August 5, 2008

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario
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Re: Consultation Paper: Accounting and Financial Reporting for Service Concession Arrangements (March 2008)

Thank you for the opportunity to provide comments on the consultation paper titled Accounting and Financial Reporting for Service Concession Arrangements.

Please find attached my responses to the three specific questions set out on page 5 of the consultation paper, as well as general comments on other proposals in the paper.

Yours truly,

John Doyle, MBA, CA
Auditor General of British Columbia

Overall comments

The consultation paper is comprehensive, lays out many of the key issues, and provides a balanced perspective on the existing and proposed guidance.

Given the complexities of SCA, we agree that there is a need for specific guidance on their accounting and financial reporting – provided the guidance remains principle based.

Response to "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)***

    In general we agree with the proposal for determining whether a SCA should be reported as an asset.

    In defining control from a public sector perspective, it makes sense to focus on service potential (and accountability for services) to the grantor, rather than purely economic risks and rewards.

    In theory, the concept of residual interest makes sense (it does provide pervasive evidence that the use of the property is preserved over the life of the agreement – e.g. operator can't sell the property). The paper provides a reasoned explanation for why residual interest is a strong indicator of control. However, we question whether it is a necessary criteria to evidence overall control. Within a principle based approach to standard setting, this criteria seems to be prescriptive. In most cases where residual interest doesn't exist, the framework leads to the use of lease accounting and likely capitalization as a finance/capital lease.

    One additional point on the proposed criteria – the guidance should include a clear definition of the term "property" to clarify that it includes both moveable and immovable property. This will assist in ensuring consistency in the treatment of all properties involved in SCA.

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)***

In general, we agree that the measurement of the asset should be based on the fair value of the property.

Base on our experience, fair value (at inception) can be measured as the amount that the operator paid to build/acquire the property. This can generally be obtained from the successful proponents financial models.

Reducing the cost of the asset if the net present value of the scheduled payments is lower than the fair value is conceptually sound. However, it does lead to several significant issues that are discussed in the paper.

<u>Does the liability need to mirror the asset?</u> At the core of this issue is whether the obligation is, in substance, a financial liability (and should be reported at fair value). We believe that the asset will mirror the liability at the start of the agreement. However, over time, it is unlikely that the payment stream (which represents the liability) will mirror the systematic amortization of the asset. As such, the asset and liability should be tracked and valued separately over the term of the agreement.

<u>What is the appropriate rate for discounting cash flows?</u> The consultation paper suggests the operator's cost of capital should be used (based on the grantor subjecting itself to the operators cost of raising capital). An alternative view is the appropriate rate for measuring the accounting net present value should be the grantor's (government) incremental cost of borrowing (as it represents the rate at which the grantor can directly finance). To use the proponents cost of capital understates the liability. There are compelling arguments for both approaches, yet the paper focussed primarily on the former. In order to provide a complete analysis, it would be useful to compare and contrast the alternative approaches to selecting the discount rate.

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)***

   We agree that inflow of resources should be deferred until the commencement of service, and recognized in a systematic manner (based on the level of service provided). This is consistent with the concept of government deriving benefit from future service potential (substance over form).

Additional Proposals in the Consultation Paper – Inflow of Resources

In instances where the SCA provides the operator with the right to collect revenue from third parties (such as a toll road), should the revenue be reported by the grantor? For example, in situations where the grantor provides a guaranteed minimum revenue and shares in revenues above a set threshold, should the grantor record the total (gross) revenue from tolls with an offsetting expense to reflect the operator's portion of revenue. One could argue that under a control based approach, where the grantor controls the underlying property and retains at last some portion of the revenue risk, the operator is collecting the revenues on behalf of the grantor therefore the gross basis of accounting for revenues should be used. In summary, the paper assumes that grantor records revenue on a net basis. It would be useful to include a discussion of the gross basis of recording revenue.