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STANDING COMMITTEE ON HEALTH, COMMUNITY AND SOCIAL SERVICES

(Reference: Inquiry into Calvary Public Hospital)

QUESTION TAKEN ON NOTICE
Wednesday 1 December 2010

Pg 39 – 40
http://www.hansard.act.gov.au/hansard/2009/comms/health17.pdf

Mr Smyth : My question is to the Treasurer:

MR SMYTH: Did the ACT make submissions to HOTARAC over this issue during the 12 years in which it was under consideration?

Ms Holmes: The ACT certainly made a comment when HOTARAC was forming its submission to the AASB on the exposure draft.

MR SMYTH: And what did that submission say?

Ms Holmes: The ACT supported the principles contained in the exposure draft. We actually differed from the views of some of the other members of other jurisdictions. The key thing here is that a number of other jurisdictions actually formed their policy in relation to service concession arrangements prior to the release of interpretation 12.

Ms Gallagher: Tom Brennan has raised all this with me—all of these questions that you are raising. I have gone back and had a look through the advice. I accept that LCM do not agree with our interpretation. But again I would ask you, Mr Smyth, what you would do if you were in our shoes, with two major accounting firms confirming the advice. Would you just want me to ignore all that and go and purchase the hospital? My hands on this are tied. I do not want to disagree with LCM.

MR HANSON: If you recall, we never wanted you to purchase the hospital.
Ms Gallagher: My hands on this are tied.

MR SMYTH: We questioned the purchase right from the start. When was that submission made?

Ms Gallagher: Not around the service concession.

Ms Holmes: I would have to double-check, but one key thing which is really important—

MR SMYTH: We always said this was an accounting problem.

Ms Holmes: is that regardless of—

Ms Gallagher: So you are agreeing with us then.

Ms Holmes: the overall submission of HOTARAC—

MR SMYTH: We are not saying that we do not; we are just questioning—

Ms Holmes: where, as I said, a number of jurisdictions—

THE CHAIR: Order, please!

Ms Holmes: had a different view from the ACT; they did not support the exposure draft. The AASB considered all submissions to it for the exposure draft; they have come out—regardless of the fact that some jurisdictions did not support it, the ACT did. They came out on 14 July in their submission to the International Public Sector Standards Board supporting governments applying the same principles as interpretation 12. They considered all of that and that is their view.

MR SMYTH: So you will find that. Could the committee please have copies of all the government submissions regarding this issue?

THE CHAIR: Thank you, Mr Smyth. I have one very final question on that. Ms Holmes, are there any taxation implications for two entities listing the same assets in their financial statements?

Ms Holmes: Each entity, of course, would have to make their own considerations on tax as well as on accounting, I am not a tax expert in this, so I would not like to comment.

Ms Gallagher: We can take that on notice.

THE CHAIR: I would like an answer on that, thank you.

Ms Gallagher: Yes. As you can imagine, the things that they have done under private-public partnerships involve considerable dollars; they would not want to change accounting treatments that they have got in place. That was the key driver of a number of other jurisdictions who had a number of those sorts of arrangements in place and who did not want to change the treatments that they had formed prior to interpretation 12 coming out.

MR SMYTH: What was the date of that government submission?

Ms Holmes: I would have to double-check.

MR SMYTH: All right

The answer to the Member's question is as follows:

The ACT provided input into the Heads of Treasuries Accounting and Reporting Advisory Committee submission on the service concession accounting by governments exposure draft on 10 May 2010 (**Attachment A**). The exposure draft was released for comment by the Australian Accounting Standards Board (AASB) on 21 April 2010.

The ACT supported the exposure draft on the theoretical grounds that the accounting principles applied by both governments and operators of service concession arrangements should be the same.

When the comments refer to the accounting of service concession arrangements they are referring to the accounting principles to be applied by the affected entities. The ACT's comments do not imply that the parties to a service concession arrangement must reach agreement on how to account for the arrangement. As stated at the inquiry, it is up to each individual entity to apply the accounting principles and reach a view as to the most appropriate accounting treatment for the arrangement.

The final HOTARAC submission dated 21 May 2010 is at **Atachment B**. The submission reflected the majority of jurisdictions' input and expressed concerns with the exposure draft.

Also attached is the AASB submission to the International Public Sector Accounting Standards Board on the exposure draft dated 14 July 2010 (**Attachment C**). The AASB submission was formulated taking into consideration the submissions that it received on the exposure draft, including the HOTARAC submission. In general the AASB supported the proposals contained in the exposure draft for governments to mirror the principles contained in Interpretation 12 which is applicable to operators of service concession arrangements.

The Committee also asked about the tax implications for two entities listing the same assets in their financial statements. Both ACT Health and Calvary Health are exempt from income tax.

Approved for circulation to the Member and incorporation into Hansard.

Katy Gallagher

Katy Gallagher MLA
Treasurer

Date:..22.:.12.:10.........

ATTACHMENT A

Holmes, Lisa

From: Holmes, Lisa
Sent: Monday, 10 May 2010 6:07 PM
To: [redacted]@dtf.vic gov.au; [redacted]@dtf.vic.gov.au; [redacted]@dtf.vic.gov.au; [redacted]@dtf.vic.gov.au; [redacted]@dtf.wa.gov.au; [redacted]@dtf.wa.gov.au; [redacted]@finance.gov.au; [redacted]@finance.gov.au; [redacted]@finance.gov.au; [redacted]@nt.gov.au; [redacted]@saugov.sa.gov.au; [redacted]@saugov.sa.gov.au; [redacted]@saugov.sa.gov.au; [redacted]@treasury.gov.au; [redacted]@treasury.gov.au; [redacted]@treasury.govt.nz; [redacted]@treasury.qld.gov.au; [redacted]@treasury.qld.gov.au; [redacted]@treasury.tas.gov.au; [redacted]@treasury.tas.gov.au
Cc: [redacted]; [redacted]; [redacted]
Subject: RE: AASB ED 194 and IPSASB ED 43 Service Concession Arrangements:Grantor

[redacted]

The ACT does not support the proposed response, specifically the proposal that alternative approaches be considered by the IPSASB rather than using the principles contained in IFRIC 12. Although HoTARAC might question the suitability / robustness of IFRIC 12, the fact remains that IFRIC 12 exists and operators of service concession arrangements in Australia must follow it. The ACT considers that it would cause difficulties if the accounting by governments did not mirror how operators were accounting for the same arrangement - difficulties with auditors, governments and external stakeholders, even potentially with the operators themselves. If mirroring of accounting did not occur there is the potential for both the government and an operator to have an asset on its books or conversely neither to have an asset on their books. Such an outcome leaves the door open for people to question the accuracy and reliability of a government's financial statements.

For your information, the ACT has recently received advice from a major accounting firm that in the absence of specific Australian guidance for governments on how to account for service concession arrangements, the principles contained in Interpretation 12 should be followed.

Thanks

LISA HOLMES| DIRECTOR ACCOUNTING| FINANCE AND BUDGET DIVISION | ACT TREASURY

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[redacted]

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ATTACHMENT B

Department of Treasury and Finance

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Tasmania

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
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Dear ~~Mr Stevenson~~ Kevin

EXPOSURE DRAFT 194 SERVICE CONCESSION ARRANGEMENTS: GRANTOR

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the Australian Accounting Standards Board on Exposure Draft 194 *Service Concession Arrangements: Grantor*.

Service concession arrangements have existed in Australia for the past 20 years and their use is increasing. There is a growing need for authoritative accounting guidance for service concession grantors. HoTARAC therefore supports the ED's objective which aims to meet this need.

HoTARAC agrees with the ED's proposals that:

- where a grantor controls service concession property it should recognise that property as its asset;
- the meaning of the word "regulates" in IFRIC 12 needs to be interpreted more narrowly when applied in a public sector context; and
- a grantor's revenues arising from a service concession arrangement may need to be recognised on an annuity, rather than a straight line, basis due to the extended duration of the arrangement.

HoTARAC appreciates the difficulty in trying to address the accounting for the various forms of service concession arrangement that exist. However, HoTARAC has concerns with the proposed approach to grantor accounting as the proposal:

- relies on rules rather than an underlying principle to determine which party controls the concession property;
- is based on the IFRIC 12 model, which HoTARAC considers to be problematic;
- does not exactly mirror IFRIC 12 despite purporting to do so, which could result in non-recognition of the service concession property by both parties;

- does not adequately explain or justify the basis for recognising a grantor's performance obligation and does not require such obligations to be recognised in all cases where they arise; and
- does not deal with service concession arrangements that fail the proposed grantor control criteria.

HoTARAC observes that some existing service concession arrangements would fall outside the scope of the ED because, despite it having a residual interest in the service concession property, the grantor does not control or regulate the operator's pricing or to whom the operator must provide services. According to the criteria in the ED, the grantor would not control or regulate the service concession property during the concession period.

The proposal will effectively scope out service concession arrangements where the property is not grantor controlled during the concession period. This will leave a number of existing arrangements without authoritative accounting guidance. It is also likely to introduce divergent accounting for economically similar arrangements which does not seem to be a sensible outcome.

HoTARAC is aware of three service concession arrangements where the grantor refrained from stepping in when the operators ran into financial difficulty and had to sell their interests in the arrangements. The grantor's lack of exposure and obligation in such circumstances suggests an absence of grantor control. However, under the proposals in the ED, two of these arrangements would meet the criteria for grantor-recognition, while the other arrangement would not. This also seems to be a questionable outcome.

HoTARAC encourages the Board to continue its deliberations on this important topic and urges the Board to consider the issues provided in Attachment 1.

If you have any queries regarding HoTARAC's comments, please contact Robert Williams from New South Wales Treasury on (02) 9228 3019.

Yours sincerely

Dan Challen

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

21 May 2010

Encl

Contact: Amy McShane
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Our Ref: RB/AM 10/56990

Attachment 1

DETAILED COMMENTS ON EXPOSURE DRAFT 194
SERVICE CONCESSION ARRANGEMENTS: GRANTOR

An Approach Mirroring IFRIC 12 is Problematic

The Exposure Draft proposes to adopt an accounting approach for grantors which mirrors that adopted for operators under IFRIC Interpretation 12 *Service Concession Arrangements* issued by the International Financial Reporting Interpretations Committee.

HoTARAC considers the proposed approach, based on IFRIC 12, to be problematic as:

- both IFRIC 12 and the ED are narrow in scope, only addressing arrangements involving property that is grantor-controlled (in accordance with the criteria in IFRIC 12 and the ED);
- the ED does not articulate a clear conceptual basis for its proposals and the consequent accounting treatments;
- both IFRIC 12 and the ED are inconsistent with existing authoritative guidance on control of an asset;
- they adopt a rule-based approach;
- the control criteria is not neutral and it presupposes grantor control of service concession property; and
- neither IFRIC 12 nor the ED define Service Concession Arrangements or Control of an Asset which are arguably their core terms.

In addition, the ED does not exactly mirror IFRIC 12 despite claiming to do so.

The approach proposed by the ED is based on an unsatisfactory model. The control criteria purports to be grantor-based, however, is developed from the operator's viewpoint, without considering the grantor's perspective.

These matters are discussed below.

Too Narrow in Scope

HoTARAC considers that, despite its title and objective, the proposals only deal with service concession arrangements where property is grantor-controlled during and after the concession period. The service concession property could include:

(a) grantor-controlled during and after the concession period;
(b) operator-controlled during the concession period and grantor-controlled thereafter;
(c) grantor-controlled during the concession period and operator-controlled thereafter; or
(d) operator-controlled during and after the concession period.

It is disappointing that the ED only considers one of these cases. This is unhelpful to grantors involved in other forms of service concession arrangement. For example, HoTARAC is aware of several service concession arrangements in category (b).

HoTARAC suggests that, if the Standard resulting from the ED only deals with service concession arrangements where the property is grantor-controlled, its title and objective should be modified to make this limitation clear.

Not concept-based

The ED outlines criteria for determining whether a grantor controls, and should therefore recognise, a service concession asset (Paragraphs 10 and 11). The recognition criteria embodies the notion of control and is based on criteria set out in IFRIC 12.

HoTARAC agrees that control is a significant factor in determining the existence of an asset. The notion of control is embodied in the definition of asset (or assets) in IPSAS 1 and in the IASB and AASB *Framework for the Preparation and Presentation of Financial Statements*.

HoTARAC notes that authoritative accounting guidance provides various ways of determining control of an asset:

- IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* contains a definition for control of an asset. Similar guidance is given in IAS 38 *Intangible Assets*;
- IPSAS 13, IAS 17 and AASB 117 *Leases* adopt a risks and rewards approach to determine whether an entity should recognise an asset; and
- IFRIC 12 sets out criteria to determine whether a grantor controls the service concession infrastructure.

A rights and obligations approach might also be adopted if two parties control different aspects of the same asset.

The ED adopts the IFRIC 12 model without giving any conceptual reasons for choosing it. The model seems to have been adopted for consistency of grantor and operator accounting. Grantors and operators would both use the approach when determining whether the service concession property should be accounted for as an asset (Paragraphs BC 2 and BC 14). Although consistency is desirable, the ED would need to demonstrate that the proposed model is conceptually justifiable and superior to alternative models.

HoTARAC notes that IFRIC 12 introduced a new model for determining control that is not based on the models used by existing Accounting Standards or the IASB's Conceptual Framework. Therefore, HoTARAC has reservations about using the IFRIC 12 model as the basis for grantor accounting. HoTARAC also notes the widespread criticism of the IFRIC 12 model by respondents during its exposure period.

HoTARAC notes that the US Governmental Accounting Standards Board is presently deliberating on its own project on Accounting for Service Concession Arrangements. The Board, although adopting tests similar to those in IFRIC 12, has decided that the concession arrangements should be articulated as scoping criteria, rather than control criteria. This suggests that there is some doubt about whether the IFRIC 12 tests are a valid model for determining control.

The ED's Basis for Conclusions dismisses the risks and rewards approach, in a cursory (single-paragraph) analysis. It asserts that:

- the primary purpose of a service concession arrangement is to provide service potential rather than economic benefits;
- a control approach focuses on service potential rather than economic benefits;
- the risks and rewards approach focuses only on economic factors; and
- therefore, the risks and rewards approach cannot be used to determine control (Paragraph BC 11).

HoTARAC disagrees with these assertions, and considers that both economic benefits and the risks and rewards approach are relevant when assessing which party controls service concession property. In addition, the concepts of control and risks and rewards are complementary not competitive. The ED has not adequately justified the reasons for rejecting a risks and rewards approach in favour of the proposed approach based on IFRIC 12.

The ED does not consider the merits of using the existing definition of control of an asset in IPSAS 23. Further, the ED's Basis for Conclusions considers and dismisses the rights and obligations approach.

HoTARAC is concerned that the ED has not offered a conceptual basis for adopting its preferred model. The ED does not articulate any underlying principle for determining control.

In light of its concerns with IFRIC 12, HoTARAC considers that there is merit in considering approaches based on other existing authoritative guidance.

HoTARAC also suggests that, given that the IPSASB is seeking greater alignment between accounting and statistical frameworks, there is merit in considering the statistical framework before concluding on this project. Chapter 22 of the *System of National Accounts 2008* refers to service concession arrangements, control and risks and rewards.

Inconsistent with existing Standards

The ED's Basis for Conclusions notes that the main accounting issue in service concession arrangements is whether the grantor should recognise a service concession asset and a related liability (Paragraph BC 10). HoTARAC agrees that determining which party controls, and should therefore recognise the service concession property, is the fundamental accounting question.

It is noted that, although the ED (like IFRIC 12) does not define it, control of an asset is defined or described elsewhere in Accounting Standards. IPSAS 23 Paragraph 7 states that "control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit".

IAS 38 and AASB 138 *Intangible Assets* also contain similar guidance.

This definition of control is based on the benefits from, and access to, an asset. However, the grantor control criteria employed in the ED is focussed on access rather than benefits. It is not clear whether this was intentional. Nevertheless, HoTARAC is concerned that the ED ignores the existing authoritative guidance on control without giving any reason. Using the IPSAS 23 definition may give different outcomes.

HoTARAC urges the Board to explain the reasons for departing from existing guidelines.

Rule-based

In accordance with Paragraph 10, the ED proposes several criteria for determining whether a grantor should recognise service concession property as its asset:

> The grantor shall recognise a service concession asset ... 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 ... any significant residual interest in the asset at the end of the term of the arrangement.

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 (Paragraph 11).

A grantor would recognise a service concession asset if it controls: the services provided with; the customers served by; the prices charged for use of; and (if not a whole-of-life asset) the residual interest in the service concession property.

These control criteria operate as a set of rules to determine whether the grantor controls the service concession property. As mentioned above, the proposal does not articulate any underlying principle. HoTARAC has a number of concerns with the proposed criteria.

In the absence of a clearly articulated underlying principle, rules can take a form over substance approach. Rules can be circumvented by structuring arrangements to achieve particular accounting outcomes. Principles are less susceptible to circumvention in this way.

Without any underlying conceptual basis for the control criteria, it may be difficult to determine whether a particular arrangement is within the scope of the ED. Could an arrangement be considered to be substantively within the scope of the ED even if it does not strictly satisfy all of the criteria? Would the mere inclusion of a recital clause in the preamble to a contract (mentioning that services are to be provided to the public) be sufficient as evidence that the grantor controls or regulates to whom the services are provided?

Further, the proposed rules may be difficult to apply in practice. It is unclear how strictly these rules should be applied. Where market forces rather than contractual specifications determine the extent of the service concession property's use, at least some of the grantor control criteria appear to be irrelevant. In HoTARAC's experience, some service concession arrangements do not specify which party controls or regulates the pricing of services. Such arrangements would arguably fail to meet the grantor control criteria and would be outside the scope of the ED.

While HoTARAC acknowledges that the ED's Basis for Conclusions (Paragraph BC 14) states that asset recognition is to be determined on all the facts and circumstances of the arrangement, the ED itself relies on rules for determining grantor control. It is difficult to take account of other facts and circumstances if an arrangement does not satisfy all of the prescribed rules.

Not neutral

Paragraph 10 of the ED proposes several control criteria to determine whether a grantor has a service concession asset.

HoTARAC is concerned that the criteria has a grantor focus rather than a property focus. To assess control on the basis of whether the grantor meets the criteria appears to assume grantor control. The proposed criteria can never demonstrate operator control. The criteria can only indicate the presence or absence of grantor control.

HoTARAC also considers it inappropriate that the ED's proposed approach is based on IFRIC 12, which specifies operator accounting based, not on whether the operator itself controls the service concession property, but on whether the grantor (not subject to IFRIC 12) controls it. Given that IFRIC 12 does not consider the grantor's perspective, it seems inappropriate to use it as a basis for specifying grantor accounting.

HoTARAC suggests that a more neutral and straightforward approach should be used. The control criteria should determine which party controls the service concession property rather than focusing on whether a particular party has such control.

Core terms are not defined

The ED does not define Service Concession Arrangement or Control of an Asset, which are identified as the ED's core terms. While acknowledging that the ED describes the nature of a service concession agreement in Paragraphs 2 and 7, HoTARAC considers that it would be helpful if the core terms were explicitly defined.

A service concession arrangement might be defined as a binding arrangement under which a public sector entity (the grantor) conveys to another, usually for-profit sector, entity (the operator) the right to use a service concession asset to provide services directly to the public on behalf of the grantor.

As noted above, IPSAS 23 contains a definition for control of an asset, which may at least provide a useful starting point for determining control of a service concession asset.

Asymmetrical

The ED's proposals are intended to mirror the IFRIC 12 approach (Paragraphs IN2 and AG3 and Specific Matter for Comment). However, in at least two instances, the ED does not exactly mirror IFRIC 12 despite claiming to do so. Consequently, some service concession property might be recognised by neither party to the arrangement.

The first instance of asymmetry with IFRIC 12 relates to the meaning of the word "regulates". Both the ED and IFRIC 12 indicate that grantor-control of a service concession asset would occur where the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price (ED 48 Paragraph 10).

In the ED, "the term 'regulate' is not intended to convey the broad sense of ... sovereign or legislative powers ... Rather, it is intended to be applied in the context of the specific terms of the service concession arrangement" (Paragraph AG8).

This contrasts with IFRIC 12 that regulation "could be by contract or otherwise (such as through a regulator). ... the grantor and any related parties shall be considered together. ... the public sector as a whole, together with any regulators acting in the public interest, shall be regarded as related to the grantor ..." (IFRIC 12, Paragraph AG2)

The meaning of the term "regulates" is narrower in the ED than it is in IFRIC 12. HoTARAC considers that IFRIC 12 is too broad and needs to be narrowed. The power of government to establish the regulatory environment within which entities operate and to impose conditions or sanctions on their operations does not itself constitute control of the assets deployed by those entities (AASB 127, Paragraph Aus17.9(d) and IPSAS 6, Paragraph 37(a)).

However, this creates an inconsistency. The ED does not consistently mirror IFRIC 12. This inconsistency could result in neither party recognising the service concession property.

For example, an operator applying IFRIC 12 may conclude that service concession property is grantor-controlled by virtue of the grantor's regulatory power arising from legislation, or through an independent price regulator established by legislation. However, a grantor applying the ED's proposals may conclude that the same service concession property is not grantor-controlled because the grantor has no regulatory power under the specific terms of the service concession agreement. Thus, the property would not be recognised by each party.

HoTARAC considers that this outcome primarily arises from the failure of IFRIC 12 to consider the public sector grantor's perspective.

The second instance of asymmetry relates to capital work-in-progress. The ED discusses the timing of recognition of a service concession asset constructed by the operator. Paragraph AG20 also notes that where the operator bears the construction risk, the grantor will normally recognise the asset (and by implication the related liability) when the asset is placed into use.

HoTARAC considers this to be problematic as the treatment proposed in the ED does not mirror that in IFRIC 12. Under IFRIC 12, the operator recognises an accruing receivable as the service concession asset is constructed. Under ED 43, the grantor's corresponding payable would not be recognised until the asset is used. A further consequence is that neither of the parties would recognise the capital work-in-progress during the construction period.

Concluding remarks on the approach mirroring IFRIC 12

HoTARAC considers that the disadvantages of adopting an approach based on IFRIC 12 greatly outweigh any perceived advantages.

HoTARAC considers that there is merit in revisiting approaches based on other existing authoritative guidance. Available models for determining which party controls service concession property include the control of an asset definition in IPSAS 23, or a risks and rewards approach as used in IPSAS 13. In addition, a rights and obligations approach, apportioning the asset between the two parties merits further consideration. The IASB's thinking appears to be heading in this direction. Its recent Discussion Paper on Revenue Recognition contemplates measuring the rights and obligations in contracts with customers.

Paragraph 10 of the ED could be modified to simply require a grantor to recognise a service concession asset that it controls, with the remainder of that paragraph being provided as application guidance. This may avoid having a new set of black-letter control criteria.

Performance obligations exist independently of payment obligations

The ED proposes that when a grantor recognises a service concession asset it should also recognise a corresponding liability for its payment obligation and/or performance obligation to the operator (Paragraphs 19, 21 and 22). The liability is initially measured at the fair value of the asset (Paragraphs 15 and 20). The payment obligation represents amounts payable to the operator for the asset. The performance obligation represents the right granted to the operator to earn revenue from the service concession asset or from another revenue-generating asset (Paragraphs 22 and AG41).

Because the payment and/or performance obligations must initially equate to the value of the asset, it appears that the performance obligation is the difference between the value of the service concession asset and the value of any payment obligation. In effect, the ED proposes that a performance obligation is recognised only to the extent that the payment obligation falls short of the fair value of the service concession asset.

HoTARAC considers that the proposed recognition of a grantor's performance obligation is unclear and irregular.

Under most, if not all service concession arrangements, the grantor would have a performance obligation to the operator to continue to provide the granted concession rights during the concession period. If such an obligation is to be recognised, it would not make sense to only recognise it to the extent that the grantor does not have a payment obligation.

Consider two service concession arrangements where the operator constructs a service concession asset and operates it on behalf of the grantor, in exchange for the right to collect user charges. In Arrangement A, the operator recovers construction and operating costs solely from user charges. In Arrangement B, the operator recovers operating costs from user charges and construction costs from the grantor via a series of predetermined payments. The grantor would have an identical performance obligation under each arrangement, regardless of it having an additional payment obligation under Arrangement B. However, the ED would only recognise a performance obligation in Arrangement A. The liability under Arrangement B would be a payment obligation.

HoTARAC considers that, if the performance obligation exists, it should be treated similarly in all cases, regardless of whether the grantor has a payment obligation. The performance obligation should be recognised in full or not at all, not just sometimes.

Further, the proposal could benefit from a more comprehensive explanation of the nature of a grantor's performance obligation and how it relates to revenue recognition.

A grantor's performance obligation is not a provision

The ED requires the grantor to account for a performance obligation, where it is recognised, in accordance with Paragraph 22 IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. The ED notes that, "when the operator is compensated by being granted a right to earn revenues from either the service concession asset or another asset provided by the grantor, the [grantor's] liability is a performance obligation because the grantor is obligated to provide the asset to the [operator]. IPSAS 19 provides guidance for such circumstances" (Paragraph AG29).

HoTARAC finds this requirement and guidance to be problematic for the following reasons:

- it is unclear whether the performance obligation relates to the right to earn revenues (a licence) or the service concession asset or other asset provided by the grantor for the operator to use (a physical asset), or both;
- IPSAS 19 does not provide any specific guidance on performance obligations;
- IPSAS 19 Paragraph 18 defines liabilities as "present obligations of the entity resulting from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying future economic benefits or service potential". Given this, it is questionable whether the grantor in the contemplated arrangement would have any continuing liability as both the licence and the physical asset given to the operator at the start of the concession period would settle any present obligation of the grantor. Further, once the licence has been granted or the physical asset transferred to the operator, no further economic benefits or service potential would be required to flow from the grantor; and
- IPSAS 19 defines a provision as "a liability of uncertain timing or amount". In the contemplated arrangement, the ED would require the performance obligation to be initially measured at fair value (Paragraph AG41) and reduced as access to the asset is provided over the term of the arrangement (Paragraphs AG38, AG40). As the timing and amount of the performance obligation are determinable there does not appear to be any requirement for a provision.

HoTARAC suggests that Paragraphs 22 and AG29 be reconsidered and the basis for recognising a performance obligation be explained and justified. The US GASB has tentatively decided that a grantor (which it calls a transferor) should recognise a deferred inflow rather than a performance obligation (outflow) in the circumstances described above.

HoTARAC is also aware that the IASB is considering the nature and measurement of performance obligations as part of its Projects on Leases and Revenue Recognition. It may be prudent for IPSASB to await the outcome of those Projects before issuing a Standard in this area.

Some arrangements are not contemplated

The Implementation Guidance accompanying the ED provides a Table of references to Standards that apply to typical types of arrangements involving an asset combined with the provision of a service (Implementation Guidance and Paragraph BC3). However, the Table does not relate the arrangements classification to the presence or absence of the grantor-control criteria in the ED. Nor does it deal with some common forms of service concession arrangement.

The Table does not deal with Build-Operate-Transfer arrangements that do not meet the grantor-control criteria in the ED. While the table suggests that BOT arrangements would normally be within the scope of the ED, the absence of grantor-control would place them outside the scope. What Standard would apply in this case?

Also, the Table does not deal with operator-owned property that transfers to the grantor at the end of the concession period. While the Table suggests that arrangements involving operator-owned infrastructure would be outside the scope of the ED, it does not contemplate Build-Own-Operate-Transfer arrangements, where operator-owned property ultimately transfers to the grantor. These arrangements are common in Australia. Are BOOT arrangements also meant to be outside scope because the operator owns the underlying property? Would it make a difference if the property was constructed on land leased from the grantor?

Guidance on accounting for these forms of service concession arrangement would be helpful.

What if the grantor does not control the service concession property?

The ED notes that, in exchange for obtaining a service concession asset, a grantor may give an operator one or more of the following:

- a right to use the service concession asset (Paragraphs 23, AG38, AG42, AG43, BC17);
- a predetermined series of payments (Paragraphs 21, AG31);
- a right to earn revenues (Paragraphs 22, AG29, AG38, AG41, AG44, BC17); and
- access to another revenue-generating asset (Paragraphs 22, AG40, AG44, BC17).

HoTARAC agrees that a service concession arrangement is an exchange transaction, and that these are the typical types of consideration given by a grantor. Further, HoTARAC considers the fundamental consideration is the right to use the service concession property. This is the essence of a service concession. The other types of consideration, though often found, are not essential. Moreover, all of these types of consideration can occur regardless of which party controls the service concession property.

The ED's approach is premised on the grantor's liability arising in exchange for receiving the service concession asset at the start of the concession period, and the grantor gaining control of the asset at that time. The grantor receives a service concession asset as consideration for, and in advance of, providing access or another asset to the operator (Paragraph BC17).

However, HoTARAC has found that service concession arrangements can also take other forms and give rise to accounting issues not addressed in the ED. For example, in a Build-Own-Operate-Transfer arrangement, a grantor might only control the service concession property from the end rather than the start of the concession period. If the grantor does not control the service concession property during the concession period, the nature of the initial transaction might be an exchange of one right (service concession) for another (right to receive control of the service concession asset at the end of the service concession). An example of this is the exchange of rights with deferred settlement by one party.

HoTARAC has identified several examples of service concession arrangements in which the grantor does not control or regulate the pricing of services and/or to whom the operator must provide them. In such cases, the grantor controls a residual interest at the end of the concession period but, applying the ED's proposed grantor control criteria, does not control the use of the property during the concession period. Such arrangements would be outside the scope of the ED.

HoTARAC considers that the Standard arising from the ED should give specific guidance on how a grantor should account for arrangements where the grantor only has a residual interest in the service concession property. The Consultation Paper that preceded the ED proposed different accounting treatments, which depended on whether the grantor had full control, part control or no control during or after the concession period. The absence of such guidance in the ED is not helpful.

HoTARAC considers that arrangements giving rights to use service concession property or to earn revenue from such property are in the nature of licensing agreements. The grantor effectively licenses the operator to operate the service concession property to provide public services, or collect revenue from the public, or both. IFRIC 12 also acknowledges that a right to charge users is a licence (IFRIC 12, Paragraph 17). However, HoTARAC notes that the Standards on Leases (IPSAS 13, IAS 17 and AASB 117) all scope out licensing arrangements.

When determining how a grantor should grantor account for the giving of the service concession in exchange for receiving a right to receive the service concession property at the end of the concession period, the Emerging Asset approach should be considered.

Under this approach, the grantor recognises both an asset and revenue that accrues over the concession period. This approach also reflects revenue arising from the granting of the concession on a systematic basis over the concession period and also the accruing right to receive the property over the same period. This approach is used in Application Note F *Private Finance Initiative and Similar Contracts* which forms part of the United Kingdom Accounting Standards Board's Financial Reporting Standard 5 *Reporting the Substance of Transactions*. The Emerging Asset approach has been used in Australia to account for the emerging value of the right. HoTARAC considers that this approach has merit and has previously endorsed it for use by Australian grantors.

It would be helpful if the Standard resulting from the ED addressed the accounting for service concession arrangements where the grantor's control of the underlying property is deferred until the end of the concession period.

Consistency and comparability are not achieved

The IPSASB believes that the ED will promote consistency and comparability in the reporting of service concession arrangements by public sector entities (Paragraph BC1).

HoTARAC observes that, in some cases, the ED may result in diverse accounting for substantively similar arrangements. For example, one Australian grantor has 14 service concession arrangements where a service concession is given in exchange for each operator building and operating the service concession property and transferring it to the grantor at the end of the concession period. All of the operators finance the arrangements solely from user charges collected from the public.

All of these arrangements are substantively similar and are presently accounted for consistently, as emerging assets. However, because of the specific terms of the contracts, just over one-third of them will fail the grantor control criteria. Those within the scope of the ED will be recognised as the grantor's physical asset at the start of the concession period. Arrangements not controlled by the grantor during the concession period in terms of the ED will be recognised as the grantor's physical asset only at the conclusion of the concession period. The grantor's interest in the latter group will be residual. In these arrangements, the accounting treatment will depend on whether the contract specifies the pricing; or that the services are to be provided to the public. If it does so specify, the grantor can demonstrate its ability to control or regulate the pricing and to whom the services are provided. Where the operator has an unrestricted choice as to pricing and to whom the services are provided, and the grantor has no contractual right to intervene, the property is not recognisable as a service concession asset under the ED.

Consider two service concession arrangements that only differ in their pricing terms. One specifies a cap on the prices the operator can charge the public for the services. The other does not specify any pricing restrictions but instead implicitly relies on market forces to keep the prices at a reasonable level. Under the ED, the grantor would control or regulate the prices in the first case but not the second. Therefore, the second arrangement would not be within the scope of the ED.

Also consider two service concession arrangements that only differ in their specification of the intended customers. One contemplates that the operator is to provide services to the public. The other does not specify any customers but instead implicitly relies on market forces to encourage the operator to provide services to any interested member of the public who is prepared to pay for the service. Under the ED, the grantor would probably be held to control or regulate to whom the services are provided in the first case but not in the second. Therefore, the second arrangement would not be within the scope of the ED.

HoTARAC considers it unfortunate that the ED is likely, in some cases, to introduce inconsistent accounting for substantively similar service concession arrangements and that it will not provide accounting guidance for the arrangements that fail its grantor control criteria. HoTARAC also considers it undesirable that different accounting outcomes could arise from the inclusion of an otherwise inconsequential phrase in a service concession arrangement.

Work-in-progress is not recognised

Paragraph AG20 of the ED discusses the timing of recognition of a service concession asset constructed by the operator. It notes that, where the operator bears the construction risk, the grantor will normally recognise the asset (and by implication the related liability) when the asset is placed into use. HoTARAC considers this to be problematical for the following reasons:

- Under accrual accounting principles, the grantor should recognise the asset and liability progressively as it is constructed rather than when it is complete, regardless of which party bears construction risk. A service concession asset is, by definition, grantor controlled and it is being constructed for the grantor pursuant to the contractual requirements of the service concession arrangement.
- As mentioned earlier, the treatment proposed in the ED does not mirror that in IFRIC 12. Under IFRIC 12, the operator recognises a cumulative receivable as the service concession asset is constructed. Under the ED's proposals, the grantor would not recognise the corresponding payable until the asset is placed into use. A further consequence is that neither of the parties would recognise the capital work-in-progress during the construction period.
- The deferred recognition of the liability could inappropriately encourage these types of transactions and provide financial engineering opportunities resulting in governments reporting lower levels of debt compared with more direct financing transactions that have similar economic or present-value impact. The financial implications could be significant given that these are typically high value contracts involving construction over several years.

HoTARAC suggests that, if a grantor is to recognise a service concession asset, the grantor should also recognise the associated work-in-progress and the related liability as they accrue.

Nature of grantor's residual interest

The ED notes that for the purpose of Paragraph 10(b), "the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the asset and give the grantor a continuing right of use throughout the period of the arrangement" (Paragraph AG9).

In other words, a grantor will not control a significant residual interest unless it also has a continuing right of use throughout the concession period.

HoTARAC considers that a fundamental feature of service concession arrangements is that they require the operator to use the service concession property to provide services to the public. It is hard to see how a grantor has a continuing right of use throughout the concession period if the operator has use of the property under a binding arrangement with the grantor. Instead of a right of use, the grantor may have a right to receive the service concession property at the end of the concession period.

HoTARAC suggests that this be explained in the resulting Standard.

Scope clarifications

HoTARAC generally supports the scope of the term "service concession arrangement" as described in the ED (Paragraphs 2, 7 and AG1).

However, HoTARAC observes that service concession arrangements do not always set the initial prices to be levied by the operator or mechanisms for adjusting such prices. There are several examples of Australian service concession arrangements which do not deal with pricing or whether the operator may set and vary the fees it charges its customers. Some arrangements go further and exempt the operator from regulation by the government's independent pricing regulator. HoTARAC considers these to be service concession arrangements even though their features may be atypical.

Further, HoTARAC suggests that for clarity, arrangements where the grantor is the primary operator should be explicitly scoped out of the description in Paragraph 7.

Under some public-private partnerships in Australia, the public sector party controls the property (for example a hospital or school) as purchaser or lessee and is the primary provider of services using the property. The for-profit sector designs, finances and constructs the property and provides ancillary services (such as property maintenance), for an extended period. HoTARAC considers that such arrangements would be outside the scope of the ED because the public sector is the primary operator of the asset. However, it could be also argued that the for-profit sector is providing some level of indirect service to the public on behalf of the grantor by servicing the buildings, and that this aspect is a service concession arrangement.

HoTARAC suggests that the description of a service concession arrangement should explicitly exclude arrangements where the public sector party is the primary operator of the property, notwithstanding that the for-profit sector may provide some secondary services. The proposal might also specifically exclude arrangements where the public sector party purchases or leases the property. Such arrangements would be covered by existing standards on property, plant and equipment or leases.

Future economic benefits can be relevant

The ED's Basis for Conclusions, in discussing the rationale for adopting a control-based approach, notes that "the primary purpose of a service concession asset is to provide service potential on behalf of the public sector entity, and not to provide economic benefits such as revenue generated by these assets from user fees" (Paragraph BC11).

While HoTARAC acknowledges the importance of the concept of control in relation to asset recognition, it does not necessarily agree that service potential, rather than economic benefit, is the primary reason for undertaking service concession arrangements. Most service concession arrangements would not proceed without the assurance of a flow of future economic benefits. This is typically how service concession property is funded.

A control model based solely on a consideration of service potential without having regard to economic benefits may produce inappropriate outcomes. In many service concession arrangements, the operator has economic control, is exposed to most of the economic risks, and enjoys the majority of the economic benefits. There are several Australian cases of the grantor refraining from stepping in when the operator ran into financial difficulty and had to sell its interests in the arrangement. Arguably, these examples suggest operator control and the operator's exposure to the risks and rewards inherent in the service concession property.

Further, HoTARAC considers that both future economic benefits and service potential are relevant. The definition of assets encompasses both. HoTARAC therefore recommends that the conceptual rationale for preferring service potential over economic benefits be reconsidered.

No guidance for Government Business Enterprises

The proposals in the ED would not apply to Government Business Enterprises (Paragraph 5). The ED's Basis for Conclusions notes that the operator may be a GBE, that IPSASs are not designed to apply to GBEs and that International Financial Reporting Standards apply to GBEs (Paragraph BC 6).

However, there is no international guidance for a service concession grantor that is a GBE. Such entities are scoped out of IFRIC 12, which only applies to operators, and scoped out of the ED which would only apply to public sector entities that are not GBEs.

HoTARAC acknowledges that IPSASs are not normally intended to apply to GBEs. However, HoTARAC encourages the Board to consider making an exception in this case and extend the Standard resulting from the ED to GBEs that are service concession grantors.

Interrelationship with Interpretation 4

The ED does not address the potential interrelationship with IFRIC (and AASB) Interpretation 4 *Determining Whether an Arrangement Contains a Lease* (IFRIC 4). This could give rise to uncertainty in countries (such as Australia) that adopt IFRIC or equivalent Interpretations.

Although IFRIC 4 requires certain arrangements to be accounted for as leases, service concession arrangements within the scope of IFRIC 12 are specifically excluded. However, because the scope of IFRIC differs slightly from that of the ED, arrangements covered by the latter will not necessarily be excluded from IFRIC 4.

From a grantor's perspective, a service concession arrangement within the scope of IFRIC 12 is scoped out of IFRIC 4, regardless of the fact that IFRIC 12 only applies to an operator, under such an arrangement.

HoTARAC considers that, because the grantor control criteria in IFRIC 12 are broader than those in the ED, a service concession arrangement within the scope of the ED would be likely to be within the scope of IFRIC 12 and would therefore be excluded from the scope of IFRIC 4. See comments above, under *Asymmetry*.

However, HoTARAC notes that the ED does not alter the IFRIC 4 scope exclusion (based on IFRIC 12). It is not the IPSASB's prerogative to amend IFRIC Interpretations. Therefore, grantors would still have to apply the slightly different grantor control criteria in IFRIC 12 to ascertain whether or not to apply IFRIC 4, despite IFRIC 12 being otherwise irrelevant to grantors. This is likely to be confusing and inconvenient for grantors.

HoTARAC therefore recommends that the interaction between IFRIC 4, IFRIC 12 and the ED be reviewed by the AASB and that consideration be given to replacing the present IFRIC 4 scope exclusion, based solely on IFRIC 12, to one which is based, in the case of grantors, on the standard resulting from the ED. The AASB might apply its agreed process for not-for-profit modifications and consider whether the use of an Aus paragraph could address any shortcomings.

Minor corrections and clarifications

HoTARAC notes the following matters in the ED that need to be corrected or clarified:

- In Paragraphs 8(c) and AG18, it seems illogical to treat parts of an upgraded asset differently; only recognising the upgraded portion as a service concession asset.
- The requirement in Paragraph 12 to reclassify but not recognise certain existing grantor assets as service concession assets seems to be internally inconsistent and needs to be clarified. This may also affect Paragraphs 8(d), 12 and the Implementation Guidance on page 31.
- It is unclear whether an asset reclassified under Paragraph 12 would also give rise to a corresponding liability under Paragraph 19.
- It would be helpful to have an example of when a service concession asset might be intangible, as contemplated by Paragraph 13.
- In Paragraphs 14(b) and AG22(b), the expression "Compensating the grantor ..." should be "Compensating the operator...".
- In Paragraph 30, the intention of the word "prospectively" is unclear. Does it mean the standard would apply to (a) new arrangements commencing after the effective date or (b) existing arrangements but only from that financial year onwards?

- Paragraph AG12 is ambiguous. The conditions in Paragraph 10(a) could never be met if the asset (being a separate cash generating unit) is used wholly for unregulated purposes.
- In Paragraph AG29, the word grantor (where last used) should be operator.
- Given the adjacent guidance about the operator's cost of capital (Paragraph 34) and the grantor's incremental borrowing rate (Paragraph AG36), the first sentence of Paragraph AG35 might clarify whether it is referring to the grantor or the operator.
- Revenue recognition requirements are inconsistent. Paragraph AG38 requires a grantor to recognise revenue as the performance obligation liability is reduced but Paragraph AG39 prohibits a grantor from recognising revenue. Perhaps Paragraph AG39 should state that "The grantor does not recognise revenue that the operator collects, unless ..."
- Paragraph AG52 might be clarified to read: "The grantor's finance charge ..."
- The proposed consequential amendments to Paragraph 27 of IPSAS 13 *Leases* incorrectly refer to a "service concession arrangement as defined in IPSAS XX (ED 43)" (Appendix B, emphasis added). However, ED 43 does not actually define service concession arrangement. The word "defined" should be replaced with "described".
- In the illustrative examples, it would be helpful to have an example that includes a revenue-sharing arrangement.

ATTACHMENT C

Australian Government

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14 July 2010

Ms Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
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CANADA

Dear Stephenie,

IPSASB Exposure Draft 43 *Service Concession Arrangements: Grantor*

The Australian Accounting Standards Board appreciates the opportunity to comment on the International Public Sector Accounting Standards Board's proposals concerning the accounting treatment by the grantor for service concession arrangements. 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 service concession arrangements.

Accordingly, the AASB issued an Exposure Draft (ED 194) in April 2010 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. The comment letters received are published on the AASB's website (www.aasb.gov.au).

In general, the AASB supports the proposals in ED 43 and encourages the IPSASB to continue its work on this important project. Our main concerns or comments regarding the proposals are noted below.

Service Concession Arrangements

The AASB notes that there is no explicit definition of 'service concession arrangement' in the proposed Standard. However, the AASB considers that the description of typical service concession arrangements in paragraph 2, combined with the requirements in paragraph 7, will be sufficient to ensure that the appropriate arrangements are captured. For example, the references in paragraph 7 to the operator being obliged to provide the public services and to arrangements not involving the delivery of public services being outside the scope of the Standard will appropriately mean that arrangements that result only indirectly in the provision of public services would not be covered by the Standard.

Scope of the Proposed Standard

The scope of the Standard proposed in the Exposure Draft reflects the requirements of IFRIC Interpretation 12 *Service Concession Arrangements*. Therefore, the scope of the proposals are effectively limited to service concession arrangements where the underlying service concession assets are controlled by the grantor during and after the concession period (or just during the concession period, in respect of 'whole-of-life' service concession assets) in accordance with the grantor control criteria set out in paragraph 10. The AASB believes that there should be consistency across the accounting by operators and by grantors, and is keen to see the project progress on a timely basis, and therefore agrees with the limited scope of the proposals.

However, the degree of consistency achieved in practice may depend upon the assessment of regulatory arrangements by grantors in applying the grantor control criteria.

Scope of Regulation

Paragraph AG6 indicates that the regulation contemplated by those criteria could be through a third-party regulator. Paragraph AG8 states that the term 'regulate' is not intended to convey the broad sense of the power of government to regulate the behaviour of entities. It is uncertain, therefore, whether the reference to 'regulate' is intended to cover regulators that have been established by a government as independent regulators (i.e. independent of direct government administration). The government may be able to apply its legislative powers to change the parameters within which an 'independent' regulator works, but unless and until it does just that, it is not clear whether such powers should be ignored as merely part of the broad sense of government power referred to in paragraph AG8.

The AASB considers that governments are likely to conclude that independent regulators should not be factored into assessing the control or regulation specified in the grantor control criteria. This potentially will result in inconsistent accounting between grantor and operator, since from the operator's perspective the nature of the source of regulation is irrelevant. This may result in significant service concession assets not being recognised by either the operator or the grantor.

GBEs as Grantors

As per paragraph 5 of the ED, the proposed Standard would apply to all public sector entities, other than Government Business Enterprises (GBEs). Although GBEs could be grantors in service concession arrangements, the AASB does not support extending the scope of the proposed Standard, given the IPSASB's general exclusion of GBEs from the scope of its Standards.

The present scope of the proposed Standard would exclude both GBEs and any private sector grantors. Such grantors would be likely to look to the Standard by way of analogy under the requirements of international or national Standards corresponding to IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors.*

BOOT Arrangements

The AASB notes that some concerns have been expressed in Australia as to whether BOOT (build-own-operate-transfer) arrangements would be covered by the proposed Standard. In its view, the reference to ownership is not a substantive matter. For example, paragraph 8(b) states that a grantor may have access to existing assets of the operator (which may or may not be owned by the operator) for the purposes of a service concession arrangement, and that the grantor therefore would recognise the assets if the grantor control criteria in paragraph 10 are satisfied. The Standard could usefully make the point that control of an asset is the critical factor, not ownership.

The AASB considers that BOOT arrangements should be identified in the proposed Standard or its Basis for Conclusions as a type of BOT (build-operate-transfer) arrangement and thus covered by the requirements. The Implementation Guidance table of typical types of arrangements and the relevant Standards (see page 32 of the ED) refers to BOT and BOO (build-own-operate) arrangements, but not BOOT arrangements, which don't fall neatly into any of the columns due to asset ownership by the operator but the residual interest being held by the grantor.

Residual Interest in Service Concession Assets

The grantor control criterion specified in paragraph 10(b) of the ED addresses grantor control of 'any significant residual interest' in the asset at the end of the term of the service concession asset. This is a change from the preceding Consultation Paper, which referred instead to 'the residual interest'. The approach in the ED is consistent with IFRIC 12.

In responding to the Consultation Paper, the AASB supported such a change to ensure that insignificant residual interests could not affect the assessment of control over service concession assets, and also that assets used in a service concession arrangement for their entire useful lives would be appropriately covered by the proposals. Accordingly, the AASB welcomes and supports the IPSASB's reference to 'any significant residual interest' in paragraph 10(b) of the ED and the coverage of whole-of-life service concession arrangements.

Grantor Recognition of Assets Constructed by the Operator

The ED (paragraph AG20) proposes requirements for the timing of initial recognition by grantors of assets constructed or developed by the operator for the purpose of a service concession arrangement. The proposed requirements distinguish the timing according to whether the operator or the grantor bears the construction risk. In the former case, recognition by the grantor would occur when the asset is placed into service, and in the latter case, as the construction takes place – provided the grantor has reliable cost information.

The AASB believes that the grantor should recognise a service concession asset being constructed by the operator as construction takes place, irrespective of whether the construction risk is apparently borne by the grantor or by the operator. In the context of significant, long-term service concession arrangements, it is normally unreasonable for the grantor to hold out that it has no obligation to the operator for its construction services until the grantor has accepted the constructed asset as suitable for its intended purpose or even until the asset is placed into use. An operator is unlikely to enter into a service concession arrangement if the grantor can simply refuse to pay for the construction work where there is some defect in the constructed asset – or else defer payment until some minor aspect has been resolved. Therefore, the reliance upon construction risk does not seem to be justified for service concession arrangements.

Indeed, the last sentence in paragraph AG20 seems somewhat at odds with the rest of the paragraph. It is not clear what cases are being referred to. In any case, the grantor's obligation for construction costs prior to completion of construction should give rise to an asset for the grantor, and it is not clear why this could not be a service concession asset. The control criteria in paragraph 10 do not apply explicitly only to service concession assets that are presently operating: the grantor's control of the services, recipients and pricing might only be *exercised* in the future, from when the assets are placed into use, but the grantor already controls the assets in the requisite manner in that case.

Recognition of Performance Obligations

While accepting the IPSASB proceeding with the recognition of performance obligations, the AASB encourages the IPSASB to consider the impact of related research (for example, on leases) by the IASB and FASB as it develops its Standard. There are a number of aspects concerning performance obligations in the ED that need to be clarified.

First, it appears that the amount of the performance obligation is the difference between the fair value of the service concession asset and any payment obligations of the grantor because the financial liability and the performance obligations must initially equate to the fair value of the asset. This means that a performance obligation is recognised by the grantor only to the extent that its payment obligation falls short of the fair value of the service concession asset.

The AASB expects that in most (if not all) service concession arrangements, the grantor would have a performance obligation to the operator to continue to provide the granted service concession rights during the concession period. Therefore, it does not seem appropriate for the grantor to recognise a performance obligation only to the extent that the grantor does not have a payment obligation to the operator. If the performance obligation exists, it should be treated similarly in all cases, regardless of whether the grantor has a payment obligation. However, if the IPSASB retains its existing proposal, the AASB requests that it clarify why a performance obligation should be recognised only to the extent that the grantor's payment obligation (financial liability) falls short of the fair value of the service concession assets.

Secondly, it is not clear from the ED whether the grantor has a performance obligation in respect of its existing assets that are reclassified as service concession assets in accordance with paragraph 12. Paragraph AG29 (corrected) explains the nature of the obligation as requiring the grantor to 'provide' the asset to the operator. This seems equally applicable to existing assets of the grantor to which the grantor gives the operator access for the purpose of a service concession arrangement. The AASB considers that all service concession assets should be treated in the same way in this respect, regardless of whether they are new or existing assets of the grantor.

Finally, the AASB questions whether the performance obligation approach is proposed essentially as a means of deferring revenue recognition by the grantor. If this is the case, the IPSASB should address revenue recognition directly instead of via partial application of the notion of performance obligations.

Disclosure Requirements

While supporting the disclosure requirements proposed in the ED, the AASB thinks that it would also be useful to require separate (rather than combined) disclosure of:

(a) service concession assets recognised during the period; and

(b) existing assets of the grantor that have been reclassified as service concession assets during the period.

As presently drafted, paragraph 27(c)(iii) of the ED does not require separate disclosure of these amounts, even though paragraph 12 appears to suggest that that is intended.

Transitional Requirements

ED 43 proposes prospective application when an entity has not previously recognised service concession arrangements. However, the AASB recommends retrospective application of the Standard when first applied by any entity, not just those that have previously recognised service concession arrangements. Such an approach would also be consistent with the transitional requirements in IFRIC Interpretation 12.

Allowing prospective application by some entities would permit the continued non-recognition of potentially significant service concession assets for many years into the future, and defer the achievement of comparability between entities in respect of the financial reporting of service concession arrangements.

Other Matters

The AASB considers that the structure of the proposed Standard could be improved. At present, there is considerable detail and cross-referencing in the Application Guidance, which is an integral part of the Standard. The complicated cross-referencing interferes with reading and understanding the requirements, and consolidation of the text into the main part of the Standard could improve the flow. Some paragraphs such as paragraph AG19 merely duplicate the requirements in the main part of the Standard and should be deleted.

Some additional, less significant matters are noted in the attached Appendix. An editorial review of the proposed Standard is also required to identify and correct numerous problems, such as references to "grantor" instead of "operator" in paragraphs 14(b), AG22(b) and AG29 (and perhaps others), missing parentheses and incorrect punctuation.

If further information or clarification is required regarding any matters in this submission, please contact me or Clark Anstis, Senior Project Manager (e-mail: canstis@aasb.gov.au).

Yours sincerely,

Kevin M. Stevenson
Chairman

APPENDIX – ADDITIONAL MATTERS

These additional comments address some less significant issues arising from the proposed Standard. Some of these are concerned with the wording used in the proposed Standard, but an editorial review will be needed to identify numerous other necessary changes.

The proposed Standard

Paragraph 7 – the footnote text can be added to the end of the paragraph to simplify the presentation of the paragraph and make it more readable.

Paragraph 15 – the meaning of 'original' service concession asset is unclear, and should be clarified by referring instead to an asset recognised in accordance with paragraph 10 or 11.

Paragraph 18 – this is already covered by paragraph 13. Paragraph 12 already covers the subsequent accounting in the case of existing grantor assets reclassified as service concession assets.

Paragraph 21 – the references in the third sentence to 'allocate the payments to the operator' and 'service portions' are unhelpful, and the sentence should be amended to refer to identifying the components of the payments according to their substance as a reduction of the liability, a finance charge or the cost of services, and accounting for them accordingly.

Paragraph 23 – seems odd here to be referring to the operator compensating the grantor when all the other requirements are in terms of the grantor compensating the operator. It would seem better for the last sentence of paragraph 23 to be simply added to paragraph 19 and the rest of paragraph 23 deleted.

Paragraph 25 – this paragraph should be amended to allow for the possibility of the finance charge being capitalised as a borrowing cost. An amendment of IPSAS 5 *Borrowing Costs* on this point is proposed in Appendix B on page 25 of the ED.

Application Guidance

Paragraph AG3(a) – the relevant description of IFRIC 12 requirements would appear to be the operator's recognition of a financial asset, rather than the revenue and derecognition aspects noted.

Paragraph AG6 – the last part of the first sentence is not helpful as it refers to circumstances in which the grantor buys all, some or none of the output; there are no other cases.

Paragraph AG23 – it is not the arrangement that may be separable, but the asset and service components can be separately identified.

Paragraphs AG33-AG36 – the requirements for determining the finance charge when the grantor makes payments to the operator seem very permissive, as there is a long list of possible interest rates that might be applied in determining the finance charge. Better to state the principle first, that the interest rate should be appropriate to the terms of the service concession arrangement, and then discuss how that rate might be determined in practice.

Amendments to Other IPSASs (Appendix B)

Three Standards are proposed to be amended: IPSASs 5, 13 and 17. However, only IPSAS 17 is proposed to have a new paragraph identifying the effective date of the amendment and the requirements for early application. This difference in approach between the Standards does not seem justified.

IPSAS 13, paragraph 25 – the present last sentence referring to a public sector entity leasing infrastructure from a private sector entity is likely to be confusing in conjunction with the proposed additional sentence regarding service concession arrangements and should be deleted.

IPSAS 13, paragraph 27 – a service concession arrangement is 'described', not 'defined', in ED 43.

Basis for Conclusions

Paragraph BC7 – the explanation for the lack of formal definitions seems weak: different nature of the Standard? A Standard is a Standard, whatever its provenance. Best to delete the first sentence and commence the paragraph simply by stating that although the Standard does not include formal definitions, the IPSASB has instead provided guidance on terminology, etc. In substance, some of the guidance amounts to definitions anyway.

Paragraph BC11 – the correlation of risks and rewards with economic benefits and of control with service potential is too stark. In Australian Accounting Standards, economic benefits and service potential are inseparable aspects of assets. A different justification for choosing the control basis should be identified.

Implementation Guidance

Accounting framework flowchart – the third box on the right-hand side of the flowchart refers to the grantor continuing to account for an asset as a leased asset. However, this is not acknowledged in the second point of the last box of the flowchart or indeed in the proposed Standard proper, which refers only to IPSAS 17 and IPSAS 31 in various paragraphs, and never to IPSAS 13.

Illustrative Examples

Table 2.3 in Example 2 – in note 4, 'CU 135' is incorrect and should be 'CU 149' instead. The other amounts in the note are correct.