Service Concession Arrangements – Standard issued for Fatal Flaw Review

Response by Queensland Treasury

Summary

Queensland Treasury (QT) considers the proposed Standard to be fatally flawed in terms of the accounting for the grant of a right to the operator (GORTO) model as set out in para 20 of the Standard.

Under the GORTO model, QT considers that the Government does not, in an economic sense, control the service concession asset and accordingly can see no justification for raising the asset on its balance sheet. QT's view is that the asset is on the operator's balance sheet as the asset is intrinsically linked to the cash flows it generates. If there is no basis for raising the asset on the State's balance sheet, QT can accordingly see no basis for raising a liability.

If the perceived problem is that a service concession arrangement (SCA) can result in the infrastructure no longer appearing on any entity's balance sheet, QT considers this would be solved by showing the infrastructure on the operator's balance sheet as a tangible, rather than an intangible, asset.

Paragraph 25B states that the control concept in this Standard is different to that defined in other standards. In our view this highlights the artificiality of the concepts expressed in this standard. Grossing up the balance sheet of the grantor does not represent a solution to a perceived problem, it simply creates another one.

Illustrative example

Noting that there would be at least twelve months required to fully investigate all the arrangements Queensland has entered into, one practical example QT has briefly considered in reviewing the proposed Standard is that of toll roads.

In 2011, the State owned a Public Non-financial Corporations Sector company, which held toll road assets. In broad terms, the infrastructure on that company's balance sheet was independently valued at $3 billion. The company was subsequently on-sold to a private operator for around $7 billion in 2014. The implication of the proposed standard is that these toll roads would now be retrospectively brought back onto the State's balance sheet, presumably at a value in excess of the original $3 billion. In our view, this does not reflect the substance of the transaction and results in the double counting of the infrastructure on the State's balance sheet as well as the private operator's balance sheet.

QT accepts that there is a CPI cap on the level of tolls the operator can charge and the operator is required to maintain the asset. However, we do not consider this to construe control by the Government during the term of the concession. The operator has willingly entered into the contract with the State knowing these requirements exist and is reaping the risks and rewards of ownership. It is not as if the State imposed these requirements after the sale.

The implication under the proposed Standard is that the road assets would be fair valued and depreciated over their useful life. The "unearned revenue" liability on the other hand is amortised over the life of the concession and not revalued. It is therefore extremely likely that over the term of the concession, the depreciation on the assets will far exceed the revenue amortised.

GFS implications

Further, in GFS terms, it appears the depreciation cost would reduce the State's net operating balance, while the amortised revenue would be treated as an Other Economic Flow and not increase the State's net operating balance. The net operating balance is one of the key reporting aggregates for the State. It is the headline surplus/deficit for the State. The State's surplus would therefore be negatively impacted potentially by tens of billions of dollars over the life of this concession. Queensland has other arrangements that may be impacted too.

Adopting the Standard could therefore significantly distort the financial performance and potentially the credit rating of the State.

Given that the only grantors discussed in the Standard are likely to be the Australian states, for which GFS reporting is paramount, it is deficient that no mention is made of this in the Standard or guidance.

Significantly, the Australian Bureau of Statistics, which issues the GFS manual, has indicated to the AASB that it does not support the control model proposed in the Standard and instead will adopt the risks and rewards approach to control.

Other issues

In terms of the valuation of the SCA assets, the State does not necessarily have access rights, which limits the ability to make a reliable valuation.

If the arrangement is in the nature of the sale of a business rather than just the asset, does that scope it out of this Standard?

In a tollroad situation where the lease of land is a major component of the transaction, is that lease part of the service concession? Or does the service concession only relate to the pavement?

For all the reasons above, it is likely that QT will not be adopting the GORTO model proposed in the Standard and will continue with its current treatment of not recognising these assets on the State's balance sheet.

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