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June 16, 2008

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
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Subject: Response to Consultation Paper: *Accounting and Financial Reporting for Service Concession Arrangements*

Staff of the Public Sector Accounting Board (PSAB) has reviewed the proposals outlined in the Consultation Paper: *Accounting and Financial Reporting for Service Concession Arrangements*. Our comments are organized according to the requested comments (below), other observations are appear in an appendix to the body of this letter.

Significant interest has been indicated by PSAB in this initiative. IPSASB is to be congratulated for undertaking to study this matter and in being able to release a comprehensive discussion of the many issues within a short time period. We hope that you will find the comments provided herein useful, understanding that they reflect the views of staff as PSAB itself has not deliberated on the issues addressed within the paper.

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)*

Staff comments: We support the proposed approach to reporting of property by the grantor applying the two part control test. We believe the criteria are appropriate. In supporting this approach, we believe these proposals offer a straightforward principle based approach to resolve the reporting of property. Further, we recognize there is a benefit in establishing an approach that will offer symmetry in accounting by the grantor (applying IPSASB) and an operator (applying IFRS). PSAB is actively monitoring this project. Staff is extremely interested in the comments and perspectives arising from these proposals.

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)

Staff comments: Separation of unified payments is a quandary as old as accrual accounting, e.g. when acquiring real estate, determining the allocation to land apart from that for structures. Recently issued standards have laid the expectation that accountants face up to these challenges and not seek refuge based on simplistic or arbitrary points of reference. As an example, the valuation and allocation of purchase price to all items in a business acquisition is required. Although allocation of unitary pricing provisions within certain SCAs may prove complex, it is a matter that in our view is best accomplished by disaggregating contractual requirements into separate performance obligations as the consultation paper proposes. We support this approach based on our understanding that it aligns with current thinking as reflected in the joint IASB/FASB revenue recognition project.

We support the principle that the present value of the scheduled construction payments be used if it is lower than the fair value of the property. However, we believe this outcome is one that should give an accountant reason to pause, much as an initial finding of negative goodwill when allocating value to items in a business acquisition. In development of the detailed standard, this issue warrants further evaluation. There are many reasons such problems can arise: it may be that the overall discount rate is too low or not all of the contributions made by the grantor (or benefits to be received) have been identified or their value properly attributed.

As well, guidance should expressly address that risk factors, as reflected in discount rates, vary over the life cycle of the arrangement: pre-construction financing, post-construction financing, and financing required to support the service provision element. Provisions within standards that explicitly provide for a single discount rate over the term and suggest the application of straight-line revenue recognition of advance receipts while expedient, may enable "income smoothing" and in our view should be avoided. Transactions involving sale of interests in established SCAs clearly signal the market's receptivity to lower discount rates once an arrangement matures into the post-construction operating phase. We note that among the distinguishing risk factors of an SCA identified in the paper is the potential that a government may "step in" to ensure continuity of an essential service. The financial implications of such an event will vary during the lifecycle of an arrangement.

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)*

Staff comments: We support this position. When a grantor is in receipt of inflows arising from contractual provisions associated with an SCA, their recognition as revenue should occur as the grantor fulfills its obligations.

In many cases, the economic obligation involves access to a resource or a right given to the operator that is integral to conduct of the SCA. The right may be exclusive or it may simply exclude others who do not hold such rights. It may be the right to provide a service, which may or may not involve the collection of a user charge.

Since liabilities are associated with the sacrifice of future economic benefits, their fulfillment may be tied to the passage of time but satisfaction of specific contractual requirements may also be relevant. This would certainly be the case where the economic benefit transferred involves a natural resource and possibly when it is known at the outset that the rights associated with the concession will be of measurably greater significance in certain years of the concession. For example, in 2008 a government might grant a concession to operate a hotel located in Whistler, British Columbia (site of the 2010 Olympics) for five years. If the terms allow the operator to set the hotel rates based on market demand, the concession's value is arguably greatest during the 2010 fiscal year.

The straight-line method may not always reflect the underlying economic consumption of the benefit foregone. Accordingly, we do not believe that the straight-line method should be given prominence over any other method that recognizes the sacrifice of economic benefits associated with the contractual rights transferred.

Thank you for the opportunity to provide comments on this important paper. We look forward to monitoring your progress on this initiative and in its ultimate success.

Yours truly,

Tim Beauchamp

Tim Beauchamp
Director
Public Sector Accounting

Appendix: Other Comments

Accounting for Residual Interests

We believe IPSASB has concluded that some aspect of control over a residual interest is a fundamental distinguishing characteristic of an SCA. As such, we believe the usefulness of the standard in practice would be enhanced if guidance is included as to measurement of the residual interest on initial recognition and the need to re-evaluate the carrying value in subsequent periods, in line with the entity's accounting policies specific to the measurement of property. This guidance should specifically address whether the value is discounted and align with other guidance provided on how the discounted rate should be determined.

Illustrative Flowcharts

We found the illustrative flowcharts valuable in understanding and gaining perspective on the proposals. However, in the development of a final standard we would suggest that reconsideration be given to Flowchart 1. As it is depicted, the right hand path applies terms that are not defined. This may allow readers to reach conclusions about accounting treatment based on the types of Public-Private Partnerships as described in paragraphs ten, eleven and sixteen. We favour an approach that would describe criteria to determine the accounting for specific types of service concession arrangements. We support this approach as we understand it to be consistent with that adopted for IFRIC Interpretation 12, "Service Concession Arrangements".

In our view, a superior approach would combine the two flowcharts, eliminating the path that presently appears on the right side of Flowchart 1.

SCAs involving existing property

Paragraph 139 states "For SCAs involving existing property that the grantor has already reported as an asset, no additional accounting associated with the property generally should be required when the SCA is entered into." The paragraph continues and indicates that an impairment should not be recorded as a result of granting access to a non-cash generating asset as defined in IPSAS 21.

In our view some further development of these comments, perhaps as part of the guidance would be useful. When existing assets are contributed to a new arrangement and control remains with the grantor, there is continuity of the grantor's interest. As such, we support the conclusion that the carrying value of the contributed assets would not be adjusted when the SCA is granted. While this result may appear to be self evident, others may wish to argue that granting the SCA is an economic event requiring a reevaluation of all assets and liabilities associated with the transaction. If IPSASB intends that this not occur, we believe it would be useful to communicate this conclusion in a direct manner.