Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Service Concession Arrangements**	**Meeting:**	21 June 2016 (M152)
Topic:	**Scope**	**Agenda Item:**	4.2
		Date:	6 June 2016
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Introduction and objective of this paper

1 The objective of this paper is to reconfirm the Board's previous tentative decision of whether the final Standard should apply to both for-profit and not-for-profit public sector entities. The paper outlines the outcomes of staff research in relation to:

(a) the reasons why a for-profit entity applying the final Standard would not be able to state compliance with IFRS;

(b) targeted outreach as to why IFRS compliance is important to a for-profit entity; and

(c) potential policy implications for the AASB.

2 This paper is structured as follows:

(a) background (paragraphs 3-6); and

(b) staff analysis (paragraphs 6-32).

Background

3 ED 261 *Service Concession Arrangements: Grantor* (ED 261) proposed that the final Standard applies to a "grantor that is a public sector entity" (ED 261.1) irrespective of whether the entity is a for-profit or not-for-profit entity.

4 The majority of constituents, in their feedback[1] on ED 261 agreed with the proposed application to all public sector entities. Some constituents in their support expressed concerns that the entities may not be able to make an "explicit and unreserved statement" of compliance with International Financial Reporting Standards (IFRSs).

5 At the October 2015 AASB meeting the Board:

"tentatively decided that, consistent with the proposals in ED 261 *Service Concession Arrangements: Grantor*, the application of the final Standard on service concession arrangements should apply to all public sector grantors in both the for-profit and NFP sectors. The Board also discussed whether a for-profit entity could make an explicit and unreserved statement that its financial statements comply with IFRS.

The Board directed staff to undertake further outreach to better understand the reasons why IFRS compliance is important to the for-profit entities and to identify all the current circumstances where the Board has permitted for-profit public sector entities to not comply with IFRS and how ED 261 would impact the Board's strategy to ensure for-profit entities can be IFRS compliant. The Board also directed staff to discuss with the IFRS Interpretations Committee staff the likelihood and timeframe of any possible response from the Committee if the Board sought confirmation from the Committee that the ED 261 proposals are consistent with IFRS, either on the narrow issue of application of IFRS 15 *Revenue from Contract with Customers*, or a broader range of issues. The Board directed staff to bring the findings for consideration at a future Board meeting."[2]

6 Staff also obtained input from the Service Concession Arrangements: Grantor Project Advisory Panel (the Panel) in the analysis of the issues in this Paper.

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[1] AASB Meeting 4 September 2015 Staff Issues Paper – Staff Collation and Analysis of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraphs 7, 8, and 10.

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

[2] Link to minutes to AASB Meeting 21-22 October 2015, Agenda Item 6, Service concession Arrangements: Grantor
http://www.aasb.gov.au/ADMIN/file/content102/c3/M148_AASB_Minutes_21-22_Oct_2015_unsigned.pdf

Staff analysis

7 In response to the Board's directive in paragraph 5 above, the issues to consider in addressing whether the final Standard should apply to all public sector entities are:

(a) the reasons why a for-profit entity in complying with the final Standard would not be able to state compliance with IFRS;

(b) whether there is precedent in existing requirements in Australian Accounting Standards that indicate public sector entities may not be able to state compliance with IFRS;

(c) the reasons why IFRS compliance is important to the for-profit entities;

(d) what the policy implications are if the Board decides to (or not to) apply the Standard to for-profit entities; and

(e) the possible approaches for determining the scope of the final standard.

Ability to state compliance with IFRS

8 Staff identified the following two areas in the final Standard that may not be consistent with IFRS:

(a) the proposed recognition of revenue arising from the grant of the right to the operator (GORTO) model; and

(b) the requirement to use the cost approach to measuring the fair value of a service concession asset where the operator has been given the rights to future cash flows.

<u>AASB 15 *Revenue from Contracts with Customers* compliance</u>

9 Some constituents, in their feedback on ED 261, commented that revenue arising from the proposed GORTO model in the final Standard may not be consistent with the revenue recognition requirements in AAS 15. These constituents are of the view that a for-profit entity in applying the final Standard may therefore not be IFRS compliant.

10 AASB 15 does not specifically address the accounting for revenue arising from service concession arrangements.

11 The Board in its previous meetings considered the implications of applying AASB 15 directly to service concession arrangements from a grantor's perspective and concluded that significant judgement would be required to apply IFRS 15 revenue model (Staff Paper 13.1 February 2016, paragraph 68).

AASB 13 *Fair Value Measurement* compliance

12 The Board at its February 2016 meeting "decided the final Standard should clarify the service concession asset is a specialised asset that the grantor uses for its service potential to achieve public service objectives. Consequently, the cost approach to measuring the fair value of service concession assets would be relevant and the measurement would be unaffected by any granting of the rights to future cash flows of the asset to the operator"[3].

13 The implication of the Board's decision to require the cost approach to fair value a service concession asset that is accounted for under the GORTO model may result in a for-profit entity being non-compliant with AASB 13 and in turn being non-compliant with IFRS. This is on the basis that in practice, the general approach to fair value a specialised asset such as a service concession asset is to use the:

(a) cost approach (of current replace cost consistent with AASB 13) for a not-for-profit entity; and

(b) income approach (of discounted cash flows consistent with AASB 13) for a for-profit entity.

14 Some may view the requirement for a for-profit entity to use the cost approach to fair value a service concession asset accounted for under the GORTO model may not be appropriate valuation technique and could potentially result in the entity being non-compliant with AASB 13.

Precedent in existing Australian Accounting Standards of non-compliance with IFRS

15 Staff in their analysis of the principal differences between the AASB pronouncements and the corresponding IFRS identified one circumstance in which the application of an Australian Accounting Standard by a for-profit entity would result in the non-compliance with IFRS. This circumstance is in paragraph Aus16.2 of AASB 101 *Presentation of Financial Statements*, which states that:

"Compliance with Australian Accounting Standards by for-profit entities will not necessarily lead to compliance with IFRSs. This circumstance arises when the entity is a for-profit government department to which particular Standards apply, such as AASB 1004 *Contributions*, and to which Aus paragraphs in various other Australian Accounting Standards apply, and the entity applies a requirement that is inconsistent with an IFRS requirement".

16 Staff reviewed all "Aus" paragraphs currently operative in Australian Accounting Standards. Staff identified only one paragraph that may result in non-compliance with IFRS by a for-profit entity: AASB 101. Aus16.2 (as outlined in paragraph 15 above).

17 Staff conducted outreach on the issue and identified there are no for-profit departments that are affected by the AASB 101.Aus16.2. Nevertheless, the existence of AASB 101.Aus16.2 demonstrates that there is a precedent in existing Australian Accounting Standards that in its application will result in non-compliance with IFRS.

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[3] Link to AASB Meeting 23-24 February 2016, Agenda 13
http://www.aasb.gov.au/admin/file/content102/c3/M150_AASB_Minutes_23-24_Feb_2016_unsigned.pdf

Importance of IFRS compliance by for-profit entities

18 While the majority of constituents supported the application of the final Standard to all public sector entities, two constituents expressed their preference for a for-profit public sector grantor to be scoped out of the final Standard. The two constituents are the Australian Council of Auditors-General (ACAG) and New South Wales (NSW) Treasury.

19 ACAG in their submission to ED 261 stated the reasons for preferring to exclude a for-profit entity from the final Standard are the difficulties in the initial fair value measurement of the service concession asset and the subsequent impairment of the asset[4].

20 NSW Treasury cited that "The ability of NSW public sector entities to state compliance with the same accounting framework as private sector buyers, partners and competitors will promote comparability, competitiveness and transparency"[5].

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[4] ACAG in their submission to ED 261 on the Specific Matters for Comment – Question 1 stated that:

"If the AASB were to create a transaction neutral standard it would force FP entities into a position where they may not be able to comply with other AIFRS standards. Should this standard be extended to the FP sector, ACAG recommends the AASB assess the impact of the proposed standard on IFRS compliance and clarify and specifically address potential compliance issues.

Most service concession assets relate to specialised assets, which generally are measured initially at cost and subsequently at depreciated replacement cost (DRC) in NFP entities. Government business enterprises (GBEs) would experience issues with impairment of service concession assets both individually and within cash generating units (CGUs). Including a service concession asset in the asset base of a CGU which is valued using discounted cash flows will trigger impairment, as the service concession asset will inflate the asset base of the public sector grantor, without a corresponding increase in cash flows in the grantor entity.

The AASB will also need to clarify the order in which these CGU assets attract impairment and the treatment of any subsequent recoupment of impairment decrements, including where the recoupment relates to a service concession asset where the underlying asset is an intangible asset.

As both public and private sector entities can contract using service concession arrangements to provide public benefits, ACAG believes there is merit in the AASB considering application beyond the government to the NFP sector. This will help in ensuring consistent application across the NFP space.

However, ACAG believes that while transaction neutrality is generally desirable, in this instance the concepts in this standard would be difficult to apply in FP entities. ACAG therefore supports the exclusion of GBEs and restriction of the application of the proposed standard to the NFP sector."

Link to ACAG submission to ED 261
http://www.aasb.gov.au/admin/file/content106/c2/ACAG%20response%20to%20ED%20261%20SCA_reduced_03-08-2015_120238.pdf

[5] NSW Treasury in their submission to ED 261 stated that:

"NSW Treasury understands that the AASB has not determined whether ED 261 is consistent with IFRS, in particular the requirement to recognise revenue over the period of the concession (paragraph 23-24, AG51-AG53). We also understand this is the reason the AASB has not included non-public sector entities in the scope of the proposed standard.

The ability to state compliance with IFRS and apply transaction neutral accounting is important to the NSW public sector. The trend in NSW is towards, innovative arrangements between the public and private sectors. The ability of NSW public sector entities to state compliance with the same accounting framework as private sector buyers, partners and competitors will promote comparability, competitiveness and transparency.

21 The majority of the Panel members acknowledged that while they prefer a for-profit entity to express compliance with IFRS in the entity's application of the final Standard, the members expressed it is more important that the final Standard is consistent with the AASB transaction neutrality policy. This is also consistent with the majority of the constituents' views in their feedback to ED 261 that the principle of transaction neutrality, taken to include sector neutrality, should take precedent over the ability of an entity to express IFRS compliance.

22 The Panel was concerned that if the final Standard was to exclude a for-profit entity from its application, this may provide an incentive or mechanism for structuring service concession arrangements to involve for-profit sector grantors so that these entities need not recognise service concession assets and liabilities on their balance sheet.

23 The Panel also noted that the ability of a for-profit entity to express IFRS compliance for the purpose of competitiveness is relevant in the context of a foreign market participant in the service concession arrangement, which can be addressed at a practical level if the need arises.

Policy implications for the AASB

24 The AASB *Policies and Processes*[6] states that:

(a) "The AASB makes accounting standards with a view to requiring like transactions and events to be accounted for in a like manner for all types of entities. This is referred to as 'transaction neutrality'"[7]; and

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NSW Treasury recommends the AASB more fully consider whether preparers could apply a proposed standard and still state compliance with IFRS. NSW Treasury's preferred approach is for the AASB initiate and prioritise a project to develop a standard and/or guidance on accounting for service concession arrangements which allows preparers to prepare financial statements that are consistent with IFRS.

Alternatively it would be useful for preparers of financial statements to understand the inconsistencies between the ED 261 and IFRS. This would allow financial statements to explain the how and why accounting policies do not comply with IFRS." ("Statement of Compliance with IFRS**"**, page 4).

Link to NSW Treasury submission to ED 261
http://www.aasb.gov.au/admin/file/content106/c2/9c%20FINAL%20SIGNED%20HoTARAC%20Submission%20-%20ED%20261%20Service%20Concession%20Arrangements%20-%20Grantor_18-08-2015_174728.pdf

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

[7] The AASB *Policies and Processes* also states the following:

"The AASB acknowledges that different business models are used by different types of entity. However, it considers that the fundamental nature of the elements of financial statements (assets, liabilities, income and expenses) and their qualitative characteristics are generally unaffected by different business models. Accordingly, the AASB considers that the promulgation of transaction-neutral Standards to the extent feasible is:

(a) consistent with the concepts underlying accounting;

(b) meets the needs of users; and

(c) brings an additional benefit of effectively and efficiently developing what is largely one central body of requirements" (paragraph 40).

(b) "In implementing this transaction-neutral policy the AASB: (a) on the basis of the need for Tier 1 for-profit entities to remain IFRS compliant in the best interests of the Australian economy, accepts that an IFRS should only be modified to the extent that the IFRS is not relevant or appropriate in a not-for-profit context" (paragraph 41(a)).

25 Staff have identified the following potential policy implications for the AASB:

(a) if the final Standard <u>does not</u> apply to for-profit entities, this would permit the entities to state compliance with IFRS. However, this approach would be inconsistent with the AASB's transaction neutrality in setting Standards; or

(b) if the final Standard <u>does</u> apply to for-profit entities, this will be consistent with AASB's transaction neutrality policy in setting Standards of requiring like transactions and event to be accounted for in a like manner irrespective of the types of entities.

However, this approach may result in a for-profit entity not being compliant with IFRS. This could set a precedent for future Standards to be non-compliant with IFRS and thereby undermining the overarching objective of the AASB to set Standards that are IFRS compliant. Nevertheless, Staff note that a precedent (although with limited application) already exists with the requirement for a for-profit entity to apply AASB 1004 which would result in the entity not being IFRS compliant (AASB 101.Aus16.2) (refer paragraph 15 above).

The AASB *Policies and Processes* also detail the power and functions of the AASB. In relation to a for-profit entity being compliant with IFRS, the document states the following:

(a) the AASB's strategies relating to its international role and domestic topics and priorities is to:
  (i) "maintain two Tiers of Australia financial reporting requirements, with Tier 1 for-profit entities being compliant with IFRSs" with the exception of the application of AASB 1004 (paragraph 7(b)); and
  (ii) "dealing with topics of domestic significance affecting for-profit entities, within the constraints of maintaining compliance with IFRSs" (paragraph 7(d));

(b) "there is a presumption that IFRSs should be adopted for use in Australia unless to do so would not be in the best interests of the Australian economy" (paragraph 9);

(c) in the context of developing Accounting Standards and Interpretations, the AASB will with respect to "domestic topics that impact on for-profit entities and that are outside the IASB's mandate, seek high-quality financial reporting outcomes, having regard to consistency with the requirements of IFRSs" (paragraph 35(c)).

Possible approaches for determining the scope of the final Standard

26 Based on the analysis in paragraphs 7-25, Staff have identified three possible approaches in determining the scope of the final Standard:

(a) Approach 1: Application to all public sector entities;

(b) Approach 2: Application to not-for-profit entities including each government's whole of government (WoG) general purpose financial statements (GPFS); and

(c) Approach 3: Application only to not-for-profit entities.

<u>Approach 1: Application to all public sector entities (previous tentative Board decision)</u>

27 Approach 1 proposes the final Standard apply to all public sector entities in both the for-profit and not-for-profit sectors. The implications of this approach are:

(a) advantages that it:

(i) would be consistent with the AASB's transaction neutrality policy;

(ii) reduces or eliminates the incentive for structuring service concession arrangements to involve for-profit sector grantors;

(b) a disadvantage is that a for-profit entity may not be able to make a statement that its financial statements comply with IFRS.

<u>Approach 2: Application to not-for-profit entities including WoG GPFS</u>

28 Approach 2 proposes the final Standard applies:

(a) to not-for-profit entities; and

(b) at a whole of government consolidated reporting level.

29 The approach attempts to capitalise on the advantages and overcome the disadvantage of Approach 1. That is, the approach uses the premise that a public sector grantor should account for a service concession arrangement. However, where this accounting will result in an entity (in this case, a for-profit entity) not being able to be IFRS compliant, the for-profit entity need not apply the final Standard. Instead the government at a WoG general purpose financial statements level would still be required to account for the service concession arrangement.

30 However, Approach 2 would have the disadvantages that it:

(a) would not be in accordance with the AASB's transaction neutrality policy; and

(b) for-profit entity would still need to prepare information for reporting to the whole of government consolidated level. Additionally, the for-profit entity may also need to account for the arrangement under the broader concept of control that exists in other Australian Accounting Standards[8].

Approach 3: Application only to not-for-profit entities

31 Approach 3 proposes the final Standard applies only to not-for-profit entities. The implications of this approach are:

(a) advantage that a for-profit entity is able to make a statement that its financial statements comply with IFRS;

(b) disadvantages that it:

(i) is not consistent with the AASB's transaction neutrality policy;

(ii) provides incentive for structuring service concession arrangements to involve for-profit sector grantors

32 Staff have mixed views of the approaches outlined above and is seeking the Board's direction as to whether the Board would like to reconfirm its previous tentative decision (Approach 1), or revise this decision based on the additional outreach and research undertaken by staff.

Questions to the Board

Q1. Based on the above analysis, does the Board wish to reconfirm its previous tentative decision that the scope of the final Standard should apply to all public sector entities (Approach 1)? If not, which approach does the Board wish to take?

Q2. If the Board does not wish to proceed with any of the approaches in Q1, how does the Board wish to proceed?

[8] The Board at its December 2015 meeting decided that the final Standard should include the requirement to apply the broader concept of control that exists in other Australian Accounting Standards.

Link to AASB Meeting 2-3 December 2015 minutes, Agenda 12
http://www.aasb.gov.au/admin/file/content102/c3/M149_AASB_Minutes_2-3_Dec_2015_unsigned.pdf