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EPSAS issue paper on the accounting treatment of service concession arrangements

Paper by PwC on behalf of Eurostat
- for discussion

Accounting treatment of service concession arrangements with a view to financial reporting requirements under the future European Public Sector Accounting Standards (EPSAS)

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1 Objectives of the issue paper

The aim of this issue paper is to summarise the approaches taken at the accounting standard level concerning the most important types of service concession arrangements in at least three Member States (MSs) with high accounting maturity. It addresses the approaches which are being used under the existing international financial reporting frameworks - IPSAS, EU Accounting Rules (AR), IFRS and ESA 2010, including where relevant and applicable the Manual on Government Deficit and Debt (MGDD) - or are likely to be developed. Also taking into account the conclusions of the issue paper on the notion of 'control', the aim is also develop an approach for organising the future discussion on the treatment of service concession arrangements with the EPSAS stakeholders.

Based on the request from Eurostat, the issue paper addresses the following questions:

- What are the most important types of service concession arrangements, and for which may problematic points/ issues concerning definition, recognition, measurement and presentation arise?

- Which accounting guidance is available for service concession arrangements in IPSAS, EU AR, national accounting standards in three EU MSs, IFRS and ESA 2010 and, where relevant and applicable, also MGDD? Also, how the accounting guidance in IPSAS differs from the respective accounting guidance in ESA 2010 and, where relevant and applicable, also MGDD?

- How do the analysed approaches in the three MSs differ from the treatment under IPSAS?

- For the main types of service concession arrangements, what are the advantages and disadvantages of the existing approaches to recognition and measurement under the existing standards (IPSAS, EU AR, national accounting standards in EU MSs, IFRS and ESA 2010 and, where relevant and applicable, also MGDD)?

- What are the main difficulties/ issues when accounting for the main types of service concession arrangements?

- If/ how a European harmonisation could be achieved in accounting for the main types of service concession arrangements?

- Taking into account costs and benefits, what way forward in practice would PwC recommend for EPSAS on service concession arrangements?

- What were the consequences of the recommended way forward for a possible convergence between IPSAS / EPSAS and ESA 2010 (and if relevant and applicable, also MGDD)?

Based on the analysis performed, an approach for organising the future discussion on service concession arrangements with the EPSAS stakeholders is proposed.

2 Background of the issue

Public authorities increasingly partner with the private sector with a view to providing public services. Whereas the public sector sets the framework for the services to be provided, it calls upon the private sector's expertise in order to, for example, build the infrastructure and operate the services to be provided. Such arrangements can also sometimes be made with a public sector entity that will act as the operator. Public services for which a concession can be granted to a private or a public operator include for instance water treatment and supply facilities, operation of motorways, car parks, tunnels, bridges, airports, telecommunication networks, prisons, etc.

Typically, service concession arrangements are either:

- Grantor pay structures - where the operator designs, builds, finances, operates and/or maintains a project in exchange for a payment stream from the grantor; or
- User pay ("traditional concession") structures - where the operator designs, builds, finances, operates and/or maintains a project in exchange for a right to charge users.

Grantor pay structures may be availability structures or demand based structures (for the latter payments by the grantor to the operator are variable based on the demand and use of the asset, e.g. infrastructure asset such as a motorway), or a combination of the two.

The common characteristic of all service concession arrangements is that the operator both receives a right and incurs an obligation to provide public services. Determination of whether an arrangement fulfils a public service obligation is a matter of judgment, and each case should be determined based on its own facts and circumstances.

There is a wide variation in the accounting treatment of service concession arrangements in the Member States, whereas accounting for such structures poses challenges to the financial accountants in the countries. The main accounting issue in service concession arrangements is whether the grantor should recognise such arrangements on or off its balance sheet.

While there is no link with the accounting treatment in general purpose financial statements, the issue is often analysed in conjunction with the treatment required under ESA 2010 rules. Governments may be interested in structures that allow them to achieve off balance sheet treatment of service concession arrangements in their statistical reporting, therefore not impacting the Maastricht debt and deficit indicators[1]. This is one of the main reasons why these arrangements usually come under close scrutiny.

The increasing use of public private partnerships (PPP) structures requires specific attention as off balance sheet treatment of PPP assets and liabilities, as currently applied by certain governments, may not be appropriate under IPSAS and the future EPSAS. Accounting for PPP transactions in general purpose financial statements prepared under IPSAS/EPSAS is an area that is likely to be significant for governments at all levels.

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[1] As part of the Stability and Growth Pact, all 28 Member States of the EU agreed, in order to maintain fiscal stability and discipline within the Economic and Monetary Union, to stay within the limits on government deficit (3% of GDP) and debt (60% of GDP). In case of having a debt level above 60%, it should each year decline with a satisfactory pace towards a level below.

The Staff Working Document accompanying the report from the Commission to the Council and the European Parliament COM(2013)[2] 114 assessing the suitability of IPSAS for the EU Member States, in Annex 7.1, points out that IPSAS 32 'Service concession arrangements: grantor' is among the standards that might be implemented with minor or no adaptation. The PwC study of 2014[3] also classifies IPSAS 32 in the category of standards that might be implemented with minor or no adaptation.

The PwC study also highlights the challenges involved when accounting for service concessions. In response to a comment received on the accounting treatment of user-pay structures, the report mentions (on page 128): "IPSAS 32 is a standard that should reflect the substance of rather complex arrangements. Recognition of a non-financial liability in circumstances described in the standard is widely accepted by accounting practitioners as reflecting the substance of the arrangements. The issue can be discussed as part of the EPSAS standard-setting process.'

For further background information on PPP transactions, we refer to the following two publications:

- The EPEC publication providing a review of the European PPP market in 2017[4] (please however note that countries outside the EU are also in the scope of this review); and
- The special report issued in 2018 by the European Court of Auditors and entitled "Public private partnerships in the EU: widespread shortcomings and limited benefits"[5].

IPSAS/IFRS terminology compared to ESA 2010 terminology

We herewith clarify the terminology that is used under IPSAS and IFRS on the one hand, and for ESA 2010 reporting purposes on the other hand, as they differ from each other.

The term that is used in IPSAS and IFRS is 'concession arrangement'. The concept covers both grantor pay structures and user pay structures. Key is that a binding arrangement should exist whereby an operator (a) uses the service concession asset to provide a public service on behalf of a grantor for a specified period of time and (b) is compensated for its services over the period of the service concession arrangement. See section 3.1 for further details.

To address similar transactions, ESA 2010 rules distinguish between service concession contracts (the operator gets payment from end users) and public-private partnerships (PPPs) (the operator gets payment from the public sector grantor). See section 3.4 for further details.

We will use the IPSAS/IFRS term 'concession' everywhere in the present issue paper, except in sections 3.4 'ESA 2010' and 3.5 comparing the different sets of rules, where the ESA terminology will be used.

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[2] Commission Staff Working Document Accompanying the document Report from the Commission to the Council and the European Parliament Towards implementing harmonised public sector accounting standards in Member States The suitability of IPSAS for the Member States /* SWD/2013/057

[3] See PwC, Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards, 2013/S 107-182395, 1 August 2014, p. 135.

[4] EPEC, Market Update, Review of the European PPP Market in 2017, 11 pages.

[5] European Court of Auditors, Special report n°9, Public private partnerships in the EU: widespread shortcomings and limited benefits, 2018, 79 pages.

IPSAS/IFRS concept of profit or loss and ESA concept of government surplus or deficit

The concept of profit or loss, or net result, or surplus or deficit under IPSAS (or profit or loss or net result under IFRS) is different from the concept of surplus or deficit under ESA 2010. The recognition and measurement/valuation rules under international accounting/financial reporting standards on the one hand and statistical rules on the other hand are different and therefore result in different numbers being reported, despite similar terminology being used.

When we use these concepts in the present paper, it is clear whether it is in the context of IPSAS/IFRS or ESA 2010 rules.

3 Description of accounting guidance available in international accounting frameworks and in statistical rules

Accounting guidance available is discussed below, successively for the following accounting and reporting frameworks: IPSAS, EU Accounting Rules, IFRS and ESA 2010 (including references to the MGDD).

IPSAS rules relating to grantors are explained more in-depth, because IPSAS has been viewed as the main reference framework for the future EPSAS, and they mirror the accounting treatment for the operator under IFRS. Particular attention is devoted to ESA 2010 rules too as application of these rules may have a significant impact on the Maastricht indicators and government statistical reporting.

3.1 International Public Sector Accounting Standards (IPSAS)

3.1.1 Applicable standards

Accounting rules relating to service concession arrangements can be found in IPSAS 32 'Service Concession Arrangements: Grantor'. Whereas IPSAS 32 addresses the general accounting requirements for service concession arrangements, assets and financial liabilities recognised as a consequence of a service concession arrangements should be treated in accordance with the relevant standards. This includes IPSAS 17 'Property, plant and equipment' and IPSAS 31 'Intangible assets' for assets, as well as IPSAS 28 'Financial Instruments: Presentation' and IPSAS 29 'Financial Instruments: Recognition' for financial liabilities.[6]

In addition, IPSAS 33 'First-time adoption of accrual basis IPSAS' allows some relaxation in accounting for service concession arrangements by public sector entities that apply IPSAS for the first time.

IPSAS 32 is a mirror of the IFRS interpretation in IFRIC 12 'Service concession arrangements' that is regulating accounting for service concession assets by an operator.

IPSAS 3 'Accounting policies, changes in accounting estimates and errors' clarifies the principles that management should follow in determining accounting policies of a public sector entity, including in areas where no guidance exists in existing standards.

3.1.2 Scope and definition of a service concession arrangement

A service concession arrangement is defined in IPSAS 32 as 'a binding arrangement between a grantor (usually a government or other public sector body) and an operator in which the operator:

(a) Uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and
(b) Is compensated for its services over the period of the service concession arrangement' (IPSAS 32.8).

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[6] IPSAS 41 'Financial instruments' replaces IPSAS 29 'Financial instruments' from 1 January 2022. Earlier application of IPSAS 41 is permitted.

3.1.3 Recognition

3.1.3.1 Recognition of service concession assets

The main accounting issue in service concession arrangements is whether the grantor should recognise a service concession asset (IPSAS 32 BC11). Whether it should be the case is based on whether the grantor controls that asset and not on whether it bears the risks and rewards related to it. All facts and circumstances of the arrangement should be considered in making this assessment.

The grantor recognises an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if it:

- Controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
- Controls - through ownership, beneficial entitlement or otherwise – any significant residual interest in the asset at the end of the term of the arrangement (IPSAS 32.9).

For 'whole of life assets', only the first requirement regarding what the operator must provide must be fulfilled (IPSAS 32.10).

The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from.

The grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the asset and give the grantor a continuing right of use throughout the period of the service concession arrangement.

A service concession asset can both be tangible or intangible as long as it fulfils the definition of an asset and is used to provide public services in a service concession arrangement. A service concession arrangement can also be either a new asset as it is being constructed or upgraded, or a reclassification from other tangible or intangible assets in the balance sheet (IPSAS 32.9).

Control-based approach compared to risks and rewards approach to asset recognition

The IPSASB considered the merits of the risks and rewards and the control-based approach to assess whether the grantor should recognise the asset. The risks and rewards approach focuses on the economic aspects of the terms and conditions in the arrangement. The IPSASB did not believe this focus to be appropriate for service concession arrangements because the primary purpose of a service concession asset, from the grantor's point of view, is to provide specified public services on behalf of the grantor using a service concession asset, and not to provide economic benefits such as revenue generated by such assets (e.g. from user fees). Thus, the service potential of the asset accrues to the grantor. Economic benefits are only likely to arise from a service concession arrangement in circumstances where the operator is granted the right to earn revenue from third-party users, of either the service concession asset or another revenue-generating asset. A control-based approach focuses on control over the economic benefits and the service potential of the service concession asset (IPSAS 32 BC12).

As it is often the case that service concession arrangements are entered into for the sharing of risks between the grantor and the operator, the IPSASB also questioned whether sufficiently objective criteria could be established for assessing risks and rewards to enable consistent results to be determined. In addition, weighting of various risks and rewards was seen to be problematic. The IPSASB concluded, therefore, that the risks and rewards approach is inappropriate (IPSAS 32 BC13).

The IPSASB also considered whether a rights and obligations approach was appropriate. Although such an approach could have conceptual merit, the IPSASB believes that it would represent a significant change in the accounting and financial reporting of assets and liabilities for public sector entities that could have implications beyond service concession arrangements. Given the IPSASB's decision to complement IFRIC 12, which uses a control-based approach, the IPSASB agreed that a rights and obligations approach was not appropriate for this standard (IPSAS 32 BC14).

The IPSASB concluded that a control-based approach was the most effective means to determine whether the grantor should recognise the asset. The IPSASB concluded that if a control-based approach is used, it should be consistent with IFRIC 12, for the same reasons cited in paragraph BC2. 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 whole-of-life assets, only condition (a) must be met for 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 recognised is made on the basis of all of the facts and circumstances of the arrangement (IPSAS 32 BC15).

3.1.3.2 Recognition of service concession liabilities

When a service concession asset is recognised, a corresponding liability is also recognised, unless the concession asset is an existing asset that the grantor simply needs to reclassify from property, plant and equipment or intangible assets, as appropriate (IPSAS 32.14).

3.1.4 Measurement

3.1.4.1 Measurement of service concession assets

Initial measurement

The grantor initially measures the service concession asset at its fair value, except when it already owns the asset. Where an existing asset of the grantor meets the conditions to be recognised as a service concession asset, the grantor reclassifies the existing asset as a service concession asset. The reclassified service concession asset is accounted for in accordance with IPSAS 17 'Property, plant and equipment' or IPSAS 31 'Intangible assets', as appropriate (IPSAS 32.11-12).

Service concession assets are accounted for as a separate class of assets in accordance with IPSAS 17 or IPSAS 31, as appropriate (IPSAS 32.13).

Subsequent measurement

After initial recognition or reclassification, service concession assets follow the accounting policies applicable to the class of assets to which they belong, in accordance with IPSAS 17 or IPSAS 31, as appropriate.

3.1.4.2 Measurement of service concession liabilities

The treatment by the grantor of the liability side in a service concession arrangement depends on the type of arrangement. The grantor should analyse the substance of the arrangement and follow either the financial liability model or the grant of a right to the operator model.

Financial liability model

When the grantor has an unconditional obligation to compensate the operator by the delivery of cash or another financial asset in exchange for its control of a service concession asset, it incurs a liability and should account for it as a financial liability (IPSAS 32.18).

A financial liability is recognised and the future payments by the grantor to the operator are allocated to the following elements: a reduction of the liability, the recognition of an imputed finance charge as well as charges for services provided by the operator under the service concession arrangement (IPSAS 31.21). The financial liability is dealt with in accordance with IPSAS 28 and IPSAS 29.[7]

To determine the finance charge, the operator's cost of capital is used, if that is practicable to determine. IPSAS 32 also permits other rates to be used: the rate implicit in the arrangement specific to the service concession asset, the grantor's incremental borrowing rate or another rate appropriate to the specific terms and conditions of the service concession arrangement (IPSAS 32 AG 40-41).

Grant of a right to the operator model

When the grantor does not have an unconditional obligation to pay cash or another financial asset to the operator but grants the operator the right to charge users of the public service related to the service concession asset (e.g. through a licence) or the right to earn revenue from another revenue-generating asset, the grant of a right to the operator model should be followed.

The grantor provides the operator access to the asset that it (i.e. the grantor) controls in order for the operator to be compensated for construction, development, acquisition or upgrade of the service concession asset and the services it provides. The liability reflects the obligation that the grantor has to put the service concession asset at the disposal of the operator to enable it (i.e. the operator) to earn revenue.

[7] IPSAS 41 'Financial instruments' replaces IPSAS 29 'Financial instruments' from 1 January 2022. Earlier application of IPSAS 41 is permitted.

The service rendered in a service concession arrangement that falls into the grant of a right to the operator model is an exchange transaction. In accordance with IPSAS 9 'Revenue from exchange transactions', when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue. However, until the criteria for recognition of revenue have been satisfied, the credit is recognised as a liability for any portion of the revenue that is not yet earned. The grantor recognises revenue and reduces the liability according to the economic substance of the service concession arrangement, usually as access to the service concession asset is provided to the operator over the term of the service concession arrangement (IPSAS 32.24 to 26).

If the consideration due to the operator consists both of a financial liability portion and a right granted to the operator portion, the grantor should account separately for each part of the total liability. The amount initially recognised for the total liability should equal the carrying amount of the service concession asset, adjusted by the amount of any consideration (e.g. cash) from the grantor to the operator, or from the operator to the grantor (IPSAS 32.27).

3.1.5 Presentation and disclosures

Service concession assets should be presented following the general presentation requirements of IPSAS 1 'Presentation of financial statements'. The corresponding financial liability or non-financial liability should be presented in accordance with the relevant standards.

Service concession assets and the related liabilities are not included in the list of items that should - as a minimum - be presented on the face of the balance sheet under IPSAS 1 'Presentation of financial statements'. There is thus as such no need to present service concession assets and the related liabilities separately on the face of the statement of financial position. IPSAS 1 however requires additional line items to be presented on the face of the balance sheet when such presentation is relevant to an understanding of the entity's financial position.

Key disclosures in respect of service concession arrangements include:

- A description of the arrangement as well as its significant terms;
- The nature and extent of rights to use specified assets and to expect the operator to provide specified services, service concession assets recognised during the period, rights to receive specified assets at the end of the service concession arrangement, renewal and termination options, other rights and obligations, and obligations to provide the operator with access to service concession assets or other revenue-generating assets;
- Changes in the arrangement occurring during the period.

In addition to the disclosures outlined in IPSAS 32, the grantor also applies the relevant presentation and disclosure requirements in other IPSAS as they pertain to assets, liabilities, revenues and expenses recognised under IPSAS 32.

3.1.6 First-time adoption of accrual basis IPSAS

Different first-time application rules apply depending on whether the grantor has previously recognised service concession assets in its balance sheet under its previous accounting policies or not.

A grantor that has previously recognised service concession assets and related liabilities should apply IPSAS 32 retrospectively in accordance with IPSAS 3 ‘Accounting Policies, Changes in Accounting Estimates and Errors’. If this is not the case, the grantor can make use of the three-year transitional relief period included in IPSAS 33 ‘First-time adoption of accrual basis IPSAS’, i.e. it is not required to recognise and measure service concession assets and the related liabilities for reporting periods beginning on a date within three years following the date of adoption of IPSAS (IPSAS 33.36).

A first-time adopter may also elect to measure service concession assets using the fair value as deemed cost exemption. The related liability is measured at the remaining contractual cash flows (if the financial liability model is used) (any difference between the asset and the liability is then reported in opening accumulated surplus or deficit in the period in which the items are recognised) or at the fair value of the asset less any financial liability, adjusted to reflect the remaining period of the service concession arrangement (if the grant of a right to the operator model is used) (IPSAS 33.127-128).

3.1.7 Accounting treatment by the operator

IPSAS 32 does not address accounting of service concession arrangements by the operator. Public sector entities may however sometimes act as operators in such transactions.

Under IPSAS 3, accounting policy choices should be made in accordance with the relevant standards. If, however, there is no IPSAS that is specifically applicable, management should use its judgment in developing and applying an accounting policy that results in relevant and reliable financial information. Management should first consider IPSAS dealing with similar and related issues and then the definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in other IPSAS. Management may also consider pronouncements from other standard-setting bodies such as IFRS (IPSAS 3.12, 14 and 15).

In addition, paragraph 7 of IPSAS 32 explicitly stipulates that the standard does not specify the accounting by operators as guidance can be found in the relevant international and national accounting standards dealing with service concession arrangements.

In application of the above, a public sector operator may account for service concession arrangements by referring to the rules included in IFRS and applicable to private companies for such transactions. See also section 3.4 for further details.

3.2 Draft EPSAS Conceptual framework

The draft EPSAS Conceptual framework (version dated May 2018) contains similar definitions for assets and the different elements included in the definition of an asset as the IPSAS Conceptual framework.

An asset is a resource presently controlled by the entity as a result of past events or transactions.

A resource is an item with service potential or the ability to generate economic benefits. Service potential is the capacity to provide services that contribute to achieving the entity's objectives. Economic benefits are cash inflows or a reduction in cash outflows.

3.3 European Union Accounting Rules (EAR)

European Union Accounting Rules (EAR) constitute the accounting framework of the European Union Institutions, including the European Commission (EC) and its agencies.

There is no specific accounting rule developed for service concession arrangements as the Commission is typically not involved in such transactions.

3.4 International Financial Reporting Standards (IFRS)

IPSAS 32 is a mirror of the interpretation IFRIC 12 'Service Concession Arrangements'. IFRIC 12 rules are thus not explained in detail here. The general differences between the two standards is that IPSAS 32 deals with the accounting for the grantor, while IFRIC 12 deals with the accounting treatment for the operator. Hence, all assessments regarding control and recognition criteria are the same for the two standards, but mirrored.
From an accounting viewpoint, when a grantor recognises a service concession asset, the operator recognises either:

- A financial asset to the extent that is has an unconditional contractual right to receive cash or other financial asset; or
- An intangible asset to the extent that it receives a right (e.g. a licence) to charge users of the public service.

As already mentioned under 3.1, public sector entities that act as operators in service concession arrangements can apply a treatment similar to the one required under IFRIC 12.

3.5 ESA 2010

3.5.1 Scope and definition

ESA 2010 makes a clear distinction between service concessions and public-private partnerships (PPPs).

The ESA 2010 manual identifies service concession contracts and PPPs as being complex contracts on which guidance is needed.

Service concession contracts provide a company the exclusive right to provide certain services. For example, in case of a public service concession, a private company enters into an agreement with the government to have the exclusive right to operate, maintain and carry out investment in a public utility (such as a water supply system or a toll highway) for a given number of years. Service concession contracts shall not be recorded as assets where they are not transferable or no value can be realised through transferring them (ESA 2010 15.42).

PPPs are long-term contracts between two units, whereby one unit acquires or builds an asset or set of assets, operates it for a period and then hands the asset over to a second unit. Such arrangements are usually between a private enterprise (operator) and government (grantor) but other combinations are possible.

In the contract period the PPP contractor has the legal ownership. Once the contract period is over, the government has both economic and legal ownership (ESA 2010 15.41). Since ESA is based on the principle of economic ownership, it must be determined which party has economic ownership of the asset(s) during the contract period (see below).

The ESA Manual on Government Deficit and Debt further elaborates on the distinction between a service concession and a PPP. The following terminology is used (MGDD[8] Part IV VI.1.1.4-5):

- Concessions: these are commonly contracts for infrastructure equipment that can be subject to commercial exploitation. In this type of long-term contract, the corporation (or group of corporations) is responsible for the building, operating and maintenance of the equipment and is predominantly remunerated by the final users (households, corporations, etc.) of the equipment who pay tolls or other fees.

- PPPs: in a growing number of countries, government units have used the services of private corporations (or group of corporations or specific vehicles) to build, operate and maintain equipment designed to render some public services, not typically subject to commercial activity: public hospitals, schools and universities, prisons, etc. It is recommended to use the term PPPs in national accounts only for those contracts where government is the main purchaser of the service. Chapter VI.4 in this Manual deals with this type of contracts.

Overall rules on the accounting of PPPs can be found in chapter 20 'The government accounts' of the ESA 2010 manual, with more specific rules in the MGDD in chapter VI.4. More specific rules on other forms of government contracts with non-government units relating to fixed assets (including leases and concessions) can be found in MGDD chapter VI.3.

A PPP contract implies the government purchase of a service produced by a partner through the creation of an asset. There can be many variations in PPP contracts regarding the disposition of the assets at the end of the contract, the required operation and maintenance of the assets during the contract, the price, quality, and volume of services produced, and so forth (ESA 2010 20.279).

When the corporation sells the services directly to the public through for example a toll road, the contract is seen as a concession rather than a PPP. The price is routinely regulated by the government and set at a level that the corporation expects will permit it to recover its costs and earn an adequate rate of return on its investment. At the end of the contract period, the government may gain legal ownership and operational control of the assets, possibly without payment (ESA 2010 20.280).

In PPP contract, the corporation acquires the fixed assets and is the legal owner of the assets during the contract period, in some cases with the backing of the government. The contract often requires that the assets meet the design, quality, and capacity specified by government, be used in the manner specified by government to produce the services required by the contract, and be maintained in accordance with standards defined by government (ESA 2010 20.281).

8 Eurostat, Manual on Government Deficit and Debt, Implementation of ESA 2010, 2016 Edition

Furthermore, the assets typically have service lives much longer than the contract period so that government may control the assets, bear the risks and receive the rewards, for a major portion of the assets' service lives. Thus, it is frequently difficult to determine whether it is the corporation or the government that bears the majority of the risks and reaps the majority of the rewards (ESA 2010 20.282).

Additional detailed guidance for PPP practitioners (i.e. authorities in charge of PPP policy, decision-making and the preparation and procurement of PPP projects) – based on the accounting rules in the ESA 2010 and in the MGDD – is included in the guide to the statistical treatment of PPPs produced by Eurostat and the European PPP Expertise Centre (EPEC) (which is part of the Advisory Services of the European Investment Bank - EIB).[9]

3.5.2 Recognition[10]

ESA 2010 rules take a risks and rewards approach to asset recognition.

If the operator bears the majority of the risks and rewards related to the asset, no asset and liability is recorded in the government entity balance sheet, and the PPP or service concession contract is reported as an off balance sheet item. The amount of the investment then does not immediately impact government debt and deficit, but only over time as service payments are made.

Where on the contrary the public sector grantor bears the majority of the risks and rewards related to the asset, the asset and the related liability should be reported on the balance sheet of the government entity, with an impact on government deficit and debt when the asset is constructed.

PPPs

As with leases, the economic owner of the assets in a PPP is determined by assessing which unit bears the majority of the risks and which unit is expected to receive a majority of the rewards of the assets. The asset will be allocated to this unit, and consequently recorded as the gross fixed capital formation of that unit, which is increasing the deficit (B.9) under ESA. The main risk and reward elements to be assessed are:

(a) construction risk, which includes costs overruns, the possibility of additional costs resulting from late delivery, not meeting specifications or building codes, and environmental and other risks requiring payments to third parties;
(b) availability risk, which includes the possibility of additional costs such as maintenance and financing, and the incurrence of penalties because the volume or quality of the services do not meet the standards specified in the contract;
(c) demand risk, which includes the possibility that demand for the services is higher or lower than expected;
(d) residual value and obsolescence risk, which include the risk that the asset will be less than its expected value at the end of the contract and the degree to which the government has an option to acquire the assets;
(e) the existence of grantor financing or granting guarantees, or of advantageous termination clauses notably on termination events at the initiative of the operator (ESA 2010 20.283).

[9] EPEC, A guide to the Statistical Treatment of PPPs, September 2016, 152 pages.
[10] The term 'recording' is used under ESA 2010.

The risks and rewards are with the operator if:

1) the construction risk; and
2) either the demand or the availability risks

have been effectively transferred to the operator.

Majority financing, guarantees covering a majority of financed levied, or termination clauses providing for a majority reimbursement of finance provider on termination events at the initiative of the operator lead to the absence of effective transfer of either of these risks (ESA 2010.284). These are examples which are elaborated upon further in the MGDD and Eurostat/EPEC guide.

In addition, owing to the specificity of PPP contracts, which involve complex assets, and when the assessment of risks and rewards is not conclusive, a relevant question is which unit has a decisive influence on the nature of the asset and how the terms and conditions of the services produced with the asset are determined, notably: (a) the degree to which the government determines the design, quality, size, and maintenance of the assets; (b) the degree to which the government is able to determine the services produced, the units to which the services are provided, and the prices of the services produced (ESA 2010.285).

The provisions of each PPP contract shall be evaluated in order to decide which unit is the economic owner. Due to the complexity and variety of PPPs, all of the facts and circumstances of each contract should be considered, and then the accounting treatment, that best reflects the underlying economic relationships, selected (ESA 2010.86).

The practical statistical assessment of PPP contracts is made on a case-by-case basis, based on the relevant rules and guidance.

Service concession contracts

Much less guidance is available in ESA 2010 rules for service concession contracts compared to PPPs.

Under paragraph 42 of chapter 15 of the ESA 2010 manual, service concession contracts shall not be recorded as assets where they are not transferable or no value can be realised through transferring them.

The ESA MGDD stipulates that one of the main issue with service concession contracts concerns the economic ownership of the assets (based on risks and rewards) during the contract, which can be allocated either to the concessionaire (the most frequent case), or to government. Under concession contracts, the major part of the concessionaire's revenue comes from a direct sale of goods or services to a variety of units under fully commercial conditions (tolls, fees paid by sub-contractors, etc.). In such arrangements, the concessionaire bears most of the commercial risk, which depends both on external factors (demand from end-users, their "willingness-to-pay", etc.), and its own performance in managing and maintaining the assets. It is possible that the concessionaire has to operate under specific government requirements and is sometimes compensated by government (e.g. through subsidies) (MGDD Part IV 3.1.5.13-14).

ESA 2010 rules thus indicate that, in most cases with service concession contracts, the government entity grantor is not expected to bear the majority of the risks and rewards related to the asset. However, this is not an absolute rule and the substance of the arrangement needs in all circumstances be carefully analysed on a case-by-case basis before coming to that conclusion. For example, the government entity grantor may provide the operator with substantial guarantees that may lead to the conclusion that the grantor is the economic owner of the asset.

Impact on government deficit (B.9)

Under ESA 2010, investments in fixed assets (including service concession assets) are recorded as increases of government deficit (or reductions of government surplus) because the acquisition of non-financial assets impacts net lending/borrowing (B.9) (MGDD 2016 p.289).

3.5.3 Measurement[11]

The general rule under ESA 2010 is that assets are measured at their market value.

In national accounts, service concession assets constructed under PPP contracts are recorded either on or off government balance sheet, depending on whether the government entity bears the majority of risks and rewards relating to the asset.

If an off balance sheet recording is made, the impact on government deficit will be limited to the regular service fees paid by the government to the partner, which are spread over the long-term contract and no immediate debt impact will be recorded at time of construction of the asset.

A significant problem arises when government is assessed as being the economic owner of the assets (i.e. the assets should be recorded on the government balance sheet) but does not make any explicit payment at the beginning of the contract. A transaction must be constructed to accomplish the acquisition. The most common suggestion is that the acquisition be made with an imputed financial lease because of the similarity with actual financial leases. The implementation of that choice, however, depends on the specific contract provisions, how they are interpreted, and possibly other factors (ESA 2010 20.289).

If the operator is assessed as being the economic owner and if - as is commonly the case - the government obtains legal and economic ownership at the end of the contract without an explicit payment, a transaction is recorded for the government's acquisition of the assets. One general approach is for the government gradually to build up a financial claim and the operator gradually to accrue a corresponding liability such that the value of both will equal the expected residual value of the assets at the end of the contract period. Implementing this approach requires existing monetary transactions to be rearranged or new transactions to be constructed using assumptions about expected asset values and interest rates. This implies partitioning the PPP payments, when the PPP asset is off government balance sheet, in a component representing the acquisition of a financial asset (ESA 2010 20.287).

[11] The term 'valuation' is used under ESA 2010.

An alternative approach is to record the change of legal and economic ownership at the end as a capital transfer in kind. The capital transfer approach does not reflect the underlying economic reality as well, but data limitations, uncertainty about the expected residual value of the assets, and contract provisions allowing various options to be exercised by either party make using a capital transfer approach the most prudent (ESA 2010 20.288).

Financial leasing and public-private partnerships (PPP) contracts when the asset is on government balance sheet imply recognising a government debt. Payments on such PPP contracts are not expenditure for the full amounts, but debt servicing: redemption of a loan and interest expenditure (ESA 2010 20.131).

3.6 Comparison between the different accounting and reporting frameworks

The table below provides an overview of the main rules relating to service concession arrangements included in the accounting and reporting frameworks analysed.

Figure 1 Rules relating to service concession arrangements in the various international financial reporting frameworks

	IPSAS	IFRS	ESA 2010
Scope and definition	A binding arrangement between a grantor and an operator in which the operator uses the service concession asset to provide a public service for a specified period of time and is compensated for its services over the period. Deals with the accounting by the grantor only.	Similar to IPSAS. Deals with the accounting by the operator only.	Similar to IPSAS. However, clear differentiation between service concession contract (payments principally made by the end users) and PPP (payments principally made by the grantor).
Recognition	The grantor recognises an asset based on the notion of control. Control exists when the grantor both regulates the service and the price and has a significant residual interest in the asset. The grantor also recognises a corresponding liability, unless the concession asset already exists.	Mirror of IPSAS approach. The operator recognises either a financial asset or intangible asset.	The asset is recognised by the party that bears the majority of the risks and rewards (an overall assessment should be made on a case-by-case basis). For PPPs, the focus is put on the construction risk, availability risk and demand risk.

Measurement	Assets: new assets are measured at fair value. Reclassified assets are accounted for in accordance with IPSAS 17 or IPSAS 31. Liabilities: (a) financial liability model: financial liabilities are initially measured at fair value and subsequently at amortised cost; (b) grant of a right to the operator model: the liability is the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.	In accordance with either IFRS 9 or IAS 38.	The asset is recorded at market value. A matching government liability (debt) is also recorded if the asset is recorded on the government balance sheet. Debt servicing impacts the government deficit.
Presentation	Asset accounted for as a separate class of assets and presented following general presentation rules under IPSAS 1. Liability presented either as a financial liability (financial liability model) or unearned revenue (deferred income) (grant of a right to the operator model).	No obligation to present service concession assets separately on the face of the balance sheet.	Data on PPPs are published alongside data on contingent liabilities of government. Additional information is collected by Eurostat in its work.
Disclosures	Summary and description of the arrangement, information on assets, liabilities and applicable accounting policies.	General disclosure requirements apply.	N/A

3.6.1 Scope of the standard

<u>IPSAS and IFRS</u>

IPSAS 32 is a mirror of its IFRS equivalent, IFRIC 12. IPSAS 32 addresses the accounting by the public sector grantor, while IFRIC 12 deals with the accounting by the private operator. Similar rules can however be applied by analogy by public operators in their IPSAS financial statements.

Under these rules, the service concession arrangement is a binding arrangement between a grantor and an operator in which the operator (a) uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time and (b) is compensated for its services over the period of the service concession period.

ESA 2010

ESA 2010 rules make a distinction between service concession contracts (the operator gets payments from end users) and PPPs (the operator gets payments from the public sector grantor).

Rules that are more detailed are available for the treatment of PPPs in the ESA 2010 manual, MGDD and Eurostat/EPEC guide.

3.6.2 Recognition and measurement

IPSAS and IFRS

Under the two frameworks, the party who has control over the service concession asset recognises the asset and a corresponding liability in the balance sheet. The grantor has control over the service concession asset when it regulates both the service and the price to the end user and has a significant residual interest in the asset.

Unless the service concession asset is an existing asset that is transferred from another asset category, the service concession asset is initially recognised at fair value together with a corresponding financial or non-financial liability. Subsequently, both frameworks require the service concession assets and liabilities to be valued in accordance with the applicable standards for assets on the one hand, financial liabilities or non-financial liabilities on the other hand.

Service concession assets are depreciated following the rules applicable to the assets of the same category.

ESA 2010

Unlike IPSAS and IFRS, ESA 2010 rules take a risks and rewards approach to determine whether the government entity should reflect the concession contract or PPP on its balance sheet or not.

For PPPs, detailed guidance is available in ESA 2010 manual and MGDD. The rules place particular focus on who bears the construction risk plus either the availability risk or the demand risk. In the case of service concession contracts, the government entity grantor is generally not expected to bear the majority of the risks and rewards related to the asset. This however needs to be confirmed by a careful case-by-case analysis of all facts and circumstances surrounding the transaction.

The difference in accounting between the two sets of rules (international accounting standards versus statistical rules) is clear. IPSAS and IFRS follow a control approach to asset recognition, while ESA 2010 rules follow a risks and rewards approach. A significant difference therefore arises as to the types of arrangements that may need to be recognised on balance sheet, with potentially more transactions being recognised on balance sheet under IPSAS or IFRS, as illustrated by the UK experience[12].

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[12] Before the introduction of IFRS (as adapted for the public sector) in the UK, UK GAAP adopted a risks and rewards approach to asset recognition in the context of private finance initiatives (PFI). 116 out of 658 projects were recognised on balance sheet. The implementation of IFRS (as adapted for the public sector) required to switch to a control approach to asset recognition. Following the introduction of IFRS, 483 out of 546 projects were recognised on balance sheet. Presentation by Ron Hodges, University of Birmingham, ACCA conference of 5 December 2013.

Impact on government balancing items[13]

Under ESA 2010, investments in service concession assets which are recorded on government entity's balance sheet directly increase government deficit (or reduce government surplus) (B.9).

Under IPSAS and IFRS, investments in service concession assets impact the statement of financial performance through the recording of a depreciation expense over the useful life of the assets.

[13] The result of the profit or loss account under IPSAS/IFRS is distinct from net lending/net borrowing (B.9) under ESA 2010.

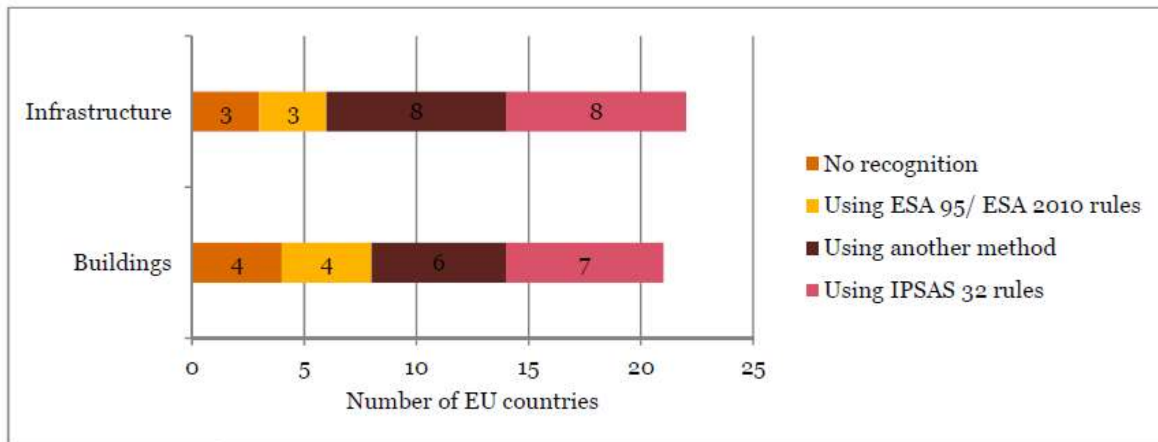
4 Description of the main types of intangible assets in selected EU Member States (Lithuania, Portugal and United Kingdom)

4.1 *Overall accounting maturity for service concession arrangements in the EU*

The figure below presents the findings from the 2014 PwC study in respect of the accounting for service concession arrangements by Member States.

Slightly more than 20 EU central governments report holding infrastructure assets and buildings under service concession arrangements and/or public-private partnerships (PPPs). Out of those, less than 10 countries declare to recognise such assets in the statement of financial position using IPSAS 32 rules (eight in respect of infrastructure assets, seven in respect of buildings). Four countries follow ESA 95/2010 recognition rules (three in respect of infrastructure assets, four in respect of buildings). Some countries also use another method, or do not report service concession arrangements in the balance sheet at all. The study therefore reveals a significant gap inside the EU in the application of accounting for service concession arrangements.

Figure 2 Number of governments recognising assets held under service concession arrangements in the statement of financial position



The study also highlights that increasing use of concession structures requires specific attention as off balance sheet treatment of such transactions, as currently applied by certain governments, may not be appropriate under IPSAS. Accounting for service concession arrangements is an area that is likely to impact all levels of government.

4.2 Selection of countries

Three countries have been selected for a deeper analysis of the accounting treatment used for service concession arrangements:

- Lithuania is a Member State with high accounting maturity (88% as per PwC study of 2014) and declares to recognise all of its concession arrangements in the statement of financial position.
- Portugal is the country reporting the highest percentage of off-balance sheet liabilities related to PPPs (3.2%) and is currently implementing an accounting reform taking IPSAS as a reference point.
- The United Kingdom is the country with the highest accounting maturity as per 2014 PwC study (96%) and experienced major impacts in its reporting when moving to IFRS (as adapted for the public sector).

4.3 Methodology

To analyse the approaches taken regarding the accounting treatment of service concession arrangements in selected Member States, PwC combined an analysis of publicly available information (financial statements, accounting policies) with responses obtained to a questionnaire addressed to government representatives. The first series of questions addresses the identification of service concession arrangements and the related recognition criteria. The questionnaire then addresses the measurement of service concession arrangements with a view to financial reporting requirements for national purposes. The last questions focus on the challenges and approach in respect of first-time implementation and ongoing application of accounting rules relating to service concession arrangements, and on how the reported numbers support the decision making.

In the following pages, we present a summary of the results of our country-by-country analysis.

4.4 Lithuania

4.4.1 Type of service concession arrangements

The main service concession arrangements include both grantor pay structures and user pay structures.

Arrangements that are grantor pay structures are mainly entered into for (1) culture, sports, leisure facilities, equipment and other infrastructure, (2) equipment and infrastructure for utilisation, recycling and management of waste and (3) roads, bridges, tunnels, parking and other road equipment infrastructure.

User pay structures include (1) equipment and infrastructure for the energy sector (heat and electric energy, oil and natural gas extraction, transmission, distribution and supply, (2) public transport infrastructure and (3) port and dam infrastructure.

4.4.2 Recognition and measurement rules

Both the central government and local governments account for service concession arrangements in accordance with IPSAS 32 requirements. They recognise a service concession asset when they control it, with as the credit side of the booking entry being a financial liability (for grantor pay structures) or a non-financial liability (for user pay structures).

Measurement is also made in accordance with IPSAS 32 rules.

Whole-of-government accounts provide disclosures relating to service concession arrangements recognised on the balance sheet, including information about the types of arrangements, the assets concerned and the significant terms and conditions. No information is however given on the amounts recognised on the balance sheet.

4.4.3 First-time implementation and ongoing challenges

The main difficulty upon first-time implementation related to the determination of the fair value of service concession assets at initial recognition. Financial models used to determine the bid price and to feature the future revenue stream of the operator were taken as a basis for the valuation.

Ongoing application issues include treatment of the differences with the statistical reporting and completeness of reporting by some municipalities.

4.5 Portugal

4.5.1 Type of service concession arrangements

Service concession arrangements concluded by entities in scope of the central government consist in both grantor pay structures and user pay structures.

The main types of assets concerned by these arrangements include:

- For grantor pay structures: toll road concessions and hospital concessions;
- For user pay structures: toll road concessions, railway concessions, airport concessions and various sorts of terminal concessions.

The information about service concession arrangements at the local government level is being updated.

4.5.2 Recognition and measurement rules

The new accounting framework has been enacted by Decree-Law 192/2015. Public Sector Accounting Standard 4 (NCP 4) that is part of the new Portuguese Public Sector Accounting Framework is based on IPSAS 32 requirements. These requirements are mandatory from January 2018 for the central government and autonomous regions (Azores and Madeira), and from January 2019 for local governments and entities that are part of the social security sector.

The cost model is the accounting policy selected for subsequent measurement of fixed assets and intangible assets, regardless of whether the assets were procured under traditional public procurement or through service concession arrangements.

4.5.3 First-time implementation and ongoing application challenges

The Portuguese government is in the process of making its transition to the new public sector accounting standards based on IPSAS. They are now developing the procedures, processes and systems for the first-time application of IPSAS 32.

One of the main challenges consists in building up a complete inventory of the existing concession contracts. The Portuguese government intends to take advantage of the three-year transition relief exemption allowed in IPSAS 33 'First-time adoption of accrual basis IPSAS' and use a pragmatic approach for the preparation of the opening balance sheet, such as using the information included in the financial statements of the operators for initial measurement purposes.

Additional challenges include analysing the accounting impact of the concession arrangements, such as asset measurement, including componentisation, treatment of contingent liabilities as well as the development of impairment models and appropriate accounting policies.

On an ongoing basis, the differences in treatment with the ESA 2010 reporting will be addressed in the consolidation and national accounts project. Under this project, a consolidation package solution will be developed, which will allow reconciliation between the consolidated financial statements and the requirements and specific needs of the national accounts based on ESA 2010.[14]

4.6 United Kingdom

4.6.1 Type of service concession arrangements

The UK government both has availability structures and user pay structures. No separate reporting is made and both types of structures are included under the term 'public finance initiatives' (PFI).

2017 summary data relating to PFI can be found at:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/696091/PFI_and_PF2_projects_2017_summary_data_March_2018_web.pdf

"Public private partnerships have been used to deliver investment in infrastructure across a wide range of sectors including hospitals, schools, roads, prisons, waste management and energy-from-waste infrastructure, housing, and military accommodation and equipment.

[14] See Luis Viana, Portuguese Public Sector Accounting and Reporting Reform, Consolidation and National Accounts Project, 6th EPSAS Working group, 7-8 May 2018, Luxembourg, https://circabc.europa.eu/sd/a/f5ef64d1-0053-4f14-9999-633dd6708d06/Agenda%20item%203%20-%20EPSAS%20WG%20-%20PT%20Presentation.pdf. See also PwC, issue paper Member States' approaches to harmonising charts of accounts for national purposes with a view to financial reporting requirements under the future European Public Sector Accounting Standards (EPSAS) on pp 26 to 32.

Projects signed pre-May 2010 have a capital value of £50.6 billion compared to £8.4 billion for projects after May 2010 (86% of the total). In the current year (FY17/18) the annual payment for projects signed pre-May 2010 is £9.7 billion (91% of the total payments). Between 1997 and 2010 on average 55 contracts were signed a year. Since May 2010, 84 contracts have been signed, an average of 12 a year.

Until 2012, the primary model of PPP used in the UK was PFI. During 2012 the government carried out a detailed review of PFI that aimed to address criticisms surrounding this form of contracting. PF2, the successor to PFI, was launched in December 2012.

[…]

The key difference between PFI and PF2 are: […] the government now acts as a minority co-investor to give greater visibility of the internal workings of projects.

[…]

Being a shareholder provides the government with much greater visibility of the way in which these projects are delivered, the risks involved and the financial returns to investors. It also brings a more collaborative approach to project performance and managing risk."[15]

4.6.2 Recognition and measurement rules

The UK uses IFRS rules (i.e. IFRIC 12) to establish whether a service concession contract is on or off the balance sheet. Contracts in departmental resource accounts (reflected in annual reports and accounts) and whole-of-government accounts (WGA) have been accounted for based on IFRIC 12 since the introduction of IFRS to central government.

Alignment between financial statements, budgets and estimates (where budgets are set by Parliament) has not been sought to date. Instead budgets and estimates treat arrangements in accordance with ESA 2010 rules. This means that there is still an element of dual recording for PFI arrangements, with it possible for PFI's to be on balance sheet for departmental resource accounts and off balance sheet for budgets and estimates (and vice versa).

The treatment is assessed on an individual project basis and depends on the detailed arrangements between the government and service provider.

The net book value of PFI assets included in the statement of financial position was £39.3 billion (2015-16: £38.8 billion) as at 31 March 2017. The PFI liability for the present value of capital amounts payable was £39.3 billion (2015-16: £39.2 billion). A number of WGA entities have PFI contracts that should not be recognised on the statement of financial position because, under IFRIC 12, the private sector contractor was, on balance, considered to have greater control over the use of the asset. Included in Note 27 of the WGA is a list of the most material PFI contracts that have been reported.[16]

[15] HM Treasury and Infrastructure and Projects Authority, Private Finance Initiative and Private Finance 2 projects: 2017 summary data, March 2018, 20 pages

[16] HM Treasury, Whole-of-government accounts for the year ended 31 March 2017, pp. 139 to 141.

The grantor measures the service concession asset in the same way as other non-current assets of that generic type. It also records a liability for the capital value of the contract, i.e. excluding the interest charge and service elements. Liabilities are measured using the appropriate discount rate, taking account of the reduction arising from the capital payments included in the unitary payment stream.

4.6.3 First-time implementation and ongoing application challenges

The main challenge consists in tracking the differences between resource accounts and national accounts. The UK Government applies EU adopted IFRS as interpreted or adapted for the public sector in its WGA. Contracts that fall within IFRIC 12 follow the ESA 2010 treatment for budgeting rather than IFRS. The recording in budgets is intended to match the fiscal impacts of the transaction and those contracts applicable under the applicable lease accounting rules in IFRS[17] are broadly in line with the national accounts standards.

Both accounting and statistical treatments are used as a support for accountability and decision making. Both WGA prepared under IFRS and budgets prepared under ESA 2010 are presented to the Parliament, which is the main user of these reports.

Comparison with national accounts is presented in Annex A to the WGA[18]. In respect of PFI, the following is mentioned:

- WGA treatment: most PFI assets and liabilities are recognised on balance sheet after assessing control of the assets. PFI payments are apportioned between repaying debt, paying interest and paying for services.
- National accounts treatment: most PFI assets and liabilities are not recognised on the balance sheet after assessing risks and rewards. Payments under PFI contracts are recognised as a current expense in-year for off balance sheet schemes and a capital expense in-year for on balance sheet schemes.

[17] Lease accounting rules under IFRIC 4 and IAS 17 take a risks and rewards approach to asset recognition (like ESA 2010 rules do).

[18] See HM treasury, Whole-of-government accounts for the year ended 31 March 2017, Annex A: Comparison to national Accounts, pp 175 to 179.

4.7 Comparison

The table below provides a high-level comparison of the main accounting principles related to service concession assets as applied by the three governments selected for our analysis.

Figure 3 Rules relating to service concession arrangements for governments in Lithuania, Portugal and the UK

	Lithuania	*Portugal*	*UK*
Types of services concession arrangements	Both grantor pay and user pay structures.	Both grantor pay and user pay structures.	Both grantor pay and user pay structures, known under the term private finance initiative or private finance 2.
Recognition and measurement	The grantor recognises an asset and a liability using IPSAS 32 criteria (based on control). Measurement rules are based on IPSAS.	The grantor recognises an asset and a liability using IPSAS 32 criteria (based on control) from 2018 and 2019 depending on the level of government. Measurement rules are based on IPSAS.	IFRIC 12 rules are used to determine whether the grantor should recognise an asset and a liability (based on control). If a transaction is not in the IFRIC 12 scope, a grantor may anyway need to recognise an asset and a liability based on IFRIC 4 and IAS 17 rules (based on a risks and rewards analysis). IFRIC 12 is also applicable to the operator.
First-time implementation and ongoing application challenges	At initial adoption: measurement of service concession assets. Ongoing challenges: management of differences between accounting and statistical reporting, completeness of reporting by some entities.	At initial adoption: inventory of all contracts and application of IPSAS rules. Intention to use three-year transition relief exemption under IPSAS 33 used to facilitate first-time adoption. Ongoing challenges: plan to implement an integrated system to reconcile consolidated accounts and national accounts.	Ongoing challenges: management of differences between accounting and statistical reporting.

All three countries have grantor pay structures and user pay structures. They all require grantors to recognise service concession assets and liabilities on the balance sheet if they control the asset, in accordance with international standards. Lithuania and Portugal have aligned their national accounting rules on IPSAS, while the UK applies IFRS as adapted for the public sector.

Keeping track of the differences between rules based on international standards and ESA 2010 rules is a challenge for the three member states. One possible solution to manage these differences on an ongoing basis is the implementation of an information system that manages the two reporting systems in an integrated way, as is e.g. done in Portugal.

5 Difficulties/issues when accounting for service concession arrangements

Based on country comparison, the findings from the 2014 PwC study, our experience in applying IPSAS and ESA 2010 rules to service concession arrangements and on the analysis performed in the context of the present issue paper, the following are identified as the main difficulties/issues that arise in the accounting of service concession arrangements:

- Conceptual approach to asset recognition.
- Treatment of service concession arrangements by the public sector operator.
- Technical complexity.
- Treatment of non-financial liabilities.
- Consistency of presentation and disclosures.
- Management of differences between accounting and statistical reporting.

5.1 Conceptual approach to asset recognition

Under IPSAS, recognition of the service concession asset by the grantor (i.e. the public sector entity) is based on whether it controls that asset and not on whether it bears the risks and rewards related to it (as under ESA 2010 rules). All facts and circumstances of the arrangement should be considered in making this assessment.

ESA 2010 rules constitute the reference for statistical reporting and are important for macro-economic analysis.

The two approaches therefore differ from each other, the issue of whether the future EPSAS rules should take a control approach to service concession asset recognition or rather follow a risks and rewards approach is of a conceptual nature.

5.2 Treatment of service concession arrangements by a public sector operator

IPSAS 32 only deals with the accounting of service concession arrangements from the perspective of the grantor. The standard does not specify the accounting by operators.

Although operators in service concession arrangements are generally private companies, public sector entities can also sometimes act as operators. It is therefore important that the future EPSAS rules can also provide guidance on the accounting by operators as well.

5.3 Technical complexity

Service concession arrangements, encompassing both transactions labelled as PPPs and concession contracts under ESA 2010 terminology, can come in many forms. Entities transitioning from the cash basis of accounting may have incomplete records of such transactions.

Service concession agreements may also be complex, making it complicated to assess how to apply recognition and measurement rules and how to report assets, liabilities and revenue. There can also be hybrid structures with features of both an availability structure and a user pay structure therefore making the accounting treatment more complex.

The analysis of such transactions under the future EPSAS rules will require specific expertise from Member States in order to properly reflect the substance of the transaction in their government financial statements.

5.4 Treatment of non-financial liabilities

When recognising a service concession asset, a liability is usually also recognised. Where the grantor has an unconditional obligation to make payments or give another financial asset to the operator, IPSAS 32 requires the recognition of a financial liability at fair value. When it does not have such an obligation, the grantor accounts for a non-financial liability as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.

One comment was received from a Member State in relation to service concession agreements (out of 147 comments received for all topics) at the time of the 2014 PwC study[19]. That comment questioned recognition of a non-financial liability when the grant of a right to the operator model is applied and found that recognition directly in net assets was instead more appropriate.

5.5 Consistency of presentation and disclosures

Service concession arrangements may involve significant amounts and usually attract a lot of attention from various stakeholders (including politicians) given the impact that such transactions may have on government debt and deficit under ESA 2010 rules and the ability of governments to invest in infrastructure assets and other domains using these types of arrangements.

Although there is no interaction between the two sets of rules, the fact that service concession arrangements attract a lot of attention because of the potential consequences of their treatment under ESA 2010 rules, also increases the potential interest of EPSAS stakeholders about how these transactions should be reported under the future EPSAS reporting.

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[19] See PwC, Collection of information […], 1 August 2014, p. 129.

5.6 Management of differences between accounting and statistical reporting

Under IPSAS and IFRS, concession assets are recognised on the balance sheet based on the concept of control. ESA 2010 however take a risks and rewards approach to asset recognition. Differences therefore arise between the two sets of rules that should be managed. This may involve some complexities if appropriate processes and systems are not implemented.

6 Discussion of matters relevant for a European harmonisation

In our opinion, the topics that are worth being discussed at a European level in the context of the EPSAS standard setting and that are relevant for a European harmonisation are the same as the ones identified as difficulties/issues in the accounting for concession arrangements:

- Conceptual approach to asset recognition.
- Treatment of service concession arrangements by the public sector operator.
- Consistency of presentation and disclosures.
- Management of differences between accounting and statistical reporting.

In our opinion, technical complexity is however not a topic for discussion between Member States. Concession arrangements are transactions that are complex in nature. As the accounting should reflect the substance of the arrangements, a certain degree of complexity is necessarily involved.

In addition, Member States experts should already analyse service concession arrangements in the context of the ESA 2010 reporting and a good degree of expertise regarding the understanding of the substance of such transactions should already be available. Finally, governments that did not report service concession arrangements on their balance sheet under previous GAAP can make use of the transitional relief exemption available under IPSAS 33 'First-time adoption of accrual basis IPSAS' and only recognise such transactions on their balance sheet three years after the IPSAS transition date.

Finally, we do not think that recognition of a non-financial liability in circumstances described in IPSAS 32 standard is a matter for discussion either; it is widely accepted by accounting practitioners as reflecting the substance of the arrangements.

6.1 Conceptual approach to asset recognition

This issue constitutes in our opinion the most important topic for discussion. It has already been addressed in the context of the issue paper on the notion of control.

The following advantages of using a control approach to asset recognition were included in the issue paper on the notion of control:

(1) Consistency with IPSAS latest developments and the IPSAS and draft EPSAS Conceptual frameworks

The latest developments in international accounting, both in IPSAS and IFRS, move away from the risks and rewards approach to take a control approach to asset recognition. Application of a control-based approach to asset recognition leads to more consistency in the way assets are recognised on the balance sheet. Application of the control-based approach leads to recognition of assets which comply with the definition of assets in the IPSAS Conceptual framework.

As the draft EPSAS Conceptual framework (version dated May 2018) contains similar definitions for assets and the different elements included in the definition of an asset as the IPSAS Conceptual framework, adopting a control-based approach would also be in accordance with the EPSAS Conceptual framework.

(2) Ensures greater neutrality and comparability of financial statements

Application of a control-based approach brings greater neutrality in the EPSAS reporting as it makes it more difficult to structure certain transactions in a way that allows assets used by the entity (and the related liabilities) to be presented off balance sheet (e.g. service concession assets). Experience shows that off balance sheet treatment was often one key objective followed by the reporting entities when structuring a service concession arrangement.

In many service concession arrangements, the risks are shared between the grantor and the operator and objectives criteria for assessing risks and rewards are difficult to determine. Assessing which party is the economic owner based on a risks and rewards analysis is therefore often highly judgemental and requires significant efforts to ensure comparability across the Member States as the concept is likely to lead to greater diversity in how the concepts are applied in practice among government entities.

(3) Better serves the accountability and decision-making objectives of financial statements

Bringing more assets on the balance sheet following application of a control-based approach seems to better serve the accountability and decision-making objectives of financial statements. It would provide a more comprehensive picture of the assets under the control of the government entity and therefore of the resources entrusted to that government entity, which is key information for a public sector entity.

Recognition of service concession assets on the balance sheet indeed makes them apparent to the public; this should force governments to make conscious decisions on how best to manage these assets and how best to negotiate the terms of the service concession arrangements with a view to better service delivery and better management of public funds.

On the other hand, following a control approach would not be in line with the ESA 2010 approach and would require a different treatment for EPSAS reporting purposes. Managing the differences between the two sets of rules is considered as a major challenge by the countries selected for the benchmark in our analysis (see chapter 4).

6.2 *Treatment of service concession arrangements by a public sector operator*

IPSAS 32 mirrors the requirements included in IFRS (IFRIC 12) for the accounting of service concession arrangements by operators.

Member States may wish to discuss whether IFRIC 12 rules might be taken as a reference for developing the future EPSAS rules by public sector entities acting as operators.

6.3 *Consistency of presentation and disclosures*

The need for a consistent presentation and/or disclosure of the service concession assets may be discussed in order to enhance comparability of the reporting between EU Member States.

Both internationally recognised accounting frameworks (IPSAS and IFRS) require accounting for service concession assets as a separate class of assets. However, such assets do not necessarily need to be presented separately on the face of the statement of financial position[20]. The same applies to (financial or non-financial) liabilities that are recorded in relation to service concession assets.

Given the importance of service concession arrangements in the political debate, making these transactions fully transparent in EPSAS financial statements may be useful.

Member States may wish to discuss if some degree of harmonisation in this respect is needed.

6.4 *Management of differences between accounting and statistical reporting*

Management of differences between accounting and statistical reporting is not as such a topic that is directly related to the EPSAS standard setting.

However, Member States may wish to discuss how such differences are managed in practice and share best implementation practices.

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[20] They are not included in the list of items that should, as a minimum, be presented on the face of the balance sheet under both IPSAS 1 'Presentation of financial statements' and IAS 1 'Presentation of financial statements'. IPSAS 1 and IAS 1 however require additional line items to be presented on the face of the balance sheet when such presentation is relevant to an understanding of the entity's financial position.

7 PwC's recommendations on the way forward

We present below our recommendations in the same order as the topics proposed for discussion for a European harmonisation under Chapter 6.

7.1 Conceptual approach to asset recognition

An analysis of the pros and cons of both a control-based approach to asset recognition and an approach based on risks and rewards is presented in the previous chapter. Based on this, we believe there are both conceptual merits (e.g. consistency in the approach) and valid reasons with regards to the users' needs and accountability and decision-making objectives of financial statements (neutrality, transparency) to recommend the use of an approach built on control, as required in international accounting standards such as IPSAS and IFRS. In addition, this would also comply with the draft EPSAS Conceptual framework (version dated May 2018).

Member States might want to confirm or discuss whether these merits overweight the disadvantage of not being aligned with ESA 2010 rules.

7.2 Treatment of service concession arrangements by a public sector operator

Taking as a reference the requirements included in IFRIC 12 for developing accounting rules for service concession arrangements complies with the approach foreseen in IPSAS 3 when existing standards do not provide guidance on certain accounting topics. IFRIC 12 rules are a mirror of the IPSAS 32 approach and we do not see valid reasons for departing from private sector rules in the present case. In addition, paragraph 7 of IPSAS 32 also explicitly refers to guidance in other relevant international and national standards for the accounting by operators.

Furthermore, adopting an accounting treatment by public sector operators that mirrors the accounting by public sector grantors can facilitate elimination in consolidation where both the grantor and the operator are included in the same consolidation scope.

We therefore recommend that the future EPSAS rules for public sector entities acting as operators in service concession arrangements be based on IFRIC 12 rules applicable to private sector operators.

7.3 Consistency of presentation and disclosures

In order to achieve consistency in the presentation and disclosure of the service concession arrangements across EU governments, the future EPSAS rules may provide guidance in this respect.

Options for separate presentation and/or disclosure could for example include:

1. Presenting service concession assets and/or the related liabilities separately on the face of the balance sheet.

2. Presenting service concession assets and/or the related liabilities separately as a subcategory within each of the main categories of assets/liabilities that are presented separately on the face of the balance sheet.
3. Presenting information on service concession arrangements (including on service concession assets and the related liabilities) in a separate note to the financial statements and making the reference to the notes about the categories of assets that contain service concession assets.

7.4 Management of differences between accounting and statistical reporting

Governments are likely to make a greater use of financial statements if they provide the necessary reconciliation or link to the statistical reporting. This is particularly important for concession arrangements as these transactions are usually under great scrutiny by parliamentarians and other stakeholders.

Sharing of best practices and experiences on how to manage differences between accounting and ESA rules and how to report these can therefore be useful. The country analysis in chapter 4 reveals that the Portuguese government is implementing an information system that manages the two reporting systems in an integrated way, while the UK government provides transparent and easy-to-read disclosures about these differences in its WGA.