IPSAS 32 Service Concession Arrangements: Grantor

Presentation by:

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Presentation agenda

- Objective and Scope of the standard
- Key definitions
- Overview of the standard
- Recognition and Measurement
- Disclosures
- Example and Interactive session

Objective & Scope

- The objective of this Standard is to prescribe the accounting for service concession arrangements by the grantor, a public sector entity.
- An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for service concession arrangements.
- This Standard applies to all public sector entities other than Government Business Enterprises.
- Arrangements within the scope of this Standard involve the operator providing public services related to the service concession asset on behalf of the grantor.

Objective & Scope

Does the grantor control or regulate what services the operator must provide with the service concession asset, to whom it must provide them, and at what price?

No

Yes

Does the grantor control, through ownership, beneficial entitlement or otherwise, any significant residual interest in the service concession asset at the end of the service concession arrangement?
Or is the service concession asset used in the arrangement for its entire useful life?

No

Yes

Is the service concession asset constructed, developed, or acquired by the operator from a third party for the purpose of the service concession arrangement, or is the asset an existing asset of the operator which becomes the service concession asset as part of the service concession arrangement?

No

Is the service concession asset an existing asset of the grantor to which the operator is given access for the purpose of the service concession arrangement?

OUTSIDE
THE SCOPE OF
THE STANDARD

Yes

WITHIN THE SCOPE OF THE STANDARD

Key definitions

- **A grantor**, for the purposes of this Standard, is the entity that grants the right to use the service concession asset to the operator.
- **An operator**, for the purposes of this Standard, is the entity that uses the service concession asset to provide public services subject to the grantor's control of the asset.
- **A service concession arrangement** is a binding arrangement between a grantor and an operator in which:
  a) The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and
  b) The operator is compensated for its services over the period of the service concession arrangement.

Key definitions

- A service concession asset is an asset used to provide public services in a service concession arrangement that:

  (a) Is provided by the operator which:

    i. The operator constructs, develops, or acquires from a third party; or

    ii. Is an existing asset of the operator; or

  (b) Is provided by the grantor which:

    i. Is an existing asset of the grantor; or

    ii. Is an upgrade to an existing asset of the grantor.

Overview of IPSAS 32

- The public sector partners with the private sector to provide public services and the public sector sets the framework for the services and the private sector entity.
- Basically, service concession arrangements are entered into for the sharing of risks between the grantor and the operator.
- There are two types of service concession arrangements:
  i. Grantor making payments to the operator
  ii. Compensating the operator by other means, such as
     a) Granting the operator the right to earn revenue from third party users of the service concession asset; or
     b) Granting the operator access to another revenue-generating asset for its use.

Grantor making payments to the operator

- The **operator** designs, builds, finances, operates and/or maintains a project in exchange for a **payment stream from the grantor**.
- The operator makes the asset available for use.
- In return, the operator receives from the grantor a **fixed payment stream during the operation phase** to recover its costs of constructing and operating the asset.
- The operator has **no exposure to demand risk** on its initial investment.

Compensations to the Operator -user pay structures

- The **operator** designs, builds, finances, operates and/or maintains a project in exchange for a **right to charge users**.
- The grantor has no obligation to make payments to the operator.
- Instead, the grantor provides the operator with a right to charge users for the asset to recover its investment.
- The operator has the demand risk.
- Common examples are the toll roads.

Financial Liability Model

- Where the grantor has an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, the grantor accounts for the liability recognized as a financial liability.
- The grantor allocates 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 in a service concession arrangement are accounted for as expenses.

Grant of a right to the operator model

- Where the operator bears the demand risk, the grantor compensates the operator by the grant of a right (e.g., a license) to charge users of the public service related to the service concession asset or of another revenue generating asset
- This Standard refers to this type of arrangement as the "grant of a right to the operator model."
- The grantor accounts for the liability recognized as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.
- The grantor recognizes revenue and reduces the liability recognized according to the economic substance of the service concession arrangement.

Accounting principles

- For the purpose of Accounting and Financial Reporting for Service Concession Arrangements, the scope of this Standard mirrors that of IFRIC 12.

- The main accounting issue in service concession arrangements is whether the grantor should recognize a service concession asset.

- Both parties to the same arrangement apply the same principles in determining which party should recognize the asset used in a service concession arrangement.

Recognition of a Service Concession Asset

- BC15.The IPSASB concluded that a control-based approach was the most effective means to determine whether the grantor should recognize the asset.
- The IPSASB concluded that if a control-based approach is used, it should be consistent with IFRIC 12.
- Accordingly, this Standard addresses only arrangements in which the grantor
  a) controls or regulates the services provided by the operator, and
  b) controls any significant residual interest in the service concession asset at the end of the term of the arrangement.
- Consistent with IFRIC 12, in the case of wholeof-life assets, only condition (a) must be met for recognition of a service concession asset.

Recognition of a Service Concession Asset

- The IPSASB concluded that it was important to stress that a service concession arrangement is a binding arrangement. Accordingly, the assessment of whether a service concession asset should be recognized is made on the basis of all of the facts and circumstances of the arrangement.

- The control model applies the principles of IPSAS 17. Thus, it reflects the fact that an exchange transaction has taken place between the operator and the grantor.

- For example, in the case of a toll road, it reflects the fact that the Government has exchanged the right to toll for the construction and operation of the road.

When does control arise?

- Does the arrangement allows the grantor to specify significant operating policies and procedures in respect of the property?
- Does the arrangement precludes or significantly limits the operator from using the property for other purposes?
- Does the arrangement precludes the operator from using other assets to fulfil its public service obligation;
- Does the arrangement precludes or significantly restricts the operator from providing services to other parties?

When does control arise?

- Does the arrangement specifies the maintenance program with respect to the property?
- Does the arrangement precludes the operator from modifying or replacing the property without the consent of the grantor? and
- Does the arrangement precludes the operator from selling or transferring the property (and the service obligation) without the consent of the grantor.

In summary

- Grantor recognizes a service concession asset, or the grantor reclassifies an item of property, plant, and equipment, an intangible asset, or a leased asset as a service concession asset
- Grantor accounts for the service concession asset as property, plant, and equipment or an intangible asset in accordance with IPSAS 17 or IPSAS 31, as appropriate
- Grantor follows impairment testing as set out in IPSAS 21 and IPSAS 26
- Grantor recognizes related liability equal to the value of the SCA asset (IPSAS 9, IPSAS 28, IPSAS 29, and IPSAS 30)
- Grantor recognizes revenues and expenses related to the SCA

When does control arise?

	Recognition and Measurement
Initial asset recognition	Asset is recognised when grantor obtains control.
Initial asset measurement	Asset is measured at fair value at date of recognition
Initial liability recognition	If the grantor is obligated to make payments to the operator under the service concession arrangement (or other agreement), a financial liability and/or a non-financial liability would be recognised.
Initial liability measurement	Liabilities are measured in accordance with IPSAS 28/29/30 as appropriate
Income recognition	Any difference between the recognised obligations and the fair value of the asset should be recognised as gain or loss on initial recognition or, in the case of gains, should be deferred and recognised as revenue over the term of the concession arrangement.
Timing of recognition	The recognition of the asset and liability depends on the grantor's contractual and/or constructive obligations during the construction phase.

Other important points

- Where the grantor has not previously recognized service concession assets, it may elect to recognize and measure service concession assets and related liabilities prospectively, using deemed cost.
- Deemed cost is determined at the beginning of the earliest period for which comparative information is presented in the financial statements.

Disclosures

- The grantor shall present information in accordance with IPSAS 1.
- Specific disclosure requirements
  - ✓ A description of the arrangement;
  - ✓ Significant terms of the arrangement that may affect the amount, timing, and certainty of future cash flows
  - ✓ The nature and extent (e.g., quantity, time period, or amount, as appropriate) of: Rights to use (operator); Rights to expect services (Grantor); Service concession assets recognized as assets during the reporting period; Renewal and termination options; Other rights and obligations
  - ✓ Changes in the arrangement occurring during the reporting period

Example in the IPSAS

- Building a road through a Build Operate Transfer (BOT) contract. The contract lasts for 10 years, during which the road will be constructed in the first 2 years , and the private sector company will operate the road in the remaining 8 years.

- The cost of constructing the road base and the surface is USD 940 and USD 110, respectively. The usable life of the base and the surface is 25 years and 6 years, respectively. This means that in 8 years, the surface will be reconstructed.

- There are two approaches of financing the project through PPPs:
  i. Government-funded: The Government pays the operator USD 200 per year during years 3 to 10.
  ii. User-funded: the Government allows the operator to charge users USD 200 per year during years 3 to 10.

Example in the IPSAS

- The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total USD1,050, comprised of USD 940 related to construction of the base layers and USD110 related to construction of the original surface layers).

- The asset is recognized as it is constructed (USD 525 in year 1 and USD 525 in year 2). Depreciation is taken annually (USD 56, comprised of USD 38 for the base layers and USD 18 for the surface layers), starting from year 3.

Example in the IPSAS

- The grantor initially recognizes a financial liability at fair value equal to the fair value of the asset under construction at the end of year 1 (USD 525). The liability is increased at the end of year 2 to reflect both the fair value of the additional construction (USD 525) and the finance charge on the outstanding financial liability.

- A finance charge at the implicit rate of 6.18% is recognized annually.

- The liability is subsequently measured at amortized cost, i.e., the amount initially recognized plus the finance charge on that amount calculated using the effective interest method minus repayments.

Example in the IPSAS

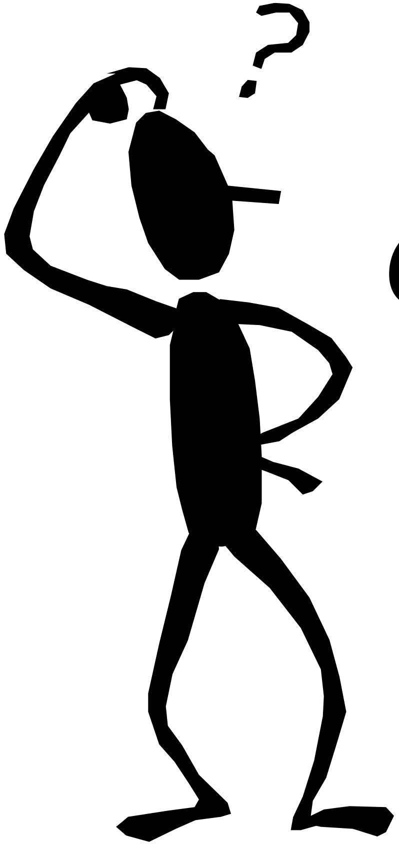
- The compensation for the road resurfacing is included in the predetermined series of payments.

- There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of USD 110/6 = USD 18, beginning in year 9.

- The compensation for maintenance and operating the road (USD12) is included in the predetermined series of payments.

- There is no cash flow impact related to this service expense; however, the grantor recognizes an expense annually.

Interactive Session - Q & A



Questions?