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# *Accounting for Service Concession Arrangements*

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# ***Table of contents***

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1. Introduction .....	1
2. What is the current accounting framework for service concession arrangements? .....	3
3. How adequate is the current accounting framework? .....	6
4. What is the most relevant model for grantor accounting for service concession arrangements? .....	9
5. What other concerns have been raised with the control approach and is it fit for purpose? .....	14
6. What needs to be done? .....	22

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# 1. Introduction

## 1.1. Background

This paper addresses issues relating to the accounting by grantors for their involvement in service concession arrangements. These are contractual and other arrangements between the public sector (the grantor) and the private sector (the operator), whereby the public sector either arranges for projects to be privately financed or provides existing infrastructure and the private sector either supplies the infrastructure and operates it, or operates existing infrastructure provided to it, in the delivery of what are ordinarily considered to be public services. Examples of service concession arrangements are public hospitals, prisons and roads.

Service concession arrangements have typically been considered to be either:

- availability structures - where the operator builds, operates and finances a project in exchange for a payment stream from the grantor, or
- user pay structures, where the operator builds, operates and finances a project in exchange for a right to charge users

However, sophisticated structures are now emerging that are designed to provide different ways of sharing risks between grantors and operators. The emergence of these new commercial structures has highlighted deficiencies in the accounting policies currently being applied by grantors for their involvement in service concession arrangements.

There is no definitive accounting guidance in Australia for grantors to apply for their involvement in service concession arrangements. Grantors have typically adopted **what has been described as ‘the risks and rewards approach’**. However, the approach has been criticised for failing to reflect fully the economics of service concession arrangements, and, in some situations, for resulting in the omission of significant assets and liabilities from grantors’ balance sheets, for example the omission of toll roads.

In recent years standard setters have been endeavouring to address the lack of guidance. In 2011, the International Public Sector Accounting Standards Board (IPSASB) issued **IPSAS 32 Service Concession Arrangements: Grantor** (IPSAS 32) which prescribes the accounting treatment for grantors of service concession arrangements. However the standard is not mandatory in Australia. The Australian Accounting Standards Board (AASB) is currently reviewing the international standard to assess its suitability for adoption in Australia.

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## 1.2. What do we hope this paper will achieve?

In this paper we critically analyse existing accounting policies being applied by grantors in accounting for service concession arrangements and we evaluate the approach advocated by the IPSASB in IPSAS 32. The analysis involves assessing the implications of the emerging commercial structures for accounting for service concession arrangements. It also involves addressing concerns identified by the AASB with IPSAS 32. We identify our preferred accounting model and we raise issues for consideration by the AASB as it develops its forthcoming proposals. The two main issues are:

- Application of AASB 16/IAS 16 **Property, Plant and Equipment** ('IAS 16') in assessing whether an infrastructure asset is controlled by the grantor. The key issue is how the notion of control, which underpins IAS 16 and is implicit, though narrower in interpretation, in IFRIC 12/AASB Interpretation 12 **Service Concession Arrangements (Interpretation 12)** and IPSAS 32, should be applied to the public sector. We believe recent guidance on the application of AASB 10/IFRS 10 **Consolidated Financial Statements (IFRS 10)** in a public sector context, contained in AASB 2013-8<sup>1</sup>, provides relevant guidance for determining when control of specific public sector assets arises.
- Application of AASB 13/IFRS 13 **Fair Value Measurement (IFRS 13)** in determining the initial measurement of infrastructure assets recognised by the grantor under service concession arrangements. The key issue is determining fair value of an infrastructure asset in circumstances where a user pay concession has been transferred to the operator. We believe IFRS 13 is unclear about whether the notion of public service benefit can be applied in these circumstances in determining the highest and best use of the asset. We believe this is a significant issue that has not been adequately addressed either in Australia or internationally in the context of applying IPSAS 32 (we note that the IPSASB does not yet have a direct equivalent to IFRS 13). Moreover, we believe the issue is not confined to the measurement of infrastructure assets recognised under service concession arrangements but potentially has broader implications for accounting for non-financial assets by public sector entities, for example valuation of social infrastructure, and, possibly, by regulated entities; for example, in the area of accounting for contributed assets by regulated entities.

We hope this paper encourages dialogue between stakeholders around the key issues relating to grantor accounting for service concession arrangements and ultimately contributes to the development of a high quality accounting standard and meaningful reporting.

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<sup>1</sup> AASB 2013- 8 *Amendments to Australia Accounting Standards – Australian Implementation Guidance for Not-for-profit Entities-Control and Structured Entities*

## 2. What is the current accounting framework for service concession arrangements?

### 2.1. The accounting landscape for service concession arrangements

Interpretation 12 was issued by the International Financial Reporting Interpretations Committee in 2006 and was subsequently endorsed by the Australian Accounting Standards Board. The Interpretation deals with an **operator's accounting for service concession arrangements** that fall within the scope of the Interpretation. IPSAS 32 essentially mirrors Interpretation 12 in relation to its scope, principles for recognising an asset and terminology. However, as yet no definitive guidance for grantors of service concession arrangements has been issued by either the IASB or the AASB.

In 2007, prior to the IPSASB issuing IPSAS 32, the AASB considered a range of alternative accounting treatments for grantors of service concession arrangements in the absence of definitive guidance<sup>2</sup>. The AASB paper was prepared by an advisory panel and was requested by the AASB in response to the introduction of Interpretation 12. The paper focussed on whether the introduction of guidance for the operator of a service concession arrangement should have an impact on the accounting policy selected by the grantor. The paper considered the following approaches:

1. The **substantially all/majority of the risks and rewards of ownership** approach (the 'risks and rewards approach') which is based on the principles in the **UK Accounting Standards Board's** Financial Reporting Standard 5 *Reporting the Substance of Transactions* (FRS 5) and IAS 17/AASB 117 *Leases* (IAS 17). The basic principle of FRS 5 is that a party will record an asset on their balance sheet where that party has access to the benefits of the asset and exposure to the risks inherent in those benefits. Under this approach, the asset in the arrangement is recognised in full by the entity that has substantially all/a majority of the risks and rewards of ownership. The asset is not bifurcated to reflect the operator's and grantor's share of the risks and rewards of ownership. Potential risks and rewards incidental to ownership that may be considered in the assessment of which party has substantially all/a majority of the risks and rewards of ownership include: demand risks; responsibility for performance-related penalties; availability of the asset; residual risk; and, obsolescence. Initial measurement of the asset is based on the measurement of the related liability, which, in accordance with the leasing literature, is equal to the lower of the minimum lease payments and the fair value of the leased asset.
2. The **control** approach is based on the principles in IAS 16. Under this approach, the asset in the arrangement is recognised by the entity that controls the use of the asset. Initial measurement is based on the fair value of the asset.
3. The **rights and obligations** approach is where the **asset's economic benefits may be considered to be** shared between the grantor and the operator. In this approach, the service concession asset may be bifurcated between the grantor and the operator. The approach results in the arrangement potentially being reflected as a smaller unit of account by the grantor than the service concession asset. This differs from the control approach where the unit of account is at the entire project level with either the grantor or operator recognising the service concession asset in full on their balance sheet.

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<sup>2</sup> AASB Agenda Paper 12.11, issued December 2007- Interpretation Advisory Panel (AASB Panel Paper)

4. The **control or regulation** approach, which applies the mirror of principles in Interpretation 12. An entity that controls or regulates the use of the asset would recognise the asset. This approach defines control in a limited context, being the grantor having control over the services provided by the operator, to whom it must provide services and at what price. **The inclusion of the ‘or regulation’** extends the scope from control by the grantor itself to include control by the grantor and related public sector entities considered together.

The AASB Advisory Panel (**‘the Panel’**) concluded in its paper that in Australia the first three approaches outlined are appropriate bases for grantors to formulate an accounting policy because they are founded on existing accounting principles: the risks and rewards approach reflects IAS 17, the control approach is aligned with the principles of IAS 16 and the rights and obligations approach is considered to be similar to the principles in IAS 39/AASB 139 *Financial Instruments: Recognition and Measurement* (IAS 39). However, the Panel indicated its preference for either the risks and rewards approach or the control approach.

The control or regulation approach was considered by the Panel to be the least preferred approach because of concerns about the possible effect of extending the notion of unilateral control by the grantor to include situations where control is achieved through a combination of the grantor’s **rights and those held by related public sector entities** through regulation. In particular, the Panel was concerned about the relevance and reliability of information about service concession arrangements reported in the grantor’s **financial statements** in circumstances where the grantor’s **‘control’ over a service concession asset is only achieved because of the ability of other public sector entities to regulate the activities of the operator.**

The AASB Panel paper noted resistance to the rights and obligations approach given that this approach relies on IAS 39 principles, and extending those principles to tangible assets may not be appropriate. Concern was expressed in particular about whether it was appropriate to recognise the arrangement as a whole or the individual assets and liabilities at a more granular level.

## **2.2. What is the generally accepted approach adopted by public sector entities in practice?**

Each State Government has separately established an accounting policy for service concession arrangements<sup>3</sup>. Generally, the accounting view point adopted has been that the risks and rewards approach is an appropriate approach.

### **2.2.1 Types of service concession arrangement**

Two common commercial structures used by governments for service concession arrangements are the availability and user pay structures. The availability structure is where the operator builds and operates an asset and makes the asset available for use (e.g. Peninsula Link in Victoria and the Sydney Convention Centre). The operator in return receives from the grantor a fixed payment stream during the operation phase to recover its costs of constructing and operating the asset. The operator has no exposure to demand risk on its initial investment.

The user pay structure is where the operator builds and operates an asset, but the grantor has no obligation to make payments to the operator. Instead, the grantor provides the operator with a right to charge users for the asset (e.g. City Link in Victoria) to recover its investment. The operator has the demand risk.

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<sup>3</sup> Examples of State Government’s accounting policies for service concession arrangements are:

- Victoria: Financial Reporting Directive 19 Private Provision of Public Infrastructure;
- NSW: Treasury Policy Paper O6-8 Accounting for Privately Financed Projects
- Queensland: APG 17 Service Concession Arrangements: Grantor

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## 2.2.2 Applying the risks and rewards approach

When applying an accounting policy to service concession arrangements, grantors initially identify the individual major components of the transaction. For example, in an availability structure a grantor payment may reflect two components; a **‘capital’** payment (for the cost of the asset) and on-going payments relating to the costs of operating the asset. In this example, the risks and rewards approach would be applied by the grantor to the capital component, and the operating costs would be recognised as an expense when incurred.

The risks and rewards approach, when applied to availability service concession arrangements, results in the grantor recognising a finance lease asset and liability on its balance sheet from the date the asset is available for use. This reflects the grantor’s **financial obligations to the operator and the ability for the grantor to control the use of the asset and receive substantially all of the asset’s benefits.**

Those who support this approach would contend that, in the context of an availability structure, the risks and rewards approach results in a financial reporting outcome that appropriately reflects the economics of the transaction; a service concession asset is recognised together with the financing undertaken to acquire the asset. Accordingly, apart from debate about the characterisation of the asset; as a lease asset or as property, plant and equipment, the risks and rewards approach has not attracted criticism when applied to an availability structure. However, when applied to user pay service concession arrangements, such as a toll road, the risks and rewards approach has attracted criticism because it often results in the grantor not recognising an asset until the end of the concession term. This financial reporting outcome arises because the grantor typically has no financial obligations to the operator. The operator bears the risk of recovering the investment through the use of the road (i.e. by tolling the road). When the concession term ends, the asset is recognised on the grantor’s balance sheet. **At this point, the ‘lease period’** has expired and the grantor becomes exposed to substantially all/a majority of the risks and rewards of the asset; in effect, at this point the control approach is applied.

However, criticism of the risks and rewards approach in the context of user pay structures has been somewhat muted because even though it may not adequately portray the benefits grantors have received from entering into the project, it does reflect the fact that the State has no financial obligations under this structure. We return to this issue in Section 3.

There is also some diversity in practice around the recognition by grantors **of the ‘residual interest’ in the asset** under the risks and rewards approach in the context of user pay structures. The residual interest at reporting date **is effectively the asset’s value at the end of the service concession arrangement** expressed in current value terms. The two policies currently adopted in Australia for user pay structures are to recognise the residual **interest in the asset gradually over the concession term (the so called ‘emerging asset model’)** or to recognise the asset in full at the end of the concession term. No amount is recognised for the service concession asset at the date the grantor begins reporting for the service concession arrangement, i.e. the date the grantor is able to benefit from rewards and is exposed to the risks associated with the service concession asset.

## 3. How adequate is the current accounting framework?

### 3.1. What are the accounting impacts for commonly used service concession arrangements?

As noted in Section 2.2, the risks and rewards approach is how grantors are currently accounting for most of their service concession arrangements. The table below summarises the accounting outcomes for the risks and rewards approach under the two most common service concession structures.

	<i>Availability structure</i>	<i>User pay structure</i>
Initial asset recognition	Asset is recognised when the asset is available for use.	No asset is recognised.
Initial asset measurement	Asset measurement is limited to the present value of the liability recognised at inception.	No asset to recognise as no liability has been recognised.
Initial liability recognition	Liability exists as the grantor has an obligation to make payments to the operator. Liability is recognised when the asset is available for use.	No liability is recognised.
Initial liability measurement	The liability will be recognised at the lower of the minimum lease payments <sup>4</sup> and the fair value of the leased asset.	No liability recognised as there are no obligations for the grantor.
Income recognition	No income recognised.	Income and asset recognised at either the end of the concession term or recognised gradually over the concession term.
Timing of recognition	The asset and liability are recognised under leasing principles at commencement of the lease term, which for service concession arrangements is generally when the asset is available for use.	Not applicable.

While the conceptual basis for the risks and rewards approach might be open to question, particularly in light of the issuance of Interpretation 12 and IPSAS 32, some would contend that it has produced reasonable financial reporting outcomes in the context of the typical uncomplicated structures that have characterised the industry until recently. For example, under the risks and rewards approach the non-tolled road Peninsula Link, which is an availability public private partnership (PPP), is recognised as an asset and liability on the Victorian Government's balance sheet. This financial reporting outcome reflects the Victorian Government's financial obligations in respect of the project. Similarly, under the risks and rewards approach the Victorian CityLink, which is a user pay arrangement, is not recognised on the Victorian Government's balance sheet because the grantor does not have a financial obligation to make payments to the operator. Again, the financial reporting outcome reflects the Victorian Government's financial obligations in respect of the project. However, the landscape for service concession arrangements is rapidly evolving. For example, 'hybrid' service concession arrangements are emerging and expected to become more commonplace. The question arises as to whether the risk and rewards approach is able to deal adequately with these more complex structures that will seek a more even distribution of the risks and rewards of ownership between the contracting parties.

<sup>4</sup> As defined in IAS 17.



### **3.2. How would the risks and rewards approach apply to emerging commercial structures?**

Hybrid service concession structures typically involve some form of sharing demand risk between the operator and the grantor. A simple example is where a service concession arrangement involves the operator having a right to receive fixed availability payments from the grantor for an agreed period and then having a right to charge users of the asset to recover its remaining investment during the remaining term of the concession. In this example, the grantor has the demand risk in the initial years, with the operator assuming the risk in the later years when the demand risk profile is established.

Hybrid structures, in most cases, are a combination of an availability structure and user pay structure, and have not been widely considered from an accounting perspective. If the risks and rewards approach is applied to such an arrangement it may be unclear which party to the arrangement has substantially all/a majority of the risks and rewards of ownership. In the example in the previous paragraph, if demand risk is shared equally between the grantor and the operator over the term of the arrangement conceivably neither party would recognise an asset under the approach. This would be an anomalous outcome because the grantor would be required to recognise a financial liability in respect of the availability payment. However, if the grantor recognised an asset equivalent to the liability recognised when it did not have substantially all/a majority of the risks and rewards of ownership this would seem to contravene a fundamental premise of the risks and rewards approach, i.e. that an asset (and liability) should not be bifurcated according to an allocation of the risks and rewards between parties to an agreement. In other words, under the risks and rewards approach an assessment is made of who has substantially all/a majority of the risk and rewards of the asset and that party recognises the asset (and liability) in its entirety.

### **3.3. What are the deficiencies of the risks and rewards approach?**

The weaknesses in the risks and rewards approach have been evident for some time, most notably when applied to a user pay structure. However, as the financial reporting outcomes for simpler commercial structures have seemed reasonable it has avoided serious scrutiny to date.

A key deficiency in the risks and rewards approach is the level at which the unit of account is determined, i.e. the arrangement as a whole. Thus, if substantially all/a majority of the risks and rewards of ownership arising under the arrangement are considered to be with the operator, there is no recognition impact for the grantor. As hybrid structures involve a sharing of risks and rewards between the grantor and the operator, the financial reporting effect of the failure of the risks and rewards approach to identify the unit of account at a more granular level becomes evident.

Another weakness in the risks and rewards approach is that when considering user pay structures the operator will typically be identified as the party that has substantially all/a majority of the risks and rewards of ownership of the asset. **This is usually due to the operator's exposure to demand risk over the concession term.** The financial reporting effect of this for the grantor is that the arrangement is off-balance-sheet. This off-balance sheet outcome, which results from focusing on the economic/demand risk of the public sector assets, fails to reflect the public sector benefits of the arrangement from the grantor's **perspective**. We discuss in Section 4.3.2 how public sector benefits should be assessed by a grantor.

In addition, under the risks and rewards approach, due to the lack of specific guidance in this area we are aware that there is diversity in practice as to whether the government is viewed as the lessor (of a finance lease) or lessee (of an operating lease) in these arrangements. As the accounting outcome is usually the same in both scenarios (being that the asset is recognised by the party with substantially all/a majority of risks and rewards of ownership, i.e. the operator), there has not been a concerted effort to determine which view is most appropriate.

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## *Conclusion*

The advent of hybrid service concession structures has highlighted deficiencies in the risk and rewards approach primarily due to the impracticality of attempting to combine the prevailing accounting for user pay and availability payment structures. However, through this analysis we feel strongly that in some cases the impact of not recognising assets on the grantor's balance sheet in user pay arrangements is inconsistent with the underlying service potential of the asset – which exists irrespective of how it is financed. The following section explores a different approach that we believe has the potential to overcome these deficiencies.

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## ***4. What is the most relevant model for grantor accounting for service concession arrangements?***

### ***4.1. Introduction***

As noted in Section 1, the AASB is currently assessing IPSAS 32 for suitability in Australia. If it is accepted that a new standard is required then an analysis of the most appropriate conceptual basis is important to ensure that more complex arrangements can be accounted for consistently. In Section 2 we noted that the AASB Panel had identified three models that they considered may be appropriate for accounting for service concession arrangements. In Section 3 we evaluated one of these approaches, the risks and rewards approach, in the context of emerging commercial structures, and found it to be inadequate.

In this section we explain why we believe the control approach, one of the three approaches considered appropriate by the Panel, is conceptually superior to the other potential approaches and, as a consequence, is better able to deal with evolving commercial structures.

### ***4.2. Why is an approach that is based on the concept of control the most appropriate model for service concession arrangements?***

The primary reason supporting our view that the control approach is the most appropriate accounting model for service concession arrangements is its focus on whether the grantor controls the service concession asset, not on whether the grantor is obligated to make payments to the operator. Under the control approach, if the grantor is considered to control the asset, it is recognised on the **grantor's** balance sheet at its fair value. By comparison, under the risks and rewards approach, the focus is on the grantor's **contractual obligations to the operator**; recognition of an asset on the grantor's **balance sheet is based on** the recognition of the contractual obligation. This means that in arrangements where there are no payment streams to the operator from the grantor, for example in user pay structures, there is no accounting recognition on the grantor's balance sheet even where the grantor has control of the asset.

The control model applies the principles of IAS 16. Thus, it reflects the fact that an exchange transaction has taken place between the operator and the grantor. For example, in the case of a toll road, it reflects the fact that the State has exchanged the right to toll for the construction and operation of the road. The risks and rewards approach would not reflect the exchange transaction because there is no contractual obligation for the State to make payments to the operator.

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### 4.3. When does control arise?

In applying the control approach, the critical issue to consider is; when does control of the service concession asset arise? Assessment of control can be problematic in a public sector context because the normal indicators of control discussed in the accounting literature, including the recently revised consolidations standard IFRS 10, either may not exist or their application in the public sector may be unclear.

The AASB Panel identified the following indicators of whether the property underlying a service concession arrangement is controlled by the operator or by the grantor:

- a. Whether the arrangement allows the grantor to specify significant operating policies and procedures in respect of the property;
- b. Whether the arrangement precludes or significantly limits the operator from using the property for other purposes;
- c. Whether the arrangement precludes the operator from using other assets to fulfil its public service obligation;
- d. Whether the arrangement precludes or significantly restricts the operator from providing services to other parties;
- e. Whether the arrangement specifies the maintenance program with respect to the property;
- f. Whether the arrangement precludes the operator from modifying or replacing the property without the consent of the grantor; and
- g. Whether the arrangement precludes the operator from selling or transferring the property (and the service obligation) without the consent of the grantor.

Conceptually, an entity controls an asset when it has the power to use the future economic benefits or service potential embodied in the asset for its own benefit and to deny or regulate the use by others of those benefits or that service potential. In the public sector, 'future economic benefits' is synonymous with the notion of service potential or 'the ability for an entity to achieve its objectives'. A key issue is; how should the notion of power be applied in a public sector context?

#### 4.3.1 How is power assessed for public sector entities?

As noted in Section 2, the control approach applies the principles of IAS 16. The key issue that needs to be considered is; how should the notion of control underpinning IAS 16 be applied to assets used in a public sector context?

The AASB recently released an amending standard (AASB 2013-8) that sets out guidance on how the concept of control in IFRS 10 might be applied by not-for-profit entities in determining whether an entity is controlled for purposes of consolidation. Although the amending standard applies to assessments of control of an entity rather than specific assets, we believe the principles can be applied in assessing whether control of public sector assets, including service concession assets, has been achieved. The three tests of control in IFRS 10 that AASB 2013-8 considers are;

- Power
- Exposure or rights to variable returns
- The ability to use that power to effect those returns

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The AASB guidance specifically addresses the notion of power and states that power arises from rights, and it notes that these rights need to be assessed to determine if they are substantive or merely protective in nature. In a public sector context, rights typically are established through statutory, legislative or contractual arrangements. Accordingly, the key issue is whether the rights provided to grantors under service concession arrangements are considered to be protective in nature, which the grantor would normally invoke in rare circumstances and would not give rise to control, or are substantive and would therefore give rise to control.

Examples in AASB 2013-8 of protective rights include the right of a regulator to curtail or close the operations of entities that are not complying with regulations or other requirements and the right to remove members of the governing body of another entity under certain restricted circumstances. An example of the former is the right of a pollution control authority to close down activities of an entity that breaches environmental regulations. An example of the latter is a right of a State government to remove or suspend the councillors of a local government and appoint an administrator for reasons relating to a lack of probity.

An example of a substantive right in AASB 2013-8 is a grantor's ability to determine the design of a toll road. Newly constructed roads, whether tolled or not, will feed into the overall road network and transportation plan of a State. Accordingly the grantor's **capacity to determine the design of the road**, including, for example, where it is located and where on and off ramps should be positioned, is a substantive right that enables the grantor to ensure that the road supports **the State's** broader transport plan objective.

Examples of clauses within service concession agreements that may convey rights indicative of control, in combination or singly, include:

- Legal title
- Residual benefit
- Initial involvement in the upfront design of the asset
- Termination of convenience clauses (i.e clauses that allow the government to cancel an agreement at their discretion)
- Responsibility for performance of the asset
- Active participation in key operating activities of the operator
- Restrictions on pricing or use of asset

The guidance in AASB 2013-8 is new and has not been widely applied in practice. The following discussion is an attempt to apply the guidance to service concession arrangements.

### ***4.3.2 How are returns assessed for public sector entities?***

As noted in Section 4.3.1, two of the three tests of control of an entity set out in IFRS 10 relate to an entity being able to benefit from returns generated by an investee. AASB 2013-8 explores how the notion of returns should be assessed in a public sector context. The guidance observes that public sector entities are not necessarily motivated by economic return in the same way as private sector entities and therefore the concept of public service benefit should take more prominence when considering whether the entity is using its power over key decisions to influence returns.

Grantors typically make investment decisions in the context of a broader network of assets for which the government is responsible. This will result in the government seeking to ensure that the critical decisions around design of the asset enable both the current and perceived future public service obligations to be met. The key point here is that not only are returns assessed differently, but also the focus on service potential will inform which are the important decisions to consider in order to assess whether the grantor has the power to influence the returns.

In terms of applying the final control test under IFRS 10, if the grantor is able to make critical decisions about the design of a project and the way that it should be operated to achieve the desired public service benefit, then it could be argued that the definition of control has been met. Importantly, this may mean that decisions on how an operator can extract more value from its concession to operate the asset may be less relevant in the assessment of whether these are key decisions that influence the returns to the Grantor **than the grantor's** ability to make critical design decisions.

The way in which assets interact with a broader network is also an important consideration. Transport infrastructure provides a good illustration. For transportation, the interconnection of a single asset with the rest of the transport network is crucial to its operation and achievement of public service benefit objectives. In contrast, an asset such as a convention centre can be operated without the use of other assets notwithstanding that public service obligations are still being met.

#### 4.4. What is the other side of the entry?

When a grantor determines that a service concession asset is controlled, the guidance in IAS 39 (IFRS 9/AASB 9 “Financial Instruments”) and IAS 37 should be considered to determine if any financial or non-financial obligations exist that would need to be recognised on the balance sheet. In situations where an asset is recognised on balance sheet and either no obligations are recognised or the recognised obligations reflect only part of the fair value of the asset, consideration needs to be given as to whether the difference between the fair value of the asset and any recognised liability should be recognised as a gain (or loss) on initial recognition or, in the case of a positive difference, deferred and recognised as income over the period of the concession arrangement. This issue is currently being addressed by the AASB, and is discussed in further detail at Section 5.2.2.

#### 4.5. Applying the control approach to more complex arrangements

We believe the control model is a robust approach that can be applied to complex arrangements, such as the emerging hybrid structures. Assume the following hybrid service concession arrangement involving a toll road:

- the grantor provides an operator with a right to toll in exchange for the operator designing, constructing and operating the road
- the grantor agrees to fund any shortfall in tolls from forecast traffic for the first 5 years
- the grantor controls the concession asset

The arrangement would be accounted for under the control model as follows:

	<b>Control-based approach</b>
Initial asset recognition	Asset is recognised when grantor obtains control.
Initial asset measurement	Asset is measured at fair value at date of recognition
Initial liability recognition	If the grantor is obligated to make payments to the operator under the service concession arrangement (or other agreement), a financial liability and/or a non-financial liability would be recognised.
Initial liability measurement	Liabilities are measured in accordance with IAS 39 (IFRS 9) or IAS 37 as appropriate
Income recognition	Any difference between the recognised obligations and the fair value of the asset would be recognised as gain or loss on initial recognition or, in the case of gains, would be deferred and recognised as revenue over the term of the concession arrangement.
Timing of recognition	The recognition of the asset and liability will be dependent on the grantor's contractual and/or constructive obligations during the construction phase. It is likely that this model would result in earlier recognition of assets and liabilities on a grantor's <b>balance sheet than under a risks and rewards approach</b> . The change in timing of recognition is considered in further detail at Section 5.3.1.

## 4.6. How does the control approach compare to existing pronouncements?

IPSAS 32 and Interpretation 12<sup>5</sup> are substantially the mirror image of each other and are quite similar to the control concept in IAS 16. However, a difference between the approaches arises from inclusion in IPSAS 32 and Interpretation 12 of a key tenet of control being the regulation of the service concession asset. For example, IPSAS 32 paragraph 9 (a) notes that an asset is recognised by a grantor when the grantor **‘controls or regulates the services the operator provides, to whom it provides and at what price’** and includes the following guidance: **‘the control or regulation referred to in paragraph 9(a) could be by binding arrangement, or otherwise** (such as through a third party regulator that regulates other entities that operate in the same industry or sector as the grantor)...’<sup>6</sup>. As noted in Section 4.3, our view is that this is a narrower view of the application of the control tests in IFRS 10. The test would potentially exclude assets from being considered to be controlled by the grantor where the grantor does not control pricing, even though this is not a substantive feature of the way in which the grantor assesses returns.

As noted in Section 2.1, the AASB Panel made a similar observation in its consideration of the implications of Interpretation 12 for accounting by grantors.

More recently, the AASB reviewed the approach in IPSAS 32 and, while expressing broad agreement with the overarching principles of IPSAS 32, identified the following concerns:<sup>7</sup>

- The role of regulation - in particular the impact of the regulator being from a different jurisdiction. The AASB paper raised a concern over a view that there may be scenarios where third party regulation may not give a grantor control of a service concession asset.
- Measurement of the liability at initial recognition – whether the liability should be based on the value of the service concession asset or what the grantor has given up (for example, the right to toll).
- Recognition of income - whether any positive difference between the recognised asset and any recognised liabilities is accounted for as deferred revenue or upfront gain.

The AASB is continuing to consider these issues, and plans to issue an exposure draft following their resolution. The issues identified by the AASB are discussed in greater detail in Section 5. It is expected the principles underlying the proposed standard will be based on the control approach.

<sup>5</sup> Scope of Interpretation 12 paragraph 5:

- a. the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- b. the grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the infrastructure at the end of the term of the arrangement

<sup>6</sup> IPSAS 32.AG6

<sup>7</sup> AASB Board Papers July 2012, Agenda Paper 8.1 and 8.2

## ***5. What other concerns have been raised with the control approach and is it fit for purpose?***

There have been several concerns raised about the control approach and whether it is fit for purpose. Some of the issues to consider in this respect are as follows:

- Measurement of the service concession asset
- Upfront recognition of any gain or deferral
- Recognition of asset during construction term
- Scope of service concession arrangements

### ***5.1. The impact of the control approach being applied***

In Section 4 we noted that the most significant impact of moving from the existing accounting policy being applied by grantors to the control approach proposed in this paper is that service concession arrangements that have a user pay element would be recognised on the grantor's **balance sheet**. Availability structures are not expected to be impacted significantly as service concession assets and related liabilities are already recognised on the grantor's **balance sheet**, and **no significant measurement differences have been identified** (particularly if the fair value of the asset had previously been recognised). An example of the implementation impact for Victoria would be the potential **recognition of the East Link and City Link toll roads on the State's balance sheet** for the first time.

Although recognition of user pay arrangements on the grantor's balance sheet may also result in recognition of a related liability (an issue discussed later in this section), the change in accounting policy for these arrangements would not impact the financial liabilities recognised by the government.

### ***5.2. What is the current state of play for grantor accounting?***

The AASB is currently considering what, if any, grantor accounting guidance should be introduced in Australia. As we noted in Section 4, to date this has principally involved an analysis of the principles in IPSAS 32 and has resulted in the identification of a number of issues that warrant further consideration, including the following:

1. Initial measurement of the service concession asset
2. Initial measurement of any related non-financial liability or upfront gain
3. Recognition of income – upfront gain or deferred revenue?



## 5.2.1 Initial measurement of the service concession asset

Although the AASB, and the IPSASB before it, identified initial measurement of service concession assets held by grantors in service concession arrangements as an issue, we believe it has not been given the degree of scrutiny or level of analysis it warrants. In our view, initial measurement is a critical issue that potentially has broader implications for the measurement of non-financial assets controlled by public sector entities and, possibly, by regulated entities.

IPSAS 32 requires service concession assets to be measured initially at fair value. The AASB has tentatively decided to agree with this approach. We too agree that fair value is the appropriate basis for measuring the service concession assets at initial recognition because we believe this measurement basis will provide a faithful representation of the value of the service potential controlled by the grantor. However, we believe application of the definition of fair value in IFRS 13 to service concession assets is unclear, particularly in circumstances where a user pay concession has been transferred to the operator.

Fair value is defined in IFRS 13 as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”. The question at issue is: to what extent, if any, would the price a market participant is prepared to pay the grantor for a service concession asset be affected by the transfer of a user pay concession to the operator of the concession?

### View 1: Fair value of the service concession asset is directly affected by the value of any user pay concession

One view is that the price would be impacted significantly, assuming the market participant buyer is unable to access other cash generating sources to compensate it for the inability to charge users for the use of the asset. A rationale for this view is that the unit of account under IFRS 13 is an individual asset (although it should be noted that a larger unit of account may be specified in specific standards) and only cash flows directly attributable to the asset would be taken into account in determining fair value. The price a market participant buyer of the service concession asset would pay for the asset would be determined by the highest and best use of the asset. If it is not legally permissible for the market participant buyer to charge customers for the use of the **asset during the period of the service concession then this cash flow source would not be included in the buyer’s** cash flow estimates. If other cash flow sources, for example sale to other parties for property development, are not accessible to the market participant buyer then the price the market participant buyer would be prepared to **pay for the service concession asset would be limited to the asset’s residual value**. While this may be a material amount at initial recognition it would typically be significantly less than the price a market participant buyer would be prepared to pay for the same asset with a user pay concession attached. In this view, the fair value of the service concession is directly affected by the value of any user pay concession that may be related to it.

**The implications of this ‘narrow’ view of the fair value of a service concession asset for the valuation of other** non-financial assets controlled by public sector reporting entities would seem to be profound. At present the valuation methodology employed by these entities is typically depreciated replacement cost (DRC), i.e. the current cost of the remaining service potential attributable to the asset. This valuation methodology is used even where the DRC is not recoverable in whole or in part by directly attributable expected future cash flows, on **the grounds that the carrying amount represents the value of the asset’s current capacity to provide goods or** services in accordance with the specified public service objective and the entity intends to deploy the asset in the future in providing the needed goods and services. Applying the above interpretation of fair value to such assets may result in significant write downs, potentially to zero in many cases.

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## View 2: Fair value of the service concession asset is independent of the value of any user pay concession

An alternative view is that if a market participant buyer of a service concession asset is prepared to pay a price for the asset that reflects the costs that would be incurred to construct the asset, then the best estimate of the **asset's fair value** may be the **asset's** current replacement cost. This would be the case if the market participant buyer is a government entity (including the grantor entity itself) that needs the asset in order to achieve a public service objective, for example, the provision of an integrated transport network, and the only way in which the asset can be acquired is if it is reconstructed. In this view, the fair value of the service concession asset would be independent of the value of any user pay concession that may be related to it because the market participant buyer must pay a price **equal to the asset's current reconstruction cost in order to access the asset's service potential**.

This view would seem to avoid the concern referred to under View 1 about the implications of that View for the valuation of other non-financial assets controlled by public sector reporting entities; provided a market participant buyer (which may be a government) would be prepared to pay a price equal the non-**financial asset's** current DRC **in order to acquire the asset's service potential, the asset's fair value** would be equal to at least the current DRC.

This alternative view of the concept of fair value would seem to be consistent with the principle underpinning the requirements developed by standard setters relating to the impairment of non-financial assets deployed by entities whose principal objective is not the generation of profit. These standards typically require assets to be carried at not more than their recoverable amount and define that amount as the higher of fair value and value in use. Value in use is, in turn, defined in a manner that reflects the intention of the entity to continue to use the **asset's remaining service potential to provided needed goods or services in accordance with the entity's mission**. For example, AASB 136 *Impairment of assets* paragraph Aus32.1 states: **"Where the future economic benefits of an asset held by such entities are not primarily dependent on the asset's ability to generate net cash inflows and where the entity would, if deprived of the asset, replace its remaining future economic benefits, value in use shall be determined as the depreciated replacement cost of the asset"**. The rationale underpinning these requirements is that even if the asset will not generate directly sufficient net cash inflows to recover its carrying amount (and therefore fair value (as narrowly defined) would be less than carrying amount), the asset may have an economic value to the entity that is higher than the cash flow driven amount. That economic value is represented by the asset's **DRC** because that is the amount the entity would need to pay, were it deprived of the asset, in order to acquire the service potential necessary to provide the needed goods or services.

## Our view

View 1 would appear to be a more technically correct interpretation of the precise wording of IFRS 13 and the **IASB's** apparent rationale underpinning the standard, i.e. the focus on identifiable cash flows. However, the financial reporting outcome of adopting View 1 seems to us to be incompatible with the concept of an asset as defined by accounting standard setters in the context of not-for-profit entities in the private or public sectors and with the economic substance of the resources used by those entities to achieve their objectives.

An asset is defined by the IPSASB in its recently issued conceptual framework as *a resource presently controlled by the entity as a result of a past event and a ‘resource’ is described as an item with service potential or the ability to generate economic benefits*<sup>8</sup>. Similarly, the AASB (together with the now superseded Public Sector Accounting Standards Board) in its transaction-neutral conceptual framework, defined assets as future economic benefits controlled by the entity as a result of past transactions or other past events and stated **that the term ‘future economic benefits’ is synonymous with the notion of service potential**<sup>9</sup>. Both conceptual frameworks state that service potential is the capacity to provide services to customers or beneficiaries that **contribute to achieving an entity’s objectives and** make it clear that this capacity can exist irrespective of whether the item generates net cash inflows<sup>10</sup>.

With this analysis of the nature of assets controlled by not-for-profit entities in mind it seems incongruous to us that a fair value measurement of such assets under View 1 may result in them being valued at negligible amounts or zero. **In our view, only if the measurement basis reflects the assets’ remaining service potential,** such as would be the case using DRC as the valuation methodology, would the basis **faithfully portray the assets’** economic substance.

What is clear to us is that the appropriate application of IFRS 13 to non-financial public sector assets is unclear. Whether the AASB can address such concerns by providing explanatory guidance to AASB 13 Fair value measurement, perhaps based on the rationale set out in View 2, or by specifying a more appropriate measurement basis, such as DRC, is an open question. Irrespective of the course of action it decides to pursue, we believe the AASB needs to resolve the issue as soon as possible.

### **5.2.2 Initial measurement of any non-financial liability or upfront gain**

#### **What concerns have been raised around initial measurement of the non-financial liability or upfront gain?**

While it appears the AASB believes the measurement of the service concession asset is relatively uncontroversial, it is concerned about the initial measurement of any related non-financial liability or gain. In a recent discussion paper<sup>11</sup> the AASB illustrated that it may not be appropriate to measure the grantor’s non-financial liability or gain on the basis of the initial fair value of the service concession asset. Instead, it may be appropriate to measure the liability or gain by reference to the value of what the grantor has exchanged for the service concession asset (for example, in the case of a toll road, the right to toll). The fair value of the asset exchanged (the right to toll in our example) may exceed the fair value of the service concession asset. This is because the operator is providing multiple services in exchange for receiving the concession. In addition to constructing the asset, they will typically also operate, maintain and repair the asset on behalf of the grantor.

<sup>8</sup> The International Accounting Standards Board, Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, October 2014, paragraphs 5.6-5.7.

<sup>9</sup> Australian Accounting Standards Board and Public Sector Accounting Standards Board, Statement of Accounting Concepts SAC 4 Definition and Recognition of the Elements of Financial Statements, March 1995, paragraphs 14 & 18.

<sup>10</sup> The following excerpt from SAC 4 provides a succinct explanation of this phenomenon:

**“The fact that not-for-profit entities do not charge, or do not charge fully, their beneficiaries or customers for the goods and services they provide does not deprive those outputs of utility or value; nor does it preclude the entities from benefiting from the assets used to provide the goods and services. For example, assets such as monuments, museums, cathedrals and historical treasures provide needed or desired services to beneficiaries, typically at little or no direct cost to the beneficiaries. These assets benefit the entities by enabling them to meet their objectives of providing needed services to beneficiaries”.** SAC 4, paragraph 21.

<sup>11</sup> AASB Discussion Paper, Agenda paper 8.2, Dated 26 July 2012, IPSAS 32 Service Concession Arrangements: Grantor, 2.20-2.23

## What measurement principles should be applied?

The AASB has acknowledged that the measurement principles for the service concession asset and related liability or gain should be consistent with the principles in the forthcoming revised IASB standard on revenue. However, the Board is concerned that IPSAS 32 does not deal adequately with the effect of an intangible asset exchange that is a feature of user pays structures, on the initial measurement of any related non-financial liability or gain. **The AASB's concern would seem to have limited applicability to availability service concession arrangements** because the asset transferred to the operator is financial and the cash flows relating to the other services can be specifically identified.

**A potential outcome of the AASB's deliberations on this issue is that** grantors may recognise a value for the related non-financial liability or gain in excess of the fair value of the service concession asset. **The AASB's** rationale is that the fair value of the licence may exceed the fair value of the service concession asset because the operator is being compensated for not only the construction of the service concession asset but also the operation of the asset during the service concession period.

The concern raised by the AASB highlights the fact that in a user pay arrangement the grantor transfers to the operator **a 'licence'** that would either not have previously been recognised on the grantor's **balance sheet or if it** had been recognised would not have been measured at fair value.

Licences transferred by grantors in the context of service concession arrangements are internally generated intangible assets. The circumstances in which internally generated intangible assets can be recognised under IAS 38 are very restrictive and if recognised they are measured initially at the costs incurred in their development. As there are minimal costs associated with the generation of licences such as the right to toll, any intangible asset recorded at cost would **not reflect the 'value' of the** asset. Under IAS 38, revaluation of an intangible asset to its fair value is permitted but only if an active market exists. Typically an active market would not exist for internally generated intangible assets that are the subject of service concession arrangements. Accordingly, even if these intangible assets meet the recognition criteria in IAS 38, the amount recognised would be a poor surrogate for fair value.

## How can these measurement principles be applied to Service Concession Assets?

Service concession arrangements involving existing infrastructure provide a good demonstration of this issue. An example is the new WestConnex structure in New South Wales (NSW), whereby an existing road, the M4, will be widened through government funding and then subsequently tolled. The tolling will then fund future **stages of the NSW Government's transport plan. The road to be tolled is currently on the NSW Government's** balance sheet and is not currently subject to a toll. The licence that will be transferred to the operator to fund **the future development of the road network is not recognised on the NSW Government's balance sheet.**

This example raises the following questions: what is the asset that should be recognised on the NSW **Government's** balance sheet – the licence or the new infrastructure the tolling of the existing road will fund? When should the asset be recognised? Should the value attributable to the licence include a component relating to the operation of the tolled road? If so, **should a separate asset 'right to receive operating services' be** recognised when the licence is transferred to the operator? What should be the timing of revenue recognition relating to the transferred licence and should the timing be affected by the existence of a service component relating to the operation of the tolled road? Should the value of the existing road be reduced when the user pay concession has been transferred to the operator?

Structures similar to WestConnex, whereby existing State infrastructure is subsequently tolled, are likely to become more common. This market development further strengthens the case for the control approach as it provides a robust framework for identifying which assets should be recognised, when they should be recognised and how and when any income arising from the transfer of licences should be recognised.

### 5.2.3 Recognition of the exchange transaction – upfront gain or deferral of revenue?

In its minutes of the September 2011 AASB meeting, the AASB raised concerns about whether any gain to be recognised by the grantor from the exchange transaction should be included in profit or loss immediately or should be deferred and recognised in profit or loss over the term of the concession arrangement. Subsequently, the AASB has considered service concession arrangements in light of IFRS 15 and tentatively concluded that service concession arrangements where the grantor transfers an intangible asset to the operator would not fall within the scope of IFRS 15. The AASB has asked for alternatives other than IFRS 15 to be explored in relation to accounting for **grantor's rights and obligations**.

**We agree with the AASB's decision to ensure there is consistency with the new revenue guidance.** We believe any future service concessions standard should provide explicit guidance for grantors in assessing the effect of any continuing involvement they might have in the provision of the service concession asset over the service concession period. This would provide guidance as to whether revenue is recognised upfront or deferred based **on the grantor's level of continuing involvement**. The guidance might cover, for example, the nature and significance of the grantor's **rights during the concession period, the nature of the asset** (for example, is it part of an integrated network such as a toll road or is it a standalone asset such as a convention centre) and rights held by other state owned corporations (e.g. regulations).

In respect of rights held by the grantor, an example of the type of guidance that might be provided is discussion of termination rights, where the grantor has a right to terminate the arrangement at its convenience. As noted in Section 3, these clauses are normally protective in nature. The rights conveyed are typically not intended to provide the grantor power over the **operator's activities**, the operator being responsible for all activities of the service concession asset, but are included to protect the grantor's **public service obligations**. Arguably in such cases the existence of the protective right *per se* should not preclude the immediate recognition of any gain arising from the exchange transaction. However, in determining whether any gain should be recognised immediately or deferred, it would be necessary to identify whether the grantor has any other continuing involvement in the provision of the service concession asset over the concession period and whether such involvement constitutes an ongoing performance obligation..

### 5.3. Other issues

While the above discussion has focussed on the key conceptual **issues arising out of the AASB's analysis of IPSAS 32**, we believe the AASB should also consider the following issues in its future deliberations:

- accounting by the grantor during the construction period
- the scope of a grantor accounting standard

#### 5.3.1 Accounting by the grantor during the construction period

An asset under the Conceptual Framework is defined as a resource controlled by an entity from which future economic benefits are obtained. For service concession arrangements it will need to be determined at what point during the term of the arrangement an asset should be recognised.

Under the risk and rewards approach, the asset is recognised by the grantor only when the service concession asset is available for use. This is consistent with the principles in IAS 17 where lease assets are recognised only when the leased property is available for use.

However, under the control model, the recognition point could be earlier if the grantor is considered to control an asset during the construction phase. Assessing the point at which control arises would involve, amongst other things, assessing whether the grantor has incurred an obligation to transfer resources to the operator during the construction phase. This would involve assessing whether a financial liability, as defined in IAS 32/AASB 132 **Financial Instruments: Presentation** (IAS 32) has arisen and/or whether a provision as defined in IAS 37 has arisen.

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A financial liability is defined in IAS 32 paragraph 11 (a) as a contractual obligation to deliver cash. If the grantor has an obligation to deliver cash as a result of work in progress during construction, a financial liability would be recognised as well as the associated work in progress asset.

**IAS 37 defines a provision as “...a liability of uncertain timing or amount” (paragraph 10) and requires a provision to be recognised in the balance sheet when:**

- a. **an entity has ‘a present obligation (legal or constructive) as a result of a past event;**
- b. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- c. a reliable estimate can be made of the amount of the obligation (paragraph 14)

A grantor would need to assess if it has a contractual obligation for work performed during the construction phase and, if so, would recognise a provision (or a financial liability). The grantor would also need to assess if it has a constructive obligation to transfer resources to the operator as a result of work performed during the construction phase.

**A constructive obligation is defined in IAS 37 as an obligation that derives from an entity’s actions where:**

- a. by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- b. as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A constructive obligation may arise in a concession arrangement if a grantor has, through its past practices etc., created a valid expectation that it will step in to assist the operator during the construction phase.

In assessing whether a constructive obligation arises during the construction phase, a key consideration will be the nature of the service concession asset. Two recent examples that demonstrate the significance of the nature of the asset in assessing how the grantor may respond is Reliance Rail in NSW and Ararat Prison in Victoria.

The Waratah train PPP consortium was on the brink of collapse when financiers did not want to honour final draw-downs for the behind schedule project. The NSW Government committed to invest \$175 million in 2018 on a commercial basis in return for 100% of the PPP consortium, giving financiers the assurance needed to release the final funds necessary to complete the project. In Victoria on the other hand, the Government did not step in for the operator of Ararat Prison when the operator was under financial distress. Instead, the Government facilitated a new tender process to appoint a replacement operator. Arguably, the contrasting **natures of the assets were pivotal to each government’s response**, for example the rail project is part of a broader public transport network, whereas the prison is a standalone asset. In both these circumstances there was no contractual obligation for the grantor to step in, however if a constructive obligation can be established based on past practices or the nature of the asset we would be of the view an obligation would need to be recognised.

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### 5.3.2 *Scope of a grantor accounting standard*

Based on discussions to date by the AASB it seems likely that the Board will propose a scope for a grantor accounting standard that is similar to IPSAS 32 and a mirror image of Interpretation 12, which was discussed in Section 4.6<sup>12</sup>. However, in light of the service concession structures emerging in practice we encourage the AASB to consider broadening the scope of the standard to encompass service concession arrangements that do not involve regulated pricing. While we acknowledge that the scope of IPSAS 32 is intended to mirror the scope of Interpretation 12 and result in a common set of arrangements from private and public sector perspectives, we are concerned that limiting the scope of a grantor accounting standard in this way will exclude a growing number of service concession arrangements from the standard and may result in a lack of comparability in financial reporting by grantors.

From our experience, there are a number of service concession arrangements that do not involve regulated pricing. In our view, the case can be made that the grantor controls the service concession asset in these arrangements because of the continuing involvement of the grantor and the benefits the grantor receives from the infrastructure. Accordingly we believe a grantor accounting standard should include these types of arrangements within its scope. Failure to do so may lead to service concession arrangements where the grantor controls the service concession asset continuing to be off-balance sheet.

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<sup>12</sup> In September 2012, the AASB tentatively decided that the scope of IPSAS 32 and the underlying control model did not need to be reconsidered. See AASB Memorandum, Agenda item 11.1, *Service Concession Arrangements: Grantor*, 5 February 2013

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## ***6. What needs to be done?***

There have been significant developments in grantor accounting for service concession arrangements since the AASB Panel considered appropriate accounting models in 2007. Since that date, an accounting standard has been issued by the IPSASB and grantors have formulated their own accounting policies in line with the AASB Panel's **Paper**. During the same period, commercial structures have been evolving in an endeavour to achieve a different sharing of risks between the grantor and the operator and this has highlighted deficiencies in current accounting policies.

Throughout this paper we have analysed existing accounting policies being applied by grantors and evaluated approaches previously considered by the AASB Panel to be appropriate. We have critically assessed these approaches in the context of emerging commercial structures. Our objectives have been to highlight the key issues relating to accounting for grantor service concession arrangements and to explore possible improvements in grantor accounting, most notably how control is applied to public sector assets and the fair value measurement of service concession assets. In the process we have identified other issues that may have broader implications for public sector reporting entities and, possibly, regulated entities, in particular the determination of fair value in the measurement of non-financial assets. We encourage debate amongst interested parties to assist the AASB in developing a high quality grantor accounting standard that provides relevant information and is able to deal effectively with the commercial structures emerging in practice.



