



Response due by 30 June 2008

ACCOUNTING STANDARDS BOARD

PROPOSED

GUIDELINE ON ACCOUNTING FOR PUBLIC- PRIVATE PARTNERSHIPS

**Issued by the
Accounting Standards Board
April 2008**



Commenting on the guideline

This proposed guideline on *Accounting for Public-private Partnerships* was prepared and published by the Accounting Standards Board (the Board). The proposals in the guideline may be modified in the final document in the light of comment received, before being issued as a final guideline.

Comment should be submitted in writing so as to be received by **30 June 2008**. E-mail responses are preferred. Unless respondents to the proposed guideline specifically request confidentiality, their comment is a matter of public record once the guideline on *Accounting for Public-private Partnerships* has been issued. Comment should be addressed to:

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Background to the development of the proposed guideline

At the August 2005 Board meeting, the Board approved the exposure of the proposed *Guideline on Accounting for Public-private Partnerships* for a period of two months. After considering the comment received during the exposure period, the Board agreed at its March 2006 meeting that the finalisation of the guideline should be postponed until the International Financial Reporting Interpretations Committee's (IFRIC) interpretation on service concessions had been issued, and until the results from the two tender projects undertaken by the National Treasury have been completed. The International Accounting Standards Board (IASB) issued the final IFRIC interpretation (IFRIC 12 *Service Concession Arrangements*) towards the end of 2006. The outcome of the two tender projects, one that involved a review aimed at the management of contingent liabilities incurred by the state through PPP agreements, and the other involving the review of the principles in the proposed guideline against four approved PPP agreements, were made available during November 2006. The results of both processes, i.e. the National Treasury project and the IFRIC process in developing IFRIC 12, were incorporated into the draft guide.

The Board has agreed to re-issue the proposed guideline for comment to allow preparers, users, auditors, standard setters and other parties with an interest in public sector financial reporting, a further opportunity to consider the revisions made to the guideline.

Due process and timetable

The due process followed by the Board in developing guidelines is similar to the due process followed in developing Standards of GRAP, in that the Board receives comment on the proposals set out in the guidelines from preparers, users, auditors, standard setters and other parties with an interest in public sector financial reporting. Accordingly, all interested parties are invited to provide comment.

Proposed guidelines usually have a comment period of three (3) months, although shorter or longer periods may be used for certain guidelines, depending on the urgency to issue the final guideline. Upon the closure of the comment period, the Board will consider all the comment received on a proposed guideline and may modify each proposed guideline in the light of the comment received before issuing a final guideline.

In developing this guideline, the Board has adopted the principles in the Standards of GRAP. The Board further considered:

- the legislative framework applicable in South Africa; and
- recent developments in pronouncements issued by other authoritative accounting standard setters.

International discussion paper on service concession arrangements

IFRIC 12 provides guidance to private sector entities who are normally the operator in a service concession arrangement, on reporting property associated with the agreement. Because the focus of IFRIC 12 is on the operator alone, the International Public Sector



Accounting Standards Board (IPSASB) initiated its own project on service concession arrangements. A consultation paper was issued during March 2008 as the first phase of the IPSASB's project. The objective of the consultation paper is to explore the accounting and financial reporting issues related to service concession arrangements. The consultation paper identifies various issues and provides proposals to be considered by the IPSASB in the development of authoritative international public sector requirements for accounting and reporting of service concession arrangements. Copies of the consultation paper can be downloaded from the IFAC website at <https://www.ifac.org>. Comment on the IPSASB discussion paper is invited until 1 August 2008.

The principles in the consultation paper was considered and taken into account in the development of the proposed guideline. The principles in the consultation paper were adjusted for South African specific circumstances, taking into account the principles in the Standards of GRAP that are approved by the Board.

The Board seeks comment on the specific matters for comment raised in the discussion paper issued by the IPSASB, to enable the Board to consider constituents comment in formulating a response to the international discussion paper. The comment received on the consultation paper will also be used to finalise the proposed guideline. Reference should be made to page 5 of the discussion paper to comment on the specific matters requested by the IPSASB.

Invitation to comment

Comment is invited until **30 June 2008** on this proposed guideline. The Board requires respondents to express an overall opinion on whether the proposed guideline, in general, is supported, and supplement this opinion with detailed comment, whether supportive or critical, on the principles in the proposed guideline. Respondents are also invited to provide detailed comment identifying the specific paragraphs to which it relates, explaining the issue and suggesting alternative wording, with supporting reasoning where this is appropriate.

The basis for accepting or rejecting significant comment will be published on the Board's website. Comment on any other matter will be welcomed. Comment is most helpful if reference is made to a specific paragraph or group of paragraphs.

Specific matters for comment

The Board seeks comment on the specific matters for comment raised in the international discussion paper issued by the IPSASB by 1 August 2008.

In addition, the Board would particularly appreciate views from respondents on the following questions by 30 June 2008:

1. This guideline outlines the Board's views on accounting for public-private-partnership (PPP) agreements by incorporating principles from the relevant Standards of GRAP. The Board is of the view that no new principles were established in this guideline, but that the principles in this guideline are based on those included in the approved Standards of GRAP. Do you agree with this view? If not, please explain your response.



2. The Board would like to have your view on the usefulness of this guideline. If you are of the view that the guideline could be more useful, please indicate the area where more guidance should be included and in what way the usefulness of the guidance could be improved.



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Objective and authority of this guideline

In accordance with section 89 of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), the Board's functions include the preparation and publication of directives, guidelines and interpretations concerning the Standards of GRAP set by the Board. While Standards of GRAP set out the recognition, measurement, presentation and disclosure requirements for financial reporting in the public sector, guidelines are used to explain and expand upon the Standards of GRAP. Guidelines will, however, not replace any of the principles in the Standards of GRAP.

This guideline outlines the Board's views on accounting for public-private partnership (PPP) agreements by a public sector entity, incorporating principles from the relevant Standards of GRAP. This guideline only illustrates the proposed accounting by a public sector entity that is the grantor under the PPP agreement, and not the accounting by a private party that is the operator in a PPP agreement. In November 2006, the International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC 12 *Service Concession Arrangements* that provides guidance to operators on reporting the asset associated with the PPP agreement. Where a public sector entity is an operator under the PPP agreement, the guidance in IFRIC 12 on reporting the asset associated with the PPP agreement should be considered.

Application of this guideline

The Board is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

- (a) departments (national and provincial);
- (b) public entities;
- (c) constitutional institutions;
- (d) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- (e) Parliament and the provincial legislatures.

The above are collectively referred to as "entities" in Standards of GRAP.

Other entities that are not required to comply with the Standards of GRAP can however also apply the principles in this guideline to similar agreements entered into in determining the appropriate financial reporting of such agreements.

The application of this guideline will be determined after the Board has followed its due process, and after consultation with the Minister of Finance as determined by section 91 of the PFMA.



1. BACKGROUND TO PUBLIC-PRIVATE PARTNERSHIP AGREEMENTS

Objective of this section

- 1.1 In recent years, more and more public sector entities are making use of the capacity and skills of private sector entities to assist with service delivery and infrastructure needs.
- 1.2 PPP agreements are an alternative to the traditional procurement methods used by public sector entities aimed at improving value for money, through high quality services that will result in a net benefit to the entity in terms of cost, price, quality or risk transfer, or a combination thereof. The infusion of private capital and management can ease fiscal constraints on public sector infrastructure and increase efficiency, which will lead to better quality and lower cost services for citizens.
- 1.3 A PPP can generally be described as an agreement between a public sector entity (entity) and a private sector institution (private party), in terms of which the private party assumes some financial, construction, technical and operational risk in the design, financing, building and operation of a project. It typically involves a private party that supplies an asset and/or services that have traditionally been developed or provided by a public sector entity. The private party provides public services through the asset and/or the management of such an asset. In return, the private party will receive a payment from the public sector entity based on service outputs delivered to specification.
- 1.4 This section provides background information on what a PPP agreement entails. It explains, amongst other things, the characteristics, the sharing of risks, the parties involved, the types of PPP agreements, and the various funding structures in a PPP agreement.

Characteristics of a PPP agreement

- 1.5 A common characteristic of all PPP agreements is the creation of a partnership between the entity and a private party for the delivery of a public service. This may require the development or construction of an asset required for the delivery of the public service. The private party assumes responsibility for supplying a service traditionally provided by the entity to meet clearly defined public needs.
- 1.6 Other features that may be dealt with in a PPP agreement include the following:
 - The agreement may stipulate the level or standards of the service required during the period and any assets to be used in providing such a service.
 - The private party assumes responsibility for some, or all, of the management of the assets and related services.



- The PPP agreement may govern the initial prices charged for the servicing by the private party and may regulate the price revisions over the period of the agreement.
- The agreement may govern the design, building and financing of an asset to be used by the private party and place restrictions on how the asset may be used.
- The PPP agreement may include arrangements or options for the asset at the end of the agreement term, which can include the legal passing of title to the private party for a fixed or nominal price, irrespective of which party initially financed the asset.

Defining a PPP

- 1.7 Certain enactments in South Africa deal with the establishment and functioning of PPP agreements in the public sector environment. Treasury Regulations, issued under the PFMA, define a public-private partnership as a commercial transaction between an institution and a private party in terms of which the private party:
- (a) performs an institutional function on behalf of the institution; and/or
 - (b) acquires the use of state property for its own commercial purposes; and
 - (c) assumes substantial financial, technical and operational risks in connection with the performance of the institutional function and/or use of state property; and
 - (d) receives a benefit for performing the institutional function or from utilising the state property, either by way of:
 - (i) consideration to be paid by the institution which derives from a Revenue Fund or, where the institution is a national government business enterprise or a provincial government business enterprise, from the revenues of such institution; or
 - (ii) charges or fees to be collected by the private party from users or customers of a service provided to them; or
 - (iii) a combination of such consideration and such charges or fees.
- 1.8 The definition of a PPP agreement in the Treasury Regulations to the Municipal Finance Management Act, Act No 56 of 2003 (MFMA), is similar to the definition in the Treasury Regulations of the PFMA. The MFMA Treasury Regulations define a PPP agreement as a commercial transaction between a municipality and a private party in terms of which the private party:
- (a) performs a municipal function for or on behalf of a municipality or acquires the management or use of municipal property for its own commercial purposes, or both performs a municipal function for or on behalf of a municipality and acquires the management or use of municipal property for its own commercial purposes; and



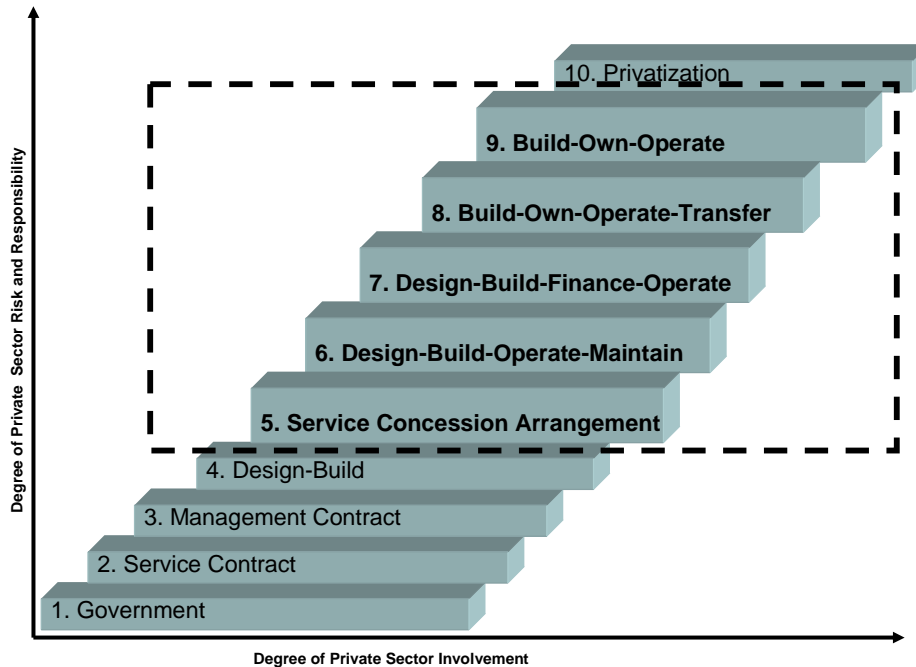
- (b) assumes substantial financial, technical and operational risks in connection with
 - (i) the performance of the municipal function;
 - (ii) the management or use of the municipal property; or
 - (iii) both; and
- (c) receives a benefit for performing the municipal function or from utilising the municipal property or from both, by way of –
 - (i) consideration to be paid or given by the municipality or a municipal entity under the sole or shared control of the municipality;
 - (ii) charges or fees to be collected by the private party from users or customers of a service provided to them; or
 - (iii) a combination of the benefits referred to in subparagraphs (i) and (ii).

Parties involved in a PPP agreement

- 1.9 The definition of a PPP agreement in the Treasury Regulations to the PFMA and MFMA identifies the involvement of two parties to the agreement, i.e. a public sector entity and a private party.
- 1.10 Public sector entities are collectively referred to as “entities”, as explained in the section “application of this guideline”.
- 1.11 The Treasury Regulations define a private party as a party to a PPP agreement, other than:
 - (a) an institution to which the PFMA applies;
 - (b) a municipality or municipal entity under the ownership control of one or more municipalities; or
 - (c) the accounting officer, accounting authority or other person or body acting on behalf of an institution, municipality or municipal entity referred to in (a) or (b).

Types of PPP agreements

- 1.12 PPP agreements are often distinguished based on the extent of private sector involvement and the extent to which risks are shared between the entity and the private party. As mentioned previously, PPP agreements are a different form of procurement. There are, however, other methods of involving the private party in public service delivery. The diagram below illustrates some of the more common procurement methods by an entity from a private party. The type of agreements that are within the scope of this guideline are included in the block:



- 1.13 Guidance on accounting for agreements that are not included in the scope of this guideline can be obtained in other Standards of GRAP. For example, a service and management contract is similar to other vendor service contracts. In such agreements, the related outlays are reported as an expense by the entity as and when these services are provided by the private party. Design-build agreements should be accounted for similarly to other types of construction-related contracts, with the asset being reported as appropriate, based on the principles in the applicable Standard of GRAP, for example, the Standard of GRAP on *Property, Plant and Equipment* (GRAP 17). In such agreements, ownership of the asset remains with the entity, together with the majority of the risks, responsibilities and control of the asset and the services being delivered.

Service concession agreement

- 1.14 In a service concession agreement, the entity transfers the right to provide services to the public through the use of an asset to the private party. The private party in turn assumes an obligation to provide such services, normally in accordance with performance requirements set forth by the entity. Compared to service or management contracts, service concession agreements are much longer in term, often so that the private party has the opportunity to earn an acceptable rate of return on its investment in the project. Examples of this type of PPP agreement include the SANRAL concession, Inkosi Albert Luthuli hospital and the Western Cape Rehabilitation/Lentegeur hospital.



Design-build-operate-maintain and design-build-finance-operate agreement

- 1.15 In a design-build-operate-maintain (DBOM) agreement, the aspects of design-build agreements are combined with those of service concession agreements. The private party assumes the risks of constructing an asset along with the risks of its operation and maintenance.
- 1.16 In a design-build-finance-operate (DBFO) agreement, the private party designs and builds the asset, finances the construction costs, and provides the associated services.
- 1.17 The difference between a DBOM and DBFO agreement lies in the allocation of the financing risk to the private party. In both DBOM and DBFO agreements, the asset will be returned to the entity at the end of the arrangement. An example of these types of PPP agreements are the 25 year PPP agreement between the department of correctional services and a private party in terms of which the private party has to design, finance, maintain and operate two prisons as well as head office accommodation projects such as the department of education.

Build-own-operate-transfer and build-own-operate agreements

- 1.18 In a build-own-operate-transfer (BOOT) agreement, ownership of the constructed asset rests with the private party until the end of the agreement, at which time ownership is transferred to the entity. Thus, in addition to the risks and responsibilities that are allocated in a DBFO agreement, the risk and responsibilities related to the asset are also allocated to the private party during the agreement. A build-own-operate (BOO) agreement differs from a BOOT agreement in that the private party is not required to transfer ownership of the constructed asset back to the entity. An example of these types of PPP agreements is the agreement between the department of labour and a private party for the provision, maintenance and upgrading of the department's computer system.

Categories of PPP agreements

- 1.19 The definition of a PPP agreement in the PFMA and the MFMA identifies two broad categories of PPP agreements, one where the private party performs an institutional function on behalf of the entity, and the other where the private party acquires the use of state property for its own commercial purposes. The PPP agreement can, however, also be a combination of these categories.

Institutional function

- 1.20 In a PPP agreement involving an institutional function, the private party will perform part of an entity's service delivery or administrative functions and assume the associated risks. The agreement involves a substantial transfer of some form of project life cycle risk to the private party. The entity, however, retains a significant role in the partnership project either as the main purchaser of the services provided or as the main enabler of the project.



- 1.21 The essence of these types of PPP agreements is the provision of services that may or may not include the construction of an asset, or the use of an existing asset that will allow the private party to deliver the specified service.
- 1.22 Under this category, the private party is rewarded for providing the service by compensation from the revenue funds, the entity's own resources, from user charges or a combination of these sources.

Use of state property

- 1.23 In a PPP agreement involving the use of state property, the entity transfers the right to use a specified asset to the private party for a specific period. During the term of the PPP agreement, the private party uses the asset, whether an existing asset or an asset to be developed or constructed, for its own commercial purpose. The entity, on the other hand, shares a percentage of the revenue generated by the private party for the duration of the PPP agreement. An example of such a PPP agreement is the De Hoop nature tourism development with the Western Cape Nature Conservation Board.
- 1.24 Under this category, the entity does not contribute any payment towards the development or construction of the asset. Instead, the private party needs to arrange its own funding to meet the capital or other expenditure requirements of the project.

Institutional function and use of state property

- 1.25 An entity can also enter into a PPP agreement that involves a combination of an institutional function and the use of state property. For example, a private party and an entity enter into a PPP agreement that requires the private party to operate and maintain an X-ray facility in a ward at a public hospital on behalf of the department of health. In addition to performing the institutional function, the private party is allowed the use of another ward in the public hospital for its own commercial purpose.

Risk characteristics in a PPP agreement

- 1.26 A PPP agreement often involves complex risks, which are shared between the entity and the private party. The private party usually assumes substantial financial, technical and operational risks in connection with the performance of the institutional function and/or use of state property. The compensation of the private party is based on a payment mechanism that provides for penalties in case of under or non performance of agreed deliverables.
- 1.27 Common risks associated with a PPP agreement include the following:
- *Financial risk.* Financial risk is the risk that the entity is not be able to acquire the funding needed for the project or that the funding is acquired at interest rates that prevent a project from achieving improved value for money. This might be due to the circumstances of the specific entity or the private party due to, for example, the credit status or debt limitations of the party involved



or investor perceptions of the risks of a project. Other financial risks include that of inflation and exchange rates.

- *Technical and operational risk.* This risk encompasses a broad range of risks that exist once the asset is in operation. Examples include price increases or shortages of input materials, increases in labour costs, damage as a result of natural disasters, costs related to deferring maintenance and obsolescence.
- *Demand risk.* This is the risk relating to variability in the amount of services required or consumed by users of the asset, i.e. the risk that the demand for the service is less than projected.
- *Availability risk.* This is the risk of the asset not providing sufficient output, for example, because of insufficient management or not meeting the required quality standards to provide service.
- *Construction risk.* This risk encapsulates the numerous issues that may be encountered during the construction phase of a project, such as budget overruns, building material defects, construction delays, planning regulation, structural integrity issues with existing assets, equipment, technical deficiencies, health risks, worksite accidents and other catastrophic events.
- *Residual value risk.* This risk relates to the market price of the asset at the end of the PPP arrangement varying from the original expectation.

1.28 In the traditional procurement process, the private party completes the project while carrying most, if not all, of the risks associated with the project. Under a PPP agreement, risks are allocated between the entity and the private party on the basis of which can best manage the risks in the particular circumstances of the project.

Funding structures in a PPP agreement

1.29 Some PPP agreements are highly capital intensive and require the private party to obtain specific funding in order to perform the service, or to construct or develop an asset to give effect to the requirements in the PPP agreement.

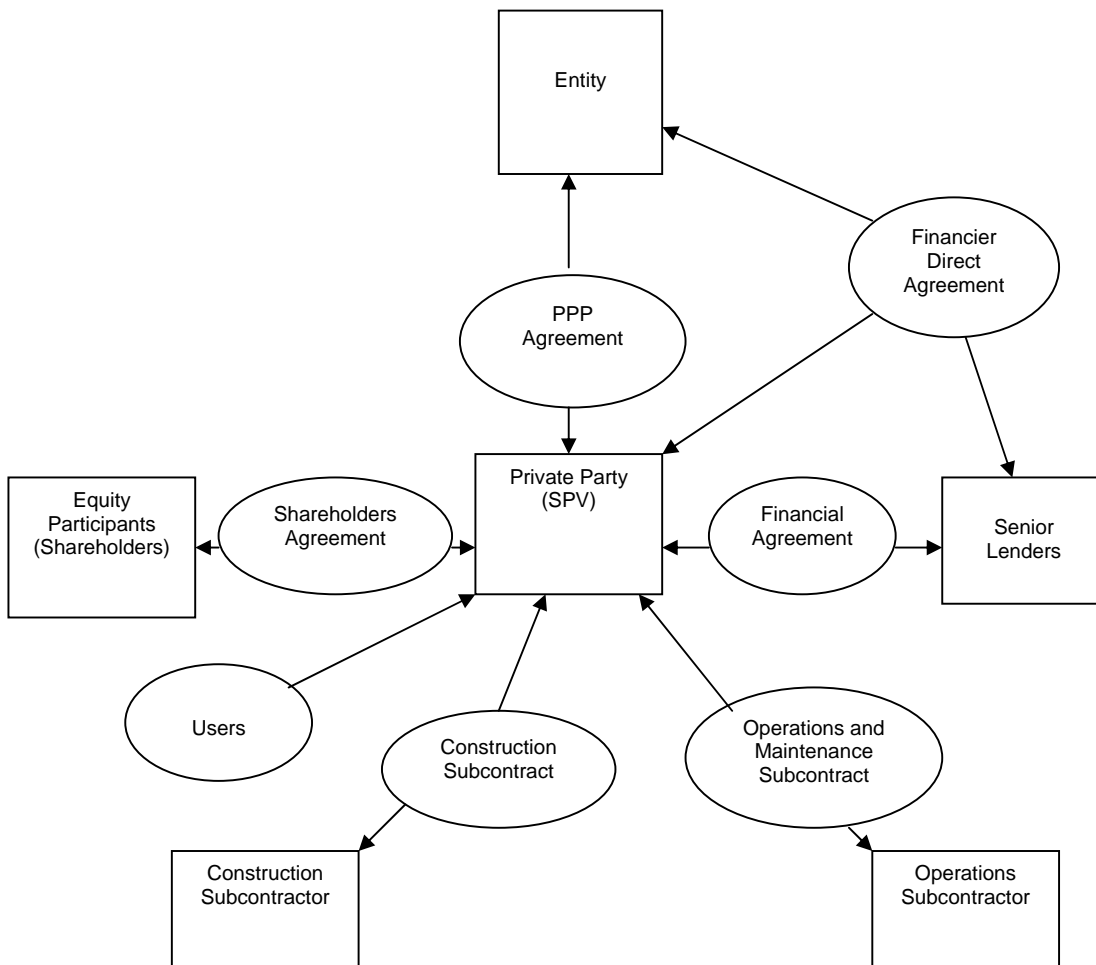
1.30 Financing for PPP investments can be raised by the private party in various ways, including capital contributions or third party finance. A special purpose vehicle (SPV) may be established to provide a vehicle through which the funding is channelled.

1.31 A SPV is established to ring-fence the project and/or the asset that may be required to perform the provisions under the PPP agreement. Substantial funding is normally provided by lenders, who will look primarily to the cash flows to be generated from the project to service the debt.

1.32 For PPP agreements that are not highly capital intensive, projects are normally funded by the private party itself from its own resources, including the raising of loans from corporate finance transactions, or through a capital contribution by the entity, or a combination of both.

Special Purpose Vehicle

1.33 The diagram below illustrates a PPP agreement where a SPV is established:



1.34 The private party is responsible for exercising the rights and performing the obligations under the PPP agreement through the SPV.

1.35 Shareholders invest in the SPV either in the form of shares or shareholder loans. Agreements are entered into between the shareholders and the established SPV.

1.36 The SPV may procure a large portion of the funding from lenders that provide funding for the project.



- 1.37 Lenders are typically given step-in rights in the financial agreements, which rights apply in the event of non-performance by the SPV. These step-in rights are aimed at restoring the service, or replacing the current service provider with one acceptable to the entity so as to secure the ongoing delivery of services.
- 1.38 The SPV will enter into agreements with construction, operation and maintenance subcontractors. These subcontractors are the service providers responsible for the construction of any assets and/or the operation and maintenance of the asset under the PPP agreement.
- 1.39 For more guidance on the establishment of a SPV, reference should be made to the manual on Standardised Public Private Partnership Provision issued by the National Treasury (see www.ppp.gov.za).

Corporate finance

- 1.40 In a corporate finance structure, the private party arranges the funding necessary to meet the capital and other expenditure requirements of the project from its own resources.
- 1.41 Under section 66(1) of the PFMA, an entity may not issue a guarantee, indemnity or security that binds or may bind the entity or the revenue fund in respect of debt raised by the private party, unless the requirements in section 66(2) have been complied with.
- 1.42 Similarly, under section 50 of the MFMA, a municipality may not issue any guarantee for any commitment or debt of any organ of state or person, except where the municipality has complied with the legislative requirements.

Capital contributions by the entity

- 1.43 A PPP agreement may also require capital contributions to the project by the entity. This usually occurs where the funds are required by the private party in the acquisition of an asset that will either immediately or on termination of the PPP agreement become the entity's asset.
- 1.44 An example of such an agreement is the PPP agreement between the state vaccine institute and the department of health in KwaZulu Natal. Under this PPP agreement, the department was required to make a cash contribution to the state vaccine institute party for the capital costs of the project.
- 1.45 These funding structures are, however, not used very often in PPP agreements, and are, therefore, not addressed in this guideline.
- 1.46 Reference should also be made to the Standards of GRAP on *Consolidated and Separate Financial Statements* (GRAP 6) and *Investments in Associates* (GRAP 7) and the Standards of GRAP on Financial Instruments for guidance on how the entity accounts for its share or equity interest when such capital contributions are made. The contribution is either accounted for as an investment, an investment in



an associate or an investment in a controlled entity, based on the degree of control over the investee's financial and operating policies.

- 1.47 For more information on the various funding structures in a PPP agreement, reference should be made to the manual on Standardised Public Private Partnership Provisions issued by the National Treasury (see section C of the Preface to the manual).

Compensation provisions in a PPP agreement

- 1.48 In some PPP agreements, the private party receives compensation from the entity when performing its obligations under the PPP agreement. This compensation can be made in various ways, as explained in paragraphs 1.7 and 1.8. The Treasury Regulations issued under the PFMA and MFMA allow for the benefit to be either by way of:

- compensation to be paid by the entity, for example from the resources of such an entity; or
- charges or fees to be collected by the private party from users or customers of a service provided to them, for example, where the private party collects toll fees from the users of a toll-road; or
- a combination of the above.

- 1.49 The provisions of the PPP agreements may also require the entity to contribute some funding to the project. This compensation can be made by the entity either as part of a unitary payment or can be in the form of an upfront payment to the private party (see section 7 of this guideline).

Unitary payment

- 1.50 The PPP definition in the Treasury Regulations requires the payment of a benefit to the private party for performing the services. This benefit is referred to as a unitary payment in the National Treasury Standardised PPP Provisions Manual.
- 1.51 The PPP agreement normally specifies the levels of service required from the private party over the period of the contract, and the private party's basic responsibilities for the delivery of services. Unitary payments are due when the conditions of the PPP agreement are met.
- 1.52 The frequency of unitary payments is also established by the PPP agreement, e.g. monthly, quarterly or annually.
- 1.53 The unitary payments may comprise compensation for services and/or the development or construction of an asset, depending on the nature of the PPP agreement.



- 1.54 The unitary payments can be made by a transfer from the relevant revenue fund or from the entity's own resources.
- 1.55 Unitary payments made from the revenue funds must be appropriated by the relevant legislature in terms of the applicable budget requirements and budgeted accordingly.

Charges or fees to be collected by the private party from users

- 1.56 Compensation to the private party can also be from user charges received from users. For example, the private party receives toll fees charged as compensation for managing the toll road. In some instances, the entity guarantees the minimum fees to be received by the private party. The PPP agreement may also set a limit on the user charges the private party is entitled to receive. Amounts received in excess of that limit are paid back to the entity.

Reduction of unitary payment for user charges collected

- 1.57 Unitary payments can also consist of a combination of transfers from the relevant revenue fund or from the entity's own resources and can be reduced by the collection of user charges by the private party. For example, the entity can partly compensate the private party for the development or construction of a toll road. After the construction of the toll road, the private party charges toll fees to the users of the toll road for the duration of the PPP agreement.



2. APPROACH TO BE ADOPTED IN DETERMINING OWNERSHIP OF AN ASSET IN A PPP AGREEMENT

- 2.1 In a typical PPP agreement, the risks, responsibilities, benefits and control of the asset are shared between the entity and the private party based on which party is in the best position to manage the particular risk. Basing the financial reporting of the asset used in a PPP agreement solely on its legal ownership, may not result in fair presentation of the financial effects of the agreement. Fair presentation requires a proper understanding of the substance rather than the legal form of the PPP agreement which varies from agreement to agreement.
- 2.2 The objective of this section is to provide guidance to assist an entity to establish which party should recognise assets that are used by the private party in performing the specified service under the PPP agreement.

Determining which party should account for the asset

- 2.3 Many countries currently apply their existing authoritative accounting and financial reporting guidance, such as their general accounting framework and leasing standards, to account for the assets involved in PPP agreements. Some standard-setting bodies have issued or proposed guidance on PPP agreements. This guidance assesses either a control approach or a risk and rewards approach to determine the appropriate recognition of the asset associated with the agreement. This section of the guideline considers when the control and risk and rewards approach should be adopted.

Local pronouncements

- 2.4 The Framework sets out the principles on which the Standards of GRAP are based. The Framework also sets out the concepts that underlie the preparation and presentation of financial statements.
- 2.5 The Framework defines an asset as a resource controlled by an entity as a result of past events and from which economic benefits or service potential is expected to flow to the entity. The Framework notes that many assets are associated with legal rights, including the right of ownership, and goes on to clarify that the right of ownership is not essential. To achieve faithful representation, the Framework requires that transactions and other events are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The principles of the Framework require an asset to be accounted for by the party that controls it using the overriding principle of “substance over form”. Conversely, an entity cannot recognise an asset it does not control. The Framework therefore adopts a control approach.
- 2.6 GRAP 17 defines property, plant and equipment as items held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and which are expected to be used during more than one period. This definition applies control by the party that recognises it as an asset.



2.7 On the other hand, the Standard of GRAP on *Leases* (GRAP 13) adopts a risk and rewards approach. GRAP 13 defines a lease as an agreement whereby the lessor conveys to the lessee in return for a series of payments the right to use an asset. The classification of a lease is based on the extent to which the risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. A lease agreement is, however, not a risk-sharing agreement, as the treatment of the asset in a lease agreement is determined by who bears substantially all the risks and rewards incidental to the ownership of the asset.

Private sector pronouncements

2.8 The IFRIC 12 interpretation on *Service Concession Arrangements* gives guidance to the private party on accounting for assets associated with PPP agreements. The IFRIC considered the nature of the rights conveyed to the operator in a PPP agreement. The IFRIC interpretation concludes that a control approach should be applied in determining which party should account for the assets that are used, developed or constructed in a PPP agreement.

2.9 IFRIC 12 is applied by the private party when:

- the entity controls or regulates what services the private party must provide with the associated asset, to whom the service should be provided and at what price, and
- the entity controls, through ownership, entitlement or otherwise, the significant residual interest in the asset at the end of the agreement.

2.10 The IFRIC applies when the private party is required to construct or develop an asset for the purpose of the PPP agreement or when the entity gives the private party access to its existing assets to be upgraded and maintained for the duration of the PPP agreement. The IFRIC does not apply when the private party is required to use, and maintains ownership of, its own assets during, and at the end of, the PPP agreement.

2.11 The IFRIC concluded that the treatment of an asset that the private party constructs or acquires, or to which the entity gives the private party access for the purpose of the PPP agreement, should be determined by whether or not it is controlled by the entity in the manner described in paragraph 2.9. If it is so controlled, then, regardless of which party has legal title to it during the agreement, the asset should not be recognised by the private party because the private party does not control the use of the public service asset.

2.12 The IFRIC further concluded that, in PPP agreements, rights are usually conveyed for a limited period, which is similar to a lease. However, for agreements within the scope of IFRIC 12, the private party's right is different from that of a lessee. Unlike a lessee, the private party does not have a right of use of the underlying asset. Rather it has access to operate the asset to provide the public service in accordance with the terms specified in the agreement.



- 2.13 The control approach adopted in IFRIC 12 is based on the principle that the entity does not transfer the right to control the asset to the other party, but only the right of access to the asset for the duration of the PPP agreement.
- 2.14 The IFRIC considered whether the scope of the interpretation might overlap with IFRIC 4 *Determining whether an Arrangement Contains a Lease*. The IFRIC amended the scope of IFRIC 4 to specify that if a PPP agreement met the scope requirements of IFRIC 12, IFRIC 4 will not apply.

Approach adopted in this guideline

- 2.15 The Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23) requires that *control of an asset* arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit. GRAP 23 requires that 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 from which they benefit.
- 2.16 Assets are associated with legal rights, including the right of ownership. In determining whether or not an entity should recognise the asset, the right of ownership is not essential. Although the capacity of an entity to control benefits is usually the result of legal rights, the asset may nonetheless satisfy the definition of an asset even when there is no legal ownership.
- 2.17 Furthermore, entities that have custody of an asset may not have all the legal powers of ownership, such as the right to sell it. There may also be restrictions on the entity's use of the asset. However, this does not necessarily mean that the entity does not control access to future economic benefits or service potential. To satisfy the requirement for control, the entity does not need unlimited power over the physical item. Instead, it is the rights or access to future economic benefits or service potential that need to be controlled.
- 2.18 IFRIC 12 concludes that for a PPP agreement to fall within its scope, the private party does not control the use of the asset, rather it has access to operate the asset to provide the public service in accordance with the terms specified in the agreement. This implies that the entity controls the use of the asset.
- 2.19 The private party, however, still has some control over the use of the asset, as it has the ability to manage the use of the asset. For example, in a toll-road PPP agreement, the agreement may specify certain conditions that the private party must comply with, but how such conditions are met is left to the discretion of the private party.
- 2.20 This guideline therefore adopts the control approach in determining whether the entity should account for the asset in a PPP agreement. This approach is in line with the definition of an asset in the Framework. The combination of the criteria



set out in IFRIC 12 establishes that the entity has a continuing right to have the asset operated to meet its public service objectives throughout the life of the agreement, and that the private party's ability to sell or pledge the asset is restricted. Despite the private party's discretion over the delivery of certain aspects of the services generated by the asset, the entity remains in control of the operational aspects as required by IFRIC 12.

- 2.21 This approach also applies if the entity provides the private party with an existing asset, and the private party upgrades, operates and maintains the asset for a specified period of time. If the PPP agreement requires the private party to use its own asset, the entity should only account for the asset in its financial statements if the entity controls and regulates the service that the private party provides, as required by IFRIC 12.
- 2.22 To conclude, the criteria for determining whether the entity controls the use of the underlying asset are similar to the scope requirements for agreements covered under IFRIC 12, which are as follows:
- The entity controls or regulates what services the private party must provide with the associated asset, to whom it must provide them and at what price.
 - The entity controls - through ownership, beneficial entitlement or otherwise - any significant residual interest in the asset at the end of the arrangement.

PPP agreements where the control approach is not met

- 2.23 If the control approach is not met by the entity, the next step will be to consider the principles in IFRIC 4 to determine whether the agreement constitutes a lease. If it is concluded that the agreement constitutes a lease, the principles in GRAP 13 should be considered to determine whether the lease should be classified as a finance lease or an operating lease.
- 2.24 If the entity concludes that the PPP agreement does not constitute a lease then any payments made to the private party under the agreement should be expensed as incurred, similar to a service contract.
- 2.25 If the underlying asset is owned by the entity at the start of the PPP agreement, the asset should be derecognised by the entity in accordance with the principles in the applicable Standard of GRAP (for example GRAP 17).

IFRIC 4 Determining whether an agreement contains a lease

- 2.26 The interpretation of IFRIC to assist an entity to determine whether an agreement contains a lease, requires an entity to consider the substance over the form of the agreement. The entity needs to assess whether:
- (a) fulfilment of the agreement is dependent on the use of a specific asset or assets; and
 - (b) the agreement conveys the right to use the asset or assets.



- 2.27 In the case of a PPP agreement, the second determining factor should be considered. The interpretation states that an agreement conveys the right to use the asset if the agreement conveys to the lessee (the entity) the right to control the use of the underlying asset. One of the conditions, which determine that the right to control the use of the underlying asset is conveyed, is if the lessee has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling a significant amount of the output or other use of the asset.
- 2.28 The entity needs to assess whether the agreement contains a lease at the inception of the agreement, being the earlier of the date of the agreement and the date of commitment by the parties to the principal terms of the agreement, on the basis of all of the facts and circumstances.
- 2.29 The interpretation concludes that, if an agreement contains a lease, the parties to the agreement shall apply the requirements of the International Accounting Standard on *Leases* (IAS 17) to the lease element of the agreement. The requirements in the IAS 17 are similar to the requirements in GRAP 13, except that GRAP 13, in addition, deals with public sector specific issues. Entities should, therefore, refer to GRAP 13.

Classification of a lease as either a finance lease or as an operating lease

- 2.30 If it is decided that the PPP agreement constitutes a lease, it is necessary to determine whether the lease is a finance or operating lease.
- 2.31 This decision is based on the extent to which risks and rewards incidental to ownership of a leased asset are transferred to the private party. GRAP 13 requires that a lease should be classified as a finance lease if the agreement transfers substantially all the risks and rewards incidental to ownership. If not, the lease should be classified as an operating lease.
- 2.32 The decision on the type of lease is based on the substance of the transaction rather than the legal form of the contract. GRAP 13 provides the following examples of situations which would normally lead to a lease being classified as a finance lease, even though not all the criteria are met:
- (a) The lease transfers ownership of the asset to the lessee by the end of the lease term.
 - (b) The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, so that at the inception of the lease it is reasonably certain that the option will be exercised.
 - (c) The lease term is for the major part of the economic life of the asset even if title is not transferred.
 - (d) At the inception of the lease, the present value of the minimum lease payments amount to at least substantially all of the fair value of the leased assets.

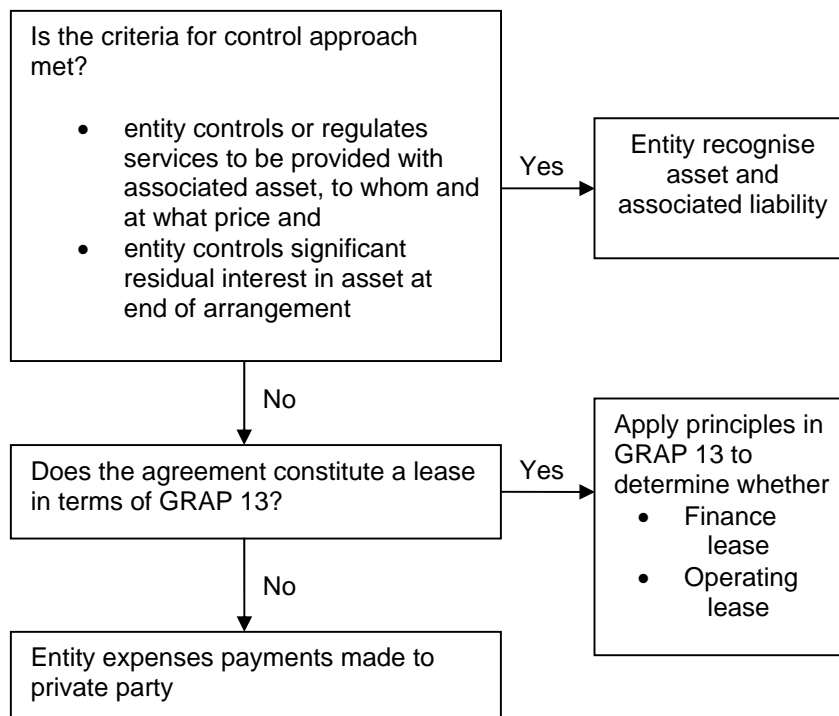
- (e) The leased assets are of a specialised nature such that only the lessee can use them without major modifications being made.
- (f) The leased assets cannot easily be replaced by other assets.

2.33 Other criteria that individually or in combination could lead to a lease being classified as a finance lease are:

- (a) if the lessee can cancel the lease, and the lessor's losses associated with the cancellation are borne by the lessee,
- (b) gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example in the form of a rent rebate equaling most of the sales proceeds at the end of the lease), and
- (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

Diagram illustrating approach to be adopted in determining ownership of an asset in a PPP agreement

2.34 The diagram below summarises the approach discussed in this section in determining ownership of assets in a PPP agreement:





3. RECOGNITION AND MEASUREMENT OF ASSETS IN A PPP AGREEMENT

- 3.1 This section deals with the principles of recognition and measurement when the entity controls an existing, or newly constructed, asset or developed asset using the control approach, or when the risks and rewards incidental to the ownership of such an asset passes to the entity at the end of the PPP agreement.

Timing of the recognition of assets

- 3.2 When the private party is required to develop or construct an asset, the principles in the applicable Standard of GRAP should be applied to determine whether the entity should recognise the asset while under construction, or only when the development or construction of such an asset is completed and the asset becomes operational.
- 3.3 GRAP 17.11 requires an item of property, plant and equipment to be recognised as an asset when:
- it is probable that future economic benefits or service potential associated with the asset will flow to the entity; and
 - the cost or fair value of the asset to the entity can be measured reliably.
- 3.4 Similar principles apply to recognising other assets such as inventory, investment property, intangible assets or heritage assets (see the Standards of GRAP on



Inventories (GRAP 12), *Investment Property* (GRAP 16), *Intangible Assets* (GRAP 102) or *Heritage Assets*).

- 3.5 The probability that future economic benefits or service potential associated with the asset will flow to the entity is determined on the basis of the available evidence at the time of initial recognition.
- 3.6 The entity may assume construction risk, for example, where constitution of an asset under the PPP agreement involves risks due to geological and environmental factors that exceed the level of construction risk that the private party is willing to accept. Under these circumstances, the entity recognises the asset while it is being constructed, because the construction risk passes to the entity prior to the completion of its construction.
- 3.7 However, in a PPP agreement where the private party bears the construction risk, the timing of recognition is different. As construction risk remains with the private party and the asset is not yet in use, the risks and rewards associated with the asset do not pass to the entity during construction.



Measurement of assets

- 3.8 This section deals with the measurement of the asset. The measurement of the liability reflecting the entity's obligation for the asset is dealt with in the next section.

Separating the asset and service element of the unitary payment

- 3.9 In some instances, the PPP agreement will not specifically distinguish between the service element and the asset element of the unitary payment. The service element of the unitary payment relates to services provided by the private party, such as repairs, maintenance and service delivery. The asset element relates to the development or construction of the asset. The entity therefore needs to analyse the amount of a unitary payment between the service and asset elements in order to account for the transaction.

Separable payments

- 3.10 If the PPP agreement specifies the service element and the asset element of the unitary payment, the principles in the applicable Standard of GRAP should be applied to the initial measurement of the asset. For example, GRAP 17.21 and .22 require that an item of property, plant and equipment should initially be recognised at cost or fair value. Similar principles apply for initially measuring inventory, investment property, intangible assets or heritage assets in the GRAP 12, 16, 102 and the Standard of GRAP on *Heritage Assets*.
- 3.11 The cost of the asset is therefore measured as the amount equal to the present value of the scheduled payments, unless the fair value of the asset is lower.

Inseparable payments

- 3.12 If the PPP agreement does not separate the service and asset elements of the unitary payment, the entity needs to determine the fair value of the asset constructed or developed at the inception of the PPP agreement to allocate the asset element of the unitary payment.
- 3.13 Similarly, the entity needs to determine the fair value of the services to be provided under the PPP agreement. This will constitute the service element of the unitary payment.
- 3.14 The remainder of the unitary payment, after deducting the fair value of the service and asset element, may constitute an onerous payment. Paragraph .86 of the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19) requires an entity to recognise and measure the present obligation under an onerous contract as a provision. If, however, the fair value of the service and asset elements is more than the unitary payment, an entity should recognise an asset if, and only if, the definition of an asset is met. Reference should be made to the applicable Standards of GRAP for guidance on the recognition and measurement of such an asset. If the definition of an asset is not met, the difference should be recognised in the statement of financial performance.



Example of inseparable payments

An entity enters into a 10 year PPP agreement with a private party in terms of which the private party is required to construct a building from which a service will be delivered. An annual unitary payment is made by the entity of R1 500 000, which includes a service element and an asset element. The fair value of the building at the start of the PPP agreement is estimated at R12 000 000. The fair value of the services to be provided under similar agreements is estimated at R2 500 000 at the inception of the PPP agreement. Inflation, finance costs and value for money are ignored in the illustration.

Asset element:

R12 000 000

Annual service element:

R2 500 000/10years = R250 000

Onerous element of the contract:

(unitary payment payable over term of PPP agreement less fair value of asset less fair value of service)

$((R1\ 500\ 000 \times 10\text{yrs}) - R12\ 000\ 000 - R2\ 500\ 000 = R\ 500\ 000.$

- 3.15 If the unitary payment consists of an asset payment for more than one asset, the fair value of the service element and each asset needs to be determined at the start of the PPP agreement.

Subsequent measurement of newly constructed or developed assets

- 3.16 The measurement principles in the applicable Standard of GRAP (for example, GRAP 12, 16, 17, 102 and the Standard of GRAP on *Heritage Assets*) should be applied subsequent to the initial recognition of the asset by the entity.

Entity's existing assets to be used in the PPP agreement

- 3.17 When the PPP agreement requires the private party to use an entity's existing asset and upgrade, operate and maintain it for a specified period of time, the entity should continue to account for the asset if the control criteria and/or the definition of an asset are met.
- 3.18 For more guidance on the measurement, recognition and disclosure of the asset, reference should be made to the applicable Standard of GRAP (for example, GRAP 12, 16, 17, 102 and the Standard of GRAP on *Heritage Assets*).

Private party's assets to be used in the PPP agreement

- 3.19 Where the private party is required to use its own asset, the entity should only account for that asset in its financial statements if the control criteria and/or the



definition of an asset are met. In this case, the entity should recognise the private party's previously owned asset at fair value by applying the principles in the applicable Standard of GRAP.



4. ACCOUNTING FOR THE SERVICE ELEMENT IN THE PPP AGREEMENT

4.1 This section explains accounting for the service element of the unitary payment.

Recognition and measurement of the service element

4.2 The service element of the unitary payment relates to services provided by the private party, such as repairs, maintenance and service delivery. The obligation is recognised on the date that the service is delivered by the private party, irrespective of when payment is made.

4.3 The expense is recognised on a straight line basis, over the duration of the agreement, unless another systematic basis is more representative of the time pattern of the service delivery. For more guidance on the recognition of expenses on a straight line basis, reference should be made to the applicable Standards of GRAP.

Example: Recognition of service element on systematic basis

A PPP agreement requires a private party to manage a building for an entity for two years. At the inception of the agreement, the entity is liable for a single payment of R180 000 to the private party for providing the service. Annual inflation increases in the service element are not taken into account for illustration purposes.

Journal entries

| Year X1 | Debit | Credit |
|---|--------|---------|
| Service costs (R180 000/2 years) | 90 000 | |
| Prepaid service payment | 90 000 | |
| Liability/Bank account (Payment of single service payment) | | 180 000 |
| | | |
| Year X2 | | |
| Service costs (R180 000/2 years) | 90 000 | |
| Prepaid service payment | | 90 000 |
| (Recognition of single service payment) | | |

Example: Recognition of annual service element escalating over contract period on a systematic basis

A PPP agreement requires a private party to manage a sub-station for a municipality for three years. The municipality is liable for three annual payments at the inception of the agreement, payable at the start of each financial year. The annual payments are R30 000, R33 000 and R36 300.



Journal entries

| Year X1 | Debit | Credit |
|--|--------------|---------------|
| Service costs (R30 000 + R33 000 + R36 300)/3 years | 33 100 | |
| Prepaid service payment | | 3 100 |
| Liability/Bank account | | 30 000 |
| (Payment of annual service payment) | | |
| | | |
| Year X2 | Debit | Credit |
| Service costs (R30 000 + R33 000 + R36 300)/3 years | 33 100 | |
| Prepaid service payment | | 100 |
| Liability/Bank account | | 33 000 |
| (Recognition of annual service payment) | | |
| | | |
| Year X3 | Debit | Credit |
| Service costs (R30 000 + R33 000 + R36 300)/3 years | 33 100 | |
| Prepaid service payment | 3 200 | |
| Liability/Bank account | | 36 300 |
| (Recognition of annual service payment) | | |



5. RECOGNITION OF THE ENTITY'S OBLIGATION IN THE PPP AGREEMENT

Recognition of the obligation when the control approach is applied to the recognition of assets

- 5.1 IFRIC 12 requires the private party to account for its right in the PPP agreement as a financial asset, to the extent that the operator has an unconditional present right to receive cash from, or at the direction of, the entity for the construction services; and the entity has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The private party therefore has a contractual right to receive cash for the construction services if the entity contractually guarantees the private party's cash flows.
- 5.2 In the basis for conclusions to the IFRIC 12 (see BC48), it is argued that, in the absence of contractual arrangements designed to ensure that the private party receives a minimum amount, the private party has no contractual right to receive cash, even if receipt of the cash is highly probable. Rather, the private party has an opportunity to charge those that use the public service in the future. The private party bears the demand risk, and, hence its commercial return is contingent on users using the public service. The private party's asset is a right to access, which would be classified as an intangible asset within the scope of the International Standard on *Intangible Assets* (IAS 38), the public sector equivalent being GRAP 102.
- 5.3 IFRIC 12 concluded that, in PPP agreements, rights are usually conveyed for a limited period, which is similar to a lease. However, for agreements within the scope of IFRIC 12, the private party's right is different from that of a lessee – the entity retains control over the use to which the asset is put, by controlling or regulating what services the private party must provide, to whom it must provide them, and at what price. The entity also retains control over any significant residual interest in the asset throughout the period of the agreement. Unlike a lessee, the private party does not have a right of use of the asset - rather it has access to operate the asset to provide the public service in accordance with the terms specified in the PPP agreement.
- 5.4 The converse should therefore apply from a public sector perspective. Thus, applying the control approach will result in the entity recognising an obligation for the asset under the PPP agreement. The obligation should be accounted for as a financial liability.

Recognition of a financial liability

- 5.5 The International Accounting Standard on *Financial Instruments: Presentation* (IAS 32) defines a financial liability as:
- “Any liability that is:



- (a) a contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
 - (b) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments."
- 5.6 The Board recently issued an *Invitation to Comment on the Discussion Paper on Financial Instruments* where certain amendments to the IAS 32 definition on a financial liability are proposed.
- 5.7 The Board has not yet completed the development of the Standard of GRAP on Financial Instruments. Entities should therefore, in the absence of a Standard of GRAP on Financial Instruments apply the guidance in IAS 32, the International Accounting Standard on *Financial Instruments: Recognition and Measurement* (IAS 39) and the International Financial Reporting Standard on *Financial Instruments: Disclosures* (IFRS 7) in the recognition, measurement and disclosure of a financial liability.
- 5.8 When the entity makes the scheduled payments to the private party under the PPP agreement, the entity should allocate the payments between the amount that reduces the financial liability associated with the asset, and the finance charges. For guidance on the use of an interest rate in calculating the finance charge portion, reference should be made to the Standards of GRAP on Financial Instruments.

Recognition of the obligation when the control approach is not applied to the recognition of assets

- 5.9 When the entity does not control the asset under the control approach, the principles in IFRIC 4 should be considered to determine whether the agreement constitutes a lease. These principles were discussed in the previous section.
- 5.10 If the entity then concludes that the agreement constitutes a lease, reference should be made to GRAP 13 that provides guidance to establish whether a lease should be classified as a finance lease or an operating lease. If the agreement constitutes a finance lease, GRAP 13.34 requires the entity to recognise the lease liability in the statement of financial position at amounts equal to the fair



value of the leased property or, if lower, the present value of the minimum lease payments. For the presentation of liabilities on the face of the statement of financial position, a distinction should be made between current and non-current liabilities. Reference should also be made to GRAP 19 for more guidance on the measurement and disclosure of liabilities.

- 5.11 If the agreement does not meet the definition of a finance lease and is therefore an operating lease, no liability is recognised. Instead, in accordance with GRAP 13.48, lease payments under an operating lease are recognised as an expense in the statement of financial performance on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit. Reference should, however, be made to GRAP 19 for more guidance on the recognition and measurement of liabilities, provisions and/or contingent liabilities.



6. ACCOUNTING FOR REVENUE RECEIVED FROM A PPP AGREEMENT

- 6.1 The compensation payable to the private party can take various forms, one of which allows the private party to collect user fees from the users instead of, or in addition to, receiving a unitary payment from the entity. For example, in a toll road PPP agreement managed by a private party, the entity compensates the private party by allowing it to collect toll fees from users up to a maximum amount.
- 6.2 Revenue-sharing by the entity is generally based on the principles that the revenue earned by the private party should exceed an agreed threshold or the revenue required should provide a specified rate of return to the private party. Revenue collected by the private party in excess of such a threshold is paid over to the entity. In some cases the entity guarantees the minimum amount of revenue that the private party should earn in excess of such thresholds.
- 6.3 A PPP agreement may provide for the entity to share in a percentage of the revenue earned by the private party during the PPP agreement. The PPP agreement may also provide for the entity to receive an upfront payment from the private party in consideration for entering into a PPP agreement.
- 6.4 This section considers the accounting implications for the various types of revenue received by the entity in PPP agreements, including upfront payments.

Revenue sharing provisions

- 6.5 In PPP agreements, where the private party is allowed to use an asset of the entity for its own commercial purposes during the period of the PPP agreement, the entity does not normally make any unitary payments to the private party. Instead, the private party arranges its own funding to meet the capital or other expenditure requirements of the project. In these types of PPP agreements, the entity may share a percentage of the revenue generated by the private party under the PPP agreement.

Recognition and measurement

- 6.6 To determine the appropriate method of recognising the revenue received by the entity under revenue sharing provisions, reference should be made to the principles in the Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9), which requires that revenue received should be measured at the fair value of the consideration received or receivable. In most instances, the consideration is in the form of cash or cash equivalents, and the amount of revenue is accordingly the amount of cash or cash equivalents received or receivable by the entity. The amount of revenue arising from such a transaction is usually determined by agreement between the entity and the private party.



- 6.7 The entity should understand the terms and conditions of the PPP agreement in order to determine when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity.
- 6.8 Revenue received from revenue sharing provisions that are based on reaching a threshold or guaranteed maximum should only be recognised when that threshold or guaranteed maximum has been reached.

Upfront payments to the entity

- 6.9 A typical example of an upfront payment is a payment by the private party in consideration for the concession rights associated with the PPP agreement. In some cases, the payment from the private party is a stream of fixed payments of cash or promissory notes over the life of the PPP agreement.

Recognition and measurement

- 6.10 The essential accounting issues related to the contractual fixed payments are the timing of the recognition and measurement of the revenue in the entity's financial statements. Again, the principles in GRAP 9 should be applied to the recognition and measurement of any upfront payments received by the entity.
- 6.11 Upfront payments under PPP agreements are made, for example, to compensate the entity for the right to operate the associated asset. These rights extend over the duration of the PPP agreement. The entity should therefore recognise revenue from the upfront payment on a straight line basis over the life of the PPP agreement, starting at the commencement of the PPP term.

Disclosure of revenue received

- 6.12 GRAP 9 requires that the following disclosures should be made with regard to revenue:
- (a) The accounting policies adopted for the recognition of revenue.
 - (b) The amount of each significant category of revenue during the period.



7. OTHER ACCOUNTING CONSIDERATIONS

Costs incurred prior to the finalisation of the PPP agreement

- 7.1 Entities contemplating a PPP agreement may incur certain costs, irrespective of whether the agreement is ultimately entered into.
- 7.2 Such costs could involve environmental impact assessments, consensus surveys for the rezoning of land, consensus surveys for the land use and other costs incurred in assessing the feasibility of the project. These costs are normally borne by the entity.
- 7.3 GRAP 102 requires that expenditure on research or on the research phase of an internal project should be recognised as an expense when it is incurred. This will include, for example, costs incurred at the feasibility stage of a project. Only when the criteria for development costs as set in GRAP 102 are met, can these costs be capitalised as part of the property, plant and equipment.
- 7.4 For guidance on the research and development costs, reference should also be made to GRAP 102, and for guidance on the recognition of initial and subsequent costs, reference should again be made to GRAP 17.

Step-in arrangements

- 7.5 In some instances, the PPP agreement provides for the entity to take over the services provided by the private party, to ensure continuity of an essential public service. Such an event could be triggered by external events or the failure of the private party.
- 7.6 This right is commonly referred to as a “step-in”, as it involves the entity, or another party appointed by the entity, to take over some or all of the private party’s obligations for a period until the problems are resolved. The period of the step-in will depend on the circumstances necessitating the step-in, and will be at the sole and absolute discretion of the entity.
- 7.7 Step-in penalty deductions may be made from the unitary payments. Such penalty deductions normally relate to the service element of the PPP agreement. The reduced unitary payment will only impact on the expense recognised in the statement of financial performance when the reduced payment is accounted for by the entity in its financial statements.

Provisions, contingent liabilities and contingent assets

Provisions and contingent liabilities

- 7.8 Entities can incur obligations under PPP agreements mainly in three areas, i.e. an obligation to compensate the private party in the form of unitary payments, an obligation arising from the termination of the PPP agreement and the issue of a guarantee, indemnity or security on behalf of the private party.



Obligations to compensate the private party in the form of unitary payments

- 7.9 The entity's obligation to compensate the private party in the form of unitary payments was discussed in the previous section. The section concluded that where the entity controls the asset, the corresponding obligation is accounted for as a financial liability.
- 7.10 When the agreement constitutes a lease as required by GRAP 13, the entity's obligation should be accounted for either as a finance lease or as an operating lease in accordance with GRAP 13.
- 7.11 If the control approach is not met, and the agreement does not constitute a lease, the entity should apply the principles in GRAP 19 to determine to what extent other liabilities and provisions should be recognised as a result of entering into a PPP agreement.

Obligations arising from termination of the PPP agreement

- 7.12 The entity will also incur a liability in situations where the entity or the private party fails to meet its obligations under the PPP agreement. This normally results in the early termination of the PPP agreement. Under such circumstances, the entity can incur a liability to compensate the private party as a result of the termination of the PPP agreement. A liability should be recognised by the entity to the extent that the principles in GRAP 19 are met.

Issue of a guarantee, indemnity or security on behalf of the private party

- 7.13 As discussed in section 1, PPP agreements can involve the private party raising finance in various ways, including capital contributions and third party finance.
- 7.14 In instances where the private party raises debt through third party finance, section 66(1) of the PFMA prohibits the entity from issuing a guarantee, indemnity or security that binds, or may bind the entity or the revenue funds, unless the conditions in section 66(2) have been complied with.
- 7.15 Similar to the PFMA, section 50 of the MFMA determines that a municipality may not issue any guarantee for any commitment or debt to any organ of state or person, except when the municipality has complied with all the relevant legislative requirements.
- 7.16 However, if the legislative requirements of the PFMA and MFMA are met and the entity issues a guarantee, indemnity or security on behalf of the private party, it remains necessary to raise provisions and disclose contingent liabilities as appropriate.
- 7.17 IAS 39 provides guidance on the initial recognition of a guarantee. IAS 39.43 determines that a financial liability should initially be recognised at its fair value plus transaction costs that are directly attributable to the issue of the financial liability. The Board recently issued an *Invitation to Comment on the Discussion*



Paper on Financial Instruments where certain amendments to the guidance in IAS 39 are proposed.

- 7.18 In the absence of the Standards of GRAP on Financial Instruments, reference should be made to the IAS 39 for guidance on the initial recognition of an entity's liability in the instances where a guarantee was issued. For subsequent measurement of the guarantee, reference should be made to the GRAP 19.
- 7.19 GRAP 19 requires that all provisions and contingent liabilities should be recognised and disclosed in the financial statements of the entity. For example, a PPP agreement may have been financed through project finance for which the entity issued a guarantee to the lenders. If the private party defaults on the payments, the entity should recognise its obligation under the guarantee as a liability in accordance with IAS 39, and subsequently, apply the principles in GRAP 19 to the obligation.
- 7.20 In PPP agreements with large investment costs and uncertain revenue collections, the entity may guarantee the minimum revenue to be received by the private party. Accounting for such an obligation by the entity is discussed later on in this section.

Other liabilities

- 7.21 The entity can also incur a liability resulting from an obligation to restore environmental damage to land. To the extent that the entity has a present obligation as required by GRAP 19, it should recognise the liability.

Recognition of provisions and liabilities

- 7.22 GRAP 19 requires that an entity should recognise a provision in the annual financial statements when:
- (a) the entity has a present obligation (legal or constructive) as a result of a past event;
 - (b) it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and
 - (c) a reasonably reliable estimate can be made of the amount of the obligation.
- 7.23 Provisions can be distinguished from other liabilities such as payables and accruals due to the uncertainty of the timing or amount of the future expenditure required in settlement. By contrast there is more certainty in the amount of:
- (a) payables, which are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and
 - (b) accruals, which are liabilities to pay for goods or services that have been received or supplied but have not been invoiced or formally agreed with the supplier.



- 7.24 A contingent liability, on the other hand, should only be disclosed in a note to the financial statements. A contingent liability is a:
- possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity (for example default by the private party to repay a loan); or
 - a present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability.
- 7.25 The entity should disclose details of the guarantee in a note to the financial statements when there has been no default that have been guaranteed by the entity in the private party's obligations.

Contingent assets

- 7.26 Contingent assets can also arise under PPP agreements. For example, a claim against a private party in respect of which legal proceedings are continuing. Unless the court rules in favour of the entity, it should disclose the claim as a contingent asset.
- 7.27 As with contingent liabilities, contingent assets are not recognised in the annual financial statements of the entity, but the financial statements should only provide details of the contingency.

Reassessment of contingent liabilities and contingent assets

- 7.28 Contingent liabilities and contingent assets need to be assessed at each reporting date. When it is probable that an inflow or outflow of economic benefits or service potential will occur and the value can be measured reliably, the asset or liability and the related revenue or expense should be recognised in the financial statements.
- 7.29 For more guidance on the recognition, measurement and disclosure requirements for provisions, contingent liabilities and contingent assets, reference should be made to GRAP 19.

Residual amounts of unitary payments

- 7.30 Section 3 discussed the need to analyse the asset and service elements of the unitary payment. If the PPP agreement does not provide information on the amounts of each element, the entity needs to determine the fair value of the asset to be constructed or developed at the start of the PPP agreement, and the fair value of the service to be provided under the PPP agreement. The remainder of the unitary payment, after deducting the fair value of the service and asset



element, may constitute an onerous payment if a positive amount is involved, or an intangible asset if a negative amount is involved.

- 7.31 GRAP 19.86 requires an entity to recognise and measure the present obligation under an onerous contract as a provision. Paragraph 3.14 requires the recognition of an asset if the definition of an asset is met. If however the definition of an asset is not met, the difference should be recognised in the statement of financial performance.

Thresholds for collection of user fees by the private party

- 7.32 As mentioned in previous sections, unitary payments can be reduced by user charges collected by the private party, which may be subject to thresholds and guarantees.
- 7.33 Section 6 deals with the situation where a guaranteed threshold established for a maximum amount of user charges results in payments to the entity.
- 7.34 If the private party collects less than the threshold of user fees, the entity recognises a provision for the shortfall as required by GRAP 19.

Example of thresholds agreed between the entity and the private party

An entity enters into a PPP agreement with a private party for the construction of a toll road to be managed for the next five years. The entity pays an upfront contribution of R100 000 to the private party to subsidise the construction of the toll road. Under the PPP agreement, the private party may collect user charges up to an amount of R1 000 000 per annum. After that, further collections are paid over to the entity. The entity and the private party further agree that the minimum fees to be received by the private party will be R600 000 per annum. The private party completed the toll road in one year. The fair value of the toll road at the start of the PPP agreement is R850 000. The toll road has a five year economic life and is depreciated on a straight-line basis over its economic life.

The following user charges were collected by the private party during the duration of the PPP agreement:

| | |
|---|------------------------|
| <i>X1 = R0 (as toll road was being constructed)</i> | <i>X2 = R500 000</i> |
| <i>X3 = R600 000</i> | <i>X4 = R950 000</i> |
| | <i>X5 = R1 350 000</i> |

Journal entries

Start of PPP agreement (X1)

The entity made a contribution to the private party of R100 000 that will not give rise to a future benefit reduction, as the entity will not make any future payments to the private party. The contribution should be recognised as part of the asset.



The entity recognises the toll road at fair value after construction, based on the control criteria. As the asset is not used in the first year, no depreciation expense is recognised.

| Year X1 | Debit | Credit |
|--|---------|---------|
| Asset | 850 000 | |
| Non-exchange revenue | | 750 000 |
| Bank account | | 100 000 |
| (The toll road is recognised at fair value and represents a net asset inflow for the entity) | | |

Year X2

The private party collects R500 000 in service charges. As the minimum agreed fees to be collected by the private party was R600 000. The entity therefore needs to compensate the private party for the shortfall of R100 000.

| Year X2 | Debit | Credit |
|--|---------|---------|
| Service costs | 100 000 | |
| Liability/Bank account | | 100 000 |
| (Payment of shortfall in terms of guarantee) | | |
| Depreciation | 170 000 | |
| Accumulated depreciation | | 170 000 |
| (850 000/5yrs) | | |

Year X3

The private party collects R600 000 in service charges. As the minimum agreed fee threshold was obtained by the private party, the entity has no obligation towards the private party.

| Year X3 | Debit | Credit |
|--------------------------|---------|---------|
| Depreciation | 170 000 | |
| Accumulated depreciation | | 170 000 |
| (850 000/5yrs) | | |

Year X4

The private party collects R950 000 in service charges. The minimum agreed fees to be collected by the private party was R600 000. As there is no shortfall, the entity has no obligation towards the private party. The private party can collect user charges up to R1 000 000 before user charges are payable to the entity.

| Year X4 | Debit | Credit |
|--------------------------|---------|---------|
| Depreciation | 170 000 | |
| Accumulated depreciation | | 170 000 |
| (850 000/5yrs) | | |

Year X5

The private party collects R1 350 000 in service charges. The minimum agreed fees to be collected by the private party was R600 000, and the maximum agreed



amount of fees to be collected by the private party was R1 000 000. The private party therefore owes the entity R350 000 for user charges collected above the agreed threshold.

| Year X5 | Debit | Credit |
|---|---------|---------|
| Receivable/Bank account | 350 000 | |
| Revenue | | 350 000 |
| (Receipt of user charges more than maximum allowed under the PPP agreement) | | |
| Depreciation | 170 000 | |
| Accumulated depreciation | | 170 000 |
| (850 000/5yrs) | | |

Upfront contributions to the private party

- 7.35 The entity may make upfront contributions to the private party at the inception of the PPP agreement to enable the private party to start functioning under the PPP agreement. These upfront contributions may take a number of forms but normally include an upfront cash payment by the entity.
- 7.36 The accounting treatment of such contributions depends on whether the contributions will give rise to future benefits for the entity. If, as a result of the upfront contribution lower unitary payments will be made in future, the upfront cash payment should be accounted for as a prepayment. It is subsequently recognised as an expense over the term of the PPP agreement.
- 7.37 However, if the upfront contribution does not give rise to future benefits such as a reduction in the unitary payments, the upfront contribution should be accounted for as an expense.
- 7.38 If the upfront cash payment to the private party is to be used for the development or construction of an asset controlled by the entity, the upfront contributions are included in the cost of the developed or constructed asset.

Example of upfront contribution: Future benefit reduction of unitary element

An entity makes an upfront cash payment of R50 000 to a private party under a PPP agreement. As a result of the upfront contribution by the entity, lower unitary payments can be made by the entity during the PPP agreement. The unitary payments for the next ten years amount to R10 000 annually.

Upfront contribution

| | Debit | Credit |
|--|-------|--------|
| | | |



| | | |
|--|--------|--------|
| Prepayment | 50 000 | |
| Bank account | | 50 000 |
| (Contribution of upfront cash payment for future service payments) | | |

Since the upfront contribution results in lower unitary payments, the following annual journal entry should be recorded for the unitary payment:

Annual service payment

| | Debit | Credit |
|---|--------------|---------------|
| Service costs | 15 000 | |
| Prepayment (R50 000/10yrs) | | 5 000 |
| Bank account | | 10 000 |
| (Recognition of actual service element) | | |

Example of upfront contribution: No future benefit reduction

An entity contributed an upfront cash payment of R45 000 to a private party under the PPP agreement. The upfront payment does not result in a reduction of future unitary payments. The unitary payments for the next five years amount to R1 000 per month.

Upfront contribution

| | Debit | Credit |
|----------------------------------|--------------|---------------|
| Service costs | 45 000 | |
| Bank account | | 45 000 |
| (Recognition of upfront payment) | | |

Annual service payment

| | Debit | Credit |
|---|--------------|---------------|
| Service costs (1 000 x 12mths) | 12 000 | |
| Bank account | | 12 000 |
| (Recognition of annual service element) | | |



8. ACCOUNTING FOR THE ENTITY'S INTEREST IN THE SPV

- 8.1 When entering into a PPP agreement, the private party assumes substantial financial, technical and operational risk in the design, financing, building and operation of a project. As discussed in section 1, the private party may obtain finance in various ways, and may establish a special purpose vehicle (SPV) through which to channel the finance.
- 8.2 Usually the entity neither has an equity interest in the SPV nor influences the functions or operations of the SPV. There is, however, nothing to prohibit an entity obtaining an equity interest in the SPV. This section explains how an entity should account for any equity interest in an SPV.

Controlling a share in the SPV

- 8.3 GRAP 6 requires an entity to prepare and present consolidated financial statements for entities under its control. Control is defined as the power to govern the financial and operating policies of another entity, so as to benefit from its activities.
- 8.4 GRAP 6.26 to 6.35 explain the concept of control for the purpose of financial reporting. GRAP 6.35 states that control is presumed to exist when at least one of the following power conditions and one of the following benefit conditions exists:

Power conditions

- (a) The entity has, directly or indirectly through controlled entities, ownership of a majority voting interest in the other entity.
- (b) The entity has the power, either granted by or exercised within existing legislation, to appoint or remove a majority of the members of the board of directors or equivalent governing body, and control of the entity is by that board or body.
- (c) The entity has the power to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of the other entity.
- (d) The entity has the power to cast the majority of votes at meetings of the board of directors or equivalent governing body, and control of the entity is by that board or body.

Benefit conditions

- (a) The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations. For example, the benefit condition may be met if an entity had the responsibility for the residual liabilities of another entity.
- (b) The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.



8.5 GRAP 6.36 further states that, when one or more of the circumstances listed in paragraph .35 does not exist, the following factors are likely, either individually or collectively, to be indicative of the existence of control:

Power indicators

- (a) The entity has the ability to veto operating and capital budgets of the other entity.
- (b) The entity has the ability to veto, overrule or modify governing body decisions of the other entity.
- (c) The entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity.
- (d) The mandate of the other entity is established and limited by legislation.
- (e) The entity holds a “golden share”¹ (or equivalent) in the other entity, which confers rights to govern the financial and operating policies of that other entity.
- (f) The entity has the ability to establish or amend the mission or mandate of the other entity.
- (g) The entity has the ability to establish borrowing or investment limits or restrict the other entity’s investments.
- (h) The entity has the ability to restrict the revenue-generating capacity of the other entity, notably the sources of revenue.

Benefit indicators

- (a) The entity holds direct or indirect title to the net assets of the other entity with an ongoing right to access these.
- (b) The entity has a right to a significant level of the net assets of the other entity in the event of a liquidation or in a distribution other than a liquidation.
- (c) The entity is able to direct the other entity to co-operate with it in achieving its objectives.
- (d) The entity is exposed to the residual liabilities of the other entity.
- (e) The entity has ongoing access to the assets of the other entity, has the ability to direct the ongoing use of those assets or has ongoing responsibility for deficits.

Special purpose entity

8.6 GRAP 6 also addresses the establishment of a special purpose entity for purposes of consolidation. GRAP 6.37 explains that an entity may be created to accomplish a narrow and well-defined objective. Such a special purpose entity may take the form of a corporation, trust, partnership or unincorporated entity.

¹ “Golden share” refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associated with the holder’s ownership interest or representation on the governing body.



Special purpose entities often are created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of their governing board, trustee or management over the operations of the special purpose entity. Frequently, these provisions specify that the policy guiding the ongoing activities of the special purpose entity cannot be modified, other than perhaps by its creator or sponsor.

- 8.7 In the context of a special purpose entity, control may arise through the predetermination of the activities of the special purpose entity or otherwise. GRAP 6.35 sets out the circumstances that result in control, even in cases where an entity owns one half or less of the voting power of another entity. Similarly, control may exist even in cases where an entity owns little or none of the special purpose entity's net assets. The application of the control concept requires judgement in the context of all relevant factors of each case.
- 8.8 Therefore, in addition to the situations described in paragraph .35, the following circumstances may indicate, in substance, a relationship in which an entity controls a special purpose entity and consequently should consolidate the special purpose entity:
- (a) The activities of the special purpose entity are being conducted on behalf of the entity according to its specific operational needs, so that the entity obtains benefits from the special purpose entity's operation.
 - (b) The entity has the decision-making powers to obtain the majority of the benefits of the activities of the special purpose entity or, by setting up an "autopilot" mechanism, the entity has delegated these decision-making powers.
 - (c) The entity has the right to obtain the majority of the benefits of the special purpose entity and, therefore, may be exposed to risks incidental to the activities of the special purpose entity.
 - (d) The entity retains the majority of the residual or ownership risks related to the special purpose entity or its assets in order to obtain benefits from its activities.
- 8.9 If it is therefore evident from the entity's equity interest in the SPV that the entity has control over the SPV, the entity should prepare consolidated financial statements as required by GRAP 6.
- 8.10 For more guidance on the consolidation procedures to be applied in preparing consolidated financial statements, reference should be made to GRAP 6.

Significant influence in the SPV

- 8.11 If the entity's equity interest in the SPV does not meet the control criteria in GRAP 6, it should be considered whether the entity has a significant influence over the SPV. GRAP 7 defines significant influence as the power to participate in the financial and operating policy decisions of the investee, but is not control over those policies.



- 8.12 GRAP 7.10 to 7.16 provides detailed guidance as to when significant influence exists. Paragraph .10 explains that, if an investor holds, directly or indirectly, 20 percent or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly, less than 20 percent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can clearly be demonstrated.
- 8.13 GRAP 7.12 provides the following examples and indicators as evidence that significant influence exist:
- (a) Representation on the board of directors or equivalent governing body of the investee.
 - (b) Participation in policy-making processes.
 - (c) Material transactions between the investor and the investee.
 - (d) Interchange of managerial personnel.
 - (e) Provision of essential technical information.
 - (f) The investor will be involved in decisions regarding strategic issues, such as the expansion or contraction of the business, participation in other entities, products, markets and activities, and determining the balance between dividend and reinvestment.
- 8.14 Therefore, as a result of the entity's equity interest in the SPV, it has a significant influence over the SPV, and the equity method should be used to account for the investment in the SPV.
- 8.15 For more guidance on the application of the equity method, reference should be made to GRAP 7.

Investment in an SPV

- 8.16 If neither control nor significant influence is evident in the entity's equity interest in the SPV, reference should be made to the Standards of GRAP on Financial Instruments to account for the investment in the SPV.

9. OTHER DISCLOSURE REQUIREMENTS

SIC Interpretation 29

- 9.1 SIC Interpretation 29 on *Disclosure – Service Concession Arrangements* prescribes information that has to be disclosed by a concession operator (private party) and the concession provider (entity) in the notes to the financial statements when they have entered into a PPP agreement.



- 9.2 For each PPP agreement that the entity has entered into, the following must be disclosed in a note to the annual financial statements:
- (a) A description of the agreement.
 - (b) Significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows.
 - (c) The nature and extent of:
 - rights to use specified items of property, plant and equipment;
 - obligations to provide or rights to expect provision of services;
 - obligations to acquire or build property, plant and equipment;
 - obligations to deliver or rights to receive specified items of property, plant and equipment at the end of the PPP agreement;
 - renewal and termination options; and
 - other rights and obligations (e.g. major overhauls).
 - (d) Changes in the agreement occurring during the period.
- 9.3 These disclosure requirements should be provided individually for each material PPP agreement or, in aggregate, for PPP agreements of a similar nature.

Finance charges

- 9.4 The Standard of GRAP on *Presentation of Financial Statements* requires that finance charges should be presented on the face of the statement of financial performance at a minimum (see GRAP 1.93(b)).

Asset related Standards

- 9.5 For guidance on the disclosure requirements of items of property, plant and equipment, inventory, investment property, intangible assets or heritage assets that are developed or constructed as a result of a PPP agreement, reference should be made to GRAP 12, 16, 17, 102 or the Standard of GRAP on *Heritage Assets*.

Provisions, contingent liabilities and contingent assets

- 9.6 For guidance on the disclosure requirements of provisions, contingent liabilities and contingent assets, reference should be made to GRAP 19.

Revenue

- 9.7 For guidance on the disclosure requirements of revenue, reference should be made to GRAP 9 and GRAP 23.



Leases

- 9.8 For guidance on the disclosure requirements of leases, reference should be made to GRAP 13.

Interest in SPV

- 9.9 For guidance on the disclosure requirements of the entity's interest in an SPV, either through control, significant influence or as an investment, reference should be made to GRAP 6, GRAP 7 and the Standards of GRAP on Financial Instruments.



10. ACCOUNTING FOR UNITARY PAYMENTS UNDER THE CASH BASIS OF ACCOUNTING

Accounting under the cash basis

- 10.1 Under the cash basis of accounting, transactions and events are recognised when cash is received or paid. Financial results are measured for the period as the difference between cash received and cash paid.
- 10.2 Under the cash basis of accounting, unitary payments made to the private party should be recognised in the statement of financial performance when the payment is made, irrespective of when the service was delivered by the private party.
- 10.3 However, unitary payments need to be distinguished between the asset element and the service element, similar to unitary payments under the accrual basis of accounting. For guidance on how to distinguish a unitary payment between an asset element and a service element, reference should be made to the relevant section of this guideline.
- 10.4 The service element of the unitary payment should be classified as current expenditure, whereas the asset element of the unitary payment should be allocated, in the statement of financial performance, between capital expenditure and current expenditure.
- 10.5 For purposes of the cash basis of accounting, capital expenditure includes expenditure related to an asset with a useful life of more than one year. Capital expenditure specifically excludes expenditure on small loose tools, consumables, etc., as this is considered to be normal current expenditure.
- 10.6 On the other hand, current expenditure under the cash basis of accounting refers to the expenditure on goods and services not classified as transfer payments and not intended for the establishment or acquisition of capital assets.
- 10.7 If the PPP agreement specifies that a portion of the asset element relates to the maintenance of the developed or constructed asset, that part of the unitary payment should be classified as current expenditure, and not as capital expenditure, as it relates to day-to-day service costs.

Disclosure in financial statements

- 10.8 The disclosure requirements discussed in the previous section of this guideline should be provided individually for each material PPP agreement, or in aggregate for each class of PPP agreements of a similar nature.
- 10.9 If the entity has any contingent liabilities or contingent assets under the PPP agreement, such contingent liabilities and/or contingent assets should be disclosed in the annual financial statements. Reference should be made to



section 9 for guidance and examples on the disclosure of contingent liabilities and contingent assets.

Transitional provisions from cash to accrual accounting

- 10.10 The transitional provisions to be applied by entities are prescribed in a directive. Reference should be made to the applicable directive containing the transitional provisions to be applied by entities on initial adoption of accrual accounting.



Glossary of terms

| Terminology | Definition |
|--------------------------------|---|
| Accrual basis | A basis of accounting under which transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognised in the financial statements of the periods to which they relate. The elements recognised under accrual accounting are assets, liabilities, net assets, revenue and expenses. |
| Assets | Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity. |
| Carrying amount | The amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses. |
| Cash | Cash comprises cash on hand and demand deposits. |
| Cash equivalents | Short-term, highly liquid investments that is readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. |
| Commencement of the lease term | The date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e. the recognition of the assets, liabilities, revenue and expenses resulting from the lease, as appropriate). |
| Constructive obligation | An obligation that derives from an entity's actions where: <ul style="list-style-type: none"> (a) by an established pattern of past practice, published policies or a sufficiently specific current Standard, the entity has indicated to other parties that it will accept certain responsibilities, and (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities. |
| Contingent asset | A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. |



| Terminology | Definition |
|---------------------------|--|
| Contingent liability | <p>A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, or a present obligation that arises from past events but is not recognised because:</p> <ul style="list-style-type: none"> (i) it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or (ii) the amount of the obligation cannot be measured with sufficient reliability. |
| Contingent rent | <p>That portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (e.g. percentage of future sales, amount of use, future price indices, future market rates of interest).</p> |
| Contributions from owners | <p>Future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets of the entity, which:</p> <ul style="list-style-type: none"> (a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or (b) Can be sold, exchanged, transferred or redeemed." |
| Control | <p>The power to govern the financial and operating policies of another entity so as to benefit from its activities.</p> |
| Control of an asset | <p>Arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.</p> |
| Cost | <p>The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Standards of GRAP.</p> |



| Terminology | Definition |
|---------------------|--|
| Depreciation | The systematic allocation of the depreciable amount of an asset over its useful life. |
| Economic life | Economic life is either: <ul style="list-style-type: none"> (a) the period over which an asset is expected to yield economic benefits or service potential to one or more users, or (b) the number of production or similar units expected to be obtained from the asset by one or more users. |
| Expenses | Decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence of liabilities that result in decreases in net assets, other than those relating to distributions to owners. |
| Finance lease | A lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred. |
| Financial liability | Any liability that is: <ul style="list-style-type: none"> (a) a contractual obligation: <ul style="list-style-type: none"> (i) to deliver cash or another financial asset to another entity; or (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or (b) a contract that will or may be settled in the entity's own equity instruments and is: <ul style="list-style-type: none"> (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments. |



| Terminology | Definition |
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| Fair value | The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. |
| Government business enterprise | An entity that, in accordance with the Public Finance Management Act, Act No. 1 of 1999, as amended: <ul style="list-style-type: none"> (a) is a juristic person under the ownership control of the national/provincial executive, (b) has been assigned the financial and operational authority to carry on a business activity, (c) as its principal business, provides goods or services in accordance with ordinary business principles, and (d) is financed fully or substantially from sources other than: <ul style="list-style-type: none"> (i) the National or Provincial Revenue Fund; or (ii) by way of a tax, levy or other statutory money. |
| Guaranteed residual value for a lessee | That part of the residual value that is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable). |
| Inception of the lease | The inception of the lease is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. |
| Interest rate implicit in the lease | The discount rate that, at the inception of the lease, causes the aggregate present value of: <ul style="list-style-type: none"> (a) the minimum lease payments, and (b) the unguaranteed residual value to be equal to the sum of: <ul style="list-style-type: none"> (i) the fair value of the leased asset, and (ii) any initial direct costs of the lessor. |
| Lease | An agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. |



| Terminology | Definition |
|------------------------|---|
| Lease term | The non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option. |
| Legal obligation | An obligation that derives from: (a) a contract (through its explicit or implicit terms), (b) legislation, or (c) other operation of law. |
| Liabilities | Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential. |
| Management | Those persons responsible for planning, directing and controlling the activities of the entity, including those charged with the governance of the entity in accordance with legislation, in instances where they are required to perform such functions |
| Minimum lease payments | The payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and, where appropriate, taxes to be paid by and reimbursed to the lessor, together with for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it. |
| Net assets | The residual interest in the assets of the entity after deducting all its liabilities. |



| Terminology | Definition |
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| Non-cancellable lease | A lease that is cancellable only: <ul style="list-style-type: none"> (a) upon the occurrence of some remote contingency, (b) with the permission of the lessor, (c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor, or (d) upon payment by the lessee of an additional amount that, at inception, continuation of the lease is reasonably certain. |
| Onerous contract | A contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it. |
| Operating lease | A lease other than a finance lease. |
| Property, plant and equipment | Tangible items that: <ul style="list-style-type: none"> (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and (b) are expected to be used during more than one reporting period. |
| Provision | A liability of uncertain timing or amount. |
| Reporting date | The date of the last day of the reporting period to which the financial statements relate. |
| Revenue | The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners. |
| Unitary payment | The charge payable by the entity to the private party in connection with the performance of the private party's obligations included in project deliverables. |
| Unguaranteed residual value | That portion of the residual value of the leased asset, the realisation of which by the lessor is not assured or is guaranteed solely by a party related to the lessor. |
| Useful life of a lease | The estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity. |
| Useful life of property, plant and equipment | The period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by an entity. |



References

Preface to Standards of Generally Recognised Accounting Practice

Framework for the Preparation and Presentation of Financial Statements

Standard of Generally Recognised Accounting Practice on *Presentation of Financial Statements* (GRAP 1)

Standard of Generally Recognised Accounting Practice on *Revenue from Exchange Transactions* (GRAP 9)

Standard of Generally Recognised Accounting Practice on *Inventories* (GRAP 12)

Standard of Generally Recognised Accounting Practice on *Leases* (GRAP 12)

Standard of Generally Recognised Accounting Practice on *Investment Properties* (GRAP 16)

Standard of Generally Recognised Accounting Practice on *Property, Plant and Equipment* (GRAP 17)

Standard of Generally Recognised Accounting Practice on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19)

Standard of Generally Recognised Accounting Practice on *Intangible Assets* (GRAP 102)

Interpretations of International Financial Reporting Standards, SIC 29 - Disclosure – Service concession arrangements

IFRIC Interpretation 4 – Determining Whether an Arrangement Contains a Lease (December 2004)

IFRIC 12 – Service Concession Arrangements

Treasury Regulation 16, issued in terms of the PFMA (March 2005)

Treasury Regulations issued in terms of the MFMA (issued 1 April 2005)

National Treasury Public Private Partnership Manual

Manual on Standardised Public Private Partnership Provisions (www.ppp.gov.za)

The SA Institute of International Affairs – NEPAD Policy Focus Report No. 2, February 2005

United Kingdom: Financial Reporting Standard (FRS5), specifically Application Note 5 “Private Finance Initiative and Similar Contracts”

United Kingdom: Technical Note 1 - How to account for PFI transactions



Report for the National Treasury of South Africa on *Managing the government's fiscal obligations in public-private partnerships* – 14 September 2006

Report for the National Treasury of South Africa on KPMG Public-private partnership Assignment – November 2006

IPSASB Research Paper on *Service Concession Arrangements* – July 2007

For more information on the basic documents required by South African public sector service managers that are involved in the design, procurement and implementation of public-private partnerships, reference should be made to the Treasury Manual on PPP projects.