



**INTERNATIONAL FEDERATION
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Agenda Item
9

DATE: June 18, 2007
MEMO TO: Members of the International Public Sector Accounting Standards Board
FROM: Rick Neville (Service Concession Arrangements Subcommittee Chair) and Barry Naik
SUBJECT: Service Concessions / PPPs

ACTION REQUIRED

- Review the attached issues paper and research paper;
- Form a view on the questions asked within the issues paper; and
- Be prepared to discuss your views.

AGENDA MATERIAL

Item

- 9.1 Issues Paper
- 9.2 Research Paper

BACKGROUND

The overall objective of the IPSASB project on public-private partnership (PPP) arrangements (also referred to as service concession agreements) is to develop financial reporting guidance on these arrangements for public sector entities. Development of this guidance will commence with the issuance of an IPSASB consultative paper which is scheduled for the IPSASB's approval for public comment at their meeting in November 2007.

The IPSASB Service Concession Arrangements Subcommittee had its inaugural conference call on May 31, 2007. The subcommittee discussed attached agenda item 9.2 *Research Paper* – refining for submission to the IPSASB for this meeting.

Agenda item 9.2 is the culmination of the first phase in the development of a consultative paper for the project – involving research into the various aspects of PPP arrangements (thanks to Greg Driscoll, Mark Stachnik and the team at GASB for their hard work in developing this material).

The paper is intended to provide Board members with the findings of the research in the following four broad areas:

- What is a public-private partnership;
- Existing accounting approaches for PPP arrangements;
- Non-economic service delivery risks; and
- Accounting and financial reporting issues related to PPP arrangements.

The objective of item 9.2 is not to serve as an initial draft of the anticipated consultative paper (although some components of this paper may be incorporated into the consultative paper). Therefore, while the paper raises accounting and financial reporting issues and various alternatives for their resolution, positions of the project staff on these issues are not presented.

Instead, the objective of staff in presenting this paper is to share our understanding of PPP arrangements and the related accounting and financial reporting issues with Board members and to confirm this understanding with them based on their experience with these arrangements in their respective jurisdictions.

The information presented in this paper will set the stage for the development of staff positions on financial reporting guidance for PPP arrangements. Development of these positions will take place in the second phase of this project. A draft of the consultative paper is the scheduled outcome of this second phase.

Given the role of this research paper, Board feedback on the information provided in the paper is critical. To facilitate the gathering of feedback and to focus the discussions during the July meeting, staff have provided a brief issues paper (agenda item 9.1) which poses numerous questions for Board response.

Next Steps

Staff will take the Board's comments and incorporate them into the next stage of the project - preparing an analysis of the accounting and financial reporting issues associated with PPP arrangements and providing proposals on the guidance for these issues – leading to the development of a final consultation paper scheduled for Board approval for public comment in November 2007.

In order to achieve this:

- the subcommittee currently has two further scheduled meetings/conference calls to finalize a consultative paper for Board approval; and
- staff consider it will be very likely (timeframes and details still to be determined) that before November 2007, a draft of the consultation paper will be provided to Board members for comment to assist in subsequent November discussions.

ISSUES PAPER

Defining a clear scope at this stage is key to enabling the staff to more effectively move forward with the next phase of the project which will involve preparing an analysis of the accounting and financial reporting issues associated with PPP arrangements and providing proposals on the guidance for these issues.

There are several components that must be addressed in determining the scope of the project. These components can be divided into two groups:

- I. Types of arrangements to be addressed
- II. Accounting and financial reporting issues to be addressed

Additionally, the project staff would like to reconfirm that the Board believes that the consultative paper that is to be the product of the next phase of the project, should not be constrained by the existing guidance provided by IFRIC Interpretation 12, *Service Concession Arrangements*.

I. Types of Arrangements to be Addressed

The research paper provides a graph and a table that detail the various types of PPP arrangements that currently exist in practice. These types of arrangements differ based on the nature of involvement of the private party to the arrangement. The paper suggests that for certain of these types of arrangements, for example, design-build arrangements and service contracts, existing guidance may suffice to determine the appropriate accounting and financial reporting. There may be a number of considerations to determining which types of PPP arrangements should be covered within the scope of the future consultative paper, for example, the nature of involvement of the private party (delivery of an asset, delivery of a service, or delivery of an asset and a service) or the party that is the end user of the asset or related service provided by the arrangement (the public party itself or third-party users, such as citizens).

The following are questions for the Board's consideration to establish the scope of the project in terms of the types of arrangements to be included:

- Are there types of PPP arrangements that are not covered within the research paper that should be considered when determining the scope?
- Are there distinguishing characteristics that the Board believes should be present as part of a PPP arrangement for it to be covered within the scope of the consultative paper?

Another type of arrangement to be considered for inclusion within the scope of the future consultative paper is an arrangement that is structured and operates similar to a PPP arrangement, except for the fact that the role of the private party, or operator, is assumed by a governmental business enterprise (a public entity). By definition, this type of arrangement would not meet the definition of a PPP arrangement because both parties are

public entities. However, given their similarity to PPP arrangements, it could be decided that the future consultative paper should include these “public-public partnerships” within its scope. Alternatively, as per the definition of a PPP, it could be decided to exclude these “public-public arrangements” from the scope of the future consultative paper.

- Should an arrangement between a central or local government and a government business enterprise (referred to as a “public-public partnership”) that operates similarly to a PPP arrangement be considered within the scope of the future consultative paper?

II. Accounting and Financial Reporting Issues to be Addressed

The paper also discusses several accounting and financial reporting issues that may arise for the public sector entity (or grantor) as a result of entering into a PPP arrangement, along with alternatives for potential guidance to address these issues. Several of the alternatives are based on existing IPSASB guidance or that of other standards-setters. The following is a listing of the issues raised with a reference to the pages in agenda item 9.2 *Research Paper* where further discussion of the issue and potential alternatives for guidance can be found:

- Reporting of the infrastructure associated with the PPP arrangement (pg 35-38);
- Timing of recognition and measurement of the newly-constructed infrastructure asset when the public party reports the asset (pg 35-36);
- Timing of recognition and measurement of the infrastructure asset when the private party reports the asset during the life of the arrangement, but the public party will receive the asset at the end of the arrangement (pg 36-37);
- Derecognition of an existing infrastructure asset when the private party reports the asset during the life of the arrangement (pg 37-38);
- Reporting of revenue-sharing provisions present in the PPP arrangement (pg 38);
- Timing of revenue recognition for upfront payments received as part of the PPP arrangement (pg 38-39);
- Reporting of guarantees made by the public party to, or on behalf of, the private party (pg 39-41);
- Potential consolidation of the private party into the economic entity of the public party (pg 39-41);
- Financial statement disclosures related to the PPP arrangement (pg 41); and
- Applicability of the future guidance to government business enterprises (pg 41-43).

The questions for the Board’s consideration related to these accounting and financial reporting issues and their alternative approaches are:

- Should the individual issues identified be addressed in the consultative paper?
- Are there other issues not considered in the research paper that should be addressed in the consultative paper?

- Are there alternative approaches for guidance related to a particular issue other than those that are covered in the research paper that should be considered in the project staff's development of proposed guidance?

III. Symmetry with IFRIC 12, *Service Concession Arrangements*

The Service Concession Arrangements project brief indicates that the consultative paper should not be constrained by any existing service concession arrangements standards. The project staff would like to confirm that this continues to be the Board's view (most notably with respect to IFRIC 12) prior to undertaking the next phase of the project. Limiting the guidance to be provided in the future consultative paper to that which is consistent with guidance in IFRIC 12 would have a significant impact on the alternatives to be explored by the project staff in preparing the consultative paper. It should be noted that even if the Board confirms its previously expressed view, symmetry with IFRIC 12 will be a consideration of the project staff in forming its proposals for guidance on PPP arrangements.

- Does the Board continue to believe that the guidance to be provided in the future consultative paper should not be constrained by the existing guidance in IFRIC 12?

Research Paper

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Executive Summary

“Public-private partnership” is a term that has been described a number of different ways by different organizations around the world. The common characteristic among these different descriptions is that a public-private partnership is an arrangement between public and private sector entities related to the delivery of a public sector asset and/or services associated with a public sector asset. In this way, public-private partnerships (“PPP”) are an alternative to traditional procurement methods used by public sector entities as a means to accomplish a public duty or responsibility. Unlike traditional procurement methods, in a PPP arrangement, the risks associated with the underlying project generally are allocated between the public sector entity and the private sector entity. These risks commonly include construction risk, availability risk, demand risk, operational and maintenance risk, residual value risk and financing risk.

Typically, the objective of a public sector entity entering into a PPP arrangement is to achieve “improved value for money” through an allocation of certain of the aforementioned project risks to the private sector entity. The allocation of project risks between the public sector and private sector entities is usually based on which entity can best manage the individual risk given the specific circumstances of the project and the resources and capabilities of the participating entities. The involvement of the private sector entity can best be described in terms of the various aspects of the project for which they are responsible. This description also is commonly used to refer to the “type” of PPP arrangement that has been undertaken. For example, in an arrangement referred to as a design-build-finance-operate public-private partnership, the private sector entity is responsible for designing and building the infrastructure, financing the construction costs, and providing the service derived from the infrastructure.

Another commonly-used term to describe certain PPP arrangements is “service concession arrangement.” This term generally is used to refer to arrangements in which the public sector entity conveys the right to provide services to the public through the use of an infrastructure asset to the private party. The private party in turn assumes an obligation to provide such services, normally in accordance with performance requirements set forth by the public party.

The “value” expected to be gained by a public sector entity’s participation in a PPP arrangement can be related to improved service delivery or economic benefit. For example, a PPP arrangement can potentially improve the public sector entity’s ability to provide new or

improved infrastructure and improve the quality of that infrastructure and the related services provided to citizens. A PPP arrangement may also, potentially, reduce the cost of construction or service delivery for the public sector entity, or result in revenue for the public sector entity from payments made by the private sector entity to enter into the PPP arrangement.

Aside from achieving improved value for money, another incentive to enter into PPP arrangements, that some public sector entities have possessed, relates to the meeting of fiscal targets. PPP arrangements have been seen by some as a vehicle to enable the fulfillment of infrastructure needs, while at the same time, excluding the infrastructure created and the resulting financing needed for construction from the budgetary process and financial reports of the public sector entity. This motivation was particularly prevalent in the early stages of developing PPP arrangements.

With the infrastructure needs of public sector entities continuing to grow and the challenges of meeting those needs through traditional means continuing to mount, PPP arrangements have emerged as an increasingly common vehicle used by public sector entities to assist in meeting their infrastructure needs. In recent years, the interest in PPP arrangements and the actual number of executed arrangements has increased substantially in several countries throughout the world. Additionally, where these arrangements originally were only commonly used in particular sectors, such as transportation and utilities, the types of infrastructure and services provided through PPP arrangements also have grown. For example, these arrangements are now being used in sectors as varied as education, corrections and health care.

Despite this global proliferation of PPP arrangements and the complexity usually involved with these arrangements, many jurisdictions are currently just applying their existing authoritative accounting and financial reporting guidance to account for these arrangements. Some standard-setting bodies have either issued or proposed guidance to address some of the unique accounting and financial reporting issues created by PPP arrangements. This guidance mainly focuses on accounting for the infrastructure associated with the arrangement, specifically, which party to the arrangement should report the infrastructure as an asset. Different approaches to answering this question are provided by the existing guidance. Guidance issued by the UK Accounting Standards Board and the European Commission (through Eurostat) applies an economic risk and rewards approach; guidance issued by the International Financial Reporting Interpretations Committee applies a control-based approach; and guidance proposed by the Accounting

Standards Board of South Africa applies an approach based on ownership of the property at the end of the agreement.

There also are a host of other accounting issues for public sector entities that could result from entering into PPP arrangements. Some of these issues are ancillary to the reporting of the infrastructure. Others relate to the following:

- Recognition of revenues generated from the PPP arrangement for the public party;
- Guarantees made by the public party as part of the arrangement, for example, those made to the private party or its creditors;
- The impact of the arrangement on the public sector entity's economic entity through potential consolidation of the special purpose vehicle that may serve as the private sector entity in a PPP arrangement; and
- Financial statement disclosures that would provide necessary transparency to the PPP arrangement for users of the financial statements.

The importance of accounting and financial reporting guidance specific to PPP arrangements is underscored by the aforementioned motivation of some governments to enter into these arrangements as a means to meet fiscal targets while achieving their service objectives.

A variation on the PPP arrangements described above related to the parties involved also exists in practice. In some arrangements, a governmental business enterprise or some other type of public sector entity functions in essentially the same role as the private sector entity to a PPP arrangement. By definition, these arrangements would not be considered PPP arrangements because both parties involved are public sector entities. However, other than the parties involved, these "public-public partnerships" often are structured and operate similarly to PPP arrangements.

The paper that follows is a first step toward IPSASB's potential development of accounting and financial reporting guidance for PPP arrangements. It essentially serves as a research paper on PPP arrangements and elaborates on much of the information included in this executive summary. It provides background on PPP arrangements through a discussion of the types of arrangements currently used in practice, the reasons why these arrangements are being used by public sector entities, and the prevalence of these arrangements in various countries and public

sectors. The paper then discusses the current existing and proposed accounting guidance for PPP arrangements, as well as the accounting and financial reporting issues related to these arrangements that could warrant consideration for inclusion in future guidance to be developed by IPSASB.

It should be noted that in this paper, the public sector entity to a PPP arrangement is generally referred to as the “public party” and the private sector entity is referred to as the “private party.” In other existing accounting guidance on PPP arrangements referred to in this paper, the “public party” is referred to as the “grantor” or “purchaser” and the private party is referred to as the “operator.” The asset associated with a PPP arrangement is generally referred to in this paper as the “infrastructure” or the “property” depending on the context of the reference.

I. What is a Public-Private Partnership?

There is no single, widely-accepted definition for the term “public-private partnership” (hereinafter referred to as “PPP”). The uniqueness and complexity of each arrangement, the breadth of forms that these arrangements take, and the manner in which these arrangements are approached in different countries make it difficult to channel them into an all-encompassing definition. Several entities have developed their own descriptions of a PPP, including the following:

- A cooperative venture between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks, and rewards. (The Canadian Council for Public Private Partnerships)
- Forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service. (European Union *Green Paper on Public-private Partnerships and Community Law on Public Contracts and Concessions*)
- A contractual arrangement between the public and private sectors (consistent with a broad range of possible partnership structures) with clear agreement on shared objectives for the delivery of public infrastructure and/or public services by the private sector that would otherwise have been provided through traditional public sector procurement. (Central Public Private Partnerships Unit in the Department of Finance, Ireland)
- Any scenario under which the private sector assumes a greater role in the planning, financing, design, construction, operation, and maintenance of a transportation facility compared to traditional procurement methods. (United States Federal Highway Administration Public-Private Partnerships Website)

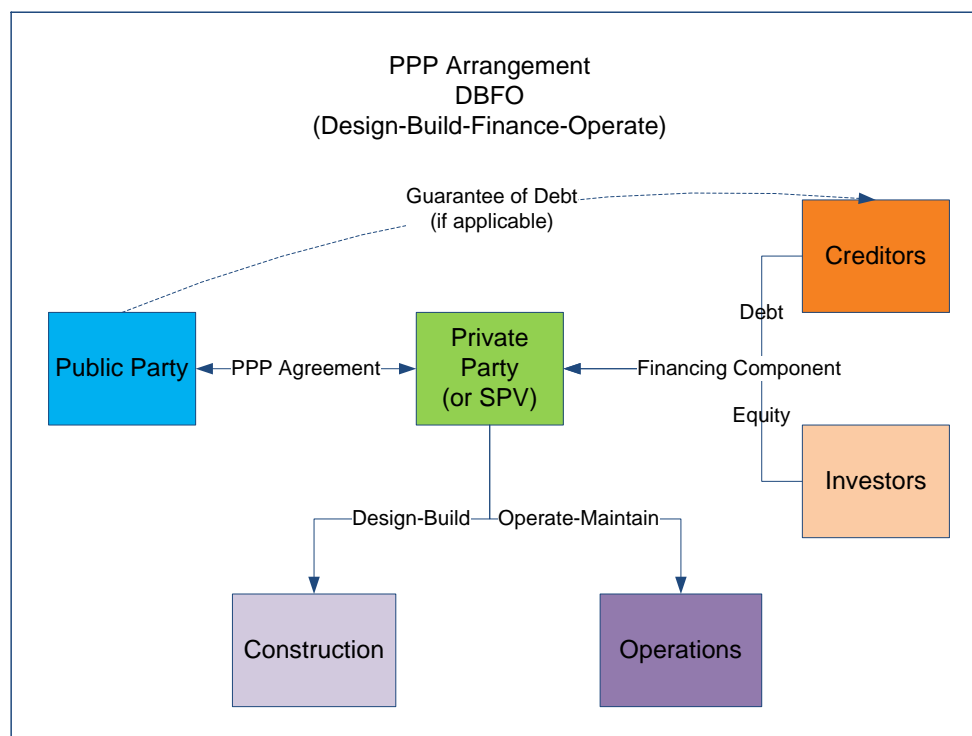
The underlying characteristic generally common to all descriptions of the term “public-private partnership” is the creation of a partnership between public and private sector entities to deliver a public sector asset and/or service. Based on these descriptions, the “users” of the services provided through a PPP arrangement can be the government itself, third-party users, such as citizens, or both.

PPP arrangements often involve a complex allocation of risks between the public party and a single private party which creates a mutually beneficial interest in the long-term success of a public project. In contrast, traditional procurement typically involves the completion of a public project through the fulfillment of generally well-defined, individual contracts, usually by multiple private parties, with the public party retaining most, if not all, of the risk associated with the project. As will be discussed in further detail later in the paper, common types of infrastructure constructed through PPP arrangements include roadways, railways, schools, prisons, courthouses, waste management facilities, utility facilities, and hospitals. In many PPP arrangements, responsibility for operating and/or maintaining the newly-constructed infrastructure is also assumed by the private party. PPP arrangements also can involve existing infrastructure where the private party assumes responsibility for its operation, along with its upgrade and maintenance.

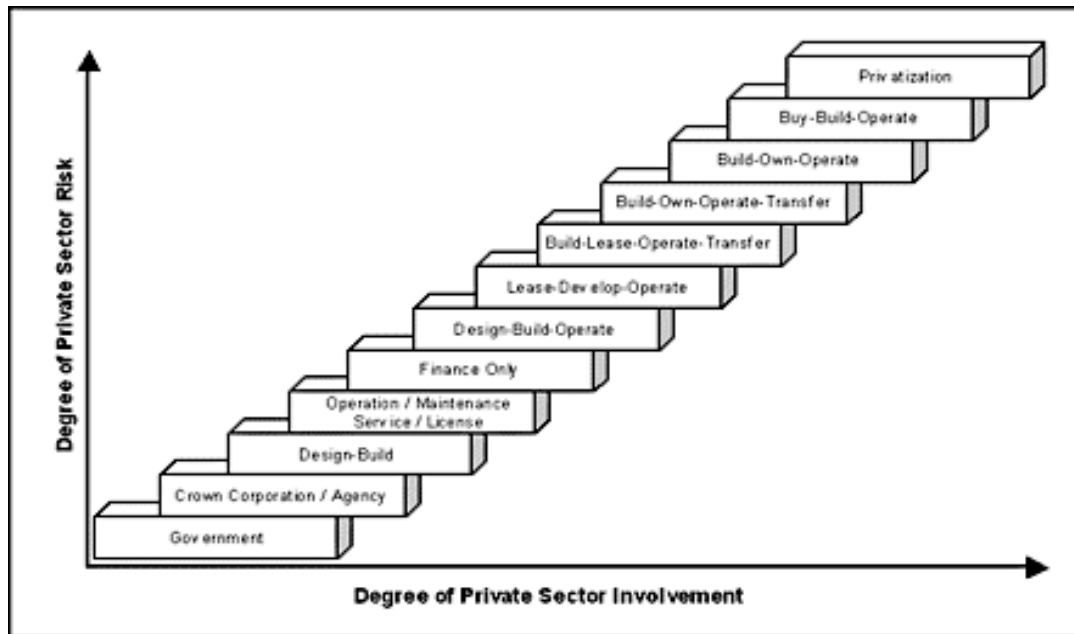
The term “public-private partnership” is an umbrella-type term used to refer to arrangements that apply this broad concept of the public sector engaging the private sector to assist in delivering public sector assets or services. In practice, however, several other terms are used somewhat interchangeably with the term “public-private partnership” to refer to these arrangements, including management contracts, service concession arrangements, design-build-finance-operate (DBFO) schemes, and build-own-operate-transfer (BOOT) schemes. These terms are all specific types of arrangements that generally fall under the broad spectrum of PPPs. These types of PPP arrangements, along with several others, will be described in further detail in the next section of the paper. In some jurisdictions, the term “public-private partnership” is also a defined legal term, which may cause procurement, contracting, and other requirements to be met by the public and private parties to a public-private partnership in those jurisdictions.

Types of PPP Arrangements

Typically, the overarching goal of a public party entering into a PPP arrangement is to achieve “improved value for money” through an allocation of certain project risks to a private party. The traditional type of PPP arrangement often used to achieve this goal is the DBFO scheme. Under this type of arrangement, the private party designs and builds the infrastructure, finances the construction costs, and provides the service derived from the infrastructure, with the infrastructure typically being returned to the public party at the end of the arrangement. The following diagram illustrates the various parties that may be involved in a DBFO arrangement:



Although the DBFO scheme may be the most common, other types of PPP arrangements also are utilized in practice based on the specific project being undertaken and the resources of the public and private entities involved in the arrangement. Most of these types of PPP arrangements can be categorized into common models. These models can be distinguished by the degree of involvement, and therefore risk, assumed by the private party. The smallest degree of private party involvement and risk lies in the design-build (DB) PPP model. In a DB PPP arrangement, there is no private party involvement beyond the design and construction of the infrastructure. Upon the completion of construction, the public party assumes all responsibility for operating and maintaining the infrastructure. At the other end of the spectrum is what could be referred to as full privatization. In this case, the private party assumes all the risks and responsibilities associated with the project. Other types of PPP models fall between these two extremes in terms of private sector involvement and risk as depicted in the following graph:



Source: The Canadian Council on Public-Private Partnerships (<http://www.pppcouncil.ca/aboutPPPdefinition.asp>)

Usually, the private party is responsible for providing the necessary financing for the PPP arrangement (that is, generating the capital required to undertake construction or renovation of the associated property). However, the decision of which party finances the arrangement depends on how the PPP arrangement is expected to generate the greatest value for money—in other words, which party appears to be best suited to assume financing risk. (Financing risk is discussed later in the paper along with other risks that may be considered in determining the greatest value for money.) This decision also may be impacted by the incentive or the need of the public party to exclude financial liabilities from their financial statements or their inability to issue debt. In any case, unless specified in the model type, for example, the DBFO model, each model could result in either the private or public party financing the arrangement. The models also do not denote the compensation provisions of a PPP arrangement. These provisions are specific to the individual PPP arrangement. Common compensation schemes for PPP arrangements are discussed later in the paper.

The following table describes the nature of involvement of the public party and the private party in certain of the PPP models referred to in the graph, along with other common PPP models:

PPP Model	Public Party Involvement	Private Party Involvement
Design-Build-Maintain (DBM)	Operates the infrastructure; holds title.	Designs, constructs, and provides maintenance for the infrastructure.
Design-Build-Operate (DBO)	Retains responsibility for maintenance of infrastructure; holds title.	Designs, constructs, and operates the infrastructure.
Design-Build-Operate-Maintain (DBOM)	Monitors project for private party compliance with agreement; holds title.	Designs, constructs, maintains, and operates the infrastructure.
Lease-Develop-Operate (LDO)	Lessor of infrastructure to private party; holds title.	Leases existing infrastructure from public party; improves and operates infrastructure.
Build-Lease-Operate-Transfer (BLOT)	Lessor of component used in PPP arrangement, for example, land on which infrastructure will be constructed; monitors project for private party compliance with agreement; receives infrastructure on termination.	Leases component from public party; designs, constructs, and operates infrastructure; holds title to infrastructure for specified period of time.
Operate-Maintain (OM)	Monitors project for private party compliance with agreement; holds title to infrastructure.	Contracts with public party to operate and maintain existing infrastructure.
Build-Own-Operate-Transfer (BOOT)	Monitors project for private party compliance with agreement; receives infrastructure on termination.	Designs, constructs, maintains, and operates the infrastructure; holds title for specified period of time.
Own-Operate-Maintain (OOM)	Essentially has divested itself of all present and future responsibility for the infrastructure; public constraints provided in original agreement and through on-going regulatory authority.	Operates and maintains infrastructure; holds title to infrastructure with no obligation to return title to public party.

Build-Own-Operate (BOO)	Essentially has divested itself of all future responsibility for the service related to the to-be-constructed infrastructure; public constraints provided in original agreement and through ongoing regulatory authority.	Designs, constructs, maintains, and operates the infrastructure; holds title to infrastructure with no obligation to return title to public party.
Buy-Build-Operate (BBO)	Essentially has divested itself of all present and future responsibility for the infrastructure; public constraints exercised through contract at time of transfer.	Purchases land on which to build infrastructure or purchases existing infrastructure under the obligation to upgrade; operates and maintains the infrastructure; holds title to infrastructure with no obligation to return title to public party.

Some of these types of PPP arrangements are also often referred to in practice as a service concession arrangement. In a service concession arrangement, the public party conveys the right to provide services to the public through the use of an infrastructure asset to the private party. The private party in turn assumes an obligation to provide such services, normally in accordance with performance requirements set forth by the public party. At the end of the arrangement, use of the asset reverts back to the public party. The infrastructure asset associated with the service concession arrangement can be built or acquired by the private party, or can be an existing asset of the public party.

Other types of agreements are often also referred to as PPPs—for example, service contracts in which the public party contracts with the private party for the latter to provide services related to the operation of infrastructure that the public party previously performed; and management contracts in which the private party is responsible for all aspects of operations and maintenance of the associated infrastructure. These agreements result in the outsourcing or contracting out of the service to a private party. In a joint venture, there is a sharing of ownership of the associated infrastructure and the responsibility for providing service between the public and private parties. Lastly, in a divestiture, the public party transfers an asset, either in part or in full, to the private party. Generally, the public party will include certain conditions with the transfer of the asset to ensure that improvements are made and citizens continue to be served.

Compensation Provisions in PPP Arrangements

Similar to the variability of the types of PPP arrangement used, compensation provisions in place to fund the construction and operational services provided by the private party are also varied. These compensation provisions can vary in their basis for payment (for example, fixed payments or variable payments based on availability or usage) and in the source of the funding (for example, the public party to the PPP arrangement or third-party users of the services provided by the associated property). The timing of the payments also may vary. For example, to lessen the financing requirement for the private party, the public party may make a substantial payment at the beginning of the arrangement with a reduced stream of periodic payments to follow in the future. The compensation of the private party in a PPP arrangement is typically based on one of the funding schemes discussed below, or on a combination of these schemes:

- *Fixed payment.* The public party pays the private party an amount specified by the contract regardless of other factors, such as the level of usage or availability of the infrastructure asset.
- *Availability payments.* The amount the public party pays the private party varies based on the level of output available from the infrastructure which the private party is responsible to operate and maintain. In other words, the payment amount is determined by the private party's ability to fulfill an expected level of output. For example, if a PPP arrangement for a prison details that a specific number of cells shall be available, the public entity would be able to reduce its payment if the number of cells actually available is less than that amount. In some arrangements, the availability payment is structured essentially as a fixed payment which may be modified subject to the private party's compliance with performance provisions.
- *Payments based on level of usage by the public party.* The amount of the payment made to the private party by the public party is based on the level of usage of the infrastructure by the public party. This type of funding scheme could exist in arrangements in which the public party is the sole user of the property. For example, the payment made to the private party providing a prison could depend on the level of *usage* of the cells by the public party (as opposed to the *availability* of the cells as described above).

- *“Shadow” payments.* This term is used to describe payments made by the public party on behalf of its citizens based on the level of their usage of the infrastructure. For example, to maintain a free-access tunnel, the public party may agree to pay the private party a “shadow toll” per vehicle that uses the tunnel.
- *Third-party user fees.* The private party is compensated directly by the users of the infrastructure. Either the public party will collect the revenues and pass them on to the private party or the private party will have the authority to collect revenues directly from the users. As a way to defray the cost of using the infrastructure to the citizens, the arrangement may call for “shadow” payments along with third-party user fees to be provided to the private party.

In the case where the compensation of the private party is based on usage, the public party can agree to a floor level of usage to mitigate the risk of low volume for the private party. In essence, the public party is guaranteeing a specified base amount of revenue for the private party.

Some PPP arrangements also include a form of compensation for the public party. For example, a PPP arrangement may involve revenue sharing between the private and public parties. This revenue sharing can be on all usage, on revenue above a certain threshold, or on revenue above that needed for the private party to achieve a specified rate of return. For example, in New Zealand, a City Council entered into a BOOT arrangement with a private party to build a large indoor arena. Under the arrangement, the Council receives a 20-cent royalty from every ticket sold to an arena event, which is used by the Council for funding community events. Also, in the United States, a public party engaged a private party to manage, operate, and maintain a toll road. Under the arrangement, the public party is entitled to receive 40 percent of gross toll revenues after the real net cash flow of the arrangement yields a pre-tax internal rate of return on total invested projected funds equal to 6.5 percent for the private party. The public party’s share increases to 80 percent of gross toll revenues after the arrangement yields an 8 percent internal rate of return for the private party.

It may also be the case that the PPP arrangement includes a substantial upfront payment to the public party with no subsequent revenue sharing, or a small upfront payment with a reduced revenue-sharing component for the public party over the life of the arrangement. For example, a state in the United States entered into a PPP arrangement with a private party in which the

private party was given the right to operate and maintain a toll road for 75 years. The private party is entitled to the tolls collected from third-party users of the road. In exchange for granting this right, the state received an upfront payment of \$3.8 billion which it plans to use on other road projects in the state. In some PPP arrangements, a stream of fixed payments, either in cash or promissory notes, by the private party to the public party is provided.

Why PPP Arrangements Are Used

PPP arrangements are undertaken by public entities for various reasons. The common, underlying reason is to leverage the benefits created from partnering with a private party which may not exist if the transaction were to remain in the public sector. As noted earlier, a common phrase in PPP literature used to refer to this objective is achieving “improved value for money.” Often, the potential “value” to a PPP arrangement perceived by the public party is a monetary objective, for example, an attempt to control or reduce costs. In other instances, the potential “value” may include improved ability to deliver new or improved infrastructure, improved quality of construction, and improved efficiency in the public service provided. Improved value for money is achieved through the proper allocation of project risks between the public and private parties based on their resources and capabilities. Common risks associated with a PPP project include the following:

- *Construction risk.* This risk encapsulates the numerous issues that may be encountered during the construction phase of a project, such as budget overruns, building material defects, construction delays, planning regulation, structural integrity issues with existing infrastructure, technical deficiencies, health risks, worksite accidents, and other catastrophic events.
- *Availability risk.* Availability risk is the risk of the infrastructure not providing sufficient output, for example because of insufficient management or not meeting the required quality standards to provide service. For example, a poorly managed hospital may not currently be operating at an acceptable level of quality, thus the volume of supplied services is lower than that required by the community.
- *Demand risk.* Demand risk is the risk related to variability in the amount of service the public requires or consumes. Demand risk stems from a variety of sources not limited to the cost and/or quality of the service provided. For example, the demand on a toll

road may vary over time. A reduction in the number of citizens using the toll road may be the result of increased tolls or poor road quality, but it can also be related to an increase in the cost of gasoline, automobile insurance, concerns over pollution, or the development of alternative toll or free roads.

- *Ongoing operational and maintenance risk.* This risk encompasses a broad range of risks that exist once the infrastructure is operational. Examples include price increases or shortages of input materials, increases in labor costs, damage as a result of natural disasters, costs related to deferring maintenance, and obsolescence. Demand and availability risk may also be considered specific components of ongoing operational and maintenance risk.
- *Residual value risk.* This risk relates to the market price of the infrastructure at the end of the PPP arrangement. This risk can be borne by either party, but since the public party is often the sole potential buyer of the infrastructure associated with a PPP arrangement, often a fixed transfer price is built into the contract, or the periodic payments made by the public party take a transfer price into account. Either of these schemes place residual value risk with the public party.
- *Financing risk.* Financing risk is the risk that due to the circumstances of the specific public or private party, or investor perceptions of the risks of a project, the required funding will not be able to be achieved or will be achieved at interest rates which would prevent projects from achieving improved value for money. Generally, private party borrowing costs are higher than those of the public party, typically because of the perceived lower risk of public debt due to the public party's ability to raise tax revenues to service debt and, in some jurisdictions, tax advantages provided to investors in public debt. Despite this fact, the public entity may still desire to allocate financing risk to the private party. In some cases, this is because the public party has an incentive or a need to exclude financial liabilities from its financial statements or does not have the capacity to issue additional debt. To lessen the cost of borrowing for the private party, the public party may provide a guarantee of the debt of the private party to its creditors.

The public and private parties to a PPP arrangement decide which party can best manage the risks associated with the project based on the specific circumstances of the project and the

resources and capabilities of the individual parties. For example, a railway agency in the United Kingdom is extending its railway network in a project that involves engaging a private party in a design, build, finance, and maintain PPP for a new twin bore tunnel under the Thames. The public party believes its greatest risk occurs in the construction phase and with the maintenance of the tunnel. They believe the costs to privately finance the operations would far outweigh the benefit of having the private party hold the operational risk. Therefore, they have decided to allocate the construction and maintenance risk to the private party but retain the ongoing operational risk.

As noted above, the potential “value” to a PPP arrangement perceived by the public party can be manifested in several ways. Some of these ways are described below:

- *Improved ability to deliver new or improved infrastructure.* Governments often face budgetary constraints or political challenges that limit their ability to undertake necessary infrastructure projects. Also, even if a government has the resources and the political will, it may lack the necessary expertise, capacity or machinery to fulfill their infrastructure needs. As a result, improvements to existing infrastructure or construction of new infrastructure may be delayed for years or may never come to fruition. Utilization of the resources of a private party through a PPP arrangement could potentially provide solutions to these challenges. As an example, an Irish town had a very rundown harbor, impeding the town’s potential tourist traffic. The town did not have the financial means to restore the harbor. However, the town engaged a private party to renovate and develop the harbor in exchange for parcels of property surrounding the harbor. The private party could then, in the future, convert the property to residential property and condominiums with harbor views. Although the town needed to concede control and rights to the land to the developer, through the use of a PPP, the town was able to achieve assets and make a much-needed improvement of its harbor when it otherwise might not have been possible.
- *Improved efficiency and quality of construction and services.* Assuming a government has the resources to build a particular infrastructure asset and/or provide a particular service, it may have difficulty containing costs while striving for a certain level of quality. In this situation, a government could potentially use private parties to exploit

the expertise and efficiency of these profit-focused firms to achieve the intended results at a lower cost or achieve higher quality results at the same cost.

Private firms are often seen as having more motivation to control costs and provide innovative solutions as they compete with one another, often in terms of cost and quality. Some observers criticize that having private firms build public infrastructure may result in lower quality output because of the immediate profit focus of the private party. Increasing oversight to help control quality may offset the cost savings of private party construction to the public entity. However, the appropriate allocation of risks to a PPP arrangement may provide the incentive to align the interests of both parties. For example, if in addition to constructing the infrastructure asset (construction risk), the private party must also operate and maintain the infrastructure for several years, as well as return the infrastructure in a particular condition to the public party at the end of the contract (operation and maintenance risks), the private party would presumably be more inclined to design and construct infrastructure so as to minimize costs over the term of the arrangement, often resulting in higher-quality infrastructure.

- *Receipt of an upfront payment.* As noted earlier, the public party may receive a substantial upfront payment from the private party to enter into a PPP arrangement. This upfront payment can subsequently be used for a variety of objectives of the public entity, including reinvestment into other infrastructure projects, retirement of existing debt, or the funding of other public programs. Upfront payments to the public party typically come in lieu of sharing in future revenues, or because the public party agrees to a smaller share of future revenues than it would agree to otherwise. The notion of receiving an upfront payment has made PPP arrangements of particular interest in the United States.
- *Access to a broader base of investors.* A private party involved in a PPP project may be able to recruit a broader base of investors than a public entity would if it were financing the project themselves. Characteristics of investment in the form of a PPP may appeal to certain investors over other vehicles that could be used to invest in the same entity or revenue stream. For example, in the United States, pension funds, which do not pay taxes on income, would not purchase government-issued toll revenue bonds as investments because the bonds are tax-exempt. However, long-term, taxable positions

in infrastructure may be an attractive source of stable cash flows and diversification for the plans.

- *Focus on providing core services.* PPP arrangements allow the public party to assign construction and ancillary services to a private party, allowing it to focus on providing core services essential to the public. This is particularly the case for PPP arrangements that involve social services. For example, in the Netherlands, an area needed additional school capacity. It decided to enter into a PPP arrangement in which the private party would build the schools, clean and maintain them, and provide security and information technology. The school system could then focus solely on the quality of the education.

In addition to the potential for achieving improved value for money, some public entities have been motivated to enter into PPP arrangements because they believe that the infrastructure created and the resulting financing needed for construction would be outside of their budgetary process and financial reports. This incentive was particularly prevalent in the early stages of developing PPP arrangements. This incentive illustrates the need for specific guidance on accounting and financial reporting for PPP arrangements so that PPP arrangements are appropriately evaluated for financial reporting purposes. Also, due to the complexity of some PPP arrangements, it is equally important that the accounting and financial reporting guidance provide transparency in the financial reports of the public party to allow reasonably knowledgeable readers to determine whether “improved value for money” was the main objective for entering into the arrangements, and not the meeting of fiscal targets.

Prevalence of PPP Arrangements in Countries and Industries

More than ever before, governments are confronted with the challenges of building new infrastructure to keep up with population growth, and refurbishing existing infrastructure that has deteriorated from years of deferred maintenance. PPP arrangements have become an increasingly common way for governments to approach these challenges. Some countries have utilized PPPs to assist in meeting infrastructure needs for several years. The United Kingdom has the longest, most developed history and experience with PPP arrangements, using them to provide numerous types of public services. Australia has also made substantial progress in utilizing PPP arrangements to provide public services, particularly in the transportation sector. The Australian state of Victoria has been quite advanced in their use of PPPs. Other European

countries such as Finland, France, Germany, Greece, Hungary, Italy, Ireland, The Netherlands, Portugal, and Spain, also have a growing number of PPP initiatives. Efforts have also been launched in North and South America, notably the United States, Mexico, Chile, and Columbia. Strong interest and executed PPP arrangements are taking place in Korea, the Philippines, Singapore, Japan, as well as India, Indonesia, Thailand, and South Africa.

Despite the seemingly broad array and amount of PPP arrangements, global use of PPP arrangements is still in an infancy stage. Legislation specifically addressing PPP arrangements, which often plays a key role in the existence, use, and evolution of these arrangements, has become increasingly widespread in recent years. However, in some jurisdictions, such legislation has yet to be enacted. A steep learning curve associated with undertaking PPPs and varying levels of complexity surrounding individual contracts also has affected the global spread of PPP arrangements. Some governments have been understandably cautious in executing PPP arrangements, and have thus far only undertaken small-scale projects to develop experience. Other governments have adopted a “wait-and-see” approach and have taken the opportunity to study and learn from the experiences of others before attempting to use PPP arrangements for their own projects.

To facilitate and encourage the effective use of PPP arrangements, centralized PPP agencies have been established in many countries. These agencies help accumulate and disseminate best practices in the designing, contracting, and monitoring of a PPP arrangement that have been identified through past experience. To facilitate the implementation and expansion of PPP concepts and projects in the United Kingdom, Partnerships U.K., a sort of public-private partnership in its own right, was created. Partnerships U.K. has three main objectives: providing support to central and local governments and other public bodies on the implementation of PPP projects and development of PPP policy; developing and managing PPP initiatives; and investing risk capital in new ventures. The Australian state of Victoria also has established a central PPP agency, Partnerships Victoria, to facilitate the effective use of PPP arrangements by serving as a source of expertise and support. Other examples of these centralized agencies include the PPP Unit of the National Treasury in South Africa, the Central Public Private Partnerships Unit in the Department of Finance in Ireland, and the PPP Knowledge Centre, under the Ministry of Finance in the Netherlands, which aims to develop and share knowledge and experience about PPP arrangements.

Just as the level of use of PPP arrangements in individual countries has been varied, the level of use of PPP arrangements across public service sectors has also been varied. The transportation sector, particularly roadways, tunnels, and bridges, is the sector with the widest use of PPP arrangements. This is because the infrastructure in this sector broadly impacts a great percentage of citizens and is often in need of significant upgrade. The size and long-term nature of transportation projects also is considered by some to be better suited for a PPP arrangement than other types of projects. User fees for transportation have a greater degree of acceptance than other sectors, allowing the public party to transfer payments to the private party on to third-party users of the infrastructure more easily for transportation PPP arrangements. Transportation projects also provide a relatively stable revenue flow which is attractive to potential private parties. A number of examples of transportation PPP arrangements have been referred to earlier in the document.

As experience with PPP arrangements is gained, they also are being increasingly used in other sectors. In fact, in the United Kingdom, PPP arrangements are used to provide public services in sectors as varied as education, corrections, and health care. Sectors of public service for which executed or proposed PPP arrangements exist include airports, defense, housing, healthcare and hospitals, ports, prisons, schools, parks, wastewater, solid waste services, and arts and leisure. Specific examples from these sectors have been included earlier in the paper and additional examples follow below:

Airports. In the United Kingdom, the Inverness Airport terminal was expanded to accommodate the increasing passenger demands on the airport. A consortium of private partners entered into an agreement to design, build, and finance the terminal, as well as to maintain and operate it for 25 years.

Defense. The United Kingdom's Ministry of Defense has used PPPs for a variety of projects. One such project has been the redevelopment of the Colchester Garrison barracks to provide accommodations and associated services (messing, education, storage, workshops etc).

Healthcare and hospitals. In New South Wales, Australia, a mixed medical and commercial building complex involves the private sector designing, building, financing, maintaining, and leasing space to the government. In Spain, the Madrid Autonomous Government, as part of its '2004-2007 Infrastructural Plan', is planning to develop eight hospitals in a PPP initiative. The

private party is responsible for designing, building, and maintaining the hospitals. The Government retains responsibilities for operating them.

Prisons. In Australia, a Partnerships Victoria project involves a private consortium responsible for the financing, design, building, and management of two new prison facilities, a 600-bed maximum security prison as well as a 300-bed medium security prison. The public party retains responsibility for operations of the facilities (that is, the provision of correctional services) in accordance with government policy.

Wastewater. One of the largest European water services PPP arrangements is in place in The Netherlands. The €1.58 billion, 30-year arrangement includes the design, construction, and operation of a new wastewater treatment plant and the refurbishment and operation of an existing plant.

In some jurisdictions, infrastructure such as airports, ports, defense, prisons, and health care raise political, national, or social concerns over the idea of having the private sector operating these functions. Also in some jurisdictions, certain core services, such as water services and education, by law must only be provided by the public entity. Thus, the public party often retains the responsibility of operating the infrastructure in these cases.

II. Existing Accounting Approaches for PPP Arrangements

Existing authoritative accounting and financial reporting guidance would appear to be sufficient to determine the accounting treatment for some types of PPP arrangements. For example, a design-build arrangement should be treated similarly to third-party contracts entered into by a government for the construction of a capital asset. Likewise, service or management contracts would be treated similarly to other types of long-term third-party service contracts, and joint ventures would be accounted for under IPSAS 8, *Interests in Joint Ventures*. True privatization through an outright sale or other transfer of assets also would not appear to need additional accounting guidance. However, for other types of PPP arrangements in which both the public party and the private party maintain involvement in the construction or renovation of a public asset and the services provided by that asset, such as service concession arrangements and BOOT arrangements, more specific guidance may be needed to appropriately address the accounting and financial reporting issues that may arise.

While many jurisdictions are currently applying existing authoritative accounting and financial reporting guidance to account for these types of PPP arrangements, such as their general accounting framework and leasing standards, some standard-setting bodies have either issued or proposed guidance specifically addressing PPP arrangements. In large part, this existing and proposed guidance on PPP arrangements focuses on accounting for the property associated with the arrangement. This is an issue because regardless of who owns the property in form, the substance is that both parties are involved in some manner with the operation of the property. For example, in a BOOT arrangement, the private party builds, owns, and operates the property until it is transferred to the public party at the end of the arrangement. However, the public party may still maintain some risk and rewards related to the asset, and some level of control over the operation of the property and provision of related services throughout the arrangement. Likewise, in a service concession arrangement related to existing property, the public party may maintain ownership of the property, as well as some level of control over its operation, but much of the economic risk and reward related to the operation of the property and provision of related services may be transferred to the private party.

The existing and proposed guidance on PPP arrangements takes different approaches to determining which party should report the associated property as an asset. This section of the paper discusses these various approaches.

Risk and Rewards Approach—UK Accounting Standards Board

In the UK Accounting Standards Board's Amendment to FRS 5, *Reporting the Substance of Transactions*, entitled *Private Finance Initiative and Similar Contracts Application Note F* (hereinafter referred to as "Application Note F"), a risk and rewards approach to accounting for the property associated with a PPP arrangement is prescribed. (FRS 5 and Application Note F also are the general basis for public sector accounting and financial reporting guidance related to PPP arrangements in Australia and New Zealand.) Application Note F works from the premise that most PPP contracts (referred to in Application Note F as private finance initiative (PFI) contracts) call for the private party to design, build, finance, and operate the associated property. Therefore, the private party becomes responsible for providing the public service associated with the property. The basic principle put forth in Application Note F for determining which party should report the associated property as an asset is as follows:

Under the general principles of the FRS, a party will have an asset of the property where that party has access to the benefits of the property and exposure to the risks inherent in those benefits. If that party is the purchaser [public entity], it will have a corresponding liability to pay the operator [private entity] for the property where the commercial effect of the PFI contract is to require the purchaser to pay amounts to the operator that cover the cost of the property. [Paragraph F5]

For purposes of determining which party should report the associated property as an asset, Application Note F states that service elements of the contract should be separated from required payments for the property to the extent they operate independently of each other (this is similar to requirements for leases under IFRIC 4, *Determining whether an Arrangement contains a Lease*). Service elements may relate to ancillary services associated with the property provided by the private entity, such as cleaning or catering. Separable service elements should be excluded from consideration because such elements are not relevant to determining which party has an asset of the property. Separable service elements would be accounted for similarly to any other service contract. Once separable service elements have been excluded, the PPP arrangement is classified into one of the following two categories:

- 1) Those where the only remaining elements are payments for the property. Application Note F states that these contracts would be similar to a lease and should be accounted for under the guidance in UK SSAP 21, *Accounting for leases and hire purchase contracts*, as interpreted under Application Note F.

- 2) Those where the remaining elements include some services. These contracts would fall under the guidance provided in Application Note F.

Under Application Note F, whether a party has access to the benefits of the property and exposure to the associated risks is reflected in the extent to which each party bears the potential variations in property profits or losses. The potential variations in costs and revenues that flow from features of the property should be distinguished from those that do not. Only those potential variations that flow from features of the property are relevant to determining which party should report the property as an asset. Application Note F describes the factors that may be relevant to assessing which party bears the potential variations in property profits and losses as follows:

- *Demand Risk.* Demand risk is the risk that demand for the property will be greater or less than predicted or expected. Application Note F states that for arrangements where demand risk is significant, it will normally give the clearest evidence of which party should report the associated property as an asset. The party that bears demand risk will largely depend on the answers to two interrelated questions:

- 1) Will the payments between the private party and the public party reflect the usage of the property or does the public party have to pay the private party regardless of the level of usage?
- 2) Who will gain if demand is greater than expected?

For example, for question 1, the public party being obliged to pay for the output or capacity of the property whether or not it is needed is evidence that the property is the asset of the public party. If the payments vary proportionately based on demand, this is evidence that the property is the asset of the private party. For question 2, if usage of the property beyond expectations results in little or no extra payment to the private party, this is evidence that the public party bears demand risk. If payments under the contract increase based on additional usage, this is evidence that the private party bears demand risk.

- *The Presence, if any, of Third-party Revenues.* Some PPP arrangements involve the expectation that the property will be used by parties other than the public party. Where the private party relies on revenues from these third-parties to cover its property costs, this is evidence that the property is an asset of the private party.

- Where third-party usage is minimal or solely a future possibility, this is evidence that the property is an asset of the public party.
- *Who Determines the Nature of the Property.* This factor relates to who determines how the PPP arrangement is to be fulfilled and, in particular, what kind of property is to be built. If the public party determines the key features of the property and how it is to be operated, bearing the cost implications of any changes to the method of operation, this is evidence that the property is the asset of the public party. If the private party has significant and ongoing discretion over how to fulfill the PPP arrangement and makes the key decisions on what property is built and how it is operated, bearing the consequent costs and risks, this is an indication that the property is the asset of the private party. Construction risk is also referenced in this section. Application Note F states that construction risk is generally not relevant to determining which party has an asset of the property *once construction is completed*, because such risk normally has no impact during the operational life of the property. However, construction risk may be relevant where it calls into question the other evidence, particularly in a case where the public party bears construction risk, but based on the other factors, the property is otherwise claimed to be the asset of the private party.
 - *Penalties for Underperformance or Non-availability.* Some PPP arrangements provide for penalties in the form of cash payments or reductions in revenue if the property is below a specified standard or is unavailable because of private party fault. To be considered in determining which party should report the property as an asset, these penalties should relate strictly to the property—not the provision of services. If the penalties are unlikely to occur or the impact of such penalties is insignificant, this is evidence that the property is an asset of the public party. If the potential penalties could cause the private party's profits associated with the property to be genuinely subject to significant potential variation, then this would be evidence that the property is an asset of the private party.
 - *Potential Changes in Relevant Costs.* Potential changes in property costs may be dealt with in different ways in a PPP arrangement. If significant future cost increases can be passed on to the public party, this would be evidence that the property is an

asset of the public party. If the private party's costs are both significant and highly uncertain, and there are no provisions for cost variations to be passed on to the public party, this is evidence that the property is an asset of the private party.

- *Obsolescence, Including the Effects of Changes in Technology.* Whether obsolescence or changes in technology are relevant will depend on the nature of the contract. Where this factor is relevant, the party that bears the costs and any associated benefits will be the one for whom there is evidence that the property is its asset.
- *The Arrangements at the End of the Contract and Residual Value Risk.* Residual value risk is the risk that the actual residual value of the property at the end of the contract will be different from that expected. Application Note F states that for arrangements where it is significant, the party that bears residual value risk will normally provide clear evidence of who should report the property as an asset. The public party will bear residual risk where:
 - 1) It will purchase the property for a substantially fixed or nominal amount at the end of the contract;
 - 2) The property will be transferred to a new private party, selected by the public party, for a substantially fixed or nominal amount; or
 - 3) Payments over the term of the PPP contract are sufficiently large for the private party not to rely on an uncertain residual value for its return.

The private party will bear residual value risk where:

- 1) It will retain the property at the end of the PPP contract; or
- 2) The property will be transferred to the public party or another private party at the prevailing market price.

Application Note F goes on to state that in determining which party has an asset of the property, the combined effect of all of the relevant factors should be considered for a range of reasonably possible scenarios, with greater weight being given to those outcomes that are more likely to occur in practice.

Risk Approach—European Commission (Eurostat)

In 2004, Eurostat published an additional chapter to its *ESA95 Manual on Government Deficit and Debt* (hereinafter referred to as “ESA 95”), entitled *Long term contracts between government units and non-government partners (Public-private-partnerships)* (hereinafter referred to as “the Chapter”). In the Chapter, Eurostat provides guidance on accounting for the property associated with a PPP arrangement for statistical reporting purposes. The Chapter defines a PPP arrangement somewhat more narrowly than described earlier in this paper, stating that a key feature of a PPP arrangement is that the public party is the main purchaser of the services provided through the property. The public party will make regular payments to the private party whether demand originates directly from the public party itself or from third-party users. Arrangements under which third-party users other than the public party are the main direct purchasers of the services provided through the property are referred to in the Chapter as “concessions.” Eurostat provides different guidance for what it terms as PPP and concession arrangements as far as determining which party should report the associated property as an asset.

For contracts that the Chapter refers to as PPP arrangements, the general principle put forth in the Chapter is that the associated property is only reported as an asset of the private party if there is strong evidence that the private party is bearing the majority of the risks attached to the contract. For purposes of applying this general principle, the Chapter states that the property must be reported as an asset of the private party if both of the following conditions are met:

- 1) The private party bears construction risk; and
- 2) The private partner bears at least one of either availability or demand risk.

This approach is somewhat similar to the approach taken by the UK Accounting Standards Board discussed above. However, in an effort to simplify the risk analysis, Eurostat limited the risks to those it perceived to be the most significant. For purposes of the guidance in this Chapter, these risks are described as follows:

- *Construction Risk.* This risk covers events related to the initial state of the associated property. In practice, it is related to events such as late delivery, non-respect of specified standards, significant additional costs, technical deficiency, and external negative effects (including environmental risk) triggering compensation payments to third parties.

- *Availability Risk.* This risk covers cases where, during the operation of the asset, the responsibility of the private party is called upon, because of insufficient management oversight (“bad performance”), resulting in a volume of services lower than what was contractually agreed upon, or in services not meeting the quality standards specified in the contract.
- *Demand Risk.* This risk covers the variability of demand (higher or lower than expected when the contract was signed) irrespective of the performance of the private party. In other words, a shift of demand cannot be directly linked to the level of quality of the services provided by the private party. Instead, it should result from other factors, such as the business cycle, new market trends, a change in final users’ preferences, or technological obsolescence. This is part of a usual “economic risk” borne by private entities in a market economy.

The Chapter also states that the contractual provisions related to the disposition of the property upon the end of the PPP arrangement can be used as a supplementary criterion for determining overall risk transfer, particularly when assessment of the aforementioned risks does not result in a clear conclusion. The guidance in the Chapter as to whether the provisions related to the disposition of the property provide evidence of risk transfer to the public party or the private party is similar to that in the guidance of the UK Accounting Standards Board described above. The Chapter also discusses that the public party’s participation in the upfront financing of the project, either directly through issuing debt or indirectly through guaranteeing the debt of the private party, could be a factor that influences the risk transfer assessment as a component of construction risk.

Although not specifically stated in the Chapter, certain guidance in the Chapter, including illustrations and a decision tree for PPP contracts, implies that the associated property in a concession arrangement (situation where third-party users other than the public party are the main direct purchasers of the services associated with the property) should be reported as assets of the private party. This position is more specifically stated in Part IV of ESA95. In this case, Eurostat believes that output is produced by the private entity by means of the property. Therefore, they believe it is appropriate for the private party to report the property as an asset.

Control Approach—IFRIC

In November 2006, the International Financial Reporting Interpretations Committee (IFRIC) issued Interpretation 12, *Service Concession Arrangements* (hereinafter referred to as the “Interpretation”). The term “service concession arrangement” as used in the Interpretation describes an arrangement where the private party receives the right to provide public services, and in some cases the right to use specified assets in the provision of those services, in exchange for committing to provide the services according to certain terms and conditions during the concession period, and when applicable, committing to return the assets at the end of the concession period in a specified condition. The provisions of the Interpretation apply to public-private service concession arrangements only if:

- 1) The public party controls or regulates what services the private party must provide with the associated property, to whom it must provide them, and at what price; and
- 2) The public party controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the property at the end of the arrangement.

Meeting this item is not required if the property is used for its entire useful life under the arrangement.

It is common for PPP arrangements to incorporate the provisions outlined in the scope requirements of the Interpretation. The Interpretation goes on to state that its provisions apply to both property that the private party constructs or acquires from a third party for the purpose of the service arrangement, and existing property to which the public party gives the private party access for the purpose of the arrangement. The Interpretation also specifies that its provisions only address the accounting by the private party (or operator)—guidance for the public entity is not provided (or grantor).

Paragraph 11 of the Interpretation addresses whether the private party should report the property associated with the service concession arrangement as an asset as follows:

Infrastructure within the scope of this Interpretation shall not be recognised as property, plant and equipment of the operator [private entity] because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. The operator has access to operate the infrastructure to provide the public service on behalf of the grantor [public entity] in accordance with the terms specified in the contract.

In paragraph BC 20 of the basis for conclusions of the Interpretation, the IFRIC cites the International Accounting Standards Board's (IASB) *Framework for the Preparation and Presentation of Financial Statements*, as the basis for this control approach, specifically that:

- an asset is defined by the *Framework* as 'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.'
- the *Framework* notes that many assets are associated with legal rights, including the right of ownership. It goes on to clarify that the right of ownership is not essential.
- Rights are often unbundled. For example, they may be divided proportionately (undivided interests in land) or by specified cash flows (principal and interest on a bond) or over time (a lease).

Therefore, regardless of which party holds legal title to the property during the arrangement, the Interpretation states that the property should not be reported as an asset by the private party for arrangements that meet the scope of the Interpretation as the private party does not control it. In this way, the Interpretation views the private party as a service provider to the public party. The asset that should be recognized by the private party is the consideration it receives in exchange for its services, not the property that it constructs or upgrades as part of the arrangement.

In the basis for conclusions of the Interpretation, the IFRIC acknowledges that respondents to the draft Interpretation questioned how determination of reporting the property could be based solely on control of use without any assessment of the extent to which the private party or public party bears the risks and rewards of ownership. They questioned how this approach reconciled with that of International Accounting Standard 17, *Leases*, in which the leased asset is recognised by the party that bears substantially all the risks and rewards incidental to ownership. The IFRIC determined that the right to property of a private party in a service concession arrangement is different than that of a lessee in a lease arrangement. Because of the control over the asset held by the public party, the private party does not have the same right of use of the property that a lessee would have. Instead, the private party only has the access to operate the property to provide the public service on behalf of the public party in accordance with the terms specified in the contract.

The Interpretation goes on to state that instead of reporting the property as an asset, in exchange for construction and upgrade services, the private party should either:

- Report a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the public entity; or
- Report an intangible asset to the extent that it receives a right to charge users of the public service, that is, there is no unconditional right to receive a financial asset because the amounts are contingent on the extent that the public uses the service.

Asset Reversion Approach—Accounting Standards Board of South Africa

In September 2005, the Accounting Standards Board of South Africa issued a proposed accounting guideline entitled, *Guideline on Accounting for Public-Private Partnerships* (hereinafter referred to as the “Proposed Guideline”). Paragraph 1.2 of the Proposed Guideline defines a PPP agreement as a “contract between a public sector entity and a private party, in which the private party assumes substantial financial, technical and operational risk in the design, financing, building and operation of a project.” The Proposed Guideline goes on to distinguish between two types of PPP agreements: one involving the performance by a private party of an “institutional function” and the other involving some form of “use of state property” by the private party for its own commercial purposes. The Proposed Guideline provides somewhat different guidance on accounting for the associated property for each type of PPP arrangement. However, for both types, the main determining factor is which party will possess the property at the end of the arrangement. It should be noted the provisions of the Proposed Guideline would only apply to the public entity—guidance for the private entity is not provided.

Similar to the approach of the UK Accounting Standards Board, the Proposed Guideline would require that for accounting and financial reporting purposes, the payments made by the public party to the private party be divided into an asset element and a service element. The Proposed Guideline then goes on to describe how to account for the asset element, that is, how the property associated with the PPP arrangement should be reported.

The Proposed Guideline describes an “institutional function” PPP as an arrangement for which the private party will perform part of the public party’s service delivery or administrative functions and assume the associated risks. The arrangement involves a substantial transfer of some form of project life cycle risk to the private party. The public party retains a significant

role in the project either as the main purchaser of the services provided or as the main enabler of the project. For property associated with this type of arrangement, the Proposed Guideline uses the provisions of the South African Standard of Generally Recognised Accounting Practice on leases as the basis for determining whether the property should be reported as an asset of the public party. In all PPP arrangements that require the development or construction of immovable property, ownership of the immovable assets will revert back to the entity at the end of the arrangement because South African legislation generally does not permit the transfer of any government property to a private party. Therefore, payments toward the development or construction of immovable property will fall within the definition of a finance lease, resulting in the reporting of the property as an asset of the public party. Ownership of movable property can either remain with the private party or revert to the public party when the PPP arrangement expires. Therefore, it must be determined whether the payments made by the public party toward the development or construction of the movable property meet the definition of a financing lease or an operating lease to determine whether the public party would report the movable property as an asset in its financial statements.

The Proposed Guideline describes the “use of state property” PPP as an arrangement for which the public party will transfer the right of use of immovable or movable property to a private party for its own commercial use. For arrangements of this type that involve the use of pre-existing immovable or movable assets, the Proposed Guideline states that those assets would continue to be reported by the public entity because control and ownership of these assets will remain with the public entity for the duration of the arrangement, and use will revert back to the public party at the termination of the arrangement. Immovable or movable property constructed or developed at the commencement of the PPP arrangement that will revert to the entity at the end of the agreement would be reported as an asset of the public party. Movable property that will remain with the private party at the end of the agreement would not be reported as assets of the public party.

III. Non-economic Service Delivery Risks

Some of the approaches to reporting the property associated with a PPP arrangement discussed above are centered on risk and rewards. These approaches focus on the *economic* risk and rewards associated with the property. However, given the public nature of the services provided in a PPP arrangement, risks and rewards (or benefits) associated with non-economic service delivery may also bear consideration in determining which party reports the associated property as an asset. While the private party may bear certain economic risks related to the property, the public party is still ultimately accountable for the delivery of the service, and therefore, the operation of the property. Because of this, and because of the general perception on the part of the citizenry that the service being provided in a PPP arrangement is a public service, political risk remains with the public party. The effect of this risk can be impacted by the effects of the economic risks discussed above on the private party from a service delivery standpoint. If the private entity is negatively impacted by these economic risks to the point where it cannot continue to operate the property, the public party will have to step in to provide the public service. Thus, it can be viewed in an ultimate sense that the public party is always subjected to the economic risks discussed above. This can be linked to the idea of a control approach to determining which party should report the property as an asset. The reason why the public party retains control over aspects of the property, such as operating condition and user charges, is because the public party is ultimately responsible for the provision of services regardless of the fact that the private party is actually providing the service.

From the perspective of benefits, while the public party may not stand to obtain economic benefit from the property in a PPP arrangement, it does obtain benefit to the extent that the property is providing services to the citizenry. There are many instances of property, plant and equipment that do not directly generate net cash inflows that are reported by a public entity because they provide service potential. For example, a roadway for which users are not subject to a toll charge is still reported as property, plant and equipment of the public entity because of its service potential. If that same roadway becomes the subject of a service concession arrangement and the private party is granted the right to charge tolls, one could argue that the roadway still maintains service potential for the public party because it remains available for use by the citizenry. Therefore, it could be argued that the roadway should continue to be reported as an asset of the public party, regardless of the private party's ability to charge a fee for use.

If a notion of non-economic service delivery risk and benefit is considered, then given the public service provided by definition in a PPP arrangement, it would appear that the associated property generally would be reported as an asset by the public party. One exception would be in a full divestiture where the public party has absolved itself of responsibility for providing the related service. This would mostly be limited to non-core service sectors such as housing or arts and leisure.

IV. Accounting and Financial Reporting Issues Related to PPP Arrangements

There are numerous accounting and financial reporting issues that may result from a PPP arrangement. As discussed earlier in the paper, the main issue is determining the accounting for the property associated with the PPP arrangement. There are also several issues that are ancillary to this determination. These issues differ depending on how the property is reported. There are also other accounting and financial reporting issues that may result from a PPP arrangement that do not directly involve the associated property. These issues relate to revenues generated from the PPP arrangement for the public party; guarantees made by the public party as part of the arrangement, for example, those made to the private party or its creditors; the impact of the arrangement on the public party's economic entity (that is, consolidation); and appropriate financial statement disclosures for the arrangement. This section discusses these accounting and financial reporting issues that may result from a PPP arrangement. This section also discusses the potential applicability of future IPSASB guidance on PPP arrangements to government business enterprises.

Issues When the Public Party Reports the Property as an Asset

For PPP arrangements that involve the construction of property, the first step for a public party in reporting the associated property is determining the timing of recognition of the asset—specifically, whether the property should be reported as an asset while under construction, or whether it should be recognized only when it becomes in place and operational. Under the guidance of the UK Accounting Standards Board, the public party should report the asset when it comes into use, unless it bears significant construction risk, in which case the property would be reported as an asset as constructed.

After the timing of recognition is determined, the initial amount at which the property should be reported must be determined. In the case in which the public party is making regularly scheduled payments over the life of the PPP arrangement, a concept similar to that in IPSAS 13, *Leases*, could be applied in which the asset and a corresponding liability would be reported at the fair value of the leased property or, if lower, the present value of the minimum scheduled payments. However, as noted earlier, these scheduled payments may be comprised of both an element related to the construction of the property and an element related to services to be

provided under the arrangement. As also noted earlier, these individual elements are often not readily identifiable. Guidance would appear to be needed to instruct whether these elements would need to be separated through estimation, and if so an appropriate methodology for performing such estimation could be provided. The portion of the payments related to the service element would be accounted for similar to other long-term service contracts.

As an alternative in lieu of separation, the estimated fair value of the property could be used straightaway as the basis for initial measurement. Under the guidance of the UK Accounting Standards Board discussed above and ESA 95, when the public party reports the asset, the initial amount reported for both the asset and related liability should be the fair value of the property. The asset would be depreciated over its life, and the liability would be reduced as payments for the property are made. An imputed finance charge on the liability would also be reported. Any remaining payments beyond those attributable to the property and finance charges would be reported as an operating cost, essentially representing the service element of the arrangement.

Issues involving the initial measurement of the asset, as well as resulting liabilities, could also occur when the payments to be made to the private party are contingent upon demand or availability. The minimum payments related to the construction of the property in this case may not be reflective of the cost of the asset and expected payments may need to be used to determine its reported amount. If there are no payments to be made by the public party, for example, in cases in which the private party is receiving payments directly from users of the property, the reported amount of the asset would appear to be its fair value at the date of acquisition which is consistent with the guidance in IPSAS 17, *Property, Plant and Equipment*, and no liability would be recognized by the public party.

There would appear to be no accounting issues related to property associated with a PPP arrangement already reported as an asset by the public entity. Once the property is measured and reported, the guidance in IPSAS 17 would appear to be applied as appropriate.

Issues When the Public Party Does Not Report the Property as an Asset

If the public party does not report the property associated with a PPP arrangement as an asset, the payments made to the private party under the arrangement could generally be expensed as incurred similar to those under an operating lease, which would generally be on a straight-line basis over the term of the arrangement. However, an issue could arise if the public entity will

acquire ownership of the property at the end of the arrangement. If the amount that the public party needs to pay (including zero) to acquire the property is specified by the contract, this amount may not equal the expectation at inception of the fair market value of the property at the termination of the arrangement. In this case, a portion of the payments made to the private party during the arrangement could be viewed to represent the difference between the expected fair market value of the property at termination and the specified amount to be paid by the public party. This portion of the payments would be accumulated in the financial statements so that when combined with the actual final payment, the amount reflects the fair value of the property. For example, if it was expected that the fair market value of the associated property would be 20 currency units at the end of a 20-year arrangement, and the public party was not required to pay for the property at the end of the arrangement, the 20 currency units would be accumulated from the payments made over the life of the arrangement. This would be consistent with the guidance of the UK Accounting Standards Board.

Another potential approach is to record the present value of the difference between the amount to be paid by the public party to acquire the asset and the expected fair market value of the property at termination as an asset at the beginning of the arrangement. A contribution (revenue) would be reported along with the asset. The fair value of this asset would be adjusted to reflect the passage of time and any change to the expectation of fair market value. For either of these two approaches, the nature of the asset being reported (for example, capital asset or intangible asset) would need to be determined.

Other approaches for this issue include the public party reporting any difference between the actual amount paid and the fair market value of the property at the end of the arrangement as a contribution (revenue) from the private party at the transfer of the property; and reporting the property at the actual amount paid at the end of the arrangement as opposed to reporting it at fair market value.

If the property associated with the PPP arrangement already exists at the inception of the arrangement and it is reported as an asset by the public party, it will need to be determined how the public party would derecognize the asset. It might initially appear clear that the public party would just remove the entire balance of the asset from its records. However, in a situation where the asset will revert back to the public party with an expected useful life still remaining, it may be appropriate to report some sort of impairment of the asset, as opposed to removing the entire

asset from the records of the public party, only to add it back to the records at the end of the arrangement.

Revenue Generated for the Public Party Through PPP Arrangements

There are two main opportunities for the public party to generate revenue through PPP arrangements. Both generally occur when the private party receives payments for the associated property or provision of services directly from third-party users. One method of receiving payments is through a revenue-sharing provision in the terms of the PPP contract. These provisions often require the private party to provide the public party with a percentage of the revenue generated from third-party revenues. As noted earlier, this requirement may apply from the first revenue earned by the private party, or it may be triggered upon reaching a specified benchmark, such as a level of revenue or utilization, or a specific rate of return.

One alternative in accounting for such a revenue-sharing provision is to consider it a contingent asset for the public party. As defined by IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, a contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Contingent assets are not recognized in the financial statements. Rather, an asset and related revenues should not be reported until the realization of revenue is virtually certain, which in the context of a revenue sharing provision of a PPP arrangement would be once amounts are owed by the private party based on the related metric.

An alternative to considering a revenue sharing provision to be a contingent asset is to consider the public party's contractual *right* to share in the revenues generated by the property to be a recognizable asset. Under this alternative, the right to receive revenue is not viewed as contingent because it exists regardless of whether revenues will ultimately be received. Therefore, there is no contingency. The method used to measure the asset representing this right would need to be determined if this alternative is further developed.

The other potential source of revenue for the public party to a PPP arrangement is an upfront payment made by the private party. As noted previously, this upfront payment has been a prominent aspect of the roadway PPP arrangements that have occurred in the United States, both

in instances where the roadway already exists and where the private party is committed to build the roadway.

The accounting issue related to these upfront payments is the timing of their recognition as revenue. This payment can be viewed as being made by the private party in exchange for the public party granting the right to use the property (either existing or to be built) throughout the duration of the PPP arrangement. In this case, the upfront payment would be reported by the public party as unearned revenue (a liability) and then recognized as revenue over the term of the PPP arrangement.

An alternative approach is based on the belief that the entirety of the exchange occurs upon the execution of the contract, or at some other point in the arrangement, such as the legislation of the PPP arrangement or when the private party begins delivering services. In this case, the entire amount of the upfront payment would be recognized as revenue upon the occurrence of this specified event.

Guarantees

As part of some PPP arrangements, guarantees are made by the public party to, or on behalf of, the private party. Two types of guarantees that are somewhat common in PPP arrangements are the public party guaranteeing to repay the debt of the private party in the event of default, and the public party guaranteeing a minimum revenue amount for arrangements in which the payments to the private party are made based on third-party usage of the property. Although these guarantees are financial liabilities of the public party, it would appear that they should be accounted for as contingent liabilities until the criteria to recognize a provision or other liability is met as provided for in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

Another potential contingent liability to consider is the obligation of the public party to assume the responsibility to provide the services associated with the PPP arrangement in the event of private party default stemming, for example, from financial insolvency or poor performance. This obligation of the public party is referred to as “step-in” responsibility. This obligation may be contractual or may be imposed by political reality.

Consolidation

A consideration that may need to be addressed for certain PPP arrangements is whether the private party would need to be consolidated into the financial statements of the public party

under the authoritative guidance in IPSAS 6, *Consolidated and Separate Financial Statements*. This would be of particular concern when the private party in a PPP arrangement is a special purpose vehicle (SPVs), also referred to in some jurisdictions as a special purpose entity. An SPV will often be created to act as the legal entity for a project consortium. The sole purpose of the SPV is to carry out the PPP arrangement, creating a focused “partnership” among the sponsors of the SPV (sponsors could include construction entities, operations entities, and equity investors). The SPV can also securitize the claims to future project revenues and sell these securities to investors. Issuing these securities through an SPV limits the risks associated with the project to the individual sponsors. If the public party has an ownership interest in the SPV, the relationship may need to be assessed under the guidance in IPSAS 7, *Accounting for Investments in Associates*, or IPSAS 8, *Interests in Joint Ventures* to determine the appropriate financial reporting. For relationships to which neither of these pronouncements apply, consolidation of the SPV into the financial statements of the public party may need to be considered.

It may not be apparent that the potential for consolidation of the SPV into the financial statements of the public party should be addressed. However, when the terms of certain PPP arrangements are considered along with the provisions of IPSAS 6, one can reach a conclusion that these SPVs may require consolidation. IPSAS 6 states that consolidated financial statements generally should include all controlled entities of the controlling entity. An entity is considered to control another entity when it has the power to govern the financial and operating policies of another entity so as to benefit from its activities. This does not necessarily require an entity to hold a majority interest in the other entity, or even that the entity has responsibility for the management of the day-to-day operations of the other entity. The controlling entity only needs to be able to govern decision-making so as to be able to benefit from the activity of the other entity. When the PPP arrangement is the sole activity of the SPV, this description of control can arguably be met fairly commonly. For example, in a common BOOT arrangement for a roadway where the SPV will collect its payments directly from third-party users of the roadway, as part of the contract the public party will often control the rates that can be charged to the third-party users by the private party. The public party will also mandate the condition of the roadway which could dictate the operating activities of the SPV. The public party will benefit from the

activities of the SPV through enabling the SPV to operate with it in the pursuit of achieving objectives related to transport.

Various other contractual terms could result in the public party having “power” over the SPV. The public party could require specific terms in the PPP contract to minimize the risk of nonperformance on the part of the SPV either through operational incompetence or financial insolvency that place restrictions on the SPV. For example, the public party could retain a level of control over changes to the sponsors of the SPV, or it could retain a level of control over the amount of debt issued by the SPV. Terms of the PPP contract may also create a benefit relationship between the public party and the SPV. For example, the contract may call for revenue or equity sharing between the SPV and the public party, or the public party may provide a guarantee of the debt of the SPV so that it can achieve a lower interest rate. Therefore, the terms of the individual PPP arrangement would need to be carefully reviewed to determine whether the private party would need to be consolidated into the financial statements of the public party. As an alternative, if it was thought that consolidation of the private party into the financial statements of the public party was an unintended consequence of applying the provisions of IPSAS 6 to the terms of a PPP arrangement, specific guidance exempting the private party from consolidation could be developed.

The IASB will be considering the treatment of special purpose entities as part of its project on consolidations. The status of this project may warrant consideration in drawing conclusions on consolidation of these entities into a public sector entity when involved in a PPP arrangement.

Disclosures

The IASB’s Standing Interpretations Committee (SIC) Interpretation 29, *Service Concession Arrangements: Disclosures*, provides financial statement disclosure requirements related to service concession arrangements for both the public party and the private party. Paragraph 6 of SIC-29 details the requirements:

All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. An operator [private party] and a grantor [public party] shall disclose the following in each period:

- (a) a description of the arrangement;
- (b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the

concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);

- (c) the nature and extent (eg quantity, time period or amount as appropriate) of:
 - i. rights to use specified assets;
 - ii. obligations to provide or rights to expect provision of services;
 - iii. obligations to acquire or build items of property, plant and equipment;
 - iv. obligations to deliver or rights to receive specified assets at the end of the concession period
 - v. renewal and termination options
 - vi. other rights and obligations (eg major overhauls); and
- (d) changes in the arrangement occurring during the period; and
- (e) how the service arrangement has been classified.

In addition to these disclosures, other disclosures for the public party related to a PPP arrangement may warrant consideration. Disclosure of information on how a PPP arrangement affects the fiscal balance and public debt (including amounts and terms of public financing for the arrangement), and whether the associated property is recognized as an asset of the public party or private party may be appropriate. Also, disclosures that address aspects of the arrangement that could impact the delivery of services to the citizens of the public party may be warranted. Service delivery could be negatively impacted if the private party is not able to fulfill their obligations under the PPP arrangement. Therefore, it could be valuable to users of the financial statements of the public party to have information about the solvency of the private party, potentially through disclosure of their credit rating or other metric, the public party's contractual ability to step-in and reassume service provision in the event of poor performance by the private party, and provisions of the arrangement related to a default on the part of the private party. Other financial statement disclosures to provide information about the stewardship of the public party's assets could be considered, for example, disclosure of management's assessment of how the PPP arrangement achieves improved value for money, the nature of the risks transferred to the private party, and general descriptions of the property condition and service requirements of the arrangement. Similar to the required financial statement disclosures for leases in IPSAS 13, disclosures related to future minimum payments to be made by the public party could also be required, along with any future minimum receipts that the public party may

be entitled to through the PPP arrangement. These types of financial statement disclosure requirements may be considered specifications of the general disclosure requirements present in SIC-29.

The need for specific financial statement disclosures may also depend on whether or not the underlying property is reported by the public party. In addition to required disclosures specifically addressing the PPP arrangement, other disclosure requirements, for example, those associated with property, plant and equipment and contingent liabilities, which may relate to aspects of the PPP arrangement should also be applied as appropriate.

Applicability of Guidance on Arrangements Involving GBEs

In some instances, the public party to a PPP arrangement is a governmental business enterprise (GBE) instead of a central or local government. Certain of these GBEs are created specifically to serve as the public party in the PPP arrangement in place of the central or local government. Given their involvement in PPP arrangements, it must be determined whether the guidance issued by IPSASB on these arrangements will be applicable to GBEs (IPSASB pronouncements are not applicable to GBEs). However, if the approach chosen for accounting for property associated with a PPP arrangement is rooted in the public nature of the governmental participant, application of the guidance to GBEs may be a consideration. Issues of consistency may also bear consideration in determining whether guidance issued by IPSASB on PPP arrangements should be applicable to GBEs, particularly if an approach different from that provided in IFRIC 12 is adopted. In this case, it would be conceivable that for the same PPP arrangement, a central or local government would not report the associated property as an asset, while a GBE accounting for the PPP arrangement (or service concession arrangement) using IFRIC 12 would report the associated property as an asset.

GBEs also participate in arrangements in which they function in essentially the same role as the private party in a PPP arrangement. In other words, a central or local government will serve as the grantor in the arrangement and the GBE will serve as the operator. By definition, these arrangements would not be considered PPP arrangements because both parties involved are public entities. However, these arrangements often are structured and operate similar to PPP arrangements. Therefore, whether these “public-public partnerships” between a GBE and another public entity should be included within the scope of the guidance issued by IPSASB on

PPP arrangements warrants consideration. If they are included within the scope, the broad category of the guidance may require a change from “public-private partnerships”, which implies that the arrangement must involve a public entity and a private entity, to a broader description that focuses on the nature of the transaction as opposed to the nature of the participating parties.