# Staff Issues Paper
# Staff Summary of Comment Letters and Outreach
# ED 261 *Service Concession Arrangements: Grantor*

## Purpose

1 The purpose of this paper is to provide the Board with a summary of the feedback received on ED 261 *Service Concession Arrangements: Grantor* [1] with a view to seeking a Board decision on the issues to be considered for redeliberation at future Board meetings.

## Due Process / Outreach Activity

2 The comment period on ED 261 closed 27 July 2015. The AASB received ten comment letters from the following respondents:

(a) Ernst & Young;

(b) PricewaterhouseCoopers;

(c) CPA Australia;

(d) Peter Batten;

(e) Heads of Treasuries Accounting and Reporting Advisory Committee;

(f) Australian Bureau of Statistics;

(g) Australasian Council of Auditors-General;

(h) KPMG;

(i) Deloitte; and

(j) The Institute of Public Accountants.

3 Roundtable discussions were undertaken in Melbourne, Brisbane and Sydney in June 2015. Further outreach and education sessions were also undertaken during the comment period.

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1 Link to ED 261 *Service Concession Arrangements: Grantor*
http://www.aasb.gov.au/admin/file/content105/c9/ACCED261_05-15.pdf

## Summary of Comments Received

### *Overall*

4 All constituents were supportive of the proposals set out in ED 261 on the basis that the draft Standard provides a consistent approach to the accounting for service concession arrangements (SCAs) from a public sector grantor perspective.

5 Some constituents commented that the proposals 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.

6 Overall, constituents requested additional guidance and examples on the concept of control, fair value measurement of the service concession assets and liabilities, and accounting for the arrangements when transitioning to the draft Standard.

### *Question 1 Proposed application to all public sector entities*

Support

7 The majority of constituents agreed with the proposed application to all public sector entities in both for-profit and not-for-profit sectors.

8 Some constituents noted that the primary focus of developing a 'transaction neutral' Standard may be more important than the ability for a for-profit entity to make an "explicit and unreserved statement" that its financial statements comply with International Financial Reporting Standards (IFRS). Other constituents were undecided.

Other views

9 One constituent[2] commented that while they would prefer transaction neutrality, they did not support the proposed application to for-profit entities on the basis that the for-profit entities will experience impairment of the service concession asset. The constituent stated that the asset impairment is a result of different fair value measurement bases used by not-for-profit and for-profit entities. Generally, service concession assets are specialised assets that are measured using depreciated replacement cost by a not-for-profit entity while for-profit entity measures these assets using discounted cash flows.

[2] Australasian Council of Auditors-General.

Concerns and suggestions

10 Some constituents in their support for the proposed application to for-profit public sector entities expressed concerns that for-profit public sector entities may not be able to make an "explicit and unreserved statement" of compliance with IFRS. Some of these constituents also prefer that a for-profit entity in applying the draft Standard can be IFRS compliant. The constituents requested an assessment of the impact of IFRS compliance for-profit entities and the inclusion of this as an explanation in the Basis for Conclusions.

11 Some constituents suggested assessing whether revenue arising from a service concession arrangement is outside the scope of AASB 15 *Revenue from Contracts with Customers* would permit the draft Standard to apply to all public sector entities. One constituent[3] noted that if this process significantly delayed the issue of the draft Standard, they would support the exclusion of for-profit entity from applying the draft Standard. Where this approach is adopted, some constituents suggested that the Basis for Conclusions explain the implication that a for-profit entity under AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, may need to apply the service concession arrangement Standard in determining the appropriate accounting policies for such an arrangement.

12 Some constituents commented that, for the draft Standard to achieve transaction neutrality, it should also apply to grantors that are private sector entities.

### *Question 2 Proposed scope to arrangements involving a 'service concession asset' including intangible assets and land*

Support

13 The majority of constituents agreed with the proposed scope to apply to arrangements involving 'service concession arrangements' that is broader than the scope of AASB Interpretation 12 *Service Concession Arrangements*.

Concerns and suggestions

14 Some constituents requested the draft Standard include examples of intangible assets (such as broadband networks) in the 'Application Guidance'.

[3] PricewaterhouseCoopers.

### *Question 3 Proposed concept of control*

Support

15 The majority of constituents agreed with the proposed specific control concept in paragraph 8(a) that a grantor controls the asset if the "grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them and at what price".

16 Some of these constituents commented that the benefits of applying a definition of control that is consistent with AASB Interpretation 12 is greater than applying the broader concept.

Other views

17 One constituent[4] did not support the control approach for recognising a service concession arrangement. Instead the constituent preferred the current risk and rewards approach as it is consistent with international statistical standards.

Concerns and suggestions

18 Some constituents had concerns regarding the practical application of the control concept, in arrangements involving:

(a) long term leases (such as 99 year leases), privatisations and outsourcing and whether these arrangements fall within the scope of the proposed service concession arrangement or current leases Standard;

(b) regulated public utilities (such as water, sewage, electricity supply); and

(c) regulated pricing and services to be provided. The constituents thought that in situations where the grantor does not control the regulator and that the basic principle could be expressed more simply as "if you implicitly or explicitly require in the contract that a price be regulated, it does not matter who the regulator is" and that some of the examples may be contradictory.

A number of constituents requested additional guidance and examples in the above areas.

19 Some constituents commented the draft Standard should:

(a) clarify that a broader concept of control currently applies in other Australian Accounting Standards. That is, an asset that does not meet the control and regulation definition of the draft Standard may still need to be recognised under other accounting Standards. This may require clarifying and/or amending the wording of "if, and only if" in paragraph 8 that "The grantor controls the asset if, and only if…the grantor controls or regulates...".

Some constituents requested more guidance, including an example, on the application of the broader concept of control in other Australian Accounting

[4] Australian Bureau of Statistics.

Standards for an arrangement that does not meet the control and regulation definition of the draft Standard;

(b) provide guidance on the application of the control concept that is more conceptual or principles-based, such as those in paragraph AG9 of "The ability to exclude or regulate the access of others for benefits of assets is essential element of control";

(c) provide guidance where the grantor's 'control' of the asset changes during the service concession arrangement. This should include guidance where there is a change in the third party regulation of the price and/or service during the term of the service concession arrangement;

(d) provide guidance on what constitutes a 'significant residual value'[5], including the determination of the 'current value'[6] of the asset, and how this concept is applied in long term arrangements in relation to the control criteria; and

(e) clarify the relationship between the concepts of 'significant residual interest' and 'whole-of-life'[7] in relation to the control criteria.

20 Some constituents also requested the inclusion of a more complex example to illustrate the concept of control.

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[5] 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." (emphasis added).

[6] Paragraph AG14 of ED 261 states that "For the purpose of paragraph 8(b), the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the asset and give the grantor a continuing right of use throughout the period of the service concession arrangement. The residual interest in the asset is the estimated **current value of the asset** as if it were already of the age and in the condition expected at the end of the period of the service concession arrangement." (emphasis added).

[7] Paragraph 9 of ED 261 states that "The grantor shall recognise an asset that will be used in a service concession arrangement for its entire useful life (a **'whole-of-life' asset**) if the conditions in paragraph 8(a) are met." (emphasis added).

### *Question 4 Proposed asset measurement at fair value*

Support

21 The majority of constituents agreed with the proposed measurement of service concession assets at fair value in accordance with AASB 13 *Fair Value Measurement*.

Concerns and suggestions

22 Some constituents raised specific concerns relating to the application of the fair value concept of AASB 13 to public sector assets. These constituents requested that the AASB undertake a separate project to address these concerns as a matter of priority. A number of constituents acknowledged that the broader project to fair value public sector assets does not need to be finalised prior to the issue of the draft Standard.[8]

23 Some constituents requested additional guidance, including examples where appropriate, for the fair value measurement of the service concession asset where the operator constructs an asset for the grantor in an exchange for the operator to generate revenue by charging users of another asset. The constituents expressed the 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 of this information.

Some constituents requested guidance on how to account for such an arrangement where the fair value of the partly constructed or completed asset cannot be reliably measured. One of these constituents[9] suggested whether in such circumstances:

(a) historical cost can be an approximation of the fair value; and

(b) where the historical cost cannot be determined, the asset would not meet the recognition criteria of AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets* and would therefore not be recognised.

24 One constituent[9] requested guidance on how to account for borrowing costs and economic obsolescence in determining the fair value of the service concession asset.

25 Some constituents have also requested guidance for the:

(a) impairment of the service concession arrangements under AASB 136 *Impairment of Assets*; and

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

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[8] AASB staff intend to table a project plan for the fair value of public sector assets at the October 2015 Board meeting.

[9] Heads of Treasuries Accounting and Reporting Advisory Committee.

### *Question 5 Proposed liability recognition and measurement*

Support

26 The majority of constituents supported the recognition of a liability measured at the same amount as the service concession asset. Some constituents expressed that it may be difficult to reliably determine the fair value of the liability independent of the service concession asset.

27 The majority of constituents expressed support for the proposed recognition and measurement of a service concession liability under the proposed financial liability model and grant of a right to the operator model.

Concerns and suggestions

28 Some constituents requested more guidance on the measurement of a liability, particularly for the:

(a) accounting of finance charges under the financial liability model; and

(b) hybrid arrangements containing both the financial liability and grant of a right to the operator models.

29 Some constituents commented that under the grant of a right to the operator model, the draft Standard, unlike the ED, should state that where the grantor initially recognises a service concession asset, the grantor should not recognise day one revenue measured at the same amount as the service concession asset. Instead, the draft Standard should specify the grantor must recognise a service concession liability. They also noted that it might be easier not to try and justify the conceptual basis, and indicate that this is the rule. Some constituents requested that the Application Guidance and/or Basis for Conclusions include an explanation for this approach.

30 In addition, one constituent[10] expressed concern on the inability to apply the proposed principles-based approach of recognising revenue "according to the economic substance of the service concession arrangement"[11]. The constituent suggested that the draft Standard should specify that the revenue should be allocated in subsequent periods on a systematic and rational basis.

31 One constituent[12] requested guidance for a service concession arrangement where the grantor has no contractual obligation to make payments to the operator nor has the grantor granted the operator the right to charge third-party users for the asset. The operator instead charges the grantor for the use of the asset. The constituents suggested that the grant of a right to the operator model be broaden to apply to such an arrangement where third-party users of the service concession asset also include the grantor. The constituent also requested additional guidance on how to recognise the

[10] PricewaterhouseCoopers.

[11] Paragraph 24 of ED 261 states that "The grantor shall recognise revenue, and accordingly reduce the liability recognised in accordance with paragraph 23, **according to the economic substance of the service concession arrangement**." (emphasis added).

[12] Heads of Treasuries Accounting and Reporting Advisory Committee .

revenue under the grant of a right to the operator for an arrangement with a long term (e.g. 99 years).

***Question 6 Proposed separate accounting for each part of the total liability recognised for hybrid service concession arrangements***

Support

32 Generally, constituents supported the proposal to separately account for each part of the total liability recognised for the service concession arrangement where the arrangement involves the grantor incurring a financial liability and grant of a right to the operator.

Concerns and suggestions

33 Some constituents do not agree that the draft Standard provides sufficient guidance for the separate accounting for each part of the total liability recognised for a hybrid service concession arrangement where the arrangement involves the grantor both incurring a financial liability and grant of a right to the operator.

34 Some constituents requested additional guidance on how to apportion such an arrangement and the inclusion of a complex example to illustrate this guidance, especially where the fair value of each component in the arrangement is difficult to estimate. 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 allocated to the grant of a right to the operator model.

***Question 7 Guidance on 'other revenues'***

Support

35 Some constituents supported the proposal not to include guidance on other revenues relating to the compensation by the operator to the grantor for access to the service concession asset by providing the grantor with a series of pre-determined inflows of resources.

Other views

36 Other constituents preferred the draft Standard to retain the IPSAS 32 guidance on the accounting treatment of other revenues on the basis that the guidance is useful and is consistent with IPSAS 32. One constituent[13] suggested that the content of paragraph BC27 on other revenues should be moved to paragraph 29 of ED 261. Another constituent[14] requested additional guidance for the accounting of variable payments in a service concession arrangement that is subject to future activity, such as usage of the service concession asset.

Concerns and suggestions

37 Some constituents commented that while they supported the cross referencing of accounting for other revenues to AASB 10XX Income of Not-for-Profit Entities, a similar cross referencing should be made for for-profit entities to AASB 15 *Revenue from Contracts with Customers*.

### *Question 8 Proposed defined terms*

Support

38 The majority of constituents supported the proposed defined terms in Appendix A.

Concerns and suggestions

39 Some constituents commented while they agree with the definition of the individual terms, however, when the defined terms are read together, the definitions can be circular, in particular the definition of a service concession arrangement and service concession asset.

40 The majority of constituents commented that, while they support the inclusion of the definition of 'public service', they find the definition unclear. 'Public service' is defined as "A service that is provided by government or one of its controlled entities, as part of the usual government function, to the community, either directly (through the public sector) or by financing the provision of services"[15]. In particular, constituents were unclear with the following expressions:

(a) 'government' in the 'public sector' definition of "A service that is provided by government …" may exclude universities from applying the draft Standard;

(b) 'usual government function';

(c) whether 'community' include services to be provided to the grantor; and

[13] Deloitte.

[14] Ernst & Young.

[15] ED 261 Appendix A Defined Terms.

(d) "financing the provision of services" may capture arrangements with non-government organisations, such as social housing providers.

41 The constituents requested that the draft Standard amend the proposed 'public service' definition to:

(a) possibly exclude the expressions 'usual' in 'usual government function' and 'community';

(b) "A service that is provided by government to the public, as matter of public policy"[16]; and

(c) include a comment that public service may change over time.

42 Some constituents also commented that the use of the proposed term 'public services' is different to the term 'services to the public' used in AASB Interpretation 12, which may lead to differences between the accounting for service concession arrangement by the grantor and operator.

43 Some constituents requested definition or guidance for the additional terms that are used in the draft Standard of 'outsourcing'[17], 'service contract'[17] and 'privatisation'[17], 'significant residual interest'[18] and 'estimated current value'[19].

[16] Ernst & Young.

[17] Paragraph 6 of ED 261 states that "Arrangements outside the scope of this [draft] Standard include those that do not involve the delivery of a public service and arrangements that involve service and management components where the asset is not controlled by the grantor, as described in paragraph 8, or paragraph 9 for a whole-of-life asset (eg **outsourcing**, **service contracts**, or **privatisation**)." (emphasis added).

[18] Paragraph 8 of ED 261 states that "…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." (emphasis added).

[19] Paragraph AG14 of ED 261 states that "Where a service concession arrangement does not clearly fall within an existing regulatory framework (eg where there is more than one possible source of regulation), the arrangement will need to incorporate the specific regulatory framework that stipulates the use, the users and/or the pricing to be charged for the services in order for the grantor to have control of the service concession asset. For the purpose of paragraph 8(b), the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the asset and give the grantor a continuing right of use throughout the period of the service concession arrangement. The residual interest in the asset is the **estimated current value** of the asset as if it were already of the age and in the condition expected at the end of the period of the service concession arrangement." (emphasis added).

### *Question 9 Proposed accounting treatment of lifecycle costs*

Support

44 Generally, constituents supported the inclusion, in the draft Standard, of examples on the accounting treatment of lifecycle costs of a service concession asset that might be of a benefit to the grantor.

Concerns and suggestions

45 Some constituents expressed that while the example of road resurfacing is useful, they prefer a more complex example on the accounting for lifecycle costs in service concession arrangements, such as hospitals and schools, where a number of assets are replaced over the term of the arrangement. One constituent[20] suggested the example include the application guidance on the accounting for of lifecycle costs under AASB 15.

46 Other constituents requested guidance on how to account for replacement components that are not easily separable or where there is no certainty that the replacement will occur.

47 One constituent[21] commented that it would be useful for the draft Standard to provide an explanation of lifecycle costs, which is not mentioned in ED 261.

### *Question 10 Proposed disclosures*

Support

48 The majority of constituents supported the proposed disclosure requirements set out in the draft Standard.

Concerns and suggestions

49 One constituent commented that the proposed disclosure requirements are "quite specific"[22] and may create a "risk of disclosure overload"[22]. The constituent suggested the principles-based approach of disclosure that "states the objective of disclosures made under the proposed standard, similar to the objective stated in AASB 15 *Revenue from Contracts with Customers* and AASB 13 *Fair Value Measurement*" and "requires that to meet the objective of the disclosures, an entity consider all aspects of a service concession arrangement including those listed in paragraph 31(b) and 31(c)."[21]

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[20] PricewaterhouseCoopers.

[21] KPMG.

[22] Heads of Treasuries Accounting and Reporting Advisory Committee.

50 Another constituent[23] was unclear about the disclosure requirements in paragraph 32[24] and requested clarification of its application.

### *Question 11 Proposed application date and transition*

Support

51 Generally, constituents supported the proposed transition requirements, and noted that the proposals will need a significant amount of time to implement and will require the review of contracts for existing service concession arrangements and systems changes to capture the required information.

Other views

52 Some constituents did not support the proposed application date, instead they preferred a later application date with early adoption permitted.

Suggestions

53 Some of the constituents who supported the proposed application date expressed the view that the proposals need not have an effective date that is the same as AASB 15. That is, the draft Standard should not defer the proposed application date to align with the proposal of ED 263 *Effective Date of AASB 15 Revenue from Contracts with Customers (Proposed amendments to AASB 15)* to defer the application date of AASB 15 to 1 January 2018. However, these constituents would prefer to have a longer transitional period, with early adoption permitted for the reasons outlined in paragraph 51 above, especially for those entities that choose to apply the draft Standard retrospectively.

54 Constituents also requested additional guidance for the application of the transition provision of using deemed cost for the grant of a right to the operator, in particular the measurement of liability in paragraph AG65[25]. Additionally, constituents requested that AG65 contain a similar statement to AG64 of "Any difference between the value of the asset and the financial liability is recognised directly in net assets/equity. If the entity chooses as its accounting policy the revaluation model in AASB 116 or AASB 138, this difference is included in equity".

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[23] Australasian Council of Auditors-General.

[24] Paragraph 32 of ED 261 states that "The disclosures required in accordance with paragraph 31 are provided individually for each material service concession arrangement or in aggregate for each class of service concession arrangements."

[25] Paragraph AG65 of ED 261 states that "Where the grantor uses deemed cost under the grant of a right to the operator model, it measures:

(a) the service concession asset at fair value (see paragraph 10); and
(b) the liability representing the unearned portion of any revenue arising from the receipt of the service concession asset. This amount should be determined as the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement."

55 One constituent[26] requested clarification on whether an existing asset of the grantor should be measured at book value prior to reclassifying the asset as a service concession asset.

### *Question 12 General matters for comment*

56 Generally, constituents:

(a) were not aware of any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

A few constituents[27] commented that there may be a potential Generally Accepted Accounting Principles/Government Finance Statistics (GFS) difference in the accounting for the grant of a right to the operator model. GFS accounts for the grant of a right to the operator as an intangible asset to be classified as a contract, lease or licence. Consequently, "…this would not be considered revenue for GFS purposes as the government is not undertaking any operating activity to increase its net worth. It is likely that the reduction in liability would be reflected in GFS as a revaluation of the grant of a right to the operator liability"[28].

Another constituent expressed their concern that "that for grant of a right model service concession arrangement the revenue will be considered an "other economic flow" and therefore excluded from the net operating balance. In contrast the depreciation charge from the service concession asset will be a "transaction" and therefore included in net operating balance "above" the budget. This would mean that all grant of a right model service concession arrangements will have a net negative result on the net operating balance, which is a key budget aggregate for a number of states." [29];

(b) believed the proposals would result in financial statements that would be useful to users; and

(c) believed the proposals would be in the best interests of the Australian economy.

[26] Heads of Treasuries Accounting and Reporting Advisory Committee.

[27] Heads of Treasuries Accounting and Reporting Advisory Committee and Australian Bureau of Statistics.

[28] Australian Bureau of Statistics.

[29] Heads of Treasuries Accounting and Reporting Advisory Committee.

### *Question 13 Other issues*

57 Generally, constituents believed the benefits of the proposals would outweigh the related costs.

58 Some constituents commented that there are likely to be significant costs in transitioning to the new draft Standard. The costs include reviewing complex service concession arrangement contracts, renegotiating the terms of existing arraignments, determining the fair value of the service concession asset on transition and the auditing of the accounting and disclosure of the arrangements.

59 A number of constituents provided examples of current and prospective service concession arrangements which can be used to develop guidance for inclusion in the draft Standard. These constituents also expressed their willingness to work with the AASB in developing the requirements and guidance in the draft Standard.