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Ms Stephenie Fox
Technical Director
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International Federation of Accountants
277 Wellington Street West
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CANADA

Dear Stephenie,

IPSASB Consultation Paper
Accounting and Financial Reporting for Service Concession Arrangements

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

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

Accordingly, the AASB issued an Invitation to Comment (ITC 16) in April 2008 to publicise the IPSASB's proposals and to seek the views of Australian constituents. The comments received from constituents have been taken into account by the AASB in preparing this submission. Our main concerns with the IPSASB proposals are noted or summarised below, with further comments in the attachment.

Consistent Financial Reporting as between Operators and Grantors

Like many jurisdictions, Australia has adopted the International Financial Reporting Standards issued by the International Accounting Standards Board in relation to for-profit entities. Consequently, the AASB issued an Australian equivalent of IFRIC Interpretation 12 *Service Concession Arrangements* in February 2007. AASB Interpretation 12 has the same scope as IFRIC 12 and thus applies explicitly only to the accounting by operators for certain public-to-private SCAs.

Pursuant to the AASB's transaction neutrality policy, not-for-profit entities in the private sector and in the public sector are normally required to comply with Australian equivalents to IFRSs when preparing general purpose financial statements. Therefore, the AASB has previously considered the relevance of Interpretation 12 for grantors. The AASB reached the view that, under the hierarchy for selecting accounting policies set out in AASB 108 (IAS 8) *Accounting Policies, Changes in Accounting Estimates and Errors*, Interpretation 12 does not necessarily determine the general accounting by public sector grantors for SCAs within the scope of the Interpretation.

Nevertheless, the AASB in general would prefer consistency across the accounting by operators and by grantors. Although the AASB does not consider that Interpretation 12 should necessarily be followed automatically, and agrees with some of the changes to the grantor control criteria proposed by the IPSASB, it is concerned that the IPSASB proposals and the Interpretation 12 requirements are not fully consistent. The outcome of this could well be that the property underlying a SCA is not recognised as an asset in full or in part by either the grantor or the operator. This illustrates the difficulties that can arise when the IASB and the IPSASB address topics independently.

Determining Control of the Underlying Property

The IPSASB proposes a particular control approach to determining whether the grantor should recognise the property underlying an arrangement as its asset: if the grantor (a) controls or regulates the services that the operator must provide with the underlying property, to whom it must provide them, and the price ranges/rates, and (b) controls the residual interest, then the grantor should recognise the property as an asset in its financial statements. If both of these control criteria are not met by the grantor, then it does not recognise the property. This is essentially an 'all or nothing' approach.

The proposed grantor control criteria reflect the approach in Interpretation 12, which is based on a distinction between control over the use of an asset and mere access to make use of the asset within the parameters set by the controlling party. This distinction is made in IFRIC Interpretation 4 *Determining whether an Arrangement contains a Lease*, but in most pronouncements control is assessed in relation to the risks and rewards arising from an asset. The IPSASB has not adequately justified rejecting a risks and rewards approach in favour of the approach proposed.

The AASB encourages the IPSASB to undertake a more detailed examination of the components (rights and obligations) approach than that included in the Consultation Paper. This approach does not assume that either party to an arrangement should recognise the underlying property in its entirety. Instead, it views the property as a bundle of risks and rewards, some of which may be controlled by one party and some by the other party. Under this approach, both parties could recognise assets (and liabilities) that arise from their association with the property, rather than the property as a whole.

Grantor Control Criteria – Scope of Regulation

Nevertheless, if a control approach is to be applied, the AASB is particularly concerned with the first of the proposed grantor control criteria referring to whether the grantor 'controls or regulates' the services in the manner specified. The interpretation of control should depend

on the substance of the arrangement without referring to the form of regulation under which the service concession operates.

The reference to regulation should be either clarified directly in the criterion or removed, as it appears to have been retained for apparent consistency with the wording of the Interpretation 12 control criteria. Differences in the scope of 'regulation' between the Interpretation 12 requirements and the IPSASB's proposals mean that the apparent consistency in the control criterion is misleading. Furthermore, the reference to regulation may allow the form in which the operating parameters for a SCA are specified to prevent proper consideration of the substance of the arrangement. Therefore, it may be helpful to clarify the criterion as based on whether the grantor 'controls or regulates (other than by general legislation)' the services in the manner specified.

Grantor Control Criteria – Residual Interest

The second of the proposed grantor control criteria is whether the grantor controls (through ownership, beneficial interest or otherwise) 'the residual interest' in the underlying property at the end of the arrangement. This contrasts with the second control criterion in Interpretation 12, which refers to "any significant residual interest" instead. The difference in wording could result in a SCA being treated differently under the IPSASB's proposals compared with Interpretation 12, with the result that neither party recognises all or part of the underlying property. Furthermore, the proposals do not appear to adequately address whole-of-life SCAs.

The AASB prefers the wording as it is in Interpretation 12, so that the proposals would clearly cover whole-of-life SCAs and insignificant residual interests would not affect the accounting.

Other Comments

Responses to the specific questions raised in the Consultation Paper are included in the attachment to this submission, together with other comments of the AASB.

Overall Conclusion

The AASB encourages the IPSASB to continue its consideration of the issues concerning public sector grantors' accounting and reporting for service concession arrangements. The issues are important and deserve a timely debate and resolution.

If further information or clarification is required, please contact myself or Clark Anstis, Senior Project Manager (e-mail: canstis@aab.gov.au).

Yours sincerely



David Boymal
Chairman

Attachment

Grantor and Operator Accounting considered Separately

The grantor control criteria proposed by the IPSASB (paragraph 102) are very similar to those set out in IFRIC (and AASB) Interpretation 12. However, the IFRIC did not address the position of grantors in developing its requirements for operators, and the IPSASB does not appear to have addressed the position of operators in developing proposals for grantors, even though the original project brief also encompassed operator accounting. The IPSASB has assumed that operators, which are generally for-profit entities in the private sector or the public sector (government business enterprises), will be considering Interpretation 12 in determining their accounting (refer to paragraph 26 of the Consultation Paper).

Therefore, although there are many similarities, different outcomes have been reached that could result in asymmetric accounting as between operator and grantor due to the differences in the requirements rather than differences in the circumstances of each entity. It may be difficult to convince the IASB and the IFRIC to put resources into revising Interpretation 12 in conjunction with the IPSASB's standard-setting processes, however that should be attempted once the IPSASB reconsiders its proposals based on comments received in response to the Consultation Paper.

Scope of Service Concession Arrangements

The scope of service concession arrangements is not clearly stated in the Consultation Paper. An explicit definition or description would usefully clarify the scope.

One issue that needs to be addressed carefully is whether SCAs should be limited to the provision of services directly to the public through the use of infrastructure or a public facility. The Consultation Paper refers to the provision of services 'directly or indirectly' to the public through operation of the underlying property (see paragraphs 12 and 103). In contrast, Interpretation 12 appears limited to the direct provision of services: paragraph 3 there states "The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity."

The inclusion of the indirect provision of services potentially expands the scope of SCAs to any contract that uses an 'infrastructure asset' for the supply of goods or services to a public sector entity, which may be interpreted as indirectly supplying services to the public. Such expansion of the scope of SCAs would not seem to be appropriate.

Determining Control of the Underlying Property

Control of Certain Operational Aspects and Residual Interest

The IPSASB proposes a particular control approach to determining whether the grantor should recognise the property underlying an arrangement as its asset: if the grantor controls the underlying property, it should recognise the property as an asset in its financial statements. Two grantor control criteria are proposed: if the grantor (a) controls or regulates the services

that the operator must provide with the underlying property, to whom it must provide them, and the price ranges/rates, and (b) controls the residual interest, then the grantor should recognise the property as an asset in its financial statements. If both control criteria are not met by the grantor, then it does not recognise the property. This is essentially an 'all or nothing' approach.

The AASB acknowledges that this outcome is consistent with the current approach to the recognition of lease assets and liabilities, which is based on assessing which party to a lease holds/bears 'substantially all' the risks and rewards incidental to ownership of an asset. However, this artificial distinction between operating and finance leases is being reconsidered by the IASB in a current project, which is addressing the unbundling of the rights and obligations inherent in the underlying leased items.

Components (Rights and Obligations) Approach

This unbundling approach could well apply to infrastructure assets that are subject to SCAs, and the AASB encourages the IPSASB to undertake a detailed examination of the components (rights and obligations) approach. This approach does not assume that either party to an arrangement should recognise the underlying property in its entirety. Instead, it views the property as a bundle of risks and rewards, or rights and obligations, some of which may be controlled by one party and some by the other party. Under this approach, both parties could recognise assets (and liabilities) that arise from their association with the property, rather than the property itself.

This possibility is noted in Concepts Statement No. 4 *Elements of Financial Statements*, issued in June 2007 by the Governmental Accounting Standards Board (USA). It states in paragraph 13:

Control of the present service capacity embodied in an asset generally arises from contractual rights or legal ownership. Some resources, such as real property, may represent a bundle of rights associated with the resource—for example, the right to develop the property, the right to extract minerals from the property, and the right to install and maintain utility lines crossing the property. Different entities may control different rights associated with a single property. Provided the various rights possess the other inherent characteristics of an asset and meet the recognition and measurement criteria, these different rights associated with real property, for example, would be reported as assets by different entities. In this example, no single entity would report the entire real property resource as its asset.

The IPSASB's proposals could be characterised as having been developed within the constraints of existing pronouncements, although the project brief originally approved by the IPSASB did not envisage such a constraint. Considering the application of a components approach would certainly move the project beyond the constraints of existing pronouncements.

Risks and Rewards Approach

The proposed grantor control criteria reflect the general approach in Interpretation 12, which is based on a distinction between control over the use of an asset and mere access to make use of the asset within the parameters set by the controlling party (see paragraph 11). This distinction is also made in IFRIC Interpretation 4 *Determining whether an Arrangement contains a Lease*, but in most pronouncements control is assessed in relation to the risks and rewards arising from an asset. The IPSASB has not adequately justified rejecting a risks and rewards approach in favour of the approach proposed.

The AASB notes that existing Standards contain various descriptions of how an entity may be regarded as controlling an asset. For example, IPSAS 13 *Leases* requires a lessee to hold substantially all the risks and rewards of ownership in order for it to recognise the leased item as an asset. IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*

defines 'control of an asset' in terms of an entity being able to use or otherwise benefit from the underlying resource and to exclude or otherwise regulate the access of others to those benefits (rewards). This access proviso can be regarded as a subset of the ability to obtain the benefits: if access by others cannot be limited, then the entity would be unable to demonstrate an ability to use or benefit from the resource.

However, the IPSASB's proposals refer to control of the property underlying a SCA in terms of operating parameters (services/target recipients/pricing) and the residual interest. The connection to risks and rewards is oblique and problematic.

The IPSASB's reconciliation of these approaches (paragraph 85ff of the Consultation Paper) is based on the notion that the grantor continues to be accountable for the services provided through a SCA, and thus bears political risk associated with service delivery. It concludes that the grantor is subject to the risks and rewards arising from the service potential of the underlying property. Furthermore, the grantor is also subject to the economic risks and rewards since it is essentially the 'operator of last resort' – stepping in as operator if the economic risks and rewards are such that the contracted operator cannot continue in that capacity. The grantor is therefore likely to seek to retain control over aspects of the underlying property, by defining the SCA's operating parameters and retaining residual interests in the underlying property. The IPSASB concludes (paragraphs 84, 98) that controlling the residual interest serves to preserve the grantor's continuous use of the property during the period of the SCA.

However, the relationship between what the grantor might wish to do to cover or limit its political risk and the division of the economic/service potential risks and rewards between the grantor and the operator under the terms of the SCA is not clear from the Consultation Paper. The grantor may well set significant operating parameters in negotiation with the operator, but the operator can still hold the substantial portion of the economic risks and rewards. However, an alternative view is that the grantor is in substance obtaining economic rewards by setting the operating parameters, such as pricing (e.g. reduced costs for constituents). So the proposed grantor control criteria do not readily address the locus of the economic risks and rewards.

It is also unclear whether any distinction should be made between economic risks and rewards versus service potential risks and rewards or, if so, how it should be handled in terms of determining control over the underlying property. As the grantor presumably retains accountability for service delivery, it is subject to service potential risks, and the operation of the underlying property to meet government objectives indicates (in the IPSASB's view) that the grantor would be receiving service potential rewards (paragraph 89). If the residual interest were insignificant or non-existent, then substantially all the economic risks and rewards appear to fall directly to the operator, depending on any payments to the grantor during the operating period. Should the grantor recognise the underlying property because it has substantially all the service potential risks and rewards, or does the operator inherently have such risks and rewards also? Should the operator recognise the underlying property because it has substantially all the economic risks and rewards, even though those are obtained subject to the operating parameters set by the grantor? Recognition of the property by both parties would be as undesirable as non-recognition by both parties.

Determining control of the property underlying a SCA on the basis of whether significant operating or policy parameters (i.e. services/target recipients/pricing) are subject to the grantor's control has not been clearly justified in the Consultation Paper, as it relies upon the recent addition to the accounting literature of the 'control over use' approach. The IPSASB should reconsider applying the traditional risks/rewards approach to control over an asset,

including addressing the issue noted above concerning economic versus service potential risks and rewards. Assessment of the risks and rewards by both the grantor and the operator should be required, rather than presumed to have been effected through applying the proposed grantor control criteria. Such an assessment would support the application of either the traditional risks and rewards approach or the rights and obligations approach.

Grantor Control Criteria – Scope of Regulation

The AASB is particularly concerned with the first of the proposed grantor control criteria referring to whether the grantor ‘controls or regulates’ the services to be provided by the operator, to whom the services ought to be provided, and the price ranges or rates. The interpretation of control should depend on the substance of the arrangement without referring to the form of regulation under which the service concession operates.

The reference to regulation in the wording ‘controls or regulates’ could be removed, as it appears to have been retained for apparent consistency with the wording of the Interpretation 12 control criteria. Differences in the scope of ‘regulation’ between the Interpretation 12 requirements and the IPSASB’s proposals mean that the apparent consistency of the control criterion is misleading.

We agree with the IPSASB’s proposed significant reduction in the scope of the meaning of ‘regulation’, as the IFRIC’s incorporation of regulation by related parties and independent regulators acting in the public interest is too broad from a public sector perspective. However, the proposed limitation of regulations to “arrangements agreed upon by the grantor and the operator, and to which both parties are bound” (paragraph 102n), suggests that it is not regulation at all but merely a part of the contractual basis for the SCA.

One problem that we see with adopting a purely contractual basis is that the form in which the grantor sets out requirements for the operator under a SCA might affect the assessment of the substance of the arrangement. For example, where parameters for services and pricing are included in legislation rather than contractual arrangements explicitly agreed between the parties, the assessment of whether the grantor controls the services might differ according to whether those legislative requirements are required to be ignored or considered. In other words, perhaps there is a need to consider “service concession-specific legislation” when assessing the first control criterion whilst excluding “generally legislated regulation” consistently with the approach in present IPSASB Standards.

This is an issue of substance, and not merely a matter of form. Therefore, it may be helpful to clarify the criterion as based on whether the grantor “controls or regulates (other than by general legislation)” the services in the manner specified, instead of deleting the reference to “regulates” altogether.

Grantor Control Criteria – Residual Interest

The second of the proposed grantor control criteria is whether the grantor controls (through ownership, beneficial interest or otherwise) ‘the residual interest’ in the underlying property at the end of the arrangement. This contrasts with the second control criterion in Interpretation 12, which refers to “any significant residual interest” instead. The difference in wording could result in a SCA being treated differently under the IPSASB’s proposals compared with Interpretation 12, with the result that neither party recognises all or part of the underlying property.

Contrary to the view expressed in the Consultation Paper that in most cases a significant residual interest in the underlying property will exist at the end of a SCA, whole-of-life

arrangements exist where there is no or no significant residual interest. Such an arrangement would be assessed under Interpretation 12 by reference only to the first control criterion, whereas under the IPSASB proposals control over the insignificant residual interest would still be required to be considered under the second control criterion. It is easy to envisage a case where the grantor is considered to control the underlying property under Interpretation 12 but not under the IPSASB proposals – because the operator controls the insignificant residual interest. Hence the operator, applying Interpretation 12, would not recognise the underlying property, and the grantor, under the proposals, would not recognise the property either.

In a case where there is no residual interest (for example, a water treatment plant built on the grantor's land is to be scrapped by the end of the arrangement), there are different views concerning how the proposed second control criterion should be applied. Under one view, the grantor cannot satisfy the second criterion because it does not control any residual interest (and therefore cannot be considered to control the property whatever the outcome under the first criterion). Under an alternative view, the second criterion is simply irrelevant because there is no residual interest, and the first criterion then becomes the determinant (which is the approach under Interpretation 12).

The discussion of residual interest in relation to whole-of-life arrangements in paragraphs 81 to 84 of the Consultation Paper is not convincing. The proposed approach appears to be based on the conclusion that controlling the residual interest preserves the grantor's continuous use of the property during the period of the arrangement as well. This seems to overstate the importance of the residual interest. Paragraph 82 indicates that grantor control over the residual interest would limit the operator's practical ability to sell or pledge the property during the period of the SCA or to terminate the agreement early and use the property for another purpose. However, the terms of the arrangement should be able to limit or prevent such action by the operator, without needing a residual interest controlled by the grantor: if the operator breaches the agreement during the period of the SCA, then presumably the grantor would be able to apply penalty clauses and even change the operator. The possibility of a breach by the operator does not mean that the grantor cannot control the property underlying a whole-of-life SCA.

The AASB prefers the wording of the second grantor control criterion as it is in Interpretation 12, so that the proposals would clearly cover whole-of-life SCAs and insignificant residual interests would not affect the accounting.

Specificity of Grantor Control Criteria

The first proposed grantor control criterion addresses whether the grantor controls or regulates a number of operating/policy aspects of a SCA: the services to be provided by the operator, the intended recipients, and the price ranges or rates that the operator can charge for the services.

It is unclear how specifically these requirements would need to be satisfied in order for the criterion to be met. For example, how broadly or narrowly need the intended recipients be identified for the grantor to be considered to control or regulate that aspect? Need the identification be explicit or in substance? Does the grantor, for instance, specify the intended recipients under a toll road SCA by stating somewhere in the documentation that the road is to (i) facilitate the movement of freight between transport hubs A and B; (ii) reduce commuter trip times to business centre C; or (iii) result in transport benefits for the citizens of region D? If the documentation says nothing, does the location of the toll road in relation to A, B, C or D mean that in substance the grantor has identified the intended recipients?

Or might it be impossible for a grantor to specify the intended recipients under some SCAs to the extent required for the grantor to be said to control or regulate the identification of the recipient group? Any specification of the recipients may be so general as to be merely some logical subset of the general populace, e.g. those with motor vehicles who are willing to pay the toll to the operator or incur fines for non-payment; or those who consume water treated by a plant operated under a SCA.

Perhaps the general wording of the first proposed control criterion means that there is scope for the parties to a SCA to negotiate the terms to the degree of detail required to produce a particular outcome. If that is the case, the only resolution is to assess the substance of the arrangement with the application of professional judgement.

Accounting Policies when Both Grantor Control Criteria are Met

Measurement of the Underlying Property and the Compensation Liability

When the construction and service elements of the grantor's scheduled payments are readily separable, the IPSASB proposes that the grantor measure the property underlying a SCA (and the liability to compensate the operator for the construction of the property) based on the fair value of the property, or on the present value of the scheduled construction payments, if lower. We consider that measurement at fair value is the appropriate principle, and then the various methods for determining fair value would be applied as required. This avoids the need to specify the basis for a discount rate. Perhaps it should be stated that the property should be measured in accordance with the requirements of IPSAS 17 *Property, Plant and Equipment*, since this Standard is also the one that the IPSASB proposes should apply generally to the subsequent accounting for the property.

In cases when the construction and service elements of the scheduled payments are not readily separable, the IPSASB's proposals are for initial measurement of the property and the 'compensation liability' at fair value. This approach is supported, for the same reasons given in the previous paragraph. The IPSASB also proposes that the subsequent grantor payments give rise to a finance charge based on the operator's cost of capital specific to the arrangement. However, this may not be known to the grantor, and it would be more appropriate in any case for the discount rate to reflect the grantor's view of the economics of the transaction. Therefore, the discount rate should be akin to that applying under lease accounting: an implicit interest rate in the arrangement, or otherwise an incremental borrowing rate for the grantor. Alternatively, and perhaps more appropriately in relation to a financial liability, the discount rate could be specified as the effective rate, as described for the effective interest method for measuring financial liabilities that is set out in IAS 39 *Financial Instruments: Recognition and Measurement*.

Recognition and Measurement of a Liability for Operator Access

When the grantor will be making payments to compensate the operator for its construction of the infrastructure underlying a SCA, it is clear that the grantor has a financial liability. The measurement of that compensation liability is considered above.

However, when the construction payments by the grantor are reduced or eliminated, the accounting is rather more problematic. The IPSASB proposes that a related liability reflecting the receipt of consideration in advance of performance (the provision of access to the underlying property) should be recognised by the grantor, and recognised as revenue generally over the period of the arrangement. The difficulty with this accounting is that the grantor's responsibility to provide the operator with access to the property during the period of the SCA also exists under arrangements that require the grantor to fully pay for the

operator's construction of the infrastructure – yet in those cases there is no proposal to recognise a liability to provide access for the operator. Such a liability would have a fair value, but to recognise it in addition to the compensation liability would be moving towards a rights and obligations approach.

Even if the operator was the lessee of the underlying property under an operating lease, the grantor as lessor would not recognise under IPSAS 13 *Leases* a liability to continue to provide the operator with access to the leased item. It would be inconsistent with present accounting Standards to require the grantor to recognise such a liability in relation to a SCA, when the operator has only a right of access rather than a right to control the use of the asset that the operator would have if it were a lessee of the property instead.

Therefore, it appears that the proposed recognition of an 'access liability' in circumstances when the construction payments are reduced or eliminated is merely a means to achieving grantor recognition of revenue over the arrangement period rather than at the inception of the SCA or when public services commence to be provided by the operator. If the pattern of revenue recognition is the issue, then it needs to be addressed as such rather than treated as the recognition in these circumstances only of a liability to provide access.

Accounting Policies when Neither of the Grantor Control Criteria is Met

If neither criterion is met, the IPSASB proposes that the grantor should not recognise the property underlying the service concession arrangement, and grantor payments should be expensed as the services are rendered by the operator.

This approach is supported in relation to property newly constructed by the operator. However, where the underlying property is or includes property that the grantor recognises as an asset prior to the inception of the SCA, it is not simply a matter of stating that the grantor should derecognise the property. This is because IPSAS 17 (paragraph 82) states that an item of property, plant and equipment shall be derecognised when the property is disposed of or when no future economic benefits or service potential is expected from its use or disposal.

As the grantor obtains service potential benefits through the provision of public services (as this meets government objectives), service potential is still expected to arise from the property. However, as the grantor does not satisfy either of the grantor control criteria, the appropriate conclusion appears to be that the grantor has 'disposed' of the property, and on that basis derecognition would be required.

Accounting Policies when Only the 'Control over Use' Criterion is Met

If the SCA meets the definition of a lease, the AASB supports the IPSASB proposal that the grantor should follow the requirements for lessees in IPSAS 13 *Leases*, including classifying the lease as either a finance lease or an operating lease.

The IPSASB concludes (see paragraph 145) that a lease can arise because the lessor (the operator) owns the underlying property and provides the right to use (or control the use of) the property to the lessee (the grantor). However, the IPSASB should clarify further when a SCA under which the grantor satisfies only the control over use criterion is or is not a lease.

As the grantor controls the use of the underlying property during the term of the arrangement, the operator is not likely to recognise the property as an asset. (The operator would not recognise the property under Interpretation 12, which would apply if the operator controlled an insignificant residual interest.) Lessors typically lease their own assets. Hence, to say that the SCA is a lease may require the conclusion that the operator/ lessor is leasing unrecognised assets. Alternatively, it might be argued that the lease arises simultaneously with the

completion of construction of the property, so that the operator's constructed asset is immediately subject to a lease. However, that analysis works only if the lease is a finance lease, so that the operator/lessor effectively replaces the constructed asset with a lease receivable.

The Consultation Paper goes on to address the accounting when the SCA does not meet the definition of a lease. Two cases are identified: first, the SCA is not a lease because the grantor owns the underlying property, and secondly, the SCA is not a lease for any other reason. Given the IPSASB's conclusion, noted above, that such a SCA is a lease when the grantor controls the use of the property, it is not clear what other circumstances are covered by this second case.

Furthermore, the AASB does not support the approach proposed when the SCA is not a lease because the grantor owns the underlying property (whether existing or newly constructed property). The IPSASB proposes that the grantor in this case should recognise the property as an asset, derecognising the remaining carrying amount only at the end of the arrangement. This appears to mean that the grantor has the same accounting during the term of the SCA as in the case when both of the grantor control criteria are satisfied, even though here only the first criterion is satisfied, which seems to reduce the significance of the second criterion. In the AASB's view, this accounting would overstate the asset recognised by the grantor, as it should not recognise the part of the property related to the post-SCA period, i.e. the residual interest. The accounting should reflect the substance of the arrangement, rather than the legal form in which the property is held (ownership by the grantor).

Accounting Policies when Only the 'Control over Residual Interest' Criterion is Met

If the SCA meets the definition of a lease, the AASB supports the IPSASB proposal that the grantor should follow the requirements for lessors in IPSAS 13 *Leases*, in relation to existing property. This would require the grantor to classify the lease as either a finance lease or an operating lease. If a finance lease, the grantor replaces the property asset with a lease receivable asset, even though it still controls the residual interest.

If the SCA is not a lease and the grantor owns the underlying property, the AASB supports the proposal for the grantor to derecognise the property and recognise an asset representing the operator's obligation to return the property at the end of the arrangement. This is effectively the same as derecognising the part of the property over which control has been relinquished by the grantor, although the nature of the asset has changed. Instead of representing the service potential of the property in the period after the end of the SCA, the asset is the grantor's right to the return of the property by the operator at the end of the arrangement. This is suggestive of a rights and obligations approach.

However, the AASB does not support the approach proposed when the SCA is not a lease and the underlying property is newly constructed by the operator. The IPSASB proposes that the grantor should progressively recognise as an asset over the period of the arrangement the excess of the expected fair value of the property at the end of the arrangement over the grantor payments to be made to the operator for the property upon reversion. The AASB notes that there is significant support in Australia for such an approach: federal and state governments in Australia presently may adopt this approach under the accounting guidelines issued by the Heads of Treasuries Accounting and Reporting Advisory Committee.

It is unclear whether this progressive recognition is justified, since the grantor controls the residual interest from the inception of the arrangement. Furthermore, the measurement basis of this 'residual interest asset' is also subject to debate. Does the grantor continue to provide the operator with access to the property (even though it no longer controls it under the

“control over use” criterion) justify either progressive recognition or periodic remeasurement, depending on how the accretion of the asset is regarded? If the asset is in the nature of an intangible asset – such as the right to obtain the property at the end of the arrangement – IAS 38 *Intangible Assets* allows periodic revaluation only if there is an active market for the asset. This would be unlikely for residual interests in infrastructure assets. Further consideration of these issues is required.

Inflows of Resources from a Service Concession Arrangement [new section]

Revenue-Sharing Provisions

The general proposal in the Consultation Paper (paragraph 190) that the grantor should recognise revenue when earned in accordance with the substance of the SCA is supported. However, the specific proposal that revenue subject to contingent events (such as reaching a specified revenue or rate of return target) should be recognised only when the contingency has been satisfied is a practical but not conceptual approach.

The AASB believes that the conceptual approach (paragraph 185) needs to be considered further. Certainly that approach may introduce subjectivity into the recognition of revenue, but there are many subjective decisions required in applying accounting methods. An objective approach is not automatically favoured. For example, in 2005 the AASB considered the accounting for volume rebates in relation to inventory purchases. The AASB reached the conclusion that when there is a binding agreement that requires the supplier to credit or pay a rebate provided the entity completes a specified cumulative level of purchases or remains a customer for a specified period of time, the entity should measure the rebate based on the amount expected to be received in relation to the underlying transactions that have occurred during the reporting period and that result in progress by the entity toward achieving the specified requirements for receiving the rebate.

The analogy to royalties in paragraph 184 is not a close one, and even the quotation from IPSAS 9 *Revenue from Exchange Transactions* indicates that revenue recognition other than when the contingent event has occurred is permissible.

Contractually Determined Inflows

The IPSASB proposes that contractually determined inflows to be received by a grantor from the operator should be recognised as revenue by the grantor as they are earned over the period of the SCA, beginning when the underlying property is fully operational. The allocation method should reflect the circumstances of the SCA, with consideration in advance of the grantor providing the operator with access to the underlying property being recognised as a liability.

These proposals need to be reconsidered. As noted earlier in this submission, a ‘liability for operator access’ might not be justified and further thought should be given to the nature of such a liability (or credit) and whether it meets the liability recognition criteria. For example, if the SCA involves the grantor providing a licence to the operator, and the grantor’s capacity to provide similar licences to other entities is not diminished, then an up-front payment for the licence might conceptually be revenue when contracted rather than over the licence period. Even payments by the operator to the grantor over the term of the arrangement conceptually could be revenue when contracted, if the grantor is not required to make payments to the operator or provide an asset or an operating lease in return. Perhaps a grantor should characterise payments from the operator as lease rentals received (whether a finance lease or an operating lease) when the grantor provides land to the operator for the duration of the SCA.

The contractually determined inflow to the grantor may comprise the residual interest in the property underlying a SCA. As noted in the section “Accounting Policies when Only the ‘Control over Residual Interest’ Criterion is Met” above, recognition of the asset (and hence revenue) over the term of the SCA might not be the most appropriate approach. Further consideration should be given to these intertwined issues concerning the recognition and measurement of assets and the corresponding credits as liabilities or revenue.
