

## SERVICE CONCESSION ARRANGEMENTS



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OF ACCOUNTANTS

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## Agenda Item

# 4

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**Date:** May 25, 2011  
**Memo to:** Members of the IPSASB  
**From:** Joy Keenan  
**Subject:** Service Concession Arrangements – Discuss Issues

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### Objectives

- To **agree** on how to address comments of Respondents to ED 43, *Service Concession Arrangements* and related amendments to ED 43; and
- To **agree** on next steps in the project.

### Agenda Material

#### 4.1 Issues Paper

Copies of ED 43 and Responses to ED 43 are provided for information purposes

### Background

1. Subsequent to the March 2011 meeting, it was decided to reconstitute the task-based group (TBG) to a task force (TF). The members of the Task Force are as follows:
  - David Bean, Chair
  - Ian Carruthers
  - Marie-Pierre Cordier
  - Paul Mason
  - Jeanine Poggiolini
  - Erna Swart
  - Ken Warren
  - Tim Youngberry
2. At its November 2010 meeting, the IPSASB considered the main issues raised by Respondents to ED 43, including whether the “mirror” approach is appropriate. The IPSASB tentatively confirmed its position in ED 43 that the proposed standard should “mirror” IFRIC 12. The Minutes for the November 2010 IPSASB meeting are included as Appendix 1 to this paper.

3. At its March 2011 meeting, the IPSASB considered certain other issues raised by Respondents to ED 43. The IPSASB tentatively agreed to accept the staff proposal presented in March 2011 to address Respondents' concerns with use of the term "performance obligation" by changing the reference to "advance receipt of revenue". The draft Minutes for the March 2011 meeting are included as Appendix 2 to this paper.
4. A number of issues raised by Respondents still remain to be discussed by the IPSASB. The Task Force has had two conference call meetings and one electronic communication, to discuss these issues and proposed actions (including proposed wording, where applicable), which are presented in agenda paper 4.1. The issues are presented in order of the material in ED 43 to which they pertain. The issues for which the main changes to wording of ED 43 are being proposed are highlighted below.
5. In developing the paper, staff and the Task Force have proceeded on the basis of the IPSASB's tentative decision regarding the mirror approach; thus, the types of arrangements to which the proposed standard would apply, and the control criteria in the proposed standard are the same as those in IFRIC 12. Specific issues Respondents raised in relation to the scope are discussed in Issue 1. Specific issues related to the control criteria are discussed in Issue 3.
6. One area of the mirror approach which the Task Force has revisited is the need for a definitions section. Staff has drafted proposed definitions and amended the Basis for Conclusions on this issue accordingly in Issue 2.
7. The paper also considers the IPSASB's tentative decision in March 2011 regarding treatment of the credit on recognition of a service concession asset. Discussions within the Task Force have led to a proposed change to what this liability is called. Staff is proposing that the reference be to "liability" with a description of the pattern of revenue recognition. It should be noted that one Member of the Task Force does not support the treatment of the credit as a liability, but favors some Respondents' proposals that it should be a direct increase in equity. Staff has incorporated those arguments in the proposed revisions to the Basis for Conclusions for Issue 5, along with other suggested changes to ED 43 to respond to further issues related to the liability. Issues pertaining to reduction of this liability and recognition of the related revenue, along with proposed wording, are discussed in Issue 6.
8. The Task Force has also discussed possible changes to the transitional provisions based on Respondents' comments. At this point, no proposal for a change is being put forth, as the Task Force has not considered the proposed changes to ED 43 as a whole to assess whether they represent a significant change from ED 43 which would require re-exposure. The possible changes are set out in Issue 8.
9. The IPSASB's confirmation of the completeness of the identification and analysis of the issues and the proposals in agenda paper 4.1 is sought. Where suggested clarifications and amendments to ED 43 are provided, your views on the appropriateness of that wording are also requested to permit staff to redraft the proposed standard with the Task Force's assistance.

10. It is proposed that, if the IPSASB reaches consensus on those issues, a revised draft of the proposed standard would be developed. At that point, the IPSASB would assess all of the changes and decide whether to approve the proposed standard for issue or for re-exposure.

## Appendix 1: Excerpt from Approved November 2010 IPSASB Meeting Minutes

### 5. SERVICE CONCESSION ARRANGEMENTS

#### Discuss responses to ED 43 (Agenda Item 7)

Staff provided an overview of the history of the project, including the IPSASB's decision to issue ED 43, *Service Concession Arrangements: Grantor*, which “mirrors” IFRIC 12, *Service Concession Arrangements*. It was noted that 33 responses were received, representing a diversity of views. The purpose of the discussion was to consider the key issues arising from responses. Technical issues raised by respondents would be considered in March 2011.

It was noted that strong support was expressed for the project on SCAs; however, respondents had raised a number of concerns with some aspects of ED 43. In some cases, these issues did not pertain to matters which the IPSASB had not previously considered in developing ED 43.

One Member indicated that the analyses of responses did not reflect the comments of respondent #20, which were consistent with other responses on some key issues. It was noted that the analyses would be amended to include the response in the IPSASB's next discussion of technical issues raised by respondents, in March 2011.

Another respondent reiterated the IPSASB's views expressed at previous meetings, that it is the substance of responses, not overall numbers of comments on an issue that the IPSASB should consider.

A Member pointed out that it was difficult to fully mirror IFRIC 12 because IFRIC 12 also links to IFRIC 4, *Determining whether an Arrangement Contains a Lease*. It was indicated, however, that in practice, it is generally clear whether IFRIC 4 or IFRIC 12 applies.

It was also noted that the IASB's project to update IAS 17, *Leases* could have an impact on IFRIC 12 in the medium term, and thus it may not be appropriate to mirror IFRIC 1 now.

Another Member indicated it was important to complete this project on a timely basis given that respondents did not raise any new issues regarding the scope and recognition criteria. It was noted that, in a discussion with an IASB staff member, the view was expressed that it was unlikely that the IASB leases project would have an impact on IFRIC 12 in the medium term.

After discussion, the IPSASB agreed that:

- Whole-of-life assets should remain within the scope of the proposed IPSAS and that additional guidance on the term, “regulate” is required to address the public sector context, which was not necessary in IFRIC 12. The Basis for Conclusions, however, needs to outline views for and against these decisions and why the IPSASB came to these decisions.
- The scope should not be broadened to include other types of public-private arrangements beyond those meeting the recognition criteria in ED 43; however, the Basis for Conclusions needs to explain clearly that these other types of arrangements are not within the scope of the proposed IPSAS and that the IPSASB may decide to undertake a project to address them in the future.

- Additional guidance is not required for circumstances when arrangements do not meet those recognition criteria.

The IPSASB considered a technical issue raised by several respondents pertaining to the need for clarity around the definition of a performance obligation and its links to IPSAS 19. One view was that the term should not be used in this document. It was noted that IFRIC 12 refers to an obligation to restore an asset—it does not refer to a performance obligation. The IPSASB agreed that it was necessary to consider this issue further.

The IPSASB agreed to consider the other changes needed to address the respondents' concerns on specific accounting issues at its next meeting.

## Appendix 2: Excerpt from Draft March 2011 IPSASB Meeting Minutes

### 7. SERVICE CONCESSION ARRANGEMENTS

#### Discuss issues (Agenda Item 8)

The IPSASB considered responses to ED 43, *Service Concession Arrangements: Grantor* pertaining to the performance obligation identified in ED 43. Respondents had raised concerns with the fact that a performance obligation is currently addressed in IPSAS 23 in relation to non-exchange transactions and service concession arrangements (SCAs) addressed in ED 43 are exchange transactions. Some respondents had suggested clarifying the term; however, in light of the fact that performance obligations are currently being considered in the Conceptual Framework project, it was not considered appropriate to address the issue in this project.

One Member expressed the concern that the performance obligation in ED 43 does not meet the existing IPSASB definition of a liability in IPSAS 1, *Presentation of Financial Statements* because it does not result in an outflow from the entity of resources embodying economic benefits or service potential. It was also noted that the IPSASB needs to consider the implications of the IASB project (which uses a derecognition approach) on lease accounting to ensure that the potential for accounting arbitrage or engineering of SCA transactions is minimized. It was agreed that a status report on the IASB project would be provided with the meeting materials for June.

The IPSASB considered a staff proposal, based on some respondents' replies to ED 43, to treat the credit side of the service concession asset recognized under ED 43 by following a revenue approach, as a payment received in advance in accordance with IPSAS 9, *Revenue from Exchange Transactions*. It was noted that the type of transaction is analogous to franchise revenue recognition in IPSAS 9. Members indicated that it was important to explore further whether the assets exchanged are dissimilar.

One Member reiterated the alternative suggested by some respondents to treat the credit on recognition of the service concession asset as an increase in equity. It was noted that IFRIC 12 does not follow a lease approach, but rather the right of access/use that drives asset recognition. Thus, there should be no revenue recognized. Other Members noted that this approach is not supported in existing IPSASs for exchange transactions as it is not a contribution from owners, resulting from a revaluation, or a gain/loss. It was also noted that there has been no change (increase) in net worth, so it was not appropriate to do so as it disguises the substance of the transaction. A Member suggested that treatment as equity raised wider concerns, as infrastructure assets need to be maintained. Members did not support the treatment of the credit as equity. It was suggested that it was important to include in the Basis for Conclusions these arguments, to be discussed by the Task Force, and why the IPSASB could support the treatment as revenue.

It was questioned whether it was necessary to change the accounting approach on this issue or whether a definition of "performance obligation" for the purposes of the proposed standard could be provided. It was noted that the majority of the respondents did not object to the performance obligation treatment, but they may not agree with the proposed staff approach. However, it was noted by some Members that the issue of performance obligation was under consideration in the IPSASB's Conceptual Framework project, and that the change in approach did not fundamentally alter the accounting treatment. Members agreed in principle that the staff

proposal, based on respondents' replies to ED 43, to treat the credit as an advance receipt was appropriate; however, the merits of the proposal, including proposed wording changes to ED 43, would be reconsidered at the June 2011 meeting.

A Member questioned how the grantor's interest in the service concession asset would be represented under a derecognition approach (IASB model) versus a performance obligation approach which would result in deferred revenue (the FASB model). It was noted that this issue needs to be considered. In addition, a question was raised as to how the interest in the service concession asset would be presented. It was noted that the grantor has given up the right to obtain the economic benefit in exchange for the service potential in the asset. Another Member noted that the netting approach identified is appropriate when the replacement cost or fair value model is used; however, there is a concern when the model is cost-based. For example, if the operator is required to return the asset in the same condition, it is difficult to argue that the asset value should be netted or reduced. A Member questioned whether the netting approach is only a presentation issue. It was noted that it is not just display, but also measurement.

A question was raised as to whether the grantor accounting appropriately mirrors IFRIC 12. It was pointed out that the right given up by the grantor is not recognized because it had not been recognized by the grantor. The Member noted that, although the netting approach has some merit, it is not yet developed, and the project should proceed on the basis of consistency with existing IPSASs. Therefore, it was recommended that the project should build on IPSAS 9 by analogizing the IPSAS 9 approach to revenue recognition to service concession arrangements, which do not exactly fit any of the scenarios outlined in IPSAS 9. It was also noted that the approach may need to be revisited if the IPSASB's Conceptual Framework project and/or the IASB's project on lease accounting warrant a change.

A Member suggested that, rather than directly link to IPSAS 9, a specific revenue recognition approach should be developed for SCAs. The approach should be clearly explained in the Basis for Conclusions. A question was raised as to whether the proposed changes to ED 43 would require re-exposure. It was noted that the decision as to whether to re-expose should be considered when the IPSASB has considered all of the changes required to address respondents' concerns and determined whether the changes in their totality, are substantive.

It was agreed that Marie-Pierre Cordier would join the TBG until completion of the project.

## **SERVICE CONCESSION ARRANGEMENTS**

### Issues That Have not been Previously Discussed by the Board

#### LIST OF RESPONDENTS to ED 43

<b>Response #</b>	<b>Respondent</b>	<b>Response #</b>	<b>Respondent</b>
1	Head of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) (Australia)	18	Wales Audit Office
2	Australasia Council of Auditors General (ACAG)	19	Fédération des Experts comptables Européens
3	Accounting Standards Board Committee on Accounting for Public-Benefit Entities (UK)	20	Conseil de normalization des comptes publics (France)
4	Joint Accounting Bodies (Aus)	21	Institute for the Accountancy Profession (Far) (Sweden)
5	Prof. Keith Glaister (University of Sheffield)	22	Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE)
6	Chartered Institute of Public Finance and Accountancy (CIPFA) (UK)	23	Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP)
7	National Financial Management Authority (ESV) (Sweden)	24	Auditor General of Quebec (Canada)
8	Public Sector Accounting Board (PSAB) (Canada)	25	Direction Générale des Finances Publiques (France)
9	New Zealand Treasury	26	Australian Accounting Standards Board (AASB)
10	Audit Commission (UK)	27	Contrôleur des finances du Québec (Canada)
11	Cour des comptes (Comité consultative sur la normalization des comptes publics) (France)	28	Institute of Chartered Accountants of Pakistan
12	Ernst & Young	29	Treasury Board of Canada Secretariat
13	Institute of Chartered Accountants of Scotland (ICAS)	30	MAZARS
14	Japanese Institute of Certified Public Accountants (JICPA)	31	US Governmental Accounting Standards Board (GASB)
15	Accounting Standards Board (ASB South Africa)	32	Office of the Comptroller General of British Columbia (OCG BC) Canada
16	Association of Chartered Certified Accountants (ACCA) (global body for professional accountants)	33	KPMG
17	Dr. Joseph Maresca		



## **COMMENTS BY ISSUE**

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## Issue 1: Scope

### 1A. Arrangements Outside the Scope of ED 43

#### *Overview of Respondents' Comments*

1. Seven respondents (R#1, 12, 15, 20, 24, 25, and 26) commented on the need to provide further guidance on arrangements which do not meet the asset recognition principle in ED 43.
2. Respondent 1 and Respondent 26 noted that the Table (in Implementation Guidance) does not deal with Build-Operate-Transfer arrangements that do not meet the grantor-control criteria in the ED and it is not clear which standard would apply in this case. Also, the Table does not deal with operator-owned property that transfers to the grantor at the end of the concession period. This Respondent also notes that the Table does not contemplate Build-Own-Operate-Transfer (BOOT) arrangements, where operator-owned property ultimately transfers to the grantor, and questions whether arrangements are meant to be outside scope because the operator owns the underlying property. The Respondents note that guidance on accounting for these forms of service concession arrangement would be helpful. This Respondent also suggested that it would be helpful if the proposed standard addressed the accounting for service concession arrangements where the grantor's control of the underlying property is deferred until the end of the concession period. Respondent 26 also commented on whether BOOT arrangements are within the scope of the proposed standard, as they do not fall neatly into any of the columns in the Table due to asset ownership by the operator but residual interest being held by the grantor.
3. Respondent 12 also notes that in some countries the scope of "SCAs" is broader than that proposed in ED 43 and questions why the IPSASB proposed to issue a Standard rather than an Interpretation (as was done by the IASB for IFRIC 12). The Respondent notes it would be helpful to have another standard deal with the broader scope of such arrangements.
4. Respondent 15 highlights in particular the private sector pronouncements applied by operators in service concession arrangements, which oblige an operator to consider whether an arrangement contains a lease if it does not fall within the scope of IFRIC 12 (specifically the guidance in IFRIC 4 *Determining Whether an Arrangement Contains a Lease* is to be considered). If the grantor concludes that an arrangement falls outside the scope of this proposed IPSAS, this respondent asserts that no further public sector guidance is currently available to assist the grantor in accounting for such an arrangement. This Respondent recommends that the proposed IPSAS, as part of the application guidance, should direct the grantor to other pronouncements that should be considered if it is concluded that an arrangement does not fall within the scope of this proposed IPSAS.
5. Respondent 20 noted that the provisions in ED 43 are not broad enough as there are no specific dispositions proposed for the assets which do not meet the control criteria or for the assets which partially meet those control criteria. This

Respondent also considers that the nature or extent of the arrangements which are within the scope of the Exposure Draft is not clear enough. It should be clarified whether it includes all arrangement involving an operator constructing or developing an asset used to provide a public service.

6. Respondent 24 suggested that an arrangement in which the operator would provide services directly to the government rather than to the general public should also be subject to the proposed Standard.
7. Respondent 25 notes that it would be useful if the IPSAS Board addressed the accounting treatment for service concession arrangements that do not satisfy all the control criteria and in particular criteria the linked to the price.

*Analysis*

8. Under ED 43, if the control criteria for recognition of a service concession asset are not met, the arrangement is NOT a SCA.
9. At its November 2010 meeting, the IPSASB tentatively reconfirmed its position to mirror IFRIC 12. The IPSASB also agreed that it was not necessary to provide guidance for types of arrangements that fall outside of the control-based asset recognition criteria.
10. The IPSASB also tentatively agreed that the scope should not be broadened to include other types of public-private arrangements beyond those meeting the recognition criteria in ED 43; however, the Basis for Conclusions needs to explain clearly that these other types of arrangements are not within the scope of the proposed IPSAS and that the IPSASB may decide to undertake a project to address them in the future. (See approved Jakarta Minutes, included as Appendix 1).
11. The second chart in the Implementation Guidance (page 32 of ED 43) is intended to be illustrative only and not exhaustive. Staff considers that there may be variations in BOOT arrangements. In some cases, an arrangement may fall within the scope of the proposed Standard, and other times, it may not, depending on the specific terms and conditions in the binding arrangement. The control criteria would need to be followed to determine whether or not the arrangement is within scope, regardless of what it is called.

*Staff Recommendation*

12. Staff has drafted proposed the following modifications to the standard section and the basis for conclusions to reflect the IPSASB's direction in November 2010.

*Proposed Amendments to draft Standard*

13. Below are the relevant paragraphs from ED 43, marked-up to show the proposed changes.

**Draft Standard**

7. ~~To be within the scope of this Standard, 1 an arrangement must be~~Service concession arrangements are binding on the parties to the arrangement~~arrangements that~~ oblige the operator to provide ~~the~~ public services related to the service concession asset to the public on behalf of the grantor. Only those arrangements that meet the criteria in paragraph 10 and paragraph 11 are within the scope of this Standard. Other arrangements, such as those that do not involve the delivery provision of public services<sup>1</sup> fall outside the scope of this Standard, as do arrangements that involve service and management components where the asset is not controlled by the grantor, as specified in paragraph 10, or paragraph 11 for a whole-of-life asset (e.g., outsourcing, service contracts, or privatization), should be accounted for using other IPSASs.

**Scope**

- BC2. After considering the various types of arrangements involving public and private sector entities ~~identified in the development of~~the March 2008 Consultation Paper, “Accounting and Financial Reporting for Service Concession Arrangements,” the IPSASB agreed that the scope of this Standard should be the mirror of IFRIC 12, in particular, the ~~circumstances~~criteria under which the grantor recognizes a service concession asset (see paragraphs BC9–BC13). The rationale for this decision is that the IPSASB considers these criteria to be appropriate. This approach would also have the benefit of requiring both parties to the same arrangement to apply the same principles in determining ~~whether~~which party should recognize the asset used in a service concession arrangement ~~should be accounted for as an asset. Thus, only arrangements in which both the criteria for recognition of a service concession asset in paragraph 10 are not satisfied, are outside the scope of this IPSAS. The IPSASB considers that this approach~~thus minimizing the possibility for an asset to be accounted for by both of the parties, or by neither party.
- BC3. ~~However, the IPSASB recognized~~concluded that the Standard should provide Implementation Guidance on the relevant IPSASs that apply to arrangements outside the scope of the Standard. The Implementation Guidance contains a flowchart illustrating the application of this Standard as well as a table of references to relevant IPSASs for the other types of arrangements that are outside the scope of this Standard because they do not satisfy the criteria for recognition of a service concession asset in paragraph xx.

<sup>1</sup> See also the discussion of the need for a definition of “public services” under Issue 2 below.

**Question for the IPSASB:**

1.1 Do you agree with the proposed revised wording in the Standard section and Basis for Conclusions set out above?

**1B. Scope Differences from IFRIC 12**

*Overview of Respondents' Comments*

14. Respondent 8 questions why ED 43 expands the scope of IFRIC 12 to include “intangible assets used for administrative purposes” and does not provide examples.
15. Respondent 12 suggests that clarification would be useful within the Introduction or in the scope paragraph on the specific types of assets included in the scope of the proposed Standard.

*Analysis*

16. The scope of the project is intended to be the same as that for IFRIC 12.
17. The reference to “intangible assets used for administrative purposes” is in the Introduction and Application Guidance of ED 43. The reference in the Introduction may be deleted under the ED 45 proposal. At this stage of the service concession arrangements project, however, staff have not deleted the Introduction, nor have any changes been proposed, pending the IPSASB’s final decisions on the ED 45 proposal. Staff considers it appropriate to consider this issue when the responses to ED 45 have been addressed by the IPSASB. If, at that time, the Respondents to ED 45 are in agreement with the proposal to delete Introduction sections from IPSASs, it may be appropriate to move the material in paragraphs IN4 and IN8 to the Scope section of the proposed Standard for greater clarity.
18. Staff considers that many large-scale technology-based projects would be considered infrastructure (e.g., software to run a facility or to support on-line service provision) as the term was used in IFRIC 12. Staff considers the administrative support feature (for both intangible and tangible assets) to be an important element of providing services to the public (e.g., on-line licensing systems, the building in which applications for social services are taken).
19. Further, with respect to providing guidance on the specific type of assets included in the scope of the proposed Standard, the IPSASB had previously discussed this issue and had agreed at that it was not necessary to do so in light of the fact that the proposed Standard is intended to address the same types of assets as those within the scope of IFRIC 12. It is not the type of asset in and of itself that determines whether the arrangement is a service concession arrangement, but rather, whether the terms of the binding arrangement meet the control criteria for recognition of a service concession asset.

*Staff Recommendations*

20. No changes are proposed.

**Question for the IPSASB:**

1.2 Do you agree that the existing guidance in ED 43 is appropriate?

**1C. Operator is a Public Sector Entity/No Guidance for GBEs**

*Overview of Respondents' Comments*

21. Three Respondents (R#1, 4, and 26) asked for guidance to address cases when the grantor is a government business enterprise (GBE).
22. Respondent 33 suggested that public-to-public arrangements should be within the scope of the proposed Standard, and if they are excluded, that this should be stated explicitly.

*Analysis*

23. ED 43 was developed to apply only to public sector grantors. This is consistent with the approach taken in IFRIC 12, which is restricted to public-to-private service concession arrangements (paragraph BC10 of IFRIC 12).
24. It is not intended to apply to operators, whether they are public sector or private sector entities. Nor is it intended to apply to GBEs that may be grantors. Staff considers the applicability is clearly stated in ED 43.

**Scope**

4. A grantor that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for service concession arrangements.
5. This Standard applies to all public sector entities other than Government Business Enterprises.
25. GBEs are not addressed in IPSASs, as stated in the Preface to International Public Sector Accounting Standards:
- The Standards do not apply to GBEs. GBEs apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB).
- As such, any specific issues that may arise when the grantor is a GBE were not considered when developing ED 43.
26. As noted in previous discussions by the IPSASB, the need for additional guidance on other types of arrangements (including government to government arrangements) may be considered as part of the IPSASB's project prioritization.

27. Staff notes that IFRIC 12.BC14 contains the following guidance to assist in applying the guidance to private-to-private arrangements. Such guidance could be provided in the proposed standard to apply to public-to-public arrangements.

**Private-to-private arrangements**

BC14 Some respondents to the draft Interpretations suggested that the scope of the proposed Interpretation should be extended to include private-to-private service arrangements. The IFRIC noted that addressing the accounting for such arrangements was not the primary purpose of the project because the IFRIC had been asked to provide guidance for public-to-private arrangements that meet the requirements set out in paragraph 5 and have the characteristics described in paragraph 3. The IFRIC noted that application by analogy would be appropriate under the hierarchy set out in paragraphs 7–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

*Staff Recommendations*

28. Staff proposes to add guidance on public-to-public arrangements similar to that noted in IFRIC 12.BC14.

*Proposed Amendments to draft Standard*

29. Below is the proposed paragraph to be added to the Basis for Conclusions.

**Basis for Conclusions (new text follows existing BC6))**

BC6. This Standard does not specify the accounting by operators, because it is addressed in IFRIC 12. In many cases the operator is a private enterprise, and IPSASs are not designed to apply to private sector entities. . The operator may also be a Government Business Enterprise (GBE).IPSASs are not designed to apply to GBEs. International Financial Reporting Standards (IFRSs) apply to private sector entities and GBEs.

BC6A. Some respondents to ED 43 suggested that the scope of the proposed Interpretation should be extended to include public-to-public service concession arrangements. The IPSASB noted that addressing the accounting for such arrangements was not the primary purpose of the project which was to provide guidance for public-to-private arrangements that meet the requirements set out in paragraph XX and have the characteristics described in paragraph XX. The IPSASB noted that application by analogy would be appropriate under the hierarchy set out in paragraphs 14-15 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

**Question for the IPSASB:**

- 1.3 Do you agree with the proposed changes to ED 43 to clarify applicability to public-to-public arrangements?



1D. Relation to IPSAS 13

*Overview of Respondents' Comments*

30. Respondent 9 suggested a consequential amendment is needed to IPSAS 13, with the same effect as the scope exclusion in IFRIC 4, to provide a scope exclusion under that standard for arrangements covered by the proposed Standard. It would ensure that accounting guidance for lessors will not be followed by grantors entering into service concession arrangements.

*Analysis*

31. Staff considers that the consequential amendment to IPSAS 13 would help clarify the applicability of the proposed Standard.
32. On a related note, the IPSASB has a lease project on its list of future projects and will assess its priority relative to other potential projects. The staff will continue to monitor the IASB project on leases and assess whether it affects the proposed Standard. However, it is noted that the planned schedule for the IASB to ballot the final IFRS is Q3 2011.

*Staff Recommendations*

33. Staff proposes to add a scope exclusion under IPSAS 13.

*Proposed Amendments to draft Standard*

34. Below is the relevant paragraph from ED 43, marked-up to show the proposed consequential change to IPSAS 13.

**Amendments to Other IPSASs**

**IPSAS 13, "Leases"**

**Paragraph 2 is amended as follows:**

**Scope**

2. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for all leases other than:
- (a) Leases to explore for or use minerals, oil, natural gas, and similar non-regenerative resources; and
  - (b) Licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents, and copyrights.
- However, this Standard shall not be applied as the basis of measurement for:
- (a) Property held by lessees that is accounted for as investment property (see IPSAS 16, "Investment Property");
  - (b) Investment property provided by lessors under operating leases (see IPSAS 16);
  - (c) Biological assets held by lessees under finance leases (see IPSAS 27, "Agriculture");
  - ~~or~~
  - (d) Biological assets provided by lessors under operating leases (see IPSAS 27); or
  - (e) Assets recognized under service concession arrangements (see IPSAS XX, "Service Concession Arrangements: Grantor).



**Question for the IPSASB:**

- 1.4 Do you agree with the proposed consequential change to IPSAS 13?

**Issue 2: Definitions**

*Overview of Respondents' Comments*

- 35. Eight respondents (R# 1, 2, 12, 15, 20, 23, 26, and 30) commented on the way in which the terminology was presented in ED 43, and on the need for definitions of specific terms.
- 36. Respondents 12, 15, and 26 commented on the treatment of terminology in ED 43 which differs from other IPSASs and the rationale for the difference. Respondent 26 suggested that the first sentence of paragraph BC7 be deleted because the reason given (i.e., the different nature of the standard) is weak. The Respondent notes that much of the guidance on terminology and scope amounts to definitions in any case.
- 37. Respondents 1 and 2 asked for a definition of “service concession arrangement”. Respondent 2 also notes that paragraph 3(c) should be expanded to include existing assets of the grantor which are reclassified.
- 38. Respondents 20, 23, and 30 asked for a definition of “public service”.

*Analysis*

- 39. The treatment of key terms as terminology rather than definitions is consistent with IFRIC 12, which is being mirrored in ED 43 for the grantor.
- 40. However, as indicated by some Respondents, IFRIC 12 is an Interpretation and ED 43 is a proposed Standard. Thus, consistency with other IPSASs would be appropriate.
- 41. Staff agrees with the suggested change by Respondent 26 to eliminate the first sentence of paragraph BC7, which It currently reads as follows:
  - “The IPSASB agreed that it was not necessary to provide definitions in light of the different nature of this Standard (i.e., it is intended to “mirror” the IFRIC 12 requirements) and the fact that IFRIC 12 does not specifically define terms.”
- 42. Consistent with IFRIC 12, “service concession arrangement” is not defined; it is described in paragraph 7. Respondent 26 supports this treatment because the description of typical service concession arrangements in paragraph 2, combined with the requirements in paragraph 7, will be sufficient to ensure that the appropriate arrangements are captured.

43. It is important that the proposed Standard identify the issue in paragraph 3 to ensure consistency with the scope set out in more detail in paragraph 8 of ED 43. Staff therefore agrees with the following change suggested by Respondent 2 to paragraph 3 to clarify that the proposed Standard also applies to existing assets of the grantor which are reclassified as service concession assets.

“...conditions for recognition or reclassification set out in...”

44. IFRIC 12, para. 1 provides examples of public services:

“In many countries, infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.”

This paragraph is adapted in paragraphs IN4 and AG2.

#### *Staff Recommendations*

45. As noted in above, staff proposes to amend paragraph 3 to clarify the applicability to existing assets of the grantor used in a service concession arrangement.
46. Staff also supports the view that certain terms could be provided as definitions. These include “service concession arrangement”, “operator”, “grantor” and “binding arrangement”.
47. Staff also proposes amend the Basis for Conclusions to clarify the reasons why the proposed standard does not contain a Definitions section like other IPSASs.

#### *Proposed Amendments to draft Standard*

48. Below are the relevant paragraphs from ED 43, marked up to show proposed definitions, if the IPSASB agrees that a “Definitions” section should replace the existing “Terminology”.

### **Draft Standard**

#### **Definitions**

#### **Terminology Definitions**

2. **The following terms are used in this Standard with the meanings specified:**

~~A service concession arrangement typically involves an operator constructing or developing the asset used to provide the public service or upgrading an existing asset (e.g., by increasing its capacity) and operating and maintaining the asset for a specified period of time. The operator is compensated for its services over the period of the arrangement. The arrangement is governed by a binding arrangement that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. The service concession arrangement is binding on the parties to the arrangement and obliges the operator to provide the public services on behalf of the public sector entity.~~

~~3. The following terminology is used in this Standard:~~

~~A **binding arrangement** describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract.~~

~~A **grantor** is the entity that grants the service concession to the operator.~~

~~An **operator** is the entity that uses the service concession asset to provide public services subject to the grantor's control of the conditions set out in paragraph 10 (or paragraph 11 for a whole-of-life asset).~~

~~A **service concession arrangement** is a binding arrangement between a grantor and an operator in which the grantor (a) controls or regulates the services provided by the operator using a service concession asset, and (b) controls any significant residual interest in the asset at the end of the term of the arrangement. For arrangements involving whole-of-life assets, the binding arrangement is only required to satisfy criterion (a) to meet the definition of a service concession arrangement.~~

~~A **service concession asset** is an asset used to provide public services in a service concession arrangement that meets the conditions for recognition set out in paragraph 10 (or paragraph 11 for a whole-of-life asset), or for reclassification as set out in paragraph 13.~~

~~Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the Glossary of Defined Terms published separately.~~

~~3. A service concession arrangement typically involves an operator constructing or developing the asset used to provide the public service or upgrading an existing asset (e.g., by increasing its capacity) and operating and maintaining the asset for a specified period of time. The operator is compensated for its services over the period of the arrangement. The arrangement is governed by a binding arrangement that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. The service concession arrangement is binding on the parties to the arrangement and obliges the operator to provide the public services on behalf of the public sector entity.~~

49. The initial wording of ED43.7 may have suggested that the provision of a public service is important in determining whether an arrangement is a service concession arrangement. This paragraph has been revised (see paragraph 13 above), and as a result, staff does not believe it is necessary to provide a definition of “public service” as suggested by some Respondents. Further, that term is used in existing IPSASs (IPSASs 1, 19, 22, 23) without definition. Staff considers the term to be well-understood, and not specific to the proposed Standard.

50. If the IPSASB considers it appropriate to retain the “Terminology” section, rather than adopting the proposed definitions, clearer explanations are required to explain the IPSASB’s rationale for not providing definitions.

51. Below are the relevant paragraphs from the Basis for conclusions, marked up to show the proposed changes to address Respondents' concerns regarding the need for a definitions section and for a better explanation of why definitions were not provided in ED 43.

## Draft Basis for Conclusions

### Terminology

- BC7. ~~The IPSASB agreed that it was not necessary to provide definitions in this~~Consistent with IFRIC 12, ED 43 requirements) ~~and the fact that IFRIC 12 does not specifically define terms, did not include definitions, but instead~~The IPSASB has provided guidance on certain terminology. ~~used in~~Respondents to ED 43 proposed that because ~~this is a Standard and not an Interpretation, it was important to include definitions for consistency in application. This ise approach used. In particular, the main term in this Standard is “service concession arrangement,” which is not defined in IFRIC 12. The guidance in IFRIC 12 on characteristics of service concession arrangements has been adapted for~~IPSASB agreed that this Standard should include definitions.

### Question for the IPSASB:

- 2.1 Do you agree with the proposed changes to the Basis for Conclusions?

### Issue 3: Control Criteria

52. The control criteria specified in ED 43.10 are as follows:
10. The grantor shall recognize a service concession asset in respect of an asset specified in paragraphs 8(a), 8(b) and 8(c); and shall reclassify an asset specified in paragraph 8(d) if:
    - (a) The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
    - (b) The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.
  11. This Standard applies to an asset used in a service concession arrangement for its entire useful life (a —whole-of-life□ asset) if the condition in paragraph 10(a) is met.
  12. Where an existing asset of the grantor specified in paragraph 8(d) meets the conditions specified in paragraph 10 (or paragraph 11 for a whole-of-life asset), the grantor shall not recognize the asset as a service concession asset in accordance with this Standard. The grantor shall reclassify the existing asset as a service concession asset for reporting purposes and disclose the reclassification in accordance with paragraph 27. The reclassified service concession asset shall continue to be accounted for in accordance with IPSAS 17, “Property, Plant and Equipment” or IPSAS 31, “Intangible Assets”, as appropriate.

**3A. “Regulates”**

*Overview of Respondents’ Comments*

- 53. Four Respondents (R#1, 9, 26, and 33) commented on the additional public sector guidance related to the “regulates” portion of the control criteria.
- 54. Respondent 1 and Respondent 9 note the additional guidance creates an asymmetry with IFRIC 12 which could result in neither the grantor nor the operator recognizing the service concession asset. They point out that this results in the broader use of the term in IFRIC 12 for private sector entities, which does not consider the public sector grantor’s perspective.
- 55. Respondent 26 further notes that governments are likely to conclude that independent regulators should not be factored into assessing the control or regulation specified in the control criteria.
- 56. Respondent 33 believes there is an apparent conflict in the Application Guidance (AG6 and AG7) and paragraph 10(a) of ED 43. This Respondent suggests clarification of the role of the “third-party regulator” and how such a regulator would impact the assessment of the criterion in paragraph 10(a).

*Analysis*

- 57. ED 43.AG6 (IFRIC 12.AG2) notes that, “The control or regulation referred to in condition (a) could be by contract or otherwise (such as through a regulator) and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. In applying this condition, the grantor and any related parties shall be considered together. If the grantor is a public sector entity, the public sector as a whole, together with any regulators acting in the public interest, shall be regarded as related to the grantor for the purposes of this Interpretation.”
- 58. The IPSASB tentatively decided the following, as noted in the excerpt from the November 2010 IPSASB minutes (see Appendix):

“Whole-of-life assets should remain within the scope of the proposed IPSAS and that additional guidance on the term, “regulate” is required to address the public sector context, which was not necessary in IFRIC 12. The Basis for Conclusions, however, needs to outline views for and against these decisions and why the IPSASB came to these decisions.”

- 59. ED 43.10(a), which is consistent with IFRIC12.5, is intended to apply only to the regulation specific to the service concession arrangement (i.e., services, recipients and price). As noted in ED 43.AG6, control or regulation in control criterion (a) is either by contract or through a regulator, and is not therefore intended to refer to the broad understanding of public sector regulatory powers from the grantor’s point of view. The guidance in ED43.AG8 is intended to reinforce this intent. For example, a regulator of rail services may determine rates that apply to the rail

- industry as a whole. Depending on the legal framework in a jurisdiction, such rates may be implicit in the binding arrangement, or they may be referred to in the binding arrangement. However, in both cases, the control is derived from either contract or the specific regulation applicable to a service concession arrangement involving rail services and not from the fact that the grantor is a public sector entity that is related to the regulator of rail services.
60. Staff considers that the inclusion of guidance for the public sector on the meaning of “regulate” does not create asymmetry. Rather, the guidance ensures that both parties are looking at paragraph 10(a) from the point of view of the specific service concession arrangement.

*Staff Recommendations*

61. Staff proposes to:
- (a) Amend paragraph AG8 to better explain how “regulates” applies to the grantor; and
  - (b) Add an explanation in the Basis for Conclusions to explain the reasons why the additional guidance has been provided.

*Proposed Amendments*

62. Below are the relevant paragraphs from ED 43, marked-up to show the proposed changes to address Respondents’ concerns on use of the term “regulates” and related guidance.

**Draft Standard**

...

- AG8. Many governments have powers to regulate entities operating in certain sectors of the economy either directly or through specifically created agencies. Governments and their agencies have the power to regulate the behavior of many entities by use of their powers and rights conferred by legislation, a constitution, or by equivalent means. For the purpose of paragraph 10(a), such the broad regulatory powers of governments, as described above do not constitute control. In this Standard, the term “regulate” is not intended to convey the broad sense of the power of governments and government entities to regulate the behavior of entities by use of those sovereign or legislative powers. Rather, it is intended to be applied only in the context of the specific terms of the service concession arrangement.

...

**Draft Basis for Conclusions**

- BCXX. ED 43 contained additional guidance on applying the term “regulates” in paragraph xx(a) to determine whether the grantor should recognize a service concession asset. Some respondents to ED 43 asserted that providing such additional guidance would create an asymmetry with IFRIC 12. However, the IPSASB considers such guidance is necessary to ensure symmetry exists between the public sector grantor and the private sector

operator. The operator applies the term “regulates” solely in the context of the service concession arrangement, and not in the broader sense of government regulation. Likewise, the guidance for the grantor ensures the grantor also considers the regulation of pricing solely in relation to the binding arrangement governing the service concession arrangement, and not in relation to the broader regulatory powers of government.

**Questions for the IPSASB:**

- 3.1 Do you agree with the proposed guidance related to use of the term “regulates” in the control criteria?
- 3.2 Do you agree with the rationale provided in the Basis for Conclusions for adding public sector guidance related to use of the term “regulates”?

**3B. Residual interest/Whole-of-life assets**

*Overview of Respondents' Comments*

63. Four Respondents (R# 1, 12, 15, and 26) commented the control criterion related to residual interest.
64. Respondent 1 considers that a fundamental feature of service concession arrangements is that they require the operator to use the service concession property to provide services to the public. This Respondent notes that a grantor will not control a significant residual interest unless it also has a continuing right of use throughout the concession period, and questions how a grantor has a continuing right of use throughout the concession period if the operator has use of the property under a binding arrangement with the grantor. The Respondent suggests the grantor may instead have a right to receive the property at the end of the concession period, rather than a right of use.
65. Respondents 12 and 15 commented on the treatment of residual interest in the control criteria for recognition of the service concession asset. Respondent 12 notes that it is not clear from the current wording of ED 43 that paragraph 10(b) does not apply to a whole-of-life asset. Respondent 15 recommends the proposed Standard provide explanatory guidance on the meaning of “significant residual interest”.
66. Respondents 12 and 15 also commented on the reference to “useful life” in IFRIC 12.6 for whole-of-life assets, and suggested the reference should be to “economic life”. IFRIC 12.6 states:
- Infrastructure used in a public-to-private service concession arrangement for its entire useful life (whole of life assets) is within the scope of this Interpretation if the conditions in paragraph 5(a) are met.
67. Respondent 26 supports the change from the March 2008 Consultation Paper, *Accounting and Financial Reporting for Service Concession Arrangements* to refer to a “significant residual interest”.



*Analysis*

68. At its November 2011 meeting, the IPSASB tentatively reconfirmed its approach to mirror IFRIC 12 (see excerpt from Minutes, attached as an Appendix). The guidance on the control criteria in ED 43, including residual interest and whole-of-life assets, is consistent with IFRIC 12. The treatment of residual interest is consistent with IFRIC 12.BC19. Staff considers that the treatment of “whole-of-life” assets in ED 43 is consistent with this approach and does not consider additional explanations to be required, as suggested by Respondents 12 and 15.
69. With respect to the comments of Respondent 1, it is noted that the operator does not have use of the service concession asset for its own purposes, but rather for the benefit of the grantor and its constituents, which results in *de facto* control of use of the asset by the grantor. Thus, the grantor does have control over the significant residual interest under the Respondent’s argument above.
70. Paragraph AG6 of IFRIC 12 notes that “Conditions (a) and (b)<sup>2</sup> together identify when the infrastructure, including any replacements required (see paragraph 21), is controlled by the grantor for the whole of its economic life.
71. As previously noted, whole-of-life assets are an exception to the control criteria – they are considered to be within the scope of IFRIC 12 (and ED 43) if they only meet criterion (a). IFRIC 12.BC19, which explains why criterion (b) is not required to be met for whole-of-life assets. Criterion (b) requires a significant residual interest in the service concession asset be returned to the grantor at the end of the service concession arrangement involving the entire physical life of the asset.
72. With respect to the comments on whether the reference should be to useful life or to economic life, staff notes that the wording is consistent with IFRIC 12.
73. IPSAS 13 defines “economic life” as follows:  
**Economic life is either:**  
(a) **The period over which an asset is expected to yield economic benefits or service potential to one or more users; or**  
(b) **The number of production or similar units expected to be obtained from the asset by one or more users.**
74. IPSAS 17 defines “useful life” as follows:  
**Useful life is:**  
(a) **The period over which an asset is expected to be available for use by an entity; or**  
(b) **The number of production or similar units expected to be obtained from the asset by an entity.**
75. Members of the Task Force also note that where the grantor obtains control of an operator’s assets, it may not have the use of the asset over its entire economic life, particularly where the operator has used it for a significant period of time prior to it being used in the service concession arrangement. In the context of describing the period related to a whole-of-life asset, it is the useful life of the asset in

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<sup>2</sup> These are referred to as “the control criteria”.



relation to an entity (in this case, the grantor) which is the key consideration. Thus, it is appropriate to retain the reference to useful life.

*Staff Recommendation*

76. No change is proposed.

**Question for the IPSASB:**

3.3 Do you agree that no changes are required?

**Issue 4: Recognition and Measurement of Service Concession Asset**

77. Nineteen respondents (R# 1, 2, 3, 8, 9, 11, 12, 13, 15, 18, 20, 22, 24, 26, 29, 30, 31, 32, and 33) commented on various aspects of the recognition and measurement principles and guidance in ED 43. Because they are individual issues, they are analyzed individually.
78. Respondents commented on various aspects of recognition and initial and subsequent measurement of the service concession asset:
- (a) Existing Assets of the Grantor Used in the SCA (recognition vs. reclassification);
  - (b) Existing Assets of the Grantor Given to the Operator and Not Used in the SCA (derecognition);
  - (c) Capital work-in-progress (recognition);
  - (d) Initial measurement at fair value;
  - (e) Subsequent measurement;
  - (f) Depreciation; and
  - (g) Impairment.

**4A. Existing Assets of the Grantor Used in the SCA**

79. Eight Respondents (R# 8, 13, 15, 18, 22, 24, 31, and 33) commented on the references in ED 43 to existing assets of the grantor. Three issues were raised.

4.A.1 – Existing assets of the grantor

*Overview of Respondents' Comments*

80. Paragraph 8 lists the types of assets included in the scope of ED 43. Respondent 15 considers that ED 43 does not include guidance on the accounting for the example in paragraph 8(d), i.e., existing assets of the grantor to which the grantor gives the operator access for the purpose of the service concession arrangement. Respondent 24 has similar concerns. Both Respondents (R# 15 and 24) consider that guidance on this type of service concession arrangement should be included in the proposed Standard. Respondent 33 comments that ED 43 requires reclassification of an asset that becomes a service concession asset. This Respondent asks whether this separate classification is necessary given that service concession assets are accounted for in accordance with IPSAS 17, *Property, Plant, and Equipment* or IPSAS 31, *Intangible Assets*, as appropriate.

Respondent 31 suggested draft wording to clarify this relationship. Respondent 31 also suggested modification to clarify that the proposed Standard applies to both new and existing assets.

*Analysis*

81. ED 43 includes in its scope existing assets of the grantor to which the grantor gives the operator access for the purpose of the service concession arrangement and meets the control criteria in paragraph 10. This reflects the scope of IFRIC 12 as tentatively agreed upon by the IPSASB. However, IFRIC 12 does not specifically deal with the accounting for this type of service concession arrangement because the rebuttable presumption underlying IFRIC 12 is that the asset will be recognized by the grantor, regardless of ownership.
82. The intent of the guidance in ED 43 was to indicate that this was not an issue of recognition of a new asset, but of reclassification of the existing assets. (i.e., nothing needed to be done other than to reclassify the asset as a service concession asset, rather than to derecognize them and then recognize them as service concession assets).

*Staff Recommendation*

83. Staff does not consider it necessary to revalue the asset on reclassification. The asset will still be used to provide services on behalf of the grantor. The existing asset needs to be reclassified for presentation purposes, and not recognized and accounted for as a new service concession asset under the control criteria in the proposed Standard. No change is proposed.

**Question for the IPSASB:**

- 4.1 Do you agree that the proposed Standard should deal only with the presentation requirements relating to existing assets of the grantor that are reclassified as service concession assets after meeting the control criteria?

4.A.2 – Separation of costs of existing asset and cost of upgrade

*Overview of Respondents' Comments*

84. Respondent 2 notes that the proposed accounting for an existing asset of the grantor, which is upgraded for the SCA, means that the same asset is separated into components with potentially different accounting treatments. The existing component may be measured at historical cost, while the upgrade is initially measured at fair value. Further, upgrading an asset may change its function or nature and extend its useful life. This Respondent suggested that, following upgrade, the whole asset be revalued and treated as a service concession asset.
85. Respondents 15, 18 and 24 have concerns that the existing asset of the grantor and related upgrade will be divided into two components. Respondent 15 considers that the wording of paragraph 8(c) is unclear as to whether the existing asset of the grantor and the cost of the upgrade should be separated. Respondents 18 and

- 24 have concerns that the existing asset of the grantor and related upgrade will be divided into two components for which the accounting treatment will differ. Both Respondents (R# 18 and 24) consider that the whole service concession asset, i.e., existing asset and upgrade, is measured at fair value or revalued.
86. Similarly, Respondent 8 comments that ED 43 does not propose requirements for the pre-upgrade existing asset of the grantor. This Respondent considers that this aspect of the accounting for an existing asset needs to be clarified and suggested that a similar sentence to the last sentence in paragraph 8(d) could be added to paragraph 8(c), i.e., the remaining asset balance is to be reclassified as a service concession asset.
87. Respondent 15 also suggested that the second sentence of paragraph 8 (c) relates to recognition requirements rather than scope and should therefore be moved to the section on recognition.

*Analysis*

88. Where the service concession asset is property, plant, and equipment, paragraph 59 of IPSAS 17 requires that each part of an item of property, plant, and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. Thus, it is likely a service concession asset with an upgrade will be accounted for as more than one component.
89. Paragraph 88 of IPSAS 17 requires the disclosure of property, plant, and equipment by class. A class is different to a part or component of an item of property, plant, and equipment.
90. The second sentence of paragraph 8(c) was added for greater clarity about the fact that the existing asset does not require recognition, only reclassification; however, if upgrades are made, those upgrades require accounting. This sentence is not a requirement, but references the requirement.
91. The situation described by Respondent 2 is analogous to how subsequent costs are recognized under IPSAS 17. Only the incremental costs are added to the asset which has already been recognized. The full amount (asset as reclassified plus any upgrade) is treated as a service concession asset. Under IPSAS 17, the revaluation model, if used, is applied subsequent to initial measurement.
92. Staff considers that separate parts or components of a service concession asset do not need to be separately disclosed in the financial statements as they do not constitute a separate class of assets.
93. Staff does not consider that guidance additional to that provided in IPSAS 17 should be provided as the issues for service concession assets are not different from other types of assets.
94. An additional point is that paragraph 28 of ED 43 requires that disclosures presented for each material service concession arrangement or in aggregate for each class of service concession arrangements. This paragraph goes on to state

that a class is a grouping of service concession arrangements involving services of a similar nature.

*Staff Recommendation*

95. Staff proposes deleting the second sentence of paragraph 8(c) to remove confusion in the scope section, and adding wording to the section on recognition as suggested by Respondent 15. Staff also has modified paragraph 13 of the proposed Standard to require separate disclosure as a separate class of asset. See proposed wording changes presented below.

**Questions for the IPSASB:**

- 4.2 Do you consider that the proposed Standard should include Implementation Guidance relating to the parts or components of a service concession asset?
- 4.3 Do you agree with the proposed change to paragraph 13?

4.A.3 – Clarity of requirements of paragraph 12

*Overview of Respondents' Comments*

96. Respondents 13, 18 and 33 commented that the requirements in paragraph 12 are unclear, overcomplicated or confusing.

*Analysis*

97. Staff agrees that clarification of the requirements relating to subsequent measurement of a service concession asset is required. See proposed wording changes presented below.

*Staff Recommendation*

98. Staff proposes to amend paragraph 8, to delete paragraph 12, and to amend paragraph 13 to clarify the requirements relating to subsequent measurement of a service concession asset.

*Proposed Amendments to draft Standard for Issue 4A*

99. Below are the relevant paragraphs from ED 43, marked-up to show the proposed changes to address Respondents' concerns.

**Draft Standard**

8. This Standard applies to the following assets, ~~when they meet the conditions for recognition specified in paragraph 10 (or paragraph 11 for a whole-of-life asset), or for reclassification specified in paragraph 12:~~
- (a) Assets that the operator constructs ~~or develops~~, or acquires from a third party for the purpose of the service concession arrangement;
  - (b) Existing assets of the operator ~~to which the operator gives the grantor access~~ for the purpose of the service concession arrangement; and
  - (c) Existing assets of the grantor (including any upgrades) to which the grantor gives the operator access upgrades for the purpose of the service concession

- arrangement. ~~Only the cost of any upgrade to the existing asset is recognized as a service concession asset in accordance with paragraph 10, or paragraph 11 for a whole-of-life asset); and~~
- (d) ~~Existing assets of the grantor to which the grantor gives the operator access for the purpose of the service concession arrangement and of which the grantor retains control, as specified in paragraph 10 (or paragraph 11 for a whole-of-life asset). Such assets are reclassified as service concession assets in accordance with paragraph 12.~~

...

### Recognition and Measurement of a Service Concession Asset

10. The grantor shall recognize a service concession asset in respect of an asset specified in paragraphs 8(a), ~~and~~ 8(b) and any upgrades specified in paragraph 8(c) and 8(e); and shall reclassify an existing asset specified in paragraph 8(d) if:
- (a) The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
- (b) The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.
11. This Standard applies to an asset used in a service concession arrangement for its entire useful life (a “whole-of-life” asset) if the condition in paragraph 10(a) is met.
- ~~1512.~~ The grantor shall initially measure the ~~original~~ service concession asset recognized in accordance with paragraph 10 or paragraph 11 (for a whole-of-life asset), at its fair value.
- ~~138.~~ After initial recognition as a service concession asset in accordance with paragraph 10 or paragraph 11 (for a whole-of-life asset), ~~The service concession asset recognized in accordance with paragraph 10 (or paragraph 11 for a whole-of-life asset) it~~ shall be accounted for as a separate class of assets in accordance with IPSAS 17, *Property, Plant, and Equipment* or IPSAS 31, *Intangible Assets*<sup>3</sup> as appropriate.

AGXX. The requirement in paragraph 12 is to initially measure assets recognized in accordance with paragraph 10 or paragraph 11 at fair value. Existing assets of the grantor used in the service concession arrangement are reclassified rather than recognized under this Standard. Enhancements to existing assets are recognized and are therefore initially measured at fair value; fair value will be equivalent to the cost of the asset and recognition at fair value of the enhancement is therefore consistent with the principles applied to the recognition of subsequent expenditure on an asset.

#### Question for the IPSASB:

4.4 Do you agree that the proposed amendments clarify the requirements?

<sup>3</sup> Paragraph AG20 provides guidance for cases when the service concession asset is constructed or developed.

#### 4B. Existing Assets of the Grantor Given to the Operator and Not Used in the SCA

##### *Overview of Respondents' Comments*

100. Respondent 15 raised two related concerns about treatment of an asset which the grantor gives to the operator for the operator's own use (i.e., not used in the SCA).
101. The Respondent notes that when the grantor provides other items to the operator that it can keep or deal with as it wishes, IFRIC 12.27 requires the operator to recognize an asset and corresponding liability; however, ED 43 does not contain a requirement for the grantor to derecognize the asset provided. The Respondent also notes that paragraph AG40 requires the grantor to apply the derecognition principles in IPSAS 17 and IPSAS 31 and views that this paragraph should not apply to service concession assets.

##### *Analysis*

102. Paragraph AG40 reads as follows:

*Grantor Gives the Operator Access to Another Revenue-Generating Asset for its Use*

AG40. When the grantor compensates the operator for the service concession asset and service by the provision of a revenue-generating asset to the operator, the liability is a performance obligation<sup>4</sup> as indicated in paragraph 22. The liability is reduced as access to the revenue-generating asset is provided to the operator. In such cases, the grantor considers the derecognition requirements in IPSAS 17 or IPSAS 31, as appropriate.

103. Staff considers that paragraph AG40, along with the heading, clearly indicates that this paragraph applies only to non-service concession assets which are provided to the operator for its own use to generate revenue (not the service concession asset), and are derecognized. For example, land adjacent to a hospital is provided to the operator to use as a revenue-generating parking facility. In such cases, the grantor considers the relevant derecognition principle as noted above.

##### *Staff Recommendation*

104. No change is proposed.

#### **Question for the IPSASB:**

4.5 Do you agree that no changes are required?

<sup>4</sup> This reference to "performance obligation" is in existing ED 43 text. It will be amended to refer to "advance receipt" in final drafting of the proposed Standard.

#### **4C. Capital Work-in-Progress**

##### *Overview of Respondents' Comments*

105. Eight respondents (R#1, 9, 12, 15, 20, 26, 30, and 32) commented on the proposed guidance on how to account for assets that would be recognized under ED 43 while the assets are under construction.
106. Respondents 1 and 9 note that under accrual accounting principles, the grantor should recognize the asset and liability progressively as it is constructed rather than when it is complete, regardless of which party bears construction risk because a service concession asset is, by definition, grantor controlled and it is being constructed for the grantor pursuant to the contractual requirements of the service concession arrangement.
107. Respondent 9 further notes that the treatment in AG20 does not mirror the treatment in IFRIC 12, the basis on which the Board agreed to prepare this standard. Under IFRIC 12 the operator recognizes a growing receivable as the service concession asset is constructed. Under AG20 the "mirror" payable will not be recognized until the asset is placed into use. A further consequence is that the capital work-in-progress is not recognized by any party while the asset is being constructed.
108. Respondents 12 and 15 indicate that since the ED is dealing with contractual arrangements (in some cases quite similar to lease agreements), it may be useful to provide explicit guidance on whether the assessment of the recognition criteria is to be performed on inception of the agreement, or continuously throughout the term of the arrangement (at each reporting period end), or at the termination/expiry of the arrangement.
109. Respondent 20 considers that the guidance in paragraph AG20 is not consistent with the control approach set out by the Exposure Draft and the asset recognition criteria have to be consistent. As a consequence, the Respondent suggests that the application guidance be corrected in order to propose a control-based approach for the recognition of the concession asset during the construction phase.
110. Respondents 26, 30 and 32 questioned whether construction risk is a factor that should be considered in determining whether to recognize a service concession asset as it is being constructed or developed. They note that the service concession asset and the related liability should be accrued throughout the construction or development period.

##### *Analysis*

111. The intent of paragraph AG20 was to expand on the requirements in IPSAS 17, and IPSAS 31 which contains a general principle for recognition of an asset:

14. **The cost of an item of property, plant, and equipment shall be recognized as an asset if, and only if:**
- (a) **It is probable that future economic benefits or service potential associated with the item will flow to the entity; and**
  - (b) **The cost or fair value of the item can be measured reliably.**
112. IPSAS 31.38 contains the same requirement (with slightly different wording).
113. IPSAS 17 also contains guidance on measurement of such assets:
19. An entity evaluates under this recognition principle all its property, plant, and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant, and equipment and costs incurred subsequently to add to, replace part of, or service it.
114. IPSAS 31.55 contains the following criteria for recognition of assets developed:
- An intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following:**
- (a) **The technical feasibility of completing the intangible asset so that it will be available for use or sale;**
  - (b) **Its intention to complete the intangible asset and use or sell it;**
  - (c) **Its ability to use or sell the intangible asset;**
  - (d) **How the intangible asset will generate probable future economic benefits or service potential. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;**
  - (e) **The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and**
  - (f) **Its ability to measure reliably the expenditure attributable to the intangible asset during its development.**
115. As noted by respondents, the costs to construct a service concession asset, if reliably measurable, should be recognized consistent with IPSAS 17 (or IPSAS 31).
116. By analogy, IPSAS 11, *Construction Contracts*, provides guidance on when construction costs can be considered probable and able to be measured reliably:
37. An entity is generally able to make reliable estimates after it has agreed to a contract that establishes:
- (a) Each party's enforceable rights regarding the asset to be constructed;
  - (b) The consideration, if any, to be exchanged; and
  - (c) The manner and terms of settlement.
117. These conditions are likely to be met in the case of a service concession arrangement, particularly if the construction risks are passed to the operator by the grantor. It is therefore necessary to determine whether the grantor's asset and liability accrues over the period of construction, or whether the asset and liability only arises when construction is completed.
118. Proponents of the former view highlight that the construction only occurs pursuant to the contract and that to the extent the construction meets the specification of the contract, the grantor will have little ability to avoid accepting the full asset and the liability. The financial statements should therefore accrue the



- asset and liability as progress is made towards that point. Failure to do so would understate the grantor's developing rights and obligations under the contract.
119. Proponents of the later view highlight that the grantor does not have control of the service concession asset until it has been accepted, and it is this passing of control that should represent the recognition point for the asset and the liability> they suggest that if the grantor bears the construction risks, then the grantor does not have control of the asset under construction, and therefore neither the asset nor the liability should be recognized until the asset is accepted by the grantor.

*Staff Recommendation*

120. Staff proposes that, depending on the terms of the contract, the grantor's asset and liability would normally accrue over the period of construction and propose that the guidance in paragraph AG20 be clarified to explain that the specific terms and conditions of the binding arrangement need to be considered. For example, where an provides the grantor, the costs incurred are measurable, and where the grantor has little ability to avoid accepting the asset constructed to meet the specifications of the contract, the costs should be recognized as progress is made towards completion. Thus, the grantor will recognize a work-in-progress (WIP) service concession asset. (The operator does not report a WIP service concession asset under IFRIC 12.)
121. Below is the relevant paragraph from ED 43, marked-up to show the proposed changes.

**Draft Standard**

*Constructed or Developed Asset*

AG20. IPSAS 17 or IPSAS 31, as appropriate, set out the criteria for ~~the timing of initial recognition of when~~ a service concession asset should be recognized. Both IPSAS 17 and IPSAS 31 require that an asset shall be recognized if, and only if:

- (a) It is probable that future economic benefits or service potential associated with the item will flow to the entity; and
- (b) The cost or fair value of the item can be measured reliably.

AGXX. Those criteria, together with the specific terms and conditions of the binding arrangement need to be considered in determining whether to recognize the service concession asset during the period in which the asset is constructed or developed. For both property, plant and equipment and intangible assets, the recognition criteria may be met during the construction or development period, and, if so, the grantor will normally recognize the service concession asset during that period.

AGXX. The first recognition criterion requires the flow of economic benefits or service potential to the entity. The primary purpose of a service concession asset is to provide service potential on behalf of the public sector entity. Similar to an

asset the grantor may construct for its own use, the grantor would assess, at the time the costs of construction or development are incurred, the terms of the binding arrangement to determine whether the service potential of the service concession asset would flow to the grantor at that time.

AGXX. The second recognition criteria in IPSAS 31 also requires that the initial cost or fair value of the asset can be measured reliably for an intangible asset to be recognized. ~~In the case of property, plant and equipment, where the operator bears the construction risk, the timing of initial recognition of the service concession asset by the grantor will normally be when the asset is placed into use. Where the grantor bears the construction risk, the recognition criteria may be met during the construction period, and, if so, the grantor will normally recognize the service concession asset (and related liability) during that period. The recognition criteria in IPSAS 31 also require that the initial cost or fair value of the asset can be measured reliably for an intangible asset to be recognized.~~ Accordingly, to meet the recognition criteria in IPSAS 17 or IPSAS 31, as appropriate, the grantor must have reliable information about the cost or fair value of the asset during its construction or development. For example, if the service concession arrangement requires the operator to provide the grantor with progress reports, the costs incurred may be measurable, and would therefore meet the recognition principle in IPSAS 17 or IPSAS 31 for constructed or developed assets. Also, where the grantor has little ability to avoid accepting an asset constructed to meet the specifications of the contract, the costs should be recognized as progress is made towards completion. Thus, the grantor will recognize a work-in-progress (WIP) service concession asset, and an associated accruing liability. ~~In some cases, the grantor may incur an obligation during construction or development before the constructed or developed asset meets the conditions in paragraph 10 (or paragraph 11 for a whole of life asset) for recognition as a service concession asset.~~

**Question for the IPSASB:**

4.6 Do you agree with the proposed revised wording in the Application Guidance set out above?

**4D. Initial Measurement at Fair Value**

122. Respondents 3 and 11 were concerned that the initial measurement of the service concession asset at “fair value” might be interpreted as a market-based exit value. The Respondent did not consider this to be appropriate in the public sector context, where service concession assets are often highly specialized and will not be traded on a market and suggested the measurement requirement should specifically refer to replacement cost.

**Analysis:** This situation would not differ from other public sector assets which may be specialized.

**Staff Recommendation:** No change is proposed.

123. Respondent 9 noted that the logic in the implementation guidance does not follow the logic in the standard. In particular, the Respondent asserted that if the fair value is to be determined from the cost of its components, the standard should state that a cost base is being used and suggested guidance should be provided as to whether public sector comparators may be used as a replacement cost valuation, or whether efforts should be made to determine the private sector costs.

**Analysis:** Staff does not consider that determining fair value in this case should pose additional difficulties to an asset recognized as property, plant and equipment under IPSAS 17. In the details of the response, there were references made to the impact of the performance obligation issue, which is subject to additional revisions, which may adequately address this issue (see Agenda Paper 8.2 from the March 2011 IPSASB meeting).

**Staff Recommendation:** No change is proposed.

124. Respondents 11, 12, 15, 20, 32 also noted that if “fair value” refers to the cost of concession assets, such measurement is not generally a problem, but if fair value is understood as market value, then it seems to contradict the provisions of IPSAS 17 according to which *“an item of property, plant and equipment which qualifies for recognition as an assets should initially be measured at its cost”*.

**Analysis:** Under IPSAS 9, exchanges of dissimilar assets are initially measured at fair value. Under IPSAS 17.38, and IPSAS 31.44, the fair value in such cases becomes the initial cost.

**Staff Recommendation:** No change is proposed.

125. Respondent 13 assets also asked for additional guidance on estimation techniques for the initial recognition and measurement of assets when a contract is not separable.

**Analysis:** Paragraph AG25 contains guidance to determine the allocation of cost between the asset and service components for the initial recognition and measurement of the service concession asset.

**Staff Recommendation:** Staff does not consider it necessary to develop further guidance on estimation techniques beyond that contained in paragraph AG25.

126. Respondent 29 suggested ED 43 be revised to provide criteria to assess whether payments are separable would help to ensure that non-substantive contract terms are not applied in such a way that the economic substance of the arrangement is improperly reflected.

**Analysis:** Whether payments are separable is a matter of fact, based on the terms of the arrangement.

**Staff Recommendation:** No change is proposed.

127. Respondent 30 asked for guidance when part of the financing of the Service Concession Asset comes from government grants (and not from the grantor).

**Analysis:** The proposed Standard is intended to address exchange transactions.

**Staff Recommendation:** No change is proposed.

128. Respondents 31 and 33 suggested a wording change to ED 43.15 to address the measurement of both new and existing assets subject to a service concession arrangement.

**Analysis:** Staff agrees that clarity is needed on this issue. See analysis under “Existing Asset of the Grantor”.

**Staff Recommendations:** See proposal under “Existing Asset of the Grantor”.

129. Respondent 33 made a number of additional suggested wording changes to paragraphs 16, 17, AG26, and AG27:

(a) Paragraph 16 of the ED should be amended to reflect more accurately the appropriate fair value of the service concession asset when payments from the grantor are separable and to be consistent with the guidance in AG24.

(b) Paragraph 17 of the ED should be amended to address the measurement of assets subject to a service concession arrangement for which the grantor compensates the operator by means other than cash payments.

(c) Paragraph AG26 should be deleted. Service concession arrangements with these circumstances are not necessarily non-monetary transactions because the *operator* may make cash payments to the *grantor* for the right to use the service concession asset. Further, the guidance in IPSAS 17 and IPSAS 31 on non-monetary transactions relates to the measurement of the involved assets, which would appear to be addressed specifically in the final standard for service concession assets.

(d) In paragraph AG27, the Respondent considers that the non-cash compensation provided by the grantor is only to compensate the operator for the provision of the service concession asset. The Respondent notes that the fees collected from third-party users of the asset (or from the government if they are paying on behalf of third-party users) are the operator’s compensation for the operation of the asset, and if the right to access the service concession asset was compensation for both the provision and the operation of the asset, it would appear that the performance obligation would exceed the value of the asset or there would be an imputed cost of service in future periods for the operation component.

**Analysis:** Paragraph 16 would be deleted under the proposed changes to address the performance obligation issue (see Issue 6A).

130. In paragraph 17, the estimation techniques are meant to refer only to the case when the grantor needs to determine how much of a “basket” contract value to allocate to the service concession asset, and not to the situation referred to by the Respondent.
131. Paragraph AG26 refers to paragraph 14(b) (now 15(b)), which only deals with the grantor’s compensation of the operator (the “grant of a right to the operator” model). The case when the grantor compensates the operator is correctly described in AG26 as a non-monetary exchange transaction because the grantor receives the service concession asset, which is non-monetary. Staff considers that the changes to ED 43 to respond to the performance obligation issue also clarify the nature of the exchange as suggested by the Respondent.
132. With respect to paragraph AG27, the allocation of the various forms of compensation from grantor to operator, and vice versa, would depend on the terms of the arrangement. The total value of all forms of compensation the grantor provided to the operator would be the fair value of the transaction. As tentatively agreed to by the IPSASB at its March 2011 meeting, the credit side of the asset recognition entry is not a performance obligation, but a payment received in advance.

*Staff Recommendations:* No changes are proposed.

**Question for the IPSASB:**

4.7 Do you agree with the staff recommendations for each of the issues identified related to initial measurement of the service concession asset?

**4E. Subsequent Measurement**

*Overview of Respondents’ Comments*

133. Two Respondents (R#20 and 32) commented on issues related to subsequent measurement of the service concession asset.
134. Respondent 20 suggested that a future standard should set out that for a same category of asset, the accounting principles and treatment have to be consistent no matter if the asset is operated directly by the public entity or through a SCA (ED 43.18).
135. Respondent 32 is concerned that if fair value is used as the basis of recognition for service concession assets, it is possible that these assets would be re-measured using the re-valuation model which would result in a distortion of the entity’s operating results.

*Analysis*

136. Paragraph 18 has been deleted in addressing the performance obligation issue. Staff agrees that accounting treatment should be consistent for same classes of assets – whether operated directly by the public entity or through a SCA. The

- issue of consistency is covered by the fact that the asset is measured subsequently via either IPSAS 17 or IPSAS 31.
137. Subsequent measurement is in accordance with IPSAS 17 or IPSAS 31, which allow for re-valuation; however, this standard does not require revaluation of assets reported at historical cost.

*Staff Recommendation*

138. No changes are proposed.

**Question for the IPSASB:**

4.8 Do you agree with the staff recommendations for the two issues identified related to subsequent measurement of the service concession asset?

**4F. Depreciation**

*Overview of Respondents' Comments*

139. Four respondents (R# 3, 15, 20, and 30) commented on depreciation. Responses 15 and 20 are addressed in conjunction with other issues.
140. Respondent 3 notes that use of straight-line depreciation in the Illustrative Examples might signal that this is the recommended method.
141. Respondent 15 suggests deletion of paragraph AG54 because paragraph AG55 covers depreciation.
142. Respondent 20 points out that when the operator has a contractual obligation to maintain the service concession asset and to restore it at the end of the contractual arrangement, the asset's residual value may equal its carrying amount and the asset may not need to be depreciated and only extraordinary events (such as accidental destruction) warrant depreciation.
143. Respondent 30 suggests more guidance is required on how the service concession asset is depreciated.

*Analysis*

144. Staff agrees with Respondent 3 that the illustrated approach may become the *de facto* method in practice and that guidance may be necessary to dispel this notion.
145. Staff agrees with Respondent 15 that paragraphs AG54 and AG55 are duplicative and could be combined.
146. Staff disagrees with Respondent 20 that only extraordinary events warrant depreciation. Such events would result in impairment and would be accounted for in addition to depreciation.
147. Staff disagrees with the suggestion of Respondent 30. If the asset is recognized by the grantor, ED 43 requires it to be accounted for under IPSAS 17 or IPSAS 31. Accordingly, it would be depreciated or amortized like other property, plant and equipment or intangible asset.

148. IPSAS 17 and IPSAS 31 require depreciation or amortization to be on a systematic basis over the asset's useful life.

*Staff Recommendation*

149. Staff proposes combining paragraphs AG54 and AG55 to avoid duplication.
150. Staff proposes adding a second sentence to footnote 1 in the Illustrative Examples Table 1.2 to indicate that straight-line depreciation may not always be appropriate.

*Proposed Amendments to draft Standard*

151. Below are the proposed amendments to ED 43.

**Draft Standard (amended)**

AG54. IPSAS 17 requires each component with a cost that is significant in relation to the total cost of the service concession asset to be depreciated separately. Service concession assets may comprise various components. For example, a road system may consist of pavements, formation, curbs and channels, footpaths, bridges, and lighting components. In most cases, the grantor would be required to depreciate separately the components within a road system.

~~AG55. When a service concession asset comprises various components, IPSAS 17 requires each component with a cost that is significant in relation to the total cost of the service concession asset to be depreciated separately.~~

**Draft Standard (new)**

**Footnote Table 1.2 in Illustrative Examples**

Although these Illustrative Examples use a straight-line depreciation method, it is not intended that this method be used in all cases. Paragraph 76 of IPSAS 17 requires that, "The depreciation method shall reflect the pattern in which the asset's future economic benefits or service potential is expected to be consumed by the entity." Likewise, for intangible assets, IPSAS 31 requires that, "The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life."

**Question for the IPSASB:**

4.9 Do you agree with the proposed change noted above?

**4G. Impairment**

*Overview of Respondents' Comments*

152. Respondent 15 commented on the need to include references to IPSAS 21 and IPSAS 26 in various locations in the proposed IPSAS (Introduction, paragraph 18 and paragraph AG55).



*Analysis*

153. Staff agrees with the need for these references. Paragraph 18 has been deleted under other proposals. No change is proposed to the Introduction, which is proposed for deletion from IPSASs under ED 45. Should the proposal be ultimately rejected (comment date is June 30, 2011, before this proposed Standard will be approved and issued), wording will also be amended in the introduction.

*Staff Recommendations*

154. Staff proposes to add guidance after paragraph AG55.

*Proposed Amendments to draft Standard*

155. Below are the proposed changes to address the Respondent's suggestion to add references to IPSAS 21 and IPSAS 26.

**Draft Standard (new)**

AGXX. Impairment of a service concession asset is determined and accounted for in accordance with IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*.

**Question for the IPSASB:**

4.10 Do you agree with the proposed changes to ED 43?

**Issue 5: Treatment of the Credit**

**5A. Recognition and Measurement of Liabilities**

*Overview of Respondents' Comments*

156. Five respondents (R#13, 15, 31, 32, and 33) commented on various aspects of the proposals on recognition and measurement of liabilities.
157. Respondent 13 suggested that a cross-reference be included to the material in IPSAS 19, *Provisions, Contingent Liabilities, and Contingent Assets* on onerous contracts.
158. Respondent 15 asked for additional guidance on the contra entry when the performance obligation is reduced, and also for additional guidance on the financial liability in the body of the proposed standard.
159. Respondents 31, 32, and 33 commented on issues pertaining to the performance obligation issue.

*Analysis*

160. ED 43 makes reference to IPSAS 19, and not to the specific requirements in IPSAS 19. All the provisions of that Standard would apply. The proposed Standard, consistent with IFRIC 12, does not provide details of other standards that also apply to SCAs. Those details are provided in the Application Guidance as they generally are related to other IPSASs.



161. Staff considers that the financial liability issue is appropriately addressed in other IPSASs, which are referred to, but not reintroduced, in the proposed Standard.
162. The IPSASB tentatively agreed in March 2011 to not treat the credit as a performance obligation, but as a liability related to revenue which is deferred until the revenue recognition criteria are met. This issue needs to be considered in light of the proposed changes to ED 43 to refer to it as an “advance payment” rather than a performance obligation.

*Staff Recommendations*

163. Staff proposes changes to ED 43 to put into effect the clarification tentatively agreed to by the IPSASB at its March 2011 meeting to treat the credit as a liability (referred to as an advance receipt in the Minutes) rather than a performance obligation.
164. Staff also proposes to add a bold-type reference to IPSAS 19 preceding paragraph 19 of ED 43.

*Proposed Amendments to draft Standard*

165. Below are the relevant paragraphs from ED 43 that show the proposed changes to describe the treatment of the credit when a service concession asset is recognized.

**Draft Standard**

**Recognition and Measurement of Liabilities**

**Financial Liability Model**

**Recognition and Measurement of Financial Liabilities**

19. ~~When the grantor recognizes a service concession asset in accordance with paragraph 10 (or paragraph 11 for a whole-of-life asset), the grantor shall also recognize a liability. The liability recognized may be any combination of a financial liability and a performance obligation.~~
20. ~~The liability recognized in accordance with paragraph 19 shall be initially measured at the same amount as the service concession asset measured in accordance with paragraphs 15–17.~~
21. ~~When the grantor recognizes a service concession asset in accordance with paragraph 10 (or paragraph 11 for a whole-of-life asset), and under the binding arrangement, has an unconditional contractual obligation to pay cash or another financial asset to the operator, the grantor shall recognize compensates the operator for the service concession asset by making payments, the liability recognized in accordance with paragraph 19 is a financial liability. The grantor shall subsequently account for the financial liability in accordance with IPSAS 28, “Financial Instruments: Presentation,” IPSAS 29, “Financial Instruments: Recognition and Measurement,” and IPSAS 30, “Financial Instruments: Disclosures.” The grantor shall allocate the payments to the operator and account for them according to their substance as a reduction in the liability recognized in paragraph 19, a finance charge and service portions.~~

20. The liability recognized in accordance with paragraph 19 shall be initially measured at the same amount as the service concession asset measured in accordance with paragraphs 15–17. The grantor shall allocate the payments to the operator and account for them according to their substance as a reduction in the liability recognized in paragraph 19, a finance charge and service portions.

20A. The grantor shall account for financial liabilities recognized under paragraph 19 in accordance with IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures*.

20B. The nature of the consideration given by the grantor to the operator shall be determined by reference to the terms of the binding arrangement.

#### *Recognition and Measurement of Expenses*

20C<sup>25</sup>. The finance charge and service components of a service concession arrangement determined in accordance with paragraph 21 shall be accounted for as expenses in accordance with IPSAS 1, *Presentation of Financial Statements*.

20D. The asset and service portions of the arrangement shall be allocated by reference to the relative fair values of the services received, when the amounts are separately identifiable. Where the asset and service portions of the arrangement are not separable, each portion is determined using estimation techniques.

#### **Recognition and Measurement of the Grant of a Right to the Operator**

~~20F~~<sup>20E</sup>. 24. Where the grantor recognizes a service concession asset in accordance with paragraph 10 (or paragraph 11 for a whole-of-life asset) and, under the binding arrangement, does not have an unconditional contractual obligation to pay cash or another financial asset to the operator, the grantor shall recognize revenue in accordance with paragraph XX.<sup>5</sup>

20F. The grantor shall account for the portion of such revenue that does not meet the criteria for recognition of revenue as a liability. (see paragraph AGXX)

~~Where the grantor recognizes a service concession asset or reclassifies an existing asset as a service concession asset in accordance with paragraph 10 (or paragraph 11 for a whole-of-life asset) and, under the binding arrangement, does not have an unconditional contractual right to pay cash or another financial asset to the operator, the grantor shall recognize revenue received in advance in liabilities and/or revenue in accordance with IPSAS 9, *Revenue from Exchange Transactions*.~~

20G. The liability recognized in accordance with paragraph XXA shall be initially measured at the same amount as the service concession asset measured in accordance with paragraph XX.

#### **Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets**

<sup>5</sup> This would refer to the revenue recognition section (see Issue 6).

20H. The grantor shall account for other liabilities, commitments, contingent liabilities, and contingent assets arising from a service concession arrangement in accordance with IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets”.

## **Draft Basis for Conclusions**

### **Consideration Given by the Grantor to the Operator**

BCXX. A service concession arrangement typically involves an operator constructing or developing the asset used to provide the public service or upgrading an existing asset (e.g., by increasing its capacity) and operating and maintaining the asset for a specified period of time. The operator is compensated for its services over the period of the arrangement. The arrangement is governed by a binding arrangement which will set out the type of rights that the grantor has in relation to the consideration due to the operator in exchange for the service concession asset. The consideration may give the operator rights to a determinable series of cash payments or a right to earn revenue from third party users of the service concession asset or by granting the operator access to another revenue-generating asset for its use or a combination of both types of consideration.

BCXX. IFRIC 12 distinguishes the type of asset that the operator recognizes by how the operator is compensated for the service concession asset. Where the grantor provides the operator with financial asset in exchange for the acquisition of the service concession asset, the payments to be made to the operator are set out in the binding arrangement. IFRIC 12 classifies this type of arrangement as the “financial asset model” because the operator receives a financial asset. This Standard refers to this type of arrangement as the “financial liability model” because the grantor has a financial liability.

BCXX. Where the grantor compensates the operator by the grant of a right (a license) to charge users of the public service related to the service concession asset, the grantor provides access to the service concession asset in order for the operator to be compensated. IFRIC 12 classifies this type of arrangement as the “intangible asset model.” This Standard refers to this type of arrangement as the “grant of a right to the operator model.”

BCXX. The grant of a right to the operator model also includes a shadow toll, in which the grantor will pay the operator for the usage of the service concession asset by third party users, such payment is compensation in exchange for the usage of the service concession asset, not for the acquisition of the service concession asset. The grantor compensates the operator only to the extent of the usage of the service concession asset.

### **Financial Liability Model**

BCXX16. A financial liability arises in cases when the grantor is obligated to make a series of ~~predetermined~~-determinable ~~series of cash~~ payments to the operator because the grantor has a contractual obligation to deliver cash or another

financial asset to another entity (the operator). The IPSASB concluded further that when there is a series of ~~predetermined~~-determinable ~~series-of-cash~~ payments, the payments should be allocated among portions that reduce the liability, an imputed finance charge and charges for services provided by the operator under the service concession arrangement.

~~BC17. The IPSASB concluded that a performance obligation arises in cases when the grantor grants the operator the right to earn revenues, either from the service concession asset or from another asset because the grantor has received exchange consideration (i.e., an inflow of resources in the form of the service concession asset) in advance of its performance under the exchange (i.e., its obligation to provide the operator access to the service concession asset or another revenue-generating asset).~~

### **Grant of a Right to the Operator Model**

~~BCXX.ED 43 proposed that when the operator recovers the cost of a service concession asset from third-party user charges, the grantor should recognize the service concession asset and a performance obligation. Some respondents to ED 43 expressed some concern with this approach in principle, and even those who generally supported the approach sought clarification as to the nature of the obligation.~~

~~BCXX. The IPSASB reconsidered its position on this issue. Based on feedback received from some respondents to ED 43, tThe IPSASB considered whether the credit when a service concession asset is recognized should be accounted for as a liability (including whether the grantor has a long-term liability, and if so, the nature of the liability), as a direct increase to equity, or as revenue.~~

~~BCXX. It was agreed that, in this circumstance, the grantor does not have a long-term liability as defined in IPSAS 19 because the service concession arrangement is an exchange of assets, with the service concession asset being obtained by the grantor in exchange for a transfer of rights to the operator to collect fees from users of the asset over the period of the concession.~~

~~BCXX. Some respondents to ED 43 indicated that the credit should be treated as equity, consistent with IPSAS 1, which defines equity as the residual interest in the assets of the entity after deducting all its liabilities. However, paragraph 95 of IPSAS 1 requires the components of net assets/equity to be disclosed separately. Those components include:~~

- ~~(a) Contributed capital, being the cumulative total at the reporting date of contributions from owners, less distributions to owners;~~
- ~~(b) Accumulated surpluses or deficits;~~
- ~~(c) Reserves, including a description of the nature and purpose of each reserve within net assets/equity; and~~
- ~~(d) Minority interests.~~

~~BCXX. The IPSASB agreed that the credit did not represent an increase in the grantor's equity. IPSAS 1 defines contributions from owners as "future economic benefits or service potential that has been contributed to the entity by parties external to~~

the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:(a) Conveys entitlement both to (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or(b) Can be sold, exchanged, transferred, or redeemed. First, the operator has not made a contribution to the grantor that results in a financial interest in the entity by the operator. In addition, the credit is not an accumulated surplus, a reserve, or a minority interest.

BCXX. The IPSASB agreed that the credit represents revenue. In accordance with IPSAS 9, when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue. In this situation, the grantor has received a service concession asset or reclassified an existing asset as a service concession asset in exchange for granting a right (a license) to the operator to charge the third party users of the public service that it provides on the grantor's behalf. However, until the criteria for recognition of revenue have been satisfied, the revenue is deferred and treated for as a liability.<sup>6</sup> (See "Recognition and Measurement of Revenues")

#### Questions for the IPSASB:

- 5.1 Do you agree with the proposed changes to replace the performance obligation with a liability approach to account for the credit on recognition of a service concession asset?
- 5.2 Do you agree with the addition of the paragraph referencing specifically to IPSAS 19 (to be inserted preceding ED 43.19)?

#### 5B. Finance Charge/Discount Rate

##### *Overview of Respondents' Comments*

166. Five respondents (R# 3, 27, 29, 32, and 33) commented on various issues related to the guidance in ED 43 on the discount rate and finance charge in cases when the grantor compensates the operator through a series of scheduled payments.
167. Respondents 3 and 27 note that where a government borrows each year to fund all of its needs and projects and where no project is funded by a specific borrowing, the financing rate the government assumes on its long-term borrowings to calculate the theoretical interest charge is the most appropriate rate.
168. Respondent 29 recommends that the discount rate proposed be consistent with that used in applying IPSAS 13, *Leases*, which requires the use of the rate implicit in the arrangement, if practicable to determine, or, if not, the grantor's

<sup>6</sup> The rest of the explanation that would follow on this statement is in the proposed BFC material under issue 6, as it explains the revenue recognition approach.

- incremental cost of borrowing. In addition, we suggest that IPSASB clarifies that the discount rate to be applied to determine the present value of separable payments in the initial measurement of the asset is the same as that used to determine the finance charge.
169. Respondent 32 suggests ED 43 should include application guidance and/or examples on calculating the effective interest rate and the periodic amounts of finance expense.
170. Respondent 33 suggests the rate should be the rate specific to the service concession asset, or the grantor's borrowing rate.

*Analysis*

171. Consistent with IFRIC 12, ED 43 requires the finance charge to be determined based on the operator's cost of capital specific to the service concession asset, if this is practicable to determine. Paragraph AG33 requires the rate to be practicable to determine. Paragraphs AG34–AG36 provide guidance on when this rate is not practicable to determine. The grantor's incremental borrowing rate is one of the approaches that can be used in such cases. Staff considered the merits of requiring the grantor's incremental borrowing rate to be used in all cases, and noted that in cases when the operator's cost of capital is known, this would result in an inappropriate amount of finance charge, and could be subject to manipulation.
172. Staff does not consider it appropriate to follow the approach in IPSAS 13 as suggested by Respondent 29, because the proposed Standard is intended to mirror IFRIC 12, and not IAS 17, *Leases*.
173. Staff considers it is not necessary to include application guidance on calculating the effective interest rate and the periodic amounts of finance expense as suggested by Respondent 32 to be unnecessary for this proposed Standard. Such guidance, if required, is in IPSAS 13.

*Staff Recommendation*

174. No changes are proposed.

**Question for the IPSASB:**

5.3 Do you agree that no changes are required?

**5C. Use of the Term "service portion of the payment"**

*Overview of Respondents' Comments*

175. Respondent 15 recommended that the term as used in paragraph 16 be explained prior to or as part of the paragraph. The Respondent suggests moving guidance from paragraph AG25 to the body of the proposed Standard.

*Analysis*

- 176. Paragraph AG25 provides guidance for determining the asset portion of the payments in cases when payments are not separable between the asset and other components of the SCA.
- 177. Staff considers the guidance is appropriately placed in Application Guidance. See also the comments under the issue “Move Application Guidance to the Body of Standard”.

*Staff Recommendation*

- 178. No change is proposed.

**Question for the IPSASB:**

5.4 Do you agree that no changes are required?

**Issue 6: Recognition and Measurement of Revenue arising from the Liability related to the Grant of a Right to the Operator Model**

*Overview of Respondents' Comments*

- 179. Respondent 33 made two comments pertaining to recognition and measurement of revenues.
- 180. The first concern was in relation the reference to IPSAS 9 with no additional guidance on the pattern of revenue recognition.
- 181. The second concern is the proposal in ED 43.AG48 that the grantor recognize revenue as the operator provides services to third party users.

*Analysis*

- 182. At the March 2011 meeting, the IPSASB considered a staff proposal on revenue recognition in accordance with IPSAS 9 (in relation to the performance obligation issue). There was general support for a treatment that would be analogous to the treatment of interest, royalties, and dividends.

*Staff Recommendations*

- 183. Staff proposes that paragraph 24 be expanded to the pattern of revenue recognition and the Basis for Conclusions explain the reasons why the approach is appropriate. Note that the Application Guidance and Basis for Conclusions on this issue address this issue partially with Issue 6A<sup>7</sup>.

*Proposed Amendments to draft Standard*

- 184. Below are the relevant paragraphs from ED 43, marked-up to show the proposed changes to address the Respondent's suggestion to add references to IPSAS 21 and IPSAS 26.

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<sup>7</sup> Once the IPSASB has agreed on the individual proposed changes, the Task Force will review a markup of the proposed wording for the Draft Standard, the Application Guidance, and the Basis for Conclusions together to ensure the flow is appropriate and the explanations are clear.



## Draft Standard

### Recognition and Measurement of Revenues

24. The grantor shall account for revenues from a service concession arrangement ~~in accordance with IPSAS 9, “Revenue from Exchange Transactions as they are earned in accordance with the substance of the service concession arrangement.”~~ (see paragraph AGXX)

AGXX. The revenue recognized under paragraph 24 is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. (see paragraph 24).

### Grant of a Right to the Operator Model

- AG45. When the conditions for revenue recognition are met, the liability related to the grant of a right to the operator model is reduced as the revenue is recognized in accordance with paragraph 24. The revenue is recognized over the term of the agreement in a pattern that reflects the economic substance of the service concession arrangement. (see paragraph XX)

- AG46. ~~However, given t~~The ~~varying~~ nature of the types of assets that may be used in service concession arrangements, and the number of years over which the arrangements operate, vary. Accordingly, there may be certain alternative methods for recognizing revenue may more appropriate ~~alternative methods for recognizing revenue associated with the inflows specified in the binding arrangement because they that~~ better reflect the operator’s economic consumption of the ~~ir~~ access to the service concession asset and/or the time value of money. For example, an annuity method that applies a compounding interest factor that more evenly recognizes revenue on a discounted basis, as opposed to on a nominal basis, may be more appropriate for a service concession arrangement with a term extending over several decades.

- AG47. When an upfront payment is received from the operator, the revenue related to that payment is recognized over ~~the term over which the grantor will meet its performance obligation~~ obligation period which best reflects the economic consumption of the related service concession asset to which the payment received relates. When the operator is required to pay annual installments over the term of the service concession arrangement, or predetermined sums for specific years, the revenue is recognized in a way that best reflects the operator’s economic consumption of ~~their~~ the access to the service concession asset and/or the time value of money.

- AG48. For service concession arrangements under which the operator will collect fees directly from third-party users of the service concession asset (the “grant of a right to the operator” model), revenue relates to the inflow of economic benefits received as the services are provided and is therefore recognized on the same basis as the liability related to the grant of a right to the operator model is reduced (see paragraph ~~AG38~~AGXX).



## **Draft Basis for Conclusions (new)**

### **Recognition and Measurement of Revenues under the Grant of a Right to the Operator Model**

BCXX. Where a grantor receives a service concession asset and does not have a contractual obligation to deliver cash or another financial asset to the operator in compensation, the operator bears the demand risk that the cash flows generated by the third party users of the public service will be sufficient to recover its investment. It is expected that the demand for the public service will be sufficient for the operator to recover its investment. That is, the cash consideration for the service concession asset is not being met by the grantor but by users of the service concession asset or other revenue-generating asset. The economic substance is that the arrangement provides a gain to the grantor, and therefore revenue accrues and should be reported as earned. The IPSASB therefore considered when such revenue would be earned.

BCXX. As a service concession arrangement is an exchange transaction, the IPSASB referred to IPSAS 9 when considering the nature of the revenue and the timing of the recognition of that revenue. Further, in this type of arrangement, the grantor recognizes a service concession asset and the operator recognizes an intangible asset (as required by paragraph 17 of IFRIC 12). The IPSASB considers that this is an exchange of dissimilar assets (i.e., the service concession asset and the intangible asset are not similar in nature), and that in accordance with paragraph 17 of IPSAS 9, this exchange is regarded as a transaction that generates revenue.

BCXX. The IPSASB noted that, in this situation, there is no cash inflow to equal the revenue recognized. This result is consistent with IPSAS 9 as, any situation in which an entity provides goods or services in exchange for another dissimilar asset that is subsequently used to generate cash revenues would lead to a similar result.

BCXX. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

BCXX. IPSAS 9 identifies three types of transactions that give rise to revenue: the rendering of services, the sale of goods (or other assets) and revenue arising from the use by others of the entity's assets, yielding interest, royalties, and dividends, and the basis on which revenue should be recognized for each.

BCXX. The IPSASB considered the approaches to revenue recognition set out in IPSAS 9 and concluded that none of those scenarios fully met the

circumstances of a service concession arrangement for the reasons set out in paragraphs BCXX – BCXX below. Nevertheless, the IPSASB noted, that the timing of revenue recognition under each of them is over the term of the arrangement, rather than immediate. The IPSASB determined that, by analogy, such a pattern of revenue recognition was also appropriate for recognizing the revenue arising from the liability related to the grant of a right to the operator model.

BCXX. The IPSASB concluded that treatment of revenue from the liability related to the grant of a right to the operator model does not fully meet the circumstances for recognition of revenue as interest, royalties or dividends. Although the operator is using the grantor's assets, in this case the service concession asset is used to provide service potential for the grantor's benefit. Ordinarily, royalties accrue to the granting entity when the asset is used for the purchaser's benefit.

BCXX. The IPSASB concluded that treatment of revenue from the liability related to the grant of a right to the operator model does not fully meet the circumstances for recognition of revenue from rendering of a service, because it addresses only the service provision portion of a service concession arrangement.

BCXX. The IPSASB concluded that the liability related to the grant of a right to the operator model does not fully meet the circumstances for recognition of revenue arising from the sale of goods, because the grantor is not selling goods, which are generally understood to mean items sold in the normal course of operations, and not items of property, plant and equipment.

**Question for the IPSASB:**

6.1 Do you agree with the proposed changes to the guidance in for revenue recognition?

6.2 Do you agree with the proposed wording in the Basis for Conclusions to explain the IPSASB's rationale for considering the credit to be a liability?

## **Issue 7: Presentation and Disclosure**

### *Overview of Respondents' Comments*

185. Eight Respondents (R#2, 5, 7, 15, 23, 26, 32, and 33) commented on aspects of the presentation and disclosure requirements in ED 43.
186. Respondents 5, 7, 23, and 26 expressed positive support for the requirements.
187. Respondent 2 suggested that paragraph 28 should indicate whether a grantor is permitted to disclose SCAs individually or in the aggregate.
188. Respondent 15 suggested the following:
  - (a) Paragraph 26 should be elaborated to clarify whether a separate line item should be included for such assets on the face of the statement of financial position. If service concession assets are to be disclosed as such, consequential amendments should be included to IPSAS 1 *Presentation of Financial Statements*.
  - (b) A paragraph should be included to refer grantors to the disclosure requirements in other IPSAS, for example IPSAS 9 *Revenue from Exchange Transactions*, IPSAS 17 *Property, Plant and Equipment*, IPSAS 31 *Intangible Assets*, etc.
  - (c) Additional disclosure requirements that could be required include:
    - (i) Disclosure of the risks that the grantor is exposed to as a result of the service concession arrangement, for example construction risk;
    - (ii) Finance costs relating to the service concession arrangement; and
    - (iii) Circumstances or events that will result in step-in arrangements.
189. Respondent 32 considers the disclosure requirements are too detailed and will detract from the usefulness of the financial statement notes.
190. Respondent 33's comments on disclosure are considered under the discussion of "Existing assets of the grantor".

### *Analysis*

191. The disclosure requirements in ED 43 are consistent with those in SIC-29, *Service Concession Arrangements: Disclosures*.
192. Specific references to other relevant IPSASs throughout the proposed Standard in relation to the accounting issues are considered to include any disclosure requirements therein.
193. Risks and step-in arrangements would be considered under IPSAS 19, to the extent they give rise to contingent liabilities. The addition of a paragraph requiring IPSAS 19 be followed for liabilities has been proposed under Issue 5A.
194. Paragraph AG61 specifically addresses disclosure of the finance charge.

*Staff Recommendation*

195. Staff proposes guidance referring to other relevant IPSASs be added to the draft Standard. Staff does not believe this requirement creates a need for re-exposure in and of itself, as the accounting requirements in those standards are required to be followed under ED 43.

*Proposed Amendments to draft Standard*

196. Below are the relevant paragraphs from ED 43, marked-up to show the proposed changes to the Basis for Conclusions.

**Draft Standard (new)**

27A. The grantor also follows the relevant presentation and disclosure requirements in IPSAS 9, IPSAS 17, IPSAS 19, IPSAS 28, IPSAS 29, IPSAS 30, and IPSAS 31 as they pertain to assets, liabilities, revenues, and expenses recognized under this Standard.

**Question for the IPSASB:**

7.1 Do you agree with the proposed changes to ED 43?

**Issue 8: Transitional Provisions and Effective Date**

*Overview of Respondents' Comments*

197. Seven Respondents (R# 5, 8, 13, 15, 18, 26 and 33) commented on the transitional provisions and effective date paragraphs in ED 43.
198. Respondent 5 did not support the transition arrangements in ED 43 because the proposals would allow entities which have not capitalized service concession assets to continue to do so for existing service concession arrangements. Respondent 5 considers that prospective application should only be permitted in very limited circumstances.
199. Respondent 8 has similar concerns and expressed a view that the general requirements in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* are appropriate for an entity that has not previously recognized service concession arrangements. Respondent 13 does not believe it is appropriate to require entities that have previously recognized service concession assets to restate their accounts and permit entities which have not previously recognized service concession assets to avoid restating their accounts.
200. Respondents 15, 26 and 33 recommend that the transitional provisions should be applied retrospectively for all entities, not just for those entities that have previously recognized service concession assets. Respondents 15 and 26 believe that this suggestion would enhance the comparability of the reporting of service concession arrangements. Additionally, Respondent 15 believes that the

- exemption from retrospective application in IPSAS 3 where it is impracticable to restate is sufficient guidance.
201. Respondent 33 considers that if there are practical concerns relating to retrospective restatement, the transitional provision in IFRIC 12 could be included in the finalized Standard as it gives further guidance as to what to do when it is impracticable for a particular service concession arrangement to be retrospectively restated. The transitional provision in paragraph 30 of IFRIC 12 relates to previously recognized assets rather than assets that have not previously been recognized
  202. Respondent 18 asks that further clarification is given on the transitional provisions to ensure that they are clearly understood.
  203. Related to the comments on transitional provisions, Respondent 13 considers that the effective date of the proposed Standard should be at least two years from the date of issue of the Standard in order for entities to have enough time to implement the proposed Standard and to have the information available to be able to restate their prior year comparatives.

*Analysis*

204. Most comments on the transitional provisions in ED 43 relate to permitting entities that have not previously recognized a service concession asset to apply the provisions of the proposed Standard prospectively. Respondents suggest that this relief from retrospective application is unnecessary.

Alternative 1: Existing approach in ED 43

205. However, when developing ED 43 the IPSASB had concerns relating to the practicality of determining the measurement of a service concession asset, and considered that this could result in inconsistent treatment of arrangements entered into in the past. This was a similar issue to that which arose in finalizing IPSAS 31, *Intangible Assets*. On that basis, the IPSASB considered it appropriate to propose transitional provisions in ED 43 that were consistent with those in IPSAS 31.
206. The IPSASB noted that there are two aspects to retrospective determination: reclassification and remeasurement. The IPSASB took the view that it will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in a grantor's statement of financial position, but that retrospective remeasurement of service concession assets might not always be practicable, particularly if an entity has not previously recognized service concession assets and related liabilities, revenues, and expenses.
207. As ED 43 gives relief to retrospective restatement for service concession assets that have not previously been recognized, Staff considers that the suggestion by Respondent 33 is not a potential solution.

Alternative 2: Follow IPSAS 3

208. Staff notes that it may be clearer to have the proposed Standard fall within IPSAS 3, with no additional guidance provided. However, it is noted that the proposed transitional requirements in ED 43 may be considered less stringent than those in IPSAS 3, so a reference to IPSAS 3 only could be considered a significant change. As such, changing the requirements may require re-exposure of ED 43. Staff considers that this would not be a desirable outcome if there is no other basis for re-exposure resulting from changes to ED 43 to address the other issues in this paper.

Alternative 3: Combination of “Date of transition to IFRS” and IFRS 1.05

209. Members of the Task Force have identified a further option – to allow a choice between IPSAS 3 retrospective treatment and an election to measure service concession assets at the beginning of the earliest period for which comparative information is presented in the financial statements. This option is a combination of the definition for “Date of transition to IFRS” and IFRS 1.05.

*Possible Amendments to draft Standard*

210. Below are the relevant paragraphs from ED 43, to show the possible changes to the transitional provisions. Note that this issue would be considered when the proposed Standard is presented for approval.

**Draft Standard (new<sup>8</sup>)**

30. **An entity that has not previously recognized service concession assets and related liabilities, revenues and expenses and uses the accrual basis of accounting shall either:**

- (a) **Apply this Standard retrospectively in accordance with IPSAS 3; or**
- (b) **Elect to measure service concession assets at the beginning of the earliest period for which comparative information is presented in the financial statements.**

- XX. An entity may elect to use one of the following amounts, determined at the beginning of the earliest period for which comparative information is presented in the financial statements, as deemed cost:

- (a) For property, plant and equipment, fair value, or depreciated replacement cost.
- (b) For intangible assets, fair value.

- XX. Subsequent depreciation is based on that deemed cost and starts from the date for which the entity established the deemed cost.

**Use of deemed cost under the financial liability model**

<sup>8</sup> Exact placement of the text to be determined.

XX. Where an entity uses deemed cost under the financial liability model, it measures:

- (a) The financial liability using the remaining contractual cash flows specified in the binding arrangement, using IPSAS 29.
- (b) The service concession asset using fair value (see paragraph XX above). Any difference between the value of the asset and the financial liability is recognised in accumulated surplus and deficit. If the entity chooses as its accounting policy the revaluation model in IPSAS 17 or IPSAS 31, this difference is included in any revaluation surplus.

**Use of deemed cost under the grant of a right to the operator model**

XX. Where an entity uses deemed cost under the financial liability model, it measures:

- (a) The service concession asset at fair value (see paragraph XX above).
- (b) The liability represents the unearned portion of any revenue arising from the receipt of the asset. This amount should be determined as the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement.

211. The suggested clarifications above take into account that:

- (a) For property, plant and equipment, IPSAS 17 allows revaluation using fair value or depreciated replacement cost, thus both are referred to in the proposals.
- (b) For intangible assets IPSAS 31 only allows fair value for revaluation, thus the deemed cost is limited to fair value.

*Staff Recommendations*

212. The Task Force would prefer that, if this is the only issue that would require ED 43 to be re-exposed, it could be exposed on a limited basis. Staff considers that the full ED would require re-exposure if the Standard is considered as a whole.

213. No change is proposed at this time. This issue will need to be considered in the totality of all other changes made to ED 43 in determining whether re-exposure is required.

*Proposed Amendments to draft Standard and Basis for Conclusions*

214. Below are the relevant paragraphs from ED 43, marked-up to show the proposed changes.

## Draft Standard<sup>9</sup>

### Effective Date

29. An entity shall apply this Standard for annual financial statements covering periods beginning on or after MM DD, YYYY. Earlier application is encouraged. If an entity applies this Standard for a period beginning before MM DD, YYYY, it shall disclose that fact and apply IPSAS 5, *Borrowing Costs*, IPSAS 13, *Leases* and IPSAS 17 at the same time.<sup>10</sup>

30. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.<sup>11</sup>

### Transition

31~~29~~. An entity that has previously recognized service concession assets and related liabilities, revenues, and expenses shall apply this Standard retrospectively in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.<sup>12</sup>

32~~30~~. An entity that has not previously recognized service concession assets and related liabilities, revenues, and expenses and uses the accrual basis of accounting shall apply this Standard prospectively. However, retrospective application is permitted.

## Draft Basis for Conclusions

### Transition

BC31. This Standard requires an entity that has previously recognized service concession assets and related liabilities, revenues, and expenses to apply this Standard retrospectively in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. The Standard also requires an entity that has not previously recognized service concession assets and related liabilities, revenues, and expenses and uses the accrual basis of accounting to apply this Standard prospectively, although retrospective application is permitted in such cases.

BCXX. Some respondents to ED 43 questioned why the general requirements in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and*

<sup>9</sup> Transition wording is subject to possible further changes to transitional provisions, discussed previously in this paper.

<sup>10</sup> IPSASB standard paragraph.

<sup>11</sup> IPSASB standard paragraph.

<sup>12</sup> Based on IFRIC 12.29.



Errors are not appropriate for an entity that has not previously recognized service concession arrangements. The general requirement in IPSAS 3 is that the changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable.

BC32. The IPSASB noted that there are two aspects to retrospective determination: reclassification and remeasurement. The IPSASB ~~took the view~~considers that it will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in a grantor's statement of financial position, but that retrospective remeasurement of service concession assets and determination of the related revenues and expenses might not always be practicable, particularly if an entity has not previously recognized service concession assets and related liabilities, revenues, and expenses.

BC33. The IPSASB noted that, when retrospective restatement is not practicable, IPSAS 3 requires prospective application from the earliest practicable date, which could be the start of the current period.

BCXX. However, when developing ED 43 the IPSASB had concerns relating to the practicality of determining the measurement of a service concession asset, and considered that this could result in inconsistent treatment of arrangements entered into in the past. This was a similar issue to that which arose in finalizing IPSAS 31, *Intangible Assets*. On that basis, the IPSASB considered it appropriate to propose transitional provisions in ED 43 that were consistent with those in IPSAS 31.

BCXX. To provide give entities sufficient time to gather the information necessary to restate their comparative financial statements, the IPSASB concluded that the effective date of the Standard would be two years after its date of issue.

...

#### Summary of Changes from ED 43

BCXX. ED 43 did not propose an effective date for implementation. A respondent suggested that for entities to have the information available to be able to restate their prior year comparatives the effective date should be at least two years from the date of issue of the Standard. The IPSASB agreed with this suggestion and modified the Standard accordingly.

#### **Questions for the IPSASB:**

- 8.1 Do you agree that the transitional provisions set out in ED 43 are appropriate?
- 8.2 Do you agree that the effective date should be two years after the date of issue of the proposed Standard?

## **Issue 9: Move Application Guidance to the Body of the Standard**

### *Overview of Respondents' Comments*

- 215. Five Respondents (R#10, 15, 24, 26, 33) commented that certain material in Application Guidance should be moved to the body of the Standard.
- 216. Respondents 10 and 15 expressed concern that note that the proposed standard does not explicitly state that guarantees made by the grantor as part of the arrangement should be accounted for as financial liabilities in accordance with IPSAS 29 or IPSAS 19 but instead refers to such matters in paragraphs AG56 to AG59 of the Application Guidance.
- 217. Respondent 15 suggested several instances where guidance in the Application Guidance section of ED 43 should be moved to the body of the proposed Standard.
- 218. Respondents 24 and 26 indicated the cross-referencing between the body and the Application Guidance is complicated.
- 219. Respondent 33 suggested that certain salient aspects of revenue recognition addressed solely in the Application Guidance section should be moved forward to the body of the final IPSAS.

### *Analysis*

- 220. The Application Guidance in ED 43 has the same authority as the body of the proposed Standard. The issue of guarantees is not addressed in IFRIC 12. Thus, they are not included as part of the body of the text. Nevertheless, grantors may issue guarantees to the operator, so these are addressed in the Application Guidance.
- 221. The IPSASB had decided when issuing ED 43 that the approach of including certain material in the Application Guidance best allowed for mirroring IFRIC 12. At its November 2010 meeting, the IPSASB tentatively reconfirmed the “mirror” approach.
- 222. In addition, apart from the control criteria for recognition of the service concession asset, the proposed Standard does not introduce new principles that are not in existing IPSASs. Existing IPSASs are referred to in ED 43, and specific Application Guidance is provided as necessary to address the matters related to those IPSASs as they pertain to service concession arrangements.
- 223. Further, as noted above, the Application Guidance in ED 43 has the same authority as the body of the proposed Standard. The IPSASB, consistent with IFRIC 12, does not provide details of other standards that also apply to SCAs. Those details are provided in the Application Guidance.
- 224. Respondents who asked for Application Guidance to be moved into the body of the proposed Standard did not express concern that the material needed to be augmented. Staff considers that, except for issues specifically identified in this paper for additional guidance, the appropriate level of guidance is provided in

Application Guidance to support principles set out in the body of the proposed Standard.

*Staff Recommendations*

225. No changes are proposed to bring up material in Application Guidance. However, because the Introduction section of ED 43 may be deleted if the proposals in ED 45 are accepted, staff proposes to add the list of other applicable IPSASs currently in IN2, following paragraph 9 of ED 43.
226. Staff also suggests adding cross-references between principles in the body of the proposed Standard and the Application Guidance. The format of these cross-references would be consistent with the structure used in IPSAS 29, *Financial Instruments: Recognition and Measurement*. The heading in the body of the Standard would be referenced to the relevant section or paragraphs of the Application guidance or AG paragraphs, and the heading in the Application Guidance would be referenced to the relevant section or paragraphs of the body of the proposed Standard.

*Proposed Amendments to draft Standard*

227. Below are the relevant paragraphs from ED 43, marked-up to show the proposed changes to the draft Standard.

**Draft Standard (new, from IN2)**

**9A.** The detailed accounting principles for the service concession asset and related ~~liability~~liabilities, revenues, ~~and~~ expenses, and contingent liabilities are set out in the following Standards:

- (a) IPSAS 1, “Presentation of Financial Statements”;
- (b) IPSAS 9, “Revenue from Exchange Transactions”;
- (c) IPSAS 12, “Inventories”;
- (d) IPSAS 13, “Leases”;
- (e) IPSAS 17, “Property, Plant and Equipment”;
- (f) IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets”;
- (g) IPSAS 23, “Revenue from Non-Exchange Transactions”;
- (h) IPSAS 28, “Financial Instruments: Presentation”;
- (i) IPSAS 29, “Financial Instruments: Recognition and Measurement”;
- (j) IPSAS 30, “Financial Instruments: Disclosures”; and
- (k) IPSAS 31, “Intangible Assets”.

**Questions for the IPSASB:**

- 9.1 Do you agree with the proposed changes to ED 43 noted above?
- 9.2 Do you agree that no other changes are required to move Application Guidance to the body of the proposed Standard?

**Issue 10: Basis for Conclusions – Rationale for Adopting the Control-based Approach**

*Overview of Respondents' Comments*

- 228. Two Respondents (R# 1 and 26) commented on the rationale in paragraph BC11 for using a control-based approach. They did not agree that service potential, rather than economic benefit, is the primary reason for undertaking service concession arrangements.

*Analysis*

- 229. Staff disagrees with this comment. From the grantor's point of view, the primary purpose of entering into SCAs is to provide service potential to its constituents that it would not otherwise be able to provide.
- 230. Staff acknowledges that there will be economic benefits, but they ordinarily accrue to the operator, as noted by Respondent 1, and not to the grantor.

*Staff Recommendations*

- 231. It is proposed to amend the paragraphs describing the IPSASB's rationale for adopting a control-based approach.

*Proposed Amendments to draft Standard*

- 232. Below are the relevant paragraphs from ED 43, marked-up to show the proposed changes to the draft Standard.

BC11. The IPSASB considered the merits of the risks and rewards and control-based approach ~~and the risks and rewards~~ approach to assessing whether the grantor should recognize the asset. The risks and rewards approach focuses on the economic aspects of the terms and conditions in the arrangement. A control-based approach focuses on which party has control over the economic benefits and service potential of the service concession asset.

BCXX. As it is often the case that service concession arrangements are entered into for the sharing of risks between the operator and grantor, t~~The~~ IPSASB also questioned whether sufficiently objective criteria could be established for assessing risks and rewards to enable consistent results to be determined. In addition, weighting of various risks and rewards was seen to be problematic. The IPSASB did not believe, therefore, that the risks and rewards approach is appropriate.

BCXX. Under the control approach, an entity decides which party has control over the economic benefits and service potential of the asset. In making this decision, the entity identifies which party controls who receives the economic benefits or service potential generated by the asset by applying the control criteria in paragraph XX. It is the grantor's ability to direct to whom benefits flow and their value that indicates control, rather than the actual flow of benefits to the grantor and the operator.

BCXX The primary objective of many service concession arrangements is the provision of specified public services by the operator on behalf of the grantor, thus the service potential of the asset accrues to the grantor. Economic benefits are only likely to arise from the arrangement where users are charged for the service provided. The grantor may indicate that some or all of the user charges should be retained by the operator as compensation for the services provided on behalf of the grantor. Under normal circumstances, these economic benefits would accrue to the grantor. However, as a means of compensating the operator for services provided, the grantor may give the here economic benefits are generated from the asset, e.g. through users charges, these benefits In many cases, the operator has economic control of the asset used in a service concession arrangement, is exposed to most of the economic risks, and enjoys the majority of the economic benefits. The grantor enters into the service concession arrangement primarily for other reasons. The IPSASB did not believe this focus to be appropriate for service concession arrangements because the primary purpose of a service concession asset is such as to provide service potential on behalf of the public sector entity, and not to provide economic benefits to the public sector entity such as revenue generated by these assets from user fees. A control based approach focuses on control over the service potential of the service concession asset.

BCXX12. The IPSASB also questioned whether sufficiently objective criteria could be established for assessing risks and rewards to enable consistent results to be determined. In addition, weighting of various risks and rewards was seen to be problematic. The IPSASB did not believe, Therefore, the IPSASB concluded that the risks and rewards approach is not appropriate.

**Question for the IPSASB:**

10.1 Do you agree with the proposed changes to better explain the IPSASB's rationale for adopting a control-based approach, rather than a risks and rewards based approach?