



Project:	Service Concession Arrangements: Grantors	Meeting	AASB March 2017 (M156)
Topic:	Summary and Analysis of Comment Letters	Agenda Item:	3.3
Contact(s):	Daen Soukseun dsoukseun@asb.gov.au (03) 9617 7633 Clark Anstis canstis@asb.gov.au (03) 9617 7616	Project Priority:	High
		Decision-Making:	High
		Project Status:	Redeliberations

Objective

- 1 The objective of this paper is to provide the Board with a summary of the feedback received on the Fatal-Flaw Review version of AASB 10XY *Service Concession Arrangements: Grantors*¹ as a basis for Board decisions on the sweep issues raised.
- 2 This paper is structured as follows:
 - (a) Background (paragraphs 4);
 - (b) Staff analysis (paragraphs 5-29); and
 - (c) Appendix A: Staff collation and analysis of submissions on Fatal-Flaw Review version of AASB 10XY [**Board only**].

Summary of staff recommendations

- 3 The staff recommend the following:
 - (a) no additional clarification in draft AASB 10XY is required for determining whether the grantor controls the pricing of the services of the service concession asset;
 - (b) retain the accounting for the recognition of a service concession arrangement involving a GORTO;
 - (c) the AASB has undertaken sufficient due process for the development of the guidance in paragraph B34(b) of AASB 10XY that the grantor reclassify an existing intangible asset that is used in a service concession arrangement, even if the grantor has not recognised the intangible asset previously;

¹ Link to Fatal-Flaw Review Version AASB 10XY *Service Concession Arrangements: Grantors*
http://www.aasb.gov.au/admin/file/content105/c9/Fatal_Flaw_Review_AASB_10XY_SCA_Grantors.pdf

- (d) retain paragraph B5 of AASB 10XY relating to public service; and
- (e) refer to ‘economic life’ instead of ‘entire useful life’ in identifying whole-of-life assets for the purpose of paragraph 6 of AASB 10XY.

Background

- 4 The comment period for the Fatal-Flaw Review version of AASB 10XY closed on 14 March 2017. The AASB received comment letters from the following seven respondents:
- (a) CPA Australia (CPAA);
 - (b) Queensland Treasury (Qld Treasury);
 - (c) Ernst & Young (EY);
 - (d) KPMG;
 - (e) Australasian Council of Auditors-General (ACAG);
 - (f) Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC); and
 - (g) Chartered Accountants Australia and New Zealand (CAANZ).

Summary of comments received

Overall

- 5 The majority of the respondents were supportive of the AASB’s approach in the Fatal-Flaw Review version of AASB 10XY of developing a Standard on the accounting for a service concession arrangement from a grantor perspective². However, the respondents particularly have concerns on the requirement to recognise an intangible asset of the grantor that has not been previously recognised and the guidance on public service.
- 6 Two respondents (ACAG and Qld Treasury) consider draft AASB 10XY to be fatally flawed in the areas of determining the grantor’s control of the pricing of the services of the service concession asset (ACAG) and the requirement to recognise a service concession arrangement that involves a grant of a right to the operator (GORTO) (Qld Treasury).

Staff analysis

- 7 Appendix A to this agenda paper contains a collation and analysis of the issues raised by respondents in their submissions to the Fatal-Flaw Review version of AASB 10XY [Board only]. Staff consider the majority of the issues raised have been or can be addressed in the Basis for Conclusions³ to AASB 10XY and through the education sessions and materials to be prepared following the issue of the Standard. The education sessions and materials would include presentations and publications such as AASB extra.

2 CPAA, EY, KPMG, HoTARAC and CAANZ

3 Agenda Paper 3.1 contains the draft Basis for Conclusions (Board only) for consideration by the Board at this meeting.

8 Staff analysis of the comments received on the Fatal-Flaw Review version of AASB 10XY for Board deliberation addresses the following issues:

- (a) Issue 1: Reasons for considering the proposed AASB 10XY to be fatally flawed;
- (b) Issue 2: Recognition of an intangible asset of the grantor that has not been previously recognised;
- (c) Issue 3: Public service guidance; and
- (d) Issue 4: The use of the term ‘economic life’ instead of ‘entire useful life’ in relation to whole-of-life assets.

Issue 1: Proposed AASB 10XY is fatally flawed

9 Two respondents identify the following as the reason for considering the proposed AASB 10XY to be fatally flawed:

- (a) the guidance for determining the grantor’s control of the pricing of the services of the service concession asset; and
- (b) the requirement to recognise a service concession arrangement that involves a GORTO.

Grantor’s control of the pricing

10 ACAG considers the guidance in paragraphs B16 to B24 of draft AASB 10XY extends the concept of the grantor’s control of the price of the services of the service concession asset (in paragraph 5(a)) “beyond the power of the grantor, or any entity in the grantor’s jurisdiction. This extension of scope is only apparent in the application guidance and does not align with the stated intent of the proposed standard. Nor does it align with the recognition criteria defined at paragraphs 5 and 6 of the proposed standard. ACAG does not believe the operator’s inability to determine the price at which services are offered is analogous to the grantor’s ability to control the price at which services are offered.”

11 Paragraphs B16 and B17 of draft AASB 10XY states that in a third-party regulated environment, the grantor need not have complete control over the services and/or pricing of the services for the grantor to have control of the service concession asset. This mirrors the guidance in IPSAS 32⁴ relating to the grantor’s control of the asset where a third-party regulator regulates the pricing or the services that the asset must provide.

12 Additionally, for the purpose of paragraph 5(a), the pricing is considered to be set implicitly by the grantor if the third-party regulation removes the ability of the operator to regulate the price. Consequently, Staff think that paragraphs B16 to B24 provides guidance that is consistent and does not extend the control concept in paragraph 5(a) of the draft Standard. Accordingly, Staff do not think additional clarification in the Standard is required.

4 Paragraph AG6 of IPSAS 32 states that “The control or regulation referred to in paragraph 9(a) could be by a binding arrangement, or otherwise (such as through a third party regulator that regulates other entities that operate in the same industry or sector as the grantor), and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. ...”

Recognition of a service concession arrangement involving a GORTO

- 13 Qld Treasury “considers the proposed Standard to be fatally flawed in terms of the accounting for the grant of a right to the operator (GORTO) model as set out in para 20 of the Standard. Under the GORTO model, QT considers that the Government does not, in an economic sense, control the service concession asset and accordingly can see no justification for raising the asset on its balance sheet. QT’s view is that the asset is on the operator’s balance sheet as the asset is intrinsically linked to the cash flows it generates. If there is no basis for raising the asset on the State’s balance sheet, QT can accordingly see no basis for raising a liability.”
- 14 This was one of the many views that the Board considered in developing a Standard for the accounting of a service concession arrangement by the grantor. The Board confirmed its decision to base the accounting requirements on the control or regulation approach of IPSAS 32 in:
- (a) the ‘Reasons for Issuing this Exposure Draft’ in ED 261 *Service Concession Arrangements: Grantor*; and
 - (b) the Basis for Conclusions to ED 261. This is further elaborated in the draft Basis for Conclusions to AASB 10XY.
- 15 Additionally, the majority of the constituents in their feedback on:
- (a) ED 261 – supported the proposed recognition of a service concession arrangement involving a GORTO; and
 - (b) Fatal-Flaw Review version of AASB 10XY – did not express objections to the proposed recognition.
- 16 Staff are of the view that the requirements for the recognition of a service concession arrangement involving a GORTO in draft AASB 10XY should be retained.

Question to the Board

- Q1. Does the Board agree with the Staff recommendations that:
- (a) no additional clarification in draft AASB 10XY is required for determining the grantor’s control of the pricing of the services of the service concession asset?
 - (b) the accounting for the recognition of a service concession arrangement involving a GORTO should be retained?

Issue 2: Recognition of an intangible asset

- 17 Three respondents (KPMG, ACAG and HoTARAC) expressed concerns regarding the proposed requirement (in paragraph 8 of draft AASB 10XY) that the grantor reclassify its existing asset that is used in a service concession arrangement, including an intangible asset of the grantor that has not been recognised previously by the grantor (paragraph B34(b)).

- 18 The respondents expressed the concern that the proposed guidance in paragraph B34(b) is not consistent with AASB 138 *Intangible Assets*. That is, the grantor may not have previously recognised an intangible asset as the item did not meet the recognition criteria of AASB 138 for recognition as an intangible asset. The respondents sought clarification regarding the following:
- (a) whether the Board intends for AASB 10XY to override the requirements in AASB 138 for the grantor to recognise an intangible service concession asset when the grantor reclassifies an existing intangible asset that was not previously recognised by the grantor. KPMG sought clarification as to whether intangible assets that are specifically precluded from recognition under paragraph 63 of AASB 138, such as internally generated brands, mastheads, publishing titles, customer lists and items similar in substance, would be recognised under AASB 10XY if they are used in a service concession arrangement; and
 - (b) whether the proposal in paragraph B34(b) above has undergone the AASB’s due process and consultation, as one respondent (KPMG) noted that the proposed guidance in paragraph B34(b) is a significant change that was not included in ED 261 and “have therefore not been exposed to the full Exposure Draft process”.
- 19 When considering the reclassification of a grantor’s existing asset as a service concession asset, the Board decided that reclassification should apply to both tangible and intangible assets. The Board also decided in December 2016 that reclassified service concession assets should be measured on the basis of fair value (current replacement cost), whether the asset is a tangible or an intangible asset (see paragraphs BC55–BC57). Staff consider that the Board intended that these decisions apply to intangible assets that the grantor has not previously recognised, including intangible assets that are prohibited from recognition under AASB 138, such as internally generated brands, customer lists and other types listed in paragraph 63 of that Standard. That is, AASB 10XY would override AASB 138 in relation to the initial recognition of intangible service concession assets. This should be stated more clearly in AASB 10XY, most likely in paragraph B34.
- 20 The ‘Due process and consultation’ section of the AASB Statement *AASB Policies and Processes*⁵ (paragraphs 46–48) states that the AASB adopts a due process when developing its pronouncements and encourages constituents to participate actively in the standard setting process by discussing its discussions and deliberations on technical issue in public, publishing its views, inviting public comments (such as Exposure Draft), undertake targeted consultation (such as Project Advisory Panels). Additionally, a “further ED may be necessary when the views of the AASB change significantly as a result of responses on the first ED ...” (paragraph 49).
- 21 Staff are of the view that the AASB has undertaken sufficient due process in developing the guidance in paragraph B34(b) for the following reasons:
- (a) paragraph B34(b) provides guidance on the requirement in paragraph 8 for the grantor to reclassify its existing asset that is used in a service concession arrangement to include an intangible asset of the grantor that has not been recognised previously by the grantor. The Board sought, in ED 261, a specific comment from constituents

5 [Link to AASB Policies and Processes](http://www.aasb.gov.au/admin/file/content102/c3/Policy_Statement_03-11.pdf)
http://www.aasb.gov.au/admin/file/content102/c3/Policy_Statement_03-11.pdf

on whether an arrangement involving a service concession asset should include intangible assets. Constituents were supportive of this inclusion. Staff therefore think that the guidance in paragraph B34(b) clarifies an intangible service concession asset that the constituents support and is not a significant change that would warrant re-exposure;

- (b) the Board’s decision to require an existing asset that is reclassified as a service concession asset (including an intangible asset) to be recognised and measured at current replacement cost in accordance with the cost approach under AASB 13 *Fair Value Measurement* was publicly discussed at the December 2016 meeting. This decision was published in the December 2016 AASB Action Alert and the Service Concession Arrangements: Grantor Project Summary⁶;
- (c) staff consulted the Service Concession Arrangements: Grantor Project Advisory Panel in drafting the guidance in paragraph B34(b) (as part of the Panel’s input on the Draft Fatal-Flaw Review version of AASB 10XY); and
- (d) the AASB issued the Fatal-Flaw Review version of AASB 10XY, which included paragraph B34(b) for public comment.

Question to the Board

Q2. Does the Board agree with the Staff recommendations that:

- (a) AASB 10XY should state more clearly that it would override AASB 138 in relation to the initial recognition of intangible service concession assets, including intangible assets that are prohibited from recognition under AASB 138; and
- (b) the AASB has undertaken sufficient due process with the development of the requirements in paragraph B34(b)?

Issue 3: Public service guidance

- 22 Paragraph 2 of the draft AASB 10XY states that the Standard applies to “arrangements that involve an operator providing a public service related to a service concession asset on behalf of the grantor”. Paragraph B5 provides guidance on public service by stating that “For an arrangement to be within the scope of this Standard, the operator must be responsible for at least some of the management of the service concession asset and related services and not act only as an agent of the grantor. For example, an operator in an arrangement to construct and operate a hospital would need to provide services more managerial in nature than cleaning and security services for the hospital after the completion of construction for the arrangement to be considered a service concession arrangement”.
- 23 The first sentence of this guidance mirrors the wording in AASB Interpretation 12 (paragraph 3(b)) in the context of common features of a service concession arrangement. However, AASB Interpretation 12 does not provide the example in paragraph B5 of draft

⁶ Link to Service Concession Arrangements: Grantor Project Summary
http://www.aasb.gov.au/admin/file/content102/c3/Service_Concession_Arrangements_Project_Summary.pdf

AASB 10XY. AASB 10XY paragraph B3(b) also notes operator management as a common feature of service concession arrangements. However, paragraph B5 turns this feature into a requirement.

- 24 ACAG expressed its concern that the inclusion of the example in paragraph B5 of draft AASB 10XY would exclude many public-private partnership arrangements such as schools, where the operator provides “facilities management” and maintenance in relation to the school. ACAG asks whether maintenance and repairs and cyclical upgrades would constitute management of the service concession asset.
- 25 Staff note the Board, at its December 2016 meeting, discussed paragraph B5, noting that this may result in some arrangements being scoped out of AASB 10XY. Staff therefore think that the Board should retain paragraph B5 of draft AASB 10XY relating to public service.

Question to the Board

- Q3. Does the Board agree with the Staff recommendation to retain paragraph B5 of draft AASB 10XY relating to public service?

Issue 4: The use of the term ‘economic life’ instead of ‘entire useful life’ in relation to whole-of-life assets

- 26 The Board, at its December 2015 meeting, decided to clarify the relationship between the significant residual interest in paragraph 5(b) and a whole-of-life asset in paragraph 6, to ensure that arrangements are appropriately scoped into the Standard. The Board agreed with the general observation that the amount of the residual interest at the end of an arrangement is inversely related to the term of the service concession arrangement relative to the economic life of an asset. That is, the residual interest at the end of the arrangement is likely to be significant if the term of the arrangement is not the majority portion of the whole of the asset’s life.
- 27 However, the draft AASB 10XY included in the December 2016 Board papers continued to refer to a whole-of-life asset as an asset that will be used in a service concession arrangement for its “entire useful life” – this was the terminology used in ED 261. Such an asset is to be recognised by the grantor if the condition in paragraph 5(a) is met. This means that the requirement for the grantor to control a significant residual interest does not apply to a whole-of-life asset. The problem with the reference to ‘entire useful life’ is that an asset used in a service concession arrangement for only its useful life to the grantor can have a significant residual interest at the end of the arrangement if the economic life of the asset is much longer – even if the grantor does not control the significant residual interest, the grantor would be required to recognise the service concession asset. This therefore permits an inconsistent outcome to paragraph 5, which requires the grantor to control any significant residual interest as a condition for controlling the service concession asset.
- 28 In preparing the draft Fatal-Flaw Review version of AASB 10XY for consideration by Board members and the Project Advisory Panel, the reference in paragraph 6 to ‘entire useful life’ was amended by staff to ‘entire economic life’ (although just ‘economic life’ would be sufficient), to ensure that paragraphs 5 and 6 were consistent with respect to the

approach to a significant residual interest (if any). This wording was retained in the public Fatal-Flaw Review version.

- 29 The phrase ‘entire useful life’ is used in describing whole-of-life assets in both AASB Interpretation 12 (paragraph 6) and IPSAS 32 (paragraph 10). However, the Basis for Conclusions for IFRIC 12 (paragraph BC19)⁷ refers to ‘entire physical life’ and the Consultation Paper preceding IPSAS 32 (paragraph 78)⁸ refers to ‘economic life’ before they both then refer to ‘entire useful life’. Therefore, the intended meaning of ‘entire useful life’ does not appear to be the useful life of the service concession asset to the grantor.
- 30 Paragraph 6 of the draft AASB 10XY requires the grantor to recognise an asset that will be used in a service concession arrangement for its economic life (a whole-of-life asset) if the conditions in paragraph 5(a) are met. The economic life of an asset is the period over which future economic benefits are expected from all possible users of the asset, which may be the entire physical life of the asset. Consequently, an asset used in a service concession arrangement for its economic life will not have a significant residual interest at the end of the arrangement, and the condition in paragraph 5(b) will not be relevant. This contrasts with the term ‘useful life’, which is defined in AASB 116 *Property, Plant and Equipment* as the period over which an asset is expected to be available for use by an entity. An asset used in a service concession arrangement for its useful life (to the grantor) could have a significant residual interest at the end of the arrangement if the arrangement is not for all or the major part of its economic life. In this case, the condition in paragraph 5(b) would be relevant, and paragraph 6 is not applicable.
- 31 Apart from one Board member, respondents to the draft Fatal-Flaw Review version and the public Fatal-Flaw Review version did not object to the use of ‘economic life’ in paragraph 6.

7 Paragraph BC19 of IFRIC 12 states “Paragraph 5(b) of D12 proposed that for a service arrangement to be within its scope the residual interest in the infrastructure handed over to the grantor at the end of the arrangement must be significant. Respondents argued, and the IFRIC agreed, that the significant residual interest criterion would limit the usefulness of the guidance because a service arrangement for the entire physical life of the infrastructure would be excluded from the scope of the guidance. That result was not the IFRIC’s intention. In its redeliberation of the proposals, the IFRIC decided that it would not retain the proposal that the residual interest in the infrastructure handed over to the grantor at the end of the arrangement must be significant. As a consequence, ‘whole of life’ infrastructure (i.e. where the infrastructure is used in a public-to-private service arrangement for the entirety of its useful life) is within the scope of the Interpretation.”

8 Paragraph 78 of the IPSASB Consultation Paper *Accounting and Financial Reporting for Service Concession Arrangements* (March 2008) states “In the exposure process that led to the issuance of IFRIC 12 (IFRIC’s draft interpretation D12), it was proposed that for the arrangement to meet the scope criteria (a) the grantor must control the residual interest in the infrastructure at the end of the concession arrangement, and that (b) the residual interest must be significant. Respondents to D12 commented that this requirement would result in the exclusion of SCAs in which the entire economic life of the underlying property is expected to be used during the term of the arrangement (whole-of-life arrangements), thereby limiting the draft interpretation’s potential usefulness.”

Paragraph 79 of the IPSASB Consultation Paper states “To address these comments, the IFRIC modified the residual interest criterion in the final version of IFRIC 12 to state that the grantor must control “*any significant residual interest in the infrastructure*” (italics added), and added an exception for whole-of-life arrangements that states that only the control over use criterion need be met for this type of arrangement to fall within the scope of IFRIC 12. This exception essentially eliminates the requirement for the grantor to have any control over the residual interest in the underlying property at the end of a whole-of-life arrangement to be considered to have control over the property for financial reporting purposes under IFRIC 12. A rationale for this position is that by the end of the arrangement the property will have been controlled by the grantor for the entire useful life of the property—therefore, no significant residual interest in the property is left to control after the end of the arrangement.”

One Board member holds the view that the correct term is useful life and not economic life on the basis that when assessing the grantor's control of the asset in paragraphs 5 and 6, the assessment should be done from the point of view of the grantor (ie the useful life to the grantor). That is, the assessment of the grantor's residual interest should be undertaken at the end of the service concession arrangement, which may be earlier than the asset's economic life. The use of the term 'useful life' would capture arrangements where the residual interest is insignificant and the useful life is shorter than the economic life of the asset, which may otherwise be outside the scope of AASB 10XY.

Question to the Board

Q4. Does the Board agree with referring to 'economic life' instead of 'entire useful life' in identifying whole-of-life assets for the purpose of paragraph 6 of AASB 10XY?