



Project:	AASB 1059 <i>Service Concession Arrangements: Grantors</i>	Meeting:	AASB June 2023 (M196)
Topic:	Stakeholder feedback on the scope and control criteria of AASB 1059	Agenda Item:	5.2
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		Project Priority:	Medium
		Decision-Making:	Medium
		Project Status:	Analysing ITC feedback

Objectives of this paper

- In respect of the scope and control criteria of AASB 1059 *Service Concession Arrangements: Grantors*, the objectives of this paper are for the Board to:
 - consider** stakeholders' comments received on [ITC 49 Post-implementation Review of AASB 1059 Service Concession Arrangements: Grantors](#);
 - consider** staff's preliminary analysis thereof;
 - decide** whether to undertake work to explore alternatives to the scope and control criteria; and
 - provide direction to staff** on any standard-setting work needed to address stakeholder comments, assuming the current scope and control criteria in AASB 1059 paragraphs 2 and 5 would be retained without significant changes to the concepts underlying those paragraphs.

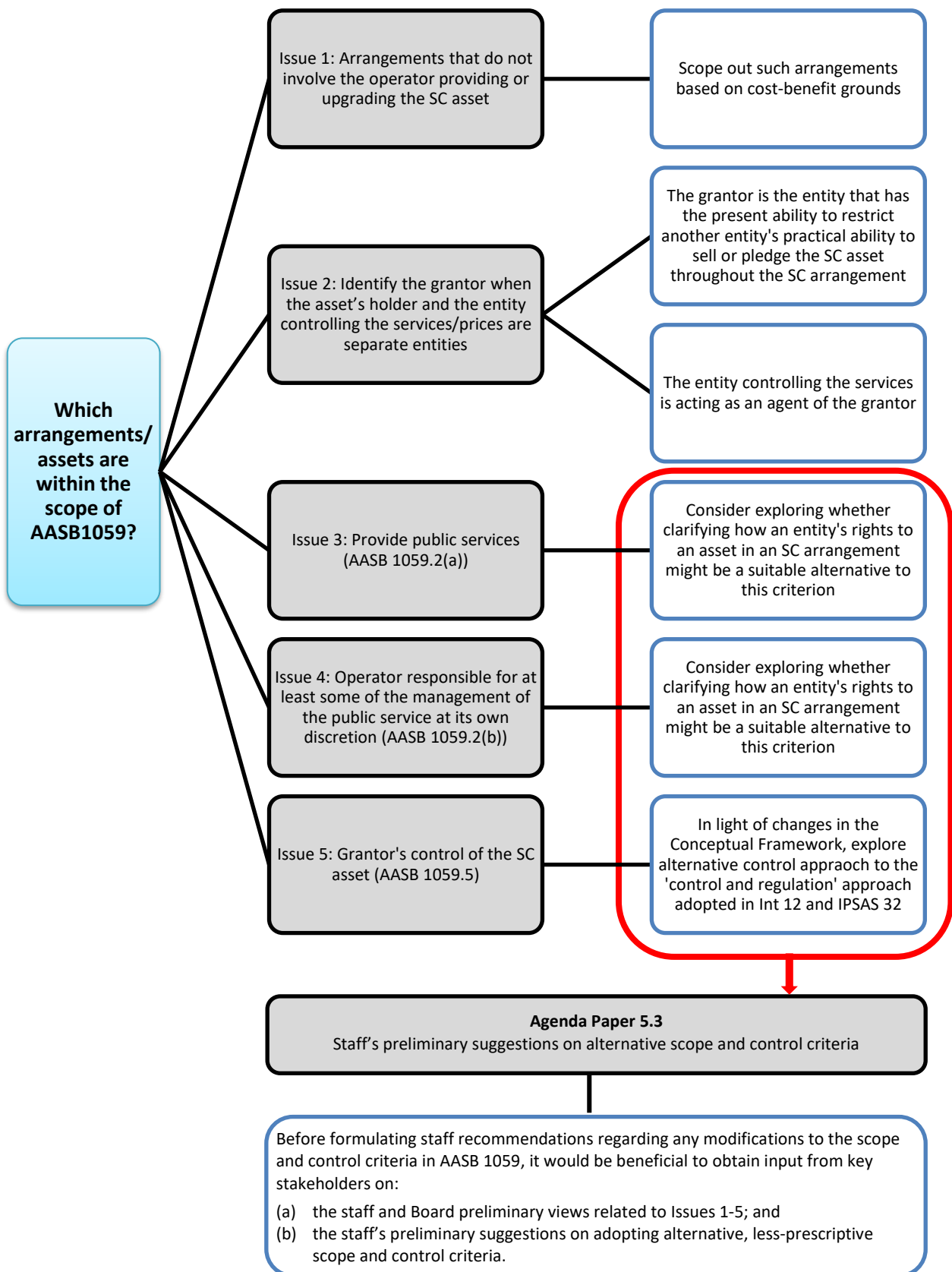
Background and overview of staff's preliminary views

- An asset is within the scope of AASB 1059 for recognition as an SC asset if all the following conditions are satisfied:
 - the operator provides public services related to an SC asset on behalf of the grantor (AASB 1059 paragraph 2(a));
 - the operator manages at least some of the public services under its own discretion (AASB 1059 paragraph 2(b));
 - the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them and at what price (AASB 1059 paragraph 5(a)); and
 - the grantor controls any significant residual interest in the asset at the end of the term of the arrangement (AASB 1059 paragraph 5(b)).
- Stakeholders provided significant comments relating to each of the conditions. Staff have categorised the issues arising from those comments broadly into five issues. The diagram below provides a high-level overview of the staff's preliminary views on each issue.

Legend:

Issue for discussion in this
Agenda Item

Staff's preliminary view



Structure of this paper

4. Each of Issues 1–5 is discussed in a separate section of this paper. The questions for Board members in this paper are designed to ask the Board to provide:
 - (a) comments to staff on the staff’s preliminary views related to each issue; and
 - (b) direction to staff regarding any further guidance or clarifications needed in addressing stakeholders’ comments, **assuming the Board would retain the current scope and control requirements** in AASB 1059 paragraphs 2 and 5, without significant changes to the concepts underlying those paragraphs.
5. One of the main preliminary views staff have formed in this Agenda Item is that staff think there is merit in exploring an alternative control approach to determining whether a grantor controls an SC asset. However, staff consider further input from stakeholders would be needed before formulating staff recommendations relating to the scope and control criteria. This is discussed in Agenda Paper 5.3.
6. Accordingly, questions for Board members regarding the staff’s suggested alternative control approach are included in Agenda Paper 5.3.

Issue 1: Arrangements that do not involve the operator providing the SC asset

Background

7. Staff observed that throughout the development of AASB 1059 the Board focused on arrangements that have the following elements:¹
 - (a) a public sector entity (the grantor) engages a private sector entity (the operator) to provide construction services – to construct a new asset or the upgrade to or a major component replacement for an existing asset of the grantor (the SC asset);
 - (b) the private sector entity would then operate and maintain that asset for a specified period of time (operation services); and
 - (c) the private sector entity would be obliged to hand over the asset to the grantor in a specified condition at the end of the period of the arrangement.
8. AASB 1059 paragraph B2 states “... An arrangement within the scope of this Standard **typically involves an operator constructing** the assets used to provide the public services or **upgrading the assets** (for example, by increasing their capacity) **and operating and maintaining** the assets for a specified period of time.” [emphasis added]
9. As a result, the Standard focused on:
 - (a) the factors that would indicate the grantor has control of the SC asset and therefore would be required to recognise the asset on its balance sheet; and
 - (b) the recognition and measurement of the grantor’s compensation to the operator for the construction service.
10. AASB 1059 does not prescribe the accounting for the grantor’s compensation to the operator for the operation services – in accordance with AASB 1059 paragraph 19, they are to be accounted for in accordance with other relevant Standards.
11. Where an SC arrangement does not involve the operator providing construction services – that is, the operator provides only operation services to operate the grantor’s existing asset – AASB 1059 (paragraph 8) requires the grantor to reclassify that asset as an SC asset and to measure that asset at its current replacement cost in accordance with the cost approach to fair value in AASB 13 *Fair Value Measurement* as at the date of reclassification. Other than this reclassification and remeasurement of existing assets and disclosure requirements, applying AASB 1059 has no effect on the grantor’s financial statements in this circumstance.

Stakeholder feedback

12. AASB 1059 paragraph 2 states:

“This Standard shall be applied to service concession arrangements, which involve an operator:

 - (a) providing public services related to a service concession asset on behalf of a grantor; and
 - (b) managing at least some of those services under its own discretion, rather than at the direction of the grantor.”
13. How AASB 1059 paragraph 2 is written implies that an arrangement can be within the scope of AASB 1059 even if the operator does not provide construction service. That is, an arrangement where an operator operates an existing asset of the grantor could be within the scope of AASB 1059.

1 From the [Project Summary](#) of the project that led to the finalisation of AASB 1059.

14. S2–ACAG commented that there is diversity in views on whether an arrangement where the operator does not provide construction service is within the scope of AASB 1059, with some entities not applying AASB 1059 to such arrangements.
15. S2–ACAG noted that one of its jurisdictions encountered the arrangements involved with the following assets that have been considered SC assets where the operator was not involved in the construction or capital expenditure renewals of the asset:
 - (a) prisons;
 - (b) water treatment plant;
 - (c) social housing;
 - (d) private sector providing health services using the grantor’s owned buildings; and
 - (e) land required to be used for public space as part of property development arrangements.
16. Another ACAG jurisdiction encountered issues with local government entities contracting with private sector operators to manage existing local government facilities (such as an aquatic centre, recreational centre or landfill site) for a short period (for example, 2 years), where the local government entity sets the prices to be charged to users. There was diversity in practice as to whether this was treated as an SC arrangement or as an outsourcing arrangement.
17. S2–ACAG questioned the benefits of scoping in AASB 1059 arrangements that do not involve an operator providing the SC asset when those arrangements are essentially a contract for the operator to operate the grantor’s existing assets, which are already recognised on the grantor’s balance sheet and measured at fair value,² and:
 - (a) requiring those assets to be remeasured at their current replacement cost on the transition to AASB 1059 would incur unnecessary costs; and
 - (b) as mentioned in paragraph 11, other than the reclassification and remeasurement of assets mentioned in (a), there is no effect on the grantor’s balance sheet and income statement.
18. In contrast with ACAG, S5–HoTARAC commented that, other than two HoTARAC members, they generally agree that existing assets of the grantor be reclassified as SC assets where they meet the control criteria in AASB 1059.
19. The two HoTARAC members are of the view that arrangements where the grantor provides its existing asset to another party to provide public services should be explicitly excluded from AASB 1059 unless the operator is required or expected to build on or expand the asset as part of the arrangement. They provided the following reasons:
 - (a) it would make AASB 1059 more consistent. The table in AASB 1059 paragraph IG12 [which is non-mandatory guidance] – that shows arrangements within the scope of AASB 1059 – states that it is the operator rather than the grantor who is responsible for capital investment. AASB 1059 paragraph B2 (quoted in paragraph 12) explained that the arrangement within the scope of AASB 1059 typically involves an operator constructing the assets used to provide the public services or upgrading the assets and operating and maintaining the assets for a specified period of time;
 - (b) when a public sector entity allows another party to use its assets to provide public services on its behalf, it is often an outsourcing arrangement because the government

2 Public sector entities elect to subsequently measure their property, plant and equipment and intangible assets under the revaluation model in the relevant Accounting Standards, consistent with the measurement requirements for the Whole of Government under AASB 1049 *Whole of Government and General Government Sector Financial Reporting*.

- normally does not intend to share the management of the provision of the services with an external party. [However, this is not the experience of all HoTARAC members]; and
- (c) from a cost-benefit perspective, it would be a favourable change to exclude those arrangements because there is often little impact on the grantor's financial statements. The reclassification of existing assets as SC assets requires effort and time to (1) determine whether the scope criteria in AASB 1059 have been met and (2) revalue those existing assets at their current replacement cost using the cost method under AASB 13. Many, but not all, existing assets are already measured using the cost method, but where they are not, it is costly to revalue those assets on that basis. For example, measuring internally generated intangibles (that were previously unrecognised by the grantor because they are prohibited from recognising those assets under AASB 138 *Intangible Assets*) and assets measured using the income approach as part of a broader cash-generating unit at their current replacement cost would be costly.

Staff analysis

20. Based on the feedback received, staff agree with the views of ACAG and the two HoTARAC members noted in paragraph 19. Staff consider that the costs involved with scoping in AASB 1059 arrangements where the operator is not providing construction service and merely providing operation services outweigh its benefits. This is because:
- (a) a public sector entity may have many contracts with third parties to provide operation services, which may or may not be within the scope of AASB 1059. The costs and effort required to assess which of those arrangements are within the scope of AASB 1059 seem unjustified when applying AASB 1059 has no effect on the grantor's balance sheet and income statement, other than the effect of reclassifying and remeasuring existing assets noted in (b) below. In particular, stakeholders have commented that assessing whether the following aspects of the scope criteria are met requires a lot of judgement and time:
- (i) whether a related asset is being used to provide a public service (see Issue 3); and
- (ii) whether the operator is managing at least some of those services under its own discretion, rather than at the direction of the grantor (see Issue 4).
- (b) the costs needed to remeasure the grantor's existing assets' fair value at their current replacement cost on the transition to AASB 1059 may not be justified. This is because the fair values of many public sector PPE are already being measured at their current replacement cost,³ and the process of remeasuring assets at their current replacement cost would incur additional costs.⁴

Staff preliminary view

21. Staff's preliminary view is that, based on cost-benefit reasons, there is merit in limiting the scope of AASB 1059 to arrangements where the operator is responsible for the construction service (to construct, develop or upgrade the SC asset) and not merely providing operation service.

3 Stakeholders informed the Board during the Fair Value Measurement for Not-for-Profit Public Sector Entities project that the cost approach in AASB 13 is the predominant valuation technique used in measuring the fair value of public sector assets. This is because many public sector assets are unique to the public sector entity and it would be unlikely that a market price for a comparable asset would be readily obtainable.

4 Additionally, some stakeholders questioned the appropriateness of prohibiting the use of other valuation techniques (e.g. the income approach or market approach) in measuring the fair value of SC assets. This issue will be discussed at a future meeting.

22. Specifically, staff consider that the following conditions must be met for an arrangement to be considered within the scope of AASB 1059. The operator is obliged to:
- (a) construction, develop or upgrade the SC asset (construction service);
 - (b) maintain and operate that SC asset (operation service) for a specified period of time; and
 - (c) hand over the SC asset to the grantor in a specified condition at the end of the period of the arrangement.
23. As discussed in Agenda Paper 5.3, staff think that this suggested scope limitation would also assist in clearly identifying the types of arrangements that AASB 1059 is intended to capture.

Question for Board members

Q1: Do Board members agree with the staff's preliminary view that, based on cost-benefit reasons, the conditions set out in paragraph 22 must be met for an arrangement to be considered within the scope of AASB 1059?

[An example of how the scope criteria in AASB 1059 paragraph 2 might be modified based on the staff's preliminary views is included in Agenda Paper 5.3.]

Issue 2: Identifying the grantor when the asset's holder and the entity controlling the services are separate entities

Stakeholder feedback

24. For an asset to be recognised within the scope of AASB 1059, among other conditions, the following conditions need to be met:
- (a) the operator providing public services related to an SC asset ***on behalf of*** a grantor (AASB 1059 paragraph 2(a));
 - (b) the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price (AASB 1059 paragraph 5(a)); and
 - (c) the grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the asset at the end of the term of the arrangement (AASB 1059 paragraph 5(b)).
25. S2–ACAG and S5–HoTARAC commented that AASB 1059 seems to imply only one entity in an arrangement can be the grantor. However, it is sometimes difficult to identify which entity is the grantor when there are multiple parties involved in the arrangement. They provided the following comments:
- (a) In some arrangements, due to how the enabling legislation is written, the asset's holder only has the legal right to hold the asset and is prohibited from operating the asset in its own right. The asset's holder therefore would need to engage another party to operate the asset. In this case, can it be said that the operator is operating the asset 'on behalf of' the asset's holder, referred to in AASB 1059 paragraph 2(a), since the holder has no right to operate the asset?
 - (b) Further to the situation described in (a) if the enabling legislation states that Agency A has the legal right to hold the asset, but Agency B has the legal right and responsibility to deliver services using that asset. In this case, is the grantor Agency A or Agency B? Can it be regarded that Agency A is acting as an agent for Agency B or vice versa?
 - (c) If the asset holder does not have the right to set the prices of the public service because the prices were set by Cabinet, and does not receive the proceeds from the service delivery because the proceeds are received by the Crown, is the grantor for the arrangement the asset's holder or the Crown?
 - (d) An asset may provide more than one type of public service and each type might be provided by a different entity. For example, a residential building being used to provide social housing (a public service related to the responsibility of the Department of Town Planning) and medical support service to the residents of that building (a public service related to the responsibility of the Department of Health). In this case, which entity should be considered the grantor of the arrangement?
 - (e) Sometimes a central agency enters into a contract on behalf of the asset's holder (being a signatory of the contract), in which case it has been treated as the central agency acting as an agent for the asset's holder.
 - (f) S2–ACAG also requested the Board to clarify whether an SC arrangement must first be recognised at an entity level before being recognised at the consolidated level.

The application of the 'on behalf of' concept in public-to-public arrangements

26. In respect of the situation described in paragraph 25(a), S5–HoTARAC commented that it is unclear how the concept of the operator providing public services 'on behalf of' the grantor is to be applied, particularly in public-to-public SC arrangements.

27. HoTARAC explained that, typically, public sector entities are unable to act on behalf of other public sector entities because each entity has its own primary responsibilities and legislative functions set out in their respective enabling legislation. This makes the 'on behalf of' concept redundant in most public-to-public arrangements.
28. S5–HoTARAC is of the view that the 'on behalf of' concept should:
 - (a) be interpreted in a way that an entity is the grantor of an arrangement only when that it has the primary responsibilities and legislative functions to provide the respective public service that is being provided via the SC asset; and
 - (b) not be interpreted in such a way that in all cases the public sector entity that signed the contract with the operator is the grantor (even if another public sector entity is primarily responsible for providing the public service). This could result in arbitrary choice of the grantor for a particular arrangement.
29. HoTARAC acknowledges that there may be rare cases where the primary responsibilities for provision of a public service are not clearly assigned to particular public sector entities, in which case a public sector entity may be considered acting on behalf of another when there is a service contract between them.

Staff analysis

30. Staff agree with S2–ACAG and S5–HoTARAC that it is quite common in the public sector that more than one public sector entity is involved in an SC arrangement. Therefore, staff agree that clarification in AASB 1059 is needed to assist entities in identifying which entity is the grantor when the asset's holder and the entity controlling the services are separate entities.
31. Under AASB 1059 paragraph 5(b), the grantor must control any significant residual interest in the asset at the end of the term of the arrangement for the asset to be considered within the scope of the Standard.
32. AASB 1059 paragraph B33 states "... the **grantor's control over any significant residual interest would both restrict the operator's practical ability to sell or pledge the asset** (by acknowledging the grantor's residual interest in the asset) **and effectively give the grantor control of the asset throughout the period of the service concession arrangement**. Consequently, where the grantor has substantive, rather than merely protective, rights to prevent the operator selling or pledging the asset during the service concession arrangement (eg the grantor must formally approve the transferee, rather than being able to refuse merely on the grounds that the transferee is not fit and proper), then the grantor is likely to have control of any significant residual interest in the asset." [emphasis added]
33. Staff are of the view that the grantor of an arrangement should be the entity that has 'the present ability to sell or pledge the SC asset, including the present ability to restrict another party's practical ability to sell or pledge the SC asset throughout the term of the SC arrangement', irrespective of whether that entity has the direct legislative power to direct the services and prices related to the asset. Staff took this view because:
 - (a) the main purpose of developing AASB 1059 was to ensure an SC asset, and related liabilities, are recognised by the entity that has control over the asset;
 - (b) AASB 1059 paragraph B33 stipulates that the entity that has the right to restrict another party's practical ability to sell or pledge the asset is an indicator of control. This is

consistent with the control concept in paragraph 4.20 of *Conceptual Framework for Financial Reporting*;⁵ and

- (c) there should only be one entity, at any point in time, that has the present ability to restrict another party's practical ability to sell or pledge the asset; whereas there might be situations where more than one entity is involved with the delivery of public services, particularly when an asset delivers more than one type of services.
34. Staff considered whether it would be appropriate to simply use the terminology in AASB 1059 paragraph 5(b) – that the grantor is the entity that controls any significant residual interest of the SC asset. However, staff rejected that idea because:
- (a) AASB 1059 paragraph 6 states that, for an SC arrangement where the asset will be used for its entire economic life, the grantor need not have control of any significant residual interest in the asset at the end of the term of the arrangement for it to recognise the asset under AASB 1059. Therefore, alternative terminology would need to be developed to address arrangements involving the operator operating the SC asset for its entire economic life; and
 - (b) as discussed in Issue 5 below, stakeholders have encountered challenges in determining whether the asset's residual interest is considered significant before then considering whether the grantor controls that residual interest.

Staff preliminary view

35. Staff's preliminary view is that the Board could consider clarifying the following in AASB 1059:
- (a) the grantor of the arrangement is the entity that has the present ability to sell or pledge the SC asset, including the present ability to restrict another party's practical ability to sell or pledge the SC asset throughout the term of the SC arrangement;
 - (b) if the grantor does not have the legislative power to control the services, the grantor may satisfy the condition in AASB 1059 paragraph 5(a) if another entity controlled by the same government has the power to control the services. In this case, the entity (or entities) controlling the services is acting as an agent of the grantor, despite the grantor not having the legislative responsibilities or power to deliver the relevant services;⁶ and
 - (c) the accounting/disclosure requirements for both the grantor and the agent (e.g. consider disclosure requirements for the agent similar to that of AASB 1050 *Administered Items*).
36. If the Board agrees with the staff's view in paragraph 35, the question about whether an SC arrangement must first be recognised at an entity level before being recognised at the consolidated level (noted in paragraph 25(f)) is resolved – the grantor recognises the SC asset and related liabilities, income and expenses.
37. In respect of the stakeholders' comment noted in paragraphs 25(e) and 28(b) regarding contract signatories, staff consider that consistent with the substance-over-form concept, the entity that has the right to restrict another party's practical ability to sell or pledge the SC asset throughout and after the term of the SC arrangement should be the grantor, irrespective of whether another entity acts on its behalf in signing the contract.

5 Paragraph 4.20 of [Conceptual Framework for Financial Reporting](#) states: "An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. **Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it.** It follows that, if one party controls an economic resource, no other party controls that resource." [emphasis added] This framework currently is applicable only to certain for-profit entities, however the Board is undertaking a project to consider how this Framework should be applied to not-for-profit entities.

6 As discussed in Agenda Paper 5.3, staff consider there is merit in exploring an alternative control approach.

Question for Board members

Q2: Do Board members agree with the staff's preliminary views in paragraph 35?

Issue 3: Providing public services

Background

38. AASB 1059 paragraph 2 states:

“This Standard shall be applied to service concession arrangements, which involve an operator:

- (a) providing **public services** related to a service concession asset on behalf of a grantor; and ...” [emphasis added]

Therefore, the meaning of ‘public service’ is an important factor to consider in determining which transactions/assets should be within the scope of the Standard.

39. When developing AASB 1059, the Board proposed a definition of the term ‘public service’ in its Exposure Draft ED 261 *Service Concession Arrangements: Grantors* (May 2015). That definition was:

“A service that is provided by government or one of its controlled entities, as part of the usual government function, to the community, either directly (through the public sector) or by financing the provision of services.”

40. Although respondents to ED 261 supported the inclusion of a public service definition, they commented that the proposed definition was unclear. The Board concluded that any definition of public service would result in similar interpretative issues as those raised by those respondents. Therefore, in lieu of a public service definition, the Board provided guidance and examples to demonstrate the existence of public services for assessing whether an arrangement is within the scope of the Standard.

41. The guidance in AASB 1059 specific to whether an asset provides public services has been reproduced in the box below:

B5 Appendix A defines a service concession asset. Examples of service concession assets include roads (and land under roads), bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, registries and databases, and other tangible or intangible assets that are expected to be used during more than one reporting period in delivering public services.

Asset provides public services

B6 Assessing whether an asset provides public services requires judgement, taking into account the nature and relative significance of each component and the services provided. For example, a courthouse building provides multiple services, such as courts, administrative offices and associated services. However, the primary purpose of the building is to provide court services, which are considered to be public services. The court services are **necessary or essential to the general public and are generally expected to be provided by a public sector entity in accordance with government policy or regulation**. The court services are accessible to the public, even if it is a subset of the community that uses the services. The services provided by the administrative offices may be unrelated to the court services and therefore considered ancillary if they are insignificant to the arrangement as a whole, and in that case would not affect the assessment that the building provides

	public services. However, if the unrelated administrative services were significant to the arrangement as a whole, the courthouse building might be assessed as not providing public services. [emphasis added]
B7	If an arrangement provides public services principally through a primary asset, and a secondary asset is used or is mainly used to complement the primary asset, such as student accommodation for a public university, the secondary asset would be regarded as providing public services as well. As another example, a hospital car park constructed by an operator as part of the arrangement to construct a hospital that largely provides public services would be considered part of the hospital service concession arrangement. The car park may provide limited ancillary services without affecting the assessment that the car park is used to provide public services. However, if the car park was not constructed as part of the hospital service concession arrangement (eg subsequent to the construction of the hospital or with a different party) and is largely of a commercial nature (eg car parking is available to the general public, including hospital patrons) , the car park would be regarded as an asset that does not provide public services, and therefore outside the scope of this Standard. [emphasis added]
B8	Where the services provided by an asset are used wholly internally by a public sector entity for the purpose of assisting the public sector entity to deliver public services, but managed by an external party, the arrangement is likely to be an outsourcing arrangement or a lease, rather than a service concession arrangement. For example, the provision of information technology services to a government department providing emergency services to the public is likely to be an outsourcing contract, which may contain a lease of the information technology hardware. The accompanying Implementation Guidance also illustrates common types of arrangements.
B9	For an asset to provide public services, it is not necessary for the public to have physical access to the asset. For example, a military base provides public services (defence activities) even though the public is unlikely to have physical access to the military base.

Stakeholder feedback

42. Despite having the above guidance, S2–ACAG, S3–PwC, S5–HoTARAC and other stakeholders have commented that determining whether an arrangement provides ‘public services’ is a key judgement area in applying AASB 1059 and that there is currently diversity in whether similar arrangements are classified as SC arrangements. S2–ACAG also commented that the consideration of whether an arrangement provides public services has resulted in significant costs in some cases relative to applying the remainder of the Standard.
43. Both S2–ACAG and S5–HoTARAC commented that AASB 1059 paragraph B6 implies that public services are expected to be “necessary or essential to the general public and are generally expected to be provided by a public sector entity in accordance with government policy or regulation”. However, it is not always clear whether the services provided by an asset:
- (a) are necessary or essential to the general public – this is a judgement area and can vary depending on different perspectives and different subsets of the general public; or
 - (b) are generally expected to be provided by a public sector entity in accordance with government policy or regulation – what is generally expected to be provided by the public sector changes over time. For example, ports, ferries, electricity, prisons and detention centres historically were all government services but some of these may now be provided wholly or partially by private sector operators. S5–HoTARAC is of the view that in the

context of a particular jurisdiction, public services should not include services in the industries that have effectively been privatised in the jurisdiction.

44. Stakeholders provided specific examples of assets/situations where there is diversity in views on whether the asset is providing a public service. The examples have been summarised in paragraphs 45–60.

Example 1: Public universities

45. S2–ACAG commented that one of its jurisdictions is of the view that since most universities earn a significant portion of revenue from international students who pay significantly higher fees than local students, it was a matter of judgement to assess whether universities provide public services. Overall, the ACAG jurisdiction considered it reasonable to conclude that Australian public universities provide public services, irrespective of the proportion of overseas exports vs local consumption, because:
- (a) international education is a key contributor to Australia’s exports and Gross Domestic Product, and therefore the level of international students’ intake and fee-setting are largely matters of government policy for Australian public universities; and
 - (b) education (primary, secondary and tertiary) is essential to the public and there would be a general community expectation government provides tertiary education and makes it accessible to the public even if a subset of the community uses those services.

Example 2: Student accommodation at a public university

46. Some stakeholders, including S2–ACAG, commented that because student accommodation is predominately occupied by full-fee-paying international students, there is diversity in views on whether student accommodation is considered to be providing a public service. There is ambiguity in determining the phrase ‘largely of a commercial nature’ referred to in AASB 1059 paragraph B7.

Example 3: Hospital car park

47. Despite the two hospital car park scenarios in the example in AASB 1059 paragraph B7, S1–GCHHS, S2–ACAG, S3–PwC (verbally), S5–HoTARAC and roundtable participants commented that there are diverse views on whether a hospital car park is considered to be providing a public service or to be ‘largely of a commercial nature’.
48. Some stakeholders are of the view that, if the car park provides services to the general public and not exclusively to hospital patrons or staff, in line with the second scenario described in AASB 1059 paragraph B7 the car park should be treated as not providing a public service.
49. However, other stakeholders took the position that if the car park is built on a parcel of land owned by the hospital entity (the grantor), it inherited the primary purpose of the hospital which is to provide public health services (i.e. the first scenario described in AASB 1059 paragraph B7 would apply).

Example 4: Ports

50. S2–ACAG and S3–PwC (verbally) commented that there is significant debate on whether ports used for importing and exporting goods should be considered to be providing public services. Some stakeholders considered that because exports primarily involve private corporations generating profits rather than providing a public service, ports that are being used for exports should not be considered to be providing a public service.
51. Other stakeholders considered that ports provide public services because:
- (a) these services are ‘necessary or essential to the general public and are generally expected to be provided by a public sector entity in accordance with government policy or regulation’ and are considered ‘accessible to the public, even if it is a subset of the

community that uses the services', as noted in AASB 1059 paragraph B6 (e.g. these services may be considered essential services under State legislation);

- (b) consumer industries rely heavily on the ports; and
- (d) goods shipped are ultimately used by the public.

Example 5: Leisure/aquatic centre

52. A stakeholder commented that it is unclear whether the provision of a leisure or aquatic centre by a local government is considered to be providing a public service. It is unclear whether this service is considered 'essential to the general public' or 'generally expected to be provided by a public sector entity' referred to in AASB 1059 paragraph B6.

Example 6: Child care and aged care

53. A stakeholder commented that it is unclear whether child care and aged care services are considered public services for the purpose of AASB 1059.
54. One view is that since there are private sector entities providing child care and aged care services, these services are not considered public services. Another view is that because many private entities providing child care and aged care services are not-for-profit (NFP) entities relying heavily on government funding, these entities could be regarded as providing child care and aged care services on behalf of the government.

Example 7: Regional airports

55. A stakeholder commented that while the main airport in most Australian Capital cities has been privatised, operating an airport in a regional area might be considered a public service.
56. This is because it is unlikely for a private sector entity to operate an airport in a regional area due to low air traffic and therefore low profitability. Therefore, if a government determines that an airport is needed in a regional area and engages a private sector entity to construct and/or operate an airport in that area, that service should be considered a public service.

Example 8: An asset providing multiple public services/being used partly for internal purposes

57. S5–HoTARAC commented that sometimes an asset is used to provide multiple services, and only one of the services is provided by the operator. For example, a residential building may be used to provide social housing (public service 1) and medical support service to the residents of that building (public service 2). They ask whether the arrangement is within the scope of AASB 1059 if the operator provides only the construction service (to construct the building) and the upkeep and maintenance of the building (public service 1), and the medical support service (public service 2) is provided by the grantor or an agent of the grantor.
58. Additionally, S5–HoTARAC commented that sometimes the services provided by an SC asset could be used partly for internal purposes. For example, a database that provides services to the public as well as for the government's own use.
59. HoTARAC asked those questions in the context of AASB 1059 paragraph B6, which requires an entity to take into account the ***nature and relative significance of each component and the services provided***. They asked whether, in the examples described in paragraphs 57 and 58, the arrangements are considered to be within the scope of AASB 1059 if the operator is providing only one of the two public services, or providing services to the grantor/grantor's agent and the general public.
60. A similar question arose as part of the determination of whether an arrangement related to the operation of a port (described in paragraphs 50 and 51) is considered to be within the scope of AASB 1059. Stakeholders questioned whether it would be necessary to divide the port activities between imports and exports to determine to what extent ports provide public services

(assuming that export activities are not considered public services), in accordance with AASB 1059 paragraph B6.

Staff analysis

61. Staff consider that the guidance in AASB 1059 appears to be insufficient to assist financial statement preparers in determining whether an asset provides a public service. In particular:
 - (a) the phrases 'necessary or essential to the general public' and 'generally expected to be provided by a public sector entity in accordance with government policy or regulation' (referred to in AASB 1059 paragraph B6) are open to different interpretations;
 - (b) the phrase 'largely of a commercial nature' (referred to in AASB 1059 paragraph B7) seems to be causing confusion because some services may generate cash inflows for an entity, but the nature of the service may still be considered essential services; and
 - (c) guidance might be needed on whether a service that is heavily subsidised by government funding but is being provided by a private sector entity is considered to be a public service.
62. Consistent with the Board's conclusion following ED 261, staff continue to think that any definition of public service would result in different interpretation issues. This view is shared by S2-ACAG, S3-PwC and S5-HoTARAC.
63. Based on the feedback received, it appears that whether an asset provides a public service is not an effective criterion to apply in determining whether an arrangement is an SC arrangement.
64. Although not specifically stated in the Basis for Conclusions for AASB 1059, staff observed that the Board added this criterion to assist entities in distinguishing assets that are part of a privatised arrangement from SC assets. Staff consider that there might be other ways to distinguish the two types of arrangements. For example, the entity's rights related to the asset in an SC arrangement would be different to that in a privatisation.

Staff preliminary view

65. Staff's preliminary view is that, before undertaking work to develop further guidance on 'public service', to:
 - (a) explore whether guidance and clarifications could be developed to explain how an entity's rights relating to the usage of an asset might be different in SC arrangements from other arrangements as an alternative to the 'public service' criterion (this is discussed in Agenda Paper 5.3); and
 - (b) consult with key stakeholders on their preference for adopting the alternative in (a) or retaining the 'public service' criterion.

Question for Board members

Q3: Do Board members agree with the staff preliminary view to undertake work to explore whether guidance and clarifications could be developed to explain how an entity's rights relating to the usage of an asset might be different in SC arrangements from other arrangements as an alternative to the 'public service' criterion?

Issue 4: Operator responsible for at least some of the management of the public service at its own discretion

Background

66. AASB 1059 paragraph 2 states:

“This Standard shall be applied to service concession arrangements, which involve an operator:

(a) ...

(b) **managing at least some of the public services under its own discretion**, rather than at the direction of the grantor ...” [emphasis added]

67. AASB 1059 paragraph 3 states: “Arrangements outside the scope of this Standard include those that do not involve the delivery of a public service, those where the **operator manages the public services merely as an agent of the grantor**, and”

68. AASB 1059 paragraph B10 provides guidance on the condition in AASB 1059 paragraph 2(b). It states:

“For an arrangement to be within the scope of this Standard, the operator must be responsible for providing public services through the service concession asset and for managing at least some of the public services and related services, and not act merely as an agent on behalf of the grantor through an outsourcing arrangement. For example, an operator in an arrangement to construct and operate a hospital in accordance with the grantor’s directions would need to provide services more managerial in nature than cleaning, building maintenance and security services for the hospital after its construction in order for the arrangement to be considered a service concession arrangement.

Cleaning, building maintenance and security services would generally be regarded as relatively insignificant to the public services provided by the hospital. Therefore, if the operator is responsible only for constructing the hospital and then providing all or any of those services, the operator is unlikely to be considered to be responsible for some of the management of the public services provided by the hospital. However, if after constructing the hospital the operator also provides **scheduling of staff and resources (even if provided by the grantor)**, the operator is likely to be responsible for some of the management of the hospital public services, and not acting like an agent of the grantor. In contrast, **if the maintenance contributes significantly to the public services provided by the asset, then the operator would be responsible for at least some of the management of the public services provided by the asset.** For example, this would be the case for an arrangement where an operator constructs and maintains (at its discretion) a toll road on behalf of the grantor, because maintenance services are a significant component of the public services provided by the toll road.” [emphasis added]

69. Illustrative Example 5(a) of AASB 1059 illustrates the circumstances where an arrangement, involving an asset that would provide electricity, might be a sale rather than an SC arrangement. That example stated that the rights of the grantor to ensure electricity supply in certain circumstances are protective rights, rather than substantive rights that would indicate the grantor controls the electricity assets.

Stakeholder feedback

70. S2–ACAG and S5–HoTARAC requested the Board to consider providing further guidance on the ‘operator managing at least some of the public services under its own discretion’ criterion in AASB 1059 paragraph 2(b). They commented that:

- (a) the phrase 'at least some of the public services' and the degree of discretion able to be exercised by the operator for the operator to be considered a principal and not an agent of the grantor are open to a significant amount of judgement;
 - (b) the examples in AASB 1059 paragraph B10 (quoted in paragraph 67) are very black and white on whether maintenance or other services are a significant component of the public service provided by the asset. While it might be clear that maintenance is not significant to a school but might be significant for a road, it is unclear whether maintenance is considered significant for other public transport assets, such as buses and ferries, especially when the grantor manages and sets the timetables for the maintenance of those assets. One ACAG jurisdiction considered proper maintenance of these assets is necessary for ensuring the smooth running of the public services and making sure these assets are hazard-free for the health and safety of commuters;
 - (c) where the grantor has a right to/needs to review the operator's plans for providing services using the assets, there is diversity in practice regarding whether the grantor's right is considered protective (and therefore AASB 1059 paragraph 2(b) is met) or substantive (and therefore AASB 1059 paragraph 2(b) is not met) in nature. One ACAG jurisdiction had determined a similar arrangement where the grantor has a right to review the operator's plan for providing services to be outside the scope of AASB 1059 because the degree of the operator's discretion on the decision was not sufficient (for example because the services were subject to strict requirements and/or changes had to be approved by the grantor – this was considered more than a protective right);
 - (d) where the grantor has ultimate approval rights over the way the services are delivered – for example, the operator prepares a detailed asset management plan and timetabling but the grantor has the right to approve or reject the operator's plan – in this case, is the grantor's right considered protective or substantive?
 - (e) Is the grantor's right considered protective or substantive where the operator has discretion and flexibility in preparing the operations and maintenance manual subject to the grantor's minimum standards, but the grantor has the right to reject the manual if (and only if) it could substantiate that the manual does not meet the minimum standards? HoTARAC is of the view that the right is protective in nature; and
 - (f) If the grantor has the ability to specify specific KPIs that must be met by the operator, but the operator has complete discretion on how it manages and achieves those KPIs – for example, if the operator has flexibility and managerial decision-making in terms of day-to-day functioning, making granular decisions while still remaining compliant with the broader KPIs – would this demonstrate that the operator is managing at least some of the services under its own discretion?
71. HoTARAC is of the view that the grantor must first determine which activities are considered 'significant activities' of a particular public service to examine whether the operator satisfies the 'managing at least some' criterion – the operator would need to be managing an activity that is significant to the public service for the arrangement to be in scope. They recommend amending AASB 1059:
- (a) so that references to 'managing at least some' are replaced by 'managing at least some of the significant components' of the public services;
 - (b) to provide further guidance on how to assess which types of activities are considered 'significant' for which types of public services; and
 - (c) to provide further guidance on whether the operator is considered to have discretion over the management of public services where the grantor has protective or substantive rights over the provision of the services.

72. HoTARAC provided the following factors that they suggest should be considered, individually or in combination, in determining whether the activities being managed by the operator are significant to the public service:
- (a) compensation to the operator for the service compared to other services provided under the arrangement;
 - (b) resource requirements (e.g. direct labour, service costs etc.) for the provision of the service relative to others provided under the arrangement;
 - (c) impact on agreed outcomes, performance and/or KPIs under the arrangement;
 - (d) senior management time and resources committed to the service relative to others provided under the arrangement; and
 - (e) physical apportionment of the asset between different services/activities.

Staff analysis

73. Staff agree with ACAG and HoTARAC that clarifications are needed to better explain the ‘operator managing at least some of the public services under its own discretion, rather than at the direction of the grantor’ criterion. Staff also agree that some of HoTARAC’s suggestions noted in paragraph 72 would be useful guidance in determining whether the activities being managed by the operator are significant to the public service.
74. However, before considering what further guidance is needed, it would be important to consider whether ‘the operator managing at least some of the public services under its own discretion, rather than at the direction of the grantor’ is an effective criterion for determining whether an arrangement/ asset is within the scope of AASB 1059. The amount of feedback on this criterion suggests that this criterion isn’t effective.
75. IPSAS 32 *Service Concession Arrangements: Grantor* (and therefore NZASB’s PBE IPSAS 32) does not contain such a criterion in its scope criteria. This is one of the key changes the Board made to IPSAS 32 when developing AASB 1059. The following table includes the text in both Standards for comparison.

	IPSAS 32/NZ PBE IPSAS 32	AASB 1059
Scope	Arrangements within the scope of this Standard involve the operator providing public services related to the service concession asset on behalf of the grantor.	This Standard shall be applied to service concession arrangements, which involve an operator: <ul style="list-style-type: none"> (a) providing public services related to a service concession asset on behalf of a grantor; and (b) managing at least some of those services under its own discretion, rather than at the direction of the grantor.
Definition of SC arrangement	A service concession arrangement is a binding arrangement between a grantor and an operator in which: <ul style="list-style-type: none"> (a) The operator uses the service concession asset to provide a public service on behalf of the 	A contract effective during the reporting period between a grantor and an operator in which: <ul style="list-style-type: none"> (a) the operator has the right of access to the service concession asset (or assets) to

	<p>grantor for a specified period of time; and</p> <p>(b) The operator is compensated for its services over the period of the service concession arrangement.</p>	<p>provide public services on behalf of the grantor for a specified period of time;</p> <p>(b) the operator is responsible for at least some of the management of the public services provided through the asset and does not act merely as an agent on behalf of the grantor; and</p> <p>(c) the operator is compensated for its services over the period of the service concession arrangement.</p>
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76. From a conceptual perspective, under the Conceptual Frameworks⁷ and other Accounting Standards, the main determining factor on whether an asset should be recognised by an entity is based on whether **the reporting entity has control** of the asset.⁸ Accordingly, whether another party might have a certain level of control of the asset should be part of the reporting entity’s control assessment.
77. Specifically, in the context of SC arrangements, staff consider that the Standard could clarify that a grantor is required to determine whether it has control over an SC asset **despite** the operator being responsible for at least some of the management of the public services provided through the SC asset.
78. As demonstrated in the Implementation Guidance and Illustrative Examples accompanying AASB 1059, the Board added this criterion to assist entities in distinguishing assets that are part of privatisation from SC assets. As mentioned in Issue 3 (paragraph 64), staff consider that the entity’s rights related to an asset in an SC arrangement are different to that in privatisation.

Staff’s preliminary view 4 – Operator responsible for at least some of the management of the public service at its own discretion

79. Staff’s preliminary view is that, before undertaking work to develop further guidance on the ‘the operator managing at least some of the public services under its own discretion’ criterion, to:
- (a) explore whether guidance and clarifications could be developed to explain how an entity’s rights relating to the usage of an asset might be different in SC arrangements from other arrangements as an alternative to that criterion (this is discussed in Agenda Paper 5.3); and
 - (b) consult with key stakeholders on their preference for adopting the alternative in (a) or retaining the ‘the operator managing at least some of the public services under its own discretion’ criterion.

7 The [Conceptual Framework for Financial Reporting](#) (paragraph 4.3), currently applicable to for-profit entities, and [Framework for the Preparation and Presentation of Financial Statements](#) (paragraph 49(a)), applicable to not-for-profit entities.

8 And whether the asset’s costs can be measured reliably

Questions for Board members

- Q4: Do Board members agree with the staff analysis in paragraphs 76 and 77 that, from a conceptual perspective, the Standard should clarify that a grantor is required to determine whether it has control over an SC asset despite the operator being responsible for at least some of the management of the public services provided through the SC asset?
- Q5: Do Board members agree with the staff view that if the condition in AASB 1059 paragraph 2(b) is retained, staff should consider how some of the factors suggested by HoTARAC (noted in paragraph 72) might be incorporated as guidance to determining whether the activities being managed by the operator are significant to the public service?
- Q6: Do Board members agree with the staff preliminary view to undertake work to explore whether guidance and clarifications could be developed to explain how an entity's rights relating to the usage of an asset might be different in SC arrangements from other arrangements as an alternative to the 'the operator managing at least some of the public services under its own discretion' criterion?

Issue 5: Grantor's control of the SC asset

Background

80. Paragraph 5 of AASB 1059 states:

"The grantor shall recognise an asset provided by the operator and an upgrade to or a major component replacement for an existing asset of the grantor as a service concession asset if the grantor controls the asset. The grantor controls the asset if, and only if:

- (a) the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, **and** at what price; and
- (b) the grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the asset at the end of the term of the arrangement." [emphasis added]

81. AASB 1059 paragraph B19 states: "If a service concession contract by itself does not result in the grantor having explicit control over the services and/or pricing of the services, the **grantor might still have control of the service concession asset as a result of regulation by a third party.**" [emphasis added]

Stakeholder feedback regarding the grantor's control of the services

Third-party regulation

82. AASB 1059 paragraph B20 states:

"... Prices are regarded as controlled by the grantor in a regulated environment when a third-party regulator regulates the pricing of the services provided with a service concession asset. The regulation removes the ability of the operator to determine the price and, for the purpose of paragraph 5(a), the pricing of the services is considered to be set **implicitly** by the grantor as the contract between the grantor and the operator effectively incorporates the price regulation. In some cases, the grantor could have specified an alternative pricing regime but has chosen not to do so, effectively asserting '**passive' control of the pricing**. If the contract specifies the grantor controls the services and the recipients of the services, the third-party regulation of the pricing of the services means that the operator does not control the pricing or the other criteria specified in paragraph 5(a), and accordingly the grantor controls the asset. If the operator is able to determine to whom the services are provided, but is subject to grantor control over what services may be provided and the pricing, the grantor does not control the asset. ..." [emphasis added]

83. S5–HoTARAC commented that where a third party regulates what services the operator must provide with the SC asset, to whom it must provide them, and/or at what price, the grantor is taken to be regulating them 'implicitly' or 'passively' because the regulation removes the ability of the operator to determine these elements of the arrangement. HoTARAC members generally disagree with the Board's rationale that a third-party regulation results in control by the grantor. However, HoTARAC members do not believe this concept has been overly problematic in terms of being able to apply the Standard.

84. One HoTARAC member commented that the terminology 'controls or regulates' in AASB 1059 paragraph 5(a) is unhelpful because one can regulate an activity or entity without controlling it. This is particularly evidenced in long-term arrangements involving a GORTO liability (e.g. a toll road) where the grantor does not benefit economically from the asset during the SC period, and 'the right to obtain economic benefits' is usually a key factor in determining whether an entity controls an asset. This HoTARAC member suggested the Board re-examine the distinction between 'control' and 'regulate' because there are some arrangements that can be regulated

but the level of regulation does not give economic control to the grantor during the term of the arrangement, even if the asset returns to the government at the end of the arrangement term.

Staff analysis

85. The Board long ago disagreed with the ‘control and regulation’ approach for determining whether a grantor controls an SC asset in its submissions to the IASB⁹ (on the development of IFRIC 12) and to the IPSASB¹⁰ (on the development of IPSAS 32).
86. Staff observed that the Board adopted the ‘control and regulation’ approach in AASB 1059 not because the Board was completely satisfied with the conceptual merits of that approach, but because the other alternative approaches considered also have flaws and, on balance, the ‘control or regulation’ approach (adopted by the IPSASB in IPSAS 32) was considered the most appropriate approach. AASB 1059 paragraph BC26 noted that the Board was of the view that the ‘control and regulation’ approach would:
- (a) lead to greater consistency in the accounting requirements for the operator and the grantor because it would require both the operator and the grantor under an SC arrangement to apply the same principles in determining which party should recognise the asset in the arrangement¹¹; and therefore
 - (a) reduce the possibility of an asset being recognised by both parties, or by neither party to the arrangement.
87. In respect of third-party regulation, as indicated in AASB 1059 paragraph B20, the Board decided that the fundamental principle is ‘control’, and that regulation of an SC asset is only one of the factors to consider in determining whether the grantor controls the asset in particular circumstances. The Board did not intend to imply that an asset is controlled because it is regulated.
88. Staff agree that, conceptually, it is unclear why a third-party regulator regulating an industry for which the prices for the services provided by the SC asset would indicate the grantor has control over the prices for the services – it only indicates that the operator does not have control of the prices.
89. Staff consider that in light of the changes the IASB made to the Conceptual Framework, including the introduction of the concept that “an entity’s rights are assets”, it would be useful to reconsider whether the ‘control or regulation’ approach adopted by IPSAS 32 and Interpretation 12 remains appropriate before undertaking work in developing further guidance. This is discussed in Agenda Paper 5.3.

9 [Submission letter](#) (June 2005) on IFRIC D12 *Service Concession Arrangements – Determining the Accounting Model*, IFRIC D13 *Service Concession Arrangements – The Financial Asset Model* and IFRIC D14 *Service Concession Arrangements – The Intangible Asset Model*, and [submission letter](#) (November 2006) on IFRIC (Near Final) *Service Concession Arrangements – Determining the Accounting Model*

10 [Submission letter](#) (October 2008) on IPSASB Consultation Paper *Accounting and Financial Reporting for Service Concession Arrangements*, and [submission letter](#) (July 2010) on IPSASB ED 43 *Service Concession Arrangements: Grantors*

11 Interpretation 12 applies to operators in public-to-private service concession arrangements if:

- (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- (b) the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement.”

Partly regulated assets

90. AASB 1059 paragraph B26 states: “There may be arrangements that include unregulated services that are neither purely ancillary nor delivered by using a physically separable portion of the total asset. For example, a grantor may control prices charged to children and seniors at a sports facility but the amounts charged to adults are not controlled. The same facilities are being used by all, regardless of the amount they pay. Alternatively, prices could be regulated by the grantor for services provided at certain times of the day rather than for different classes of users. In such cases, it will be a matter of judgement whether **enough of the service is regulated** in order to demonstrate that the grantor has control of the asset.” [emphasis added]
91. S2–ACAG and S5–HoTARAC commented that there were different views on what ‘enough of the service is regulated’ means, and consequently what level of regulation is sufficient for classifying an arrangement as an SC arrangement. They queried whether the assessment can be judged from:
- (a) the quantum of revenue generated from regulated and unregulated services; or
 - (b) the volume of regulated services vs unregulated services.
- If so, how to assess the amount of revenue and the volume of services? For example, revenue and the volume of services can vary from one year to another and which year’s results should be used in assessing whether enough of services are regulated?
92. Examples of partly regulated assets that respondents are having particular difficulties assessing whether they would fall within the scope of AASB 1059 include transport assets, ports and car parks.

Staff analysis

93. Staff agree that significant judgement is needed to determine whether a partly regulated asset is (1) providing a public service and (2) subject to enough regulation for the grantor to have control of the SC asset (or for the operator to not have control of the asset). Therefore, staff consider that clarification on this issue is needed if the current ‘control and regulation’ approach is retained.
94. Staff consider that, if the Board agrees to provide further guidance regarding ‘whether enough of the service is regulated’, the two suggestions by stakeholders noted in paragraph 91 can be considered. An alternative approach could be that the assessment is to be made on the basis of the initial operating period and not reconsidered thereafter.

Government grants

95. One ACAG jurisdiction suggested that the Board clarify whether a grantor providing a subsidy (for example, an aged care subsidy) would result in the determination of the grantor controlling the price of the public service. That ACAG jurisdiction is of the view that the availability of such government subsidy on its own does not indicate the grantor has control of prices unless the grantor is also able to determine the price charged to customers.

Staff analysis

96. Staff agree with that ACAG jurisdiction. Although having a government subsidy might lead to the operator charging a lower fee to the customers, this alone does not indicate that the grantor has control of the prices.
97. If the Board decides to retain the current ‘control and regulation’ approach, staff consider that further guidance should be developed to clarify whether (and if so, how) the control assessment would be affected if the operator receives government grants related to the services it provides using the SC asset.

Stakeholder feedback regarding the grantor's control of the asset's residual interest

98. AASB 1059 includes the following guidance regarding residual interest.

Residual interest	
B32	The grantor must also control through ownership, beneficial entitlement or otherwise any significant residual interest in the asset at the end of the term of the arrangement (paragraph 5(b)).
B33	For the purpose of paragraph 5(b), the grantor's control over any significant residual interest would both restrict the operator's practical ability to sell or pledge the asset (by acknowledging the grantor's residual interest in the asset) and effectively give the grantor control of the asset throughout the period of the service concession arrangement. Consequently, where the grantor has substantive, rather than merely protective, rights to prevent the operator selling or pledging the asset during the service concession arrangement (eg the grantor must formally approve the transferee, rather than being able to refuse merely on the grounds that the transferee is not fit and proper), then the grantor is likely to have control of any significant residual interest in the asset.
B34	The residual interest in the asset is the estimated fair value (current replacement cost) of the asset, determined at the inception of the arrangement, as if it were already of the age and in the condition expected at the end of the service concession arrangement.
B35	Paragraph 5 identifies whether the asset, including any replacements required, is controlled by the grantor for the whole of its economic life, beyond the term of the service concession arrangement. For example, if the operator has to replace part of an asset during the period of the arrangement (eg the top layer of a road or the roof of a building), the asset shall be considered as a whole. Thus the condition in paragraph 5(b) is met for the whole of the asset, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part. However, replacements of major components are treated as a separate service concession asset (see paragraphs B38 and B48).
Whole-of-life assets	
B37	For the purpose of paragraph 6, a whole-of-life asset is an asset that will be used in a service concession arrangement for either its entire economic life or the major part of its economic life. In both cases, there is no significant residual interest in the asset at the end of the arrangement, so that the condition in paragraph 5(b) is not relevant.

99. S5–HoTARAC commented that assessment of whether the grantor controls any significant residual interest in the asset can be challenging, for example, where two or more assets are involved in the service provision. HoTARAC suggested the Board add real-life examples to the guidance on significant residual interest.
100. S2–ACAG commented that often the residual interest test is met because the SC asset is on the grantor's land and at the end of the arrangement the grantor gains legal ownership and/or beneficial entitlement to the SC service concession asset that remains on that land. Also, often it is an operating asset (for example, a toll road that has to meet a specific performance standard) and consequently, the SC asset is well-kept and therefore is expected to have a significant residual value. However, sometimes the SC asset is on the operator's land and the grantor needs to pay the operator an amount when the asset is handed back to the grantor. In such circumstances, it is uncertain how to determine whether the grantor controls the 'significant' residual interest of the asset.
101. S2–ACAG also provided the following comments:
- (a) AASB 1059 did not specify how residual interest of the asset is to be calculated in order to assess whether the interest held by the grantor is 'significant';
 - (b) When assessing what level 'significant' represents, should reference be made to the 20% threshold under equity accounting, or the 20–30% some entities applied under the impairment testing requirement for available for sale financial assets under the superseded AASB 139 *Financial Instruments: Recognition and Measurement*, or other

- percentages? ACAG asks whether the Board had another view of what quantitative level 'significant' means;
- (c) AASB 1059 paragraph B35 appears contradictory. In the first part, it treats replacements and lifecycle costs as part of the asset. However, in the second part, it appears to treat replacements and lifecycle costs as separate assets. It is unclear when assessing the estimated residual value of the asset, determined at the inception of the arrangement, whether to calculate based on:
- (i) the fair value of the original asset, which would result in a very low amount because major components of the original asset would have been replaced over the term of the arrangement; or
 - (ii) the fair value of the asset at the end of the arrangement which would include replacement components of the original asset;
- (d) additional guidance should be provided on the effect of common contractual alternatives at the end of the concession period including:
- (i) the grantor acquires the assets at a set operating performance standard (for example, a working toll road) for nil consideration;
 - (ii) the grantor acquires the assets at a set operating performance standard for a consideration equals the fair value of the SC asset;
 - (iii) the operator is granted a second concession term; and
 - (iv) a new operator is allowed to acquire the assets.

Staff analysis

102. The Board previously decided not to provide guidance on the term 'significant' because that term is used in numerous Standards without specific guidance as to what would constitute 'significant'.¹² Therefore, staff consider that it would be inappropriate to provide specific guidance on that term in AASB 1059.

103. Staff observed that AASB 1059 paragraph B33 (quoted in the box in paragraph 98) provided guidance on a qualitative assessment of whether the grantor controls any significant residual interest of the SC asset – if the grantor could restrict the operator's practical ability to sell or pledge the asset. It also clarified that "where the grantor has substantive, rather than merely protective, rights to prevent the operator selling or pledging the asset during the service concession arrangement (eg the grantor must formally approve the transferee, rather than being able to refuse merely on the grounds that the transferee is not fit and proper), then the grantor is likely to have control of any significant residual interest in the asset."

104. As mentioned in Issue 1 (paragraph 33(b)) staff observed that AASB 1059 paragraph B33 is consistent with the control concept in paragraph 4.20 of *Conceptual Framework for Financial Reporting* (the Revised Conceptual Framework). Accordingly, staff consider that it might be sufficient to conclude that the grantor has control of the SC asset without undergoing an assessment of the monetary value of the asset's residual interest if the grantor has 'the right to

12 For example:

- (a) AASB 10 *Consolidated Financial Statements* – 'significant' is used in the context of activities that significantly affect the investee's returns (paragraphs 10 and 13) and significant influence of an investor over an investee (paragraph 14); and
- (b) AASB 116 *Property, Plant and Equipment* – 'significant' is used to in the context of 'some ... property, plant and equipment experience significant and volatile changes in fair value' (paragraph 34), and in determining the depreciation of property, plant and equipment in paragraphs 43-47, such as "Each part of the property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately" (paragraphs 43).

restrict another party's practical ability to sell or pledge the SC asset throughout and after the term of the SC arrangement'.

105. If the Board decides to retain the 'any significant residual interest in the asset at the end of the term of the arrangement' criterion, staff agree with stakeholders that clarification would be helpful on how to assess an asset's residual interests in the situations described in (c) and (d) of paragraph 101.

Staff preliminary view

106. Staff's preliminary view is that, before undertaking work in developing further guidance on the two conditions in AASB 1059 paragraph 5, to:

- (a) explore whether introducing elements of the new asset definition in the Revised Conceptual Framework (e.g. introducing 'rights of an entity') would be a suitable alternative to the control criteria in AASB 1059 paragraph 5 (this is discussed in Agenda Paper 5.3); and
- (b) consult with key stakeholders on their preference for adopting the alternative in (a) or retaining the control criteria in AASB 1059 paragraph 5.

Questions for Board members

Q7: Do Board members agree with the staff analysis that if the conditions in AASB 1059 paragraph 5 are retained, further guidance/clarification would be needed on:

- (a) whether a partly regulated asset is (1) providing a public service and (2) subject to enough regulation for the grantor to have control of the SC asset (paragraphs 93 and 94);
- (b) whether (and if so, how) the control assessment would be affected if the operator receives a government grantor related to the services it provides using the SC asset (paragraph 97); and
- (c) how to estimate the SC asset's residual interests in the situations described in (c) and (d) of paragraph 101 (paragraph 105)?

Q8: Do Board members agree with the staff preliminary view to undertake work to explore whether introducing elements of the new asset definition in the Revised Conceptual Framework (e.g. introducing 'rights of an entity') would be suitable alternative to the control criteria in AASB 1059 paragraph 5?