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4 July 2008

Dear David

AASB Invitation to Comment ITC 16 Request for Comment on IPSASB Consultation Paper *Accounting and Financial Reporting for Service Concession Arrangements*

We write in response to the request for comments contained in the April 2008 Australian Accounting Standards Board (AASB) Invitation to Comment on the IPSASB Consultation Paper *Accounting and Financial Reporting for Service Concessions* (ITC 16).

Guidance on the accounting for service concession arrangements (SCAs) by grantors is needed, as there are a large number of these projects in Australia and there is still divergence in the accounting adopted by grantors. The overall approach taken in the Consultation Paper is appropriate and it would therefore make sense for the AASB to utilise the IPSASB's work in this area.

However, further consideration should be given to the measurement of the asset and liability on initial recognition and the recognition of a non-financial liability. Our response to the specific matters for comment is provided in the Appendix.

We would welcome the opportunity to discuss our views at your convenience. Please contact me on 02 8266 8099 if you would like to discuss this further.

Yours sincerely



Wayne Andrews
 Partner
 Assurance

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Appendix

Specific Matters for Comment

AASB Questions

(a) Should the AASB use the IPSASB's work on service concession arrangements, such as issuing in Australia an Exposure Draft based on a subsequent IPSASB Exposure Draft or Standard?

Yes. The overall approach taken by the IPSASB is appropriate, subject to our specific comments on IPSASB questions 2 and 3 below.

(b) Are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the IPSASB proposals?

We do not believe that there are any specific issues arising in the Australian environment that would affect the implementation of the IPSASB proposals at present. However, in discussing whether control exists, the paper refers to "accountability" as a key concept. This is not something discussed in the current Australian Framework and the AASB will need to ensure that the justification for the recognition of the asset (and liability) is consistent with the local framework.

(c) Would the IPSAS proposals result in financial statements that would be useful to users overall?

Yes, subject to our specific comments on IPSASB questions 2 and 3 below.

(d) Are the IPSASB proposals in the best interests of the Australian economy?

We believe that a standard on the accounting for service concession arrangements is in the best interests of the Australian economy as it will remove existing divergence.

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IPSASB Questions

1. It is proposed that a grantor report the property underlying an SCA as an asset in its financial statements if it is considered to control the property. Criteria for determining control are proposed in the Consultation Paper. Do you agree with this approach and the control criteria identified?

We support consistency with the IFRIC 12 model and generally agree with the proposed approach and the criteria for determining control. However, we are concerned that there could be a difference in scope between IFRIC 12 and the IPSASB proposals for two reasons:

- The IPSASB paper states that the concept of regulation is restricted to arrangements agreed upon by the grantor and the operator and that it excludes generally legislated regulation that does not establish control for the purposes of financial reporting.
- IFRIC 12 states that there must be control over "any significant residual interest" at the end of the arrangement. It further clarifies that arrangements which cover the entire useful life of the asset, ie where there is no residual interest at the end of the arrangement, are within its scope provided the criterion in paragraph 5(a) is satisfied.

In contrast, the IPSASB proposals require that the grantor must have control over the residual interest in the property at the end of the arrangement. This could be read to say that if there is no residual interest at the end of the arrangement, or there is an insignificant residual interest which the grantor does not control, the asset would fall outside the scope of the proposals and would hence not be recognised by the grantor.

We are concerned that the IPSASB approach may capture too few arrangements. We recommend that the AASB and IPSASB undertake a review of existing arrangements to determine how they would be dealt with under this approach.

2. It is proposed that the underlying property reported by the grantor as an asset and the related liability (reflecting any obligation to provide compensation to the operator) is initially measured based on the fair value of the property other than in cases where scheduled payments made by the grantor can be separated into a construction element and a service element. In such cases, the present value of the scheduled construction payments should be used if lower than the fair value of the property. Do you agree?

We question why it would be necessary to apply the principles in the leasing standard where the payments made by the grantor can be separated into a construction element and a service element. In discussing Interpretation 12 the IFRIC considered at length whether IAS 17 should be applied to SCAs but concluded that this was not appropriate. Instead, the IFRIC opted to build a model based on IAS 16 and the related asset definition and recognition requirements. On that

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basis, we do not believe that the leasing principles should be used to determine the initial carrying amount of the asset.

It is also not clear to us, what is the underlying measurement principle of using the lower of fair value of the property and the present value of the scheduled construction payments. In our view, this is not a measurement basis but rather a method without a driving measurement principle. Even under leasing principles, the present value of the minimum payments would be determined such that they would equate to the fair value of the asset.

From our experience, it should always be possible to determine or reliably estimate the fair value of the underlying asset. We would therefore support a fair value hierarchy approach to determining fair value, as is used in other more recent international financial reporting standards. The fair value should reflect the service potential of the asset from the grantor's point of view.

A financial liability should only be recognised if the grantor has an obligation to make future payments. It should be measured using the principles in IAS 39. Initially the liability would be recognised at its fair value, being the amount for which it could be settled in an arm's length transaction. This amount will only be the same as the fair value of the underlying asset, if the grantor pays the operator for the construction expenses, ie the operator recognises a financial asset in its own balance sheet. In this case, the financial liability should mirror the financial asset recognised by the operator. In all other cases, the fair value of the liability will need to be determined using valuation techniques.

Subsequently, the liability will be recognised at amortised cost using the effective interest rate method. The effective interest rate is defined in IAS 39 and will not necessarily be the same as the operator's cost of finance.

Under the proposals, a non-financial liability would be recognised for arrangements involving reduced or eliminated grantor payments, ie where the operator recognises an intangible asset. As explained in our answer to question 3 below, we have some concerns on the nature of this liability.

3. It is proposed that contractually determined inflows of resources to be received by a grantor from an operator as part of an SCA should be recognized as revenue by the grantor as they are earned over the life of the SCA beginning at the commencement of the concession term, that is, when the underlying property is fully operational. These inflows generally should be considered earned as the grantor provides the operator access to the underlying property, and amounts received in advance of providing a commensurate level of access to the property should be reported as a liability. Do you agree?

We believe that further thought should be given to the nature of such a liability and whether recognition would be justified under the existing framework.

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For example, a government may create tradeable spectrum licences which are granted to operators in exchange for an upfront non-refundable payment. Once the license is granted, the government does not have any further obligations. How would the recognition of a liability, on the basis of providing access over time, be justified in this scenario? Does it make a difference whether the asset is a spectrum or a toll road?

The recognition of a non-financial liability would only be justified if there will be a future outflow of resources embodying economic benefits or service potential. Future research should be undertaken to determine whether there may be circumstances in which the credit would be more appropriately recognised as a contribution or in an equity reserve.