



**INTERNATIONAL FEDERATION  
OF ACCOUNTANTS**

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**Agenda Item**  
**7**

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**DATE:** November 5, 2007  
**MEMO TO:** Members of the International Public Sector Accounting Standards Board  
**FROM:** Rick Neville (Service Concession Arrangements Subcommittee Chair)  
**SUBJECT:** Service Concession Arrangements (SCAs)/Public-Private Partnerships (PPPs)

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**ACTION REQUIRED**

Review the agenda item and be prepared to discuss your views with the objective of approving the Consultation Paper – Accounting and Financial Reporting for Service Concession Arrangements for public comment.

**AGENDA MATERIAL**

Item

7.1 Draft Consultation Paper – Accounting and Financial Reporting for Service Concession Arrangements

**BACKGROUND**

The IPSASB Service Concession Arrangements Subcommittee had its inaugural conference call on May 31, 2007 resulting in the production of a research paper which was reviewed by the IPSASB at its meeting in Montreal in July, 2007.

Overall, there was general confirmation from the IPSASB that the research paper covered all of the major issues. The Board also (re)confirmed that:

- in considering alternatives for accounting for PPP arrangements, the draft Consultation Paper should not be constrained by any existing accounting guidance for PPP arrangements; and
- public-public partnerships should be considered within the draft Consultation Paper.

Staff took the Board's views into consideration in drafting a preliminary draft Consultation Paper for subcommittee consideration. The preliminary draft proposed control criteria that, if met, would result in the public sector entity reporting the underlying property to the PPP arrangement. While this criteria focused on control over the property, the risks and rewards associated with the property that would lie with the public sector entity were also considered.

On 15-16 October, the subcommittee met in Toronto, Canada, to review and discuss the preliminary draft, which was finalized through a subsequent conference call.

The attached draft Consultation Paper – Accounting and Financial Reporting for Service Concession Arrangements identifies the following themes and, for each, provides detailed analysis and subcommittee proposals:

- Scope of arrangements to be considered;
- Financial reporting of infrastructure and public facilities;
- Ancillary accounting issues associated with infrastructure and public facilities;
- Inflows of resources from SCAs;
- Guarantees and other commitments;
- Consolidation; and
- Financial statement note disclosures.

The main issues identified by the subcommittee in finalizing the draft Consultation Paper for IPSASB consideration were:

- whether the control criteria could be considered met if the entire useful life of the property is spent during the SCA resulting in no significant residual interest at the end of the arrangement;
- providing more discussion with respect to liabilities/obligations flowing from SCAs including their classification within liabilities (financial liabilities, finance lease liabilities);
- providing more discussion on accounting for those SCAs where the proposed criteria for control have not been satisfied;
- the positioning within the paper of existing leasing guidance in accounting for SCAs; and
- note disclosures.

The attachment to this covering memo provides further details on the activities of the subcommittee leading to the presentation of the draft Consultation Paper at this meeting.

#### *Next Steps*

Once approved by the IPSASB, staff will finalize the draft Consultation Paper for distribution as soon as practicable after the November meeting. Decisions as to the next steps in the due process for developing guidance will be determined based upon the feedback received on the Consultation Paper.

## ATTACHMENT

### Subcommittee Activities

|    |                        |   |
|----|------------------------|---|
| 1  | May 31, 2007           | 1 <sup>st</sup> subcommittee conference call – discuss research paper.  |
| 2  | July 3 – 6, 2007       | Montreal - IPSASB reviews research paper and provides responses on issues paper.                                      |
| 3  | 24 September, 2007     | Preliminary draft Consultation Paper sent to subcommittee for comment.  |
| 4  | 8 October, 2007        | Deadline for comments on preliminary draft Consultation Paper from subcommittee members.                              |
| 5  | 11 October, 2007       | Distribution of aggregation of comments on preliminary draft Consultation Paper to subcommittee members.              |
| 6  | 15 – 16 October, 2007  | Meeting of subcommittee to discuss preliminary draft Consultation Paper and related comments – <b>Toronto, Canada</b> |
| 7  | 25 October, 2007       | Revised preliminary draft Consultation Paper sent to subcommittee for 2 <sup>nd</sup> conference call.                |
| 8  | 1 November, 2007       | 2 <sup>nd</sup> subcommittee conference call - discuss revised preliminary draft Consultation Paper.                  |
| 9  | 5 November, 2007       | Distribute draft Consultation Paper to IPSASB for consideration.  |
| 10 | 27 – 30 November, 2007 | Beijing—IPSASB reviews draft Consultation Paper for approval for public comment.                                      |

**Draft Consultation Paper  
November 5, 2007**

**Accounting and Financial Reporting for  
Service Concession Arrangements**

**International Federation of Accountants**

**International Public Sector Accounting Standards Board**

**REQUEST FOR COMMENTS**

The International Public Sector Accounting Standards Board (IPSASB) is an independent standard-setting body within the International Federation of Accountants (IFAC). It approved this Consultation Paper, *Accounting and Financial Reporting for Service Concession Arrangements*, for publication in **Month, 200X**. This Consultation Paper identifies a number of matters relating to the accounting and financial reporting of service concession arrangements.

The IPSASB welcomes comments on the proposals in this Consultation Paper. Please submit your comments, preferably by email, so that they will be received by **Month XX, 200X**. All comments will be considered as a matter of public record. Comments should be addressed to:

Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017 USA

Email responses should be sent to: [publicsectorpubs@ifac.org](mailto:publicsectorpubs@ifac.org)

Copies of this Consultation Paper may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

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3 exposure and feedback provided that each copy bears the following credit line:  
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5 reserved. Used with permission.”

6 **Views Expressed in this Consultation Paper**

7 This Consultation Paper addresses issues relating to the accounting treatment of service  
8 concession arrangements and makes a number of proposals. The views expressed and the  
9 proposals made in this Consultation Paper are not necessarily the views of the  
10 International Public Sector Accounting Standards Board.

11

- 1 **Foreword**
- 2 **[To be drafted after IPSASB approval of the issuance of the paper]**
- 3

**1 The Consultation Paper**

2 The Consultation Paper is the result of research and deliberations on public-private  
3 partnerships, and more specifically, service concession arrangements, conducted by an  
4 IPSASB subcommittee. The process undertaken by the subcommittee to issue the  
5 Consultation Paper was performed in two stages. In the first stage, the subcommittee  
6 conducted broad research into the nature of public-private partnerships, including the  
7 various types of public-private partnerships and their proliferation throughout the world,  
8 along with the accounting and financial reporting issues for public sector entities that  
9 emanate from executing such arrangements. In the second stage, the subcommittee  
10 deliberated on the accounting and financial reporting issues identified in the first phase as  
11 they relate to service concession arrangements and came to consensus on proposals to  
12 address such issues. The Consultation Paper is the product of those deliberations. The  
13 members of the subcommittee, as well as the members of the Project Advisory Panel  
14 created to assist the subcommittee, are listed below.

**15 Subcommittee Members**

| <b>16 Name</b>            | <b>Jurisdiction</b>                      |
|---------------------------|--|
| 17 Richard Neville, Chair | Canada                                   |
| 18 Peter Batten           | Australia                                |
| 19 Andreas Bergmann       | Switzerland                              |
| 20 Amanda Botha           | South Africa                             |
| 21 Michelle Crisp         | United Kingdom                           |
| 22 Abdul Khan             | International Monetary Fund              |
| 23 Stephen Mayes          | International Monetary Fund              |
| 24 Stefano Pozzoli        | Italy                                    |
| 25 Philippe de Rougemont  | Eurostat                                 |
| 26 Noreen Whelan          | International Accounting Standards Board |
| 27 Marcin Woronowicz      | Eurostat                                 |



1                    **Project Advisory Panel Members**

|   |                         |                     |
|---|-------------------------|---------------------|
| 2 | <b>Name</b>             | <b>Jurisdiction</b> |
| 3 | D. Victor Nicolas Bravo | Spain               |
| 4 | Annette Davis           | New Zealand         |
| 5 | John Peace              | United States       |
| 6 | Patrick Soury           | France              |

7

8

**1 Background**

**2 History of the Project**

Over the past several years, the use of public-private partnership arrangements, and more specifically, service concession arrangements, by public sector entities to meet infrastructure needs has continued to become more prevalent worldwide. These arrangements raise accounting and financial reporting issues that could have a significant impact on the financial statements of the public sector entities that execute them. The IPSASB has had a project on public-private partnership arrangements on its work program for many years. In the initial stage of the IPSASB standards setting program, these arrangements were identified as a public sector issue that, at that time, was not addressed, or not adequately addressed, by international accounting standards.

With the actioning of a project addressing service concession arrangements (a type of public-private partnership) by the International Financial Reporting Interpretations Committee (IFRIC) of the International Accounting Standards Board (IASB), and the existence of other priorities on the IPSASB work program, an IPSASB project on these arrangements was not immediately undertaken. Instead, a subcommittee charged with monitoring the developments in the IFRIC service concession arrangements project was formed. Additionally, a broad survey of IPSASB members was conducted to determine whether service concession arrangements were an issue in their jurisdictions, whether guidance was in place in their jurisdictions that addressed these arrangements, and if so, whether that guidance was consistent with what was anticipated to be issued by the IFRIC in their draft interpretations. At that time, the survey indicated the importance of the issue in a number of jurisdictions, that guidance was in place or being developed in a number of those jurisdictions, and that such guidance was not necessarily the same in all jurisdictions, nor the same as what was anticipated to be proposed by the IFRIC.

In March 2005, the IFRIC issued its draft interpretations addressing financial reporting of service concession arrangements. The IPSASB raised several concerns in its response to those draft interpretations, one of which was the fact that the accounting for the grantor (typically a public sector entity) in a service concession arrangement was not addressed.

1 Instead, the draft interpretations solely addressed the accounting for the operator  
2 (typically a private sector entity). The IPSASB continued to monitor the work of the  
3 IFRIC on service concession arrangements; however, in July 2006, the IPSASB decided  
4 to initiate its own project on accounting and financial reporting for service concession  
5 arrangements. It was determined by the IPSASB that this would be a collaborative  
6 project with national standards setters and other interested organizations. In November  
7 2006, a project brief on service concession arrangements was approved by the IPSASB  
8 and a new subcommittee was formed with the first objective of issuing this Consultation  
9 Paper.

### 10 **Purpose of this Consultation Paper**

11 The objective of this Consultation Paper is to propose accounting and financial reporting  
12 guidance on service concession arrangements for public sector entities. The Consultation  
13 Paper identifies issues and provides proposals to be considered by the IPSASB in the  
14 development of any authoritative international requirements for accounting and financial  
15 reporting of service concession arrangements and to obtain feedback from constituents.  
16 Specific matters on which IPSASB would welcome comments are set out on pages 10 –  
17 12.

18 Although the project brief refers specifically to service concession arrangements, the  
19 Consultation Paper begins by discussing the various types of arrangements that are  
20 considered to fall under the broader term “public-private partnerships”, which would  
21 include service concession arrangements. The Consultation Paper analyzes the nature of  
22 these different types of arrangements to determine whether existing authoritative  
23 guidance is sufficient to address their accounting and financial reporting implications.  
24 Based on this analysis, the Consultation Paper proposes that specific authoritative  
25 guidance is needed for public-private partnerships involving service concession  
26 arrangements, while existing authoritative guidance is sufficient for other types of public-  
27 private partnerships, such as design-build arrangements and service contracts not  
28 necessarily dependent on the use of a specific asset.

29 The central issue related to service concession arrangements addressed in the  
30 Consultation Paper is the reporting of the underlying property to a service concession

1 arrangement. The Consultation Paper describes existing or proposed approaches to this  
2 issue put forth by national standards setters and other organizations, along with other  
3 potential approaches. After analyzing these various approaches and the definition of an  
4 asset present in IPSAS 1, *Presentation of Financial Statements*, the Consultation Paper  
5 proposes that the grantor should report the underlying infrastructure and public facilities  
6 (also referred to as “property”) as an asset in its financial statements when it a) controls  
7 or regulates what services the operator must provide with the associated property, to  
8 whom it must provide them, and the price range or rate that can be charged for services;  
9 and b) controls any significant residual interest in the property at the end of the  
10 arrangement. The Consultation Paper goes on to provide proposals related to the timing  
11 of recognition and method of measurement of the underlying property and related  
12 liabilities in the financial statements of the grantor when the proposed control criteria is  
13 met. The Consultation Paper also provides proposals related to the accounting and  
14 financial reporting for service concession arrangements when the proposed control  
15 criteria is not met, including the potential applicability of existing leasing guidance in  
16 IPSAS 13, *Leases*.

17 The objective of the Consultation Paper was to address all aspects of service concession  
18 arrangements that may have accounting and financial reporting implications for public  
19 sector entities. Therefore, guarantees or commitments made by the grantor to, or on  
20 behalf of, the operator to the arrangement, and inflows of resources received by the  
21 grantor through the service concession arrangement are addressed in the Consultation  
22 Paper. The Consultation Paper also addresses the potential impact of a service  
23 concession arrangement on the economic entity of the grantor for financial reporting  
24 purposes, as well as financial statement note disclosures related to service concession  
25 arrangements that would provide information relevant to users’ understanding of the  
26 financial statements of the grantor.

27 With respect to accounting and financial reporting guidance for operators involved in  
28 service concession arrangements, the project brief approved by the IPSASB in November  
29 2006 notes that “The primary focus of the project will be on the identification of issues  
30 and their resolution in financial reporting by the public sector grantor. However, the

project should also draw out the implications of any recommended approaches for financial reporting by a public sector operator”. Given the scope of the Consultation Paper, very limited consideration is devoted to operators to these arrangements primarily because it is believed (as raised within the Consultation Paper) that operators (whether a private sector entity or GBE) would apply the IASB’s IFRIC Interpretation 12, *Service Concession Arrangements*, and the IASB’s Standing Interpretation Committee (SIC) Interpretation 29, *Service Concession Arrangements: Disclosures*, to determine their accounting and financial reporting for service concession arrangements. The IASB’s IFRIC Interpretation 4, *Determining whether an Arrangement contains a Lease*, may also be applicable in certain cases.

### **Key Matters and Observations from Constituents**

The IPSASB’s consideration of the issues identified in the Consultation Paper and the related proposals provided will need to acknowledge a potentially wide range of different institutional and legislative environments, and will need to be developed within the evolving framework for financial reporting established by IPSASs. The IPSASB welcomes comments on any of the proposals in the Consultation Paper. In particular, the IPSASB has highlighted a number of matters which it will need to consider as it carries out further work into the accounting treatment of service concession arrangements. In order to inform its approach to service concession arrangements, the IPSASB would value comments on these matters which are highly relevant to the international standard-setting context:

1. The Consultation Paper proposes that authoritative guidance be provided for public-private partnerships that are or involve service concession arrangements. Do you think that the description of service concession arrangements and public-private partnerships that involve service concession arrangements in the Introduction section is appropriate? Do you think that the development of authoritative guidance for these arrangements, beyond what currently exists, is necessary? Do you think that guidance for additional types of public-private partnerships should be provided in any future IPSAS on this topic?

2. Do you think the specific control criteria proposed in the Consultation Paper that, if met, results in the grantor reporting the underlying property to a service concession arrangement as an asset in its financial statements, and the general approach used to develop those criteria is appropriate? If not, please give your reasons and indicate whether you think one of the other approaches described in the Consultation Paper, or another approach not otherwise contemplated, would be more appropriate and why.
3. Do you agree with the proposal that in cases where the entire economic life of the underlying property is expected to be used under a service concession arrangement, the proposed control criteria should be considered met if the grantor holds rights and powers over any residual interest in the property at the end of the arrangement and the grantor controls or regulates the use of the property during the arrangement as described in the first criterion of the control criteria? If not, please give your reasons and any thoughts as to an alternative approach.
4. Do you agree that the underlying property reported by the grantor as an asset and the related liability should be initially measured based on the fair value of the property, with the exception that in cases where scheduled payments made by the grantor can be separated into a construction element and a service element, the present value of the scheduled construction payments should be used if lower than the fair value of the property? If not, please give your reasons and any thoughts as to an alternative approach.
5. Do you agree that the operator's cost of capital specific to the service concession arrangement should be used to impute finance charges when the construction element and service element of scheduled payments made by the grantor to the operator are inseparable? If not, what rate do you believe would be more appropriate, if any, and why?
6. Do you agree with the proposals related to accounting and financial reporting for service concession arrangements when the proposed control criteria are not met? Specifically, do you agree that a service concession arrangement that does not meet the proposed control criteria should be subject to the guidance in IPSAS 13, *Leases*, if

1 the arrangement meets the definition of a lease provided in IPSAS 13? If not, please  
2 give your reasons.

3 7. Do you think that upfront inflows of resources received by the grantor from the  
4 operator, as part of a service concession arrangement, generally should be reported as  
5 unearned revenue and recognized as revenue over the life of the arrangement  
6 beginning at the commencement of the concession term, that is, when the underlying  
7 property is fully operational? If not, please give your reasons and any thoughts as to  
8 an alternate approach. Do you think such unearned revenue should be permitted to be  
9 recognized as revenue either using the straight-line method or another method that is  
10 more reflective of the operator's economic consumption of their access to the  
11 property and/or the time value of money? If not, please state which method is  
12 preferred and the reasons for your preference.

13 8. Do you agree that the existing guidance in IPSAS 19, *Provisions, Contingent*  
14 *Liabilities and Contingent Assets*, generally should be applied to determine the  
15 appropriate financial reporting of guarantees and other commitments made by the  
16 grantor as part of a service concession arrangement? If not, please give your reasons.

17 9. Are the proposed disclosures related to both individual material service concession  
18 arrangements and all service concession arrangements in the aggregate appropriate?  
19 If not, please provide alternatives that are auditable and practical.

20

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**PREFACE**

The use of service concession arrangements by the public sector as a vehicle to build and improve infrastructure and other public facilities, and provide the services associated with these structures, has continued to grow worldwide over recent years. This growth is reflected in both the number of countries in which service concession arrangements have been executed or studied and the types of infrastructure and public facilities that are associated with these arrangements.

Service concession arrangements are unique in that the risks and benefits associated with constructing, owning and operating the underlying property, along with the control over the property, are shared to some degree by the public sector entity and private sector entity involved in the arrangement. The sharing of these aspects of the property, as well as the general complexity of these transactions, often has made the financial reporting of the property for the public and private sector entities unclear.

This lack of clarity also stems from the fact that, until recently, there was little in the way of accounting and financial reporting guidance specific to service concession arrangements. The UK Accounting Standards Board issued an amendment to its FRS 5, *Reporting the Substance of Transactions*, which addressed service concession arrangements. This amendment also forms the basis for guidance in Australia and New Zealand. Additionally, the European Commission issued guidance on accounting for service concession arrangements for statistical reporting purposes. However, many jurisdictions continue to only apply their existing authoritative accounting and financial reporting guidance, such as their general accounting framework and leasing standards, to account for the property associated with service concession arrangements.

This lack of specific guidance for service concession arrangements has caused divergence in how the property in these arrangements are reported, even occasionally resulting in the property not being reported as an asset by either the public sector entity or the private sector entity. The lack of specific guidance has also provided public sector entities the opportunity to use service concession arrangements as a means to fulfill their infrastructure needs while having the property and related financing remain off of their financial statements, thereby enabling the meeting of fiscal targets.

1 In November 2006, the IASB's International Financial Reporting Interpretations  
2 Committee issued Interpretation 12, *Service Concession Arrangements*. This  
3 interpretation provides guidance on reporting the property associated with service  
4 concession arrangements that meet specified criteria related to control over the property.  
5 However, the guidance in this interpretation only specifically applies to private sector  
6 entities.

7 In July 2006, the IPSASB initiated its own project on service concession arrangements so  
8 that accounting and financial reporting issues related to these arrangements would be  
9 considered from the perspective of the public sector entity. The IPSASB formed a  
10 subcommittee to identify and deliberate these issues. This Consultation Paper is the  
11 product of such deliberations.

12 Much of the Consultation Paper focuses on the financial reporting of the underlying  
13 property to service concession arrangements. The paper discusses the determination of  
14 whether the public sector entity should report the underlying property as an asset in its  
15 financial statements and the circumstances involved in making this determination. The  
16 paper also discusses reporting issues resulting from the public sector entity reporting the  
17 underlying property as an asset. These issues largely relate to the timing of the  
18 recognition and the measurement of the underlying property, as well as any associated  
19 liabilities.

20 The Consultation Paper also addresses other accounting and financial reporting issues for  
21 public sector entities that may result from the execution of a service concession  
22 arrangement. The paper discusses the recognition of revenue from inflows of resources  
23 related to a service concession arrangement. These inflows most often occur when the  
24 private sector entity receives fees for services directly from third-party users of the  
25 underlying property. The public sector entity may receive inflows from revenue-sharing  
26 provisions established as part of the contractual terms of the service concession  
27 arrangement, or through an upfront payment, or predetermined series of payments, made  
28 by the private sector entity to enter into the arrangement.

29 The Consultation Paper goes on to discuss the reporting of guarantees and commitments  
30 made by the public sector entity as part of a service concession arrangement. These

1 guarantees and commitments can be made to the private sector entity, or to third parties  
2 on the behalf of the private sector entity. Common examples of guarantees made by the  
3 public sector entity as part of a service concession arrangement are guarantees to repay  
4 the debt of the private sector entity in the event of default and the guarantee of a  
5 minimum revenue amount from third parties for the private sector entity. The public  
6 sector entity generally also has a commitment to its constituents to continue the service  
7 being provided under the arrangement in case the private sector entity becomes unable to  
8 perform or otherwise defaults on the arrangement. This may occur, for example, because  
9 of financial insolvency or violation of contractual performance standards by the private  
10 sector entity.

11 The Consultation Paper also addresses the potential for the private sector entity to be  
12 considered a controlled entity of the public sector entity for purposes of consolidation,  
13 particularly when the private sector entity is a special purpose entity or a government  
14 business enterprise. In cases where the public sector entity holds an ownership or equity  
15 interest in the private sector entity, the Consultation Paper suggests existing IPSASB  
16 guidance related to investments in associates or joint ventures may also need to be  
17 considered.

18 Lastly, the Consultation Paper discusses financial statement note disclosures related to  
19 service concession arrangements that would provide information useful for decision-  
20 making and demonstrate the accountability of the public sector entity for the resources  
21 entrusted to it. The balance of the cost and benefit of providing such information is  
22 considered in the proposals outlined in the paper.

23 A summary of the proposals detailed in the Consultation Paper follows.

24

**SUMMARY OF PROPOSALS**

The Consultation Paper provides a number of proposals related to the accounting and financial reporting of the various aspects of service concession arrangements (SCAs) by public sector entities acting as the grantor in an arrangement. Existing authoritative guidance issued by the IPSASB, as well as the guidance of other standards setters and other organizations were considered in the development of these proposals. The objective of these proposals is to assist in the potential development of accounting and financial reporting guidance for public sector entities related to SCAs.

*Scope of the Consultation Paper*

1. The subcommittee proposes that the scope of the Consultation Paper be limited to public-private partnerships that are or involve SCAs. An SCA is described in the Consultation Paper as an arrangement in which the grantor (normally a public sector entity) conveys to the operator (normally a private sector entity) the right to provide services either directly or indirectly to the public through the use of infrastructure or a public facility. The operator in turn assumes an obligation to provide such services, normally in accordance with performance requirements set forth by the grantor.
2. The subcommittee also proposes that sufficient authoritative guidance currently exists to address the accounting and financing reporting related to public-private partnerships that do not involve SCAs. Accordingly, these arrangements are not included within the scope of the Consultation Paper.

*Financial Reporting of Infrastructure and Public Facilities*

3. The subcommittee proposes that a control approach be adopted for determining the grantor reporting of the underlying property to an SCA. Under this approach, if the grantor is determined to control the use of the underlying property to the SCA, then the grantor would report the property as an asset in its financial statements. The criteria for determining grantor control are as follows:

1) The grantor controls or regulates what services the operator must provide with the associated property, to whom it must provide them, and the price range or rates that can be charged for services; and

2) The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the property at the end of the arrangement.

Regulation in the first criterion is restricted to arrangements agreed upon by the grantor and the operator and to which both parties are bound. It excludes generally legislated regulation that does not establish control for the purposes of financial reporting as concluded in IPSAS 6, *Consolidated and Separate Financial Statements*, and IPSAS 23, *Revenue From Non-Exchange Transactions (Taxes and Transfers)*. If the underlying property to an SCA is expected to be used for its entire useful life during the term of the SCA, the subcommittee proposes that the control criteria be considered met if the grantor holds the rights and powers over any residual interest in the property at the end of the arrangement and the first criterion above is met.

*Ancillary Accounting Issues Associated with Property*

4. For SCAs in which the proposed control criteria is met, the subcommittee proposes that the criteria for recognition of property, plant and equipment present in IPSAS 17, *Property, Plant and Equipment* should be used to determine the point at which the property should be recognized as an asset (for example, during construction or once in place and operational).

5. For SCAs in which the construction element and service element of the scheduled payments made by the grantor can be separated, the subcommittee proposes that the property and related liability should be reported at the fair value of the property, or if lower, the present value of the payments related to construction. Subsequent to initial recognition, the property should be measured following the guidance in IPSAS 17 (e.g. depreciation, impairment and subsequent measurement using the cost model or the revaluation model). The liability should be measured similar to a

liability resulting from a finance lease subsequent to initial recognition and should be considered a financial reporting liability for reporting purposes. The service elements of these payments would be expensed as incurred.

6. If the construction and service elements of scheduled payments to be made by the grantor are not separable, the subcommittee proposes that the property be reported at its fair value along with the related liability. Subsequent to inception, any scheduled payments on the SCA should be allocated between repayment of the liability, an imputed finance charge (based on the cost of capital of the operator specific to the SCA) and operating costs to reflect the service element of the SCA. Measurement and reporting of the property and the related liability subsequent to initial recognition should be similar to that for arrangements in which the payments are separable as described in item 5 above.

7. For SCAs in which the cash payments made by the grantor to the operator for construction of the property are reduced or eliminated because the operator is collecting third-party fees or receiving other non-cash compensation from the grantor (typically through the letting of additional land for a nominal rent amount), the subcommittee proposes that the underlying property to the arrangement should be reported by the grantor at its fair value. A related liability reflecting unearned revenue (also referred to as deferred income in some jurisdictions) should be initially reported for the same amount, adjusted for cash received or paid (or to be paid) by the grantor. This unearned revenue should be recognized as revenue generally over the life of the SCA as more fully described below in item 11.

8. For SCA arrangements in which neither of the control criteria discussed in the previous section are met, the subcommittee proposes that the grantor should not report the underlying property as an asset. Any payments made by the grantor to the operator under the arrangement should be expensed as incurred, that is, as the economic benefits of the service are rendered. The subcommittee proposes that the guidance in IPSAS 13 for lessees should be followed for SCAs in which the grantor only controls the use of the property during the arrangement, such as in a BOO arrangement, if the arrangement meets the definition of a lease. The subcommittee

1 further proposes that the grantor should continue to report existing underlying  
2 property to an SCA if it maintains ownership and controls the use of the property  
3 during the arrangement, but the property reverts to the operator at the end of the  
4 arrangement.

- 5 9. For SCAs involving newly constructed property in which the grantor does not  
6 control use of the property during the arrangement, but controls the significant  
7 residual interest in the property at the end of the arrangement, such as in a BOOT  
8 arrangement, the subcommittee proposes that the grantor report the difference  
9 between the expected fair value of the property at the end of the arrangement and  
10 the amount the grantor will be required to pay the operator upon reversion as an  
11 asset. This asset should be built up from payments made by the grantor to the  
12 operator over the life of the SCA. For SCAs involving existing property in which  
13 the grantor does not control use of the property during the arrangement, but controls  
14 the significant residual interest in the property at the end of the arrangement, the  
15 subcommittee proposes that the guidance in IPSAS 13 for lessors should be  
16 followed if the arrangement meets the definition of a lease. If the arrangement does  
17 not meet the definition of a lease, the grantor should derecognize the asset reflecting  
18 the property and recognize a receivable reflecting the operator's obligation to return  
19 the property at the end of the arrangement. This receivable should be recognized at  
20 the expected fair value of the property at the end of the SCA. The net derecognition  
21 amount should be reported as a gain or loss in the period of execution of the SCA.

22 *Inflows of Resources from a Service Concession Arrangement*

- 23 10. The subcommittee proposes that grantors should recognize revenue and related  
24 receivables associated with amounts received through revenue-sharing provisions in  
25 SCAs as it is earned in accordance with the substance of the relevant agreement  
26 once any contingent event, such as the achievement of a revenue threshold, is  
27 deemed to have occurred.
- 28 11. The subcommittee proposes that an upfront inflow of resources received by a  
29 grantor from an operator as part of an SCA should be recognized as revenue by the  
30 grantor over the life of the SCA beginning at the commencement of the concession

term, that is, when the property is fully operational and the operator has the ability to use the property to generate third-party usage fees. Upfront inflows should be reported as unearned revenue until the property reaches this condition. Once the property is fully operational, the subcommittee proposes that the grantor should amortize the unearned revenue amount and recognize revenue using the straight-line method or a method that is more reflective of the operator's economic consumption of their access to the underlying property and/or the time value of money given the facts and circumstances of the SCA.

*Guarantees and Other Commitments*

12. The subcommittee proposes that the guidance in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* be applied to determine the accounting and financial reporting for guarantees and commitments made by grantors as part of SCAs.

*Consolidation*

13. The subcommittee proposes that the relationship between the grantor and the operator to an SCA should be evaluated using the guidance in IPSAS 6, *Consolidated and Separate Financial Statements* to determine whether the grantor controls the operator for financial reporting purposes. The subcommittee also proposes that the guidance in IPSAS 7, *Investments in Associates* and IPSAS 8, *Interest in Joint Ventures* should also be considered if the grantor has an ownership or equity interest in the operator.

*Financial Statement Note Disclosures*

14. The subcommittee proposes the financial statement note disclosures below for grantors of SCAs.

A. For each individual arrangement considered material:

- A description of the arrangement, including management's objectives for entering into the arrangement;



- Significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (e.g. the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);
- The nature and extent of rights under the arrangement, including rights to expect provision of services and revenue-sharing provisions;
- The nature and extent of obligations, guarantees, and other commitments under the arrangement, including debt guarantees made on behalf of the operator and guarantees of minimum revenue amounts for the operator;
- Terms related to renewal and termination of the arrangement, as well as potential events of default and their impact;
- Terms related to the ownership and required condition of the property at the end of the arrangement; and
- Changes in the arrangement occurring during the period;

B. For each individual arrangement considered material and for all SCAs in the aggregate:

- The nature and amount of assets and liabilities recognized in the statement of position; and
- Total future minimum outflows and total future minimum inflows for each of the following periods:
  - Not later than 1 year,
  - Later than 1 year and not later than 5 years, and
  - Later than 5 years.

The total future minimum outflows and total future minimum inflows must be provided on a nominal basis. Disclosure of the present value of these

- 1 amounts is also recommended. If present value amounts are disclosed, the
- 2 discount rate used to determine these amounts should also be disclosed.
- 3
- 4

## 1 INTRODUCTION

### 2 What Are Public-Private Partnerships?

3 More than ever before, governments are confronted with the challenges of building new  
4 infrastructure and public facilities to keep up with population growth, and refurbishing  
5 existing infrastructure and public facilities that have deteriorated from years of deferred  
6 maintenance. They are also faced with the challenge of providing the services that are  
7 associated with infrastructure and public facilities to their constituents in an efficient and  
8 cost-effective manner. An increasingly common way for governments to approach these  
9 challenges is through the execution of public-private partnership arrangements.

10 No single, widely-accepted definition for the term “public-private partnership” exists.  
11 However, an underlying characteristic generally common to all descriptions of the term  
12 “public-private partnership” (hereinafter referred to as “PPP”) is the creation of an  
13 arrangement between public and private sector entities to deliver a public sector asset  
14 (normally infrastructure or a public facility) and/or service. In this way, PPP  
15 arrangements are an alternative to traditional procurement methods used by public sector  
16 entities as a means to accomplish a public duty or responsibility.

17 In traditional procurement methods, most of the risks associated with the underlying  
18 project remain with the public sector, although fixed price contracts may transfer some of  
19 the construction risk to the private sector. In a PPP arrangement, these risks generally are  
20 allocated between the public sector entity and the private sector entity. Project risks  
21 commonly include the following:

- 22 • *Construction risk.* This risk encapsulates the numerous issues that may be  
23 encountered during the construction phase of a project, such as cost overruns,  
24 building material defects, construction delays, planning regulation, structural  
25 integrity issues with existing infrastructure, technical deficiencies, health risks,  
26 worksite accidents, and other catastrophic events.
- 27 • *Availability risk.* This is the risk of the infrastructure or public facility not  
28 providing sufficient output, for example because of insufficient management or  
29 not meeting the required quality standards to provide service.

- 1       • *Demand risk.* This is the risk related to variability in the amount of service  
2       required or consumed by users of the infrastructure or public facility. Users of the  
3       services provided through a PPP arrangement can be the public sector entity itself,  
4       third-party users, such as citizens, or both.
- 5       • *Operation and maintenance risk.* This risk encompasses a broad range of risks  
6       that exist once the infrastructure or public facility is operational. Examples  
7       include price increases or shortages of input materials, increases in labor costs,  
8       damage as a result of natural disasters, costs related to deferring maintenance, and  
9       obsolescence. Demand and availability risk may also be considered specific  
10      components of ongoing operational and maintenance risk.
- 11      • *Residual value risk.* This risk relates to the market price of the infrastructure or  
12      public facility at the end of the PPP arrangement varying from original  
13      expectation.
- 14      • *Financing risk.* This is the risk that the funding required for the project will not be  
15      achieved or will be achieved at interest rates which would prevent projects from  
16      achieving its expected benefits. This might be due to the circumstances of the  
17      specific public or private sector entity (for example, credit status or debt  
18      limitations), or investor perceptions of the risks of a project.

19   PPP arrangements are undertaken by public sector entities for various reasons. The  
20   common, underlying reason is to leverage the benefits created from partnering with a  
21   private sector entity which may not otherwise exist if the construction of the property  
22   and/or the delivery of the associated service were to remain in the public sector. A  
23   common phrase used to refer to this objective is achieving “improved value for money.”  
24   Often, the potential “value” to a PPP arrangement perceived by the public sector entity is  
25   a monetary objective, for example, an attempt to control or reduce costs or the receipt of  
26   an upfront inflow of resources. In other instances, the potential “value” may include  
27   improved ability to deliver new or renovated infrastructure or public facilities, improved  
28   quality of construction and maintenance or improved efficiency in the public service  
29   provided. Improved value for money is achieved through the proper allocation of project  
30   risks (many of which are listed above) between the public and private sector entities

1 based on their ability to manage such risks given their respective resources and  
2 capabilities.

3 For some public sector entities, the opportunity to share in certain tax benefits gained by  
4 the private sector entity has also been seen as a financial benefit to entering PPP  
5 arrangements. For example, in some jurisdictions, state and local governments are  
6 typically not income tax payers and do not benefit from asset deductions. If, however,  
7 they acquire services utilizing an asset from a taxable entity, that private sector entity  
8 may be able to claim tax deductions relating to the asset and reflect that benefit in a lower  
9 overall charge to the public sector entity for the service.

10 Aside from achieving improved value for money, the incentive of some public sector  
11 entities to enter into PPP arrangements has been the meeting of fiscal targets. PPP  
12 arrangements have been seen by some as a vehicle to enable the fulfillment of needs for  
13 new or renovated infrastructure or public facilities, while at the same time, excluding  
14 from the budgetary process and financial reports of the public sector entity the  
15 infrastructure or public facilities created and any resulting financing. This motivation  
16 was particularly prevalent in the early stages of developing PPP arrangements.

17 The benefit for the private sector entity in entering into a PPP arrangement generally is  
18 the compensation garnered from the arrangement. Compensation provisions of PPP  
19 arrangements can vary in their basis for payment (for example, contractually fixed  
20 payments or variable payments based on level of availability or usage of the underlying  
21 property) and in the source of the funding (third-party users, the public sector entity itself,  
22 or both). The timing of the payments may vary as well. For example, to lessen the  
23 financing requirement for the private sector entity, the public sector entity may make a  
24 substantial payment at the beginning of the arrangement with a reduced stream of  
25 periodic payments to follow in the future.

26 The level of proliferation of PPP arrangements in individual countries around the world  
27 varies greatly. Some countries, such as the United Kingdom and Australia, have utilized  
28 PPP arrangements to assist in meeting their needs related to infrastructure and public  
29 facilities for a number of years. In other countries, PPP arrangements have either only  
30 recently begun to be executed or are still being explored by public sector entities. In

1 either case, the interest in PPP arrangements and the actual number of executed  
2 arrangements is growing steadily on a global basis. Additionally, where these  
3 arrangements originally were only commonly used in particular sectors, such as  
4 transportation and utilities, the types of infrastructure and public facilities and associated  
5 services provided through PPP arrangements have become increasingly diverse. For  
6 example, these arrangements are now being used in sectors of public service including  
7 education, corrections, healthcare and hospitals, airports, defense, housing, ports, parks,  
8 and arts and leisure.

9 **Types of Public-Private Partnerships**

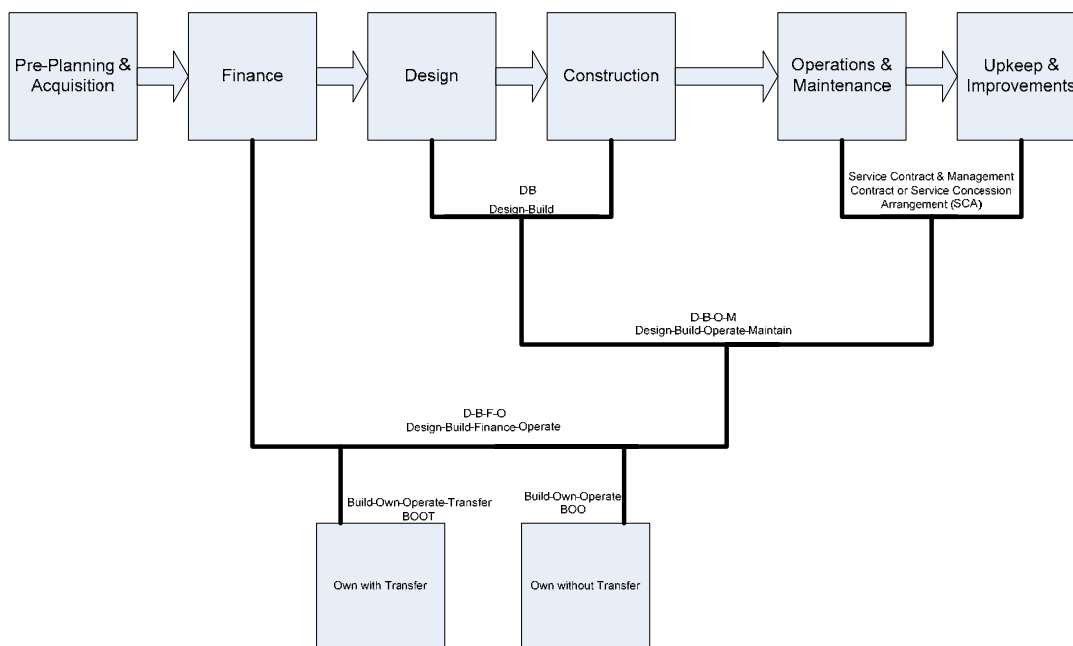
10 Just as the usage of PPP arrangements<sup>1</sup> has grown and become more diverse over recent  
11 years, so too have the types of PPP arrangements being executed. The various types of  
12 PPP arrangements are often distinguished based on the extent of private sector  
13 involvement with the major phases of the underlying project. As the level of  
14 involvement of the private sector entity increases, their assumption of risk and  
15 responsibility for the project also increases. This is depicted in Charts A and B below.  
16 Chart A<sup>2</sup> indicates the major phases of an infrastructure or public facility project and  
17 common types of PPP arrangements that may be used to carry them out, while Chart B  
18 plots these types of PPP arrangements by the degree of risk and responsibility allocated to  
19 the private sector entity.

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<sup>1</sup> In the context of this Consultation Paper, the term “PPP arrangements” does not include arrangements in which the public sector entity has an ownership interest in the private sector entity, such as a joint venture. These arrangements may be subject to the guidance in IPSAS 7, *Accounting for Investments in Associates* or IPSAS 8, *Interests in Joint Ventures*.

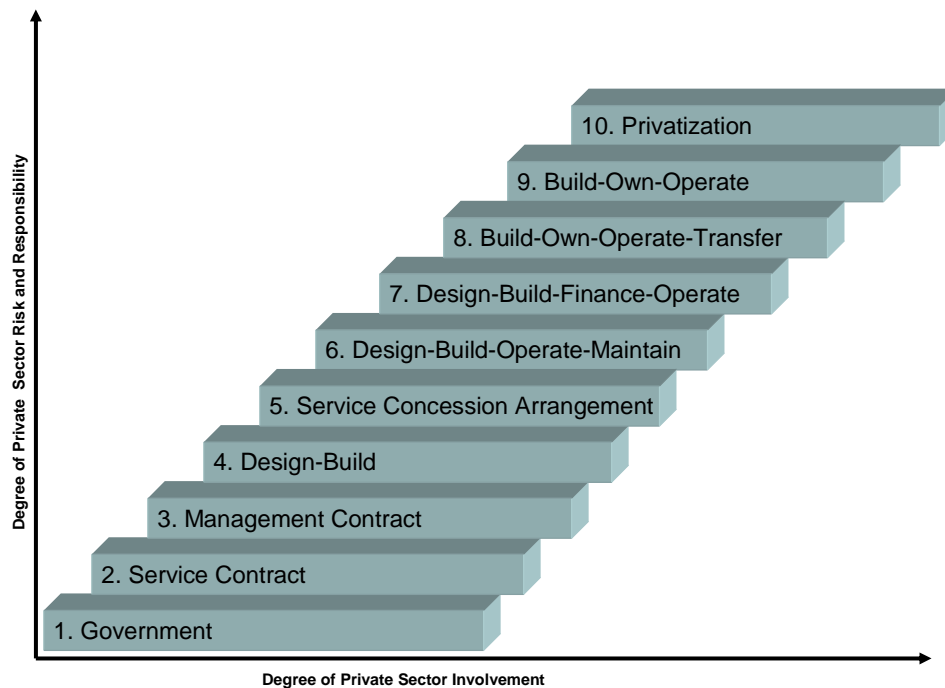
<sup>2</sup> Adapted from AECOM Consult, Inc. 2007 “Case Studies of Transportation Public-Private Partnerships around the World” p. 2.7 (prepared for the U.S. Department of Transportation Federal Highway Administration Office of Policy and Governmental Affairs). Arlington, VA.

1 **Chart A**



2

3 **Chart B**



4

***Service and Management Contracts***

In a service contract, the public sector entity contracts with the private sector entity to provide services that would previously or otherwise be performed by the public sector entity. For example, a public sector entity may enter into a service contract with a private sector entity for the performance of waste collection services. A management contract builds on a service contract by placing management responsibilities for the service with the private sector entity. In contrast to a service contract, using the previous example, in a management contract, the private sector entity may be contracted not only to perform the actual collection of waste, but also management functions associated with the operation of the service, such as, hiring employees, interacting with other vendors, and preparing budgetary information related to the operation of the service. In both cases, the relationship between the public sector entity and the private sector entity is similar to that of a purchaser and vendor, and the arrangement is generally short-term. Risk and responsibility for delivery of the service largely remains with the public sector entity. These arrangements can be similar to those referred to as “outsourcing” or “contracting-out.” These arrangements may or may not involve the use of infrastructure of public facilities.

***Design-Build Arrangements***

In design-build<sup>3</sup> arrangements, the private sector entity is responsible for designing and building the infrastructure or public facility in accordance with requirements set by the public sector entity. In these arrangements, the private sector entity usually assumes the construction risk. Once construction is completed, the public sector entity is responsible for the operation and maintenance of the infrastructure, leaving the private sector entity with little or no further risk on the project.

***Service Concession Arrangements***

In a service concession arrangement, the public sector entity conveys to the private sector entity the right to provide services either directly or indirectly to the public through the use of infrastructure or a public facility. The private sector entity in turn assumes an

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<sup>3</sup> In the context of this section, the term “build” refers to new construction of infrastructure and public facilities or renovation of existing infrastructure and public facilities.

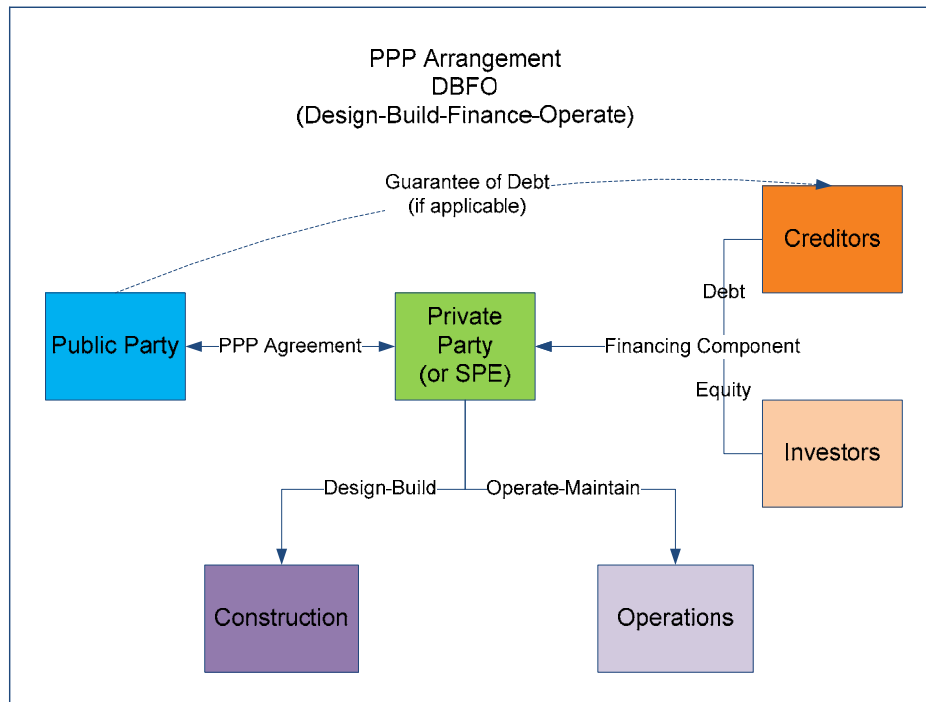


1 obligation to provide such services, normally in accordance with performance  
2 requirements set forth by the public sector entity. This is a common form of arrangement  
3 to allocate economic risks and benefits related to delivering services associated with  
4 existing infrastructure or public facilities to a private sector entity. In many of these  
5 arrangements, the public sector entity will receive an upfront inflow of resources or a  
6 series of inflows of resources from the private sector entity in exchange for the service  
7 concession. In other arrangements, the public sector entity will make payments to the  
8 private sector entity, generally as performance criteria are met. As compared to service  
9 or management contracts, service concession arrangements are generally longer in term,  
10 often so that the private sector entity has the opportunity to earn an acceptable rate of  
11 return on their investment in the project.

12 ***Design-Build-Operate-Maintain & Design-Build-Finance-Operate Arrangements***

13 In a design-build-operate-maintain (DBOM) arrangement, the aspects of design-build  
14 arrangements are combined with those of service concession arrangements. The private  
15 sector entity is allocated the risks of constructing the infrastructure or public facility  
16 along with the risks of its operation and maintenance. In a design-build-finance-operate  
17 (DBFO) arrangement, the private party designs and builds the infrastructure or public  
18 facility, finances the construction costs, and provides the associated services, with the  
19 infrastructure or public facility typically being returned to the public sector entity at the  
20 end of the arrangement. In this type of arrangement, financing risk is added to the risks  
21 allocated to the private sector entity in a DBOM arrangement. The DBFO scheme is  
22 viewed by many as the traditional PPP model used when the project involves  
23 construction of the infrastructure or public facility. Chart C below illustrates the various  
24 parties that may be involved in a DBFO arrangement:

1 **Chart C**



2

3 Note: SPE refers to “special purpose entities”, also known as “special purpose vehicles”.

4 ***Build-Own-Operate-Transfer & Build-Own-Operate Arrangements***

5 In a build-own-operate-transfer (BOOT) arrangement, ownership of the constructed  
6 infrastructure or public facility rests with the private sector entity until the end of the  
7 arrangement, at which time ownership is transferred to the public entity. Thus, risks and  
8 responsibilities related to property ownership are allocated to the private sector entity  
9 during the arrangement in addition to those that are allocated in a DBFO scheme. A  
10 build-own-operate (BOO) arrangement differs from a BOOT arrangement in that the  
11 private sector entity is not required to transfer ownership of the constructed infrastructure  
12 or public facility back to the public sector entity. Retaining the risks of property  
13 ownership beyond the term of the arrangement places an even greater degree of risk and  
14 responsibility with the private sector entity in a BOO arrangement.

15 ***Privatization***

16 In the context of Chart B, privatization generally occurs when the public sector entity  
17 transfers, generally through sale, the infrastructure or public facility from which a service

1 is derived to a private sector entity. The public sector entity divests itself of  
2 responsibility for the property sold and related service delivery (other than potential  
3 ongoing regulatory authority), resulting in maximum risk and responsibility for the  
4 private sector entity.

5

**SCOPE OF THE CONSULTATION PAPER**

When considering the accounting and financial reporting implications of the various types of PPP arrangements discussed in the previous section for the public sector entity, they appear to be straightforward for some types of arrangements. For example, service and management contracts would be reported similarly to other vendor service contracts, with related outlays being reported as an expense by the public sector entity as services are provided by the private sector entity. Likewise, design-build arrangements would be accounted for similarly to other types of construction-related contracts, with property, plant and equipment being reported as appropriate based on the guidance in IPSAS 17, *Property, Plant and Equipment*. In these cases, ownership of the infrastructure or public facility remains with the public sector entity, as does the majority of the risk, responsibility and control of the infrastructure or public facility and the associated services being delivered.

There may be instances in which a single arrangement combines the aspects of a design-build arrangement and a service or management contract (as opposed to a service concession arrangement). For example, a public sector entity may contract a private sector entity to design and build a bridge and provide maintenance and toll collection services on the bridge for a period after completion of construction. In these instances, each portion of the arrangement—the design-build portion and the service contract portion—would be accounted for as discussed in the previous paragraphs. In many of these arrangements, the amount of the payments related to the construction aspect and the service aspect of the arrangement can be discretely identified in the contract. If they cannot, estimates may be required to allocate the payments to each portion of the arrangement.

Privatization through an asset sale would generally be reported similarly to any other asset sale. In this case, ownership of the infrastructure or public facility passes to the private sector entity along with the majority of the risk, responsibility and control of the infrastructure or public facility and the associated services to be delivered.

Unlike the arrangements discussed above, the accounting treatment for PPPs that involve service concession arrangements is not as clear and is often contentious. This is because

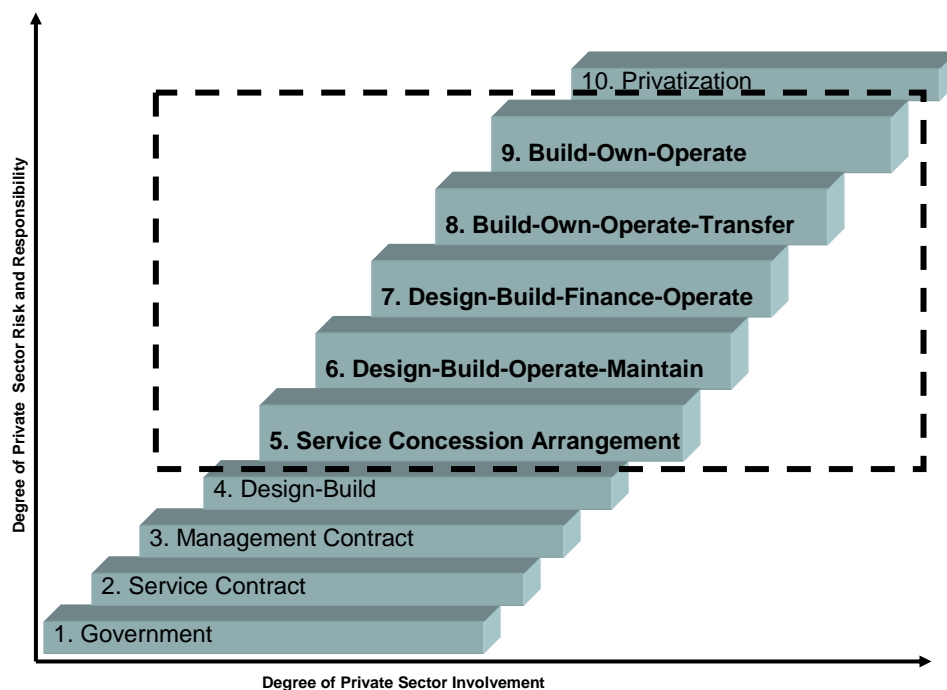
1 the public sector entity and the private sector entity more evenly *share* in the risks,  
2 responsibilities, benefits and control of the infrastructure and public facility and the  
3 delivery of the associated services. This brings into question which party to the  
4 arrangement should report the underlying infrastructure or public facility as an asset in  
5 their financial statements. The party that may legally own the infrastructure or public  
6 facility in form may not be the same party that, in substance, is benefiting from the  
7 property and related service delivery and bearing its risks.

8 ***Subcommittee Proposal***

9 Based on the discussion above, the subcommittee proposes that the scope of the  
10 Consultation Paper be primarily focused on the accounting and financial reporting issues  
11 related to PPP arrangements that are or involve service concession arrangements,  
12 irrespective of how the arrangement is funded. As discussed in the Introduction section,  
13 this includes a variety of arrangements, such as DBOM, DBFO, BOOT and BOO  
14 arrangements. Originally, the term “service concession arrangement” was generally used  
15 in the narrower sense in that these arrangements would be funded by the private sector  
16 entity receiving a concession that would enable it to directly charge the public. More  
17 recently, however, the International Accounting Standards Board’s (IASB) International  
18 Financial Reporting Interpretation Committee (IFRIC) Interpretation 12, *Service*  
19 *Concession Arrangements*, (hereinafter referred to as “IFRIC 12”) has defined service  
20 concession arrangements more widely to include both those arrangements where the  
21 private sector entity charges the public (as third-party users) and those where the public  
22 sector entity makes payments to the private sector entity. In this paper, service  
23 concession arrangement is used in this wider sense. Also, as alluded to in the  
24 Introduction section, service concession arrangements can involve new or existing  
25 infrastructure or public facilities.

26 Examples of the types of arrangements included in Chart B (in the Introduction section)  
27 that would be within this scope are highlighted in Chart D below:

1 **Chart D**



2

3 The key issue to be addressed under this scope is the reporting of the new or existing  
4 infrastructure or public facility associated with the service concession arrangement  
5 (including potential derecognition by the public sector entity) and any related liabilities.  
6 Other ancillary accounting and financial reporting issues related to service concession  
7 arrangements that will be addressed in the Consultation Paper include recognition of  
8 revenues for the public sector entity generated through these arrangements, guarantees  
9 and commitments made by the public sector entity as part of these arrangements, the  
10 potential consolidation of the private sector entity into the public sector entity's economic  
11 entity, and financial statement disclosures for the arrangement.

12 While most service concession arrangements involve a public sector entity, or multiple  
13 public sector entities<sup>4</sup>, (commonly referred to as the “grantor”) and a private sector entity  
14 (commonly referred to as the “operator”), in some cases the parties to the arrangement  
15 are both public sector entities. Generally, the “operator” in these arrangements is a  
16 government business enterprise (GBE). Although, by definition, this would not be

<sup>4</sup> When multiple public sector entities constitute the grantor, those entities may be subject to IPSAS 7 or IPSAS 8.

1 considered a PPP arrangement, the subcommittee proposes that the discussion in this  
2 Consultation Paper be applicable to these arrangements as the difference in the nature of  
3 the “operator” party would not impact the accounting and financial reporting  
4 implications.

5 The discussion in this Consultation Paper will focus on the accounting and financial  
6 reporting implications of service concession arrangements (SCAs) for the grantor in these  
7 arrangements. The guidance in the Consultation Paper could be applied for government  
8 business enterprises that are grantors because International Financial Reporting Standards  
9 (IFRSs) issued by the International Accounting Standards Board (IASB) currently do not  
10 provide accounting and financial reporting guidance for grantors in SCAs.

11 Operators in these arrangements are generally private sector entities or GBEs that would  
12 apply IFRIC 12, and the IASB’s Standing Interpretation Committee (SIC) Interpretation  
13 29, *Service Concession Arrangements: Disclosures*, to determine the appropriate  
14 accounting and financial reporting for service concession arrangements.

15

## **FINANCIAL REPORTING OF INFRASTRUCTURE AND PUBLIC FACILITIES**

The central accounting and financial reporting issue related to SCAs is the reporting of the infrastructure or public facility (referred to hereinafter as “property”) associated with these arrangements and any related liabilities and revenues. As noted previously, because of the notion present in SCAs that risk, responsibility, benefits and control of the property is shared in varying degrees between the grantor and the operator, determining the financial reporting of the property based solely on legal ownership may not result in the most faithful representation of the effects of the arrangement. The relationship among the parties to the SCA and the underlying property must be analyzed to determine the financial reporting that most faithfully represents the “substance over form” ownership of the property.

Many jurisdictions are currently applying their existing authoritative accounting and financial reporting guidance, such as their general accounting framework and leasing standards, to account for the property associated with SCAs. However, some standard-setting bodies have either issued or proposed guidance specifically addressing the unique nature of SCAs (or PPP arrangements more broadly). This existing and proposed guidance on SCAs (or PPP arrangements, as applicable) takes different approaches to determining the appropriate reporting of the property associated with the arrangement. This section of the paper summarizes these different approaches, along with other alternative approaches to reporting the property associated with an SCA.

### **Economic 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”), an economic risk and rewards approach to accounting for the property associated with a private finance initiative<sup>5</sup> (PFI) 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

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<sup>5</sup> Private finance initiative is the term used in the UK for a type of SCA or PPP arrangement.



1 Australia and New Zealand.) Application Note F works from the premise that most PFI  
2 arrangements call for the operator to design, build, finance, and operate the associated  
3 property, thereby creating an SCA as previously described. The basic principle put forth  
4 in Application Note F for determining the reporting of the property associated with a PFI  
5 contract is as follows:

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

13 For purposes of determining which party should report the associated property as an  
14 asset, Application Note F states that service elements of the contract should be separated  
15 from required payments for the property to the extent they operate independently of each  
16 other. Service elements may relate to ancillary services associated with the property  
17 provided by the private entity, such as cleaning or catering. Separable service elements  
18 should be excluded from consideration because such elements are not relevant to  
19 determining which party has an asset of the property. Separable service elements would  
20 be accounted for similarly to any other service contract. Once separable service elements  
21 have been excluded, the PFI arrangement is classified into one of the following two  
22 categories:

- 23 1) Those where the only remaining elements are payments for the  
24 property. Application Note F states that these contracts would be  
25 similar to a lease and should be accounted for under the guidance in  
26 UK SSAP 21, *Accounting for leases and hire purchase contracts*, as  
27 interpreted under Application Note F.
- 28 2) Those where the remaining elements include some services. These  
29 contracts would fall under the guidance provided in Application Note  
30 F.

31 It should be noted that many if not most of these PFI arrangements are constructed so as  
32 to fall into the second category.

33 Under Application Note F, whether a party has access to the benefits of the property and  
34 exposure to the associated risks is reflected in the extent to which each party bears the

1 potential variations in property profits or losses. The potential variations in costs and  
2 revenues that flow from features of the property should be distinguished from those that  
3 do not. Only those potential variations that flow from features of the property are  
4 relevant to determining which party should report the property as an asset. Application  
5 Note F describes the factors that may be relevant to assessing which party bears the  
6 potential variations in property profits and losses as follows:

- 7       • *Demand Risk.* Demand risk is the risk that demand for the property will be  
8       greater or less than predicted or expected. Application Note F states that for  
9       arrangements where demand risk is significant, it will normally give the  
10      clearest evidence of how the associated property should be reported, with the  
11      bearer of demand risk being the party that should report the asset.
- 12      • *The Presence, if any, of Third-party Revenues.* Some PFI arrangements  
13      involve the expectation that the property will be used by parties other than the  
14      grantor. Where the operator relies on revenues from these third-parties to  
15      cover its property costs, this is evidence that the property is an asset of the  
16      operator. Where third-party usage is minimal or solely a future possibility,  
17      this is evidence that the property is an asset of the grantor.
- 18      • *Who Determines the Nature of the Property.* This factor relates to who  
19      determines how the PFI arrangement is to be fulfilled and, in particular, what  
20      kind of property is to be built. If the grantor determines the key features of  
21      the property and how it is to be operated, bearing the cost implications of any  
22      changes to the method of operation, this is evidence that the property is the  
23      asset of the grantor. If the operator has significant and ongoing discretion  
24      over how to fulfill the PFI arrangement and makes the key decisions on what  
25      property is built and how it is operated, bearing the consequent costs and  
26      risks, this is an indication that the property is the asset of the operator.
- 27      • *Penalties for Underperformance or Non-availability.* Some PFI arrangements  
28      provide for penalties in the form of cash payments or reductions in revenue if  
29      the property is below a specified standard or is unavailable because of the  
30      fault of the operator. 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 grantor. If the potential penalties could cause the operator'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 operator.

- *Potential Changes in Relevant Costs.* Potential changes in property costs may be dealt with in different ways in a PFI arrangement. If significant future cost increases can be passed on to the grantor, this would be evidence that the property is an asset of the grantor. If the operator's costs are both significant and highly uncertain, and there are no provisions for cost variations to be passed on to the grantor, this is evidence that the property is an asset of the operator.

- *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 which party should report the property as an asset. The grantor 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 operator, selected by the grantor, for a substantially fixed or nominal amount; or

- 1                               3) Payments over the term of the PPP contract are sufficiently large  
2                               for the operator not to rely on an uncertain residual value for its  
3                               return.

4                               The operator will bear residual value risk where:

- 5                               1) It will retain the property at the end of the PPP contract; or  
6                               2) The property will be transferred to the grantor or another operator  
7                               at the prevailing market price.

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

12     It is worthwhile to note that construction risk is not included in the list of factors above.  
13     Construction risk is referred to in Application Note F in the discussion on “who  
14     determines the nature of the property”. Construction risk was specifically excluded  
15     from Application Note F because the risk occurs before the service concession period  
16     starts. The UK Accounting Standards Board took the view that construction risk  
17     generally is not relevant to determining which party has an asset of the property once  
18     construction is completed because such risk normally has no impact during the property’s  
19     operational life. However, Application Note F does state that construction risk may be  
20     relevant where it calls into question the other evidence, particularly in a case where the  
21     grantor bears construction risk, but based on the other factors, the property is otherwise  
22     claimed to be the asset of the operator.

23     **Economic Risk Approach—European Commission (Eurostat)**

24     In 2004, Eurostat published an additional chapter to its *ESA95 Manual on Government*  
25     *Deficit and Debt*, entitled *Long term contracts between government units and non-*  
26     *government partners (Public-private-partnerships)* (hereinafter referred to as “the  
27     Chapter”). In the Chapter, Eurostat provides guidance on accounting for the property  
28     associated with PPP arrangements for statistical reporting purposes. The general  
29     approach put forth in the Chapter is based on the bearing of economic risk similar to the

UK guidance discussed above. However, in an effort to simplify the risk analysis, Eurostat limited the risks to be considered to those it perceived to be the most significant. The guidance in the Chapter also makes a distinction between arrangements for which the grantor is the primary purchaser of the services provided by the operator, either on their own behalf or that of third-party users, and arrangements for which third-party users are the primary purchasers of the service. The Chapter refers to the former as a *PPP arrangement* and the latter as a *concession agreement*.

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 operator if there is strong evidence that the operator is bearing the majority of the risks attached to the contract. For purposes of applying this general principle, the Chapter states that the property should be reported as an asset of the operator only if both of the following conditions are met:

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

These risks are described in the Chapter 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 operator is called upon, because of insufficient management, 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 operator. In other words, a shift of demand cannot be directly linked to

the level of quality of the services provided by the operator. Instead, it results from other factors, such as the business cycle, new market trends, a change in final users' preferences, or technological obsolescence.

In many acquisitions (including those acquisitions considered traditional procurement) there would normally be some attempt to transfer construction risk to the builder (eg by use of a fixed price contract). So, it has been argued that, in substance, to pass this test the operator often only needs to accept either availability or demand risk. However, 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 grantor or the operator is similar to that in the guidance of the UK Accounting Standards Board described above. The Chapter also discusses that the grantor's participation in the upfront financing of the project, either directly through issuing debt or indirectly through guaranteeing the debt of the operator, could be a factor that influences the risk transfer assessment as a component of construction risk.

As far as *concession agreements* are concerned, although not specifically stated, certain guidance in the Chapter implies that the associated property in such an arrangement should be reported as assets of the operator.

#### **Control Approach—IFRIC**

In November 2006, IFRIC 12 was issued. The provisions of IFRIC 12 cover public-private service concession arrangements in which:

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

Arrangements are also considered within the scope of IFRIC 12 if the underlying property is used for its entire useful life under the arrangement and the first criterion above is met.

IFRIC 12 goes on to state that its provisions apply to both property that the operator constructs or acquires from a third party for the purpose of the SCA, and existing property to which the grantor gives the operator access for the purpose of the arrangement. IFRIC 12 also specifies that its provisions only address the accounting by the operator—guidance for the grantor is not provided.

Paragraph 11 of IFRIC 12 addresses whether the operator should report the property associated with the SCA as an asset as follows:

Infrastructure within the scope of this Interpretation shall not be recognised as property, plant and equipment of the operator 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 in accordance with the terms specified in the contract.

In the basis for conclusions of IFRIC 12 the IASB's *Framework for the Preparation and Presentation of Financial Statements*, is cited 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, IFRIC 12 states that the property should not be reported as an asset by the operator for arrangements that meet its scope because the operator does not control it and

the definition of an asset is not met. In this way, IFRIC 12 views the operator as a service provider to the grantor—the operator is managing the property on the grantor’s behalf. IFRIC 12 states that the asset that should be recognized by the operator is the consideration it receives in exchange for its services, not the property that it constructs, upgrades, or accesses as part of the arrangement.

IFRIC 12 goes on to state that instead of reporting the property as an asset, in exchange for construction and upgrade services, the operator 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 grantor; 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.

As noted above, IFRIC 12 only provides guidance for operators. However, it can be inferred that, as a practical matter, the implication of the operator guidance provided under IFRIC 12 is that the grantor should report the underlying property as an asset.

#### **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”). In the Proposed Guideline, two different types of PPP arrangements are distinguished: one involving the performance by an operator of an “institutional function” and the other involving some form of “use of state property” by the operator 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 factor used to determine the financial reporting for the associated property is possession of the property at the end of the arrangement. It should be noted the provisions of the Proposed



1 Guideline would only apply to the public entity—guidance for the private entity is not  
2 provided.

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

8 The Proposed Guideline describes an “institutional function” PPP as an arrangement for  
9 which the operator will perform part of the grantor’s service delivery or administrative  
10 functions and assume the associated risks. The arrangement involves a substantial  
11 transfer of some form of project life cycle risk to the operator. The grantor retains a  
12 significant role in the project either as the main purchaser of the services provided or as  
13 the main enabler of the project.

14 For property associated with this type of arrangement, the Proposed Guideline uses the  
15 provisions of the South African Standard of Generally Recognised Accounting Practice  
16 on leases as the basis for determining whether the property should be reported as an asset  
17 of the grantor. In all PPP arrangements that require the development or construction of  
18 immovable property, ownership of the immovable assets will revert back to the grantor at  
19 the end of the arrangement because South African legislation generally does not permit  
20 the transfer of any government property to a private party unless adherence to the  
21 applicable legislative requirements with regards to the disposal of government assets has  
22 been achieved. Therefore, payments toward the development or construction of  
23 immovable property will fall within the definition of a finance lease, resulting in the  
24 reporting of the property as an asset of the grantor. Ownership of movable property can  
25 either remain with the operator or revert to the grantor when the PPP arrangement  
26 expires. Therefore, it must be determined whether the payments made by the grantor  
27 toward the development or construction of the movable property meet the definition of a  
28 financing lease or an operating lease to determine whether the grantor would report the  
29 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 grantor will transfer the right of use of immovable or movable property to an operator 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 grantor because control and ownership of these assets will remain with the grantor for the duration of the arrangement, and use will revert back to the grantor 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 grantor at the end of the agreement would be reported as an asset of the grantor. Movable property that will remain with the operator at the end of the agreement would not be reported as assets of the grantor.

#### **Other Approaches**

##### *Lease Approach*

It can be argued that for purposes of reporting the underlying property, an SCA can be viewed similarly to a lease—an agreement that conveys the right to control the use of an asset for an agreed-upon period of time. Therefore, the criteria used to determine whether a lease is a finance lease or an operating lease could be used to determine which party to the SCA should report the underlying property as an asset in its financial statements. These criteria are designed to determine whether the risks and rewards incident to ownership of the property substantially lie with the lessor or lessee (and therefore, arguably which party has ultimate control of the property). Risks include the possibilities of losses from idle capacity, technological obsolescence or changes in value due to changing economic conditions. Rewards may be represented by the expectation of service potential or profitable operation over the property’s economic life and of gain from appreciation in value or realization of a residual value.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. IPSAS 13, *Leases*, provides the following examples of situations which would normally result in a finance lease and reporting of the asset by the lessee:

- (a) The lease transfers ownership of the asset to the lessee by the end of the lease term;

- 1 (b) The lessee has the option to purchase the asset at a price which is
- 2 expected to be sufficiently lower than the fair value at the date the
- 3 option becomes exercisable, so that at the inception of the lease it is
- 4 reasonably certain that the option will be exercised;
- 5 (c) The lease term is for the major part of the economic life of the asset
- 6 even if title is not transferred;
- 7 (d) At the inception of the lease the present value of the minimum lease
- 8 payments amounts to at least substantially all of the fair value of the
- 9 leased asset;
- 10 (e) The leased assets are of a specialized nature such that only the lessee
- 11 can use them without major modifications being made; and
- 12 (f) The leased assets cannot easily be replaced by another asset.

13 If the lease is not classified as a finance lease, it is considered an operating lease and the  
14 property continues to be reported as an asset by the lessor.

15 *Unbundling/Components (Rights and Obligations) Approach*

16 One aspect that all of the above approaches to reporting infrastructure and public  
17 facilities associated with SCAs have in common is that only one of the parties should  
18 report the underlying property in their financial statements as property, plant and  
19 equipment. An alternative approach may be one in which both parties report a portion of  
20 the underlying property to an SCA based on the allocation of project risks and benefits.  
21 This may have similarities to a 'rights and obligations' approach as sometimes proposed  
22 in accounting journals and other literature, and which is currently a subject of an  
23 IASB/FASB review into possible approaches to a leasing standard replacement. An  
24 unbundling/components approach is suggested in the paper, *Public-Private Partnerships,*  
25 *Government Guarantees, and Fiscal Risk*, prepared by a staff team from the International  
26 Monetary Fund led by Richard Hemming:

27 More important, however, is the question of whether this binary  
28 approach, under which PPP assets are classified either as government  
29 assets or private assets, is an appropriate way of accounting for risk  
30 transfer. The specific concern is that such an approach is insensitive to the  
31 fact that PPPs are intended to share risk according to which party can best  
32 manage it. The fact is that government exposure to PPP risk will vary  
33 widely across projects, and the accounting profession ideally should be  
34 seeking to develop a workable approach to identifying and quantifying the  
35 risk to which the government is exposed under PPPs and for assessing and  
36 disclosing the fiscal consequences of such risk.

1 While that paper acknowledges that this type of approach would be difficult to develop, it  
2 goes on to warn that a binary approach creates the risk that PPPs in which the grantor  
3 bears the larger share of project risk might be discouraged. This is because, in that case,  
4 the grantor would be required to report the property as an asset along with a related  
5 obligation to the operator, which in some circumstances could be an undesirable  
6 accounting result. This could result in arrangements being tailored so that the operator  
7 bears more risk resulting in higher project costs which could impact the operational  
8 efficiency of the arrangement. A control approach that leads to more robust and reliable  
9 conclusions would avoid attempts to tailor the classification and thus these undesirable  
10 outcomes.

11 An approach that could result in both the grantor and the operator reporting a portion of  
12 the underlying property as an asset would also honor the concept that property ownership  
13 is essentially ownership of a “bundle of rights” that in some cases can be separated and  
14 individually transferred. For example, the right to benefit from the use of property  
15 through the collection of rents could be transferred separately from the rest of the rights  
16 of ownership. The conclusions of IFRIC 12 may be interpreted to consider this  
17 possibility in that the operator is to report an intangible asset representing the right to  
18 charge users of the service provided through the underlying property when it does not  
19 have an unconditional contractual right to receive cash or another financial asset from, or  
20 at the direction of, the grantor.

### 21 *Subcommittee Analysis*

22 The existing or proposed guidance on reporting the underlying property to an SCA (or  
23 PPP) discussed above each have a different focus that can result in different reporting  
24 results even with the same set of circumstances. As an example of this fact, under IFRIC  
25 12, the operator should not report the underlying property for any SCA that is within its  
26 scope. However, of the 53.4 billion (UK) capital values of PFI arrangements declared by  
27 the UK Treasury (which are required to be accounted for by grantors using Application  
28 Note F as implemented currently by HM Treasury Technical Note 1 (revised) ‘How to  
29 account for PFI Transactions’ based on Chapter 5 of the UK Government Financial  
30 Reporting Manual), approximately 29.1 billion (UK) is currently off-balance sheet for the

1 grantor<sup>6</sup>, which implies that this property is either reported by the operator, or by neither  
2 party. A 2004 report of the UK Financial Reporting Advisory Board noted that in a  
3 number of cases underlying property to a PFI was not reported as an asset on the balance  
4 sheet of either the grantor or the operator.<sup>7</sup> Even in the case of the UK and Eurostat  
5 approaches, both of which place emphasis on economic risk, the difference in the specific  
6 risks considered, particularly construction risk, can result in different reporting results.  
7 This potential for differing results illustrates the need for a harmonized approach to  
8 reporting the property associated with these arrangements.

9 Despite their differences, the existing and proposed guidance can be grouped into two  
10 different broad approaches to addressing this reporting issue—a control approach and a  
11 risk and rewards approach. While the concepts of control and risk and rewards are not  
12 mutually exclusive, these approaches place emphasis on one concept or the other in  
13 determining the reporting of the underlying property to an SCA. Each of the  
14 aforementioned approaches applies a different aspect of the definition of an asset in  
15 IPSAS 1, *Presentation of Financial Statements*. That Statement defines assets as  
16 “resources controlled by an entity as a result of past events and from which future  
17 economic benefits<sup>8</sup> or service potential are expected to flow to the entity.” The notion of  
18 control over the resources is clearly laid out in the definition. The notion of risk and  
19 rewards is connected to the expected flow of future economic benefits or service potential  
20 because sufficient certainty that future economic benefits or service potential will flow to  
21 an entity is generally considered to exist when there is assurance that the entity will  
22 receive the rewards attaching to the asset and will undertake the associated risks.

23 Based on the definition of an asset in IPSAS 1, for the grantor to report the property  
24 associated with an SCA as an asset, both the aspects of control and future economic  
25 benefit or service potential would need to be achieved. Therefore, both approaches  
26 outlined above should be considered in developing an approach to determine how  
27 grantors should report this property.

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<sup>6</sup> Statistic from Paul Gosling article on [publicfinance.co.uk](http://publicfinance.co.uk) 7/27/07

<sup>7</sup> (7th) Report for the period April 2003 to March 2004 of the UK Financial Reporting Advisory Board to the House of Commons, section 2.3.

<sup>8</sup> As used in this section, the term ‘future economic benefits’ specifically refers to the direct generation of net cash inflows which is consistent with how such term is used in the definition of an asset in IPSAS 1.

1 **Control**

2 Control over the use of the property is the key principle to the conclusion reached in  
3 IFRIC 12 that the operator should not report the underlying property to an SCA that  
4 meets its scope as an asset. IFRIC 12 focuses on control over the operational aspects of  
5 the property—the services that must be provided with the property, to whom the services  
6 must be provided and the rate to be charged for such services—as well as control over  
7 any significant residual interest in the property at the end of the arrangement. Although  
8 based in leasing principles, the proposed South African guidance also indirectly focuses  
9 on control over the property. In their case, it is control over the property at the end of the  
10 term of the arrangement which dictates the reporting of the property. Because this aspect  
11 of control over the property is a subset of the aforementioned IFRIC 12 criteria for  
12 control, the focus of the rest of this section will be on the guidance in IFRIC 12.

13 A basic question to be answered related to control is how control over the use of the  
14 property should be determined. To answer this question, IFRIC 12 cites guidance in  
15 IFRIC 4, *Determining whether an Arrangement contains a Lease*. IFRIC 4 discusses  
16 control over the use of an asset in the context of determining whether an arrangement  
17 contains a lease. IFRIC 4 states that the right to control the use of the underlying asset to  
18 an arrangement is conveyed if any of the following conditions are met:

- 19 • The purchaser (lessee) has the ability or right to operate the asset or direct others  
20 to operate the asset in a manner it determines while obtaining or controlling more  
21 than an insignificant amount of the output or other utility of the asset.
- 22 • The purchaser has the ability or right to control physical access to the underlying  
23 asset while obtaining or controlling more than an insignificant amount of the  
24 output or other utility of the asset.
- 25 • Facts and circumstances indicate that it is remote that one or more parties other  
26 than the purchaser will take more than an insignificant amount of the output or  
27 other utility that will be produced or generated by the asset during the term of the  
28 arrangement, and the price that the purchaser will pay for the output is neither

1 contractually fixed per unit of output nor equal to the current market price per unit  
2 of output as of the time of delivery of the output.

3 It is concluded in IFRIC 12 that for SCAs that meet its scope criteria, the operator would  
4 not control the use of the property based on the IFRIC 4 criteria above, thereby implying  
5 that the grantor would control use of the property. Without control over the use of the  
6 property, the operator cannot report the property as an asset based on the definition of an  
7 asset in the IASB *Framework*.

8 IFRIC 12 also cites IFRIC 4 as justification for not considering the allocation of risk and  
9 rewards in its approach to reporting the underlying property to SCAs. Respondents to the  
10 draft IFRIC 12 questioned how the control approach reconciled with the approach in  
11 International Accounting Standard 17, *Leases*, (which is similar to that in IPSAS 13) in  
12 which the leased asset is recognised by the party that bears substantially all the risks and  
13 rewards incidental to ownership. IFRIC 4 states that an arrangement is a lease if it  
14 conveys the right to control the use of the underlying asset. Because the operator is  
15 deemed not to have control over the use of the property in SCAs that meet the scope of  
16 IFRIC 12, the arrangement would not be a considered a lease, and the operator could not  
17 report a leased asset for the property<sup>9</sup>.

18 In this way, IFRIC 12 concludes that the right to property of an operator in a SCA is  
19 different than that of a lessee in a lease arrangement. Because of the control over the use  
20 of the asset held by the grantor, the operator does not have the same right of use of the  
21 property that a lessee would have. Instead, the operator only has the *access* to operate the  
22 property to provide the public service on behalf of the grantor in accordance with the  
23 terms specified in the contract.

24 Despite the existence of the circumstances laid out in the scope of IFRIC 12, it can be  
25 argued that the operator still has some control over the use of the asset. The operator has  
26 the ability to administer how the property is used within the standards established by the  
27 terms of the arrangement. For example, in an SCA for a roadway, the terms of the  
28 arrangement may specify certain physical conditions that the operator must maintain.

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<sup>9</sup> As illustrated in Information Note 2 of IFRIC 12, it is generally assumed that the grantor owns the underlying property for SCAs that meet the scope of IFRIC 12.

1 Generally, however, the contract will not specify how such conditions must be met,  
2 leaving this to the discretion of the operator. In this way, the question to be answered in  
3 determining the financial reporting of the property is which party has *ultimate control*  
4 over the property having assessed the relative position of the individual parties.

5 The subcommittee believes that the criteria incorporated into the scope of IFRIC 12 are  
6 appropriate to determine whether the grantor has control over the use of the underlying  
7 property to an SCA. The combination of these criteria indicate that the grantor would  
8 have a continuing right to have the property operated to meet its public service objectives  
9 throughout the life of the arrangement and beyond, and that the operator's practical  
10 ability to sell or pledge the property, potentially resulting in a different use for the  
11 property, is restricted. Despite the operator's control over the delivery of certain aspects  
12 of the services generated by the property, the overall use of the property is still limited to  
13 the objective of the grantor set forth in the terms of the arrangement, and key operational  
14 aspects of the property, such as the rates to be charged for usage, are controlled by the  
15 grantor. In this way, the subcommittee concurs that the operator is operating the property  
16 on behalf of the grantor if the control criteria in IFRIC 12 are met. Even if the question  
17 were which party has ultimate control over the property, the subcommittee believes that if  
18 the control criteria are met, that party would be the grantor.

19 As an alternative, it can be argued that the nature of grantor control over property in the  
20 context of an SCA meeting the IFRIC 12 scope is no different than that which a  
21 government often has in its regulatory role of certain industries. This can particularly be  
22 seen as the case when the industry is providing services that otherwise had been provided  
23 by the government. Paragraph 32 of IPSAS 23, *Revenue From Non-Exchange*  
24 *Transactions (Taxes and Transfers)* addresses whether control derived solely from a  
25 government's regulatory role can result in control over assets for purposes of meeting the  
26 definition of an asset for financial reporting purposes as follows:

27           The ability to exclude or regulate the access of others to the benefits  
28           of an asset is an essential element of control that distinguishes an entity's  
29           assets from those public goods that all entities have access to and benefit  
30           from. In the public sector, governments exercise a regulatory role over  
31           certain activities, for example financial institutions or pension funds. This  
32           regulatory role does not necessarily mean that such regulated items meet



1 the definition of an asset of the government, or satisfy the criteria for  
2 recognition as an asset in the general purpose financial statements of the  
3 government that regulates those assets.

4 Furthermore, paragraph 37 of IPSAS 6, *Consolidated and Separate Financial Statements*,  
5 states that regulatory powers do not constitute control for the purposes of financial  
6 reporting. Such paragraph states that the meaning of control for the purposes of IPSAS 6  
7 does not extend to:

8 ...the power of the legislature to establish the regulatory framework  
9 within which entities operate and to impose conditions or sanctions on  
10 their operations. Such power does not constitute control by a public sector  
11 entity of the assets deployed by these entities.

12 Based on this guidance, if the grantor's control over the underlying property through the  
13 SCA agreement is akin to regulatory control, it could be argued that such control alone is  
14 not sufficient for that property to meet the definition of an asset for the purposes of the  
15 grantor's financial reporting.

16 The subcommittee believes that there is a distinction in these two scenarios in that the  
17 IFRIC 12 scope requires that the grantor must control any significant residual interest at  
18 the end of the arrangement. This is not normally the case when the government  
19 establishes rules or restrictions on use of property in a regulatory role. The private sector  
20 owner in this case can normally transfer its property or even choose to use it for another  
21 purpose if it so desires. The subcommittee believes that in most cases there will be a  
22 significant residual interest at the end of an SCA because of the long-lived nature of the  
23 underlying property and the frequent inclusion of a contractual requirement for the  
24 operator to return the asset in a state of good condition. Additionally, the grantor's  
25 control over the underlying property in an SCA is based on a contract willingly entered  
26 into by the operator. It is not established through legislation as contemplated in the  
27 guidance in IPSAS 6.

28 Another argument can be made that the restrictions on the use of the property present in  
29 the IFRIC 12 control criteria can be analogized to stipulations on non-exchange  
30 transactions. For example, a national government may transfer a parcel of land to a  
31 public university with the stipulation that the land be used to build a campus. Under  
32 IPSAS 23, despite the stipulation on the use of the land, the public university in this

1 example (the “user” of the property) would still be considered to have control of the land  
2 and would recognize the land as an asset in its financial statements. The university also  
3 would report a liability if the stipulation was considered a condition, meaning that it  
4 would have to return the land to the donor if it was not used for its intended purpose. It  
5 could appear that the financial reporting results in this example are in conflict to those  
6 discussed above related to control over property in SCAs in which the party imposing the  
7 restrictions on the use of the asset (the grantor) reports the asset and not the user of the  
8 asset (the operator).

9 The key distinction between the transfer example in the preceding paragraph and an SCA  
10 that meets the control criteria in IFRIC 12 is again the aspect of the grantor controlling  
11 any significant residual interest in the underlying asset. Typically, the assets involved in  
12 a transfer arrangement will not revert back to the transferor at the end of a specified  
13 period (in some cases with property, plant and equipment, the transferor will hold a  
14 residual interest in the salvage value of the property, however, this is often expected to be  
15 insignificant). Even for cases in which the stipulation is a condition, the asset only  
16 reverts back to the transferor if the transferee breaches the condition. So long as the  
17 condition is not breached, the asset will remain with the transferee.

18 As discussed previously, IFRIC 12 states that SCAs in which the underlying property is  
19 expected to be used for its entire useful life under the SCA are within its scope if the first  
20 control criterion (control over use during the arrangement) is met. The rationale for this  
21 position is that the property will have been controlled by the grantor for the entire useful  
22 life of the property by the end of the arrangement—therefore, there is no significant  
23 residual interest in the property left to control beyond the end of the term of the  
24 arrangement.

25 As stated above, the subcommittee believes that in most cases a significant residual  
26 interest in the underlying property will exist at the end of an SCA. This is mainly  
27 because of the “state of good condition” requirement referred to above that is frequently  
28 included in SCA contracts. Even in cases where the contract does not require the return  
29 of the property to the grantor in a state of good condition, there are often maintenance  
30 requirements that must be met by the operator throughout the life of the term that would

1 help ensure that the property is in operational condition at the end of the SCA. Given the  
2 core nature of the public services provided through the property, it would seem that such  
3 property would provide future service potential or future economic benefit, and therefore,  
4 have a significant residual interest, if it is in operational condition at the end of the SCA.

5 Despite the above discussion, the subcommittee believes there may be certain SCAs for  
6 which the underlying property is expected to be used for its entire economic life (i.e.  
7 whole-of-life property) and be of no future use to the grantor. For example, an SCA may  
8 involve property used to deliver a service that is not expected to continue to be provided  
9 at the end of the arrangement; or an SCA may require that the operator demolish the  
10 property at the end of the arrangement and return the underlying land in clean fashion.  
11 The subcommittee believes that the grantor in these cases will have controlled the  
12 property throughout its economic life during the arrangement. However, the  
13 subcommittee believes that the grantor must also hold the rights and powers over any  
14 residual interest in the property at the end of the arrangement for the control criteria to be  
15 met. Such rights and powers would allow the grantor to do, for example, any of the  
16 following at the end of the arrangement:

- 17 • Upgrade the property to keep it functioning economically;
- 18 • Sell the property to the operator; while the underlying property to the SCA would  
19 most likely involve a nominal amount, a market price would normally be  
20 expected for any transfer of use of the associated land;
- 21 • Sell the property to a third party for its scrap value, the proceeds from which may  
22 be retained by the grantor or operator based on the contractual terms of the  
23 arrangement;
- 24 • Require the operator to demolish the property and return the underlying land in a  
25 clean fashion; or
- 26 • Use the property for another purpose.

27 Requiring that the grantor hold the rights and powers over any residual interest in the  
28 property for the control criteria to be met would also protect against an underestimation  
29 of the economic life of the property that would result in a significant residual interest in

the property being controlled by the operator while the grantor reported the property as an asset during the term of the SCA.

**Expected Flow of Future Economic Benefits or Service Potential**

Even though the grantor in an SCA may control the use of the underlying property, for that property to meet the definition of an asset in IPSAS 1, as noted above, an expected flow of future economic benefits or service potential for the grantor should result from the property. Because it was concluded in IFRIC 12 that the use of the underlying property to SCAs that meet its scope is not controlled by the operator (thereby precluding it from meeting the definition of an asset for the operator), and IFRIC 12 only covers operator accounting, it does not address the resulting flow of benefits from the property.

As noted above, an expected flow of future economic benefits or service potential can be evidenced through the receipt of the rewards related to the asset and the assumption of the risks associated with the asset. Allocation of risks and rewards is the basis of the approaches to account for the underlying property to SCAs put forth by the UK Accounting Standards Board and Eurostat. It is also the basis for the guidance on reporting leases in IPSAS 13, as noted above.

In the UK guidance, 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. Determining the bearer of the risks described in the Eurostat guidance is also related to their economic impact, with the guidance referring to potential additional payments and impact on operator profit as indicators of the party that bears risk. This focus on the *economic* risk and rewards of the underlying property may be effective in determining whether future economic benefits will flow to an entity from an asset. However, it omits consideration of the service potential aspect of the future benefits that may flow to an entity from an asset.

The service potential aspect of the future benefits that may flow from an asset is the key difference in the definition of an asset in IPSAS 1 and that in the IASB *Framework for the Preparation and Presentation of Financial Statements*, which focuses only on future

1 economic benefits. Paragraph 11 of IPSAS 1 further explains this “service potential”  
2 aspect of the definition of an asset as follows:

3           Assets provide a means for entities to achieve their objectives. Assets  
4           that are used to deliver goods and services in accordance with an entity’s  
5           objectives but which do not directly generate net cash inflows are often  
6           described as embodying “service potential.”

7 For example, a toll-free roadway is considered an asset of a government because it  
8 delivers services used to meet a government’s transportation objectives, despite the fact  
9 that it generates no future economic benefit<sup>10</sup> for the government.

10 Generally, governments enter into SCAs to meet service delivery objectives through the  
11 construction, renovation, or improved operation of the underlying property. In this way,  
12 the underlying property would be providing rewards related to service potential to the  
13 grantor even if it will not provide any future economic benefit. Even if the grantor’s  
14 motivation for entering into the SCA is financial benefit, for example, to receive an  
15 upfront inflow of resources in exchange for the right to operate a roadway, the underlying  
16 property would still be used to meet the government’s objectives—it would just be  
17 operated by the operator—and therefore, would also be providing service potential  
18 rewards to the grantor.

19 Along with rewards associated with service potential that can be achieved by the grantor  
20 through the underlying property to an SCA, there are also risks associated with the  
21 property that are assumed by the grantor. This is because the grantor generally is still  
22 ultimately accountable for the delivery of the service provided through the property.  
23 Therefore, the grantor is accountable for the operation of the property, even though its  
24 operation is being undertaken by the operator. Because of this, and because of the  
25 general perception on the part of the citizenry that the service being provided in an SCA  
26 is a public service, political risk associated with the underlying property remains with the  
27 grantor.

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<sup>10</sup> As used in this section, the term ‘future economic benefits’ specifically refers to the direct generation of net cash inflows which is consistent with how such term is used in the definition of an asset in IPSAS 1.

1 The effects of political risk can be impacted by the effects of the economic risks  
2 discussed above, even when they are borne by the operator. For example, if events  
3 considered in construction risk cause delays in the delivery of the property, or events  
4 occur that limit the availability of the underlying property to users, the grantor's political  
5 risk associated with service delivery will be impacted. Further, if the operator is  
6 negatively impacted by these economic risks to the point where service quality declines,  
7 the political risk of the grantor will be heightened, and in extreme cases, if the operator is  
8 impacted such that it cannot continue to operate the property, the grantor will have to step  
9 in to provide the public service. Thus, it can be viewed that in an ultimate sense the  
10 grantor is always subjected to the economic risks discussed above.

11 The notion of accountability for the services provided through the underlying property to  
12 an SCA is a key distinction. It can be argued that if the grantor maintains accountability  
13 for those services, it will be entitled to the rewards related to the service potential of the  
14 property and it will be subject to the risks that may impact the service potential of the  
15 property (along with any economic risks and rewards that it may be allocated). It can  
16 further be argued that a grantor's accountability for the services provided by the  
17 underlying property can be evidenced by its control over the use of the asset. The reason  
18 why the grantor retains control over aspects of the property, such as operating conditions  
19 and user charges, is because the grantor remains accountable for the provision of the  
20 services provided through the property to the citizenry regardless of the fact that the  
21 operator is actually providing the service on a day-to-day basis.

22 The grantor's ability to control the use of the underlying property, as discussed above,  
23 also secures its ability to benefit from the service potential of the property for the life of  
24 the arrangement and beyond. The ability of the grantor to control how and for whom the  
25 property must be used secures that the property will be operated for public use during the  
26 term of the arrangement. The grantor's control over any significant residual interest at  
27 the end of the arrangement secures the opportunity for the property to continue to be  
28 available for public use after the arrangement ends.

29 Therefore, if the grantor retains control over the use the underlying property to an SCA, it  
30 can be argued that it is accountable for that property and the services provided using the

1 property. This accountability would subject the grantor to the risks associated with the  
2 property related to service delivery and allow it to obtain the rewards related to the  
3 achievement of its service objectives. This flow of future service potential benefits when  
4 combined with control over the use of the property would appear to result in the property  
5 being an asset to be reported by the grantor.

6 An approach to grantor reporting of the underlying property to an SCA that is solely  
7 based on economic risks and rewards does not consider the service delivery function of a  
8 public entity and the future service potential aspect of the definition of an asset in IPSAS

9 1. Consider a toll-free roadway that is reported as an asset by a grantor based on its  
10 service potential. That roadway becomes the subject of a service concession arrangement  
11 where the operator is granted the right to charge tolls to users of the roadway in exchange  
12 for taking responsibility for making renovations and operating the roadway to the  
13 specifications of the grantor. If the grantor has control over the use of that roadway by  
14 the terms of the agreement, the roadway would appear to provide the same service  
15 potential benefits for the grantor that it did prior to the execution of the SCA. This is in  
16 spite of the fact that the grantor has transferred the economic risk and reward of the  
17 roadway to the operator. It can be argued, therefore, that the roadway should continue to  
18 be reported as an asset of the grantor because the basis for reporting it as an asset in the  
19 first instance has not changed, that is, it is an asset of the grantor based on its service  
20 potential.

21 An argument can be made, however, that ignoring the economic risks and rewards that  
22 may be assumed by the operator through the SCA when determining the reporting of the  
23 property is flawed similarly to ignoring the risks and rewards associated with service  
24 potential borne by the grantor. Consistent with the concept discussed above, when the  
25 grantor controls the property, the operator is essentially operating the property on behalf  
26 of the grantor, and in this way, is a service provider for the grantor. The economic risks  
27 and rewards assumed by the operator through the SCA can be analogized to those that a  
28 vendor in a service contract would assume. These would be different from the risks and  
29 rewards associated with ownership of the property, and therefore, would not be factored  
30 into the determination of reporting the property.

***Subcommittee Proposal***

The subcommittee proposes that a control approach be adopted for determining the grantor reporting of the underlying property to an SCA. Under this approach, if the grantor is determined to control the use of the underlying property to the SCA, then the grantor would report the property as an asset in its financial statements. The criteria for determining grantor control would be consistent with the scope requirements for arrangements covered under IFRIC 12, which are as follows:

- 1) The grantor controls or regulates what services the operator must provide with the associated property, to whom it must provide them, and the price range or rate that can be charged for services; and
- 2) The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the property at the end of the arrangement.

Regulation in the first criterion is restricted to arrangements agreed upon by the grantor and the operator and to which both parties are bound. It excludes generally legislated regulation that does not establish control for the purposes of financial reporting as concluded in IPSAS 6 and IPSAS 23. If the underlying property to an SCA is expected to be used for its entire useful life during the term of the SCA, the control criteria is considered to be met if the grantor holds the rights and powers over any residual interest in the property at the end of the arrangement, and the first criterion above is met.

In addition to the approaches discussed above, the subcommittee did consider a potential approach that would result in both the grantor and the operator reporting an asset representing the property. The amount of the asset would be based on their respective shares of the risk and rewards related to the property. While the subcommittee believes such an approach could have conceptual merit, it also believes that the complexity of quantifying the risk and rewards assumed by each party to determine the value of the asset would make such an approach difficult to apply. Such an approach would also necessitate the application of significant judgment in deriving such quantification, which could result in inconsistencies in application. Therefore, the subcommittee chose not to pursue such an approach further.



1 The accounting and financing reporting for the underlying property to SCAs in which the  
2 proposed control criteria is not met is covered in the next section of the paper.

3 As noted above, the proposal of the subcommittee is based in large part on the current  
4 definition of an asset in IPSAS 1. Definition of elements of financial statements is a  
5 component of IPSASB's current project to develop a public sector conceptual framework  
6 that would be applicable to the preparation and presentation of general purpose financial  
7 statements. The conceptual conclusions drawn regarding the definition of elements of  
8 financial statements as part of that project may impact the aforementioned proposals of  
9 the subcommittee related to the reporting of the underlying property to an SCA.

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**ANCILLARY ACCOUNTING ISSUES ASSOCIATED WITH  
PROPERTY**

**Grantor Financial Reporting When the Proposed Control Criteria is Met**

If it is determined that the grantor should report the underlying property to an SCA as an asset in its financial statements based on the proposed control criteria, issues related to timing of recognition and measurement of the property and related liability must be addressed. These issues largely arise when the SCA involves the construction of the underlying property.

***Timing of Recognition***

The first step for a grantor reporting the property associated with an SCA that involves construction of the property is determining the timing of recognition of the property as an asset—specifically, whether the property should be reported as an asset by the grantor while under construction, or whether it should be recognized only when it becomes in place and operational. Of the existing or proposed SCA guidance discussed above, only the guidance of the UK Accounting Standards Board directly addresses this issue. Such guidance provides that the grantor should report the asset when it comes into use, unless the grantor bears significant construction risk, in which case the property would be reported as an asset as constructed.

IPSAS 17 requires that an item of property, plant and equipment be recognized as an asset when:

(a) It is probable that future economic benefits or service potential associated with the asset will flow to the entity; and

(b) The cost or fair value of the asset to the entity can be measured reliably.

[Paragraph 14]

The focus of determining when to recognize the construction in an SCA as an asset using this guidance is the first criterion above. To determine whether this criterion is met, the degree of certainty attaching to the flow of future economic resources or service potential generally should be assessed on the basis of the available evidence at the time of initial recognition. Existence of sufficient certainty that the flow of future economic benefits or

1 service potential will flow to an entity typically necessitates an assurance that the entity  
2 will receive the rewards attaching to the asset and will undertake the associated risks.  
3 This assurance is usually only available when the risks and rewards have passed to the  
4 entity. Before this occurs, the transaction to acquire the asset can usually be canceled  
5 without significant penalty, which would preclude associated risks and rewards from  
6 passing to the entity.

7 The guidance in IPSAS 17 for determining when property, plant and equipment should be  
8 recognized, and the practical application of such guidance described in the preceding  
9 paragraph, would appear to be appropriate for determining when the grantor should  
10 recognize the underlying property to an SCA. For SCAs in which the grantor bears  
11 construction risk, for example, arrangements that involve geological or environmental  
12 factors that result in the level of construction risk being greater than the operator is  
13 willing to accept, it would seem clear that application of this guidance would result in the  
14 grantor recognizing the property as an asset as it is being constructed. This is because  
15 risk associated with the property has passed to the grantor prior to the completion of  
16 construction.

17 For SCAs in which the operator bears construction risk, the timing of recognition is not  
18 as clear. As construction risk remains with the operator and the asset is not yet in use, the  
19 risks and rewards associated with the property have arguably not yet passed to the  
20 grantor. As noted above, this is usually considered necessary for it to be deemed probable  
21 that future economic benefits or service potential will flow to the entity. However, the  
22 terms of an SCA contract often will prohibit either party to cancel the transaction without  
23 significant penalty. Thus, the execution of the SCA contract may provide evidence of the  
24 sufficient certainty of the flow of future economic benefits or service potential associated  
25 with the property to the grantor prior to the passage of risks and rewards (that is, while  
26 the property is under construction). This determination, however, would ultimately be a  
27 matter of professional judgment.

28 Although the focus of determining when to recognize the construction in an SCA as an  
29 asset may be the probability of future economic benefits or service potential flowing to  
30 the entity, the ability to reliably measure the asset (criterion (b) above) must also be

1 considered. For some SCAs, the grantor may be unable to estimate a percentage of  
2 construction completion that would allow for a reliable measurement of the value of the  
3 construction in-progress as of the reporting date. In this case, under IPSAS 17, the  
4 grantor should not report the construction-in-process as a property, plant and equipment  
5 asset until a reliable measurement can be made. In some instances this may not occur  
6 until construction is completed.

7 ***Measurement of the Property and Related Liability***

8 Once the timing of recognition by the grantor is determined, the initial measurement of  
9 the asset reflecting the property and the related liability reflecting the obligation to pay  
10 the operator for constructing such property upon recognition must be determined.  
11 Measurement of the asset and liability subsequent to initial recognition must also be  
12 addressed. The circumstances of the SCA may influence these measurements as  
13 discussed below.

14 **Separable Payments**

15 For SCAs in which the grantor is making regularly scheduled payments over the life of  
16 the arrangement and the portions of those payments related to the construction (or  
17 acquisition) of the property can be separated from those related to the service element of  
18 the SCA based on the terms of the contract or other information, measurement of the  
19 asset and related liability can be determined similarly to the guidance for finance leases in  
20 IPSAS 13. That is, the asset and related liability could be recognised at amounts equal to  
21 the fair value of the property, or, if lower, at the present value of the scheduled  
22 construction payments<sup>11</sup>. After the asset is measured upon recognition, it would be  
23 subject to the guidance in IPSAS 17 for subsequent measurements (e.g. depreciation,  
24 impairment and subsequent measurement using the cost model or the revaluation model).  
25 The construction element of the scheduled payments would be allocated between the  
26 imputed finance charge and the reduction of the outstanding liability. The service

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<sup>11</sup> If the scheduled construction payments are based on contingencies, for example, minimum fixed payments with increases based on availability of the property, the calculation of the present value of scheduled construction payments should consider the expected level of payments.

1 element of the scheduled payments would be expensed as incurred, that is, as the  
2 economic benefits of the service are rendered.

3 While reporting the property in a manner similar to a finance lease in IPSAS 13 may  
4 appear readily appropriate, a potential alternative approach may be suggested for  
5 reporting the liability. This liability would appear to meet the definition of a financial  
6 liability in IPSAS 15, *Financial Instruments: Presentation and Disclosure* because it is a  
7 contractual obligation to deliver cash or another financial asset to another entity. IPSAS  
8 15 only addresses presentation and disclosure related to financial liabilities. However,  
9 IAS 39, *Financial Instruments: Recognition and Measurement* provides guidance on the  
10 recognition and measurement of financial liabilities. IAS 39 requires that upon initial  
11 recognition, financial liabilities should be measured at their fair value. After initial  
12 recognition, IAS 39 requires financial liabilities to be measured at amortized cost using  
13 the effective interest method, except for financial liabilities at fair value through profit or  
14 loss, which are generally measured at fair value, and financial guarantee contracts and  
15 commitments to provide a loan with a below-market interest rate, which are generally  
16 measured at the higher of the amount of the initial measurement and the amount that  
17 would be reported under the provisions of IAS 37, *Provisions, Contingent Liabilities and*  
18 *Contingent Assets*. The application of the guidance in IAS 39 for the measurement of  
19 the liability associated with SCAs could perhaps result in a different treatment than  
20 applying the guidance in IPSAS 13 for liabilities related to finance leases.

21 In comparing the guidance in IAS 39 for financial liabilities and that in IPSAS 13 for  
22 liabilities related to finance leases, it would appear that the amount at which the liability  
23 associated with an SCA would initially be recognised is similar, that is, the fair value of  
24 the property, or if lower, the present value of the scheduled payments. This is because  
25 this amount could be viewed as the “price” of the transaction which would be the basis  
26 for the fair value of the liability at the execution of the SCA. The general requirement in  
27 IAS 39 to make subsequent measurements of financial liabilities at amortized cost using  
28 the effective interest method would also appear to garner the same result as would a  
29 treatment similar to IPSAS 13. A difference could result, however, if the financial  
30 liability met one of the exceptions to measurement at amortized cost discussed above.

1 The liability related to future cash payments to be made for property acquired through an  
2 SCA would clearly not be considered a financial guarantee contract or a commitment to  
3 provide a loan at a below-market interest rate. The subcommittee also believes that these  
4 liabilities would generally not meet the conditions required to be considered a financial  
5 liability at fair value through profit or loss present in paragraph 9 of IAS 39. Therefore,  
6 these liabilities generally would be measured subsequent to initial recognition at  
7 amortized cost. The subcommittee believes this would result in essentially the same  
8 treatment as that under IPSAS 13 for liabilities related to finance leases. The  
9 subcommittee does believe that these liabilities meet the definition of a financial liability.  
10 Therefore, they would be subject to the disclosure requirements of IPSAS 15.

### 11 **Inseparable Payments**

12 Unlike the scenario described above, for many SCAs the construction and service  
13 elements of the scheduled payments are not readily separable. In this case, the  
14 construction and service elements of the scheduled payments will need to be estimated.  
15 One method to make this estimation is based on the fair value of the property. This  
16 method is utilized in the PPP guidance issued by the UK Accounting Standards Board  
17 which states that the initial amount recorded for the asset and related liability should be  
18 the fair value of the property. When the scheduled payments are made in subsequent  
19 years, a portion of the payment would be attributed to repaying the liability, another  
20 portion would be reported as an imputed finance charge on the property, and the  
21 remainder of the payment would be reported as an operating cost reflecting the service  
22 element of the payment. This method is similar to that prescribed in IFRIC 4 for  
23 separating payments for a lease from other payments related to the arrangement.

24 The guidance on PPPs proposed by the Accounting Standards Board of South Africa is  
25 also similar in this area with the exception that it does not take an imputed financing  
26 charge into account. That proposed guidance provides an example in which an entity  
27 enters into a 10-year PPP agreement in which the operator will construct a building from  
28 which a service will be delivered. An annual payment of 1.5 million currency units is  
29 made by the grantor to the operator covering both the construction and service elements,  
30 and the fair value of the building at the inception of the arrangement is 12 million

1 currency units. Ownership of the property will be with the grantor at the end of the  
2 arrangement. Under the South African proposal, the asset and offsetting liability would  
3 be the 12 million currency units. Based on the fair value of the asset, the example goes  
4 on to illustrate that the portion of the annual payment related to the construction element  
5 is 1.2 million currency units (15 million units divided by the 10 year term) with the  
6 remaining 0.3 currency units considered the service portion of the annual payment, and  
7 therefore, expensed as incurred.

8 The subcommittee believes that using the fair value of the property as the initial  
9 measurement of the asset and related liability is the best approach in cases where the  
10 construction element of the scheduled future payments cannot be separated from the  
11 service element. This is consistent with the guidance prescribed in IPSAS 17 for another  
12 circumstance when there is no discernable “historical cost” to use for the initial  
13 measurement of property, plant and equipment—the acquisition of property, plant and  
14 equipment at no cost, or for a nominal cost. It is also analogous with the guidance for  
15 reporting assets and liabilities associated with finance leases in IPSAS 13.

16 The subcommittee also concurs with the approach put forth in the UK guidance on PPPs  
17 in allocating the scheduled payments between amounts that reduce the liability associated  
18 with the asset, imputed finance charges, and charges for services provided by the operator  
19 as the remainder of the payment. The subcommittee believes that it is important to reflect  
20 the financing aspect of these transactions in the financial statements through the imputed  
21 finance charge. This raises the question, however, of what rate to use to impute the  
22 finance charge. The UK guidance states that a rate that reflects the operator’s expected  
23 return on the property (a “property-specific” rate) should be used. In contrast, IPSAS 13  
24 states that the incremental borrowing rate of the lessee (which in this context is similar to  
25 the grantor) should be used to discount minimum lease payments if the interest rate  
26 implicit in the lease cannot be determined. The subcommittee believes by transferring  
27 financing risk to the operator, the grantor has subjected itself to the operator’s cost of  
28 raising capital through borrowings or equity contributions. It is this cost of capital that  
29 will be considered when arriving at the payments to be made by the grantor as part of the  
30 arrangement. Therefore, the subcommittee believes that an estimate of the operator’s

1 cost of capital specific to the SCA should be used to determine the imputed finance  
2 charges.

### 3 **Arrangements Involving Reduced or Eliminated Grantor Payments**

4 Another reporting issue arises with SCAs involving the construction of property in which  
5 the operator will be collecting usage fees from third-parties. Often these usage fees are  
6 expected to cover all, or at least a majority, of the operator's costs of construction,  
7 financing and service provision, as well as their expected rate of return. In these cases,  
8 the grantor's obligation to make payments to the operator are greatly reduced or  
9 eliminated, and in some cases, the grantor may even *receive* an inflow of resources from  
10 the operator.

11 To determine how to report the property and related liability in these instances, the  
12 exchange embodied in the transaction must be examined. The grantor is receiving the  
13 construction of the underlying property from the operator. In exchange, the operator is  
14 receiving access to the underlying property once it is operational to provide services to  
15 fee-paying users. Cash also may potentially be provided by either party. For purposes of  
16 measuring the property for financial reporting, this exchange can be viewed similarly to  
17 an exchange of non-monetary assets covered in IPSAS 17, which states:

18           One or more items of property, plant and equipment may be acquired  
19           in exchange for a non-monetary asset or assets, or a combination of  
20           monetary and non-monetary assets. The following discussion refers  
21           simply to an exchange of one non-monetary asset for another, but it also  
22           applies to all exchanges described in the preceding sentence. The cost of  
23           such an item of property, plant and equipment is measured at fair value  
24           unless (a) the exchange transaction lacks commercial substance or (b) the  
25           fair value of neither the asset received nor the asset given up is reliably  
26           measurable. The acquired item is measured in this way even if an entity  
27           cannot immediately derecognize the asset given up. If the acquired item is  
28           not measured at fair value, its cost is measured at the carrying amount of  
29           the asset given up [Paragraph 38]

30 Therefore, the subcommittee believes that the grantor should report the property at its fair  
31 value. A related liability of that amount, adjusted for cash received or paid (or to be paid  
32 in the future) by the grantor, reflecting unearned revenue (also referred to as deferred  
33 income in some jurisdictions) would also be reported. This liability would reflect



1 unearned revenue because the grantor is receiving an inflow of resources in the form of  
2 the property, net of cash received, paid or to be paid without having delivered on its  
3 portion of the exchange, which is the provision of access to the property (see section on  
4 Arrangements Involving Existing Property below for a discussion as to whether the  
5 granting of this access should result in a reduction in the carrying value of the property in  
6 the financial statements). This unearned revenue would be recognized as revenue over  
7 the life of the SCA as access to the property is provided by the grantor (see section on  
8 Inflows of Resources from a Service Concession Arrangement for more detail on  
9 amortizing upfront inflows of resources).

10 The exchange for the service element of an SCA where the operator collects usage fees  
11 from third-party users is between the operator and the third-party user. Therefore, the  
12 grantor would not report this aspect of the arrangement in its financial statements.  
13 However, the grantor would be reporting revenue as it provides the operator with access  
14 to the property as discussed in the paragraph above.

15 In some instances, the future cash payments to be made by the grantor to the operator as  
16 part of an SCA also may be reduced or eliminated by the provision of non-cash  
17 compensation to the operator. This non-cash compensation is most often provided  
18 through the letting of grantor-owned land to the operator (often adjacent to the property  
19 underlying the SCA) for a nominal amount. The operator typically develops such land  
20 for its own profit, for example, through the construction of retail space.

21 The reporting of the underlying property to the SCA and unearned revenue in these  
22 circumstances would be similar to that described above for SCAs in which the operator is  
23 compensated through the collection of third-party revenues. The unearned revenue in  
24 this case, however, would be recognized as revenue over the period that the nominal rent  
25 is being charged to the operator, as opposed to the life of the SCA, and this revenue  
26 would reflect rental revenue for the rights to the additional land.

27 ***Arrangements Involving Existing Property of the Grantor***

28 Generally, for SCAs involving existing property that the grantor is already reporting as an  
29 asset, no additional accounting associated with the property would need to be done at the

1 execution of the SCA. Financial reporting considerations for other aspects of those types  
2 of arrangements, including guarantees and the receipt of upfront inflows of resources, are  
3 discussed later in this paper.

4 It can be argued, however, that the grantor has relinquished an aspect of its rights of  
5 ownership in the existing property to the operator through the SCA (that is, the right to  
6 charge for usage of the property). Therefore, the carrying value of the property could be  
7 reduced to reflect this fact (assuming the property is reported at historical cost as opposed  
8 to fair value under the revaluation approach in IPSAS 17). While the ability of the  
9 grantor to charge third parties for usage may be limited by the execution of the SCA,  
10 thereby impacting potential future cash flows to be generated from the property, the  
11 subcommittee believes the service potential of the property is not impacted by this  
12 limitation. In IPSAS 21, *Impairment of Non-Cash-Generating Assets*, the present value  
13 of remaining service potential of the asset (termed “value in use”) is one of the key  
14 measurements to determining whether a non-cash-generating asset is impaired resulting  
15 in a reduction in the carrying value of the asset. Under IPSAS 21, if the value in use of  
16 the asset exceeds the carrying value of the asset, then no reduction in the carrying value  
17 should be recorded. Although an SCA is not an impairment circumstance, the  
18 subcommittee believes this principle can be applied to conclude that because there is no  
19 reduction in service potential of the property through granting the operator to collect fees  
20 from users of the property, the value of the property in the financial statements should not  
21 be reduced.

### 22 ***Additional Application of IPSAS 17***

23 For other aspects of reporting the underlying property to an SCA beyond recognition and  
24 initial measurement, including reporting subsequent expenditure related to the property,  
25 measurement subsequent to initial recognition, and financial statement note disclosures,  
26 the guidance in IPSAS 17 should be applied, as appropriate.

### 27 ***Subcommittee Proposals***

28 For SCAs in which the proposed control criteria is met, the subcommittee proposes that  
29 the criteria for recognition of property, plant and equipment present in IPSAS 17 should  
30 be used to determine the point at which the property should be recognized as an asset (for

1 example, during construction or once in place and operational). The subcommittee  
2 expects that the recognition criteria will often be met during construction if the value of  
3 the construction-in-progress can be reliably measured, because of construction risk being  
4 borne by the grantor or because the terms of the arrangement prohibit either party from  
5 canceling the arrangement without significant penalty.

6 The subcommittee also proposes that for SCAs in which the construction element and  
7 service element of the scheduled payments made by the grantor can be separated, the  
8 property and related liability should be reported at the fair value of the property, or if  
9 lower, the present value of the payments related to construction. Subsequent to initial  
10 recognition, the property should be measured following the guidance in IPSAS 17 (e.g.  
11 depreciation, impairment and subsequent measurement using the cost model or the  
12 revaluation model). The liability should be measured similar to a liability resulting from  
13 a finance lease subsequent to initial recognition and should be considered a financial  
14 liability for reporting purposes. The service elements of these payments would be  
15 expensed as incurred.

16 If these payments are not separable, the subcommittee proposes that the property be  
17 reported at its fair value along with the related liability. The scheduled payments on the  
18 SCA, if applicable, should be allocated between repayment of the liability, an imputed  
19 finance charge (based on the operator's cost of capital specific to the SCA) and operating  
20 costs to reflect the service element of the SCA. Measurement and reporting of the  
21 property and related liability subsequent to initial recognition should be similar to that for  
22 arrangements in which the payments are separable as described above.

23 For SCAs in which the cash payments made by the grantor to the operator for  
24 construction of the property are reduced or eliminated because the operator is collecting  
25 third-party fees or receiving other non-cash compensation from the grantor (typically  
26 through the letting of additional land for a nominal rent amount), the subcommittee  
27 proposes that the underlying property to the arrangement should be reported by the  
28 grantor at its fair value. A related liability reflecting unearned revenue (also referred to  
29 as deferred income in some jurisdictions) should be initially reported for the same  
30 amount, adjusted for cash received or paid (or to be paid) by the grantor. This unearned

revenue should be recognized as revenue generally over the life of the SCA as more fully described in the section on Inflows of Resources from a Service Concession Arrangement below.

**Grantor Financial Reporting When the Proposed Control Criteria is Not Met**

If the proposed control criteria are not met for an SCA, then the accounting and financial reporting of the underlying property will depend on the facts and circumstances of the arrangement. A number of factors may impact the reporting, including:

- Which, if any, of the proposed control criteria are met;
- Whether the underlying property exists and is reported by the grantor prior to the execution of the arrangement or whether the property will be newly constructed; and
- Which party legally owns the property during the arrangement.

A number of scenarios in which the proposed control criteria are not met are analyzed below. A decision tree illustrating these scenarios and the related subcommittee proposals are included in Appendix A.

***Arrangements For Which Neither of the Control Criteria Are Met***

If neither of the proposed control criteria are met in an SCA arrangement, it would appear clear that the grantor should not report the underlying property as an asset. Instead, any payments made by the grantor to the operator would be expensed as incurred (that is, as the economic benefits of the arrangement are rendered), similar to a service contract. If the underlying property exists at the time of execution of the SCA and is reported by the grantor, it would appear that the asset reflecting such property should be derecognized. This circumstance would be similar to a disposal of the property, which is one of the instances identified in IPSAS 17 that would result in derecognition of property, plant and equipment.

*Arrangements For Which Only the Control over Use Criterion is Met<sup>12</sup>*

The subcommittee believes that most SCAs for which the grantor controls the use of the underlying property during the arrangement, but does not control the significant residual interest expected at the end of the arrangement are structured as a BOO arrangement—the operator builds, owns and operates the underlying property without transfer to the grantor at the end of the arrangement. This type of arrangement would not meet the proposed control criteria that would result in the grantor reporting the underlying property as an asset. However, an argument can be made that the arrangement could still meet the criteria for a finance lease. In this circumstance, the grantor would recognize the property as an asset under IPSAS 13 as set out below.

Paragraph 13 of IPSAS 13 provides the following examples of situations which would normally lead to a lease being classified as a finance lease (for purposes of this discussion, the grantor is assumed to be the lessee and the operator to be the lessor):

- (a) The lease transfers ownership of the asset to the lessee by the end of the lease term;
- (b) The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, so that at the inception of the lease it is reasonably certain that the option will be exercised;
- (c) The lease term is for the major part of the economic life of the asset even if title is not transferred;
- (d) At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;
- (e) The leased assets are of a specialized nature such that only the lessee can use them without major modifications being made; and
- (f) The leased assets cannot be replaced by another asset.

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<sup>12</sup> The guidance in this section relates to SCAs for which a significant residual interest in the underlying property will exist at the end of its term. Guidance for SCAs for which there will not be a significant residual interest in the underlying property at the end of its term because the property has been used for its entire economic life is discussed in a previous section of the paper.

1 It is possible for the terms of an SCA to be such that certain of the above circumstances  
2 could be met. However, a fundamental question that must first be addressed is whether  
3 an SCA should be considered a lease, or be subject to leasing guidance, for financial  
4 reporting purposes.

5 IPSAS 13 defines a lease as “an agreement whereby the lessor conveys to the lessee in  
6 return for a payment or series of payments the right to use an asset for an agreed period of  
7 time.” Common examples are the leasing of the use of office space in a building or the  
8 leasing of the use of a piece of equipment. The lessor owns the building or equipment  
9 and provides the right to use such property to the lessee in exchange for a payment or  
10 series of payments. Also, while not formally adopted through an IPSAS, IFRIC 4 further  
11 describes the right to use property in the context of the right to control the use of the  
12 property, and provides criteria for determining whether such right has been conveyed (the  
13 specific criteria are listed in the Subcommittee Analysis of the Financial Reporting of  
14 Infrastructure and Public Facilities section of the paper).

15 The subcommittee believes that BOO arrangements in which the grantor controls the use  
16 of the underlying property would often meet the definition of a lease. The operator’s  
17 ownership of the property and the grantor’s control over the use of the property would  
18 indicate that the arrangement involves the conveyance of the right to use an asset, as  
19 described in IFRIC 4, for an agreed period of time. These arrangements will also often  
20 involve the grantor making payments to the operator for the right to use the underlying  
21 property. If the BOO arrangement does meet the definition of a lease, then the guidance  
22 on determining whether a lease is a finance lease or an operating lease should be  
23 followed to determine the reporting of the underlying property.

24 An SCA involving existing property reported by the grantor as an asset in which the  
25 grantor transfers ownership of the property to the operator, but maintains control over the  
26 use of the asset, is similar to a BOO arrangement described above, except in this case,  
27 instead of building the asset, the operator is “buying” the asset from the grantor. This  
28 type of arrangement would appear to be similar to a sale-leaseback arrangement,  
29 assuming the “leaseback” portion of the arrangement meets the definition of a lease as  
30 contemplated above. If this is the case, the guidance in IPSAS 13 for sale-leaseback

1 transactions and for determining whether a lease is a finance lease or an operating lease  
2 should be followed by the grantor.

3 In the case of an SCA involving existing property reported by the grantor as an asset over  
4 which the grantor retains ownership and control over use during the arrangement, but the  
5 property transfers to the operator upon termination of the agreement, the definition of a  
6 lease would not appear to be met because there is no conveyance of the right to use an  
7 asset—the grantor owns and controls the use of the asset. Therefore, it would appear that  
8 the grantor should continue to report the property during the life of the arrangement.  
9 Upon the end of the arrangement, the remaining carrying value of the property would be  
10 derecognized, reflecting the transfer to the operator.

11 ***Arrangements For Which Only the Control over Significant Residual Interest***  
12 ***Criterion is Met***

13 The central financial reporting issue for SCAs in which only the control over significant  
14 residual interest criterion is met is when and how the underlying property should be  
15 recognized in the financial statements of the grantor. This is an issue because the amount  
16 the grantor is required to pay (including zero) upon the reversion of the property at the  
17 end of the arrangement will often not equal the expectation at inception of the fair market  
18 value of the property at the end of the arrangement. Determination of the appropriate  
19 reporting treatment in this case may also depend on whether the underlying property is  
20 being newly constructed or whether it already exists and is being reported by the grantor  
21 as an asset prior to the arrangement.

22 The subcommittee believes that SCAs with these circumstances for which the underlying  
23 property is being newly constructed will most often be structured as a BOOT  
24 arrangement—the operator will build, own and operate the property and then transfer  
25 ownership of the property to the grantor at the end of the arrangement. One approach to  
26 reporting the reversion of the property in such an arrangement is to consider a portion of  
27 the payments made by the grantor to the operator during the SCA to represent the  
28 difference between the expected fair value of the underlying property at termination and  
29 the specified amount to be paid by the grantor upon reversion. This portion of the  
30 payments would be accumulated in the financial statements as an asset, similar to a

1 prepaid item, so that when combined with the actual final payment, the amount reflects  
2 the fair value of the property. For example, if it was expected that the fair value of the  
3 associated property would be 20 currency units at the end of a 20-year arrangement, and  
4 the grantor was not required to pay for the property at the end of the arrangement, the 20  
5 currency units would be accumulated from the payments made over the life of the  
6 arrangement. This would be consistent with the guidance of Application Note F of the  
7 UK Accounting Standards Board. Specifically, Application Note F states the following:

8           Where the contract specifies the amount (including zero) at which the  
9           property will be transferred to the purchaser [grantor] at the end of the  
10          contract, the specified amount will not necessarily correspond with the  
11          expected fair value of the residual estimated at the start of the contract.  
12          Any difference must be built up over the life of the contract in order to  
13          ensure a proper allocation of payments made between the cost of services  
14          under the contract and the acquisition of the residual. At the end of the  
15          contract, the accumulated balance (whether positive or negative), together  
16          with any final payment, should exactly match the originally estimated fair  
17          value of the residual. [Paragraph F56]

18 Another potential approach is to record the present value of the difference between the  
19 amount to be paid by the grantor to acquire the asset and the expected fair value of the  
20 underlying property at termination as an asset at the beginning of the arrangement.  
21 Contribution revenue would be reported along with the asset. The fair value of this asset  
22 would be adjusted to reflect the passage of time (interest) and any change to the  
23 expectation of fair value. This approach can also be altered to have the contribution  
24 revenue reported at the end of the arrangement when the underlying property reverts back  
25 to the grantor. A final approach to this issue would be to report the property at the actual  
26 amount paid at the end of the arrangement instead of reporting it at its fair value. This  
27 could be seen as consistent with the provisions of IPSAS 17 which require initial  
28 measurement of property, plant and equipment to be at historical cost.

29 The subcommittee believes that building the difference between the expected fair value  
30 of the underlying property at the termination of the SCA and the amount to be paid by the  
31 grantor upon reversion as an asset over the life of the arrangement is the most faithful  
32 representation of the economics of the transaction. The subcommittee believes it would  
33 normally be the intention of the operator to receive fair value for the property at the end



1 of the arrangement. If the expected fair value amount is not to be paid by the grantor at  
2 the end of the arrangement, it is likely any difference has been incorporated into the  
3 payments made during the arrangement. Thus, such payments reflect a service element  
4 and an element representing the “purchase” of the property. Therefore, the subcommittee  
5 believes that the grantor is “prepaying” for the property and should be reporting an asset  
6 for such prepayment. Also, as suggested by Application Note F, such an approach would  
7 result in the appropriate allocation of service expense associated with the arrangement.

8 The scenario of an arrangement in which the grantor does not control the use of the asset  
9 during the arrangement but receives the asset at the end of the arrangement is made more  
10 complicated when the underlying property exists and is reported by the grantor as an  
11 asset prior to execution of the SCA. The subcommittee believes in most of these  
12 situations, the grantor would retain ownership of the property during the arrangement, but  
13 control over its use would fall to the operator through the terms of the arrangement. In  
14 most cases, the operator would provide services to third-parties, which may be paid for  
15 either directly by the third-party or by the grantor on their behalf. In these cases,  
16 treatment of the asset reported by the grantor upon execution of the arrangement must be  
17 determined—in other words, whether or not the asset should be derecognized—along  
18 with the treatment of the residual interest at reversion.

19 Paragraph 82 of IPSAS 17 states that the carrying amount of an item of property, plant  
20 and equipment shall be derecognized (a) on disposal; or (b) when no future economic  
21 benefits or service potential is expected from its use or disposal. It can be argued that the  
22 grantor has disposed of the property because it no longer controls its use, and item (a)  
23 referenced above would be met. Following this argument, it would then need to be  
24 determined whether the entire asset should be derecognized, and how the derecognition  
25 should be reported in the financial statements.

26 It might initially be clear that if a derecognition approach is applied for the above  
27 scenario, the entire carrying value of the property should be removed from the financial  
28 statements upon execution of the arrangement. However, this leaves the reporting of the  
29 reversion of the asset in question. It may be appropriate to leave some value in the  
30 financial statements reflecting the future return of the property. This could be reported at

1 the expected fair value of the property at the end of the arrangement. This obligation of  
2 the operator would exist at the execution of the arrangement and the grantor would  
3 generally not be required to perform to be entitled to reversion. Therefore, it appears this  
4 would be a recognizable asset upon the execution of the arrangement. The resulting net  
5 amount of assets to be derecognized would be the difference between the carrying value  
6 of the property at the execution of the SCA and the expected fair value of the property at  
7 reversion. Because the transaction would be considered the disposal of an asset, this net  
8 derecognition amount, adjusted for any cash paid or to be paid by the operator would be  
9 reported as a gain or loss upon execution of the arrangement.

10 Another approach to this circumstance is to apply the leasing guidance in IPSAS 13 to  
11 this arrangement. Conversely to the above discussion of an SCA meeting the definition  
12 of a lease, in this case, the grantor would be considered to be conveying the right to use  
13 the property to the operator. Therefore, the grantor would be considered the lessor and  
14 the operator would be considered the lessee. Many of these types of arrangements will  
15 involve the operator making a payment(s) to the grantor for the right to use the asset (any  
16 payments made by the grantor to the operator would be for the consumption of services,  
17 either for itself or on behalf of third-parties, and would not impact the reporting of the  
18 property). If the leasing guidance were followed, the key determination to be made  
19 related to derecognition is whether the arrangement would be considered a finance lease  
20 or an operating lease. If considered a finance lease, the grantor would no longer report  
21 the property as an asset. Instead, it would report its gross investment in the lease as a  
22 receivable, which would include the expected residual value of the property upon  
23 reversion. If considered an operating lease, the grantor would continue to report the  
24 property without any derecognition.

### 25 ***Subcommittee Proposals***

26 The subcommittee proposes that for SCA arrangements in which neither of the proposed  
27 control criteria discussed in the previous section are met, the grantor should not report the  
28 underlying property as an asset. Any payments made by the grantor to the operator under  
29 such an SCA should be expensed as incurred, that is, as the economic benefits of the  
30 service are rendered.

1 The subcommittee proposes that the guidance in IPSAS 13 for lessees should be followed  
2 for SCAs in which the grantor only controls the use of the property during the  
3 arrangement, such as in a BOO arrangement, if the arrangement meets the definition of a  
4 lease. The subcommittee further proposes that the grantor should continue to report  
5 existing underlying property to an SCA if it maintains ownership and controls the use of  
6 the property during the arrangement, but the property reverts to the operator at the end of  
7 the arrangement.

8 For SCAs involving newly constructed property in which the grantor does not control use  
9 of the property during the arrangement, but controls the significant residual interest in the  
10 property at the end of the arrangement, such as in a BOOT arrangement, the  
11 subcommittee proposes that the grantor report the difference between the expected fair  
12 value of the property at the end of the arrangement and the amount the grantor will be  
13 required to pay the operator upon reversion as an asset. This asset should be built up  
14 from payments made by the grantor to the operator over the life of the SCA. For SCAs  
15 involving existing property in which the grantor does not control use of the property  
16 during the arrangement, but controls the significant residual interest in the property at the  
17 end of the arrangement, the subcommittee proposes that the guidance in IPSAS 13 for  
18 lessors should be followed if the arrangement meets the definition of a lease. If the  
19 arrangement does not meet the definition of a lease, the grantor should derecognize the  
20 asset reflecting the property and recognize a receivable reflecting the operator's  
21 obligation to return the property at the end of the arrangement. This receivable should be  
22 recognized at the expected fair value of the property at the end of the SCA. The net  
23 derecognition amount should be reported as a gain or loss in the period of execution of  
24 the SCA.

25

## 1 INFLOWS OF RESOURCES FROM A SERVICE CONCESSION 2 ARRANGEMENT

3 There are two main opportunities for a grantor to receive inflows of resources from an  
4 operator through an SCA. These both occur most often when the operator receives fees  
5 for services directly from third-party users of the underlying property to the SCA. One  
6 means by which a grantor may receive inflows of resources is through a revenue-sharing  
7 provision in the terms of the SCA contract. The other is through receipt of inflows of  
8 resources established as part of the contract terms. These inflows typically include an  
9 upfront payment from the operator to enter into the SCA, but may take the form of  
10 several installments, or even a predetermined stream of payments over all or a portion of  
11 the life of the concession. The following paragraphs discuss revenue recognition for the  
12 grantor in both of these circumstances.

### 13 Revenue-Sharing Provisions

14 For SCAs in which the operator will be collecting revenue directly from third-party users  
15 of the underlying property, the grantor will often negotiate for a revenue-sharing  
16 provision in the terms of the contract with the operator. This way, if the usage of the  
17 underlying property exceeds projections, the revenue-sharing provision will allow the  
18 grantor to share in the financial success of the project. This type of provision also  
19 protects the grantor from the political risk and public criticism of entering into an  
20 agreement that is excessively profitable monetarily for the operator.

21 Revenue sharing as part of an SCA is generally based on all revenue earned by the  
22 operator, on revenue above a certain threshold, or on revenue above that needed for the  
23 operator to achieve a specified rate of return. For example, as part of a BOOT  
24 arrangement for construction of an indoor arena in a Pacific Island country, the grantor  
25 receives a fixed royalty amount on every ticket sold to an arena event, which is used by  
26 the grantor for funding community events<sup>13</sup>. Also, in an SCA involving a toll road in a  
27 North American country, the grantor is entitled to receive 40 percent of gross toll

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<sup>13</sup> Controller and Auditor General, New Zealand; Performance Audit Report. *Achieving Public Sector Outcomes with Private Sector Partners. Appendix 1.2006*

1 revenues after the real net cash flow of the arrangement yields a pre-tax internal rate of  
2 return on total invested projected funds equal to 6.5 percent for the operator. The  
3 grantor's share increases to 80 percent of gross toll revenues after the arrangement yields  
4 an 8 percent internal rate of return for the operator<sup>14</sup>.

5 Revenue-sharing provisions often are incorporated in the terms of an SCA in tandem with  
6 a minimum revenue guarantee for the operator. For example, as part of an SCA for a  
7 highway in a Middle Eastern country, the contract includes both a provision requiring the  
8 grantor to pay the operator 80 percent of the difference between actual and projected  
9 revenues whenever a shortfall occurs, as well as a revenue-sharing provision requiring  
10 the operator to pay the grantor 57 percent of the excess of actual revenue over projected  
11 revenue<sup>15</sup>. In this way, the grantor compliments the demand risk it assumes with the  
12 minimum revenue guarantee made to the operator with the potential reward if revenues  
13 exceed the projected amount.

#### 14 *Subcommittee Analysis*

15 To determine the appropriate method of revenue recognition for inflows to be received by  
16 the grantor through a revenue-sharing provision, these inflows can potentially be  
17 analogized to royalties (a type of revenue arising from the use of an entity's assets by  
18 others) which are addressed in IPSAS 9, *Revenue From Exchange Transactions*. IPSAS  
19 9 states that royalties should be recognized as they are earned in accordance with the  
20 substance of the relevant agreement when it is probable that economic benefits or service  
21 potential associated with the transaction will flow to the entity. An example on royalties  
22 included in the Appendix to IPSAS 9 also goes on to provide further clarification related  
23 to royalties for which receipt is contingent upon the occurrence of a future event. The  
24 example states that, in this case, revenue is recognized only when it is probable that the  
25 royalty will be received, which is normally when the event is deemed to have occurred.  
26 Therefore, inflows of resources to be received by a grantor through revenue-sharing

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<sup>14</sup> Obtained from memorandum of understanding between Virginia Department of Transportation and a consortium consisting of Transurban, Inc. and DEPFA Bank plc.

<http://www.virginiadot.org/news/resources/PocaPkwyAssocPubPrivPart.pdf>

<sup>15</sup> S. Ping Ho. Book chapter for *Government Policy on PPP Financial Issues: Bid Compensation and Financial Negotiation*. Book to be published, chapter available at:  
[http://crgp.stanford.edu/publications/working\\_papers/S\\_Ping\\_Ho\\_PPP\\_Policy.pdf](http://crgp.stanford.edu/publications/working_papers/S_Ping_Ho_PPP_Policy.pdf).

1 provisions that are predicated on reaching a certain metric can be recognized as revenue  
2 and a receivable once receipt is probable, which generally would be when the metric is  
3 reached.

4 Another issue related to accounting for a revenue-sharing provision is whether an asset  
5 should be recognized by the grantor representing its right to share in the revenues of the  
6 operator. This asset would be separate from the physical property associated with the  
7 arrangement (if reported by the grantor) and any receivables from the operator associated  
8 with the recognition of revenue discussed above. As discussed earlier in this paper,  
9 IPSAS 1 defines assets as resources controlled by an entity as a result of past events and  
10 from which future economic benefits or service potential are expected to flow to the  
11 entity. It can be argued that this revenue-sharing right meets this definition—the grantor  
12 usually has control over this right (even if it does not have control over the underlying  
13 property to the SCA), the past event would be the execution of the SCA contract, and the  
14 cash flows to be received through this right represent the future economic benefits.

15 The subcommittee does not believe that the execution of the SCA contract is a past event  
16 that results in an asset related to a revenue-sharing provision. The subcommittee instead  
17 believes that the only past events that would result in recognition of an asset related to  
18 revenue-sharing provisions are the third-party usage of the services provided by the  
19 operator and, if applicable, the meeting of any prescribed thresholds upon which the  
20 sharing of revenue with the grantor is contingent. Before such events occur, the  
21 subcommittee does not believe it can be expected that future economic benefits or service  
22 potential will flow to the grantor from revenue-sharing provisions. Therefore, the  
23 subcommittee does not believe that an asset representing the right to share in the revenues  
24 of the operator should be reported by the grantor.

25 ***Subcommittee Proposal***

26 The subcommittee proposes that grantors should recognize revenue (and related  
27 receivables) associated amounts received through revenue-sharing provisions in SCAs as  
28 it is earned in accordance with the substance of the relevant agreement once any  
29 contingent event, such as the achievement of a revenue threshold, is deemed to have  
30 occurred.

**Contractually Determined Inflows (Upfront Inflows to the Grantor)**<sup>16</sup>

The other potential source of inflows of resources for the grantor in an SCA is a contractually determined payment(s) where the value is effectively pre-determined. A typical example of this is an upfront payment made by the operator in exchange for the concession rights associated with the SCA, but other patterns of inflows such as a few installments or predetermined sums for predetermined years are also encountered. The former circumstance most often occurs when the SCA involves existing infrastructure or public facilities. For example, in an SCA for a North American toll road<sup>17</sup>, the operator received the right to operate an existing toll road, which includes maintenance and renovation responsibilities, in exchange for an upfront inflow of \$3.85 billion to the grantor. However, upfront inflows may also occur in SCAs involving construction of new property. For example, in an SCA for another North American toll road, an operator paid \$1.3 billion for the right to design, build, finance and operate the toll road. In some more limited cases, these inflows received from the operator are not entirely made upfront, but rather as a stream of fixed inflows of cash or promissory notes over the life of the SCA.

***Subcommittee Analysis***

The accounting issues related to these contractual inflows are the timing of their recognition and their measurement as revenue in the grantor's financial statements. There are two basic approaches to the former issue. One approach is that the entire value of the consideration (including any other amounts owed by the operator) should be recognized as revenue by the grantor at the execution of the contract. This approach is based on the premise that the entirety of the exchange occurs upon the execution of the contract—in essence; the grantor has fulfilled its contractual responsibilities to the operator at execution. The other approach is that the value of the consideration should be recognized as revenue over the life of the agreement. This approach is based on the premise that the SCA is an executory contract under which the grantor must continue to

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<sup>16</sup> This guidance applies for SCAs in which the grantor reports the underlying property. Refer to the previous section, Grantor Reporting the Property When the Proposed Control Criteria is Not Met, for SCAs in which the grantor does not report the underlying property.

<sup>17</sup> Indiana Toll Road Concession and Lease Agreement, 2006; <http://www.in.gov/ifa/files/4-12-06-Concession-Lease-Agreement.pdf>

1 perform—the grantor’s contractual responsibilities have not been fulfilled at execution.  
2 Therefore, the recognition of revenue should occur as it is earned by the grantor through  
3 its performance on the contract. Until it is earned, the unrecognized portion of the  
4 upfront inflow would be reported as unearned revenue (a liability).

5 Generally in SCAs featuring an upfront inflow of resources or other contractually  
6 determined inflows by the operator, the consideration being exchanged by the grantor is  
7 the right to operate (potentially along with other functions) the underlying property to the  
8 SCA. Given this exchange, it would appear that the grantor would be required to  
9 continue to maintain some performance responsibility through the life of the agreement,  
10 even if the performance is nothing more than allowing the operator access to the  
11 property. In this regard, the revenue recognition method for the upfront inflow can be  
12 analogized to that for the rendering of services present in IPSAS 9.

13 Paragraph 19 of IPSAS 9 states that revenue associated with a transaction involving the  
14 rendering of services should be recognized with reference to the stage of completion of  
15 the transaction at the reporting date, presuming the outcome can be estimated reliably.  
16 Paragraph 24 further clarifies that when services are performed by an indeterminate  
17 number of acts over a specified time frame, revenue is recognized on a straight line basis  
18 over the specified time frame. This would appear to be the circumstance in many SCA  
19 agreements. Therefore, it would appear that the upfront inflows received by a grantor as  
20 part of those SCAs could be recognized similarly. The Appendix to IPSAS 9 also  
21 provides an illustration of a concession fee and reaches a similar conclusion, stating that  
22 fees charged for the use of continuing rights granted by the agreement are recognized as  
23 revenue as the rights are used.

24 However, given the varying nature of the types of property associated with SCAs and the  
25 length of the term of many such arrangements, alternative methods for amortizing the  
26 unearned revenue associated with upfront inflows that better reflect the operator’s  
27 economic consumption of their access to the underlying property and/or the time value of  
28 money may be more appropriate. For example, an annuity method that applies a  
29 compounding interest factor which serves to more evenly amortize the unearned revenue



1 on a discounted basis, as opposed to a nominal basis, may be more appropriate in the case  
2 of an SCA with a term extending over several decades.

3 ***Subcommittee Proposals***

4 The subcommittee proposes that an upfront inflow of resources received by a grantor  
5 from an operator as part of an SCA should be recognized as revenue by the grantor over  
6 the life of the SCA beginning at the commencement of the concession term, that is, when  
7 the property is fully operational and the operator has the ability to use the property to  
8 generate third-party usage fees. The subcommittee believes that prior to this point, the  
9 grantor cannot begin to deliver on its portion of the exchange—generally, the provision  
10 of access to the property to the operator. Accordingly, the upfront inflows should be  
11 reported as unearned revenue until the property reaches this condition. Once the property  
12 is fully operational, the grantor should amortize the unearned revenue amount and  
13 recognize revenue using the straight-line method or a method that is more reflective of  
14 the operator's economic consumption of their access to the underlying property and/or  
15 the time value of money given the facts and circumstances of the SCA.

16

## 1 **GUARANTEES AND OTHER COMMITMENTS**

2 As part of some SCAs, guarantees or other commitments are made by the grantor to the  
3 operator, or to third parties on behalf of the operator. A common example of a guarantee  
4 made by a grantor as part of an SCA is a commitment to repay the debt of the operator in  
5 the event of default. In many countries, debt issued by public sector entities has a lower  
6 cost than that issued by private sector entities. However, for a variety of reasons, some  
7 grantors may have an incentive to require the operator to secure the financing for the  
8 underlying project in an SCA. In this case, the grantor may guarantee the debt of the  
9 operator to lower the cost of borrowing, which in turn would lower the cost of the project  
10 for the grantor. Also, in some circumstances, lenders may require a guarantee from the  
11 grantor before providing the financing to the operator that is necessary to undertake the  
12 project. For example, an Asian government had to provide a debt guarantee as part of its  
13 first “mega” public-private partnership, which involved the construction and operation of  
14 a high speed rail system, because the lenders would not finance the project without a full  
15 government debt guarantee<sup>18</sup>.

16 While these debt guarantees are often contractual in nature, in some circumstances, the  
17 grantor may take on the responsibility of repaying operator debt in the event of default in  
18 the absence of a contractual requirement. For example, in a case where the operator  
19 provides a key public service that the grantor could not readily step in and provide, the  
20 grantor may be willing to voluntarily repay operator debt in the event of default so that  
21 the operator can remain solvent, thereby avoiding an interruption in service provision.

22 A second type of guarantee made by the grantor that is common as part of an SCA is a  
23 guarantee of a minimum revenue amount for the operator. This guarantee is often made  
24 in arrangements in which the payments to the private party are made based on third-party  
25 usage of the underlying property. For example, as discussed in the Inflows of Resources  
26 from Service Concession Arrangements section above, the Middle Eastern highway SCA  
27 includes a provision that requires the grantor to pay the operator 80 percent of the

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<sup>18</sup> S. Ping Ho. Book chapter for *Government Policy on PPP Financial Issues: Bid Compensation and Financial Negotiation*. Book to be published, chapter available at:  
[http://crgp.stanford.edu/publications/working\\_papers/S\\_Ping\\_Ho\\_PPP\\_Policy.pdf](http://crgp.stanford.edu/publications/working_papers/S_Ping_Ho_PPP_Policy.pdf).

1 difference between actual and projected revenues whenever a shortfall occurs<sup>19</sup>. This  
2 type of guarantee can also be made when the grantor is the primary user of the services  
3 provided by the operator. For example, as part of an SCA for an Australian waste  
4 treatment facility, the grantor is obligated to provide a minimum amount of municipal  
5 solid waste to the operator for processing<sup>20</sup>. Similar to the discussion in the previous  
6 paragraph, in some circumstances, a grantor may make payments to the operator in the  
7 event of revenue shortfalls, even if such payments are not originally mandated by  
8 contract, in order to prevent decreases in service quality or service interruptions.

9 Also incorporated as part of many SCAs is the right of the grantor to re-assume the  
10 responsibility to provide the services associated with the SCA in the event of operator  
11 default stemming from circumstances such as financial insolvency or violation of  
12 performance standards. For instance, in an SCA for the operation of a toll road in a  
13 North American country, the contract contains the right of the grantor to declare a  
14 “concessionaire default” and terminate the arrangement based on cause. Causes may  
15 include failure to comply with, perform or observe a contractual operating standard if  
16 such violation creates a material danger to the safety of the operations of the toll road or a  
17 material impairment to the toll road or to the continuing use of the toll road for  
18 transportation purposes<sup>21</sup>. Even if this right is not explicitly stated in the terms of the  
19 arrangement, the grantor will generally have a moral responsibility to take over the  
20 provision of services if the operator fails to perform given the public nature of the  
21 service. This responsibility of the grantor is often referred to as “step-in”  
22 responsibility—it is a responsibility to the constituents of the grantor that use the service  
23 being provided through the SCA or that are otherwise impacted by the service, as  
24 opposed to the operator.

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<sup>19</sup> AECOM Consult, Inc. 2007 Case Studies Report 4-18. “Case Studies of Transportation Public-Private Partnerships around the World” p. 2.7 (prepared for the U.S. Department of Transportation Federal Highway Administration Office of Policy and Governmental Affairs). Arlington, VA.

<sup>20</sup> New South Wales Eastern Creek UR-3R Facility;  
[http://www.treasury.nsw.gov.au/\\_data/assets/pdf\\_file/0020/3098/awt\\_cont.pdf](http://www.treasury.nsw.gov.au/_data/assets/pdf_file/0020/3098/awt_cont.pdf).

<sup>21</sup> Indiana Toll Road Concession and Lease Agreement, 2006; <http://www.in.gov/ifa/files/4-12-06-Concession-Lease-Agreement.pdf>

***Subcommittee Analysis***

The aforementioned guarantees and commitments, and others similar to them, would fall under the scope of IPSAS 19. Paragraph 22 of IPSAS 19 states that a provision should be recognized as a liability in the financial statements if all of the following criteria are met:

- (1) An entity has a present obligation (legal or constructive) as a result of a past event;
- (2) It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and
- (3) A reliable estimate can be made of the amount of the obligation.

A past event that leads to a present obligation is referred to as an obligating event in IPSAS 19. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. In the case of the guarantees and commitments made by the grantor as part of the contractual terms of the SCAs, it would be fairly clear that the grantor has an obligating event—the giving of the guarantee—because settlement of the obligation (the guarantee) can be enforced by law.

Determination of whether an obligating event has occurred is less clear when the guarantee or commitment is not contractually mandated; in other words, the guarantee or commitment is constructive in nature. In this case, IPSAS 19 states that an obligating event has occurred only if the event creates valid expectations in other parties that the entity will discharge the obligation. The event may be an action of the entity, such as an established pattern of past practice, published policies or a sufficiently specific current statement. The determination of whether execution of an SCA results in a present constructive obligation(s) for the grantor would be based in large part on judgment given the facts and circumstances of the specific situation.

Professional judgment would also be required in determining whether it is probable that the present obligation created by the guarantee or commitment will result in an outflow of resources. Paragraph 31 of IPSAS 19 states that an outflow of resources is considered probable if there is a greater percentage that the outflow will occur, than that it will not. If such outflow is not probable (or the amount of the obligation cannot be reliably

1 measured), then the present obligation is considered a contingent liability. Contingent  
2 liabilities are not recognized in the financial statements; instead they are disclosed in the  
3 notes to the financial statements unless the possibility of an outflow of resources is  
4 remote, in which case disclosure is not required.

5 Based on the guidance in IPSAS 19, in many cases, a provision would not be recognized  
6 in the financial statements of the grantor for the guarantees or commitments associated  
7 with SCAs until the contingent event that is the subject of the guarantee occurs or does  
8 not occur—for example, the operator defaults on its debt, or the minimum revenue  
9 threshold is not achieved by the operator. An argument can be made that this treatment  
10 does not provide an optimum level of transparency in the financial statements for the  
11 additional risk being assumed by the grantor through these guarantees and commitments.  
12 This raises the question whether a liability should be recognized in the financial  
13 statements of the grantor upon the creation of a present obligation by the giving of a  
14 guarantee or commitment regardless of the probability of an outflow of resources.

15 This type of approach has been proposed by the IASB in its Exposure Draft, *Amendments*  
16 *to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee*  
17 *Benefits* (hereinafter referred to in this section as the “Exposure Draft”) issued in June  
18 2005 (the provisions of IAS 37 serve as the basis for those in IPSAS 19). Under the  
19 proposals in the Exposure Draft, the concept of contingent liabilities would be eliminated.  
20 ‘Contingency’ would only be used to refer to uncertainty about the amount required to  
21 settle a liability, not uncertainty about whether or not a recognizable liability exists. A  
22 present obligation arising from a past event for which the settlement amount is contingent  
23 on one or more uncertain future events would be recognized independently of the  
24 probability that the uncertain future event(s) will or will not occur. In other words, the  
25 probability of the outflow of resources would not be a factor in determining whether a  
26 present obligation should be recognized as a liability in the financial statements. Instead,  
27 such probability would factor into the measurement of the liability to be recognized.

28 The Exposure Draft proposes that for cases in which the amount required to settle a  
29 present obligation is contingent on the occurrence or non-occurrence of an uncertain  
30 future event, the entity has incurred two obligations—an unconditional obligation and a

1 conditional obligation. For example, under the Exposure Draft, if a grantor guarantees  
2 the debt of an operator, it would have an unconditional obligation to *stand ready* to  
3 guarantee the debt of the operator and a conditional obligation to actually repay the debt  
4 if the operator defaults. The grantor would recognize its liability arising from its  
5 unconditional obligation to guarantee the debt of the operator. Uncertainty about whether  
6 the operator will default would be reflected in the measurement of the liability. This  
7 approach, as compared to that of IPSAS 19, would likely result in a greater number of  
8 guarantees and commitments made by grantors as part of SCAs being recognized as  
9 liabilities in their financial statements.

10 The Exposure Draft proposes that measurement of these liabilities should be at the  
11 amount that the entity would rationally pay to settle the present obligation or to transfer it  
12 to a third party at the balance sheet date. This can be approached several ways.  
13 Contractual or other market evidence could be used, although market evidence often will  
14 not exist given the nature of the liability. If the amount must be estimated, an expected  
15 discounted cash flow approach would be an appropriate method of measuring the liability  
16 amount to recognize on the balance sheet. As stated above, the measurement should  
17 reflect the risks and uncertainties associated with the contingent future events.

18 The comment period for the Exposure Draft closed in October 2005 and deliberations on  
19 the project are currently ongoing. A final Standard is projected to be issued by the IASB  
20 late in 2008 or early 2009.

21 It should also be noted that contractual guarantees of the operator's debt entered into by  
22 the grantor would generally meet the definition of a financial guarantee contract provided  
23 in IAS 39. IAS 39 defines a financial guarantee contract as "a contract that requires the  
24 issuer to make specified payments to reimburse the holder for a loss it incurs because a  
25 specified debtor fails to make payment when due in accordance with the original or  
26 modified terms of a debt instrument." Under IAS 39, all financial liabilities are initially  
27 recognised at fair value. Where the contract is an arm's length transaction, the  
28 transaction price will represent fair value. If the transaction is not at arm's length, the  
29 transaction price will be not representative of fair value. In this case, the cost of similar

1 guarantees or another valuation technique, such as the present value of future cash flows,  
2 are suggested by IAS 39 to determine fair value of the liability.

3 In the case of debt guarantees associated with an SCA, there generally will be no “price”  
4 to the transaction, because the grantor will be required to provide the guarantee by the  
5 terms of the arrangement, or to ensure that the operator can execute the arrangement.  
6 Additionally, given the unique nature of the operators (often an SPE), a cost of a similar  
7 guarantee, while conceptually determinable, could be difficult to ascertain. The fair  
8 value of future cash outflows would also often be a nominal amount or zero, because the  
9 grantor may not expect the operator to default, and therefore, there would be no cash  
10 outflows associated with the guarantee. Therefore, the fair value of a debt guarantee at  
11 initial recognition would often be zero.

12 For measurement subsequent to initial recognition, IAS 39 requires that financial  
13 guarantee contracts be measured at the higher of: (a) the amount determined in  
14 accordance with IAS 37; and (b) the amount initially recognised less, when appropriate,  
15 cumulative amortization recognised in accordance with IAS 18, *Revenue*. As discussed  
16 above, the subcommittee believes that the fair value at initial recognition for most debt  
17 guarantees associated with SCAs will be zero. Therefore, subsequent measurement of the  
18 guarantee would therefore be based on the amount that would be determined under IAS  
19 37. Because the provisions of IAS 37 are currently the same as IPSAS 19 (the existence  
20 of the aforementioned Exposure Draft notwithstanding), it would appear that the results  
21 reporting of a debt guarantee associated with an SCA under IAS 39 would generally be  
22 the same as reporting such guarantee under IPSAS 19.

### 23 ***Subcommittee Proposal***

24 The subcommittee proposes that the guidance in IPSAS 19 be applied to determine the  
25 accounting and financial reporting for guarantees and commitments made by grantors as  
26 part of SCAs. As stated above, these guarantees and commitments would fall within the  
27 scope of IPSAS 19, and the subcommittee believes that the existence of these guarantees  
28 and commitments through an SCA would not necessitate accounting treatment different  
29 than that for similar guarantees and commitments provided in another context. Potential  
30 amendments to IPSAS 19 based on any amendments made to IAS 37 by the IASB may

1 be considered by the IPSASB as part of a broader project on provisions, contingent  
2 liabilities and contingent assets in accordance with its policy to converge public sector  
3 accounting standards with private sector standards to the extent appropriate. Proposals  
4 for disclosures related to guarantees and other commitments are discussed later in the  
5 paper.

6



**CONSOLIDATION**

An area that may need to be addressed for certain SCAs is whether the operator should be considered a controlled entity of the grantor for financial reporting purposes under the authoritative guidance in IPSAS 6. In this case, the financial accounts of the operator would be included in the consolidated financial statements of the grantor. Addressing this area may be particularly relevant when the operator in the SCA is a GBE. Often in these cases, the GBE operator is closely related to the grantor, or the GBE may even be created by the grantor or another governmental entity for the purpose of serving as the operator to the SCA.

Addressing this area may also be relevant when the operator in an SCA is a special purpose entity (SPE), also referred to in some jurisdictions as a special purpose vehicle. An SPE will often be created by a project consortium to serve as the “legal” operator to an SCA. There may be a number of participants in such a consortium, including construction entities, operations entities, and equity investors among others. The sole purpose of the SPE is to carry out the operator responsibilities of the SCA. The SPE can also securitize the claims to future project revenues and sell these securities to investors. Issuing these securities through an SPE limits the risks associated with the project for the individual participants. The potential for consolidation of an SPE serving as the operator to an SCA into the financial statements of the grantor may not be apparent. However, certain terms included in SCA contracts may be viewed as indicators of control as identified in IPSAS 6.

***Subcommittee Analysis***

IPSAS 6 includes guidance to determine whether for financial reporting purposes one entity (a controlling entity) controls another entity (the controlled entity). In the context of an SCA, generally the grantor would be the potential controlling entity and the operator would be the potential controlled entity. Control, as defined by IPSAS 6, is the power to govern the financial and operating policies of another entity so as to benefit from its activities. For one entity to control another, two separate elements must be present in the relationship between the two entities: power and benefit.

1 *Power* relates to the power to govern the financial and operating policies of another  
2 entity. The existence of power in the context of IPSAS 6 does not necessarily require a  
3 majority shareholding or any kind of equity interest in the potential controlled entity.  
4 The power to control must be presently exercisable, but its existence is not dependent  
5 upon whether the power has been exercised. That is, the mere existence of the power to  
6 control is sufficient to establish power under IPSAS 6. Similarly, the potential  
7 controlling entity is not required to have involvement in the day-to-day operations of the  
8 potential controlled entity to establish the power to control, only the existence of the  
9 ability to be involved must exist. In many cases, this power may only be invoked by a  
10 breach or violation of a contractual agreement.

11 *Benefit* relates to the ability of the potential controlling entity to benefit from the  
12 activities of the potential controlled entity. These benefits may be financial, such as the  
13 distribution of a dividend, non-financial, such as the achievement of policy objectives, or  
14 a combination of both. Although the focus in IPSAS 6 is on how the relationship with  
15 the potential controlled entity benefits the potential controlling entity, the concept of  
16 benefit also considers circumstances where the relationship between the two entities  
17 creates a financial burden for the potential controlling entity.

18 Paragraph 39 of IPSAS 6 states that in examining the relationship between two entities,  
19 control is presumed to exist when at least one of the following power conditions and one  
20 of the following benefit conditions exists, unless there is clear evidence of control being  
21 held by another entity:

22 *Power Conditions*

23 (a) The entity has, directly or indirectly through controlled entities, ownership of a  
24 majority voting interest in the other entity.

25 (b) The entity has the power, either granted by or exercised within existing  
26 legislation, to appoint or remove a majority of the members of the board of  
27 directors or equivalent governing body and control of the other entity is by that  
28 board or by the body.

(c) The entity has the power to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of the other entity.

(d) The entity has the power to cast the majority of vote at the meeting of the board of directors or equivalent governing body and control of the other entity is by that board or by that body.

*Benefit Conditions*

(a) The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations. For example, the benefit condition may be met if an entity had responsibility for the residual liabilities of another entity.

(b) The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.

When one or more of the above circumstances does not exist, paragraph 40 of IPSAS 6 provides the following factors that are likely, either individually or collectively, to be indicative of the existence of control.

*Power Indicators*

(a) The entity has the ability to veto operating and capital budgets of the other entity.

(b) The entity has the ability to veto, overrule, or modify governing body decisions of the other entity.

(c) The entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity.

(d) The mandate of the other entity is established and limited by legislation.

(e) The entity holds a “golden share”<sup>22</sup> (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that other entity.

*Benefit Indicators*

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<sup>22</sup> “Golden share” refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associate with the holder’s ownership interest or representation on the governing body.

(a) The entity holds direct or indirect title to the net assets/equity of the other entity with an ongoing right to access these.

(b) The entity has a right to a significant level of the net assets/equity of the other entity in the event of a liquidation or in a distribution other than liquidation.

(c) The entity is able to direct the other entity to co-operate with it in achieving its objectives.

(d) The entity is exposed to the residual liabilities of the other entity.

### **Government Business Enterprises**

In the case where the operator is a GBE, the subcommittee believes that certain of the indicators of control discussed in paragraph 39 and 40 of IPSAS 6 will often exist between the grantor and the GBE, particularly if the GBE was specifically created to serve as the operator to the SCA. It generally would be appropriate to consolidate the GBE operator into the financial statements of the grantor in these circumstances as provided for under IPSAS 6.

### **Special Purpose Entities**

In the case where the operator is an SPE, the indicators of control described in paragraph 39 of IPSAS 6 would generally not be present in the relationship between the grantor and the operator. However, the contractual terms of the SCA may result in certain of the control indicators in paragraph 40 of IPSAS 6, or analogous indicators, being present. For example, in an SPE for an African toll road<sup>23</sup>, the following contract provisions may be indicators of the grantor's power to control the operator:

- The operator is only permitted to issue debt as specified in the contract and the grantor must approve any additional indebtedness of the operator prior to issuance of that debt.
- All toll rates are subject to approval by the national Minister of Transport (on recommendation from the grantor) and amendments to the toll rates may be made by the grantor.

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<sup>23</sup> Report to South Africa National Treasury—PPP Unit from KPMG November 27 2006.

- The grantor may require the operator to remove any employee which the grantor believes is incompetent or is guilty of misconduct.

Provisions from this SCA that may indicate the grantor's ability to benefit from the activities of the operator are as follows:

- The operator is required to ensure that the highway is open to traffic at all times and that the traffic flow satisfies certain pre-determined standards pursuant with grantor objectives related to transport (an indication of the grantor's ability to direct the other entity to co-operate with it in achieving its objectives).
- The operator is required to make payments to the grantor if the return on the project is in excess of a certain threshold.

Another provision somewhat common to SCAs that could be viewed as a benefit indicator is a guarantee of the debt of the operator made by the grantor. This could expose the grantor to residual liabilities of the operator as described in paragraph 40 of IPSAS 6.

Given the limited operations of an SPE, the presence of these or similar indicators could lead to the conclusion that the grantor can "control" the operator based on the guidance in IPSAS 6. However, as described in paragraph 39 of IPSAS 6 above, it should be considered whether there is clear evidence that an entity other than the grantor holds control over the operator. In most cases involving an SPE as an operator, the subcommittee expects that such evidence will exist. The subcommittee believes that the sponsors or shareholders of the SPE generally will exhibit a greater degree of control over the SPE through voting rights or ownership stake in the SPE. The indicators of control for the grantor will generally be based on the binding nature of the contract terms as opposed to control over the entity itself. Therefore, the subcommittee expects that in most cases where the operator is an SPE, such operator would not be determined to be a controlled entity of the grantor.

The subcommittee believes this expectation is also consistent with the guidance in the IASB's Standing Interpretations Committee (SIC) Interpretation 12, *Consolidation – Special Purpose Entities*. SIC 12 provides circumstances to consider when determining

whether an SPE is controlled by another entity. These circumstances are in addition to those provided in paragraph 13 of IAS 27, *Consolidated and Separate Financial Statements*, (which are similar to the power conditions in paragraph 39 of IPSAS 6), and include the following:

(a) in substance, the activities of the SPE are being conducted on behalf of the entity according to its specific business needs so that the entity obtains benefits from the SPE's operation;

(b) in substance, the entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an "autopilot" mechanism, the entity has delegated these powers;

(c) in substance, the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or

(d) in substance, the entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The subcommittee believes that in the context of an SCA, the grantor generally would not meet any of these criteria before one of the participants to the SPE. This is particularly the case when the criteria are considered in the context of the establishment of the SPE in the first instance and when it is considered that the risks and benefits referred to in the criteria relate to the generation of future economic benefits.

If the grantor does have an ownership or equity interest in the operator, in addition to assessing the reporting impact of the relationship between grantor and operator under IPSAS 6, the relationship should also be assessed under IPSAS 7, *Investments in Associates*, and IPSAS 8, *Interest in Joint Ventures*, for purposes of consolidation. IPSAS 7 provides accounting and financial reporting guidance for ownership interest in which the investor has significant influence over the investee. IPSAS 7 defines significant influence as the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

- 1 (a) representation on the board of directors or equivalent governing body of the
- 2 investee;
- 3 (b) participation in policy-making processes, including participation in decisions
- 4 about dividends or other distributions;
- 5 (c) material transactions between the investor and the investee;
- 6 (d) interchange of managerial personnel; or
- 7 (e) provision of essential technical information.

8 If the investor's ownership interest is in the form of shares and it holds, directly or  
9 indirectly, 20 percent or more of voting power of the investee, it is presumed that the  
10 investor has significant influence; if the investor holds less than 20 percent then it is  
11 presumed that the investor does not have significant influence. If the grantor has  
12 ownership interest in the operator and the criteria for significant influence are met, then  
13 the appropriate guidance in IPSAS 7 should be followed.

14 When the grantor has an equity interest in the operator, the operator could be considered  
15 a jointly controlled entity, which is a form of joint venture under IPSAS 8. More  
16 specifically, as defined by IPSAS 8, a jointly controlled entity is a joint venture that  
17 involves the establishment of a corporation, partnership or other entity in which each  
18 venturer has an interest. IPSAS 8 requires that in order for a joint venture to be  
19 established there must be a binding arrangement that establishes joint control. The  
20 participants in the jointly controlled entity typically transfer assets and liabilities to the  
21 separate jointly controlled entity to carry out an activity. In some cases, the operator to  
22 an SCA could be an entity jointly controlled by the grantor and another entity (either a  
23 public or private sector). If the criteria established by IPSAS 8 are met for a jointly  
24 controlled entity, then appropriate guidance should be followed.

25 ***Subcommittee Proposal***

26 The subcommittee proposes that the relationship between the grantor and the operator to  
27 an SCA should be evaluated using the guidance in IPSAS 6 to determine whether the  
28 grantor controls the operator for financial reporting purposes. However, the  
29 characteristics of the reporting entity is a component of IPSASB's current project to

1 develop a public sector conceptual framework that would be applicable to the preparation  
2 and presentation of general purpose financial reports of public sector entities. The  
3 conceptual conclusions drawn regarding the reporting entity as part of that project may  
4 impact determinations reached related to consolidation in the context of SCAs. The  
5 subcommittee also proposes that the guidance in IPSAS 7, *Investments in Associates* and  
6 IPSAS 8, *Interest in Joint Ventures* should also be considered if the grantor has an  
7 ownership or equity interest in the operator.

8



**FINANCIAL STATEMENT NOTE DISCLOSURES**

Given the general complexity of SCAs and the potential magnitude of their impact on the financial statements of the grantor, note disclosures is an area that needs to be considered for the benefit of financial statement users. When considering the types of note disclosures that should be required for SCAs, the objectives of general purpose financial reporting in the public sector must be taken into account.

Overall, according to IPSAS 1, those objectives should be to provide information useful for decision-making, and to demonstrate the accountability of the entity for the resources entrusted to it by:

- (a) Providing information about the sources, allocation and uses of financial resources;
- (b) Providing information about how the entity financed its activities and met its cash requirements;
- (c) Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments;
- (d) Providing information about the financial condition of the entity and changes in it; and
- (e) Providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments.

Paragraph 16 of IPSAS 1 also states that general purpose financial statements can have a predictive or prospective role, providing information useful in predicting the level of resources required for continued operations, the resources that may be generated by continued operations, and the associated risks and uncertainties.

Furthermore, IPSAS 1 states that note disclosures should provide additional information that is not presented on the face of the financial statements, but that is relevant to an understanding of them. Aspects of SCAs may appear on the face of the financial statements of the grantor, such as the cash flow statement for the receipt of an upfront payment from the operator, or the statement of financial position by the addition of a

1 building that has been constructed through the SCA, but further information is essential  
2 for users to understand the transactions that have taken place.

3 The IASB's Standing Interpretations Committee (SIC) Interpretation 29, *Service*  
4 *Concession Arrangements: Disclosures*, provides financial statement disclosure  
5 requirements related to service concession arrangements for both the grantor and the  
6 operator. Paragraph 6 of SIC-29 details the requirements:

7 All aspects of a service concession arrangement shall be considered in  
8 determining the appropriate disclosures in the notes. An operator and a  
9 grantor shall disclose the following in each period:

10 (a) a description of the arrangement;

11 (b) significant terms of the arrangement that may affect the amount, timing  
12 and certainty of future cash flows (eg the period of the concession, re-  
13 pricing dates and the basis upon which re-pricing or re-negotiation is  
14 determined);

15 (c) the nature and extent (eg quantity, time period or amount as appropriate)  
16 of:

17 i. rights to use specified assets;

18 ii. obligations to provide or rights to expect provision of  
19 services;

20 iii. obligations to acquire or build items of property, plant and  
21 equipment;

22 iv. obligations to deliver or rights to receive specified assets at  
23 the end of the concession period

24 v. renewal and terminations options

25 vi. other rights and obligations (eg major overhauls); and

26 (d) changes in the arrangement occurring during the period;

27 (e) how the service arrangement has been classified.

1 Additionally, in *Public-Private Partnerships, Government Guarantees, and Fiscal Risk*,  
2 prepared by a staff team from the International Monetary Fund led by Richard Hemming,  
3 the following disclosures related to SCAs (or more broadly PPPs) are also suggested for  
4 financial reports:

- 5 • An outline of the objectives of current or planned PPP programs and a summary  
6 description of projects that have been contracted or are at an advanced stage in  
7 the contracting process.
- 8 • Future service payments and receipts (such as concession and operating lease  
9 fees) by government specified in PPP contracts for the following 20-30 years.
- 10 • Details of contract provisions that give rise to contingent payments or receipts  
11 (eg, guarantees, shadow tolls, profit-sharing arrangements, events triggering  
12 contract renegotiation), with the latter valued to the extent feasible.
- 13 • Amount and terms of financing and other support for PPPs provided through  
14 government on-lending or via public financial institutions and other entities (such  
15 as SPVs) owned or controlled by government.
- 16 • How the project affects the reported fiscal balance and public debt, and whether  
17 PPP assets are recognized as assets on the government balance sheet. It should  
18 be noted whether PPP assets are recognized as assets on the balance sheet of any  
19 SPV or the private sector partner.

20 ***Subcommittee Analysis***

21 The financial statement note disclosures required by SIC-29 are consistent with the  
22 objectives of IPSAS 1. Indeed, in the basis for conclusions, the IASB's *Framework* and  
23 IAS 1, which was the basis for IPSAS 1, are referenced as justification for financial  
24 statements to provide additional information, not on the face of the statements, that is  
25 relevant to the needs of users of those financial statements.

26 The suggested disclosures provided in *Public-Private Partnerships, Government*  
27 *Guarantees, and Fiscal Risk*, are also consistent with the objectives of IPSAS 1, as well  
28 as the requirements of SIC-29. The disclosures suggested by Hemming however are

1 more specific than those in SIC-29. For example, “future service payments and receipts  
2 (such as concession and operating lease fees) by government specified in PPP contracts  
3 for the following 20-30 years” can be interpreted to be encompassed in SIC-29’s  
4 requirement to disclose “significant terms of the arrangement that may affect the amount,  
5 timing and certainty of future cash flows”.

6 In addition to these disclosures, other disclosures for the grantor related to an SCA may  
7 warrant consideration. These include disclosures that address aspects of the SCA that  
8 could impact the delivery of services to the constituents of the grantor. Service delivery  
9 could be negatively impacted if the operator is not able to fulfill the obligations under the  
10 SCA contract. Therefore, it may be relevant to users’ understanding of the financial  
11 statements of the grantor to have information about the solvency of the operator,  
12 potentially through disclosure of their credit rating or other metric, the grantor’s  
13 contractual ability to step-in and reassume service provision in the event of poor  
14 performance by the operator, and provisions of the arrangement related to a default on the  
15 part of the operator. Other financial statement note disclosures demonstrating  
16 accountability of the grantor for the resources entrusted to it need to be considered as  
17 well, for example, disclosure of management’s assessment of how the SCA achieves  
18 improved value for money, the nature of the risks transferred to the operator, and general  
19 descriptions of the property condition and service requirements of the arrangement.  
20 While this information may be useful to certain constituents of the grantor, the  
21 subcommittee believes that it is not necessarily relevant to users understanding the  
22 financial statements. This type of information may be more appropriate in the context of  
23 financial reports and other documents of the grantor.

24 Another disclosure warranting consideration is a comparison of any upfront inflows of  
25 resources received by the grantor and the present value of the estimated net future  
26 revenues to be earned by the operator from third-party collections. The US  
27 Governmental Accounting Standards Board (GASB), in its Statement No. 48, *Sales and*  
28 *Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and*  
29 *Future Revenues*, requires an analogous disclosure for sales of cash flows from future  
30 revenue. In the context of an SCA agreement, this disclosure would provide an analysis

1 of the financial benefit of the arrangement to the grantor for the users of the financial  
2 statements. However, due to the benefits of the service (operations, management, etc.)  
3 that an operator provides for the grantor through an SCA, a straight comparison of an  
4 upfront inflow and the estimated future net revenues to be earned by the operator would  
5 not be representative of the entire exchange in the SCA. Also, the disclosure would  
6 involve many complicated estimates that may not be readily determinable by the grantor.  
7 For these reasons, the subcommittee does not believe that this should be a required note  
8 disclosure for SCAs.

9 The subcommittee believes that the effort required for the grantor to provide note  
10 disclosure information on SCAs must be considered. Some grantors may have several  
11 SCAs in place at one time which could cause the cost and burden of developing detailed  
12 information to be onerous. One method of balancing the cost and benefit of providing  
13 SCA information in the note disclosures is to allow for key quantitative information to be  
14 provided on an aggregate basis while limiting requirements for detailed information  
15 specific to individual SCAs to those that are material. Omissions or misstatements are  
16 considered material by IPSAS 1 if they could, individually or collectively, influence the  
17 decisions or assessments of users made of the basis of the financial statements.  
18 Materiality depends on the nature or size of the omission or misstatement judged in the  
19 surrounding circumstances; the nature and/or size of the item could be a determining  
20 factor. The benefit of arrangement-specific information in the notes to the financial  
21 statements is in its predictive value as opposed to its retrospective view into the grantor's  
22 operations. Therefore, the subcommittee believes information limited to those SCAs  
23 considered material is appropriate.

24 ***Subcommittee Proposal***

25 The subcommittee proposes the financial statement note disclosures below for grantors of  
26 SCAs.

27 A. For each individual arrangement considered material:

- 28 • A description of the arrangement, including management's objectives  
29 for entering into the arrangement;

- 1                   • Significant terms of the arrangement that may affect the amount,  
2                   timing and certainty of future cash flows (e.g. the period of the  
3                   concession, re-pricing dates and the basis upon which re-pricing or re-  
4                   negotiation is determined);
- 5                   • The nature and extent of rights under the arrangement, including rights  
6                   to expect provision of services and revenue-sharing provisions;
- 7                   • The nature and extent of obligations, guarantees, and other  
8                   commitments under the arrangement, including debt guarantees made  
9                   on behalf of the operator and guarantees of minimum revenue amounts  
10                  for the operator;
- 11                  • Terms related to renewal and termination of the arrangement, as well  
12                  as potential events of default and their impact;
- 13                  • Terms related to the ownership and required condition of the property  
14                  at the end of the arrangement; and
- 15                  • Changes in the arrangement occurring during the period;

16    B.     For each individual arrangement considered material and for all SCAs in the  
17            aggregate:

- 18                  • The nature and amount of assets and liabilities recognized in the  
19                  statement of position; and
- 20                  • Total future minimum outflows and total future minimum inflows for  
21                  each of the following periods:
  - 22                       ○     Not later than 1 year,
  - 23                       ○     Later than 1 year and not later than 5 years, and
  - 24                       ○     Later than 5 years.

25    The total future minimum outflows and total future minimum inflows must be provided  
26    on a nominal basis. Disclosure of the present value of these amounts is also

1 recommended. If present value amounts are disclosed, the discount rate used to  
2 determine these amounts should also be disclosed.

3 In addition to these proposed disclosures specifically addressing the SCA contract, other  
4 disclosure requirements, for example, those associated with property, plant and  
5 equipment, financial liabilities (including financial guarantees), contingent liabilities, and  
6 the summary of significant accounting policies, which may relate to aspects of the SCA  
7 also should be applied, as appropriate.

8

## APPENDIX A

### Decision Tree for Service Concession Arrangements That Do Not Meet Both of the Proposed Control Criteria

The decision tree below illustrates the various scenarios that may occur for service concession arrangements that do not meet the proposed control criteria, along with the proposed accounting and financial reporting for those scenarios. These proposals are more fully described on pages 73–80 of the Consultation Paper.

