

## STAFF NOTE ON IPSASB ED

### *ED 43 SERVICE CONCESSION ARRANGEMENTS: GRANTOR*

#### Introduction and Purpose

1. The IPSASB published ED 43 (refer Agenda Paper B8.2) on 20 February 2010, with a comment deadline of 30 June 2010.
2. The purpose of this agenda item is to consider the nature of any AASB and FRSB due process regarding the Exposure Draft—specifically, to consider whether:
  - (a) the Boards would like to issue a joint Invitation to Comment on the ED; and
  - (b) the Boards intend to make a joint submission to the IPSASB on the ED.
3. This paper:
  - (a) provides background on the IPSASB ED and the Australian and New Zealand context;
  - (b) seeks feedback from the Boards on whether to issue a joint Invitation to Comment on the ED and matters to be highlighted in that Invitation for Comment; and
  - (c) seeks feedback from the Boards on whether to make a joint submission on the ED.

#### Background

4. The IPSASB issued a Consultation Paper *Accounting and Financial Reporting for Service Concession Arrangements* in March 2008. The development of a Consultation Paper (CP) was a collaborative project which the IPSASB agreed to lead, with participation from a group of national standards setters and other organizations.
5. Both the AASB and the FRSB sought comment from constituents on this Consultation Paper. The AASB made a formal submission to the IPSASB but the FRSB did not. The IPSASB considered that responses to the Consultation Paper were generally favourable. A selection of comments made by Australian and New Zealand submitters in relation to the 2008 Consultation Paper are noted in Appendix 1 of this paper.
6. ED 43 *Service Concession Arrangements: Grantor* proposes requirements and guidance on how grantors should recognise, account for, and disclose assets in service concession arrangements. Currently, there is no international standard addressing the accounting for such arrangements from the grantor's perspective. Interpretation IFRIC 12 *Service Concession Arrangements* applies only to the operators of these arrangements. The ED mirrors IFRIC 12 in terms of scope of arrangements covered, terminology and criteria for asset recognition. The disclosure requirements are based on those in Interpretation SIC-29 *Service Concession Arrangements: Disclosures*.
7. The ED proposes recognition and disclosure requirements in respect of assets used to provide service concession arrangements. The criteria for recognising service concession assets are based on principles set out in IFRIC 12.

#### Australian and New Zealand context

8. Both Australia and New Zealand have issued domestic equivalents to Interpretations IFRIC 12 and SIC-29.

## Australia

9. Many government agencies in Australian jurisdictions are grantors under service concession arrangements. Service concession arrangements exist in relation to toll roads, airports, ports and railways. In 2006 the AASB noted that grantors typically do not recognise infrastructure assets under service concession arrangements (except perhaps in relation to residual interests in infrastructure assets). [Letter dated 10-11-06 from David Boymal to Sir David Tweedie in relation to the Near-final Draft IFRIC Interpretation *Service Concession Arrangements*]
10. In the absence of authoritative accounting pronouncements on service concession arrangements from the grantor's perspective, various Australian bodies have developed guidance. For example:
  - HoTARAC developed and issued its own guidance for grantors in 2004 and 2005.
  - The Victorian Auditor-General's Office agreed a framework with the Victorian Department of Treasury and Finance based on the principles contained in existing Australian accounting standards that considers the economic substance of each arrangement.

## New Zealand

11. New Zealand currently has only a few projects in which the government could be regarded as the grantor in a service concession arrangement. These include the Wellington and Hutt Valley water and waste water projects, Vector Arena in Auckland, Papakura District Council's franchising of its water facilities and several healthcare facilities. There have been other projects which have not yet come to fruition, particularly in the roading and land transport arena. However, the environment is now changing with a number of public private partnerships (PPP) projects being actively pursued.
12. In the National Infrastructure Plan released on 3 March 2010, the New Zealand Government has publicly stated "The Government intends to use public private partnerships (PPPs) where they represent value for money to taxpayers. However, PPPs do not change the fiscal position (unless they generate additional revenue, such as tolls). Both the underlying economics and New Zealand accounting treatment of PPP arrangements mean that 'off-balance sheet' considerations are not a factor in the Government's choice of procurement option."
13. In 2009 the Treasury released *Guidance for Public Private Partnerships (PPPs) in New Zealand*. This Guidance outlines the general direction and principles that will be adopted for PPPs, the processes that are to be followed and the rationale for them. It also provides a framework for assessing whether a PPP is to be preferred over other forms of procurement in any given situation. It contains limited accounting guidance (as shown below).

### **Extract from *Guidance for Public Private Partnerships (PPPs) in New Zealand***

To the extent that the PPP contract provides for the government to make service payments over the life of the contract (as opposed to users paying directly, as in the case of toll roads), the PPP gives rise to a liability. The liability is equivalent to debt and is likely to be counted as such. The size of the liability is the discounted sum of the service payments and is in practice likely to be equal to the construction cost plus the net present value of the operating and maintenance costs over the life of the contract. The actual parliamentary appropriation, however, is not required until the contract is signed.

## **Usual due process**

### Australia

14. The AASB considers on a case-by-case basis whether to formally issue a consultative document in Australia for public comment in relation to an IPSASB exposure draft or other

proposal document. The AASB notes that issuing a consultative document does not signify that it will necessarily develop recommendations or requirements on the topic.

#### New Zealand

15. The FRSB's usual procedures in relation to notifying constituents about IPSASB exposure drafts and making submissions to IPSASB are addressed in the FRSB's Operating Manual. Relevant extracts from that Manual are set out in Appendix 2 to this memo. Key points are:
  - Constituents are notified of all IPSASB EDs (in a number of ways, including posting the ED on the Institute's website).
  - If the FRSB is considering adopting the IPSASB proposals in New Zealand the FRSB will follow appropriate due process, which includes issuing a New Zealand specific request for comment.
  - Whether the FRSB makes a submission is determined on a case-by-case basis (depending on the priority of the project and the implications for New Zealand). This project is a priority 2 project on the FRSB's workplan. The FRSB submits on priority 2 projects as resources permit.
16. The FRSB Operating Manual does not specifically address the circumstances in which joint Invitations to Comment or joint submissions will be appropriate. However, it implies that joint papers may be appropriate where the Boards have similar views.

#### **Invitation to Comment**

17. This section identifies some issues that could be considered in an Invitation to Comment. Following consideration of these issues at the joint meeting the Boards are asked to provide feedback on whether they wish staff to develop a joint Invitation to Comment and the issues that should be addressed in the Invitation to Comment. Staff note that a joint Invitation to Comment would need to be developed quickly to ensure that constituents have sufficient time to comment to the AASB and the FRSB prior to their completion of submission(s) (if any) before the IPSASB's closing date of 30 June.

#### Mirror of IFRIC 12

18. The IPSASB is seeking feedback on all the proposals in the ED, and has identified only one specific matter for comment. ED 43 requests feedback on the approach taken in developing the ED – that is, the intention of mirroring the principles set out in IFRIC 12.
19. The Basis for Conclusions, paragraphs BC2 to BC5, discusses IPSASB's reasons for taking this approach. The main reason was to ensure that both parties to the same arrangement apply the same principles in determining whether the asset used in a service concession arrangement should be accounted for as an asset, thus minimizing the possibility for an asset to be accounted for by both of the parties, or by neither party.
20. Because IFRIC 12 deals only with the accounting by the operator, it does not address some of the issues faced by grantors. There was some debate at IPSASB meetings as to whether, and if so how, the ED should include additional guidance on such matters. The solution adopted by the IPSASB has been to include application guidance on grantor issues not addressed by IFRIC 12 in order to lead to more consistent accounting.
21. The ED presents the proposed Application Guidance as an integral part of the (draft) standard. For example, the Application Guidance addresses (i) accounting for the liability related to the service concession asset and (ii) applying the general revenue recognition principles in IPSAS 9 *Revenue from Exchange Transactions* to service concession arrangements because of the unique features of some service concession arrangements (e.g., revenue-sharing provisions, provision of a revenue-generating asset for nominal rent).

22. The ED also includes proposed Implementation Guidance on arrangements that are outside the scope of the ED and Illustrative Examples. These sections are presented as accompanying material that is not integral to the (draft) standard.
23. *Do the Boards agree with the IPSASB's approach?*  
*Do the Boards consider that the IPSASB has achieved its objective of mirroring IFRIC 12?*  
*Do the Boards consider that there is an appropriate balance between the principles in the ED and the Application Guidance?*

#### Control-based approach

24. The ED takes a control-based approach to determining whether the grantor should recognize a service concession asset. The ED addresses only arrangements in which the grantor (a) controls or regulates the services provided by the operator, and (b) controls any significant residual interest in the service concession asset at the end of the term of the arrangement. Consistent with IFRIC 12, in the case of an asset used in a service concession arrangement for its entire useful life (a "whole-of-life" asset), only condition (a) must be met for recognition of a service concession asset.
25. *Do the Boards agree with the IPSASB's approach?*

#### Asset and liability recognition – criteria

26. The proposed standard requires the recognition of a service concession arrangement asset and also a liability when specified criteria are met (paragraphs 10 and 11).
10. **The grantor shall recognize a service concession asset in respect of an asset specified in paragraphs 8(a), 8(b) and 8(c); and shall reclassify an asset specified in paragraph 8(d) if:**
- (a) The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
  - (b) The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.
11. **This Standard applies to an asset used in a service concession arrangement for its entire useful life (a whole-of-life asset) if the condition in paragraph 10(a) is met.**
27. *Do the Boards agree with these criteria?*

#### Asset recognition – consistency with IFRIC 12?

28. Paragraph AG20 (shown below) discusses the recognition of a constructed asset (and by implication the corresponding liability), where the construction risk is borne by the operator. It states that recognition will normally occur when the asset is placed into use.
- AG20. IPSAS 17 or IPSAS 31, as appropriate, set out the criteria for the timing of initial recognition of a service concession asset. In the case of property, plant and equipment, where the operator bears the construction risk, the timing of initial recognition of the service concession asset by the grantor will normally be when the asset is placed into use. Where the grantor bears the construction risk, the recognition criteria may be met during the construction period, and, if so, the grantor will normally recognize the service concession asset (and related liability) during that period. The recognition criteria in IPSAS 31 also require that the initial cost or fair value of the asset can be measured reliably for an intangible asset to be recognized. Accordingly, to meet the recognition criteria in IPSAS 17 or IPSAS 31, as appropriate, the grantor must have reliable information about the cost or fair value of the asset during its construction or development. In some cases, the grantor may incur an obligation during construction or development before the constructed or developed asset

meets the conditions in paragraph 10 (or paragraph 11 for a whole-of-life asset) for recognition as a service concession asset.

29. Under IFRIC 12 paragraph 13 the operator recognises a growing receivable *as the service concession asset is constructed*.
30. *Do the Boards consider that paragraph AG20 is consistent with IFRIC 12?*

#### Measurement at initial recognition

31. The proposed standard requires the initial measurement of a service concession arrangement asset at fair value and the liability to be measured at the same amount (paragraphs 15 and 20).
15. **The grantor shall initially measure the original service concession asset at its fair value.**  
...
- 20 **The liability recognized in accordance with paragraph 19 shall be initially measured at the same amount as the service concession asset measured in accordance with paragraphs 15–17.**
32. *Do the Boards agree with these measurement requirements?*

#### Subsequent measurement of the SCA asset and liability

33. The proposed standard refers to other standards for subsequent measurement of the service concession arrangement asset and liability. For example:
- paragraph 18 requires service concession assets to be measured in accordance with the requirements in IPSAS 17 *Property, Plant and Equipment*, or IPSAS 31 *Intangible Assets*, as appropriate;
  - paragraph 21 requires financial liabilities to be subsequently accounted for in accordance with the new financial instrument IPSASs; and
  - paragraph 22 requires performance obligations to be subsequently measured in accordance with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.
34. *Do the Boards agree this guidance is appropriate and sufficient?*

#### Disclosure

35. Paragraph 27 of the ED sets out the proposed disclosure requirements.
36. *Do the Boards agree with the disclosure requirements?*

#### Incorporation of the IPSAS from ED 43 into Australian and New Zealand accounting standards

37. If the Boards agree to prepare a joint Invitation to Comment, and the Invitation to Comment is to serve as a due process document, the Invitation to Comment will need to indicate the Boards' view as to whether the IPSAS resulting from ED 43 will be included in Australian and New Zealand accounting standards. Staff is of the view that a joint Invitation to Comment should propose that the resulting IPSAS will be incorporated into Australian and New Zealand accounting standards without further exposure, subject to no material changes being made by the IPSASB to the proposals in ED 43.

38. *Do the Boards agree with that an Invitation to Comment on ED 43 should flag the future adoption of the IPSAS resulting from ED 43?*

### **Implications for IASB**

39. Should the IASB be encouraged to make a submission on the ED? In the absence of other authoritative guidance on accounting by the grantor, private sector grantors (to the extent that there are private sector grantors) could look to an IPSAS for guidance.
40. Do the Boards consider that the IASB should be encouraged to review IFRIC 12 following the issue of an IPSAS on *Service Concession Arrangements* on the same reasoning used in the IASB-FASB convergence processes – a later standard should be used as the basis for the review of an earlier standard?

### **Recommendations**

41. It is recommended that the Boards:
- (a) agree to issue a joint Invitation to Comment on the IPSASB ED;
  - (b) agree the Invitation to Comment should include information from the “Background”, “Australian and New Zealand Context” and relevant parts of the “Invitation to Comment” sections of this paper;
  - (c) agree the Invitation to Comment should be approved out of session by the Chairs and a small number of Board members; and
  - (d) agree to make a joint submission on the IPSASB ED.

## Appendix 1

### Australian and NZ Submitters' Comments on the IPSASB SCA Consultation Paper

- (a) There may be instances when neither party controls the service concession asset, particularly when an external regulator is involved (HoTARAC).
- (b) Support for a risks and rewards model rather than the modified IFRIC 12 proposals in the Consultation Paper (HoTARAC).
- (c) Support for the proposed control approach (NZ OAG).
- (d) A grantor's regulatory capacity, as embodied in the IFRIC 12 model, is an inappropriate indicator of a grantor's control of SCA property (HoTARAC).
- (e) The expression 'service concession arrangement' should be explicitly defined (HoTARAC).
- (f) A need for guidance on payments received in advance by the grantor (NZ OAG).
- (g) The need for guidance on how IPSAS 5 *Borrowing Costs* should be applied to service concession arrangements (NZ OAG).
- (h) A request for more examples (NZ OAG).

#### Main concerns of the AASB:

- (i) The potential for inconsistent outcomes under IFRIC 12 and the IPSASB model such that neither the grantor nor the operator recognises as an asset all or part of the property underlying the SCA.
- (j) Inadequate justification for adoption of 'all or nothing' approach to control of the underlying property – a components approach may be justified.
- (k) If a control approach is to be applied, interpretation of 'control' should depend on the substance of the arrangement without referring to the form of regulation for an SCA, or at least the reference should be clarified in application to the public sector.
- (l) The second grantor control criterion should refer to "any significant residual interest" instead of "the residual interest" in order to adequately address whole-of-life SCAs (and to be consistent with IFRIC 12).

## Appendix 2

### Extracts from FRSB Operating Manual (May 2008)

#### 8. IPSASB EXPOSURE DRAFTS

- 8.1 The FRSB's usual procedures in relation to IPSASB exposure drafts, as set out in the FRSB's Operating Manual, are as follows:
- Notify New Zealand constituents.
  - Invite New Zealand constituents to provide feedback to IPSASB.
  - Seek feedback from the Public Benefit Entity working group (determined on a case-by-case basis).
  - If the FRSB is considering adopting the IPSASB proposals in New Zealand the FRSB will follow appropriate due process, which includes issuing a New Zealand specific request for comment.
  - FRSB submission determined on a case-by-case basis (depending on the priority of the project and the implications for New Zealand).

#### 11 SUBMISSIONS TO OTHER STANDARD SETTING BODIES

- 11.1 This section sets out the FRSB's policies and procedures on making submissions to other standard setting bodies, principally the IASB and IPSASB.
- 11.2 The FRSB will not submit on all IASB or IPSASB proposals, but will focus on those proposals that are considered to be a high priority. The FRSB has previously agreed that:
- Discussion papers will generally be given a higher priority than exposure drafts.
  - IFRIC Draft Interpretations will generally be given a low priority.
- 11.3 The FRSB usually does not submit on IFRIC Draft Interpretations on the grounds that the specific issues addressed either have little application in New Zealand or are of a lower priority than those addressed in IASB discussion papers and exposure drafts.
- 11.4 As part of its process for preparing a submission the FRSB will generally:
- receive an education session from staff or have a preliminary discussion of key issues;
  - obtain input from the relevant working group or others with expertise (from either Australia or NZ) in the topic area;
  - consider the nature of any working arrangements with the AASB in respect of the project and whether the FRSB intends to make a separate or joint submission. This is discussed further below;
  - consider submissions received by the FRSB to see if these submissions raise issues that the FRSB wishes to include in its submission. The FRSB does not regard itself as a conduit for NZ constituents' views. Instead, where relevant, submissions are forwarded to the IASB or IPSASB; and
  - consider the submissions made by other standard setting bodies (for example, the AASB, UK ASB or EFRAG) to see if these submissions raise issues that the FRSB wishes to include in its submission.
- 11.5 FRSB submissions will generally focus on the general principles and the more significant proposals, rather than detailed application or implementation issues.
- 11.6 The nature of working arrangements with the AASB will vary across projects. Staff should explore the possibility of sharing resources with the AASB so that one staff member is primarily responsible for preparing joint papers for both boards on key issues on high-priority projects. Consistency with the AASB submission is not essential or an objective of the process, as each board should form its own views. However, where the FRSB and AASB have been working closely on issues the two boards may have similar views.