

## AASB Staff Issues Paper

### Service Concession Arrangements (Grantor) Project – Potential Issues for Redeliberation

#### Purpose

- 1 The purpose of this paper is to highlight a number of potential issues that have been raised with staff on the accounting for service concession arrangements by grantors and which may require further research and possibly further deliberations by the Board before its proposals on grantor accounting can be finalised and an Exposure Draft published for public comment.
- 2 The remainder of this paper is structured as follows:
  - (a) Background (paragraphs 3-4);
  - (b) Applying the principles of IPSAS 32 as a basis for an Australian pronouncement (paragraphs 5-7);
  - (c) Potential issues for redeliberation (paragraphs 8-36):
    - (i) The scope of the service concession arrangements project
    - (ii) Control of the service concession asset; and
    - (iii) Measurement of the service concession asset; and
  - (d) Broader issues for consideration (paragraphs 37-40).

#### Background

- 3 AASB Interpretation 12 *Service Concession Arrangements* specifies the accounting for service concession arrangements from the operator's perspective. The purpose of the Board's project is to develop requirements for accounting for service concession arrangements by grantors.
- 4 At its July 2012 meeting, the Board considered the suitability of applying the requirements in IPSAS 32 *Service Concession Arrangements: Grantor* to Australian grantors. The Board tentatively agreed that the requirements in IPSAS 32 may be appropriate for application in Australia, although some modifications to IPSAS 32 might be needed subject to a further analysis of the following issues:
  - (a) **Issue 1:** whether IPSAS 32 is clear that the grantor controls the asset used in a service concession arrangement if a third party regulator is involved (Issue 1);
  - (b) **Issue 2:** whether the grantor should initially recognise a liability (IPSAS 32 requirement) or revenue when it receives the service concession asset in exchange for granting the operator a licence for the 'right to charge users' of the service concession asset (Issue 2); and
  - (c) **Issue 3:** how the liability or revenue should initially be measured (Issue 3).

## Applying the principles of IPSAS 32 as a basis for an Australian pronouncement

- 5 Since the commencement of the service concession arrangements project, various Standards have been issued by the IASB and the AASB that have the potential to impact the decisions made by the Board to date in relation to the service concession arrangements. These Standards are as follows:
- (a) AASB 10 Consolidated Financial Statements (and, in particular, AASB 2013-8: Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities – Control and Structured Entities);
  - (b) AASB 13 Fair Value Measurement; and
  - (c) IFRS 15 Revenue from Contracts with Customers.<sup>1</sup>
- 6 Given these developments (especially the forthcoming issuance of AASB 15 *Revenue from Contracts with Customers* (incorporating IFRS 15) and the recent implementation of AASB 10 and AASB 13 in Australia), a number of questions have been raised by constituents and Board members about the Board's decision to base an Australian pronouncement on IPSAS 32. In addition, if IPSAS 32 is to be retained as a base, some have queried whether further modifications would need to be considered, in addition to those noted in paragraph 4 above.
- 7 The key issues raised are as follows:
- (a) The scope of the service concession arrangements project, including whether service concession arrangements are a licence (paragraphs 8-26);
  - (b) Control of the service concession asset (paragraphs 27-31); and
  - (c) Measurement of the service concession asset (paragraphs 32-36).

Each of these issues are discussed further below.

## Potential issues for reconsideration

### Reconsidering the scope of the service concession arrangements project

#### *Scope of IPSAS 32*

- 8 The relevant aspects of the scope of IPSAS 32 are as follows (paragraphs 5, 6 and 9 of IPSAS 32):
- 5. Arrangements within the scope of this Standard involve the operator providing public services related to the service concession asset on behalf of the grantor.
  - 6. Arrangements outside the scope of this Standard are those that do not involve the delivery of public services and arrangements that involve service and

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1 IFRS 15 *Revenue from Contracts with Customers* was issued by the IASB in May 2014. An equivalent Australian Accounting Standard, AASB 15 *Revenue from Contracts with Customers*, is expected to be issued in mid-December 2014.

management components where the asset is not controlled by the grantor (e.g., outsourcing, service contracts, or privatization).

#### Recognition and Measurement of a Service Concession Asset

9. 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:
  - (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.
- 9 IPSAS 32 is intended to ‘mirror’ IFRIC 12 *Service Concession Arrangements* (IFRIC 12), which applies to the private sector operator in a service concession arrangement. Accordingly, the scope, principles for recognition of an asset and terminology used in IPSAS 32 are consistent with the requirements in IFRIC 12.<sup>2</sup>
- 10 In its comment letter to the IPSASB on ED 43 *Service Concession Arrangements: Grantor*,<sup>3</sup> the AASB agreed that there should be consistency across the accounting by operators and by grantors. However, the AASB also noted that the degree of consistency achieved in practice may depend upon the assessment of regulatory arrangements by grantors in applying the grantor control criteria.

#### Consideration of potential impact of AASB 15

- 11 The question has been raised to staff as to whether the scope of IPSAS 32 is appropriate for use in the Australian environment, particularly in the light of the forthcoming AASB 15. A related question raised was whether the payment by a grantor to an operator for the construction and operation of a service concession asset by way of providing a right to charge users is a unique type of transaction, or whether it is no different to any other licence issued by a public sector entity.

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2 However, because IPSAS 32 deals with the accounting issues of the grantor, the Standard addresses the issues identified in IFRIC 12 from the grantor’s point of view, as follows:

- (a) The grantor recognises a financial liability when it is obliged to make a series of payments to the operator for provision of a service concession asset (i.e., constructed, developed, acquired, or upgraded). Using the measurement requirements specified in this Standard in paragraphs 12, 14, and 20 of IFRIC 12, the operator recognises revenue for the construction, development, acquisition, upgrade, and operation services it provides. Under paragraph 8 of IFRIC 12, the operator derecognises an asset that it held and recognised as property, plant, and equipment before entering the service concession arrangement;
- (b) The grantor recognises a liability when it grants the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset. Under paragraph 26 of IFRIC 12, the operator recognises an intangible asset; and
- (c) The grantor derecognises an asset it grants to the operator and over which it no longer has control. Under paragraph 27 of IFRIC 12, the operator recognises the asset and a liability in respect of any obligations it has assumed in exchange for the asset (paragraph AG1).

3 [http://www.aasb.gov.au/admin/file/content106/c2/AASB\\_Submission\\_to\\_IPSASB\\_ED\\_43.pdf](http://www.aasb.gov.au/admin/file/content106/c2/AASB_Submission_to_IPSASB_ED_43.pdf) (accessed 4 December 2014)

- 12 Staff note that IPSAS 32 was issued in 2011, prior to the issuance of IFRS 15 by the IASB. The International Public Sector Accounting Standards Board (IPSASB) does not currently have an equivalent standard to IFRS 15, nor does it currently have an active project on its agenda to issue an equivalent standard.
- 13 Although the scope of IFRS 15 differs from the scope of the relevant Standards that it superseded, staff note that the issuance of IFRS 15 by the IASB did not make any consequential amendments to the scope of IFRIC 12.
- 14 Although there is no IPSAS equivalent to IFRS 15, the IPSASB has an equivalent Standard to IAS 18/AASB 118 *Revenue* – IPSAS 9 *Revenue from Exchange Transactions*.
- 15 The scope of IPSAS 9 is as follows (paragraph 1 of IPSAS 9):
1. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for revenue arising from the following exchange transactions and events:
    - (a) the rendering of services;
    - (b) the sale of goods; and
    - (c) the use by others of entity assets yielding interest, royalties, and dividends.
- 16 Staff note that licences are within the scope of IPSAS 9 (see IPSAS 9 paragraph 1(c)).
- 17 The scope of IPSAS 9 is similar to AASB 118; however, in contrast to AASB 118 the definition of revenue in IPSAS 9 does not refer to ‘ordinary activities’. The IASB definition of income encompasses both revenue and gains whereas IPSAS 9 uses the term ‘revenue’, which encompasses both revenues and gains, in place of the term ‘income’.
- 18 Further, it is the understanding of staff that the scope of IFRS 15 (and similarly, the scope of the forthcoming AASB 15) is not broader than the scope of AASB 118. That is, staff are of the view that there would not be any contracts within the scope of AASB 15 that would not have previously been outside the scope of AASB 118.<sup>4</sup>
- 19 Although some may view service concession arrangements as a licence with similar features to other licences that are within the scope of existing guidance (e.g. IPSAS 9), the IPSASB has taken the view that specific guidance on service concession arrangements is required. Further, by not specifically scoping service concession arrangements out of general revenue requirements implies that these arrangements within the scope of these standards are not simultaneously within scope of the ‘general’ revenue standard IPSAS 9 and IPSAS 32.

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4 Although staff also note that there are transactions previously captured within the scope of AASB 118 that would no longer be within scope of AASB 15 (e.g. dividends and non-contractual royalties).

*AASB staff outreach*

- 20 Staff have undertaken targeted outreach with staff of the New South Wales and Victorian State Treasury departments. Staff from both jurisdictions indicated that while an economic service concession arrangement is in the nature of a licence, they are considered sufficiently different (in nature, frequency and intent) to other licences (both public and private), and warrant separate requirements.<sup>5</sup>
- 21 In addition, the results of staff targeted outreach suggest that if the Board does not proceed with developing separate requirements for service concession arrangements, some may take the view that such transactions are outside the scope of AASB 15 and an alternative accounting practice may be developed.

*Staff recommendation*

- 22 As noted above, IPSAS 32 is intended to mirror the scope of IFRIC 12. Further, the fact that the IPSASB issued separate guidance in relation to service concession arrangements suggests that the IPSASB considers these arrangements to be sufficiently different to other licences to warrant separate guidance from general revenue requirements. In addition, targeted staff outreach has indicated that preparers also consider service concession arrangements to be different to other licences.
- 23 Staff are of the view that establishing a different scope for each side of the same transaction could cause issues, including IFRS compliance problems if a private sector entity sought to analogise to the broader scope of a Standard addressing the accounting by grantors.
- 24 Accordingly, staff recommend retaining the scope of IPSAS 32 as the basis for the AASB service concession arrangements project.

**Question to Board Members**

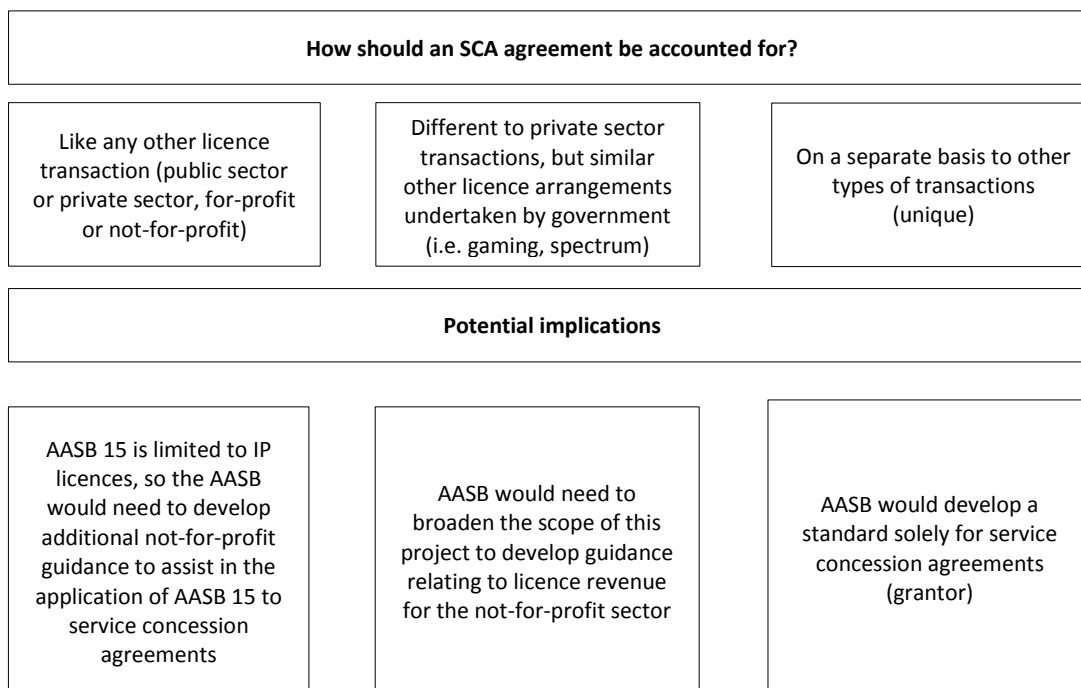
- Q1(a) Does the Board agree with the staff recommendation in paragraph 24 above to retain the scope of IPSAS 32 as the basis for the AASB service concession arrangements project?

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5 Treasury staff also noted that the lack of guidance on the matter has led to each jurisdiction taking a slightly different approach to the accounting treatment of economic service concession arrangements as shown in Agenda Paper 7.5

Alternative project scope (if the Board disagrees with Question 1(a))

- 25 If the Board disagrees with the staff recommendation in paragraph 24 above to retain the scope of IPSAS 32 as the basis for the AASB service concession arrangements project, staff seek direction from the Board on how to proceed with the project.
- 26 Staff have identified three possible approaches the Board may wish to take as illustrated in the diagram below:



**Question to Board members**

Q1(b) Does the Board want staff to do further work in relation to any, or all, of the above approaches?

Control of the service concession asset

*AASB 2007 review of control*

- 27 In 2007, prior to the IPSASB issuing IPSAS 32, the AASB reviewed a number of alternative approaches to account for service concession assets by grantors. This review was undertaken by an advisory panel established by the Board to provide it with advice following the introduction of Interpretation 12. The full paper is included as Agenda Paper 7.6. In summary the paper considered the following approaches to the assessment of control:
- (a) Risks and rewards;
  - (b) 'Pure' control;
  - (c) Rights and obligations; and
  - (d) Control or regulation

- 28 In the paper, the panel did not conclude on the best way forward, but does comment that it does not support the ‘control or regulation’ approach that is employed by Interpretation 12 (and subsequently IPSAS 32).

*The control or regulation approach*

- 29 In September 2012, the Board decided that the ‘control or regulation’ approach in IPSAS 32 was appropriate to use as a base for an Australian pronouncement. In agreeing this, the Board decided to include guidance in the ED emphasising that the fundamental principle is ‘control’, and that regulation of a service concession asset is only one of the factors to consider in determining whether the grantor controls the asset in particular circumstances. Consistent with the Board’s thinking, the ED to be developed should avoid implying that an asset is controlled because it is regulated. Furthermore, because the not-for-profit Implementation Guidance being developed [at that time] for AASB 10 *Consolidated Financial Statements* refers to regulation in a different context to the issues pertinent to service concession arrangements, care needs to be taken in adapting that not-for-profit guidance in this project.
- 30 Consistent with this and the findings of the original panel, some constituents challenge the adoption of the ‘control or regulation’ approach, advocating that the ‘control’ approach is superior as the current wording of IPSAS 32 provides a narrower view of the application of the control tests in IFRS 10. Following from this narrower approach, the requirements would potentially exclude assets from being considered to be controlled by the grantor where the grantor does not control pricing, even though this is not a substantive feature of the way in which the grantor assesses returns from the service concession asset.
- 31 Staff will bring proposed drafting around the concept of control back to a future Board meeting so the Board can consider whether the previous decision to make amendments to include additional guidance in the ED in relation to control overcomes the constituent concerns.

Measurement of the service concession asset

- 32 IPSAS 32 requires the grantor to recognise the service concession asset at fair value and recognise revenue (or a liability, deferred revenue) measured at the same amount as the asset. While this is consistent with the requirements of IFRS 15, which provides guidance that the ‘revenue’ for a transaction should be determined by what is being received (whether it be cash or non-cash consideration), non-cash consideration may be difficult to measure in practice (Issue 3 noted in paragraph 4 above). Where non-cash consideration cannot be reliably measured, a substitute is used to inform the measurement, which in this instance is the fair value of what the grantor has given up.<sup>6</sup>
- 33 Whilst identifying the potential need to make amendment to IPSAS 32 in relation to revenue/deferred revenue, the Board has not yet specifically discussed the application of fair value measurement to the service concession asset.
- 34 The issue of measuring the fair value of the service concession asset has been raised by staff in particular in relation to the implementation of AASB 13 in Australia.

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<sup>6</sup> IFRS 15 *Revenue from Contracts with Customers* paragraph 67

Specifically, the application of what this means in practical terms which causes some uncertainty, particularly in instances in which an economic (or user pays) service concession arrangement is entered into.

- 35 In accordance with AASB 13, fair value is 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. Some of the key issues in relation to this measurement identified to staff include:
- (a) if the grantor sells the service concession asset during the concession period, what effect (if any) would the fact that the grantor has transferred the right to charge users to the operator have on the price a market participant would be willing to pay for the asset?
  - (b) how to determine the highest and best use of the service concession asset. Specifically, clarification of which cash flows should be included in the fair value measurement. Depending on how fair value measurement is interpreted, some may take the view that the relevant cash flows are limited to the residual value.
- 36 Although staff acknowledge that AASB 13 was issued by the Board prior to the Board deciding to adopt IPSAS 32 requirements in relation to service concession assets, staff consider that, consistent with issues raised in relation to other current AASB projects, the full implications of AASB 13 have only emerged once entities have begun to apply the Standard. Accordingly, staff recommend considering the implications of AASB 13 requirements in detail for both the service concession asset and the related revenue/deferred revenue.

#### **Question to Board members**

- Q2 Does the Board agree that staff should do further work to consider the implications of AASB 13 requirements in detail for both the service concession asset and revenue/deferred revenue?

#### **Broader issues for consideration**

##### Fair value in the public sector

- 37 Staff note that the issue of the application of AASB 13 is not limited to service concession assets – but is potentially a broader issue in the public sector and not-for-profit sector. Staff note that, at the time of incorporating IFRS 13 into an Australian Accounting Standard, the Board considered whether any not-for-profit specific modifications were required to IFRS 13 and ultimately decided that no amendments were warranted.
- 38 Staff have reservations as to whether the application of AASB 13 to a specific type of public sector asset can be resolved in isolation without also considering the application of AASB 13 to other public sector assets. Accordingly, staff are seeking views from the Board as to whether the Board would like staff to consider the issue of the



application of AASB 13 more broadly to public sector assets; not just limiting their considerations to service concession assets<sup>7</sup>.

Accounting for government licences

- 39 A further issue that was raised to staff was in relation to how government licences more generally should be accounted for – for example, spectrum licences, gaming licences and fishing licences. Specifically, whether such licences are within the scope of the forthcoming AASB 15, and whether additional Australian requirements or guidance is required in this regard.
- 40 Staff are of the view that the broader issue of accounting for government licences other than service concession arrangements is beyond the scope of the existing service concession arrangements project. Accordingly, staff are seeking views from the Board as to whether the Board would like staff to do further work on a separate project to consider the accounting for government licences more generally, subject to staff resource constraints.

**Question 3 to the Board**

- Q3 Does the Board want staff to do further work to consider the broader issues noted in paragraphs 37-40 above?

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<sup>7</sup> Staff note that a related issue with regards to the application of AASB 13 to not-for-profit public sector entities is also discussed in Agenda Item 9 of this Board meeting.