Australian Government

Australian Accounting Standards Board

Staff Paper

Project:	**Service Concession Arrangements**	**Meeting**	AASB October 2015 (M148)
Topic:	**Redeliberation of Proposed Application to All Public Sector Entities**	**Agenda Item:**	6.1
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		Decision-Making:	High
		Project Status:	Redeliberations

Introduction and objective of this paper

1 The objective of this paper is to obtain Board decisions by considering the proposed:

(a) application of the final Standard on service concession arrangements to all public sector entities; and

(b) approach to implementing the application of the final Standard to all public sector entities.

2 This paper is structured as follows:

(a) Summary of staff recommendations (paragraph 3);

(b) Background (paragraphs 4-6); and

(c) Staff analysis (paragraphs 7-24).

Summary of staff recommendations

3 Staff recommend:

(a) retaining the application of the final Standard to all public sector entities in both the for-profit and not-for-profit sectors (as proposed in Exposure Draft 261 *Service Concession Arrangements: Grantor*[1]) as the final Standard would:

(i) be consistent with the AASB's transaction neutral policy; and

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

(ii) reduce the divergence in accounting for service concession arrangements; and

(b) the following in implementing the application of the final Standard to all public sector entities:

(i) the Board refer the issue of whether revenue arising from service concession arrangements is within the scope of IFRS 15, and if so, what the appropriate revenue recognition basis would be, to the IFRS Interpretations Committee; or

(ii) if the Board does not agree with the recommendation above to refer the issue to the IFRS Interpretations Committee:

- amend the scope of AASB 15 to exclude revenue arising from service concession arrangements; and
- include, in the final Standard, the requirement that revenue arising from service concession arrangements is recognised in accordance with the final Standard

noting that, although this approach will clarify the scope of AASB 15 and the final Standard, it will not address the issue of whether a for-profit entity is IFRS compliant.

Background

4 ED 261 proposed to apply to public sector entities in both the for-profit and not-for-profit sectors[2].

5 At its September 2015 meeting, the Board approved the project plan[3] for progressing the project. The first step of the project plan is to redeliberate the proposed application to all public sector entities in both the for-profit and not-for-profit sectors, in response to feedback received on ED 261. The Board further agreed to assess the impact of for-

[2] Paragraph BC6 of ED states that:

"The Board decided that the Exposure Draft should:

(a) propose the application to all public sector entities, rather than being limited to not-for-profit public sector entities. This approach is consistent with the AASB policy of making Australian Accounting Standards with a view to requiring like transactions and events to be accounted for in a like manner for all types of entities, referred to as 'transaction neutrality'. The Board noted that this scope is wider than that of IPSAS 32 as International Public Sector Accounting Standards do not apply to Government Business Enterprises;

(b) seek comments from its constituents on whether they agree with the proposed application to all public sector entities."

[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

profit entities applying the final Standard and consider alternatives for determining the scope of the final Standard.

Feedback received on ED 261

6 The following is a summary of the feedback received[4] from constituents on ED 261 in relation to the application of the proposals to all public sector entities in both the for-profit and not-for-profit sectors:

(a) the majority of constituents agreed with the proposed application;

(b) some constituents, in their support for the application to for-profit entities, expressed concerns that the entities may not be able to make an "explicit and unreserved statement" of compliance with IFRSs. Some of these constituents prefer that a for-profit entity in applying the final Standard can be IFRS compliant. These constituents requested an assessment of the impact of IFRS compliance for for-profit entities.

Some constituents expressed the view that if the final Standard did not apply to for-profit entities, the entities would be IFRS compliant[5]. The constituents based this view on the rationale that ED 261 requires under the grant of the right to the operator model, where "the grantor compensates the operator for the service concession arrangement 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"[6]. These constituents expressed concerns as to whether this revenue recognition is consistent with AASB 15 *Revenue from Contracts with Customers*. Consequently, the constituents are of the view that if a for-profit entity applies the requirements of the final Standard and recognises revenue under the grant of a right to the operator model, the entity may not technically comply with AASB 15 and would not be able to make an "explicit and unreserved statement" that its financial statements comply with IFRSs[7].

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[4] Staff Issues Paper – Summary of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraphs 7, 8, 10 and 11.

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

[5] Staff Issues Paper – Summary of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraphs 10 and 11.

[6] ED 261, paragraph 25.

[7] A not-for-profit entity does not need to comply with the AASB 101 requirement to make an explicit and unreserved statement of compliance with IFRSs (AASB 101, paragraph Aus 16.3).

(c) some constituents noted the primary focus of developing a ‘transaction neutral’ Standard may be more important than the ability for a for-profit entity to make an a statement of IFRS compliance; and

(d) some constituents suggested assessing whether revenue arising from a service concession arrangement is outside the scope of AASB 15 would permit the final Standard to apply to all public sector entities.

Staff analysis

7 Staff analysis of the application of the final Standard considers the following approaches:

(a) Approach 1: Application to not-for-profit public sector entities only;

(b) Approach 2: Application to not-for-profit public sector entities initially and consider application to for-profit entities at a future date; and

(c) Approach 3: Application to public sector entities in both for-profit and not-for-profit sectors (the approach proposed in ED 261).

<u>Approach 1: Application to not-for-profit public sector entities only</u>

8 Approach 1 proposes the final Standard apply only to not-for-profit entities in the public sector (rather than all public sector entities). As noted in paragraph 6 above, this approach did not receive strong support from constituents responding to ED 261. The approach would have the following implications.

Advantages

9 The advantages of Approach 1 are:

(a) the final Standard would be consistent with the application of International Public Sector Accounting Standard (IPSAS) 32 *Service Concession Arrangements: Grantor*, on which the proposals are based[8]. Staff note, however, that IPSASs do not apply to Government Business Enterprises. A GBE is akin to a for-profit public sector entity; and

(b) it is clear that a for-profit entity grantor may continue to be able to make an “explicit and unreserved statement” that its financial statements comply with IFRSs[9].

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[8] This is consistent with the Board’s decision to develop an Australian Accounting Standard on grantor accounting for service concession arrangements based on IPSAS 32 as stated in paragraph BC3 of ED 261.

[9] AASB 101 *Presentation of Financial Statements*, paragraph 16.

Disadvantages

10 The disadvantages of Approach 1 are:

(a) the final Standard may not be consistent with the AASB's transaction neutrality policy[10]; and

(b) the exclusion of for-profit entities from applying the final Standard may provide a mechanism for structuring service concession arrangements to involve for-profit public sector grantors so that these entities need not recognise service concession assets and liabilities on their statement of financial position. This would potentially contradict one of the key reasons for the Board issuing a Standard on service concession arrangements, that is, to reduce divergence in accounting for such arrangements, where some public sector entities recognise service concession assets and liabilities while others do not[11].

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[10] AASB *Policies and Processes*, paragraph 39 states that:

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

This is further supported by paragraphs 40(a) and (b), which state that:
"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…".

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

[11] ED 261, "Reasons for Issuing this Exposure Draft", page 7 states that:

"The lack of a specific Australian Accounting Standard that prescribes the accounting for a service concession arrangement from the grantor's (public sector entity) perspective has resulted in divergence in the accounting for such arrangements. Consequently, some public sector entities recognise service concession assets and liabilities in their statement of financial position while others do not. Given the increasing number and value of service concession arrangements, it is important that the AASB issue an accounting Standard to address the lack of guidance in relation to accounting for such arrangements."

Additionally, this approach would not align with the Board's decision to "develop an Accounting Standard on grantor accounting for service concession arrangements … to address the lack of guidance in Australian Accounting Standards for accounting for service concession arrangements from the grantor perspective" (ED 261, paragraph BC3).

A counter view to the above, expressed by some constituents, is that the exclusion of for-profit entities from applying the draft Standard may not necessarily result in a for-profit grantor not recognising a service concession arrangement. As a for-profit grantor, 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 treatment for such an arrangement.

Approach 2: Application to not-for-profit public sector entities initially, and consider application to for-profit entities at a future date

11 Approach 2 is a modification of Approach 1 in that the final Standard applies to not-for-profit entities initially, with a view that the Board will consider the application to for-profit entities at a future date, for example, following a post implementation review of the final Standard. As noted in paragraph 6 above, this approach did not receive strong support from constituents responding to ED 261. The approach would have the following implications.

Advantages

12 In addition to the advantages outlined in paragraph 9 above in relation to Approach 1, Approach 2 provides constituents with an opportunity to apply the final Standard and provide feedback as to whether the application of the Standard should extend to for-profit entities. This would avoid the Board requiring the application of the final Standard to entities that are not warranted[12].

Disadvantages

13 In addition to the disadvantages outlined in paragraph 10 above in relation to Approach 1, the disadvantages of Approach 2 are:

(a) entities would need to review their existing and future service concession arrangements under the final Standard for not-for-profit entities initially and potentially repeat the process should the final Standard changes its scope to apply to for-profit entities. This would add to the already significant costs that some constituents have indicated in transitioning to a Standard on service concession arrangements[13]; and

(b) the approach may create uncertainty for for-profit entities as to whether the final Standard may apply to their service concession arrangements in the future. These uncertainties may increase the entities' cost of conducting business.

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[12] A counter view to this is the comment by some constituents received on the feedback of ED 261 that the final Standard should be more principles-based so as "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" (Staff Issues Paper – Summary of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraphs 5).

[13] Staff Issues Paper – Summary of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraph 58.

<u>Approach 3: Application to public sector entities in both for-profit and not-for-profit sectors</u>

14 Approach 3 retains the proposed application of ED 261 to public sector entities in both the for-profit and not-for-profit sectors. As noted in paragraph 6 above, this approach received strong support from the majority of constituents responding to ED 261. The approach would have the following implications.

Advantages of approach

15 The advantages of Approach 3 are:

(a) Approach 3 overcomes the disadvantages outlined in paragraph 10 above in relation to Approach 1, in that the final Standard:

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

(ii) in the application to for-profit entities, may prevent service concession arrangements being structured to involve for-profit public sector grantors to circumvent the application of the final Standard or rely on the use another accounting standard such as AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* in applying the service concession arrangement Standard. This, in turn, would help to reduce the divergence in accounting for such arrangements, where some public sector entities recognise service concession assets and liabilities on their balance sheet while others do not; and

(iii) reinforces the Board's decision to "develop an Accounting Standard on grantor accounting for service concession … to address the lack of guidance in Australian Accounting Standards for accounting for service concession arrangements from the grantor perspective"[14]; and

(b) Approach 3 overcomes the disadvantages outlined in paragraph 13 above in relation to Approach 2, in that the final Standard:

(i) in the application to all public sector entities would reinforce the Board's due process of considering whether the requirements are warranted before finalising the Standard. This would help minimise the implementation costs incurred by constituents in transitioning to the Standard (once rather than twice); and

(ii) creates certainty for the for-profit entities for the application of service concession arrangements and avoids entities incurring costs associated with conducting business in an environment where the accounting requirements are unclear.

[14] ED 261, paragraph BC3.

Disadvantages of approach

16 The disadvantages of Approach 3 are:

(a) the extension of the application of the final Standard to for-profit entities would be inconsistent with IPSAS 32, which excludes GBE from applying the Standard. This inconsistency should not be an impediment for the Board to include for-profit entities in the application of the final Standard, as the Board decided to develop a Standard based on,[15] but not necessarily equivalent to, IPSAS 32[16]; and

(b) a for-profit entity grantor, in applying the final Standard, may not be IFRS compliant. This can be addressed with the implementation proposals for Approach 3 below.

Staff recommendation

17 Staff recommend Approach 3 – application of the final Standard to all public sector entities in both the for-profit and not-for-profit sectors (as proposed in ED 261) for the reasons outlined in paragraph 15 above. Staff note that the perceived disadvantages of Approach 3 are able to be minimised via the implementation approach proposed in paragraphs 18-24 below.

Question 1 to the Board

Does the Board agree with the recommendation that the final Standard apply to public sector grantors in both the for-profit and not-for-profit sectors? If not, which alternative approach does the Board prefer?

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[15] ED 261, paragraph BC3.

[16] Staff note that, in developing ED 261, the Board departed from the requirements of IPSAS 32 in a number of circumstances. The "Comparison with IPSAS 32" section of the Basis for Conclusion to ED 261, paragraphs BC38 to BC43, outline the differences between IPSAS 32 and ED 261. The major areas of difference are as follows, ED 261:

(i) modifies the defined terms of a 'grantor', 'operator' and includes the definition of 'public service';

(ii) includes additional Application Guidance on the principle of control;

(iii) explicitly requires when an existing asset of the grantor is upgraded, only the upgrade component is recognised as a service concession asset; and

(iv) requires, where the grantor uses deemed cost under the financial liability model, any difference between the value of the asset and the financial liability is to be included in equity on transition to the draft Standard.

Implementing Approach 3 – proposed application to all public sector entities

Note to the Board: The staff analysis below is based on the Board agreeing with the staff recommendation to adopt Approach 3 of applying the final Standard to all public sector entities.

18 Some constituents have commented that revenue arising from the proposed grant of the right to the operator model in the final Standard may not be consistent with the revenue recognition requirements in AASB 15. These constituents are of the view that a for-profit entity in applying the final Standard may therefore not be IFRS compliant.

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

20 The Basis for Conclusions to ED 261 states that "Following extensive discussions and analysis, the Board concluded that, from a grantor's perspective, a service concession arrangement in which the grantor promises to transfer an intangible asset to the operator would not be a contract with a customer within the scope of AASB 15. The Board considered that the intangible asset that the grantor promises to transfer to the operator in exchange for the operator's services is in the nature of financing the construction of the service concession asset" (paragraph BC24).

21 Some constituents suggested a method for addressing the potential issue of a for-profit entity not being IFRS compliant is to amend the scope paragraph of AASB 15 to exclude revenue arising from service concession arrangements[17].

22 Staff concur with the proposal to remove revenue arising from service concession arrangements from the scope of AAS 15 along with the inclusion in the final Standard, the requirement that revenue arising from service concession arrangements is recognised in accordance with the final Standard. These amendments would add clarity to the basis of accounting for such transactions.

23 However, although staff support clarifying the scope of AASB 15, staff are of the view that this approach would not alleviate the issue raised by some constituents that there is uncertainty as to whether a for-profit entity is able to make an "explicit and unreserved statement" of compliance with IFRSs.

Staff, instead, are of the view that the issue of a for-profit entity's ability to make a statement of compliance with IFRSs relates to an interpretation of the requirements of IFRS 15 *Revenue from Contracts with Customers* (the IFRS equivalent of AASB 15). Accordingly, in accordance with the AASB *Interpretations and Improvements Model*[18]

[17] Staff Issues Paper – Summary of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraph 11.

[18] The AASB *Interpretations and Improvements Model*, page 1 states that:
"(b) … Issues relating to interpreting IFRS adopted in Australia that the AASB considers warrant further guidance are forwarded to the IFRSIC for consideration for inclusion on the IFRSIC work program or for the IFRSIC to refer to the IASB for consideration as improvements to IFRS…"

staff consider that the Board, in the first instance, should consider referring the issue of whether revenue arising from service concession arrangements is within the scope of IFRS 15, and if so, what the appropriate revenue recognition basis would be, to the IFRS Interpretations Committee.

Staff recommendation

24 Staff recommend the following in implementing Approach 3:

(a) the Board refer the issue of whether revenue arising from service concession arrangements is within the scope of IFRS 15, and if so, what the appropriate revenue recognition basis would be, to the IFRS Interpretations Committee; or

(b) where the Board does not agree with the recommendation in paragraph 24(a) above to refer the issue to the IFRS Interpretations Committee, in the short term:

(i) amend the scope of AASB 15 to exclude revenue arising from service concession arrangements; and

(ii) include, in the final Standard, the requirement that revenue arising from service concession arrangements is recognised in accordance with the final Standard

noting that, although this approach will clarify the scope of AASB 15 and the final Standard, it will not address the issue of whether a for-profit entity is IFRS compliant.

Question 2 to the Board

Does the Board agree with the recommendation to refer the issue of whether revenue arising from service concession arrangements is within the scope of IFRS 15, and if so, what the appropriate revenue recognition basis would be, to the IFRS Interpretations Committee?

Question 3 to the Board

If the Board does not agree with the recommendation in Question 2 above to refer the issue to the IFRS Interpretations Committee, does the Board agree in the short term to:

(a) amend the scope of AASB 15 to exclude revenue arising from service concession arrangements; and

(b) include, in the final Standard, the requirement that revenue arising from service concession arrangements is recognised in accordance with the final Standard?

Question 4 to the Board

If the Board does not wish to proceed with the options in Questions 2 or 3, what alternative option does the Board prefer?

Link to AASB Interpretations and Improvements Model
http://www.aasb.gov.au/admin/file/content102/c3/AASB_Interpretations_and_Improvements_Model_Feb_2012.pdf