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Dear Stephenie

Consultation paper on “Accounting and Financial Reporting for Service Concession Arrangements”

The Public Sector Committee of the Institute of Chartered Accountants of Scotland (ICAS) welcomes the opportunity to comment on the International Public Sector Accounting Standards Board’s consultation on accounting and financial reporting for service concession arrangements (SCAs). The Public Sector Committee is a broad based committee of ICAS members with representation from across the public services.

The Institute’s Charter requires it to act primarily in the public interest, and our submissions are therefore intended to place the general public interest first. Our Charter also requires us to represent our members’ views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Overall Comments

In the UK, accounting for PFI and PPP arrangements has been the subject of much debate and controversy particularly since the Government announced in its 2007 Budget that the UK public sector was to comply with international financial reporting standards (IFRS) from 1 April 2008. The absence of an accounting standard or any specific guidance on how grantors should account for SCAs under IFRS has been a major sticking point in moving the UK public sector from a UK GAAP-based framework to an IFRS-based framework. Uncertainty over how to account for PFI and PPP arrangements is one of the key reasons that the implementation of IFRS by the UK public sector has now been postponed until 1 April 2009.

The preparation of guidance on SCAs will fill a gap in the existing guidance. Although International Public Sector Accounting Standards (IPSASs) and guidance flowing from these have not been adopted by the UK, any guidance produced by IPSASB is likely to be influential as PPP arrangements continue to be a major source of funding for infrastructure projects.

We believe that the consultation paper is a useful starting point for the development of more formal guidance on SCAs by exploring the accounting treatment of various forms of service concession. We believe that guidance on SCAs will be useful to public sector organisations and we support the substance over form approach taken in the consultation document. However, the consultation document contains an excessive amount of detail on the research undertaken in developing the guidance and this approach obscures the actual guidance itself. We are of the view that a further consultation should be undertaken on a more focussed document before a final version of the guidance is issued.

We broadly support IPSASB's proposals on determining grantor control as set out in paragraph 102 of the consultation paper. However, we believe that the criteria should be amended to provide a stronger and clearer framework for determining grantor control. In particular, we believe that control by the grantor should be determined if either one of the criteria is met: under the proposals both criteria have to be met before grantor control is determined. We are also concerned that the consultation paper takes a different approach to determining grantor control in relation to the residual interest compared to IFRIC 12 'Service Concession Arrangements.' IFRIC 12 requires an interest in the residual interest to be significant for control to be determined whereas the consultation paper only requires the existence of a residual interest for control to be determined. We support a consistent approach with IFRIC 12 on this issue and as a general point take the view that any guidance issued by IPSASB should be consistent with IFRS.

Our more detailed comments, including our response to each of the specific matters for comment, are included in the Appendix.

Please do not hesitate to contact me if you would like to discuss our response further.

Yours sincerely

CHRISTINE SCOTT
Assistant Director, Accounting & Auditing

Specific Matters for Comment

Specific matter for comment 1

It is proposed that the grantor reports the property underlying the SCA as an asset in its financial statements if it is considered to control the property. Criteria for determining control are identified in the consultation paper. Do you agree with the approach and the control criteria identified?

Response

We agree with the proposal that the grantor reports the property underlying the SCA as an asset in its financial statements if it is considered to control the property. However, we believe that a bolder approach to determining ‘grantor control’ is required and that the property underlying a SCA should be reported by the public sector entity if either the first or the second criterion set out in paragraph 102 is met. Our detailed comments on the criteria for determining ‘grantor control’ are set out below.

First criterion

The first criterion for determining ‘grantor control’ is that “The grantor controls or regulates what services the operator must provide.....” The concept of regulation in this criterion is explained in a footnote as being “restricted to arrangements agreed upon by the grantor and the operator, and to which both parties are bound. It excludes generally legislated regulation that does not establish control for the purposes of financial reporting as concluded in IPSAS 6 and IPSAS 23.”

We have the following comments on the first criterion:

- We have concerns about how the concept of ‘regulation’ is handled in the consultation document and take the view that the terms ‘regulates’ and ‘regulation’ should not be used in any criteria for determining ‘grantor control’. The use of the words such as ‘regulate’ could be easily misinterpreted. For example, governments regulate some private industries but these should clearly be outside the scope of the guidance.
- We recommend that footnotes are not used in guidance in relation to the determination of ‘grantor control’. As this is fundamental to accounting for SCA’s, we believe it should be defined entirely within the main text of any guidance.
- We are not clear why IPSAS 6 ‘Consolidated and Separate Financial Statements’ is referred to here as it deals with the definition of control in relation to one entity controlling another entity rather than an entity’s control of a tangible fixed asset. Secondly, there are also difficulties with the reference to ‘regulation’, if the concept of ‘regulation’ is a separate concept from that of ‘control’ then ‘regulation’ should not be defined using the term ‘control’ to avoid using a self-referring definition.
- We have a similar difficulty with the cross-reference to IPSAS 23 ‘Revenue from Non-Exchange Transactions’. Paragraph 32 of IPSAS 23 states that “The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity’s assets from those public goods that all entities have access to and benefit from.” This also indicates that the ability to regulate is an aspect of control of an asset not a separate concept.

Second criterion

The second criterion also needs to be strengthened to reflect the position in IFRIC 12 in relation to the residual interest. This would be achieved if the grantor’s interest in the residual interest is required to be ‘significant’ in order to evidence ‘control’. If the grantor’s interest in the residual is ‘insignificant’ then it is inconsequential and has no bearing on whether the grantor controls the property for financial

reporting purposes.

Specific matter for comment 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?

Response

We agree with the proposal that:

- the underlying property and related liability should be measured at fair value where contracts are not separable; and
- if contracts are separable, the property and related liability should be measured at the lower of the present value of construction payments or fair value.

Specific matter for comment 3

It is proposed that contractually determined inflows of resources to be received by the grantor from an operator as part of an SCA should be recognised as revenue by the grantor as they are earned over the life of the SCA beginning at 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 commensurate level of access to the property should be reported as a liability. Do you agree?

Response

We believe that inflows of resources received by a grantor from an operator should be recognised when the grantor has the right to consideration. We believe that the right to consideration should be the basis of any accounting policy on revenue recognition and we agree that in the case of a SCA it is likely that the right to consideration is earned over the life of the SCA beginning at the commencement of the concession term.

Other comments

Government Business Enterprises

The guidance is not applicable to government business enterprises. This is the same approach taken by IPSASs as government business enterprises are expected to follow private sector GAAP. However, any inconsistencies between accounting policies adopted by government business enterprises and other public sector entities could cause difficulties for countries preparing whole of government accounts: hence, the importance of IPSASB guidance and IPSASs as a whole being consistent with IFRS. We consider that the treatment of government business enterprises should be considered as part of IPSASB's conceptual framework project.

Re-financing

The re-financing of projects is not addressed by the consultation document. Refinancing is common when operators are in financial difficulties. Even if re-financing arrangements are to be outside the scope of the guidance then there should at least be a cross-reference to those IPSASs which would apply in such circumstances.

Definitions of 'grantor' and 'operator'

We recommend that the use of terminology used to describe the 'grantor' and the 'operator' should be applied consistently throughout the document, for example, the word 'purchaser' is also used to describe the 'grantor'. We would support the use of more intuitive terminology in describing the 'grantor' and the 'operator' such as the 'user' and the 'contractor'. However, we understand the need for consistent terminology to be used within IPSASs, and related guidance, and that consistency with terminology used in IFRS is desirable.