issues, since paragraph BC21 suggests that retrospective measurement of service concession amounts may be difficult. The Basis for Conclusions paragraphs on transition seem to suggest that application of the requirements to existing arrangements would not be required, but a clear statement would resolve the uncertainty.

Q8 Are there any additional issues in relation to transition?

9 Other Issues

There are numerous issues that could be raised in a submission to the IPSASB, such as the following:

- (a) providing a definition of "service concession arrangement" – instead of or in addition to the description in various paragraphs;

- (b) clarifying the scope of “regulation” that should be taken into consideration in assessing grantor control of service concession assets;
- (c) the structure of the proposed Standard, with considerable detail and cross-referencing in the Application Guidance, and some paragraphs merely duplicating the requirements in the main part of the Standard (e.g. paragraph AG19);
- (d) the permissiveness in determining the finance charge when the grantor makes payments to the operator (see paragraphs AG33-AG36); and
- (e) clarifying whether the grantor has a performance obligation in respect of its existing assets that are reclassified as service concession assets.

Q9 Should these issues be addressed in an AASB submission? Are there additional issues that Board members would wish to include?