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Dear Stephenie Fox

Accounting and Financial Reporting for Service Concession Arrangements

CIPFA is pleased to present its comments on the above consultation paper, which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

General Comment

CIPFA welcomes this Consultation Paper, which addresses a very significant issue for public sector entities in many jurisdictions. We were very concerned over the lack of guidance for public sector grantors in IFRIC 12 'Service Concession Arrangements', and the IPSASB proposals attend to a very pressing need.

The Consultation paper covers a wider class of arrangements than IFRIC 12, and in so doing it also provides a very comprehensive overview of the accounting and financial reporting requirements, providing very helpful background on the factors relevant to grantor accounting.

Specific Matters for Comment

1. It is proposed that a grantor report the property underlying an SCA as an asset in its financial statements if it is considered to control the property. Criteria for determining control are proposed in the Consultation Paper. Do you agree with this approach and the control criteria identified? (See Paragraphs 28-104)

The Consultation Paper discusses the various approaches which might be used. CIPFA expressed initial concern to IFRIC over their proposals to adopt a control based approach rather than consideration of risks and rewards. However, given that IFRIC 12 has been implemented on that basis, we agree with the IPSASB proposal to use a control based approach.

Applying the proposed control criteria and related reporting guidance should result in operator and grantor reporting on that are mutually consistent. In particular, for arrangements which are in the scope of IFRIC 12, the operator balance sheet will show financing or intangible assets, while the grantor balance sheet will include property, plant and equipment (PPE).

However, we have some concerns arising from the use of a 'residual interest' control criterion which is not the same as the criterion used to define the scope of IFRIC 12.

The Consultation Paper proposes that a common approach to grantor reporting should apply to arrangements where any residual interest (whether significant or not) is controlled by the grantor at the end of the arrangement, whereas IFRIC 12 requires the residual interest to be significant unless the arrangement is a 'whole life' arrangement.

These two approaches will normally be equivalent, but using terminology which differs from IFRIC 12 increases the risk that operator and grantor accounting on some Service Concession Arrangements may be inconsistent. We suggest that in developing an Exposure Draft, the Board might consider whether it can more closely reflect the IFRIC 12 wording, or provide further explanation which makes it clearer that the proposed approach does not introduce a risk that PPE assets 'go missing' or are 'double counted' in operator and grantor balance sheets.

2. It is proposed that the underlying property reported by the grantor as an asset and the related liability (reflecting any obligation to provide compensation to the operator) is initially measured based on the fair value of the property other than in cases where scheduled payments made by the grantor can be separated into a construction element and a service element. In such cases, the present value of the scheduled construction payments should be used if lower than the fair value of the property. Do you agree? (See Paragraphs 105-140)

CIPFA agrees with this proposal.

3. It is proposed that contractually determined inflows of resources to be received by a grantor from an operator as part of an SCA should be recognized as revenue by the grantor as they are earned over the life of the SCA beginning at the commencement of the concession term, that is, when the underlying property is fully operational. These inflows generally should be considered earned as the grantor provides the operator access to the underlying property, and amounts received in advance of providing a commensurate level of access to the property should be reported as a liability. Do you agree? (See Paragraphs 191-196)

CIPFA agrees with this proposal.

Other Matters

IFRIC 12 recognised a tension between developing a workable standard and providing an accurate reflection of economic substance, and the consequences of this taken together with a decision not to 'unbundle' assets give rise to some results which we see as counterintuitive. This affects the Consultation Paper proposals, and specifically paragraph 138 which explains that the requirement to recognise a PPE asset and a corresponding financing liability applies even under those circumstances where the grantor is not required to make any payments for the service, typically when charges are levied on users of the service.

This may well be the treatment which best fits with IFRIC 12, but it does seem rather odd to recognise a liability under these circumstances, and we are only partially persuaded by the comments on the requirement for the grantor to continue to ensure that the operator has access to the asset. Paragraph 138 refers to subsequent guidance on Inflows, but that later guidance mainly covers revenue sharing, and may be difficult for readers to interpret when considering arrangements where the only benefit received by the grantor is the service potential. It would be helpful to provide worked examples or other explanation, to distinguish these benefits from more conventional sharing of a cash inflow.

I hope these comments are a helpful contribution to the development of authoritative international public sector requirements for accounting and financial reporting of Service Concession Arrangements.

Yours sincerely

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