Australian Government
Australian Accounting Standards Board

# Staff Paper

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| **Project:** | **Service Concession Arrangements** | **Meeting:** | AASB February 2016 (M150) |
| **Topic:** | **Redeliberation of Proposed Asset and Liability Recognition and Measurement** | **Agenda Item:** | 13.1 |
| | | **Date:** | 8 February 2016 |
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| | | **Decision-Making:** | High |
| | | **Project Status:** | Redeliberations |

**Introduction and objective of this paper**

1 The objectives of this paper are:

(a) to obtain Board decisions:

(i) to address the fair value measurement of the service concession asset and liability at fair value in accordance with AASB 13 *Fair Value Measurement*; and

(ii) to include in the Basis for Conclusion to the final Standard, the rationale for the decision to adopt the grant of the right to the operator model; and

(b) to provide the Board with a project update (refer to Appendices A and B).

2 This paper is structured as follows:

(a) Summary of staff recommendations (paragraph 3);

(b) Background, including the relevant feedback received on ED 261 *Service Concession Arrangements: Grantor* (paragraphs 4-7); and

(c) Staff analysis (paragraphs 8-91).

**Summary of staff recommendations**

3 Staff recommend in relation to:

(a) fair value measurement of a service concession asset:

(i) guidance on the fair value measurement of a service concession asset should be provided in the final Standard in service concession arrangements from a grantor's perspective, if the Board decides that a separate (broader) project to provide guidance on the fair value of public sector assets is not necessary;

(ii) in determining the fair value of the service concession asset, the right of access provided to the operator should be considered in determining whether it represents a restriction on the asset under GORTO model;

(iii) the unit of account of the service concession asset, in determining the asset's fair value, is the entire useful life of the asset, including any residual value of the service concession asset;

(iv) the appropriate valuation technique used to measure the fair value of the service concession asset should reflect the principles of AASB 13 that is appropriate in circumstances and for which sufficient data are available that maximises the relevant observable inputs and minimises the unobservable inputs that are consistent with the characteristics for the asset;

(v) not to apply AASB 140 by analogy to measure the asset's fair value where the arrangement is accounted for under the GORTO model, for the reasons outlined in paragraphs 45 and 46; and

(vi) the fair value assessments of a service concession asset for revaluation and impairment purposes are no different to other assets that are subject to the requirements of AASB 116, AAB 138 and AASB 136;

(b) rationale for adopting the GORTO model:

(i) the analysis for Models 1 to 3 be included in the Basis for Conclusion to the final Standard to explain the Board's rationale and decision in adopting the GORTO model;

(ii) retain the existing GORTO model on the basis that:

- Model 2 does not meet the financial liability definition for application; and

- the measurement approach proposed in Model 3 to value the asset based on only the cash flows that the asset can directly generate (residual cash flows to the grantor) could understate the fair value of the asset.

## Background

4 ED 261 proposed that:

(a) the grantor initially measures the service concession asset at its fair value in accordance with AASB 13 unless the service concession asset is an existing asset of the grantor;

(b) where the grantor recognises a service concession asset, the grantor also recognises a liability measured at the same amount as the service concession asset adjusted for other consideration between the grantor and operator;

(c) depending on the nature of the arrangement, the grantor accounts for the service concession liability using the:

(i) financial liability model[1]; and/or

(ii) 'grant of a right to the operator model' (GORTO model)[2]; and

(d) the grantor accounts separately for each part of the total liability recognised for the service concession arrangement where the arrangement involves the grantor both incurring a financial liability and granting a right to the operator.

5 At its September 2015 meeting, the Board approved the project plan[3] for progressing the project. The project plan includes redeliberating the proposed asset and liability recognition and measurement in response to feedback received on ED 261.

6 At its December 2015 meeting, the Board discussed whether the proposed GORTO model in ED 261 is the appropriate model for recognising the service concession liability. The Board decided that the project should continue on the basis that it is the appropriate model and instructed Staff to research, for completeness, the rationale for the decision to adopt the model, taking into account issues around determining the fair value of the asset under this model.

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[1] The financial liability model is used to account for the service concession liability where the grantor compensates the operator for the service concession asset by making payments to the operator (ED 261.16(a)).

[2] The GORTO model is used to account for the service concession liability where the grantor compensates the operator for the service concession asset by other means, such as granting the operator the right to earn revenue from third party users of the asset or granting the operator access to another revenue-generating asset for the operator's use (ED 261.16(b)).

[3] Link to Exposure Draft 261 *Service Concession Arrangements: Grantor* – Draft Project Plan September 2015 http://www.aasb.gov.au/admin/file/content102/c3/M147_6.3_Draft_Project_Plan_SCA.pdf

*Feedback received on ED 261*

7 The following is a summary of the feedback received[4] from constituents on ED 261 in relation to the recognition and measurement of service concession assets and liabilities:

Asset measurement

(a) the majority of constituents agreed with the proposed measurement of service concession assets at fair value in accordance with AASB 13;

(b) some constituents raised specific concerns relating to the application of the fair value concept in AASB 13 to public sector assets. These constituents requested that the AASB undertake a separate project to address these concerns as a matter of priority. A number of constituents acknowledged that the broader project on fair valuing public sector assets does not need to be finalised prior to the issue of the draft Standard[5];

(c) some constituents requested additional guidance including examples where appropriate on:

(i) the fair value measurement of the service concession asset where the operator constructs an asset for the grantor in an exchange for the operator to generate revenue by charging users of the asset. The constituents also noted the potential difficulties in establishing a fair value of a partly constructed asset, where the grantor may not have an agreement with the operator for the access to this information[6];

(ii) impairment of the service concession arrangements under AASB 136 *Impairment of Assets*; and

(iii) initial valuation of service concession assets that are intangibles assets, given that, generally, intangible assets are not measured at fair value;

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[4] AASB Meeting 4 September 2014 Staff Issues Paper – Staff Collation and Analysis of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraphs 21 to 34.

Link to Staff Issues Paper
http://www.aasb.gov.au/admin/file/content102/c3/M147_6.2_Staff_Collation_and_Analysis_of_Comment_Letters_on_ED_261_SCA.pdf

Link to comment letters to ED 261
http://www.aasb.gov.au/Work-In-Progress/Pending.aspx

[5] In November 2015, the AASB issued Invitation to Comment 34 *AASB Agenda Consultation 2017–2019* for comment by 4 March 2016. The AASB will await the outcome of the agenda consultation process prior to developing the project plan for the fair value public sector assets.

[6] One of these constituents, Heads of Treasuries and Reporting Advisory Committee, asked whether in such circumstances, the historical cost can be an approximation of the fair value, and where the historical cost cannot be determined, the asset would not meet the recognition criteria of AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets* and would therefore not be recognised.

(d) one constituent[7] requested guidance on how to account for borrowing costs and economic obsolescence in determining the fair value of a service concession asset.

Liability recognition and measurement

(e) the majority of constituents supported the recognition of a liability measured at the same amount as the service concession asset. Some constituents noted that it may be difficult to reliably determine the fair value of the liability independent of the service concession asset;

(f) the majority of constituents expressed support for the proposed recognition and measurement of a service concession liability under the proposed financial liability model and GORTO model;

(g) some constituents requested more guidance on the measurement of a liability, particularly for the:

(i) accounting of finance charges under the financial liability model; and

(ii) hybrid arrangements containing both the financial liability and GORTO models;

(h) some constituents commented that under the GORTO model, it might be easier not to try and justify the conceptual basis for initially recognising a liability, and indicate that this is the rule. Some constituents requested that the Application Guidance and/or Basis for Conclusions include an explanation for this approach;

(i) in addition, one constituent[8] expressed the view that the proposed principles-based approach of recognising revenue "according to the economic substance of the service concession arrangement"[9] will not be able to be applied. The constituent suggested that the final Standard should specify that the revenue should be allocated in subsequent periods on a systematic and rational basis; and

(j) One constituent[10] requested guidance for a service concession arrangement where the operator charges the grantor for the use of the asset and the grantor has no contractual obligation to make payments to the operator and nor has the operator been granted the right to charge third-party users for using the asset. The constituent suggested that the GORTO model be broadened to apply to

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[7] Heads of Treasuries Accounting and Reporting Advisory Committee.

[8] Pricewaterhousecoopers.

[9] Paragraph 24 of ED 261 states that "The grantor shall recognise revenue, and accordingly reduce the liability recognised in accordance with paragraph 23, **according to the economic substance of the service concession arrangement**." (emphasis added).

[10] Heads of Treasuries Accounting and Reporting Advisory Committee.

such an arrangement by identifying third-party users as including the grantor. The constituent also requested additional guidance on how to recognise the revenue under the GORTO model for an arrangement with a long term (e.g. 99 years).

Accounting for hybrid arrangements

(k) Generally, constituents supported the proposal to separately account for each part of the total liability recognised for the service concession arrangement where the arrangement involves the grantor incurring a financial liability and grant of a right to the operator;

(l) Some constituents do not agree that the draft Standard provides sufficient guidance for the separate accounting for each part of the total liability recognised for a hybrid service concession arrangement; and

(m) Some constituents requested additional guidance on how to apportion such an arrangement and the inclusion of a complex example to illustrate this guidance, especially where the fair value of each component in the arrangement is difficult to estimate. Some constituents suggested that the fair value under the financial liability model may be easier to estimate and this may be used to allocate the financial liability portion of the hybrid arrangement, with the remaining portion regarded as relating to the GORTO model.

**Staff analysis**

8 Some constituents requested that the AASB undertake a separate (broad) project to provide guidance on the fair value of public sector assets (as noted in paragraph 7(b)), while other constituents noted that service concession assets pose particular difficulties in applying the fair value concept under AASB 13. Consequently, guidance on the fair value measurement of a service concession asset should be provided in the final Standard to the accounting for service concession arrangements. Staff have analysed the measurement and recognition of service concession assets and associated liabilities with this in mind.

9 Staff analysis on the redeliberation of the proposed asset and liability recognition and measurement comprise of two parts:

(a) Part 1: Analyse the fair value measurement of a service concession asset in accordance with AASB 13; and

(b) Part 2: Analyse the rationale for the decision to adopt the proposed GORTO model for inclusion in the Basis for Conclusions to the final Standard.

With respect to the remaining areas for which constituents have requested guidance, Staff intend to prepare a Staff Paper for Board redeliberation at the next Board meeting. The remaining areas for redeliberation are:

- potential difficulties in establishing a fair value of a partly constructed asset, where the grantor may not have an agreement with the operator for the access to this information;
- initial valuation of service concession assets that are intangibles assets, given that, generally, intangible assets are not measured at fair value;
- accounting for borrowing costs and economic obsolescence in determining the fair value of a service concession asset;
- accounting for finance charges under the financial liability model;
- accounting for hybrid arrangements to which both the financial liability and the GORTO models apply;
- applying a principles-based approach to recognising revenue "according to the economic substance of the service concession arrangement"; and
- arrangements where operators charge grantors on the basis of usage of assets.

## Part 1: Fair value measurement of a service concession asset

10 Part 1 of this Agenda Paper analyses the fair value measurement of a service concession asset under AASB 13. This is to addresses constituents' request for guidance on the application of the fair value concept of AASB 13 to service concession assets (refer paragraphs 7(b) and (c) above).

ED 261 proposals

11 ED 261 proposed that the grantor initially measures the service concession asset at its fair value in accordance with AASB 13 unless the service concession asset is an existing asset of the grantor[11]. The grantor also recognises a liability measured at the same amount as the service concession asset (adjusted for other consideration between the grantor and operator) using the financial liability model and/or the GORTO model.

12 ED 261 also proposed that the "fair value is used to determine the cost of a constructed or developed service concession asset or the cost of any upgrades to existing assets, on initial recognition" (ED 261.AG31).

[11] Where the service concession asset is an existing asset of the entity, "the grantor shall reclassify the existing asset as a service concession asset. The reclassified service concession asset shall be accounted for in accordance with AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets,* as appropriate, in accordance with this [draft] Standard" (ED 261.11).

AASB 13 requirements

13 AASB 13 states that fair value is the price to sell an asset or transfer a liability that represents an exit price. Fair value is a market-based measurement, not an entity specific measurement. When determining fair value, the entity would be required to use assumptions that a market participant would use when pricing the asset, regardless of entity's intent and/or ability to sell or transfer the asset at the measurement date (AASB 13.2, 3, 22 and 23). That is, fair value, being an exit price and not an entry price, is considered from market participant's view and not from the entity's perspective.

14 Application of the fair value measurement under AAS 13 requires the consideration of the following:

(a) the characteristics of the asset;

(b) the unit of account of the asset; and

(c) the valuation technique used to measure the fair value of the asset.

15 The fair value measurement also takes into account the characteristics of the service concession asset being measured in conjunction with the highest and best use of the asset from a market participant's perspective (AASB 13.11 and 27).

Characteristics of the asset

16 When measuring fair value, AASB 13 requires the grantor to consider the characteristics of the service concession asset that market participants would take into account when pricing the asset at the measurement date. Characteristics include for example, the condition and location of the asset as well as any restrictions, if any on the sale, transfer or use of the asset (AASB 13.11).

17 In determining the effect of restrictions on the sale or use of the service concession asset, this will depend on whether the restriction is deemed to be a characteristic of the asset or a characteristic of the grantor holding the asset. Where a restriction would transfer with the asset in an assumed sale or transfer, then such a restriction would generally be deemed a characteristic of the asset and would likely be considered by a market participant in pricing the asset. On the other hand, a restriction that is specific to the grantor and which would not transfer with the asset in an assumed sale, would not be considered in measuring the fair value of the asset. Whether a restriction is a characteristic of the service concession asset or specific to the grantor will require judgement based on the specific facts and circumstances of the arrangement.

18 The assessment in paragraph 17 above is specifically important under the GORTO model, where the grantor has provided the operator with a right to charge the users of the asset. In determining fair value, to the extent that a market participant (acting in its economic best interest) would take into account the fact that a third party operator has been granted a right of access to charge users in pricing the asset, this could result in a different fair value being recognised than that which may arise under the financial liability model for an equivalent asset without such a characteristic.

19 On the other hand, it may be considered by a market participant that the right of access provided to the operator does not represent a restriction on the use of the asset. In a service concession arrangement, control of the asset and therefore the right of use of the asset is retained by the grantor (and transferred to the market participant in the hypothetical transaction). Therefore the right of access provided to the operator does not represent a restriction on the use of the asset.

20 There is also an argument that the service potential of a service concession asset (e.g. road) which arises under the financial liability model and the service potential of an identical asset (e.g. toll road) which arises under a GORTO model is the same from the grantor's perspective as both assets will provide the same utility to the public and hence should be fair valued consistently. However, the concept of service potential is not a consideration in determining fair value under AASB 13.

Unit of account

21 AASB 13 defines the unit of account as "The level at which an asset or a liability is aggregated or disaggregated in a Standard for recognition purposes" (Appendix A).

22 Staff are of the view that there are three possible outcomes for the unit of account, comprising of an asset covering:

(a) the service concession period;

(b) both the concession period and beyond; or

(c) the residual only.

23 Some constituents view the grant of this right to the operator as meaning that the asset should be measured only in relation to service potential after the service concession period has expired, i.e. at the asset's residual value. This is on the basis that the market participant buyer will not have the right to all the cash flows that could be generated by the asset as the right to the cash flows for the service concession period has been granted to the operator. This view adopts the notion that the individual asset, being the service concession asset's residual value is the unit of account under AASB 13. Therefore, the service concession asset's fair value is only the cash flows that can be directly generated by the asset[12] by the grantor. The implication of this view is that, the fair value of the asset could be measured at a zero amount or at the asset's residual value.

[12] PricewaterhouseCoopers comment letter to ED 261, page 6.

24 In the development of IFRIC 12 *Service Concession Arrangements*[13], IFRIC decided that an operator in a service concession arrangement does not have the right to control the underlying use of the asset. Instead, the operator has access to operate the asset to provide a service on behalf of the grantor. In essence, the operator acts as a service provider) (IFRIC 12.BC24 and 25). Accordingly, it is the grantor that has control of the underlying use of the asset both during the service concession period as well as any residual. Staff are therefore of the view that in determining the fair value of a service concession asset, the unit of account is the asset over its entire useful life, including any residual value of the asset.

Valuation techniques

25 AASB 13 outlines three 'widely used' valuation techniques used to estimate fair value (AASB 13.62), the:

(a) market approach uses the prices and other relevant information generated by market transactions for identical or similar assets or liabilities (AASB 13.B5);

(b) cost approach "reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replace cost)" (AASB13.B8). This approach uses mainly Level 3 inputs which are based on unobservable inputs. Current replacement cost (CRC) is the "cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence" (AASB13.B9); and

(c) income approach "converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts" (AASB13.B10).

26 AASB 13 does not specify which valuation technique is more appropriate. Instead the Standard states that "An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs" (AASB13.61). Additionally, "An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability" (AASB13.69). The Standard notes the fair value hierarchy "prioritises the inputs to the valuation techniques, not the valuation techniques used to measure fair value" (AASB 13.74).

27 AASB 13 establishes a fair value hierarchy that categorises three levels of inputs to the valuation techniques for measuring fair value. The hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs (AASB 13.72).

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[13] The Board decided to base ED 261 on IPSAS 32 *Service Concession Arrangements: Grantor*, which mirrors IFRIC 12 (ED 261.BC2 and BC3). Additionally, the Board at its December 2015 meeting redeliberated the concept of control in determining if the grantor has control of the service concession asset confirmed the importance of the final Standard being consistent with the principles of IFRC 12.

28 The three levels of inputs are as follows:

(a) Level 1 – "quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date" (AASB 13.76);

(b) Level 2 – "inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly" (AASB 13.81)[14]; and

(c) Level 3 – "are unobservable inputs for the asset or liability" (AASB 13.86).

29 Service concession assets are specialised assets with features and terms and conditions determined on a project by project basis and are rarely exchanged between willing sellers and buyers. Accordingly, Staff are of the view that it is highly unlikely that the market approach to measuring the service concession asset would be applicable, although this will depend on facts and circumstances.

30 The valuation techniques under the income approach include present value techniques (AASB13.B11). A fair value measurement using the present value technique reflects the market participants' estimated future cash flows, possible variations in the amount and timing of the cash flows, time value of money and other factors (AASB13.B13). This valuation technique uses Level 2 inputs that are observable inputs other than quoted prices. Level 2 inputs in a service concession arrangement could be the value derived from observable market data of the cash flows generated by charging users for the use of the service concession asset. This valuation technique may also use Level 3

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[14] AASB 13 also states that:

"If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

(a) quoted prices for similar assets or liabilities in active markets.

(b) quoted prices for identical or similar assets or liabilities in markets that are not active.

(c) inputs other than quoted prices that are observable for the asset or liability, for example:

  (i) interest rates and yield curves observable at commonly quoted intervals;

  (ii) implied volatilities; and

  (iii) credit spreads.

(d) *market-corroborated inputs*." (paragraph 82).

"Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the following:

(a) the condition or location of the asset;

(b) the extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in paragraph 39); and(c) the volume or level of activity in the markets within which the inputs are observed." (paragraph 83).

"An adjustment to a Level 2 input that is significant to the entire measurement might result in a fair value measurement categorised within Level 3 of the fair value hierarchy if the adjustment uses significant unobservable inputs." (paragraph 84).

inputs that are unobservable inputs. A discounted cash flow basis using Level 2 and/or Level 3 inputs is used by some public sector entities when feasible[15,16].

31 The cost approach "reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replace cost)" (AASB13.B8). This approach uses Level 2 and/or Level 3 inputs which are based on observable or unobservable inputs. Current replacement cost (CRC) is the "cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence" (AASB13.B9). The CRC is often used to measure the fair value of assets that are used in combination of other assets or with other assets and liabilities (AASB13.B9). This is particularly relevant if the service concession asset is part of an integrated network of assets and services, such as the provision of a transport network.

32 One view under the financial liability model, is to use the grantor's contractual obligation to make a pre-determined series of payments to the operator as a measure of the fair value of the asset with the liability being accounted for as a financial liability. The grantor's payments to the operator may represent the price that the grantor has paid for the construction, development, acquisition or upgrade of a service concession asset (ED 261.16(a) and 17) based on the expectations of the cash flows which could be generated by the asset. Some view this measurement as analogous to the discounted cash flow method of the income approach, where the grantor's pre-determined series of payments to the operator takes into account the factors outlined in paragraph 30 above, which reflects the current market expectation of the cash flows to be generated by the asset. Accordingly, the income approach could be used to initially measure a service concession asset where there are observable inputs (such as the cash flow generated by the asset from users of the asset). However, the cash payments promised

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[15] NSW Treasury *Accounting Policy: Valuation of Physical Non-Current Assets at Fair Value* (February 2014, revised June 2014), states the following:

"For specialised assets held by public sector entities, the income approach will generally be appropriate to for-profit entities or cash generating units of not-for-profit entities. The income approach may also be appropriate to valuing generalised property, such as office buildings, for either not-for-profit or for-profit entities.

Where the income approach is applied in the public sector, the most common method is likely to be a present value technique." (section 5.3, page 20).

"Specialised plant and infrastructure would generally be measured using the cost approach, or if the entity (or unit of an entity) is for-profit (or cash-generating), the income approach." (section 7.3.2, page 26).

[16] Victorian Department of Treasury and Finance Financial Reporting Direction 103F *Non-Financial Physical Assets* (June 2015) requires the income approach to value water infrastructures that are part of the metropolitan network of a cash generating entity**.**

All other infrastructure or specialized assets are to be measured using the cost approach of depreciated replacement cost:

- specialised buildings with limited alternative uses and/or substantial customisation eg. prisons, hospitals and schools;
- specialised plant and equipment with limited alternative uses and/or substantial customisation;
- water and rail infrastructures; and
- road, infrastructure and earth works (Appendix E, page 27).

to the operator under the financial liability model may have no direct relationship to the cash flows expected to be generated from the asset, i.e. the grantor may choose not to charge users. Similarly, the fees the operator can charge users may be at a significant discount and hence this would not reflect the fair value of the asset, i.e. what a market participant may choose to charge under commercial terms.

33 An alternative view to paragraph 32 is the view that under the financial liability model, the fair value of the asset is most likely the price (i.e. cost) that the grantor has agreed to pay the operator for the "construction, development, acquisition or upgrade of a service concession asset" (ED 261.17). Consequently, the grantor's contractual obligation to make payments to the operator in return for the service concession asset could be a method in measuring the fair value of the asset as the initial cost of obtaining the asset. Under this approach, the components of grantor's payments can be used to determine the fair value of the asset. However, any components of the payments which the grantor is contractually obliged to make to the operator which would not be included by a market participant in determining fair value, should be excluded from the determination of fair value.

34 As stated in paragraph 24, Staff think that the relevant unit of account is the whole asset that covers both the concession period and beyond, not just the residual or the service concession period. That is, a public sector entity often uses the asset's capacity or service potential to provide goods or services to achieve public service objectives. The asset is often valued using the CRC under the cost approach[17] irrespective of whether the cost of replacing the asset will be recovered by the expected cash flows that the asset may generate, This would support the view that, the price the market participant buyer is prepared to pay for the asset is the cost that would be required to replace the service potential or capacity of the asset. This is especially the case where the market participant buyer is another government entity. This view would be consistent with measuring the asset using the CRC method of the cost approach of AAS 13.

35 However, if the view, in paragraph 23 above is considered more appropriate and that the asset's fair value is only the cash flows that are directly generated by the service concession asset or measured at the asset's residual value, some constituents are concerned that the resulting fair value may not reflect the true value of the asset. This implication may be addressed by determining the fair value of the asset by assessing the measurement of the asset and liability together. Some constituent have suggested this could be achieved by using the guidance in AASB 140 *Investment Property* by analogy (refer to the analysis in the 'Application of AASB 140 by analogy' section below).

36 Additionally, Staff think that the view in paragraph 23 above that the market participant buyer will not have the right to all the cash flows generated by the asset that has been granted to the operator could only be valid if there is an active market for the same service concession asset. However, some may argue that, despite the absence of an active market for service concession assets, the principle of AASB 13 is to benchmark to that active market value by using other methods as surrogates for the

[17] Refer footnotes 15 and 16.

market price. Consequently, the fair value of the asset could still be measured as only the cash flows that are directly generated by the service concession asset or at the asset's residual value consistent with paragraph 23. The counter view to this is that the active market benchmark should be for an asset that includes re-directing the cash flows (that have been granted to the operator) to the prospective market participant buyer. Therefore, the fair value of the asset would cover the whole of the asset over the service concession period and its residual value. This is consistent with paragraph 24 that the unit of account for the service concession asset under the GORTO model therefore would cover both the concession period and its residual.

37 Based on the above analysis, Staff are of the view that a service concession asset that is accounted for using the GORTO model, the CRC method of measuring the asset could be more appropriate. The rationale for this approach could be that the market participant buyer acquires the asset to achieve public service objectives. Therefore, the price that the market participant buyer is prepared to pay for the asset could be the cost to replace the asset. Consequently, Staff are of the view that if the fair value of the asset is measured at a zero amount or at the asset's residual value on the basis that the grantor has granted to the operator the right to the cash flows generated by the asset (as referred to in paragraph 23 above), this would understate the true value of the asset.

38 In essence, Staff are of the view that a service concession asset is a specialised asset that is obtained through construction, development, acquisition or upgrade of a service concession asset. The asset's capacity or service potential is used to achieve public service objectives irrespective of whether the cost of the asset will be recovered by the expected cash flows that the asset may generate. Staff consider the more appropriate fair value to initially measure the asset is the cost approach being cost to construct or develop the entire asset. For the financial liability model, this cost could be determined by considering the payments that the grantor is contractually obliged to pay the operator in exchange for the asset.

39 Staff are of the view that ultimately, the valuation technique used to fair value a service concession asset is dependent on the specific terms and conditions of each service concession arrangement. That is, the appropriate valuation technique to measure the fair value of the service concession asset should reflect the principles of AASB 13 that is appropriate in circumstances and for which sufficient data are available that maximises the relevant observable inputs and minimises the unobservable inputs that are consistent with the characteristics for the asset (AASB 13.61 and 69).

Application of AASB 140 by analogy

40 This section examines the application of AASB 140 by analogy to address the implication of measuring the asset's fair value based on only the cash flows that are directly generated by the service concession asset under the GORTO model (as outlined in paragraph 23 above). This analysis assumes that while this approach is appropriate under AASB 13, the resulting fair value of the service concession asset however may not reflect the true value of the asset. The use of AASB 140 by analogy attempts to overcome this.

41 AASB 140 requires an investment property to be measured initially at cost (AASB 140.20). Additionally, the initial cost of a property interest held under a lease and classified as an investment property is prescribed as a finance lease and measured in accordance with AASB 117 *Leases*. That is, the asset is recognised at the lower of the fair value of the leased property and the present value of the minimum lease payments (AASB 140.25). Additionally, any premium paid for a lease is treated as part of the minimum lease payments and therefore included in the cost of the leased asset but is excluded from the liability (AASB 140.26).

42 Additionally, AASB 140 states that "the fair value of investment property held under a lease reflects expected cash flows ... Accordingly, if a valuation obtained for a property is net of all payments expected to be made, it will be necessary to add back any recognised lease liability, to arrive at the carrying amount of the investment property using the fair value model." (AASB 140.50(d)).

43 Therefore, if the entity obtains a property valuation net of the valuer's estimate of the present value of future lease obligations (which is a common practice), to the extent that the lease obligations have already been accounted for in the statement of financial position as a lease obligation, an amount is to be added back to arrive at the fair value of the investment property for the purposes of the financial statements.

44 Applying the AASB 140 approach above to the GORTO model, the fair value of the service concession asset is determined taking into account the fact that the grantor has provided a right of access to the operator, assuming that there is a restriction on the use of the asset. This amount is then grossed up for the recognition of a separate liability under the GORTO model.

45 The investment property model above may be applied by analogy only where both the service concession asset and the liability under the GORTO model are valued separately. However, Staff do not think this can be applied by analogy, as under the investment property model, the lease liability is measured separately and independently of the fair value of the investment property asset. This contrasts with the GORTO model where, the value of the asset is used to derive the value of the liability. This is consistent with feedback from constituents on ED 261 that they support the recognition of a service concession liability measured at the same amount as the service concession asset. Some constituents also noted that it be difficult to reliably determine the fair value of the liability independent of the service concession asset (refer paragraph 7(e) above).

46 Additionally, Staff are not convinced that the above AASB 140 principles can be applied to measure the fair value of a service concession asset. This is because AASB 140 states that "When measuring the fair value of investment property in accordance with AASB 13, an entity shall ensure that the fair value reflects, among other things, rental income from current leases and other assumptions that market participants would use when pricing investment property under current market conditions" (paragraph 40). That is, the investment property owner is the recipient of the rental income which contrasts with the GORTO model where the operator (not the grantor) is the recipient of the cash flows from the asset. Furthermore, an investment property owner would generally not have the use of the asset during the period that the property is being rented. This contrasts with a service concession asset under a

GORTO model, the grantor is able to deploy the asset to achieve its public service objectives.

Impairment and subsequent measurement

47 Some constituents have requested additional guidance on the application of impairment under AASB 136 for service concession assets (refer paragraph 7(c)(ii) above). Staff in responding to this request have, for completeness, extended their analysis to the implication of the fair value measurement of a service concession asset subsequent to its initial recognition.

48 ED 261 proposed that after the initial recognition or reclassification, a service concession asset shall be accounted in accordance with AASB 116 or AASB 138 (ED 261.12).

49 After initial recognition, where an entity chooses the revaluation model as its accounting policy, the assets are carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses (AASB 116.31 and AASB 138.75). Fair value is defined by reference to the fair value of AASB 13 (AASB 116.6 and AASB 138.8).

50 Additionally, the grantor shall refer to AASB 136 to determine whether any of the indicators of impairment have been triggered for assessing whether the asset is impaired (ED 261.AG22).

51 AASB 136 provides impairment indicators, derived from sources of information that are external and internal to the entity, which can be used to determine whether the asset may be impaired[18]. If any impairment indicator exists, the entity is required to assess whether the asset is impaired.

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[18] AASB 136, paragraph 12 states the following:

"In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External sources of information

(a) there are observable indications that the asset's value has declined during the period significantly more than would be expected as a result of the passage of time or normal use.

(b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially.

(d) the carrying amount of the net assets of the entity is more than its market capitalisation.

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an asset.

52 An asset is impaired when its carrying amount exceeds its recoverable amount (AASB 136.8). The recoverable amount is defined as the "amount of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use" (AASB 136.6).

53 Value in use is defined as the present value of the future cash flows expected to be derived from an asset or cash-generating unit (AASB 136.6). For a not-for-profit entity, value in use is defined as the depreciated replacement cost (or current replacement cost) of an asset when the future economic benefits of the asset are not primarily for the generation of net cash flows and the entity if deprived of the asset, would replace its remaining future economic benefits (AASB 136.Aus6.1).

54 Staff are of the view that generally, an asset's carrying amount is less likely to be impaired if the measurement basis of the asset under the revaluation model is the same as that used for determination of its recoverable amount for impairment purposes. To the extent that the fair value under AASB 116, AASB 138 and AASB 136 is measured in accordance with AASB 13, it is unlikely that the asset subsequent to its initial recognition at fair value will differ for revaluation or impairment purposes unless if there are changes such as those that would affect the asset's usage, value and/or condition and/or the market in which the entity operates. If this is the case, the asset may need to be assessed for impairment purposes under the relevant Accounting Standards. Staff think that this assessment for a service concession asset is no different to other assets held by not-for-profit entities that are subject to the requirements of AASB 116, AAB 138 and AASB 136.

*Staff recommendation*

55 Staff recommend the following:

(a) guidance on the fair value measurement of a service concession asset should be provided in the final Standard in service concession arrangements from a grantor's perspective, if the Board decides that a separate (broader) project to provide guidance on the fair value of public sector assets is not necessary;

(b) in determining the fair value of the service concession asset, the right of access provided to the operator should be considered in determining whether it represents a restriction on the asset under GORTO model;

(c) the unit of account of the service concession asset, in determining the asset's fair value, is the entire useful life of the asset, including any residual value of the service concession asset;

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(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected."

(d) the appropriate valuation technique used to measure the fair value of the service concession asset should reflect the principles of AASB 13 that is appropriate in circumstances and for which sufficient data are available that maximises the relevant observable inputs and minimises the unobservable inputs that are consistent with the characteristics for the asset;

(e) not to apply AASB 140 by analogy to measure the asset's fair value where the arrangement is accounted for under the GORTO model, for the reasons outlined in paragraphs 45 and 46; and

(f) the fair value assessments of a service concession asset for revaluation and impairment purposes are no different to other assets that are subject to the requirements of AASB 116, AAB 138 and AASB 136.

**Questions to the Board**

Q1. Does the Board agree with the recommendation that guidance on the fair value measurement of a service concession asset should be provided in the final Standard, if the Board decides that a separate (broader) project to provide guidance on the fair value of public sector assets is not necessary? If not, how does the Board wish to address the fair value measurement of a service concession asset?

Q2. Does the Board agree with the recommendation that in determining the fair value of the service concession asset, the right of access provided to the operator should be considered in determining whether it represents a restriction on the asset under GORTO model?

Q3. Does the Board agree with the recommendation that the unit of account of the service concession asset, in determining the asset's fair value, is the entire useful life of the asset, including any residual value of the service concession asset?

Q4. Does the Board agree with the recommendation that the appropriate valuation technique used to measure the fair value of the service concession asset should reflect the principles of AASB 13 that is appropriate in circumstances and for which sufficient data are available that maximises the relevant observable inputs and minimises the unobservable inputs that are consistent with the characteristics for the asset?

Q5. Does the Board agree with the recommendation not to apply AASB 140 by analogy to measure the asset's fair value where the arrangement is accounted for under the GORTO model?

Q6. Does the Board agree with the recommendation that the fair value assessments of a service concession asset for revaluation and impairment purposes are no different to other assets that are subject to the requirements of AASB 116, AAB 138 and AASB 136?

## Part 2: Rationale for adopting GORTO model

56 Part 2 analyses whether the proposed GORTO model in ED 261 is the appropriate model for recognising the service concession liability where the grantor, in exchange for the service concession asset, compensates the operator by granting the operator the right to earn revenue from third-party users or another revenue-generating asset.

57 Staff proposes to include the resulting analysis in the Basis for Conclusion to the final Standard to explain the Board's rationale and decision in adopting the proposed GORTO model.

58 The analysis of whether the GORTO model is the appropriate model considers the following alternative models:

(a) Model 1: Applying the licensing Application Guidance in AASB 15 *Revenue from Contracts with Customers*' by analogy;

(b) Model 2: Applying the 'financial liability' model to all service concession arrangements; and

(c) Model 3: Accounting for the assets in the arrangement and not the right to charge users for the use of the service concession assets that has been granted from the grantor to the operator.

59 Staff analysis also considers the implication of adopting an alternative model to the proposed GORTO model.

Model 1: Applying licensing application guidance in AASB 15 by analogy

60 Model 1 examines whether the grantor's compensation to the operator by granting the right to earn revenue from third-party users of the service concession asset or granting the operator access to another revenue-generating asset for the operator's use is akin to the grantor's promise to transfer an intangible asset to the operator that can be accounted for, by analogy, using the Application Guidance for licences in AASB 15.

61 The Board redeliberated Model 1 at its previous meetings[19]. The redeliberation considered whether the following five steps of revenue recognition in AASB 15 applies to the grantor's rights and obligation in a service concession arrangements:

(a) identifying the contract with a customer;

(b) identifying the performance obligations in the contract[20];

[19] 10-17 July 2014, 3-4 September 2014 and 17-18 December 2014 meetings.

[20] The identification of the performance obligations in the contract involves:
- identifying the promised goods or services in a service concession arrangement;
- what is the nature of the intangible asset for the 'right to charge users'; and
- identifying the distinct goods or services in the service concession arrangement.

(c) determining the transaction price;

(d) allocating the transaction price to each performance obligation; and

(e) recognising revenue when (or as) the entity satisfies its performance obligations.

62 The Board redeliberated[21] whether from the grantor's perspective, a service concession arrangement would be a contract with a customer that is within the scope of AASB 15. This would require the grantor to determine:

(a) the goods or services that the operator will obtain from the grantor; and

(b) whether those goods or services are an output of the grantor's ordinary activities.

63 The Board noted that the types of goods and services (i.e. assets) that the grantor may promise to transfer to the operator should be the same as the assets that AASB Interpretation 12 identifies as forming the consideration received by the operator. AASB Interpretation 12 identifies that those assets may be:

(a) a financial asset, being the unconditional contractual right to receive cash or another financial asset from the grantor;

(b) an intangible asset, being a right to charge users of the public service; or

(c) both a financial asset and an intangible asset (AASB Interpretation 12.15 and 18).

64 AASB Interpretation 12 distinguishes between the financial asset and the intangible asset based on which party bears demand risk associated with the use of the service concession asset. Consequently, even though the operator may have the risk to collect and retain cash directly from users, the asset promised by the grantor would be a financial asset "to the extent that the grantor bears the risk (demand risk) that the cash flows generated by the users of the public service will not be sufficient to recover the operator's investment" (see IFRIC 12 paragraph BC42).

65 The definition of a customer also refers to 'ordinary activities', a term that is not defined in IFRS 15. The Board considered:

(a) whether a financial asset is an output of the grantor's ordinary activities noting that the cash or a right to cash (or another financial asset) that will be transferred to the operator should not be regarded as an output of the grantor's ordinary activities. This is because if obtaining cash was considered to be an ordinary activity of the government, the consequence would be that the grantor

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[21] AASB Meeting 3-4 September 2014 Agenda Paper 15.2 Issues Paper *Assessing whether service concession arrangements are within the scope of IFRS 15 from the grantor's perspective*

Link to Agenda Paper 15.2
http://www.aasb.gov.au/admin/file/content102/c3/M140_15.2_Issues_Paper_SCAs_scope_IFRS_15.pdf

conceivably would be simultaneously an entity and a customer for every procurement contract it enters into. Such an outcome would not faithfully represent all of the grantor's contracts;

(b) whether an intangible asset is an output of the grantor's ordinary activities noting the following views:

(i) View A – the intangible asset is unrelated to the entity's ordinary activities. This view adopts a relatively narrow view of the scope of a grantor's ordinary activities and considers that charging users of a public asset (including a service concession asset) is typically a financing activity rather than an ordinary activity of the grantor. The act of assigning that right to charge users to another party (i.e. an operator) does not change the character of that right or the nature of the grantor's activities. In that regard, the right to charge users could be akin to a securitisation of the future cash flows that the grantor could otherwise generate from the asset; and

(ii) View B – the intangible asset is an output of the entity's ordinary activities. This is a relatively broader view of the scope of a grantor's ordinary activities. It is based on the view that a government's ordinary activities include regulating access to, and the usage of, public assets. In that regard, a right to charge users for access to public assets that is transferred to an operator could represent an output of the grantor's ordinary activities, especially if the grantor charges for the use of other public assets. Furthermore, the competitive tendering environment that is associated with many service concession arrangements could be viewed as operators offering construction and operations services as consideration in order to acquire an asset – being the right to charge users.

66 The Board also considered the similarities between an intangible asset and the following types of arrangements:

(a) a grantor charging users for access to other public assets (e.g. fishing licences); and

(b) in the for-profit sector, a franchisor transferring franchise rights (and access to underlying intellectual property).

67 The Board noted a key distinguishing factor between the arrangements above and the rights in a service concession arrangement is that the 'access' granted to the operator is to enable the operator to fulfil its performance obligations of providing construction and operation services to the grantor. This is acknowledged by paragraph BC25 of IFRIC 12 which states "Under the terms of the contract the operator has access to operate the infrastructure to provide the public service on the grantor's behalf". Furthermore, the 'access' granted to the operator is the same regardless of whether the consideration transferred from the grantor is in the form of a financial asset or an intangible asset. In both cases, the operator needs to have the right to access the public asset in order to provide the contracted services to the grantor. Consequently, the intangible asset is not transferring a benefit of access to the grantor's assets in the

same way as a holder of a fishing licence or a franchisee benefits from access to the assets identified in their contracts. This is because the holder of a fishing licence or a franchisee pays to access the asset in order to generate future cash flows. In contrast, the operator generates future cash flows by providing services to the grantor and those future cash flows are in the form of an intangible asset that exposes the operator to demand risk associated with the use of the public asset by third parties.

68 The Board acknowledge that the above illustrates the difficulty associated with determining conclusively whether a right to charge users in a service concession arrangement can represent an output of the grantor's ordinary activity. Notwithstanding this difficulty, the Board considered the implications and suitability of a grantor applying IFRS 15, either directly or by analogy, to service concession arrangements that are accounted for using the GORTO model. This involved considering the remaining steps (of paragraphs 61(b) to (e) above) of the revenue recognition in IFRS 15. The consideration assumed that the service concession arrangement is a contract with a customer[22]. The Board noted that:

(a) significant judgement is required to apply IFRS 15's revenue model to service concession arrangements from the grantor's perspective. This is because service concession arrangements are typically complex in nature and have specific facts and circumstances that could result in different arrangements being accounted for differently;

(b) this suggested that IFRS 15 may not be particularly suitable to be directly applied to service concession arrangements from the grantor's perspective. This is because, within the context of IFRS 15, the licence application guidance applies only to a licence of intellectual property. Intellectual property is not defined but it commonly refers to assets such as an entity's brand or operational know-how. Paragraph B52 of IFRS 15 provides examples of licences of intellectual property, including software and technology, franchises, patents and copyrights. Although a grantor's 'right to charge users' could represent an intangible asset, it is unlikely to be regarded as a form of intellectual property.

The Board also noted that IPSAS 32 is intended to mirror the scope of IFRIC 12. Further, the fact that the IPSASB issued separate guidance in relation to service concession arrangements suggests that the IPSASB considers these arrangements to be sufficiently different to other licences to warrant separate guidance from general revenue requirements. In addition, targeted staff outreach indicated that preparers also considered service concession arrangements to be different to other licences[23].

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[22] AASB Meeting 3-4 September 2014 Agenda Paper 15.3 Issues Paper *Application of IFRS 15 on the Right to Charge Users of a Service Concession Asset*

Link to Agenda Paper 15.3
http://www.aasb.gov.au/admin/file/content102/c3/M140_15.3_Issues_Paper_Application_of_IFRS_15_on_Right_to_Charge_Users.pdf

[23] AASB Meeting 17-18 December 2014 Agenda Paper 7.2 Staff Issues Paper *Service concession arrangements (Grantor) Project – Potential Issues for Redeliberation*

(c) if the principles of IFRS 15 were to be applied to service concession arrangements, a separate set of revenue requirements tailored specifically to service concession arrangements (from the grantor's perspective) would need to be developed. The tailored requirements would be based on IFRS 15's core principle of recognising revenue to depict the transfer of goods and services and using control as a basis for that core principle. The requirements would broadly retain the revenue recognition requirements in IFRS 15, but would include modification to those requirements to ensure that the accounting of a grantor's rights and obligations in a service concession arrangement provides relevant information to users of a grantor's financial statements. Any modifications to IFRS 15 would be made in accordance with the *Process for Modifying IFRSs for PBE/NFP*. This would require further research on how many changes to IFRS 15 would be necessary to overcome the concerns and subsequently assessing whether the modified version of IFRS 15 is preferable (from a conceptual and operability perspective) to the corresponding requirements in IPSAS 32.

69 Based on the above analysis, the Board "decided that, from a grantor's perspective, a service concession arrangement in which the grantor promises to transfer an intangible asset to the operator would not be a contract with a customer within the scope of IFRS 15. The Board considered that the intangible asset the grantor promises to transfer to the operator in exchange for the operator's services is in the nature of a financing arrangement for the construction of the service concession asset and, as such, would not be an output of the government's ordinary activities"[24]. Additionally, the Board decided that given the importance of service concession arrangements to governments and the current lack of accounting guidance for such arrangements, service concession arrangements should be treated separately from licences granted by governments[25].

Model 2: Applying 'financial liability' approach to all service concession arrangements

70 ED 261 proposed that the grantor uses the financial liability model, where the grantor compensates the operator for the service concession asset by making payments to the operator, and the GORTO model where the grantor compensates the operator by other means, such as granting the operator the right to earn revenue from third-party users of the service concession asset. This approach is consistent with IFRIC 12.

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Link to Agenda Paper 7.2
http://www.aasb.gov.au/admin/file/content102/c3/M142_7.2_SCA_Potential_issues_for_redliberation.pdf

[24] Link to AASB Meeting 3-4 September 2014 Minutes, Agenda Item 15, page 11
http://www.aasb.gov.au/admin/file/content102/c3/AASB_Minutes_M141_3-4_Sept_2014_unsigned.pdf

[25] Link to AASB Meeting 17-18 December 2014 Minutes, Agenda Item 7, page 6
http://www.aasb.gov.au/admin/file/content102/c3/AASB_Minutes_M142_17-18_December_2014_unsigned.pdf

71 Model 2 examines whether the financial liability model can be applied to all service concession arrangements irrespective of whether it is the grantor or the users of the service concession asset that make the payments to the operator.

72 The issues to consider for Model 2 are:

(a) whether the party (the grantor or users of the service concession arrangement) that makes the payment to the operator determines the accounting model for the grantor to recognise the a service concession liability; and

(b) whether the grantor has a financial liability under Model 2.

*Party that makes payment to the operator*

73 The IFRIC in its development of the draft Interpretation on service concession arrangements from an operator's perspective proposed that the nature of the operator's asset is dependent on "who had the primary responsibility to pay the operator for the services. The operator should recognise a financial asset when the grantor had the primary responsibility to pay the operator for the services. The operator should recognise an intangible asset in all other cases" (AASB Interpretation 12.B37). ED 261 contains the mirror requirement in accounting for a service concession arrangement from a grantor's perspective.

74 Respondents to the draft IFRIC Interpretation proposals argued that accounting for a service concession arrangement based on who has the primarily responsibility to the operator for the services, regardless of who bears the demand risk (such as the ability or willingness of the users to pay for the services) would not reflect the economic substance of the arrangement (AASB Interpretation 12.B38). The concern is that the proposals required the operator to use different models to account for an asset that generate similar or identical cash flows.

75 The opposing view to paragraph 74 is that the party that has the responsibility to make payments to the operator is important in determining the accounting model for the grantor's recognition of the liability. This view takes into account who bears the demand risk (i.e. the ability and willingness of the users to pay for the services). This view is consistent with the proposed models in ED 261 and mirrors the requirements of IFRIC 12. That is, under the financial liability model, the grantor is the party with the primary responsibility to make payments to the operator for the services. This contrasts with the GORTO model, where the operator is the party that bears the demand risks. Accordingly, the use of different models (i.e. financial liability model and GORTO model) to account for the liability is more appropriate. Staff think this view has more merit than the view outlined in paragraph 74.

*Recognising a financial liability under GORTO model*

76 This section examines whether the liability recognised under the proposed GORTO model of ED 261 meets the definition of a financial liability for recognition under the financial liability model. Staff have used IFRIC's considerations in the development of the accounting requirements for the financial asset model from an operator's perspective in IFRIC 12. This is on the basis that the mirror application of the financial

liability model from a grantor's perspective of ED 261 would also need to consider similar issues to those deliberated by IFRIC.

77 IFRIC decided that the operator should recognise a financial asset to the extent that has "an unconditional present right to receive cash from or at the direction of the grantor for the construction services; and the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has a contractual right to receive cash for the construction services if the grantor contractually guarantees the operator's cash flows, in the manner described in paragraph 16. The IFRIC noted that the operator has an unconditional right to receive cash to the extent that the grantor bears the risk (demand risk) that the cash flows generated by the users of the public service will not be sufficient to recover the operator's investment." (AASB Interpretation 12.BC42).

78 However, if the "the operator's revenue is conditional on usage and it bears the risk (demand risk) that the cash flows generated by users of the public service will not be sufficient to recover its investment" (AASB Interpretation 12.BC47), as in the user-pay arrangements, the financial asset model would not be appropriate.

79 Additionally, if there are no contractual arrangements to ensure that the operator receives the minimum amount, the operator has no contractual right to receive cash. The operator would therefore not have a financial asset. Instead the operator has an intangible asset that is within the scope of IAS 38 *Intangible Assets* (AASB Interpretation 12.BC48).

80 The IFRIC analysis in paragraphs 77-79 above is consistent from the grantor's perspective in determining that the grantor does not have a financial liability under the GORTO model.

81 A financial liability is defined as:

"(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments…" (AASB 132 *Financial Instruments: Presentation*, paragraph 11).

82 Under the GORTO model, the grantor in exchange for the service concession asset compensates the operator by granting the operator the right to charge users of the asset. The grantor in this arrangement:

(a) does not have a contractual obligation to deliver cash or another financial asset to the operator nor exchange financial assets or financial liability with the operator under potentially unfavourable conditions; or

(b) does not have a contract that will or may be settled with the grantor's equity instrument.

Accordingly, the grantor does not have a financial liability as defined in AASB 132.

83 Some may view the right (an intangible asset) that the grantor has granted to the operator is a financial asset and therefor the grantor has a contractual obligation to deliver a financial asset in exchange for the service concession asset. The grantor therefore has a financial liability.

84 However, AASB 132 states that intangible assets are not financial assets. Additionally, control of intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset (AASB 132.AG10). This is supported by IFRIC's conclusion that "although the operator's asset might have characteristics that are similar to those of a financial asset, it would not meet the definition of a financial asset in IAS 32: the operator would not at the balance sheet date have a contractual right to receive cash from another entity. That other entity (ie the user) would still have the ability to avoid any obligation. The grantor would be passing to the operator an opportunity to charge users in future, not a present right to receive cash" (AASB Interpretation 12.BC49).

85 Based on the above analysis, Staff are of the view that under the GORTO model, the grantor does not have a financial liability as defined in AASB 132.

Model 3: Accounting for the assets and not the right to charge users

86 Model 3 examines whether the measurement of the asset under the GORTO model would be overstating the fair value of the asset. Instead, the more appropriate approach is to recognise the asset's fair value based on only the cash flows that the asset can directly generate (residual cash flows to the grantor). The implication is that the fair value of the asset could be measured at a zero amount or at the asset's residual value which exclude the rights to the cash flows generated by the asset that have been granted to the operator.

87 Staff analysed the merits of Model 3 in paragraphs 18-19, paragraphs 23-24 and paragraphs 36-39 above and concluded that this model would understate the true value of the asset.

Implication of adopting an alternative model to proposed GORTO model

88 Staff analysis also considers the implication of adopting an alternative model to the proposed GORTO model.

89 The Board decided to base ED 261 on IPSAS 32, which mirrors IFRIC 12 (ED 261.B2 and B3) and confirmed at the December 2015 meeting the importance that the final Standard is consistent with the principles of IFRIC 12[26] as departures from the

[26] Refer to footnote 13.

principles of IFRIC 12 would require the Board to refer the areas of differences to the IFRIC for consideration[27].

90 Additionally, the adoption of an alternative model to the proposed GORTO model would be a fundamental change to the proposals in ED 261 for which the AASB has sought comment from its constituents. This would potentially require the AASB to re-expose the alternative model for comment.

91 The implications of paragraphs 89 and 90 will delay the target issue date of the final Standard[28] by six to 12 months. Consequently and for the reasons outlined for Models 2 and 3, Staff are of the view that the proposed GORTO model is the most appropriate model.

*Staff recommendation*

92 Staff recommend the following:

(a) the analysis for Models 1 to 3 be included in the Basis for Conclusion to the final Standard to explain the Board's rationale and decision in adopting the GORTO model;

(b) retain the existing GORTO model on the basis that:

(i) Model 2 does not meet the financial liability definition for application; and

(ii) the measurement approach proposed in Model 3 to value the asset based on only the cash flows that the asset can directly generate (residual cash flows to the grantor) could understate the fair value of the asset.

**Question 7 to the Board**

Does the Board agree with the recommendation:

(a) to include the analysis for Models 1 to 3 be included in the Basis for Conclusion to the final Standard to explain the Board's rationale and decision in adopting the GORTO model;

(b) retain the existing GORTO model on the basis that:

(i) Model 2 does not meet the financial liability definition for application; and

(ii) the measurement approach proposed in Model 3 to value the asset based on only the cash flows that the asset can directly generate (residual cash flows to the grantor) would understate the true fair value of the asset?

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[27] The AASB *Interpretations and Improvements Model*, page 1 states that:
"(b) … Issues relating to interpreting IFRS adopted in Australia that the AASB considers warrant further guidance are forwarded to the IFRSIC for consideration for inclusion on the IFRSIC work program or for the IFRSIC to refer to the IASB for consideration as improvements to IFRS …"

[28] The final Standard is scheduled to be issue in the last quarter of 2016.

# Appendix A: Service Concession Arrangements Project Plan (Updated for February 2016 Board Meeting)

## Summary of Project Plan in order of Board meeting dates

The table below summarises the main topic areas for Board consideration and deliberations in order of Board meeting dates.

| Board meeting | Board actions | Project step(s)[29] | Status |
|---|---|---|---|
| 2–3 Sep 2015 | Board to consider comments received from ED 261 and approve draft Project Plan | | **Completed** |
| 21–22 Oct 2015 | Board to:<br>(a) redeliberate the proposed application to all public sector entities; and<br>(b) consider the proposal the 'field test' | 1 | (a) Staff to undertake further outreach and report findings at future Board meeting for consideration<br>(b) **Completed** |
| 2–3 Dec 2015 | Board to redeliberate the proposed:<br>(a) concept of control;<br>(b) asset measurement at fair value; and<br>(c) liability recognition and measurement | 2 – 4 | (a) **Completed Redeliberated concept of control**<br>(b) and (c) to be considered at February and April 2016 Board meeting |
| 23–24 Feb 2016 | Board to redeliberate:<br>(a) asset and liability recognition and measurement; and<br>(b) its rationale and decision of adopting the grant of the right to the operator model for inclusion as Basis for Conclusion | 3 – 4 | |
| 19–20 Apr 2016 | Board to redeliberate the remaining areas of asset and liability recognition and measurement not dealt with at the February 2016 Board meeting<br>Present preliminary findings of field test | 3 – 4 | |
| 21–22 Jun 2016 | Board to redeliberate the proposed:<br>(a) defined terms;<br>(b) other revenues, lifecycle costs and GAAP/GFS implications;<br>(c) application date and transitional provisions; and<br>(d) disclosures | 5 – 8 | |
| 30–31 Aug 2016 | Board to deliberate findings of 'field test' and changes to draft Standard of:<br>(a) application to all public sector entities;<br>(b) concept of control;<br>(c) asset measurement at fair value; and<br>(d) liability recognition and measurement | 1 – 4 | |
| 18-19 Oct 2016 | Board to consider any sweep issues<br>Board to review pre-ballot draft Standard | 8 – 9 | |
| Nov/Dec 2016 (out of session) | Board to vote on Ballot Standard | 10 | |

[29] The 'Project step(s)' correspond to those contained in the 'Detailed draft Project Plan and timetable' approved by the Board at the September 2015 Board meeting http://www.aasb.gov.au/admin/file/content102/c3/M147_6.3_Draft_Project_Plan_SCA.pdf

## Appendix B: Field Test Project Plan (Updated for February 2016 Board Meeting)

The table below details the major steps and timing of the field test.

| | Project step | Responsibility | Estimated completion time | Status |
|---|---|---|---|---|
| **1** | **Establish field test participants (FTP) and terms of reference** | | | |
| 1.1 | Determine the role and draft composition of FTP | Staff | 30/10/15 | **Completed** |
| 1.2 | Establish terms of reference for field test | Staff, Academic | 30/10/15 | **Completed** |
| 1.3 | Confirm FTP | Staff | 30/10/15 | **Completed** |
| **2** | **Conduct field test – Application of proposed requirements in ED 261 to FTP fact patterns** | | | |
| 2.1 | Meetings (teleconferences) with FTP to discuss:<br>(a) Terms of reference of field test including participants' role; and<br>(b) Scope of issues to be explored in field test | Staff, Academic, FTP | Meeting schedule for 8/12/15 | **Completed** |
| 2.2 | FTP apply the proposals in ED 261 to their specific service concession arrangement fact patterns | FTP | Mid Dec 2015 – Mid Mar[30] 2016 | In progress |
| 2.3 | Meet with FTP to discuss outcomes of application of ED 261 to fact patterns | Staff/Academic | End Mar – Mid Apr[31] 2016 | |
| **3** | **Develop guidance and blended examples** | | | |
| 3.1 | Analyse comments and examples received from steps 2.2 and 2.3 | Staff/Academic | Apr/May 2016 | |
| 3.2 | Present preliminary findings of field test to the Board | Staff | 19-20 Apr 2016 | |
| 3.3 | Draft guidance and blended examples | Staff/Academic | Apr/May 2016 | |
| 3.4 | Comments on draft guidance and blended examples from FTP members and Project Advisory Panel | FTP/Project Advisory Panel | Jun 2016 | |
| 3.5 | Collate and update comments on draft guidance and blended examples and finalise guidance and blended examples for Board consideration | Staff/Academic | Jul 2016 | |
| 3.6 | Prepare Staff Paper for August 2016 Board meeting | Staff | Aug 2016 | |
| **4** | **Present finding and guidance for Board consideration and decision** | **Staff** | **30-31 Aug 2016** | |

[30] FTP requested report on field test findings be extended by two weeks to mid-March 2016

[31] AASB meetings with FTP extended by two weeks to mid-April 2016, as a consequence of revised timeline for project step 2.2