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Regulation of the Ministry of Finance on the
"Establishment of the Guidelines of the Accounting Standards Board"
Note 16
In force from: 01.01.2019
Applicable to the accounting periods, starting on 01.01.2018 or later.

ASBG 16 SERVICE CONCESSION ARRANGEMENTS

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OBJECTIVE AND BASIS FOR PREPARARTION

1. The objective of this Accounting Standards Board's guideline ASBG 16 "*Service Concession Arrangements"* is to describe the accounting policies for the classification and recognition of service concession arrangements entered into between public and private sector bodies in both private and public sector accounting entities' financial statements prepared in accordance with the Estonian financial reporting standard (hereinafter also the *financial statement*). Estonian financial reporting standard is a body of financial reporting requirements directed at the public and based on the internationally accepted accounting and reporting principles, which principal requirements are established by the Accounting Act and which is specified by a regulation of the minister responsible for the area established on the basis of subsection 34 (4) of the Accounting Act (hereinafter *guideline of the Standards Board* or for short *ASBG*).

2. ASBG 16 is based on Section 34 of IFRS for SMEs "*Specialised Activities*" and on concepts defined in Sections 2 "*Concepts and Pervasive Principles"*, 17 "*Property, Plant and Equipment"*, 18 "*Intangible Assets other than Goodwill"*, 21 "*Provisions and Contingencies"*, 11 "*Basic Financial Instruments*" and "*Glossary of Terms"*. In areas where ASBG 16 does not specify a particular accounting method but that are covered by IFRS for SMEs, it is recommended to abide by the accounting methods described in the relevant international standards.

SCOPE

3. ***ASBG 16 "Service Concession Arrangements" must be applied for the classification and recognition of service concession arrangements entered into between public and private sector bodies by private sector entities' financial statements prepared in accordance with the Estonian financial reporting standard. In classification and recognition of service concession arrangements, the public sector bodies proceed from the public sector financial accounting and reporting guidelines.***

DEFINITIONS

4. ***The following terms are used in this guideline with the meanings specified:***

<u>Service concession arrangements</u> are contract-based long-term cooperation projects between a public sector body and a private sector body whereby the private sector body provides public services using a specific asset (infrastructure asset) and (IFRS for SMEs 34.12):

> ***(a) the public sector body controls or regulates which public services the private sector body must provide, to whom, and at what price; and***

(b) the public sector body obtains control over the infrastructure asset at the end of the contract term (either through ownership, discounted purchase option or some other manner).

***A public sector body** is the state, a state accounting entity, a local government body, another legal person in public law and other legal person under their direct or indirect predominant influence, incl. a company under direct or indirect control of public sector bodies if it does not intend to maximise its profit when entering into a service concession arrangement.*

***A private sector body** is a company, incl. a company under direct or indirect control of public sector body if it intends to maximise its profit when entering into a service concession arrangement, a sole proprietor or other legal person that is not a public sector body.*

***Public services** are services, which pursuant to law or general practice, are to be provided by public sector bodies, including services related to the operation or maintenance of infrastructure assets necessary for public sector bodies to provide services.*

***An asset** is a resource under control of an accounting entity that:*

(a) has occurred as a result of past events and

(b) is estimated to bring economic benefits in the future (participates in the realisation of set targets for non-profit accounting entities). (IFRS for SMEs 2.15)

***A financial asset** is an asset that is:*

(a) cash;

(b) a contractual right to receive cash or other financial assets from another entity (e.g. trade receivables);

(c) a contractual right to exchange financial assets with another party under conditions that are potentially favourable (e.g. derivatives with positive fair value);

(d) equity instrument of another entity (e.g. investment in the shares of another entity). (IFRS for SMEs Glossary of Terms).

***Property, plant and equipment** are tangible assets that an entity uses for the production of goods, rendering of services, for rental to others, or for administrative purposes (a non-profit accounting entity for attaining the goals set for it) and that are expected to be used during a period exceeding one year. (IFRS for SMEs 17.2).*

***Intangible assets** are non-monetary assets without physical substance that are clearly identifiable from other assets. (IFRS for SMEs 18.2)*

***A liability** is an obligation of an accounting entity*

(a) which arises from the past events; and

(b) the release from which is expected to reduce the economically useful resources. (IFRS for SMEs 2.15).

***A financial liability* is a contractual obligation:**

> ***(a) to deliver cash or other financial assets to another entity; or***
>
> ***(b) to exchange financial assets with another entity under conditions that are potentially unfavourable to the entity. (IFRS for SMEs Glossary of Terms).***

***A contingent liability* is a possible or present obligation:**

> ***(a) the settlement of which is not probable; or***
>
> ***(b) whose amount cannot be measured with sufficient reliability. (IFRS for SMEs 2.40, 21.12)***

***A provision* is a liability of uncertain timing or amount. (IFRS for SMEs 21.1)**

***The effective interest rate method* is the calculation of the amortised cost of a financial asset or a financial liability using its effective interest rate. (IFRS for SMEs 11.16).**

***The effective interest rate* is the rate that discounts the estimated future cash flows arising from the financial asset or the financial liability to the carrying amount of the financial asset or the financial liability. (IFRS for SMEs 11.16).**

***Fair value* is the amount for which an asset could be exchanged or a liability settled in a transaction between knowledgeable, willing and independent parties in an arm's length transaction. (IFRS for SMEs 2.34 (b))**

5. In many countries, infrastructure assets requiring a large initial investment such as roads, bridges, tunnels, prisons, hospitals, airports, water and sewerage pipelines, energy distribution and telecommunications networks have traditionally been built and operated by public sector bodies and financed from their budget. Some countries have started using various forms of public-private partnership (PPP) in order to include private sector bodies in the construction and maintenance of infrastructure assets. Objectives for carrying out PPP projects may be for example to leverage private sector competence, increase service quality, public sector cost savings or to spread risks. Service concession arrangements are one of the forms of PPP projects, whereby a public sector body grants to a private sector body the long-term right to provide services related to a certain infrastructure asset.

6. Service concession arrangements are typically characterised by the following circumstances (IFRS for SMEs 34.12):

> (a) a public sector body contracts with a private sector body to partially or fully provide certain public services;
>
> (b) a private sector body provides public services related to an infrastructure asset for a time period, in the volume and quality specified in the contract;
>
> (c) the contract provides for an initial price that the private sector body may charge for public services provided and terms for changing the price;
>
> (d) the contract provides for the terms, which quality requirements the infrastructure asset must meet at the end of the contract term and whether it is delivered to the

public sector body free of charge at the end of the contract term or for a charge substantially lower than its fair value at the time of delivery.

7. This guideline shall apply in cases where (IFRS for SMEs 34.12):

(a) the service concession arrangement provides for the construction, acquisition or reconstruction of an infrastructure asset prior to providing a service by a private sector body, based on quality criteria specified by a public sector body; or

(b) a public sector body grants to a private sector body the right to use an existing infrastructure asset for providing a service (e.g. through right of superficies or usufruct).

8. This guideline shall also apply if the duration of a service concession arrangement covers the entire useful life of an infrastructure asset, irrespective of who obtains control over the infrastructure asset after the end of the contract term.

9. This guideline shall apply both when a public sector body pays for all services provided by a private sector body using an infrastructure asset, as well as if part or all of the public services provided at an infrastructure asset are purchased by other users. Prices and terms for changing them may be determined by the contract that is the basis for the service concession arrangement or derive from law. (IFRS for SMEs 34.13).

10. This guideline shall also apply if a public sector body does not have full control over service prices. It shall be deemed to have control over prices even if a contract specifies the upper limit for prices or if a private sector body bears the obligation to transfer profit exceeding a certain level to a public sector body.

11. A public sector body's control over an infrastructure asset at the end of the contract term also means that the private sector body shall not have the right to independently sell or pledge the infrastructure asset and the public sector body shall continue to have the right to decide over the future use of the asset until the end of its useful life.

12. If an infrastructure asset is partially used to provide a public service and partially not, different components of the asset are addressed separately if they can be divided into different cash-generating units based on the concept provided in ASBG 5 "*Property, Plant and Equipment and Intangible Assets*". If a public sector body does not regulate the use of a certain infrastructure asset component, it may be a lease agreement between a public sector body and a private sector body that must be accounted for based on the ASBG 9 "*Accounting for Leases*".

13. In practice, service concession arrangements may adopt different forms and various terms, so it may be insufficient to rely on this guideline alone. Each contract should be accounted for based on its substance. In case of complex additional terms and conditions that do not correspond to situations described in this guideline, accounting policies should be selected based on other guidelines of the Accounting Standards Board, IFRS for SMEs, and their conceptual framework.

RECOGNITION IN PRIVATE SECTOR BODIES' FINANCIAL STATEMENTS

General Rules

14. ***As a private sector body owns the right to use an infrastructure asset to provide public services only on terms prescribed by a public sector body, control over the use of the infrastructure asset belongs to the public sector body. Therefore, the private sector body shall not recognise the infrastructure asset as property, plant and equipment on its balance sheet. (IFRS for SMEs 34.14, 34.15).***

15. A private sector body shall not recognise an infrastructure asset as its property, plant and equipment or as its leased asset. A private sector body shall recognise revenue from services rendered, including from the sale of construction and reconstruction services based on ASBG 10 "*Revenue Recognition"* at the fair value of the consideration receivable (IFRS for SMEs 34.16). If a private sector body renders more than one service as part of a service concession arrangement (e.g. both construction or reconstruction as well as operation service) and the consideration receivable for them has not been separately determined in the contract, the total revenue shall be allocated between different services based on the ratio of their fair values.

Construction or Reconstruction Services

16. A private sector body shall recognise revenue generated from construction or reconstruction services as operating income and expenses incurred in the same period as operating expenses based on the stage of completion method described in the ASBG 10 "*Revenue Recognition*". (IFRS for SMEs 34.16).

17. A private sector body shall recognise its right to the consideration for construction or reconstruction services either as financial assets or intangible assets depending on whether the right is unconditional or not. (IFRS for SMEs 34.14, 34.15).

18. If a private sector body has an unconditional right to receive cash or other financial assets from a public sector body in exchange for construction and reconstruction services, the receivable shall be recognised as a financial asset based on the guideline ASBG 3 "*Financial Instruments*". (IFRS for SMEs 34.14) An unconditional right means that a public sector body is obligated to pay to the private sector body either a determinable amount or the difference between a determinable amount and amounts receivable from service users, even if the size of the consideration depends on meeting the quality or deadline criteria set for construction or reconstruction services. Example in Note 1 to this guideline describes the recognition of such service concession arrangements whereby a private sector body has an unconditional right to receive cash, therefore it recognises on its balance sheet the relevant receivable (financial asset) from the public sector body.

19. A private sector body shall recognise as intangible assets and as income received for the construction and reconstruction services the right (incl. license) to use the infrastructural asset and sell the related public services to the users of the service. (IFRS for SMEs 34.15) A right to sell public services to service users is not an unconditional right to receive cash because the consideration received from the sale of services depends on the volume of service usage. Such right is accounted for as intangible asset pursuant to ASBG 5 "*Property, Plant and Equipment and Intangible Assets*". Example in Note 2 to this guideline describes the accounting for a service concession arrangement whereby a private sector body has the right to sell public services related to an infrastructure asset to service users and thus recognises the relevant intangible asset on its balance sheet.

20. If a private sector body is paid for construction or reconstruction services rendered partially in financial assets (i.e. with an unconditional right to receive cash or another financial asset) and partially in intangible assets (i.e. with a right to use an infrastructure asset to provide a public service), both components shall be recognised separately based on the fair value ratio of these components. (IFRS for SMEs 34.13) Example in Note 3 to this guideline describes the accounting for a service concession arrangement whereby a private sector body has an unconditional right to receive from a public sector body a certain minimum amount of cash and at the same time has the right to sell public services related to an infrastructure asset to service users, thus it recognises both financial assets and intangible assets on its balance sheet.

Operation Services and Additional Services

21. The accounting for operation services related to an infrastructure asset (including for example maintenance and repair services) shall be based on ASBG 10 "*Revenue Recognition"*. (IFRS for SMEs 34.16).

22. If a private sector body is obligated to perform additional construction and reconstruction work at an infrastructure asset during the contract term (e.g. related to a requirement to maintain assets at a certain quality level) and the private sector body lacks an unconditional right to receive payment for such work, the private sector body shall recognise on its balance sheet a provision with regard to the expenses resulting from performing reconstruction work based on the ASBG 8 "*Provisions, Contingent Liabilities and Contingent Assets*". In recognising provisions, the opinion of management or other experts regarding the amount probably needed for settling the liability and the timing of realisation of the liability shall be used.

Borrowing Costs

23. Borrowing costs are not capitalised into the cost of assets. (IFRS for SMEs 25.2).

COMPARISON WITH IFRS FOR SMES

24. The accounting policies prescribed in ASBG 16 for private sector bodies are in compliance with the accounting policies provided in section 34 of IFRS for SMEs.

NOTE 1

Example - Private sector body recognising financial assets

A public authority (public sector body) enters into a contract with an operator (private sector body) based on which the operator shall build a new road within two years and must maintain and repair it over the next eight years. Contract terms mandate that the operator must also lay a new road surface at the end of the 8th year.

Based on the contract, the public authority must pay to the operator from year 3 to year 10 for the construction and maintenance of the road 200 thousand euros each year (i.e. a total of 1.6 million euros over eight years).

Services provided by the operator under the contract, estimated price and fair value of the services (in thousands of euros) are as follows:

Service provided	Year	Estimated expenditure	Normal profit margin	Fair value of the service
Construction work	1	500	5%	525
	2	500	5%	525
Maintenance and repair work	3-10	8 x 10	20%	8 x 12
New road surface	8	100	10%	110
Total		**1,180**		**1,256**
Interest income (6.18% per annum)				344
Consideration receivable (undiscounted)	**3-10**	**8 x 200**		**1,600**

Due to the different timing of the expenditures related to the project and the consideration receivable, the effective interest rate of the project is 6.18% per annum and the total interest income is 344 thousand euros.

The allocation of the consideration between different services and the effective interest rate of the project may or may not be prescribed by the contract. If they are prescribed by the contract, the project should be recognised based on the allocation of the consideration in the contract (assuming that this allocation is based on the fair value of service components). Otherwise the consideration should be allocated to different services based on the management's or experts' estimate regarding the fair value of these components.

The operator finances services provided under the contract with a loan carrying an interest rate of 6.7% per annum.

To simplify the example. it is assumed that all payments always take place once per year at the end of the year.

The operator shall recognise revenue and expenses from providing services based on ASBG 10 "*Revenue Recognition*". The expenses of construction, maintenance and repair work and laying a new surface and revenue from providing those services shall be recognised based on the stage of completion of these services. As the public authority pays for those services in part later, a receivable from the public authority (financial asset) shall also be recognised and interest income shall be recognised on this receivable based on the project's effective interest rate.

The operator's accounting entries (in thousands of euros) for revenue recognition in the first three years:

Revenue from providing construction services in the first year (fair value of construction works):

D Receivable from public authority 525
C Revenue from providing construction services 525

Revenue in the second year:

a) from providing construction services (fair value of construction works)
   D Receivable from public authority 525
   C Revenue from providing construction services 525
b) interest income (525 * 6.18%)
   D Receivable from public authority 32
   C Interest income 32

Revenue in the third year:

a) from providing maintenance services (fair value of maintenance and repair works)
   D Receivable from public authority 12
   C Revenue from providing maintenance services 12
b) interest income ((525+525+32) * 6.18%)
   D Receivable from public authority 67
   C Interest income 67

Expenses related to the project and loan and interest payments shall also be recognised. From year 3, the consideration receivable from the public authority shall also be recognised as a reduction of the receivable from the public authority.

D Cash 200
C Receivable from public authority 200

Overview of the cash flows related to the project and its impact on the operator's income statement and balance sheet (in thousands of euros) is provided below.

Overview of the operator's cash flows

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**Total**
Consideration received	0	0	200	200	200	200	200	200	200	200	1600
Expenditures incurred	-500	-500	-10	-10	-10	-10	-10	-110	-10	-10	-1180
Interest payments	0	-34	-69	-61	-53	-43	-33	-23	-19	-7	-342
Proceeds from borrowings	500	534	0	0	0	0	0	0	0	0	1034
Repayments of borrowings	0	0	-121	-129	-137	-147	-157	-67	-171	-105	-1034
Net cash flow	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**78**	**78**

Overview of the operator's income statement

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**Total**
Revenue from services	525	525	12	12	12	12	12	122	12	12	1256
Operating expenses	-500	-500	-10	-10	-10	-10	-10	-110	-10	-10	-1180
Interest income	0	32	67	59	51	43	34	25	22	11	344
Interest expenses	0	-34	-69	-61	-53	-43	-33	-23	-19	-7	-342
Profit	**25**	**23**	**0**	**0**	**0**	**2**	**3**	**14**	**5**	**6**	**78**

Overview of the operator's balance sheet

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Cash	0	0	0	0	0	0	0	0	0	78
Receivables	525	1082	961	832	695	550	396	343	177	0
Loan liabilities	500	1034	913	784	647	500	343	276	105	0
Net assets	**25**	**48**	**48**	**48**	**48**	**50**	**53**	**67**	**72**	**78**

NOTE 2

Example - Private sector body recognising intangible assets

Assumptions for the example are the same as in Note 1, except the method of receiving revenue from road operation. The public authority does not pay to the operator for its services. Instead, the operator is given a contractual right to collect a fixed service charge for each vehicle using the road. The operator assumes that the number of vehicles using the road will remain the same from year 3 until 10 and the consideration collected each year will be 200 thousand euros.

Based on the ASBG 5 "*Property, Plant and Equipment and Intangible Assets*", the operator shall recognise on its balance sheet an intangible asset (right to use the road for generating revenue) at its fair value which is the fair value of the revenue receivable for the construction services.

The operator's entries (in thousands of euros) during the construction period regarding the recognition of revenue and intangible assets.

a) in the first year (fair value of construction works):

D Intangible assets 525
C Revenue from providing construction services 525

b) in the second year (fair value of construction works):

D Intangible assets 525
C Revenue from providing construction services 525

Expenses related to the project and loan and interest payments shall also be recognised. From year 3, amortisation of intangible assets shall be expensed (1050 / 8 = 131.3 thousand euros each year) and service charges collected from drivers (in thousands of euros) for using the road shall be recognised as revenue.

D Depreciation expense 131
C Intangible assets 131

D Cash 200
C Revenue from road operation 200

As the operator has the obligation to lay a new road surface in year 8 but lacks an unconditional right to receive payment for it, it shall recognise a liability on its balance sheet for the laying of a new road surface based on ASBG 8 "*Provisions, Contingent Liabilities and Contingent Assets*". A provision for the laying of a new road surface shall be established in years 3 to 8 based on the ratio of the number of vehicles having used the road by the reporting date to the total number of vehicles estimated to use the road until the new road surface is laid and discounting the liability at the discount rate determined according to ASBG 8 (the discount rate used in this example is 6%).

Setting up a provision (in thousands of euros)

Year	**3**	**4**	**5**	**6**	**7**	**8**	**Total**
Operating expenses	12	13	14	15	16	17	87
Interest expenses	0	1	1	2	4	5	13
Total increase in provision	**12**	**14**	**15**	**17**	**20**	**22**	**100**

Assuming that consideration is received from road users according to plan, the operator's cash flows broken down by year shall be the same as in Note 1. Overview of the impact of the project on the operator's income statement and balance sheet (in thousands of euros) is provided below.

Overview of the operator's income statement

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**Total**
Revenue from services	525	525	200	200	200	200	200	200	200	200	2650
Depreciation	0	0	-131	-131	-131	-132	-132	-131	-131	-131	-1050
Other project expenses	-500	-500	-22	-23	-24	-25	-26	-27	-10	-10	-1167
Interest expenses	0	-34	-69	-62	-54	-45	-37	-28	-19	-7	-355
Profit	**25**	**-9**	**-22**	**-16**	**-9**	**-2**	**5**	**14**	**40**	**52**	**78**

Overview of the operator's balance sheet

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Cash	0	0	0	0	0	0	0	0	0	78
Intangible assets	525	1050	919	788	657	525	393	262	131	0
Loan liabilities	500	1034	913	784	647	500	343	276	105	0
Provisions	0	0	12	26	41	58	78	0	0	0
Net assets	**25**	**16**	**-6**	**-22**	**-31**	**-33**	**-28**	**-14**	**26**	**78**

NOTE 3

<u>Example - Private sector body recognising financial assets and intangible assets</u>

Assumptions for the example are the same as in Note 2, except for an additional guarantee granted by the public authority to the operator for guaranteeing revenue generated by road operation - if the service charges collected from road users by the operator are below 700 thousand euros, the public authority shall pay the difference and interest on the difference at the rate of 6.18%. The operator still assumes that the number of vehicles using the road will remain the same from year 3 until 10 and the consideration collected each year will be 200 thousand euros.

The operator shall recognise revenue from providing construction services partially as a financial asset (unconditional right to receive at least 700 thousand euros) and partially as an intangible asset (right to use the road to be built for generating revenue). As the charge for providing the construction services is guaranteed within 67% (700 / 1,050), the financial asset (liability) is recognised within this extent and intangible assets are recognised within the remaining extent.

The recognition by the operator of revenue on construction works and assets (in thousand euros) during the construction period shall be as follows:

	Receivable (67%)	**Intangible asset (33%)**	**Total**
Revenue from construction services in year 1	350	175	525
Revenue from construction services in year 2	350	175	525
Total revenue from construction services	**700**	**350**	**1050**
Interest income added to receivable in year 2 (350 * 6.18%)	22	0	22
Total assets by end of year 2	**722**	**350**	**1072**

Service charges collected from drivers using the road shall be allocated into collection of the receivable and revenue. Given the annual interest calculated on the carrying amount of the receivable (6.18% per annum), a total of 936 thousand euros (700 thousand euros of principal and 236 thousand euros of interest) shall be spent on repayment of the receivable. Accordingly, each year 936 / 8 = 117 thousand euros are recognised as collection of receivable. The remaining part of accumulated service charges (200 - 117 = 83 thousand euros) is recorded as period income.

Expenses related to the project and loan and interest payments shall also be recognised. From year 3, amortisation of intangible assets shall also be expensed (each year 350 / 8 = 44 thousand euros). The provision established for laying a new road surface shall be recognised in the same manner as in Note 2.

Assuming that consideration is received from road users according to plan, the operator's cash flows broken down by year shall be the same as in Note 1. Overview of the impact of the project on the operator's income statement and balance sheet (in thousands of euros) is provided below.

Overview of the operator's income statement

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**Total**
Revenue from services	525	525	83	83	83	83	83	83	83	83	1714
Depreciation	0	0	-44	-44	-44	-44	-44	-44	-43	-43	-350
Other project expenses	-500	-500	-22	-23	-24	-25	-26	-27	-10	-10	-1167
Interest income	0	22	45	40	35	30	25	19	13	7	236
Interest expenses	0	-34	-69	-62	-54	-45	-37	-28	-19	-7	-321
Profit	**25**	**13**	**-7**	**-6**	**-4**	**-1**	**1**	**3**	**24**	**30**	**78**

Overview of the operator's balance sheet

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Cash	0	0	0	0	0	0	0	0	0	78
Loans receivable	350	722	650	573	491	404	312	214	110	0
Intangible assets	175	350	306	262	218	174	130	86	43	0
Loan liabilities	500	1034	913	784	647	500	343	276	105	0
Provisions	0	0	12	26	41	58	78	0	0	0
Net assets	**25**	**38**	**31**	**25**	**21**	**20**	**21**	**24**	**48**	**78**