Session Two;

Presentation of Financial Statements and Specific Disclosures

IPSAS 1

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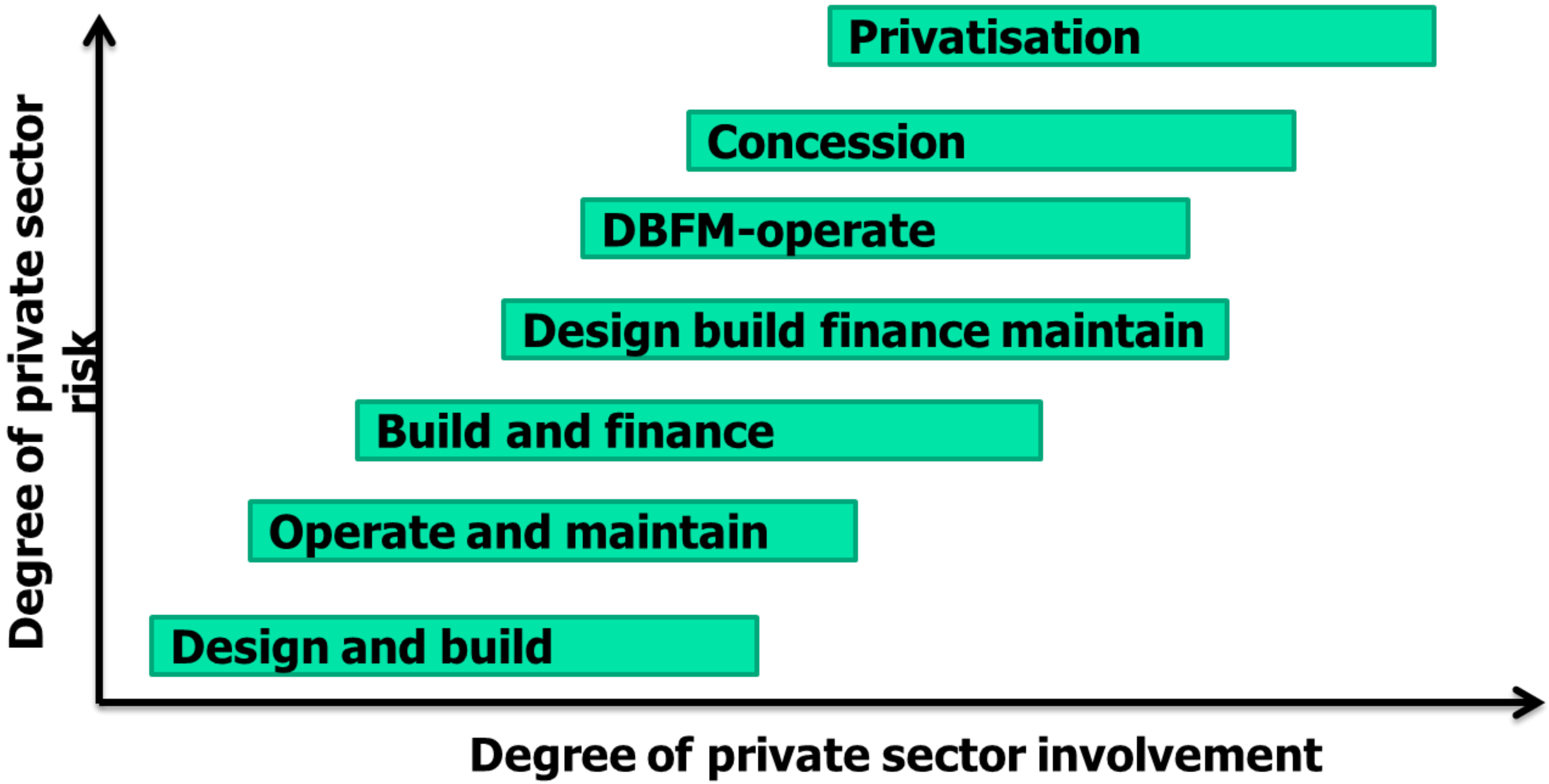
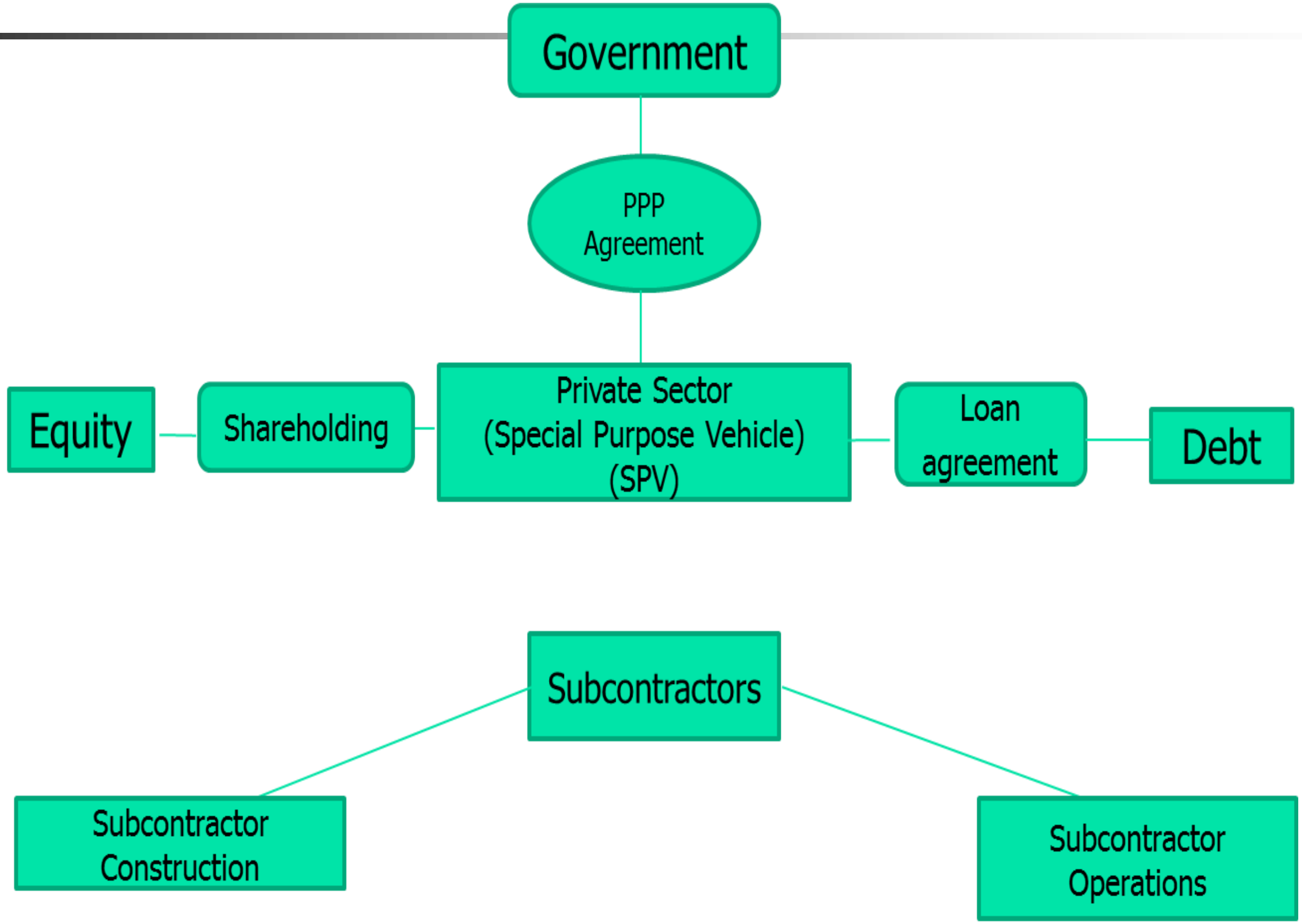
Concession arrangements

- A service concession arrangement is a binding arrangement between a grantor and an operator in which:
- The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and
- The operator is compensated for its services over the period of the service concession arrangement.

Possible model



Finance structure



Concession asset

- A service concession asset is an asset used to provide public services in a service concession arrangement that:
- Is provided by the operator which either the operator constructs, develops, or acquires from a third party; or Is an existing asset of the operator; or
- Is provided by the grantor which either is an existing asset of the grantor; or is an upgrade to an existing asset of the grantor.

Recognition

- grantor recognize an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if:
- The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
- The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.

Measurement and classification

- The grantor initially measure the service concession asset recognized at its fair value, or
- reclassify the existing asset as a service concession asset.
- accounted for in accordance with IPSAS 17, or IPSAS 31 as appropriate.
- service concession assets accounted for as a separate class of assets

Liability recognition

- the grantor recognize a liability in respect to all asset supplied by the operator
- Initially at an amount equal to the service concession asset
- Amount adjust for any additionally consideration provided to or by the operator

Compensation to the operator

- Grantor may compensate the operator for the service concession asset by any combination of:
- Making payments to the operator (the “financial liability” model);
- Granting the operator the right to earn revenue from third-party users of the service concession asset (right model); or
- Granting the operator access to another revenue-generating asset for the operator’s use

Example

- County government enter into concession arrangement where the operator will provide specialised treatment in the private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients

- a private parking facility adjacent to a public facility

Financial liability model

- grantor allocate the payments to the operator and account for them according to their substance as
  - a reduction in the liability recognized
  - a finance charge, and
  - charges for services provided by the operator.
- The finance charge and charges for services provided by the operator accounted for as expenses.

Right to the Operator Model

- If the operator has the right to earn revenue from third-party users or another revenue-generating asset,
- the grantor account for the liability recognized as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.

Accounting for PPPs

- IFRIC 12 *Service Concession Arrangements* 2006
- IPSASB issued IPSAS 32 *Service Concession Arrangements – Grantor* 2011

- Existing accounting treatment only covers style long-term service contracts
- Focus on which party has control

Issues arising from accounting treatment

- IFRIC 12 improves disclosure but creates a balance sheet measurement problem for assets and liabilities:
  - Asset valuation under a fair value approach is more subjective
  - It does not address the issue of contingent liabilities, which remain a matter for judgement

Issues arising from accounting treatment (2)

- Many European governments are in the process of adopting IPSAS, but the net debt problem still remains:

  - Whilst the UK uses mirror image IFRIC 12 to prepare government financial statements, the debt associated with PFI still remains off balance sheet and is still excluded from net debt calculations prepared according to Eurostat guidelines

  - It would be politically controversial to change Eurostat

Issues arising from contracts (1)

- Poor transparency/restricted access to contract detail

- Lack of skills/public resources devoted to monitoring and using performance data, in contrast to private sector

- Payment mechanisms do not deliver budget certainty nor mitigate against costs to the public sector

- Difficult to determine penalties applied, most seem to be small or non-existent

Issues arising from contracts (2)

- There are opportunities for further arbitrage around contracts to avoid meeting the IFRIC 12 definition

- Furthermore, contract negotiation is not a neutral activity:
  - Many contracts are subject to political will
  - Financial and legal advisors have a vested interest in maintaining the market: 'Why go to this level of bureaucracy? It's almost as though there was a PFI industry with consultants out there… how can we make it even more complicated?'
  - Conflicts of interest abound: 'I'm one of the X private sector partner group directors sitting on the board of the LEP and also of the PFI company. I suppose obviously the shareholders will sit there with almost two hats on. …'

Treatment of Infrastructure – Books of Operator

Determine whether Operator should recognise PPE

Recognition /DeRecognition

Grantor has right of use

Infrastructure comprises/includes pre-existing assets of Grantor

Is there a Sale Of Infrastructure to Operator? IAS 18.14 Test

Yes

Apply IAS 16

Explanation:
-conveys right of use;
-transfers risks and rewards to operator; and
-grantor has no managerial involvement

No

Is there a lease of the Infrastructure to the Op?

Yes

Apply IAS 17 Substantially all R&R Op. = Fin Lse R&R Gr. = Op Lse

Explanation:
-grantor not the operator has 'right of use' - because the grantor :
(a): controls or regulates services provided by the operator and (b) controls the significant residual interest in the infrastructure at the end of the concession

No

Apply D12 – Operator has right to Access/Operate only – (Asset remains PPE Of Grantor)

Does Grantor have primary responsibility to pay

Yes

D13 – Financial Asset Model

No

D14 – Intangible Asset Model

Determine whether Operator should recognise PPE

Derecognition IAS 16

Pre-existing Infrastructure of Operator (used exclusively for purposes concession)

Is there a Sale of Infrastructure to Grantor?

No → **Is there a lease of the infrastructure to Grantor?**

Yes → **Apply IAS 17**
R&R Gr. = Fin Lse
R&R Op. = Op Lse

No → **Apply IAS 16**
(Asset remains PPE Of Operator)

Yes → **Apply IAS 18**

Explanation:
-conveys right of use and transfers risks and rewards to grantor; and
-operator has no managerial involvement

Treatment of Infrastructure – Books of Operator

Determine whether Operator should recognise PPE`

Infrastructure is constructed or acquired* by the Operator

Explanation:
Whose asset?
-Definition of an asset from *Framework*;
-Definition of PPE from IAS 16

Grantor

Operator supplied construction services/acquires on grantors behalf

See flowchart A

Operator

Operator constructed/acquired own asset

See flowchart B

- **Public Private Partnerships (PPPs)** can be defined as co-operative institutional arrangements between public and private actors
  - Most common form is the **PFI (Private Finance Initiative)**
- Global interest and involvement in PPPs continues to grow:
  - Worldwide investment in roads, rail, water & buildings
  - Investment in energy and telecom

Rationale for PPPs

- Rationale
  - Additionality plus private sector efficiencies
  - In some economies, PPPs enable debt to be kept off the public sector balance sheet
  - Need for improved infrastructure in order to bring about economic development
  - May be requirement in order to receive funding e.g. from WB/IMF
  - May also be need for assistance with financial management expertise

- The financing of long-term infrastructure is based upon a non-recourse or limited recourse financial structure where the debt and equity used to finance the project are paid back from the cash flows generated by the project.

- Focus on outputs
- PPPs make projects affordable
- Better value for money over the lifetime of the project
- More efficiency in procurement
- Faster project delivery with more projects in a defined timeframe
- Risks are allocated to the party best able to manage the risk

- Deliver certainty of budget and outcomes
- Better asset utilisation and social and economic benefits
- Sustainable development and improved regulation
- Public sector only pay when services are delivered
- Injection of private sector capital

- Initial feasibility
- Procurement phase
- Construction phase
- Operation phase

- Optimal risk sharing
- Risk borne by the party best able to manage it
- Risk management process
  - Identification
  - Risk quantification
  - Allocation
  - Mitigation
  - Risk monitoring and control

Sustainability of ppp projects

- Embedded environmental and social safeguards
- Focus on longer timescales
- Public, business and government working in partnership
- Consider and manage the success factor
  - Political will
  - Government commitment
  - PPP Champion
  - Clear output specification
  - Appropriate risk sharing
  - Value for money
  - Performance management

Disclosures

- disclose the following information in respect of service concession arrangements in each reporting period:
- A description of the arrangement;
- Significant terms of the arrangement that may affect the amount, timing, and certainty of future cash flows (e.g., the period of the concession, re-pricing dates, and the basis upon which re-pricing or re-negotiation is determined);

Disclosures

- The nature and extent (e.g., quantity, time period, or amount, as appropriate) of:
  - Rights to use specified assets;
  - Rights to expect the operator to provide specified services in relation to the service concession arrangement;
  - Service concession assets recognized as assets during the reporting period, including existing assets of the grantor reclassified as service concession assets;
  - Rights to receive specified assets at the end of the service concession arrangement;
  - Renewal and termination options;
  - Other rights and obligations (e.g., major overhaul of service concession assets); and
  - Obligations to provide the operator with access to service concession assets or other revenue-generating assets; and
- Changes in the arrangement occurring during the reporting period.

Thank you

Interactive session