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The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
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Per e-mail
29 June 2010

Dear Stephenie,

**COMMENT ON EXPOSURE DRAFT: ED 43 SERVICE CONCESSION ARRANGEMENTS:
GRANTOR**

We welcome the opportunity to provide comment on Exposure Draft 43 – *Service Concession Arrangements: Grantor* issued by the International Federation of Accountants – International Public Sector Accounting Standards Board (IPSASB).

In compiling our comment, the Accounting Standards Board, the official accounting standard setter for the public sector in South Africa, consulted widely with our stakeholders (comprising professional bodies, auditors and preparers) in formulating our comment to you.

Enclosed please find our comment that is structured into specific matters and other matters.

Please do not hesitate to contact me should you wish to discuss any of our comment.

Yours sincerely

A handwritten signature in blue ink that reads 'Erna Swart'.

Erna Swart
Chief Executive Officer

SPECIFIC MATTERS FOR COMMENT

This Exposure Draft addresses service concession arrangements from the grantor's perspective. It mirrors the principles set out in IFRIC 12 for accounting by the operator.

Do you agree with this approach?

We are of the view that the proposed IPSAS does not mirror the principles set out in IFRIC 12 in all instances. For example, under IFRIC 12.27, the operator is required to recognise an asset and corresponding liability in a service concession arrangement where the grantor provides other items to the operator that it can keep or deal with as it wishes. The proposed IPSAS does not include accounting requirements to the grantor to "mirror" the principles in IFRS 12.27, i.e. accounting requirements where the grantor is required to de-recognise existing assets and to recognise its right to receive future services from the operator.

Another example is the requirement in AG20 that requires that where the operator bears the construction risk, the timing of the initial recognition of the service concession asset will be when the asset is placed in use. This requirement will result in neither the grantor nor the operator recognising the asset under construction, as in terms of IFRIC 12, the operator will recognise a growing receivable, as oppose to an asset. In this regard, the accounting in the proposed IPSAS does not mirror IFRIC 12. If the grantor is not required to recognise the asset under construction, the grantor can also not recognise a corresponding liability until the construction of the asset is complete. The grantor will however have a liability in terms of the principles in other IPSAS (i.e. the IPSASs dealing with financial liabilities and provisions) when the construction commences, but which will not be recognised as the corresponding asset is not accounted for as required by paragraph .19 of the proposed IPSAS. We therefore do not support the approach outlined in AG 20.

Additional accounting principles to be considered for inclusion

In addition, we recommend that the proposed IPSAS should be expanded to provide guidance to a grantor where it transfers the right to use a specified asset to the operator for a specific period. In these types on service concession arrangements, the operator is not required to render a service on behalf of the grantor, as in the scope of IFRIC 12, but is rather granted the right to use an existing asset of the grantor for its own commercial purposes. In these types of arrangements, the grantor does not have any obligation towards the operator, but rather share a percentage of the revenue generated by the operator for the duration of the service concession arrangement. If the service concession arrangement allows the operator to construct or develop an immovable asset on, for example land that belongs to the grantor, the grantor may, at the end the service concession arrangement receive the constructed asset. Currently, there is no guidance to the grantor on how to account for assets that will be received at the end of the service concession arrangement, without having a performance obligation during the arrangement. However, because the asset is constructed on government owned land, the grantor may, at the commencement of the agreement, need to account and recognise the existence of such an asset.

OTHER MATTERS

Introduction

1. As the proposed IPSAS intends to provide guidance on assets used for public services such as roads, bridges, tunnels prisons, hospital etc. (as noted in IN4), we question the inclusion of the reference to IPSAS 12 *Inventories* in paragraph IN2. As inventories is not included within the scope of IFRIC 12 on which this proposed IPSAS is based, we are of the view that the reference to IPSAS 12 should be deleted as it is inappropriate.
2. The scope of this Standard also excludes leases, and we therefore also recommend that the reference to IPSAS 13 *Leases* should be deleted in paragraph IN2.
3. In addition, we propose the inclusion of references to IPSAS 21 *Impairment of Non-cash-generating Assets* and IPSAS 26 *Impairment of Cash-generating Assets* in paragraph IN2.
4. We recommend that paragraph IN8 should be further elaborated to clarify the type of assets that falls within the scope of this Standard. IN8 currently explains that the scope of this Standard is not just limited to infrastructure assets as in IFRC 12, but collectively refers to the assets within the scope of this proposed IPSAS as “service concession assets”. Even though AG2 clarifies that non-current tangible or intangible assets fall within the scope of the proposed IPSAS, the explanation in IN8 is however not indicative of whether immovable and/or movable assets are also within the scope of the proposed IPSAS. For example, if the operator is required to construct, for example a prison in terms of a service concession arrangement, should the principles in this proposed IPSAS be applied to the building constructed and to the equipment to be used within the building, or does the principles only apply to the constructed asset?

In order to clarify the type of assets that falls within the scope of the proposed IPSAS, we recommend that paragraph IN8, as well as the scope paragraph in the proposed IPSAS should be elaborated to clearly state whether immovable and/or movable assets falls within the scope of the IPSAS.

5. If the proposed IPSAS applies to all movable and immovable assets, we further recommend the inclusion of a reference to the IPSAS dealing with agriculture as part of the list in IN2.

Terminology

6. Consistent with other IPSASs, we recommend that the heading should be amended to “definitions”. The terms used within this section should be drafted as definitions, and any additional explanatory guidance could be included after the “definitions”.

The section dealing with definitions should be included after the “scope”.

Scope

7. Paragraph 8 clarifies the scope of the proposed IPSAS. We are of the view that the circumstances in paragraph 8(d) are not dealt with appropriately in the proposed IPSAS. In this scenario, the grantor will not be required to recognise an asset, as the asset that is to be used in the service concession arrangement is already recognised by the grantor in its financial statements. Paragraph .12 requires that such an asset be re-classified as a service concession asset. As a result, the principles in paragraphs .10 to .18, and specifically paragraphs .13 and .15 that requires the recognition of the asset, will not be applied. Even though the grantor may have an obligation towards the operator in this type of service concession arrangement, the principles in paragraph .19 cannot be applied as the grantor did not recognise an asset (i.e. because the existing asset is already recognised by the grantor and paragraph .13 could not be applied). The application guidance in AG14 also does not provide

clarification on the recognition of the corresponding obligation under these circumstances.

We are of the view that guidance on the recognition of the obligation should be provided to the grantor in the circumstances described in paragraph 8(d). Currently the proposed IPSAS lacks such guidance.

8. The second part of paragraph 8(c) determines that only the cost of the upgrade should be recognised as a service concession asset. We are of the view that this explanation deals with recognition principles and should rather be included in the section dealing with recognition.

In addition, it seems as if this paragraph requires that the existing asset and the cost towards the upgrade of that asset should be separated. If this is the expectation, we question the application of the principles in other IPSAS to the separated asset, for example testing the asset for impairment, determining the depreciation method, useful life and residual value, etc. We recommend that further explanatory guidance should be included to clarify the intention of the requirement in this paragraph.

Recognition and measurement of a service concession asset

9. We recommend that guidance should be included that clarifies when the criteria specified in paragraph 10 should be considered, i.e. at the commencement of the arrangement, only after the service concession asset was constructed (if appropriate), or only once the operator commences with the provision of the service on behalf of the public sector entity.

10. Paragraph 11 determines that only the condition in paragraph 10(a) applies to whole-of-life assets. Even though IFRIC 12 also explains “whole-of-life-assets” as assets that are used for its entire useful life, we question whether “useful life” should not refer to “economic life”. In our view, the “useful life” of a service concession asset should be based on the terms of the service concession arrangement, which may be different to other assets.

As an alternative, a definition could be included for “whole-of-life assets” as part of the definition section of this proposed IPSAS.

11. The second recognition requirement in paragraph 10(b) introduces the concept of “significant residual interest”. We recommend that the proposed IPSAS provides explanatory guidance on this concept as part of the text of the IPSAS, to assist in understanding and clarifying the concept. The guidance in AG9 could, for example, be useful for inclusion in the proposed IPSAS.

12. We recommend that the first sentence in paragraph 12 be amended as follows

.....grantor shall not recognise ~~the~~ an additional asset....

13. Paragraph 15 requires that the service concession asset should be recognised at fair value. This principle, however, contradicts the principles included in existing IPSASs that requires the recognition of assets at cost, and only when the asset is acquired at no or nominal value, should it be recognised at fair value. As AG24 as AG25 provides some clarification on the amount at which the service concession asset should be recognised, we propose that the guidance in AG24 and AG25 should be included as part of the text of the proposed IPSAS.

14. Paragraph 8 describes the kind of assets that could be classified as service concession assets to fall within the scope of this proposed IPSAS. As the service concession arrangement may require the construction or development of new assets, we question the reference to “original” in paragraph 15, and recommend that “original” should be deleted.

15. Even though guidance on the timing of the recognition of the service concession asset is included in AG20, we recommend that such guidance should be included in the text of the proposed IPSAS to explain black letter paragraph 15.
16. Paragraph 16 makes reference to the “service portion of the payment”. Prior to this reference, no explanation or guidance is provided on what a service portion entails and how it should be calculated. We therefore recommend that explanatory guidance should be included in the proposed IPSAS prior to, or as part of this paragraph. The guidance included in AG25 could, for example, be useful for inclusion in the proposed IPSAS.
17. Even though guidance on the use of estimation techniques is included as part of the application guidance (AG25), we recommend that such guidance should be included in the text of the proposed IPSAS to explain the principle paragraph 17.
18. The reference to IPSAS 21 *Impairment of Non-cash-generating Assets* and IPSAS 26 *Impairment of Cash-generating Assets* should be added to paragraph 18.

Recognition and measurement of liabilities

19. We recommend that more explanatory guidance be included on the recognition and measurement of the financial liability and the performance obligation to be recognised in accordance with black letter paragraphs 21 and .22. The guidance in AG31, AG38, AG40 and AG41 could, for example, be useful for inclusion in the proposed IPSAS.

We also recommend that guidance should be provided to explain how the contra entry should be recognised in the statement of financial performance when the performance obligation is reduced, as such guidance is not included in IPSAS 19.

20. The scenario dealt with in paragraph .23 is not included as an option in paragraph 14. We recommend that the paragraph should be elaborated to explain how:
 - the performance obligation, that was recognised as a result of the receipt of the service concession asset and as a result of the right to receive payments, should be reduced by the grantor; and
 - the contra entry should be recognised in the statement of financial performance under each of these circumstances.

Examples of these scenarios should also be included as part of the illustrative examples for further clarification.

Recognition and measurement of revenues

21. We recommend that paragraph 24 should be elaborated to explain under what circumstances the grantor will receive revenue, and how such revenue should be accounted for before the reference to the applicable IPSAS is included. The guidance in AG42 to AG31, AG38, AG40 and AG41 could for example, be useful for inclusion in the proposed IPSAS.

Recognition and measurement of expenses

22. This section should be elaborated with guidance on the calculation and recognition of the finance charge, as included in AG33 to AG35 and AG52. We recommend that the guidance as currently included in the application guidance should rather be included as part of the text of the proposed IPSAS.

Similarly, principles for the recognition of the service portion, as included in AG53, should also be included as part of the text of the proposed IPSAS.

Presentation and Disclosure

23. 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*.
24. 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.
25. Additional disclosure requirements that could be required include:
 - Disclosure of the risks that the grantor are exposed to as a result of the service concession arrangement, for example construction risk;
 - Finance costs relating to the service concession arrangement; and
 - Circumstances or events that will result in step-in arrangements.

Transition

26. Consistent with other IPSASs, we recommend that the heading should be amended to “transitional provisions”.
27. To ensure comparability of financial results, we recommend that the transitional provisions should be applied retrospectively in both scenarios, i.e. where entities have previously recognised service concession assets, and where entities have not previously recognised service concession assets. If it is impracticable for entities to apply the principles in the proposed IPSAS retrospectively, they could still apply the requirements in IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* under such circumstances.

Application guidance

28. We recommend that the application guidance should be elaborated to explain how service concession assets are to be distinguished from other assets used in, for example, service agreements.
29. The guidance in AG3 to AG13 does not provide additional clarification on the scope of the proposed IPSAS, but rather on the principles dealing with recognition and measurement of a service concession asset (paragraphs 10 to 18) and the recognition and measurement of liabilities (paragraphs 19 to 23). We therefore recommend that the current heading to AG3 to AG13 “scope”, should be deleted and a more appropriate heading be included.
30. We are of the view that some of the guidance in AG5, AG6, AG 10 and AG 11 should be added to the text of the proposed IPSAS as it is useful in understanding and clarifying the principles in black letter paragraphs 10 and 11.
31. We do not support the principle in AG20 that requires that when the operator bears the construction risk, the timing of the initial recognition of the service concession asset will be when the asset is placed in use, for the reasons outlined in a previous comment above. We recommend that the grantor should be required to recognise the service concession asset under construction to the extent that the requirements in paragraph 10 have been met, irrespective of who bears the constructions risk.
32. AG30 determines that the accounting for guarantees provided by the grantor is included in AG56 to AG58. We recommend that the principle for the accounting of guarantees and contingencies should rather be included as part of the text of the proposed IPSAS. The application guidance could then further clarify the principles in this regard.

33. AG32 requires the recognition of advance payments as prepayments. The proposed IPSAS should, as part of the text of the proposed Standard, explain the recognition principles for advance or pre-payments. Guidance should also be provided on how and when such advance or pre-payments should be reduced by the grantor.
34. AG40 requires that the grantor applies the de-recognition principles in IPSAS 17 and IPSAS 31. If a service concession arrangement falls within the scope of this proposed IPSAS, the grantor should control the service concession asset, whether a new asset will be constructed by the operator, or whether it is an existing asset of the grantor. We are thus of the view that the last sentence in this paragraph should be deleted as it is not applicable to service concession assets that are within the scope of the proposed IPSAS as the grantor has not transferred its right to control the asset, but only granted the operator the *right to use* an asset.
35. We are of the view that the first part of AG48 provides guidance to the operator for the recognition of revenue and therefore recommends that the sentence should be deleted.
36. We recommend that the term “ordinarily” as used in AG53 should be explained.
37. We question the usefulness of AG54 and recommend that it should be deleted. The principle dealing with the separate depreciation of service concession assets is dealt with in AG55.
38. Furthermore, if reference is made to depreciation of service concession assets, we recommend that reference should also be made to the impairment of such an asset. An additional paragraph could be included after AG55 as a reference to impairment in IPSAS 21 and IPSAS 26.

General matters

39. In terms of the private sector pronouncements applied by operators in service concession arrangements, an operator should consider whether an arrangement contains a lease if it does not fall within the scope of IFRIC 12, and 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, no further public sector guidance is currently available to assist the grantor in accounting for such an arrangement.

We therefore recommend 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.
40. The proposed IPSAS requires the classification, or re-classification of existing assets, as service concession assets. We recommend that the guidance in the proposed IPSAS should be elaborated to explain when such assets should be re-classified to existing assets, for example to property, plant and equipment or intangible assets.
41. In some instances, reference is made to “assets” as opposed to “service concession assets” (as explained in IN8) in the proposed IPSAS, for example paragraphs 2, 7, 8 and 17. We recommend that, after the term “service concession assets” has been defined and/or explained as recommended previously, the phrase “service concession asset” should be used throughout the proposed IPSAS.