The Canadian Council for
Public-Private Partnerships

Le Conseil Canadien pour
les Partenariats Public-Privé

**President**
Dale Richmond

**Executive Director**
Jane Peatch

**Sponsor Members**
407 ETR Concession Company Limited
Acciona
Aecon Group Inc.
Aird & Berlis LLP
Altus Group Cost Consulting
Bennett Jones LLP
Bilfinger Berger Project Investments Inc.
Blake Cassels & Graydon LLP
BMO Capital Markets
Bombardier Transportation
Borden Ladner Gervais LLP
Borealis Infrastructure Management Inc.
Bridgepoint Group Ltd.
Brun-Way Construction Inc.
Bull, Housser & Tupper LLP
Carillion Canada Inc.
CH2M HILL
CIBC World Markets
CIT Energy & Infrastructure
Davies Ward Phillips & Vineberg LLP
Davis LLP
Deloitte & Touche LLP
DEPFA Bank plc
Ernst & Young Orenda Corporate Finance Inc.
Fasken Martineau DuMoulin LLP
Fraser Milner Casgrain LLP
Goodmans LLP
Government of Ontario
Gowling Lafleur Henderson LLP
Heenan Blaikie LLP
Honeywell Limited
In Tech Risk Management Inc.
Investec Capital Markets
IRIDIUM Concesiones de Infraestructuras, S.A.
John Laing
Macquarie North America Ltd.
McCarthy Tétrault LLP
McMillan LLP
Miller Thomson LLP
Morrison Hershfield Limited
Ogilvy Renault LLP
Osler, Hoskin & Harcourt LLP
P1 Consulting
Parsons
Plenary Group
PricewaterhouseCoopers LLP
RBC Capital Markets
Scotia Capital Inc.
Serco North America
SNC-Lavalin
Société Générale (Canada)
Stikeman Elliott LLP
Stonebridge Financial Corporation
TD Securities Inc.
Torys LLP
Transurban Group
Travelers Guarantee Company of Canada
United Water

July 31, 2008

International Public Sector Accounting Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017
USA

RE: Accounting and Financial Reporting for Service Concession Arrangements Response to Exposure Drafts

Dear Chairman (International Public Sector Accounting Standards Board):

The Canadian Council for Public-Private Partnerships respectfully submits comment related to the above Exposure Draft. Over the past two years our organization has developed a position paper entitled "Public Sector Accounting for Public-Private Partnership Transactions in Canada". The position paper was developed through an inclusive process of public and private sector member input. A copy of the position paper is available for downloading at our website: www.pppcouncil.ca.

The attached comment related to the IPSASB exposure draft has also benefited from the input of members of CCPPP and builds upon the work done in our own review of the issues related to CCPPP position paper relative to Canadian PPP.

Please find CCPPP's comments attached in two versions (PDF and WORD) for your convenience and use.

Regards,

Dale Richmond,
CCPPP

1 First Canadian Place, 100 King Street West, Suite 1600, Toronto, ON M5X 1G5
TELEPHONE: 416-861-0500 FACSIMILE: 416-862-7661
EMAIL: partners@pppcouncil.ca

# A Response to the IFAC Consultation Paper: Accounting and Financial Reporting for Service Concession Arrangements

The Canadian Council for Public-Private Partnerships

August 1, 2008

The Canadian Council for Public-Private Partnerships (CCPPP) welcomes the opportunity to comment on the *Consultation Paper: Accounting and Financial Reporting for Service Concession Arrangements* issued by the International Federation of Accountants (IFAC) in March 2008.

## About CCPPP

The Canadian Council for Public-Private Partnerships was established in 1993 as a member-sponsored non-profit organization, with over 300 member representatives from both the public and private sectors. As proponents of the concept of public-private partnerships (PPPs), CCPPP conducts research, publishes findings, facilitates forums for discussion and sponsors an annual conference on topics related to PPPs both domestic and international. The objective of CCPPP is to foster innovative forms of cooperation between the public sector – at the municipal, regional, provincial and federal levels – and the private sector in the pursuit of addressing the public infrastructure requirements in Canada.

## CCPPP's Interest in Accounting for PPPs

CCPPP's interest in, and concern regarding, the accounting treatment for PPP transactions has grown over recent years as a large number of PPP transactions have gone from planning stages to financial close and implementation. CCPPP has consistently heard concerns from its membership, representing both private and public bodies, that accounting issues are having a significant influence on PPP delivery structures and that there is a lack of clarity on the ultimate accounting outcomes associated with PPPs. In response to this, CCPPP has facilitated extensive discussion and analysis of key accounting issues over the last three years.

The Canadian Council for Public-Private Partnerships believes that well-structured and implemented public-private partnerships can enhance the capacity of government to meet its current and future infrastructure and service obligations. Based on this belief, CCPPP has been actively encouraging dialogue among public- and private-sector decision-makers on important accounting issues that influence the effective use of partnerships in providing better service to the public.

In 2005, CCPPP formed a task force of key stakeholders to examine key PPP accounting issues and advise CCPPP. The task force conducted two large workshops – in November 2005 and November 2006 – to discuss and where possible reach consensus on PPP accounting issues, with the objective to:

- educate decision makers on the implications of budgetary and accounting treatment for PPP delivery;
- achieve a degree of consistency in treatment across Canada;
- ensure that auditors have access to appropriate accounting standards; and
- ultimately achieve a PPP accounting standard for Canada, as has occurred in the United Kingdom with the introduction of FRS 5.

In 2006, CCPPP engaged a PPP accounting and auditing consultant, Mr. Keyvan Ahmadi, CA – former Senior Principal, Office of the Auditor General of British Columbia – to assist the CCPPP's task force with this effort.

Based on these activities and in consultation with its members, associates and other stakeholders, The Canadian Council for Public-Private Partnerships (CCPPP) has now established its position on the need for better accounting guidance to enable partners in a public-private partnership (PPP) to record and report financial activities based on the essence and substance of their PPP transactions.

CCPPP's detailed views are set out in a Position Paper published in July 2008 entitled *Public Sector Accounting for Public-Private Partnership Transactions in Canada*, which is referenced in these comments (as the *Position Paper*) and appended to this letter.

CCPPP has concluded that:

There is a lack of consistent accounting treatment for PPPs in Canada and internationally.

In the absence of a PPP accounting standard (equivalent, for example, to FRS 5 in the United Kingdom), PPP partners risk applying lease accounting rules or other guidance to PPP transactions, with inappropriate and sometimes misleading results.

Potentially inappropriate accounting rules can result in the structuring of PPP transactions on an inefficient basis, for instance, by limiting levels of risk transfer to the private sector. This may not allow the full potential of PPP to be reached in the delivery of public services.

CCPPP accordingly welcomes IFAC's initiative and believes many of the recommendations in the *Consultation Paper* will be important in clarifying treatment.

## Commercial Features of PPPs

We approach the accounting and financial reporting issues for PPPs from a commercial perspective. Commercially, PPPs developed in response to three key failings of conventional procurement:

1. The public sector did not value or manage risk well and was not sensitive to the time value of money, resulting in projects that often exceeded their defined budgets and had a larger impact on the public sector accounts than expected. PPPs are intended to deliver greater cost certainty; and
2. The public sector's outlook was too short-term and focused on reduction of upfront capital costs (which are capitalized on the balance sheet) at the expense of future operating, maintenance and rehabilitation costs (which are expensed only as and when they are incurred). PPPs view an asset on a "lifecycle" basis and optimize the mix of capital, operating and maintenance expenditures to achieve the best long-term result, unconstrained by the differing accounting treatment. In some cases governments undertook PPPs to ensure that operating and maintenance funds would be available when needed.
3. In the recent past, PPPs developed because under cash accounting practices, many governments would fully expense the cost of the asset in the year of acquisition. This meant that projects were often delayed until the budgetary resources were available to fund them. Although many governments have now moved to accrual accounting, many of their budgetary procedures are still influenced by practices carried over from cash accounting days. PPPs can therefore still be seen as a way of avoiding budgetary constraints.

As we discuss further below, under accrual accounting techniques now commonly used by public sector grantors, there should theoretically be indifference between an asset which is capitalized and depreciated compared to one under which the same costs are expensed annually. The annual budgetary impact could be the same, but as a result of timing differences and varied methods of capitalization, there could be significant variance between the two methods. The reality is that most public sector agencies work on the basis of debt limits which make capitalization of assets and liabilities more challenging and which do not emphasize the actual economic result of a transaction, but rather focus on the accounting result.

The most significant concern expressed by the CCPPP membership is that if PPP transactions are accounted for in exactly the same way as conventional government procurement, then they will start to suffer from some of the same problems as conventional procurement. For example, government budgetary constraints will favour PPPs with the lowest upfront costs rather than those which have the lowest net present value (NPV) over the full life of the concession. The best risk-transfer results are only likely to be achieved when there is a "reward" for effective risk transfer in the potential for more favourable accounting treatment. Our objective for an accounting policy regime is to see all projects treated consistently so that accounting does what it should – measure activity but not distort economic choices or the substance of transactions.

This is of course, easier said than done. One of the challenges is to distinguish between the wide variety of P3 models and projects being created.

These concerns are described in detail in the CCPPP *Position Paper* and inform our comments below.

## Control of Assets

IPSAB identified three Specific Matters for Comment that it is particularly interested in.

The first asks whether we agree with the proposed approach that a grantor reports the property underlying a Service Concession Arrangement as an asset in its financial statements if it is considered to control the property.

CCPPP's *Position Paper* espouses a risk rather than a control approach to the recognition of assets and liabilities. This is important because it focuses more attention on the *financial* risks and rewards associated with ownership rather than the broader *economic* risks and rewards.

The philosophy espoused in the *Consultation Paper* seems to imply that an asset (and associated liabilities) which costs $1 but delivers economic benefits to the community of $7 should be reflected in the government's financial statements at $7. CCPPP would argue that the associated liabilities should be recorded at a dollar. In the event that a private-sector operator will take the risk on delivering the improved services or receive only $0.80 cents, then this lower amount should be recorded.

## Residual Interest as a Determinant of Control

CCPPP believes that the *Consultation Paper* places excessive emphasis on the residual interest in the property as a determinant of control (#74-84). CCPPP considers this as one of the defects of lease accounting which was commonly used for SCAs in the absence of the more specific guidance proposed in this *Consultation Paper*. In particular, CCPPP believes that the value of any residual interest as a proportion of the total value of the asset needs to be considered (the proposition put forward in #83 but then rejected). Residual interest should also be only one of the considerations taken into account.

Hence there would be a difference in accounting treatment between a public sector building (for example a hospital) which:

1. Is designed, built and operated by an operator over a 20-year concession term and handed back to a public-sector grantor in a condition which allows for a further 20 years of useful life, or
2. Is designed, built and operated by an operator over a 60-year concession term which reflects the design life of the facility

It is important to note that typical SCAs pass the risk of the performance of the asset at the end of the SCA term to the operator (not the grantor) and therefore it is inappropriate for the asset to be fully depreciated in the statements of the grantor at the end of the term, and a portion of the payments in effect represents a pre-payment for service yet to be delivered by the asset. We attempt to address this in our comments on "Extending the Useful Life of the Asset" below.

The *Consultation Paper* does recognize (#81) that some SCAs may be whole of life arrangements resulting in a less than significant residual interest in the underlying property.

CCPPP is concerned that this emphasis could inappropriately incentivize transactions which transfer a residual interest to the private operator, where the public interest may be better served by retaining the flexibility for the grantor to do whatever is in its best interests at the end of the concession arrangement.

We therefore agree with the position set out in #83 and find the *Consultation Paper*'s overall conclusions inappropriate. If the main purpose of the residual interest criterion is to determine preservation of the right of continuous use during the arrangement (#84), then this should be addressed more directly.

We think that the compensation-upon-termination provisions of the typical SCA are potentially more pertinent to control than the simple fact that there may be a residual interest. Most SCAs do provide for the payment of compensation at fair market value for the impaired asset in the event of termination. However, CCPPP's recommendation is that these provisions constitute a contingent rather than an actual liability.

## Use as a Determinant of Control

CCPPP believes that the *Consultation Paper* places excessive emphasis on the control of *use* of the property. CCPPP believes the appropriate emphasis should be on who controls and takes the risks associated with the *performance* of the property.

In particular we believe that:

The key element of control is whether "the purchaser has the ability or right to operate the asset in the manner it determines" in order to achieve the performance requirements . . . and not "while obtaining or controlling more than an insignificant amount of the output or other utility of the asset."

We are not sure why control of physical access to the asset is so significant. The key issue is who controls the risk of deterioration of the performance of the asset. A useful example to illustrate this would be that most road PPP's would allow the operator to obtain a pre-determined increase in its payments if traffic volumes exceed a certain benchmark or if heavier load vehicles are allowed to use the road, as both of these things would increase wear and tear on the road. In other words, the operator takes performance risks within normal boundaries of physical access, but if the grantor approves access outside these ranges, then the risk remains with the grantor.

This is another way of saying that the key criterion should be how variable are the payments. CCPPP believes that there is a big difference between a grantor buying an asset and committing to make a certain level of payments regardless of the performance of the asset compared to a grantor making payments only if the asset meets reasonably high-performance standards.

CCPPP finds the proposed definition of control of use (#102) to be too broad and encompassing all likely SCA arrangements other than outright privatization. By way of example, CCPPP does not see why the accounting treatment should be different for a direct toll road:

1. Under which the grantor controls or regulates the price ranges or rates that can be charged for services; compared to
2. One in which the operator is free to set tolls at whatever the market will bear.

Again this treatment could encourage a lack of regulation of tolls which may not be in the public interest, while not materially changing the level of risk borne by the private operator.

CCPPP therefore strongly supports the position set out in IPSAS 23 (#71) that public sector control of a regulatory nature should not satisfy the criteria for recognition of an asset.

## Lease Guidance

CCPPP believes that it is inappropriate to revert to lease guidance if the SCA meets the control-over-use criterion but does not meet the residual-interest criterion.

CCPPP believes that the typical SCA does not meet the definition of a finance lease (#57) which "transfers to the lessee substantially all of the risks and rewards incident to ownership". We believe that under most

SCAs the majority of the risks and the majority of the financial rewards belong to the operator not the grantor. The key provision in our view is whether at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset. Under most SCAs, the asset does not exist at the inception of the transaction. The operator is exposed to the full risk of completing construction of the asset and will typically not be entitled to any payments until this is achieved. Once construction is completed successfully, there may be a probability argument that the required level of service is likely to be met and therefore that the payments are relatively certain, but in fact the operator is rarely entitled to minimum lease payments and is exposed to the risk of both the underlying asset and any associated services meeting the performance standards necessary to receive any or all payments.

This is a radically different arrangement from, for example, buying a motor vehicle from General Motors and accepting a lease financing package.

## Consideration of Risk

CCPPP agrees with the UK Accounting Standards Board that transfer of demand risk is a key determinant of control. This does not appear to have enough emphasis in the *Consultation Paper*. We are surprised that there appears to be no significant distinction between a user pay asset and one in which the payments are made directly by the public grantor. Although there is a valid argument that both should in some way be reflected in the public sector's financial statements, CCPPP believes that there is a very significant difference between the nature of the liability associated with these different transactions.

CCPPP supports the unbundling Approach to Rights and Obligations under an SCA described in #58 - 61. In particular, CCPPP believes in the concept that SCAs which successfully and appropriately transfer greater risk to the private operator should be "rewarded" by more favourable accounting treatment than those which transfer less risk. CCPPP therefore disagrees with the *Consultation Paper* conclusions in #101 and encourages further exploration of this issue.

## Fair Value

The second of the Specific Matters for Comment is the proposal that the underlying property reported by the grantor as an asset and the related liability (reflecting any obligation to provide compensation to the operator) should be based upon the fair value of the property. An exception would be where scheduled payments made by the grantor can be separated into a construction element and a service element, in which case the value of scheduled construction payments should be used if lower than the fair value of the property.

In this area, CCPPP believes there is potential to reconcile the differing needs of the asset side of the public sector balance sheet (to fully record the fair value of the public capital stock) with the liability side of the balance sheet (to record the financial obligations which must be met by user charges, taxation or other forms of public sector revenue). In other words, the asset recorded in respect of an SCA could be greater than the corresponding liability.

This goes to the heart of the PPP model. CCPPP believes the *Consultation Paper* does not effectively address one of the major issues associated with PPP accounting. This can be best summarized in the context of #114.

Under most SCAs, the operator takes the risk on whether its proposed mix of investment in the construction of the property and its anticipated service (OMR) expenses provide the necessary performance to earn the concession payments.

It is in practice quite difficult to separate capital improvements on an asset (capitalized) from O&M costs (expensed). This separation becomes almost impossible under an SCA arrangement when the operator will typically have the discretion to choose the approach used to meeting the performance standards.

Where payments are regarded as inseparable, the *Consultation Paper* recommends capitalization of fair value at inception (#119). The practical challenge is how to determine fair value. Again using the simplified example above, the fair value of Bidder A may be determined to be higher than the fair value of Bidder B. The solution is the same – to ensure that fair value is determined in a way which does not prejudice the approach taken by any one bidder.

Even if these payments are separable (#114) into capital and service payments, as long as a performance abatement affects both types of payment, then it is inappropriate to capitalize one and expense the other.

This can best be seen in this very simplified example of two separate operators bidding for the same project.

| | Bidder A | Bidder B | Public Sector Comparator |
|---|---|---|---|
| Construction Costs | $150,000,000 | $100,000,000 | $80,000.000 |
| Cost of Capital | 8% | 10% | 6% |
| Annual Capital Payments | $27,000,000 | $20,000,000 | $12,800,000 |
| Annual O&M Payments | $3,000,000 | $10,000,000 | $15,000,000 |
| Annualized Rehabilitation Payments | $2,000,000 | $5,000,000 | $10,000,000 |
| Total Annual Payments | $32,000,000 | $35,000,000 | $37,800,000 |

Bidder A chooses a more capital-intensive solution to meeting the performance requirements than Bidder B and enjoys a lower cost of capital as a result of this approach. Under the approach proposed in #114 and #122, if Bidder A is selected as the operator, the grantor will capitalize on its balance sheet a much higher amount than if Bidder B is successful. Although in theory the total budgetary impact of the two bidders may be the same, many grantors have debt limits in addition to annual budgetary constraints. Accounting treatment may influence the grantor to select Bidder B in preference to Bidder A, despite Bidder B being more expensive overall.

However, both bidders could appear to be more expensive than the conventional delivery alternative indicated by the Public Sector Comparator as the NPV of the future payments from PPP delivery could far exceed the cost of the asset which would be capitalized under conventional delivery (because of the O&M and rehabilitation payments implicit in the total payments, the risk transfer costs, and the higher costs of private financing relative to the cost of government borrowing).

In CCPPP's opinion, it is essential for the fair value of the asset which is capitalized to reflect only the minimum level of capital cost. In other words, if a PPP operator chooses to invest more upfront to mitigate long-term operating and maintenance expenditures then this should not increase the capitalized value.

The value of the capital asset could be computed using the fixed-price contract entered into by the private sector concessionaire adjusted by:

1. Any ongoing operations required to be undertaken by the design-build contractor for an existing facility during construction;
2. The insurance- and executory-cost component of the design-build contract, which can be disclosed by the contractor; and

3. The monetary value of any specific, additional requirements placed on the design-build contractor by the private sector developer beyond the scope of the government requirements. Note: the monetary value of these requirements should be lower or equivalent to the present value of future operating and maintenance payments that would have otherwise been required if not for the intervention of the private sector developer.

The valuation above can be checked for reliability against a crude estimate of the asset value derived using the present value of the minimum-payment stream discounted based on the internal rate of return of the private sector concessionaire.

The valuation can also be checked against the potentially more reliable fair-value assessment of the assets provided by the insurer of the project.

CCPPP also recommends the importance of a public authority establishing its accounting treatment for a transaction prior to receiving bids from the market, to avoid accounting treatment prejudicing one bidder's approach over another's. This means the following types of solutions:

- using a hypothetical mix of construction and service inputs based on the grantor's own public sector comparator approach; or
- using the average mix of construction and service inputs of all the bids received.

It means not digging into the actual mix of construction and service inputs used by the winning bidder.

## Extending Useful Life of Asset

CCPPP endorses the *Consultation Paper's* recommendation that the portion of payments attributable to extending the useful life of the asset should be recognized as an asset (#154).

A typical SCA hands back to the grantor at the end of the term an asset with a significant useful life and a fair value which will typically greatly exceed the cost to the grantor of purchasing back the asset (usually zero). This value is rarely recognized because the built costs of the asset are fully amortized during the term in parallel with the reduction in liability as the payments are made. The remaining portions of the payments (reflecting OMR) are expensed, even those which actually contribute to ensuring that the asset has a useful life and value after the end of the term.

A simplified way to achieve this would be as follows:

A grantor will usually depreciate its highway assets over 40 years. However, the hand-back conditions under an SCA over a new highway require an asset condition which delivers a useful economic life of 10 years after a 40-year concession period. The capital payments should accordingly be amortized over 50 years rather than the typical 40.

Note this does not solve two problems:

1. The capitalized "debt" value of the SCA will still be higher than appropriate, even though the annual budgetary impact will be lower.
2. It does not address the portion of the service payments spent on capital rehabilitation which will be expensed as incurred rather than capitalized as they appropriately should be.

Another way to look at this would be to try to specifically identify the proportion of the capital payment that is being allocated to extend the life of the asset and capitalize this as the increase in the asset value. The emerging asset approach described below as applicable to user pay transactions may have some application here. For example, as the initial fair value of the asset is being amortized, the value could be written back by an index reflecting the increase in construction costs for a new road.

## Discount Rate

CCPPP strongly endorses the recommendation (#122) that the appropriate discount rate used to discount minimum lease payments should be the operator's cost of capital specific to the SCA. This should ideally be done on an average basis so as not to discriminate between the costs of capital of different operators bidding.

## Interest During Construction

CCPPP believes that there is considerable uncertainty over whether or not interest during the construction period should be included in the fair value of the asset capitalized. It does not appear that the *Consultation Paper* addresses this.

## Timing of Recognition

The *Consultation Paper* does not appear to provide clear guidance on the issue of the timing of recognition of the asset and liability associated with an SCA. Paragraph #135 implies that recognition during construction is likely as long as construction-in-progress can be measured and the SCA prevents either party terminating without a penalty even if the risk of construction completion is transferred to the operator.

CCPPP agrees with the guidance of the UK Accounting Standards Board (#106) and recommends that typically the asset and liability should only be recognized upon completion of construction as this is typically the trigger point for commencement of payments by the grantor. We disagree with the guidance in IPSAS 17. Under most PPP transactions, any construction risk obligations of the grantor are contingent in nature and are capable of being mitigated without requiring financial payment from the grantor. For example: (1) sharing risk for geotechnical conditions outside normal expectations, which is capable of mitigation through design variation or (2) having an obligation to make compensation payments upon termination which can be mitigating by procuring an alternative concessionaire or contractor. The main exception would be circumstances in which the grantor makes progress payments during the course of construction, which should be recognized as an asset as and when they are incurred.

## Reporting Limited to Cash Transfers

With regard to #124-132, CCPPP agrees with the position set out in #131 which would record the SCA on the face of the financial statements only to the extent that cash is or will be transferred between the grantor and the concessionaire. We do not support the recommendation made in #132 which we believe risks confusing broad economic benefits with financial assets and liabilities.

The *Consultation Paper* seems to imply that an asset which costs $1 but delivers economic benefits to the community of $7 should be reflected in the government's financial statements at $7. CCPPP would argue that it should be recorded at a dollar. In the event that a private-sector operator will take the risk on delivering the improved services or receive only $0.80 cents, then this lower amount should be recorded.

## Nature of Liabilities

The *Consultation Paper* does not sufficiently address the nature of the liability which should be recorded. This is addressed in #114 - 118. CCPPP believes that there is a significant difference between, for example:

- consolidation of the debt associated with the private sector special purpose vehicle;
- the present value of the scheduled construction payments;
- an amount equal to the fair value of the as built asset;

- a contingent liability to make service payments subject to performance; and
- an obligation to continue to provide access to the asset in return for a pre –payment under a user pay transaction.

It is not clear from the *Consultation Paper* that each of these different scenarios would not receive substantially the same treatment on the liability side of the financial statements.

## Potential Double Recording of Assets and Liabilities

The likely effect of the *Consultation Paper's* recommendations is that many assets and liabilities will be recorded on both the public- and the private-sector balance sheets. This is not a desirable outcome.

## User-Pay Transactions

The third of the Specific Matters for Comment requests a response on sections #191-196 of the *Consultation Paper*, which argue that contractually-determined inflows of resources should be recognized as revenue by the grantor as they are earned over the life of the SCA and amounts received in advance of providing a commensurate level of access should be reported as a liability.

With regard to #126-132, this implies that the grantor must recognize as an asset property at its fair value and then record as an offsetting liability the obligation of the grantor to provide access to the property.

We note above that we believe there is a significant difference in risk transfer between a "user-pay" transaction under which the operator is exposed to demand risk and commits to make payments to the grantor, and one in which the public sector makes all the payments.

CCPPP believes that there are some challenging practical issues involved in this recommendation.

The most common forms of payments from a concessionaire to a grantor are:

1. Payments to reimburse the grantor for certain costs incurred in making the concession available, for example costs of property acquisition.
2. Concession payments made upfront at financial close in return for the rights to a long term concession.
3. Concession payments made overtime in return for the rights to a long-term concession
4. Revenue-sharing arrangements under which the grantor receives payments provided that certain operating results are achieved.

We believe that only Example 1 one fully meets the recommendations of the *Consultation Paper*.

Under Example 2, the conservative approach set out in the *Consultation Paper* would be to recognize the cash received as an asset but offset this by an equal liability in the form of a prepayment which is amortized proportionately over the term of the concession. However, this arguably understates the financial position as the grantor is typically not undertaking any activities or taking any risks in providing access to the operator and accordingly (other than not exercising its rights to terminate) is not doing anything which could result in an obligation to refund the upfront concession payments. CCPPP believes, therefore, that it is inappropriate to record a liability associated with the concession payments if there is no situation under which the concession payment can be reimbursed.

Example 3 is not different in concept to Example 2 other than the fact that the grantor is taking the credit risk of the project in order to receive its payments over time. As the project will typically be a special-

purpose vehicle with limited resources beyond the success of the project, it is likely appropriate to conservatively record the cash inflows as an asset only as and when they are received.

Under Example 4, it is definitely appropriate to record any cash inflows as an asset only as and when they are received.

In order to avoid "over inflating" the public-sector balance sheet and potentially providing misleading information about the nature of private sector liabilities, CCPPP favours an approach which has been utilized in Australia referred to as the "emerging asset" approach. Under this approach, a public sector agency which has a residual interest in a user-pay asset such as a toll road at the end of an SCA term, would estimate the fair value of the asset at the end of the term and record the asset proportionately over the life of the SCA. In other words, a toll road under a 20-year concession with an estimated fair value of $100 million at the end of the term, would add an asset value of $5 million each year.

## Conclusions

In conclusion, CCPPP welcomes IFAC's initiative to provide greater clarity to public-sector accounting treatment of PPP transactions.

We believe that the control tests recommended to determine whether the underlying asset is recorded on balance sheet do not sufficiently differentiate between conventional delivery and the many varied types of PPP transaction which could be described under an SCA. We recommend a risk-based approach to determine which party should recognize the asset and liabilities.

We believe that the *Consultation Paper* was very practical in recommending that the lower of fair value or identified scheduled construction (capital) payments is used to recognize an asset. We believe that it is important to specify in more detail how the fair value should be ascertained under an SCA arrangement, as this is an area in our members' experience in which there is the potential for significant differences of opinion. In particular, it is vital for accounting treatment to avoid recording as a capital asset, costs which are more akin to operating, maintenance and rehabilitation expenses. This risks penalizing SCA arrangements compared to conventional delivery as well as potentially distorting commercial differentiation between operators who may provide a required service using different mixes of capital and operating inputs.

CCPPP believes that the nature of the liabilities which arise out of SCAs can be very different. In order to avoid misleading information, we favour the recognition of contingent liabilities accompanied by substantive notes to the statements wherever liabilities are variable and not certain.

In particular, we believe that the proposed treatment of "user-pay" assets is potentially misleading and that these should be clearly differentiated from transactions where the payment liability falls on the taxpayer. CCPPP supports the use of an emerging asset concept, where an asset with commercial value to the grantor at the end of the SCA is gradually and proportionately recognized over the life of the SCA.