

Exposure Draft

Public Sector Accounting Board

Proposed accounting standards

Public Private Partnerships

January 2020

CCPPP RESPONSE TO THE EXPOSURE DRAFT (PSAB 3160)

Executive Summary

The Canadian Council for Public-Private Partnerships (CCPPP)

CCPPP is pleased to provide a response to the Exposure Draft issued on November 1, 2019 by The Public Sector Accounting Board (PSAB) of Certified Public Accountants (CPA) that proposes new requirements for recognizing, measuring and classifying infrastructure procured through a public-private partnership.

Established in 1993, CCPPP is a national not-for-profit, non-partisan, member-based organization with more than 400 members providing broad representation from across the public and private sectors. Its mission is to collaborate with all levels of government, Indigenous communities and the private sector to enable smart, innovative and sustainable approaches to developing and maintaining infrastructure that achieve the best outcomes for Canadians. The Council is a proponent of evidence-based public policy in support of P3s, facilitates the adoption of international best practices and educates stakeholders and the community on the economic and social benefits of public-private partnerships.

Canada is a world leader in PPPs. Our country has used the model to build, operate and maintain a variety of vital infrastructure, from hospitals to transit to water and wastewater treatment plants. In fact, there are currently 285 active P3 projects in Canada, with those already in operation or under construction valued at more than \$139.4 billion. The standards used in Canada are universally recognized as ‘best in class’ around the world.

PSAB’s proposed new requirements are timely and important given the ongoing evolution of the Canadian P3 sector. That is why CCPPP supports PSAB’s objective of developing a Canadian-specific PPP accounting standard. The Council sees great benefit in providing market participants, especially public sector accounting professionals, with clear accounting rules on PPPs given the diversified structures, legal agreements and financing arrangements that have emerged over the last 10 years and which are continuing to develop.

CCPPP previously published a report on [*Public Sector Accounting for Public Private Partnership Transactions in Canada*](#) in May 2008. The Council’s response to the Exposure Draft draws upon this work. It has also engaged with its members, comprising key stakeholders in the development of PPP transactions in Canada about the proposed new requirements, including holding a session on the issue at our 27th Annual Conference on November 19, 2019. CCPPP’s members have expressed concern at the potential unintended consequences of the accounting requirements as currently purposed.

CCPPP has structured its comments on the Exposure Draft to strike a fair and balanced approach between public-private partnerships and other procurement models.

The Council's response to the Exposure Draft is focused on the 11 questions posed by PSAB. However, some of its responses go beyond the specific questions and cover other aspects of the Exposure Draft.

CCPPP has also attempted to structure its responses within the overall framework established by PSAB in the Exposure Draft and by international standard setters. The Council addresses specific gaps, inconsistencies and contradictions within the Exposure Draft in comparison with international standards.

PPPs have many unique characteristics, which is why the Council recommends a more comprehensive review of PPP accounting standards be undertaken by PSAB in conjunction with government and industry stakeholders. For this reason, CCPPP also provides thoughts for an "Alternative View" on how to more appropriately account for PPP transactions.

It is in this context CCPPP also makes comments on the presentation and disclosure guidance. The Council finds the examples used to be out of step with the practical experience of Canadian PPPs and proposes amendments to these.

Overview of Exposure Draft

CCPPP would like to see the new Canadian standard represent world leadership in public sector accounting in the same way that our PPP transactions represent world best practices. For this reason, the Council's response cross references to the relevant provisions of the international standard IPSAS 32 and comments on where it considers these to be inadequate in the context of Canadian P3s.

The Council's review of IPSAS 32 suggests there remain a number of challenging and potentially contradictory aspects of international guidance. IPSAS tends to address these issues in detail in application guidance and the basis for conclusions. CCPPP recommends PSAB expand its application guidance and basis for conclusions to provide greater clarity. Certain of these issues could be raised to the attention of IPSAS as a source of potential ambiguity in the future.

The Council expects its comments, which are objective in nature and create the right balance between financial and accounting considerations, will result in enhanced amendments to the Exposure Draft prior to finalization of the standard.

The evolution of accounting standards is similar to the evolution of PPP transactions and it is understandable that standards and procedures keep shifting and improving based on market feedback and experiences. In that spirit, CCPPP proposes a continuing dialogue between PPP stakeholders and PSAB in order to ensure the standards reflect continued evolution of the PPP model in Canada.

It is particularly important that the treatment of PPP assets and liabilities is accurate and appropriate as Canadian public sector accounting moves closer to the presentation of full public sector entity balance sheets over the next few years.

CCPPP is not arguing that PPP transactions should be “off-balance sheet” for public sector entities. However, the Council strongly believes recognition of assets and liabilities associated with PPP transactions should be based on the economic substance of the transaction and differentiate between PPPs that create different financial risk profiles for the public sector entity.

CCPPP is concerned that accounting treatment should be neutral with respect to procurement methods but should still reflect material differences in the substance of the public sector asset and liability and should avoid creating inappropriate incentives for the parties to the transaction. The Council is not attempting to promote one model over another but rather to ensure that the standards reflect fair representation of the financial exposure of tangible or intangible assets or actual or contingent liabilities.

The application of the PPP standards should ensure all transactions are recorded based on accounting standards and principles considered together. The current Exposure Draft focuses on the principles of matching, conservatism and materiality, but does not also consider adequately equally important accounting principles like going concern, cost principle and economic entity.

While there are a number of potential models available for PPPs, the majority of current Canadian PPPs have the following features:

- Full transfer of design and construction risks to the private sector
- Retention of risks that cannot be transferred fully or partially to the private sector on linear infrastructure are budgeted but not recorded as they are uncertain and contingent
- For DBFOM, the risks of maintenance, operation and lifecycle are transferred to the private sector. The only risk retained by the public sector may be change orders
- Life cycle costs are paid based on contractual obligations. Life cycle works are not commissioned nor is it possible to know if they constitute a betterment.
- The capital cost at risk is intended to provide a warranty beyond the legal warranty period through a financial instrument (PPP contract)

The typical Canadian PPP will also have many different types of financing:

- 1) A grant or contribution from a higher level of government (reflecting a contributed surplus)
- 2) General government borrowings supported by the taxpayer
- 3) Self-supported government debt supported by user pay revenues
- 4) Non-recourse debt raised by a private sector partner with a government obligation to make payments for services delivered

- 5) Non -recourse debt raised by a private sector partner and supported by the right to collect user pay revenues
- 6) Private sector equity

When risks materialize the first loss is experienced by the parties that financed the project and the exposure of the public sector grantor in almost all cases is marginal.

The CCPPP approach to the report starts from the perspective that most PPP transactions are a combination of an asset and a service (in some cases just service with underlying asset) with the choice of the relative combination of the two components largely left up to the private sector partner.

It is fundamental to the commercial and public interest use of PPPs that some degree of flexibility and responsibility for these choices is transferred to the private partner. The private sector when bidding the capital, service or life cycle components should not be taking into account whether the bifurcation of their costs would result in the best accounting representation from the public entity's perspective.

It is CCPPP's Alternative View that the bifurcation of PPP payments into an asset and an O&M component is harmful and not necessary. The entire transaction should be viewed as a service rendered at a combined unitary cost. Any asset recognition should be over the life of the asset where capable of estimation or at the end of the contract where residual value can be estimated.

It is of great concern to CCPPP that under the proposed Exposure Draft the accounting treatment for the following transactions would be the same (assuming the same construction cost):

- 1) A Design – Build, paid entirely by government through milestone construction payments and/ or substantial completion payments (DBF)
- 2) An availability payment based PPP concession with performance based payments made over 30 years (DBFOM)
- 3) A user pay transaction, where no payments are made directly by government but revenues are created by the right to levy a charge on users.

These three transactions have very different risk profiles and liabilities for the public sector and to record the same asset and liability for each seems *prima facie* wrong. It is important that accounting treatment is able to distinguish between these and provide for a fair representation of the financial exposure of the public entity.

CCPPP recommends an approach based on the economic substance of the transaction.

Principal Observations and Recommendations

CCPPP's recommendations can be summarized as follows:

Scope

CCPPP finds the scope to be clear for public-private partnerships. We consider appropriate the definition of a PPP as an arrangement under which the private sector partner:

- Builds or better infrastructure, and
- finances the transaction past the point of substantial completion, and
- maintains or operates the infrastructure

However, CCPPP questions the purpose of having a distinct accounting standard in respect of public-private partnership transactions if the provisions of the standard result in the transaction being accounted for exactly as if it had been delivered directly by the public sector entity.

Definitions

CCPPP agrees with the definitions provided in the Exposure Draft. However, the Council recommends a number of additional definitions it feels are important to the interpretation and application of the standard.

Recognition of Infrastructure Asset

CCPPP does not find the control guidance provided in the Exposure Draft to be sufficient or appropriate as it relates to the recognition of infrastructure for the reasons set out below.

CCPPP agrees a liability should be recognized when the public sector entity has an *unconditional* (the Council's emphasis) obligation to deliver cash or another financial asset as consideration for the building, acquisition or betterment of infrastructure.

CCPPP disagrees with the statement that a performance obligation (also a liability) should be recognized for the unsatisfied portion of the performance obligation when consideration transferred for the building, acquisition or betterment of infrastructure is the right to charge users or earn revenue from another revenue generating asset.

CCPPP's concerns with respect to control guidance can be summarized as follows:

- 1) Control provisions are broad and would capture virtually all PPP transactions, including both financial liability (availability payment) and performance obligation (user pay transactions). This matters in particular because asset and liability

measurement guidance is also essentially binary with limited flexibility for differing circumstances.

CCPPP recommends the control recognition and initial measurement provisions should operate in combination with each other such that the degree and nature of control exercised is a determinant of asset and liability recognition and measurement.

- 2) The definitions of Purpose and Use of infrastructure assets are imprecise and overlap with access to future economic benefits and risks.

CCPPP recommends that control over the purpose of an infrastructure asset should require rights to make payment deductions or obtain damages (including default) should an infrastructure asset not meet specifications or performance standards not be met.

CCPPP further recommends that access to economic benefits and risks of the infrastructure asset should be clearly distinguished from purpose and use. Otherwise the same criteria can be used to satisfy both of these control criteria, rendering the criteria excessively broad.

- 3) The proposed control guidance appears inconsistent with and more onerous than both IPSAS 32 and control guidance in other areas of the PSAB Handbook.
- 4) The Exposure Draft removes price control as a necessary element of control, further broadening the criteria. CCPPP regards control over price as being a necessary but not sufficient criterion for control.

CCPPP recommends that consistent with IPSAS 32 price control is a necessary condition for economic control.

CCPPP recommends that in order to be sufficient evidence of control the public sector grantor should also share in the risks of the price being set at a level which does not generate sufficient revenue through a liability to make shortfall payments or a right to share in the benefits through a revenue sharing arrangement.

- 5) There is no recognition of the risk transfer features of PPPs, differences from conventional delivery or that choices between initial capital expenditures and O&M and lifecycle costs may differ significantly under PPP delivery. In most cases this means that PPPs will reflect a higher capitalization of asset and liabilities (which affects government budgeting) than conventional delivery. This will discourage the use of high quality PPP transactions. PPPs are all about the transfer of risk between the public sector and private sector partners. It is therefore disappointing that the Exposure Draft does not address any risk-based approach. IPSAS 32 Basis for Conclusions explicitly rejects a risk-based approach (BC13) *“IPASB also questioned whether sufficiently objective criteria could be established for addressing 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.”

CCPPP recommends that the different types of payment profile under a PPP can easily and objectively be categorized by the nature of their level of risk transfer. A “one principle fits all” approach is an oversimplification and creates misleading results. The Exposure Draft does not provide guidance as to the risk exposure of the public sector grantor, although control is stated as dependent upon exposure to risks.

CCPPP recommends that the public sector grantor controls access to the future economic benefits when it:

- (a) can benefit from the economic resource through its capacity to provide goods and services, to provide future cash inflows or to reduce cash outflows;
- (b) can deny or regulate access to those benefits by others; and
- (c) is exposed to the risks associated with the economic resource.

CCPPP is of the view that there are a number of circumstances under which the public sector may be exposed to the economic risks and benefits of a user pay PPP transaction:

- a) Where the public sector entity guarantees a payment equal to the shortfall between forecast revenues and actual revenues or similarly guarantees a specified rate of return on investment to the private sector partner.
 - b) Where the public sector entity participates in a share of revenues beyond a specified amount.
 - c) Where the public sector guarantees a level of utilization of the infrastructure asset and restricts it from competition (denial or regulation of access to those benefits by others)
- 6) The distinction between PPP transactions, which are typically governed by a project specific contractual agreement, and other types of regulated infrastructure transactions, which may be governed by an industry wide regulatory model, is arbitrary. Many of the features of PPP transactions that would trigger recognition of control under the Exposure Draft are in the public good and regulatory in nature rather than exposing the public sector grantor to specific benefits or liabilities. The standard risks confusing regulatory controls in the public interest and control over economic interests. This leads to concerns with respect to inappropriate incentives where a public sector grantor may seek to avoid regulatory control mechanisms that are in the public interest in order to avoid recognition. This is of particular concern given the penal recognition of a performance obligation liability.

CCPPP recommends that controls of a regulatory nature are clearly distinguished from those that lead to economic control. The control provisions make no distinction between an availability payment and a user pay PPPs, Financial Liability (availability payment) projects and Performance Obligation projects in which the private sector collects user pay revenue streams have very clear and obvious differences in government's exposure to economic risks and benefits. User pay demand risk transactions will be consolidated on government balance sheets reflecting a liability equivalent to the forecast revenues. This will significantly discourage the use of user pay PPP transactions and does not reflect accounting principles of fair representation. The concept of the performance obligation liability has been artificially created for matching purposes and to address the concern that a future public sector residual value interest in a user pay asset may not be recognized or may be over inflated. This reflects the challenges of proportionate recognition of a residual interest which is very long dated.

CCPPP recommends the position that the performance obligation is on the private sector and the performance obligation liability is not a fair representation of the public sponsor's actual liability and risk exposure. The assumption and justifications made in the Exposure Draft that the government stands ready to step in and repair damages is misleading and does not reflect the transaction economics and the parties' contractual obligations. Instead, consistent with our other recommendations, the public sector residual interest in a user pay asset should be recognized only at the point it is capable of reasonable estimation.

- 7) The Exposure Draft provides limited guidance on mixed use assets where the public sector grantor may exercise control over portions of the infrastructure asset but not the entire asset.

CCPPP broadly agrees with the provisions of IPSAS 32 AG 12-13 and AASB 1059 BC25 -27 in this regard and **CCPPP recommends** that the Exposure Draft adopts similar guidance.

- 8) The control condition in respect of "significant residual interest" could lead to inappropriate incentives to lengthen concession terms beyond commercially optimum timeframes and requires greater definition and interpretation guidance.

CCPPP recommends that "significant residual interest" is defined as the estimated current value of the asset as if it were already of the age and in the condition expected at the end of the service concession arrangement" (consistent with IPSAS 32 AG9), that this current value must be reasonably capable of estimation at the beginning of the concession and that the residual value should be material in the context of the overall transaction. In general CCPPP, believes that residual risk and benefit, especially in respect of User Pay transactions is not capable of reasonable estimation at the inception of a long-term contractual

arrangement and accordingly should be reflected as a contingent liability until the point at which it can be reasonably estimated.

- 9) It would be beneficial to include an example of a PPP transaction that would not meet the control provisions. The example provided is not realistic and exposes the challenges in the control provisions identified above.

CCPPP recommends detailed changes to the control example and recommends the addition of an example where control criteria are not met.

Under CCPPP's control recognition recommendations the vast majority of Availability Payment (Financial Obligation) transactions would satisfy the control conditions whereas the majority of User Pay (Performance Obligation) transactions would not meet the control requirements because there is uncertainty (or absence) of future payments, there is inherent risk transfer and lack of ability to reasonably estimate residual value.

CCPPP's Alternative View is more nuanced and less binary with the degree of control being reflected in the nature of the asset and liability recognized. Under IFRIC 12 (4), service concession assets in the private sector deemed to be under the control of the public sector entity are still recorded on the entity balance sheet as a financial asset without raising concerns with respect to double counting.

One option may be to recognize a PPP as a financial instrument and offset the asset and the obligation in a swap-like transaction where the government is regarded as paying a premium to hedge the asset residual risk. The premium cannot be limited to the financing differential between the private and the public sector but rather the entire capital portion is a premium to cover the risk of delivering the required service performance levels and the O&M costs associated with these plus the risk of the asset residual value that remains unconfirmed until expiry or a few years preceding expiry.

In this respect, the cost of finance (debt credit spreads and equity premiums charged by lenders and investors) in PPP is not a function of the cost to finance the asset itself but to mainly hedge against construction, operation and maintenance poor performance and default. The higher the scope of maintenance and operation (including revenue risk), regardless of the asset value, the higher will be the private sector rate.

Public sector accounting should not, therefore, attempt to artificially pre-suppose these choices by attempting to identify an asset value and corresponding financing cost where there may be an inability to quantify such a cost.

CCPPP recommends an approach that is consistent across both availability style and user pay PPP transactions. In both cases the economic substance of the transaction should be recognised through recognition of the stream of payments between the public sector and private concessionaire.

Initial Measurement

The Council divides its comments on Initial Measurement between Financial Obligation (Availability Payment) transactions and Performance Obligation (User Pay) transactions.

CCPPP agrees in principle with the statement that the cost of the infrastructure should be measured initially at the infrastructure asset's fair value; however the Council believes the provisions of the standard and the application guidance in respect of how fair value should be estimated require additional work.

CCPPP's comments with respect to Financial Obligation transactions can be summarized as:

- 1) The Exposure Draft places excessive reliance on historic cost as the basis for Fair Value
 - Ignores the likelihood of embedded O&M costs in bid prices
 - Establishes capital costs by means of an artificial point in time (Substantial Completion) rather than based on the substance of the costs

CCPPP recommends that the Exposure Draft wording is amended to: *“Relative Fair Value of the asset and O&M components of the transaction can be estimated from the public sector comparator (or similar estimates of what the government may choose to build) and from the bids submitted as part of a competitive tender process.”*

The Exposure Draft provides insufficient and potentially misleading guidance in respect to the separation of capital and operating & maintenance components of a PPP transaction. **CCPPP recommends** that the proposed standard on the separation of capital and operating & maintenance components of a PPP transaction include the wording:

“Payments under a service concession agreement should only be considered separable where one of the following conditions is met:

- a) *There is part of the payment stream that varies according to the availability of the service concession asset itself and another part which varies according to the usage or performance of certain services with no cross deductions between the two payment streams, or:*
- b) *Different components of the service concession arrangement run for different periods or can be terminated separately. For example, a material individual service component can be terminated without affecting the continuation of the rest of the agreement, or:*
- c) *Different components of the service concession arrangement can be negotiated separately. For example, a service component is market tested and some or all (a material portion) of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified*
- d) *The grantor has an unconditional obligation to make a predetermined series of payments to the operator, consistent with IPSAS 32 AG37-38.”*

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- 2) The Exposure Draft is insufficiently clear that a PPP asset should be amortized over its useful life rather than the term of the PPP concession.

CCPPP recommends that the standard should explicitly require an analysis of the expected useful life and residual value under the PPP transaction and that the amortization period should reflect this analysis.

- 3) Financial Obligations are recognized and presented in the same way regardless of their nature and conditionality. IPSAS 32 suggests that only unconditional obligations should be recognized as a Financial Obligation.

CCPPP recommends that the asset which exists at substantial completion should only be recorded as an asset in the grantor's financial statements to the extent that the grantor has made unconditional obligations to pay for it or a portion of it. It is too early at this stage to know whether the asset has achieved its forecast fair value or whether it suffers from impairment. We note that the grantor explicitly does not accept completion of the asset at service commencement. Recognition of the full value of the asset would not be prudent.

CCPPP also recommends that the grantor's liabilities should clearly distinguish between:

- a. Financial indebtedness
- b. Unconditional payments
- c. Payments conditional on performance

CCPPP's Alternative View is that many of the potential public sector liabilities created under PPP transactions are contingent in nature and it is accordingly inappropriate to recognize an asset value and corresponding liability at inception which may not be capable of reasonable estimation. This is compounded by weaknesses in the Exposure Draft guidance with respect to subsequent measurement. In most Canadian PPPs, including availability payment based transactions, the obligation to pay future payments is not an unconditional financial obligation. It is entirely performance related and subject to deductions. It should therefore represent payment for a service proportionately undelivered and accordingly should be expensed. Only where a portion of the future payments are effectively guaranteed (for example through an explicit separation of capital payment and protection against deductions or through capped deductions) should the future payments be recognized as a financial obligation and capitalized. Where the government does choose to make financial commitments that are certain in nature and reflect an asset value rather than the provision of a service which is proportionately unperformed throughout the concession term, then these should be recognized as the proportionate acquisition of an underlying asset.

Initial Measurement: Performance Obligations

CCPPP has very significant concerns with the application of the Performance Obligation to user pay transactions, which can be summarized as:

- 1) Recognition of an asset at inception of a transaction under which the financial and economic risks and benefits have been transferred to a third-party private sector partner for an extended period of time is inappropriate and not prudent.

CCPPP recommends that asset recognition should only occur when a reasonable estimation can be made of the residual value interest. In most cases, asset value should be recognized proportionately as the term of the PPP concession progresses.

- 2) Recognition of a corresponding “performance obligation” liability to offset this asset recognition is also inappropriate.

CCPPP recommends that a “performance obligation” should only be recognized where the public sector entity has a meaningful and measurable liability (for example an obligation to make up shortfalls in forecast revenues or make some other adjustment to price or concession term to guarantee the private sector partner a return).

- 3) Some potential public sector obligations, including relief events due to construction risks materializing or PPP default that may ultimately require government to step in, are remote events that are unquantifiable and therefore clearly fall under the definition of contingent liability. For example, a BBB user-pay infrastructure project is assigned a probability of default of 8% over 35 years based on both S&P and Moody’s Project Finance historical data. Government obligations to step in to provide service will only arise with 8% chance and if they do the magnitude of the impact is only based on the damages to be remediated and the quantum of security both of which cannot be determined reasonably. This example illustrates an inconsistent aspect of the proposed standard where an event with a low probability and an unquantifiable impact is recorded as a full liability on the balance sheet.

CCPPP recommends such obligations should be noted as contingent liabilities unless and until they are triggered by default events.

- 4) Use of the term “performance obligation” for the public sector liability is misleading and confusing since the actual performance obligations under a PPP are requirements on the private sector partner.

Should there be a continuing need for the term then **CCPPP recommends** using the term “Self-supported user pay obligation” which we consider better reflects the nature of any potential liability.

- 5) The proposed approach leaves little room for reflecting different types of user pay transactions including the more nuanced approach of user pay transactions in which risks are shared between government and private sector partners.

CCPPP recommends that the Exposure Draft should provide clear guidance on the conditions under which the public sector entity has a meaningful and measurable liability which it should recognize.

- 6) Unlike IPSAS 32 (BC32), the Exposure Draft does not make a distinction between a user pay transaction under which the operator is guaranteed by the grantor a certain level of revenues or net return on investment and one in which demand risk is taken fully by the operator. CCPPP considers this distinction important.

CCPPP recommends that the Exposure Draft is amended to reflect this situation to ensure that a public sector liability is not recorded where no meaningful or measurable liability exists.

- 7) Whether or not it is desirable, establishing Fair Value of the asset and the timing and nature of the corresponding liability is extremely challenging. The Exposure Draft implies the same methodology as for a Financial Obligation transaction.

CCPPP recommends that, to the extent initial asset measurement is required following CCPPP’s recommendations; the Exposure provides specific guidance on estimation for user pay assets.

- 8) To the extent that the current Exposure Draft approach is retained, CCPPP notes that “performance obligation” liabilities should be clearly distinguished as “self-supported user pay obligations” which do not reflect a financial liability in the presentation of financial statements.

Overall **CCPPP recommends** that the concept of a performance obligation liability is removed from the standard except in circumstances where the government grantor has a clear liability for a shortfall in revenues. CCPPP also recommends that greater guidance is provided in this regard.

Public Sector Capital Contributions

The Exposure Draft is silent on the fact that most Canadian Availability Payment transactions include significant payments by the Grantor during construction and at substantial completion and that these payments are financed by taxpayer supported indebtedness that is unrelated to the performance of the project. Such indebtedness should evidently be recorded as a liability.

CCPPP recommends that such unconditional indebtedness should be recorded as a different class of liability from performance payments to the private sector partner, which are conditional in nature. Such indebtedness will typically be incurred at a different finance charge and repayment profile from payments under the PPP and should not be confused with the Contract Rate.

In the typical Canadian availability payment PPP, these grantor payments for construction are now very material relative to long-term private sector financing exposed to performance-based availability payments. This trend is driven by a desire to reduce financing costs in a public sector accounting environment where no distinction is made between the risks of paying for construction compared to paying for long-term operational performance.

Under CCCPP's Alternative View, these payments are unconditional obligations and should be reflected as such, while availability payments are conditional on performance.

Discount Rate

CCPPP applauds the decision in the Exposure Draft that the discount rate applicable to calculating initial capital value from a stream of future payments should be the weighted average cost of capital of the private sector partner. The use of any other rate, and in particular the cost of government borrowing, would result in a capital cost that does not reflect reality. For example, the same asset delivered in Gatineau and Ottawa will have two different values simply because the provinces of Ontario and Quebec have different rates.

However, this in itself is not sufficient to determine accurately the fair market value of the infrastructure asset because it is also necessary to distinguish between payments made in respect of the capital cost and payments that are related to the risks of long-term operation, maintenance and life cycle.

Consistent with our Alternative View, **CCPPP recommends** the cost of capital of a transaction could be used as a reasonable proxy for the level of risk transfer and accordingly measurement of the fair market value of a PPP transaction.

Timing of recognition

The Exposure Draft currently does not address whether Interest During Construction (IDC) should be capitalized. This represents a material difference between conventionally procured assets which do not typically capitalize IDC and PPP transactions which typically incorporate this in the costs to completion. (Section 5.1)

CCPPP recommends adding more guidelines on when these development/early works should be capitalized (Section 5.2)

Subsequent Measurement

CCPPP finds the Exposure Draft needs to be strengthened on the subject of subsequent measurement. While this is beyond the scope of the Exposure Draft alone, CCPPP believes a major impediment to the efficient delivery of infrastructure by the public sector is the lack of timely revaluation or impairment of assets relative to private sector accounting requirements. This encourages, for example, common practices such as the creation of significant maintenance deficits without any discipline imposed by the risk of impairment or reduction in useful economic life. PPPs are a mechanism to introduce commercial disciplines to public sector infrastructure and so impairments can be easily observable. However, CCPPP is concerned that if PPP accounting treatment is the same as that for public sector delivery then many of the potential advantages will be lost.

CCPPP's comments can be summarized as:

- 1) The Exposure Draft currently does not address how a capital cost overrun absorbed by the private sector partner should be treated. Following the Exposure Draft logic of replacement cost equaling historic cost, this should in theory result in an increase in the asset recognized but with no corresponding increase in the public sector liability. The net result would then be a reduction in the finance charge as a percentage of asset value. This makes sense to CCPPP as the higher cost of financing a PPP is intended to cover the risk of cost overruns.
- 2) The Exposure Draft currently does not address how consistent performance deductions of O&M payments should be treated. A similar logic should apply to a capital cost overrun except in this case it could be argued that the asset value is impaired.
- 3) A significant contractual event, such as a termination for default, would not necessarily have any effect on the accounting treatment. **CCPPP recommends** that a contingent event of this nature should result in a change in the asset and liability recorded.
- 4) The Exposure Draft treats significant life cycle expenditure as an expense even if it is necessary to achieve the useful economic life of the asset (for example a new roof). A betterment which would be capitalized is narrowly defined as an investment which expands the service capacity of the asset. **CCPPP**

recommends that replacement of a material component of an asset necessary to its useful life should be capitalized rather than expensed.

- 5) Subsequent Measurement under user pay or Performance Obligation transactions is even more important and challenging since there is a likelihood of significant variability in the user pay revenue streams which are used as a proxy for amortization of the performance obligation. Consistent with our recommendations on initial measurement of user pay assets, **CCPPP recommends** the Exposure Draft should provide guidance on fair market valuation of user pay assets if there is a continuing desire to record an asset and liability.

Presentation and Disclosure

The Exposure Draft is not as clear as IPSAS 32 that PPP transactions (or service concession arrangements) should be presented as a separate and distinct class of assets.

CCPPP recommends that more guidance on disclosure should be added. It is important to note why and when a liability is a contingent liability to be disclosed in the financial statements and when it is normal to record a liability (although based on an unlikely scenario) and then disclose that is not an “actual liability or debt obligation”

Transitional Arrangements

CCPPP does not anticipate any challenges with the transitional arrangements with respect to the current Exposure Draft as we believe the proposed approach is not materially different from that current followed by most Canadian jurisdictions. However, **CCPPP recommends** significant additional stakeholder consultation prior to any new standard taking effect. The Council would be happy to provide a platform for this consultation.