Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Service Concession Arrangements**	**Meeting:**	AASB April 2016 (M151)
Topic:	**Redeliberation of Proposed Asset and Liability Recognition and Measurement**	**Agenda Item:**	4.1
		Date:	4 April 2016
Contact(s):	Daen Soukseun dsoukseun@aasb.gov.au (03) 9617 7633	**Project Priority:**	High
		Decision-Making:	High
		Project Status:	Redeliberations

Introduction and objective of this paper

1 The objectives of this paper are to:

(a) obtain Board decisions to address the remaining issues raised by constituents on the proposed recognition and measurement of a service concession asset and liability;

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

(c) present the preliminary findings of the field test on service concession arrangements.

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 8-65).

Summary of staff recommendations

3 Staff recommend in relation to:

(a) the issues below, there is sufficient guidance in ED 261 and/or existing Australian Accounting Standards that does not warrant additional guidance. However, Staff recommend that the Basis for Conclusion include the content of the Staff analysis on:

(i) Issue 1: Establishing the fair value of a partly constructed asset;

(ii) Issue 2: Initial valuation of an intangible service concession asset;

(iii) Issue 3: Accounting for economic obsolescence in determining the asset's fair value; and

(iv) Issue 6: Principles-based approach to recognising revenue under GORTO model.

(b) Issue 4: Accounting for finance charges under the financial liability model – amending paragraphs AG46 and AG47 of ED 261 to state that the finance charge in the financial liability model is to be determined based on the use of rate implicit to the arrangement that is consistent with the use of the effective interest rate in AASB 9 *Financial Instruments*;

(c) Issue 5: Accounting for hybrid arrangements – include in the Application Guidance that an acceptable method of dividing a hybrid arrangement is to allocate the total liability in a hybrid arrangement to the financial liability in the first instance, with the remaining portion of the liability to be allocated to a grant of the right to the operator; and

(d) Issue 7: Arrangements where an operator charges a grantor based on use of the asset – include in the Basis for Conclusion the content of Staff analysis that a service concession arrangement where a grantor compensates the operator for the usage of the service concession asset by a third-party user, the accounting for the service concession liability would be accounted for under the financial liability model where the grantor contractually guarantees to pay the operator specified or determinable amount. In the absence of this contractual guarantee to the operator, the grantor would account for the service concession liability under the GORTO model.

Background

4 ED 261 proposed that:

(a) the grantor initially measures the service concession asset at its fair value in accordance with AASB 13 *Fair Value Measurement* 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 financial liability model[1] and/or '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 February 2016 meeting, the Board:

(a) discussed the fair value measurement of the service concession asset in accordance with AASB 13. The Board clarified that a "service concession asset is a specialised asset that the grantor uses for its service potential to achieve public service objectives. Consequently, only the cost approach to measuring the fair value of service concession assets is relevant and in the specific instance where the operator has been granted the rights to future cash flows, this need not be considered in the valuation"[4]. The Board also confirmed the proposal that, under the grant of the right to the operator model, the grantor would recognise revenue, and accordingly reduce the liability, in accordance with the economic substance of the arrangement; and

---

[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

[4] Link to Service Concession Arrangements: Grantor Project Summary, AASB February 2016 Action Alert http://www.aasb.gov.au/admin/file/content102/c3/Service_Concession_Arrangements_Project_Summary.pdf

(b) noted that at its April 2016 meeting, it will redeliberate the remaining areas relating to the measurement and recognition of service concession assets and associated liabilities, for which constituents have requested guidance.

Feedback received on ED 261

7 The following is a summary of the feedback received[5] from constituents on ED 261 relating to the remaining areas of recognition and measurement of service concession assets and liabilities:

(a) 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;

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

(c) accounting for economic obsolescence in determining the fair value of a service concession asset;

(d) accounting for finance charges under the financial liability model;

(e) accounting for hybrid arrangements when both the financial liability and the GORTO models apply;

(f) applying a principles-based approach to recognising revenue "according to the economic substance of the service concession arrangement"; and

(g) arrangements where an operator charges a grantor based on the use of the asset.

Staff analysis

8 Staff analysis on the remaining areas, referred to in paragraph 7 above, relating to the measurement and recognition of service concession assets and liabilities are detailed below.

---

[5] 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

Issue 1: Establishing the fair value of a partly constructed asset

9 Some constituents expressed the potential difficulties in determining the fair value of a partly constructed service concession asset, where the grantor may not have an agreement with the operator for the access to this information during the construction phase. These constituents requested the AASB provide guidance in this respect.

10 ED 261 requires a grantor to recognise a constructed or developed asset where the grantor controls[6] the asset (ED 261.AG27)[7]. Additionally, the asset is to be measured initially at fair value in accordance with AASB 13 (ED 261.10). For the service concession asset to be recognised, it must meet the recognition criteria in AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets*, being that (a) it is probable that future economic benefits associated with the item will flow to the entity and (b) the cost of the item can be measured reliably.

11 Staff are of the view the two possible approaches to addressing the issue of reliable measurement of a partly constructed service concession asset where a measure of fair value is impracticable are:

(a) only recognise the asset upon the completion of the construction of the asset; or

(b) recognise the asset progressively by reference to the percentage of completion method.

Method 1: Upon completion of asset construction

12 Method 1 proposes where a measure of fair value is impracticable during the construction phase, the grantor recognises a service concession asset only at the completion of the construction of the asset. This method is analogous to the recognition of a service concession arrangement that is currently accounted for under AASB 117 *Leases*. AASB 117 requires the lessee to recognise a finance lease at the inception of the lease[8], which is commonly at the practical completion of the

---

[6] Paragraph 8 of ED 261 states that:

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

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

[7] Paragraph AG27 of ED 261 states that:

"Where a constructed or developed asset meets the conditions in paragraph 8 (or paragraph 9 for a whole-of-life asset) the grantor shall recognise and measure the asset in accordance with this [draft] Standard. This recognition is contingent on the asset also meeting the recognition criteria in AASB 116 or AASB 138."

[8] Paragraph 4 of AASB 117 states that:

"The *inception of the lease* is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date:

construction of the asset. Under a lease, the operator (which is also the lessor) is considered to have control over the asset during the construction phase and the grantor obtains a right of use only once the asset is constructed and made available to the grantor.

13 Method 1 however, may not be consistent with the principles of ED 261, which requires a grantor to recognise a constructed or developed asset where the grantor controls the asset (ED 261.AG27). The grantor's control of the asset may arise during the construction phase and not necessarily arise only at the completion of the service concession asset construction. The grantor has control of the asset when the grantor has the "ability to exclude or regulate the access of others to the benefits of an asset" (ED 261.AG90). This concept of control is consistent with the AASB *Framework for the Preparation and Presentation of Financial Statement*, which states that in determining "the existence of an asset … if the entity controls the benefits which are expected to flow from the property … Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control …" (paragraph 57). Additionally, AASB 138.13 states that "An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way."

14 Consequently, the grantor may have control of the service concession asset during the period of asset construction. Accordingly, the grantor's recognition of the asset at the completion of its construction may not always be appropriate or consistent with AASB 116 or AASB 138 where such control arises earlier.

Method 2: Percentage of completion method

15 Method 2 proposes where a measure of fair value is impracticable, the grantor recognise a service concession asset by reference to the percentage of completion of the asset where the grantor has control of the asset during the construction phase. This approach is analogous to the accounting for revenue of a construction contract using the "stage of completion of a contract which is often referred to as the percentage of completion method" (paragraph 25 of AASB 111 *Construction Contracts*). Contract revenue is recognised under the percentage of completion method as the work is

---

(a) a lease is classified as either an operating or a finance lease; and
(b) in the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined.

The *commencement of the lease term* is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (ie the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate)."

performed and when, among other factors, "it is probable that the economic benefits associated with the contract will flow to the entity" (AASB 111.23, 24 and 26)[9].

16 AASB 111.30 provides guidance on the percentage of completion method, which depending on the nature of the contract, can be determined by:

(a) "the proportion of the costs incurred for the work performed to date bear to the estimated total contract costs;

(b) surveys of work performed; or

(c) completion of a physical portion of the contract work."

17 Staff are of the view that, where a measure of fair value is impracticable, the percentage of completion method would provide a reasonable and reliable basis for the grantor to recognise the service concession asset during the construction phase when the grantor has control of the asset during asset construction. This approach would be consistent with ED 261.

18 In determining the percentage of completion of the asset, the grantor may evidence this in the terms specified in service concession arrangement, progress reports from the operator[10] and/or an assessment by independent surveyors.

---

[9] AASB 111 states that:

"23 In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:
(a) total contract revenue can be measured reliably;
(b) it is probable that the economic benefits associated with the contract will flow to the entity;
(c) both the contract costs to complete the contract and the stage of contract completion at the end of the reporting period can be measured reliably; and
(d) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

24 In the case of a cost plus contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:
(a) it is probable that the economic benefits associated with the contract will flow to the entity; and
(b) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

26 Under the percentage of completion method, contract revenue is recognised as revenue in profit or loss in the reporting periods in which the work is performed. Contract costs are usually recognised as an expense in profit or loss in the reporting periods in which the work to which they relate is performed. However, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 36."

[10] Estimating the fair value of a completed service concession asset based on information provided by the operator is a practice the IPSASB staff noted in its "Staff Questions and Answers on IPSAS 32 The "Grant of a Right to the Operator Model" in IPSAS 32, Service Concession Arrangement: Grantor" (February 2016). IPSASB staff noted that:

"The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework) includes a number of different measurement bases for assets. In the absence of an open, active and orderly market, the most appropriate basis for estimating the fair value of a service concession asset is likely to be replacement cost[4]. For a new asset, this will be the cost of purchasing or constructing an equivalent asset.

19 Staff are of the view there is sufficient guidance in existing Australian Accounting Standards to account for the fair value of a partly constructed asset. However, it may be useful for constituents to understand the Board considerations on this issue. Consequently, Staff propose to include in the Basis for Conclusion to the final Standard the content of this Staff analysis above.

Staff recommendation

20 Staff recommend:

(a) there is sufficient guidance in existing Australian Accounting Standards to account for the fair value of a partly constructed asset that does not warrant additional guidance; and

(b) including in the Basis for Conclusion the content of the above Staff analysis of the use of percentage of completion method as an acceptable method in establishing a fair value of a partly constructed asset where a more reliable measure of fair value is impracticable.

Question to the Board

Q1. Does the Board agree with the Staff recommendation in paragraph 20 above?

Issue 2: Initial valuation of an intangible service concession asset

21 ED 261.5 proposes the scope applies to "arrangements that involve an operator providing public service related to a service concession asset on behalf of the grantor". Appendix A to ED 261 defines a service concession asset and paragraph AG4 provides intangible assets as examples of service concession assets. This is consistent with the scope of IPSAS 32 *Service Concession Arrangements: Grantor*. The majority of constituents agreed with the proposed scope to apply to arrangements involving an intangible asset[11].

Estimating the cost of purchasing or constructing an equivalent asset may not be a simple task. Some jurisdictions have overcome this problem by requiring the operator (through the contractual terms) to provide their financial models to the grantor. This enables the grantor to determine the fair value of the service concession asset by reference to the operator's costs and return on investment. Other jurisdictions use proxies, for example the typical construction cost per m2 (or m3) for similar assets, in estimating the fair value of the service concession asset." (page 2).

Link to Staff Questions and Answers on IPSAS 32
http://www.ifac.org/publications-resources/staff-questions-and-answers-ipsas-32

[11] AASB Meeting 4 September 2014 Staff Issues Paper – Staff Collation and Analysis of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraph 13.

22 However, some constituents requested the final Standard include guidance on the initial valuation of a service concession asset that is an intangible asset. This is due to ED 261 requiring a service concession asset to be measured initially at fair value in accordance with AASB 13 (ED 261.10) and subsequently accounted for in accordance with AASB 116 or AASB 138 (ED 261.12 and AG41)[12].

23 The Board, at its February 2016 meeting, noted that 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. It is therefore, unlikely that there is an active market for a service concession asset. Consequently the cost approach to measuring the fair value of service concession assets is relevant.

24 The implications of applying the Board's decision and the requirements of ED 261 are that an intangible service concession asset would initially be measured using the cost approach in accordance with AASB 13, being the fair value of the asset at that date. The fair value for an asset that is accounted for under the:

(a) GORTO model would be the current replace cost of the asset; and

(b) financial liability model could be determined using the cost approach (being the current replace cost of the asset)[13].

25 The key considerations in addressing the constituents' request for additional guidance on the initial valuation of an intangible service concession asset are:

(a) whether the valuation of intangible service concession arrangements on initial recognition should be different to other tangible service concession assets;

(b) whether the existing guidance in ED 261 and AASB 13 is sufficient; and

(c) whether additional guidance should be included in the final Standard on this issue.

---

[12] AASB 138 requires an intangible asset to be subsequently measured either using the:

(a) cost model where there is no active market for such an asset; or

(b) revalued model, being the fair value of the asset, where there is an active market for such an asset (paragraphs 72, 74 and 75).

[13] Staff analysis of the fair value measurement of a service concession asset at the Board's February 2016 concluded:

"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." (AASB Meeting 23-24 February 2016, Staff Paper 13.1, paragraph 38).

26 Staff are of the view the intangible service concession arrangements on initial recognition should not be different to other tangible service concession assets. This is based on:

(a) the Board's decision at its February 2016 meeting 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" (refer paragraph 23 above). Consequently, the cost of the asset at initial recognition should not be affected by whether the service concession asset is a tangible or intangible asset; and

(b) AASB 138.24 which requires an intangible asset to be measured at cost[14]. Cost is defined as "the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction …" and fair value is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See AASB 13 *Fair Value Measurement*.)" (ASB 138.8).

27 Based on the analysis in paragraph 21 to 26 above, Staff are of the view there is sufficient guidance in ED 261, AASB 13 and AASB 138 for the initial measurement of an intangible service concession asset. However, it may be useful for constituents to understand the Board considerations on this issue. Consequently, Staff propose to include in the Basis for Conclusion to the final Standard the content of this Staff analysis above.

Staff recommendation

28 Staff recommend:

(a) there are sufficient guidance in ED 261, AASB 13 and AASB 138 for the initial and subsequent measurement of a service concession asset that is an intangible asset that does not warrant additional guidance; and

(b) including in the Basis for Conclusion the content of the above Staff analysis.

Question to the Board

Q2. Does the Board agree with the Staff recommendation in paragraph 28 above?

[14] AASB 138.Aus24.1 also states that:

"Notwithstanding paragraph 24, in respect of not-for-profit entities, where an asset is acquired at no cost, or for a nominal cost, the cost is its *fair value* as at the date of acquisition."

Issue 3: Accounting for economic obsolescence in determining the asset's fair value

29 Some constituents requested guidance on accounting for economic obsolescence in determining the fair value of a service concession asset.

30 The Board, at its February 2016 meeting, decided that final Standard should clarify the service concession asset is a specialised asset that the grantor uses for its service potential to achieve public services. Consequently, only the cost approach of AASB 13 to measuring the fair value of a service concession asset is relevant.

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 replacement cost)" (AASB13.B8).

32 Current replacement cost takes into consideration obsolescence. This is noted in the Application Guidance of AASB 13, which states that, "From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset" (AASB13.B9).

33 AASB 13 also provides examples of obsolescence to "encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives)" (AASB13.B9).

34 Staff are of the view there is sufficient guidance in AASB 13 for the accounting of obsolescence in determining the fair value of a service concession asset based on the cost approach. However, it may be useful for constituents to understand the Board considerations on this issue. Consequently, Staff propose to include in the Basis for Conclusion to the final Standard the content of this Staff analysis above.

Staff recommendation

35 Staff recommend:

(a) there is sufficient guidance in AASB 13 for the accounting of obsolescence in determining the fair value of a service concession asset based on the cost approach that does not warrant additional guidance; and

(b) including in the Basis for Conclusion the content of the above Staff analysis.

Question to the Board

Q3. Does the Board agree with the Staff recommendation in paragraph 35 above?

Issue 4: Accounting for finance charges under the financial liability model

36 Some constituents have requested guidance on the accounting for finance charges under the financial liability model. This is on the basis that the finance charge specified under ED 261 may be different to that specified under the financial instruments Accounting Standards.

37 ED 261 requires;

(a) the application of the financial instrument Accounting Standards of AASB 132 *Financial Instruments: Presentation*, AASB 9 *Financial Instruments* and AAS 7 *Financial Instruments: Disclosures*, except where the final Standard provides requirements and guidance (ED 261.19);

(b) under the financial liability model, "the grantor allocates the payments to the operator under the contract and account for them according to their substance as a reduction in the liability recognised, … a finance charge and charges provided by the operator" (ED 261.20). Additionally, "The finance charge and charges for services provided by the operator in a service concession arrangement determined in accordance with paragraph 20 shall be accounted for in accordance with other relevant Australian Accounting Standards" (ED 261.21); and

(c) the finance charge specified above "is determined based on the operator's cost of capital specific to the service concession asset, if this is practicable to determine" (ED 261.AG46). However, "If the operator's cost of capital specific to the service concession asset is not practicable to determine, the rate implicit in the arrangement specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement, is used" (ED 261.AG47)[15].

38 AASB 9 requires a financial liability to be initially measured at fair value, adjusted for any transaction costs and subsequently carried at amortised cost (paragraphs 5.1.1 and 5.21.1). Amortised cost is measured using the effective interest rate method (paragraph 4.2.1)[16]. In calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all contractual terms of the financial instrument …"[17].

---

[15] Additionally, paragraph AG48 of ED 261 states that:

"Where sufficient information is not available, the rate used to determine the finance charge may be estimated by reference to the rate that would be expected on acquiring a similar asset (eg a lease of a similar asset, in a similar location and for a similar term). The estimate of the rate should be reviewed together with:

(a) the present value of the payments;
(b) the assumed fair value of the asset; and
(c) the assumed residual value;
to ensure all figures are reasonable and mutually consistent."

[16] Paragraph 4.21 of AASB 9 states that:
"An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:

(a) *financial liabilities at fair value through profit or loss ...*
(b financial liabilities that arise when a transfer of a financial asset …

39 The rate to be used for the finance charge under ED 261 differs to that of AASB 9. That is, AASB 9 requires the use of an effective interest rate specific to the financial instrument, while ED 261 proposes the use of the operator's cost of capital. ED 261 only permits the use of rate implicit to the arrangement and any other appropriate rate (including the grantor's incremental borrowing rate) if it is not practicable to determine the operator's cost of capital. While the operator's cost of capital may be reflective of the rate implicit in the arrangement, this may not always be the case. In addition, the rate implicit in the arrangement may differ significantly to the grantor's incremental borrowing rate.

40 Staff are of the view there are two possible options to address the above differences between ED 261 and AASB 9.

41 Option 1 proposes retaining the existing proposals in paragraphs 19, AG46 and AG47 of ED 261, which mirrors the requirements in IPSAS 32[18]. This approach would ensure that the final Standard would be consistent with IPSAS 32. The approach, however, would not be consistent with the requirements of AASB 9 and the accounting for financial liabilities.

42 Option 2 proposes amending paragraphs AG46 and AG47 of ED 261 to state that the finance charge in the financial liability model is to be determined based on the rate implicit to the arrangement, consistent with the effective interest rate in AASB 9. This

---

(c) *financial guarantee contracts* …
(e) contingent consideration …"

Amortised cost of a financial asset or financial liability is defined as:

"The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance" (AASB 9, Appendix A Defined Terms).

[17] Effective interest rate is defined as:

"The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument …" (AASB 9, Appendix A Defined Terms).

[18] Paragraph 20 of IPSAS 32 states that:

"IPSAS 28, *Financial Instruments: Presentation*, the derecognition requirements in IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures* apply to the financial liability recognized under paragraph 14, except where this Standard provides requirements and guidance."

Paragraphs AG40 and AG41 of IPSAS 32 states that:

"AG40. The finance charge specified in paragraph 21 is determined based on the operator's cost of capital specific to the service concession asset, if this is practicable to determine.

AG41. If the operator's cost of capital specific to the service concession asset is not practicable to determine, the rate implicit in the arrangement specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement, is used."

would involve determining the rate that exactly discounts estimated future cash payments through the expected term of the arrangement to the gross carrying amount of the financial liability, which is determined based on the fair value of the service concession asset. This approach would:

(a) remove the inconsistency between the current ED 261 proposals and the requirements of AASB 9; and

(b) retain the principles of the final Standard that is consistent with IPSAS 32, to apply the financial instrument accounting standards in paragraph 19 of ED 261.

43 Staff think option 2 has more merit than option 1.

Staff recommendation

44 Staff recommend option 2 of amending paragraphs AG46 and AG47 of ED 261 to state that the finance charge in the financial liability model is to be determined based on the use of rate implicit to the arrangement that is consistent with the use of the effective interest rate in AASB 9 for the reasons outlined in paragraph 42.

Question to the Board

Q4. Does the Board agree with the Staff recommendation in paragraph 44 above?

Issue 5: Accounting for hybrid arrangements

45 ED 261 proposes the separate accounting for each part of the total liability recognised for a hybrid service concession arrangement where the arrangement contains a grantor incurring a financial liability and grant of the right to the operator. Generally, constituents supported this proposal.

46 However, the constituents did not agree that ED 261[19] provides sufficient guidance for the separate accounting for each part of the total liability recognised for a hybrid service concession arrangement.

---

[19] The paragraphs of ED 261 relating to the accounting for hybrid service concession arrangements are as follows:

"26 If the grantor pays for the construction, development, acquisition, or upgrade of a service concession asset partly by incurring a financial liability and, partly by the grant of a right to the operator, it is necessary to account separately for each part of the total liability recognised in accordance with paragraph 13. The amount initially recognised for the total liability shall be the same amount as that specified in paragraph 14.

27 The grantor shall account for each part of the liability referred to in paragraph 26 in accordance with paragraphs 17 – 25.

47 The constituents requested additional guidance on how to apportion such an arrangement. 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.

48 Staff agree with the constituents' suggestion, in paragraph 47 above, that the Application Guidance in the final Standard should state that an acceptable method of dividing a hybrid arrangement is to allocate the total liability in a hybrid arrangement to a financial liability in the first instance. This is on the basis that under the financial liability model, the grantor has a contractual obligation to make a pre-determined series of payments to the operator in exchange for the service concession asset. The remaining portion of the liability in the hybrid arrangement would be allocated to a grant of the right to the operator. This approach is the only approach permitted under AASB Interpretation 12[20]. Staff think that because service concession arrangements are complex and have specific features, terms and conditions that are unique to each arrangement, it is more prudent to provide the above guidance as an acceptable method of dividing a hybrid arrangement rather than requiring it as the definitive method. This approach would also 'future proof'[21] the final Standard should other more appropriate methods of dividing a hybrid arrangement arise in the future.

…

AG54 If the operator is compensated for the service concession asset partly by a predetermined series of payments and partly by receiving the right to earn revenue from third-party use of either the service concession asset or another revenue-generating asset, it is necessary to account separately for each portion of the liability related to the grantor's consideration. In these circumstances, the consideration to the operator is divided into a financial liability portion for the predetermined series of payments and a liability portion for the right granted to the operator to earn revenue from third-party use of the service concession asset or another revenue-generating asset. Each portion of the liability is recognised initially at the fair value of the consideration paid or payable."

[20] AASB Interpretation 12.BC53 states that IFRIC noted that "in some arrangements, both parties to the contract share the risk (demand risk) that the cash flows generated by users of the public service will not be sufficient to recover the operator's investment. In order to achieve the desired sharing of risk, the parties often agree to arrangements under which the grantor pays the operator for its services partly by a financial asset and partly by granting a right to charge users of the public service (an intangible asset). The IFRIC concluded that in these circumstances it would be necessary to divide the operator's consideration into a financial asset component for any guaranteed amount of cash or other financial asset and an intangible asset for the remainder".

[21] Constituents in their feedback on ED 261 commented that the proposals in ED 261 "are more rules-based than principles-based. These constituents recommended that a principles-based Standard be developed to 'future proof' the Standard to address emerging innovative service concession arrangements that perhaps a rules-based Standard will not be able to adequately address" (AASB Meeting 4 September 2014 Staff Issues Paper – Staff Collation and Analysis of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraph 5).

Staff recommendation

49 Staff recommend the final Standard include in the Application Guidance that an acceptable method of dividing a hybrid arrangement is to allocate the total liability in a hybrid arrangement to the financial liability in the first instance, with the remaining portion of the liability to be allocated to a grant of the right to the operator.

Question to the Board

Q5. Does the Board agree with the Staff recommendation in paragraph 49 above?

Issue 6: Principles-based approach to recognising revenue under GORTO model

50 ED 261.24 proposes under the GORTO model, the grantor recognises revenue by reducing the liability recognised "according to the economic substance of the service concession arrangements". Some constituents requested additional guidance on applying this principles-based approach of recognising revenue. This is despite the Application Guidance stating the revenue would be recognised "usually as access to the service concession asset is provided to the operator over the term of the service concession arrangements" (ED 261.AG52).

51 Staff are of the view there are two possible options to address the above request from constituents.

52 Option 1 is to require revenue to be recognised on a systematic and rational basis using the straight line method, as suggested by some constituents. This option would eliminate the divergence in recognising revenue. However, this option would not be consistent with the objective of the Board and requests from the constituents for the AASB to develop a principles-based accounting standard for service concession arrangements.

53 Option 2 is to not provide additional guidance in the final Standard on the basis that there is sufficient guidance in ED 261 for the recognition of revenue associated with the liability accounted for under the GORTO model. Under the GORTO model, the grantor recognises a liability reflecting the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator. The grantor then recognises revenue according to the substance of the arrangement and reduces the liability accordingly, using a method that reflects "economic substance of the service concession arrangements" (ED 261.23 and 25).

54 Staff analysed the IPSASB staff view that "The grantor's revenue is earned as the grantor allows the operator access to the service concession asset to earn revenue from third-party users. Consequently, the pattern of revenue recognition should reflect the access granted to the operator. Where the access remains constant over the period of the service concession arrangement, this may suggest that it would be appropriate to recognize revenue on a straight-line basis over the life of the service concession arrangement. However, if the access granted to the operator varies over the period of

the service concession arrangement, it would be appropriate to recognize revenue proportionately to the access granted. ... The grantor's revenue is not the same as the operator's revenue. The level of revenue generated by the operator does not (except where there are additional mechanisms such as revenue sharing requirements incorporated into the service concession arrangement) impact the grantor's revenue. The operator earns revenue from the users of the service; often that revenue will be variable and dependent on a number of factors. The grantor earns revenue from the operator; that revenue is generally determined by the terms of the service concession arrangement."[22]

55 Staff also analysed IFRIC's consideration in developing amortisation methods for an intangible asset in AASB Interpretation 12. As, ED 261 contains the mirror requirements of AASB Interpretation 12 in the accounting for a service concession arrangement from a grantor's perspective. This is despite under a service concession arrangement where the grantor grants the right to the operator to charge the users of the asset, the grantor accounts for the arrangement as a liability under the GORTO model (in ED 261) while the operator accounts for the arrangement as an intangible asset (in AASB Interpretation 12). IFRIC concluded that "there was nothing unique about these intangible assets that would justify use of a method of depreciation different from that used for other intangible assets. The IFRIC noted that paragraph 98 of IAS 38 provides for a number of amortisation methods for intangible assets with finite useful lives. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits" (AASB Interpretation 12.BC64). Additionally, the International Accounting Standards Board in its development of IAS 138 *Intangible Assets* noted that requiring the use of "the straight-line method could be inconsistent with the general requirement … that the amortisation method should reflect the expected pattern of consumption of the expected future economic benefits embodied in an intangible asset" (IAS 38.BC72A).

56 Based on the above analysis, Staff are of the view the revenue recognition should be based on the economic substance of the specific arrangement to be assessed by the grantor involved and not prescribed by the Board, as proposed in option 1. Instead, Staff think there is sufficient guidance in ED 261, as outlined in option 2, which assists the grantor in the recognition of revenue under the GORTO model.

[22] IPSASB "Staff Questions and Answers on IPSAS 32 The "Grant of a Right to the Operator Model" in IPSAS 32, Service Concession Arrangement: Grantor" (February 2016) (page 3).

Staff recommendation

57 Staff recommend there is sufficient guidance in ED 261 for the recognition of revenue under the GORTO model that does not warrant additional guidance. However, it may be useful for constituents to understand the Board considerations on this issue. Consequently, Staff propose to include in the Basis for Conclusion to the final Standard the content of this Staff analysis above.

Question to the Board

Q6. Does the Board agree with the Staff recommendation in paragraph 57 above?

Issue 7: Arrangements where an operator charges a grantor based on use of the asset

58 ED 261.16(b) proposes the use of the GORTO model to account for the service concession liability where the grantor compensates the operator for the service concession asset by granting the operator the right to earn revenue from third-party users of the asset.

59 Some constituents have requested that "… the AASB consider broadening the scope to situations where the operator instead charges the grantor for services provided, rather than third-parties. For example a public hospital built and operated by the operator where the operator charges the grantor based on the volume of patients treated and a pre-agreed price list. In this case the grantor does not have a contractual obligation to pay cash or another financial asset, nor does it grant a right to charge third party users (paragraph 23), and therefore does not appear to fall under either model."[23]

60 Staff think one of the issues to consider is whether the party (i.e. the grantor or the third-party users of the service concession asset) that makes the payment to the operator determines the accounting model for the grantor to recognise the service concession liability. Staff used IFRIC's considerations in its development of IFRIC 12 *Service Concession Arrangements* from an operator's perspective for their analysis of this issue. This is on the basis that the accounting from a grantor's perspective in ED 261 mirrors the application of IFRIC 12[24].

---

[23] Link to Heads of Treasuries Accounting and Reporting Advisory Committee submission to ED 261 http://www.aasb.gov.au/admin/file/content106/c2/HoTARAC%20submission%20to%20ED%20261%20service%20concession%2010%20aug%202015_11-08-2015_091729.pdf

[24] This issue was also considered at the Board's February 2016 meeting, where the Board noted that 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.BC37). Applying this proposal would suggest that the grantor in the arrangement under consideration could have a financial liability.

61 To satisfy the definition of a financial asset (by the operator), 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).

62 AASB Interpretation 12.16 states that the "operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if the payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements".

63 Additionally, AASB Interpretation 12, paragraphs:

(a) BC47 states that, "The IFRIC concluded that the right of an operator to charge users of the public service meets the definition of an intangible asset, and therefore should be accounted for in accordance with IAS 38. In these circumstances 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."; and

(b) BC48 states that, "In the absence of contractual arrangements designed to ensure that the operator receives a minimum amount … the operator has no contractual right to receive cash even if receipt of the cash is highly probable. Rather, the operator has an opportunity to charge those who use the public service in the future. The operator bears the demand risk and hence its commercial return is contingent on users using the public service. The operator's asset is a licence, which would be classified as an intangible asset within the scope of IAS 38."

64 Based on the above IFRIC decisions, Staff are of the view that the above arrangement would be accounted for using the financial liability model, where the grantor contractually guarantees to pay the operator specified or determinable amounts as outlined in paragraph 62 above. In the absence of this contractual guarantee to the operator, the grantor would not have a financial liability, as outlined in paragraph 63(b) above. That is, the grantor would not have a contractual obligation to deliver cash, under a financial liability, even though it is highly probable that the grantor will make the payments to the operator based on third-party usage of the service concession asset. The grantor would instead account for the service concession liability under the GORTO model. However, it may be useful for constituents to understand the Board's considerations on this issue. Consequently, Staff propose to

include in the Basis for Conclusion to the final Standard the content of the Staff analysis above[25].

Staff recommendation

65 Staff recommend including in the Basis for Conclusion the content of the above analysis that a service concession arrangement where a grantor compensates the operator for the usage of the service concession asset by a third-party user, the accounting for the service concession liability would be accounted for under the financial liability model where the grantor contractually guarantees to pay the operator specified or determinable amount. In the absence of this contractual guarantee to the operator, the grantor would account for the service concession liability under the GORTO model.

Question to the Board

Q7. Does the Board agree with the Staff recommendation in paragraph 65 above?

[25] Staff in their analysis on this issue also considered the Interpretations Committee's decision at is meeting in January 2016 on variable payments made to an operator by a grantor in the context of IFRIC 12.

"The Interpretations Committee noted that accounting for variable payments to be made by the operator in a service concession arrangement, when the intangible asset model in IFRIC 12 applies, is linked to the broader issue of accounting for variable payments for asset purchases. In its discussions on that broader issue, the Interpretations Committee could not reach a consensus on whether the variable payments that depend on the purchaser's future activity should be recognised as a liability before that activity is performed or on what the initial measurement of this liability should be. In the case of the broader issuer on variable payments for asset purchases, the Interpretations Committee concluded that the issue was too broad for it to address… However, on balance, the Interpretations Committee concluded that addressing service concession arrangements that included such variable payments would also be too broad for it to address. The Interpretations Committee [decided] not to take the issue of accounting for payments by an operator to a grantor in a service concession arrangement onto its agenda."

Link to IFRIC Update January 2016
http://media.ifrs.org/2016/IFRIC/January/IFRIC-Update-January-2016.html#B

Appendix A: Service Concession Arrangements Project Plan (Updated for April 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)[26]	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: (a) redeliberate the proposed application to all public sector entities; and (b) consider the proposal the 'field test'	1	(a) Staff to undertake further outreach and report findings at future Board meeting for consideration (b) **Completed**
2–3 Dec 2015	Board to redeliberate the proposed: (a) concept of control; (b) asset measurement at fair value; and (c) liability recognition and measurement	2 – 4	(a) **Completed Redeliberated concept of control** (b) and (c) to be considered at February and April 2016 Board meeting
23–24 Feb 2016	Board to redeliberate: (a) asset and liability recognition and measurement; and (b) its rationale and decision of adopting the grant of the right to the operator model for inclusion as Basis for Conclusion	3 – 4	**Completed**
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 Present preliminary findings of field test	3 – 4	
21–22 Jun 2016	Board to redeliberate the proposed: (a) defined terms; (b) other revenues, lifecycle costs and GAAP/GFS implications; (c) application date and transitional provisions; and (d) disclosures	5 – 8	
30–31 Aug 2016	Board to deliberate findings of 'field test' and changes to draft Standard of: (a) application to all public sector entities; (b) concept of control; (c) asset measurement at fair value; and (d) liability recognition and measurement	1 – 4	
18-19 Oct 2016	Board to consider any sweep issues Board to review pre-ballot draft Standard	8 – 9	
Nov/Dec 2016 (out of session)	Board to vote on Ballot Standard	10	

[26] 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 April 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: (a) Terms of reference of field test including participants' role; and (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 2016	**Completed**
2.3	Meet with FTP to discuss outcomes of application of ED 261 to fact patterns	Staff/Academic	End Mar – Mid Apr 2016	In progress
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**	