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STAFF QUESTIONS AND ANSWERS

February 2016

THE "GRANT OF A RIGHT TO THE OPERATOR MODEL" IN IPSAS 32, *SERVICE CONCESSION ARRANGEMENTS: GRANTOR*

This Questions & Answers (Q&A) publication is issued by the staff of the International Public Sector Accounting Standards Board® (IPSASB®) to discuss the approach to recognition and measurement of an asset and a liability under the "grant of a right to the operator model" in IPSAS™ 32, *Service Concession Arrangements: Grantor*.

The objective of this document is to summarize the accounting requirements for assets and liabilities under the grant of right to the operator model in IPSAS 32.

This publication does not constitute an authoritative pronouncement of the IPSASB or an interpretation of an authoritative pronouncement of the IPSASB. It does not amend, or override the requirements of existing IPSASs or provide further implementation guidance. This publication is not meant to be exhaustive and this Q&A is not a substitute for reading IPSAS 32.

Background

IPSAS 32 provides requirements and guidance for accounting by the grantor for two types of service concession arrangement—the "financial liability model" and the "grant of a right to the operator model". The grant of a right to the operator model is sometimes referred to as "the intangible asset model" (based on the operator's recognition of an intangible asset under IFRIC 12, *Service Concession Arrangements*) or the "earned revenue model."

Under the financial liability model the grantor compensates the operator by the delivery of cash or another financial asset in exchange for the grantor's control of a service concession asset. Under the grant of a right to the operator model the operator earns revenue from third-party users of the service concession asset (or from another revenue-generating asset).

The IPSASB does not have an interpretations capability. However, IPSASB staff have recently received a number of queries related to the accounting for assets and, particularly, liabilities under the grant of a right to the operator model. The IPSASB staff therefore considered it appropriate to provide their views on such issues in the form of a short Questions and Answers (Q & A) document.

Questions and Answers

Q1. *IPSAS 32 specifies the conditions under which the grantor recognizes a service concession asset. How should that asset be measured?*

Paragraph 11 of IPSAS 32 requires service concession assets, including those recognized under the grant of a right to the operator model, to be initially measured at fair value. Fair value is defined in paragraph 11 of IPSAS 9, *Revenue from Exchange Transactions*, as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction."

Under the grant of a right to the operator model, an entity obtains the service concession asset in exchange for a non-monetary asset, usually the right to earn revenue from third-party users[1]. Other IPSASs also require the cost of an asset acquired in exchange for a non-monetary asset or assets to be measured at fair value[2].

Other IPSASs require that the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident[3]. In a service concession arrangement, it will generally be appropriate to determine the fair value of the asset received (the service concession asset). This is because the right to earn revenue from third-party users (which is the asset given up under the grant of a right to the operator model) will not have been previously recognized in the grantor's statement of financial position. Consequently, the fair value of the asset received (the service concession asset) will be more clearly evident than the fair value of the asset given up (the right to earn revenue from third-party users).

Determining the fair value of the service concession asset will often involve the use of estimation techniques appropriate to that type of asset. Where there is an open, active and orderly market for the type of asset, it will be possible to determine the fair value of the service concession asset based on market transactions for similar assets. Where there is no such market for the type of asset, the fair value will need to be estimated on a different basis.

The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) includes a number of different measurement bases for assets. In the absence of an open, active and orderly market, the most appropriate basis for estimating the fair value of a service concession asset is likely to be replacement cost[4]. For a new asset, this will be the cost of purchasing or constructing an equivalent asset.

Estimating the cost of purchasing or constructing an equivalent asset may not be a simple task. Some jurisdictions have overcome this problem by requiring the operator (through the contractual terms) to provide their financial models to the grantor. This enables the grantor to determine the fair value of the service concession asset by reference to the operator's costs and return on investment. Other jurisdictions use proxies, for example the typical construction cost per m^2 (or m^3) for similar assets, in estimating the fair value of the service concession asset.

1 The operator accounts for this right as an intangible asset under IFRIC 12, *Service Concession Arrangements*.

2 For example, paragraph 38 of IPSAS 17, *Property, Plant and Equipment* and paragraph 44 of IPSAS 31, *Intangible Assets*.

3 For example, paragraph 40 of IPSAS 17 and paragraph 45 of IPSAS 31.

4 Replacement cost is the cost of replacing an asset's service potential. Replacement cost adopts an optimized approach.

Q2. ***IPSAS 32 requires that where a grantor recognizes a service concession asset the grantor shall also recognize a liability. How should that liability be measured at initial recognition?***

Paragraph 15 of IPSAS 32 requires that the liability is initially measured at the same amount as the service concession asset, adjusted by the amount of any other consideration transferred between the grantor and the operator.

Q3. ***How should that liability be subsequently accounted for? Is it a requirement of IPSAS 32 that the liability be reduced, and revenue recognized, on a straight-line basis over the life of the arrangement?***

It is not a requirement that the liability be reduced, and revenue recognized, on a straight-line basis. This method is only used in the Illustrative Examples in IPSAS 32 because it reflects the economic substance of that example. Under the grant of a right to the operator model, the liability represents the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator. Paragraph 25 of IPSAS 32 requires the grantor to recognize revenue, and therefore reduce the liability, according to the economic substance of the service concession arrangement.

The grantor's revenue is earned as the grantor allows the operator access to the service concession asset to earn revenue from third-party users. Consequently, the pattern of revenue recognition should reflect the access granted to the operator. Where the access remains constant over the period of the service concession arrangement, this may suggest that it would be appropriate to recognize revenue on a straight-line basis over the life of the service concession arrangement. However, if the access granted to the operator varies over the period of the service concession arrangement, it would be appropriate to recognize revenue proportionately to the access granted. Because service concession arrangements typically cover many years, it will often be appropriate to recognize revenue using discounting methods, to reflect the time value of money[5]. In such cases, the discount rate used should reflect the term of the service concession arrangement. Other IPSASs[6] provide guidance on determining the appropriate discount rate for arrangements with long terms.

The grantor's revenue is not the same as the operator's revenue. The level of revenue generated by the operator does not (except where there are additional mechanisms such as revenue sharing requirements incorporated into the service concession arrangement) impact the grantor's revenue. The operator earns revenue from the users of the service; often that revenue will be variable and dependent on a number of factors. The grantor earns revenue from the operator; that revenue is generally determined by the terms of the service concession arrangement.

The operator may provide other revenue, such as an upfront payment, a stream of payments, or other consideration to the grantor for the right to use the service concession asset over the term of the service concession arrangement. In such cases, the grantor accounts for these payments separately, in accordance with IPSAS 9[7].

[5] Paragraph AG59 of IPSAS 32 provides additional guidance.

[6] For example, IPSAS 25, *Employee Benefits*, paragraphs 91–95.

[7] See paragraph AG56 of IPSAS 32.

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Published by: International Federation of Accountants®

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