AASB Staff Issues Paper

Service Concession Arrangements (Grantor) Project – Potential Issues for Consideration

Purpose

1 Staff have prepared a draft Exposure Draft reflecting the Board's decisions[1] on its project to develop an Australian Accounting Standard on grantor accounting for service concession arrangements, based on IPSAS 32 *Service Concession Arrangements: Grantor*.

2 In developing the draft Exposure Draft (Agenda Paper 5.3) a number of issues have been identified that staff wish to raise to the Board for consideration at the February 2015 Board meeting. In addition, any further issues identified by Board members in their review of the draft Exposure Draft prior to the February Board meeting will be tabled (Agenda Paper 5.2.1 – to be tabled).

3 The remainder of this paper is structured as follows:

- (a) Specific issues for Board consideration:
  - (i) Concept of control (paragraphs 4-10); and
  - (ii) Recognition of a liability (paragraphs 11-15)

Specific issues for Board consideration

<u>Concept of control</u>

4 At the December 2014 meeting, the Board decided to follow the IPSAS 32 concept of control – the 'control or regulation' approach, noting a need for additional clarification as to when third party regulation is involved (outlined in paragraphs 9 and 10 of the Exposure Draft). The reasons for the Board's decision are outlined in BC7–BC14 of the Exposure Draft.

5 As noted in paragraph BC13 of the Draft Exposure Draft, the Board concluded that the control or regulation approach was the most appropriate approach as it is consistent with AASB Interpretation 12 *Service Concession Arrangements* (Interpretation 12).

6 Staff have received feedback at recent targeted outreach meetings that there are concerns in applying the control or regulation approach. These concerns include:

- (a) The control or regulation approach is too broad; and
- (b) Only achieving relevant and reliable information because of the ability of other public sector entities to regulate the activities of the operator.

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[1] Refer to the *Service Concession Arrangements: Grantor* project summary for a summary of key decisions made to date in relation to the project: http://www.aasb.gov.au/admin/file/content102/c3/Service_Concession_Arrangements_Project_Summary.pdf (accessed 23 January 2015)

7 These concerns are similar to the concerns raised by the AASB's Interpretations Advisory Panel in 2007 when considering the appropriateness of application of Interpretation 12 to grantors[2].

Staff recommendation

8 The Board discussed, and rejected, the control approach most recently at its December 2014 meeting. While there is some merit in the 'control' approach over the 'control by regulation' approach, staff are of the view that the potential issues previously identified in the control and regulation approach in IPSAS 32 have been addressed in the Exposure Draft. In particular, the proposed amendments from the IPSAS 32 drafting in paragraphs AG5.1 and AG7.1.

9 In addition, staff note that the adoption of a 'control' approach would lead to the grantor and operator having inconsistent recognition criteria which would likely lead to asymmetrical accounting for service concession arrangements.

10 Accordingly, staff recommend retaining the control by regulation approach in the Exposure Draft.

Question to Board Members

Q1 Does the Board agree with the staff recommendation in paragraph 10 to adopt the 'control or regulation' approach for the Exposure Draft

<u>Recognition of a liability</u>

11 As noted in paragraphs BC19–BC20, the Board considered whether the grantor should recognise a liability or recognise revenue when it provides the operator a right to charge third party users of the service concession asset. Consistent with IPSAS 32, the Board decided it was appropriate for the grantor to recognise a liability. However, the Board's reasons for reaching the conclusion differed from those reached by the IPSASB in issuing IPSAS 32.

12 The Basis for Conclusions to IPSAS 32 notes that the IPSASB considers the 'credit' to be revenue that has not yet met the recognition criteria, and is therefore deferred. The AASB's decision to recognise a liability was for the following reasons:

(a) the grantor's obligation to step-in to provide the public service if the operator fails to perform its obligations under the service concession arrangement;

(b) the grantor controls the asset and only provides a right of access to the asset;

(c) the grantor would be obliged to undertake various activities in relation to the service concession asset over the term of the arrangement; and

(d) IFRS 15 requires a performance obligation that grants a right of access to be a performance obligation to be satisfied over time.

[2] http://www.aasb.gov.au/admin/file/content102/c3/M142_7.6_SCA_Interpretation_Advisory_Panael.pdf

13 A Board member has raised a concern as to whether the term 'liability' is appropriate and has recommended that the term be replaced with 'deferred revenue' to better reflect the Board's basis for its decision. To address this concern staff have proposed an alternative version of this section as follows (marked up from IPSAS 32):

Recognition and Measurement of ~~Liabilities~~ Consideration

14 Where the grantor recognises a service concession asset in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset), ~~the grantor shall also recognise a liability~~ whether deferred revenue or a financial liability is recognised is dependent on the nature of the compensation provided to the operator. The grantor shall not recognise ~~a liability~~ any consideration when an existing asset of the grantor is reclassified as a service concession asset in accordance with paragraph 12, except in circumstances where additional consideration is provided by the operator, as noted in paragraph ~~15~~16.

15 In exchange for the service concession asset, the grantor may compensate the operator for the service concession asset by any combination of:

(a) Making payments to the operator (the "financial liability" model) (see paragraphs: 18-23);

(b) Compensating the operator by other means (the "grant of a right to the operator" model) such as (see paragraphs: 24-26):

(i) Granting the operator the right to earn revenue from third-party users of the service concession asset ; or

(ii) Granting the operator access to another revenue-generating asset for the operator's use (e.g., a private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients or a private parking facility adjacent to a public facility).

~~15~~16 The ~~liability~~ consideration recognised in accordance with paragraph 14 shall be initially measured at the same amount as the service concession asset measured in accordance with paragraph 11, adjusted by the amount of any other consideration (e.g., cash) from the grantor to the operator, or from the operator to the grantor.

~~16~~17 ~~The nature of the liability~~ Whether deferred revenue of a liability is recognised is based on the nature of the consideration exchanged between the grantor and the operator. The nature of the consideration given by the grantor to the operator is determined by reference to the terms of the binding arrangement and, when relevant, contract law.

~~17 In exchange for the service concession asset, the grantor may compensate the operator for the service concession asset by any combination of:~~

~~(a) Making payments to the operator (the "financial liability" model);~~

~~*(b) Compensating the operator by other means (the "grant of a right to the operator" model) such as:*~~

~~*(i) Granting the operator the right to earn revenue from third-party users of the service concession asset; or*~~

~~*(ii) Granting the operator access to another revenue-generating asset for the operator's use (e.g., a private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients or a private parking facility adjacent to a public facility).*~~

Financial Liability Model

18 *Where the grantor has an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, the grantor shall account for ~~the liability recognised in accordance with paragraph 14~~ this as a financial liability.*

19 *The grantor has an unconditional obligation to pay cash if it has guaranteed to pay the operator:*

(a) Specified or determinable amounts; or

(b) The shortfall, if any, between amounts received by the operator from users of the public service and any specified or determinable amounts referred to in paragraph 19(a), even if the payment is contingent on the operator ensuring that the service concession asset meets specified quality or efficiency requirements.

20 *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 recognised under paragraph 14, except where this Standard provides requirements and guidance.*

21 *The grantor shall allocate the payments to the operator and account for them according to their substance as a reduction in the liability recognised in accordance with paragraph 14, a finance charge, and charges for services provided by the operator.*

22 *The finance charge and charges for services provided by the operator in a service concession arrangement determined in accordance with paragraph 21 shall be accounted for as expenses.*

23 *Where the asset and service components of a service concession arrangement are separately identifiable, the service components of payments from the grantor to the operator shall be allocated by reference to the relative fair values of the service concession asset and the services. Where the asset and service components are not separately identifiable, the service component of*

payments from the grantor to the operator is determined using estimation techniques.

Grant of a Right to the Operator Model

24 *Where the grantor does not have an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, and grants the operator the right to earn revenue from third-party users or another revenue-generating asset, the grantor shall ~~account for the liability~~ ~~recognised~~ recognise deferred revenue in accordance with paragraph 14 as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.*

25 *The grantor shall recognise revenue and reduce the ~~liability~~ deferred revenue recognised in accordance with paragraph 24 according to the economic substance of the service concession arrangement.*

26 *Where the grantor compensates the operator for the service concession asset and the provision of services by granting the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset, the exchange is regarded as a transaction that generates revenue. As the right granted to the operator is effective for the period of the service concession arrangement, the grantor does not recognise revenue from the exchange immediately. Instead, ~~a liability~~ deferred revenue is recognised for any portion of the revenue that is not yet earned. The revenue is recognised according to the economic substance of the service concession arrangement, and the ~~liability~~ deferred revenue is reduced as revenue is recognised.*

Dividing the Arrangement

27 *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 transaction ~~total liability recognised~~ in accordance with paragraph 14. ~~The amount initially recognised for the total liability shall be the same amount as that specified in paragraph 15.~~*

28 *The grantor shall account for each part of the consideration provided for the service concession asset ~~liability~~ referred to in paragraph 27 in accordance with paragraphs 18–26.*

Staff recommendation

14 Staff consider that, while it could be argued alternative wording (as marked up in the paragraphs above) better reflects the recognition and measurement of consideration provided to the operator by the grantor in return for the service concession asset, staff are concerned that the alternative wording may inadvertently create potentially misleading concepts such as the 'recognition of consideration'.

15 Accordingly, on balance staff recommend that the Exposure Draft *not* be amended to reflect this wording (i.e. retain the IPSAS 32 drafting).

Question to Board Members

Q2 Does the Board agree with the staff recommendation in paragraph 15 to retain the IPSAS 32 drafting for the 'Recognition and Measurement of Liabilities' section in the Exposure Draft?