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Dear Sir

Exposure Draft 43: Service Concession Arrangements: Grantor

I welcome the opportunity to comment on ED43. I should begin by stating that my comments here reflect personal views and observations and should not necessarily be taken to represent those of the University of Sheffield or any of the professional or academic organisations with whom I work.

I welcome the publication of EDE43 by IPSASB which represents an important step in the development of enabling accounting for Service Concession Arrangements (SCA) to be applied consistently internationally and across both grantors and operators. One of the key strengths of the proposals in ED43 is the attempt to mirror the equivalent accounting in IFRIC 12. Accounting for Private Finance Initiative (PFI) contracts in the UK has been bedevilled by contradictions between accounting for individual PFI contracts in the public and private sector. For example, various papers tabled at meetings of the Financial Reporting Advisory Board point to some PFI deals being on both the public and private sector balance sheet with others being on neither. Such inconsistencies suggest that accounting for PFI provides opportunities to arbitrage between different regulations, or the interpretation of regulations, which should be reduced by the application of these proposals.

I support the proposal that recognition of SCA assets be based upon the control-based approach rather than the risk-and-rewards approach. Experience in the UK in the application of the risks-and-rewards approach is that it has led to different interpretations of the appropriate balance of risks in determining the accounting treatment by both accounting preparers and audit firms; this is a major cause of the inconsistencies between sectors mentioned above. I make a simple point here: if the (private sector) contractor and the (public sector) grantor both believe that they do not carry the principle risks in the contract, then someone has got it wrong. Our recent experience of mismanagement in the banking sector suggests that, if in doubt, residual risk will land with the public sector and require taxpayers to pay the cost. An accounting approach which recognises that the public sector grantor both controls the strategic use of the asset and will foot the bill for its use is more likely to achieve consistency between sectors and reflect the inherent risk that the public sector bears in entering into these arrangements.

I support the recognition criteria in paragraph 10 and its consistency with IFRIC12. It is pleasing to see that the residual interest test in the Discussion Paper has been amended to refer to interests which are significant. I suspect that the interpretation of 'control' is one area which IPSASB (and the IASB) will need to return in the future. It will be this interpretation which will be used by those promoting SCA to seek to move assets and obligations on or off balance sheets in ways which will meet the letter of the standard without always reflecting the substance of underlying schemes.

I support the proposals for the recognition of revenues and expenses in paragraphs 24 and 25. The allocation of SCA payments between capital repayment, service costs and finance charges is critical to the application of this proposed standard. The experience in the UK in developing accounting for PFI was that many argued that such allocation of payments was infeasible or inappropriate[i]. I do not support that view but it may indicate that a number of different approaches may be adopted in the allocation of expenses so that details of the approach taken would be a useful addition to the disclosure requirements in paragraph 27.

I do not support the transition arrangements in paragraph 30. If I understand this correctly, the proposals would allow those organisations which have not capitalised SCA assets previously to continue to do so for existing schemes. In the UK there are PFI schemes that run for 30 or more years; so the implication of paragraph 30 is that such organisations may continue to use inadequate accounting for many years ahead. The default position in paragraph 30 should be for public sector organisations to apply the new standard retrospectively from the effective date. Prospective application should only be allowed in very limited circumstances (e.g. of extreme cost or impracticality) and, in such circumstances, there should be detailed disclosures of those schemes which are not being accounted for retrospectively under the standard.

I trust that these comments will be useful in the development of the standard.

Yours faithfully

Ron Hodges
Professor of Public Services Accounting

[i] For example: see Hodges, R. and Mellett, H. (2002), 'Investigating Standard Setting: Accounting for the United Kingdom's Private Finance Initiative', Accounting Forum, vol. 26, no. 2 pp. 126-151.