



Project:	Service Concession Arrangements	Meeting	AASB December 2015 (M149)
Topic:	Redeliberation of Proposed Concept of Control	Agenda Item:	12.1
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		Decision-Making:	High
		Project Status:	Redeliberations

Introduction and objective of this paper

- 1 The objective of this paper is obtain Board decisions to address the issues on the application of the control concept by considering the proposed:
 - (a) application guidance on the control concept that is more principles-based;
 - (b) application guidance on the broader control concept; and
 - (c) additional guidance and examples for inclusion in the final Standard.
- 2 This paper is structured as follows:
 - (a) Summary of staff recommendations (paragraph 3);
 - (b) Background (paragraphs 4-6); and
 - (c) Staff analysis (paragraphs 7-51).

Summary of staff recommendations

- 3 Staff recommend in relation to:
 - (a) principles based approach to the control concept – the final standard:
 - (i) retain the requirements of the control concept in paragraph 8, which the majority of the constituents support; and
 - (ii) structure and refine the application guidance paragraphs relating to the control concept as proposed in AGx1-AGx3 (in Appendix A);
 - (b) broader application of the control concept – that the final Standard include a new:

- (i) application guidance paragraph AGx5 (in Appendix A) to make explicit the requirement to apply the broader concept of control in other Australian Accounting Standards; and
 - (ii) a table, in a new ‘Implementation Guidance’ section (in Appendix B), that sets out the typical types of arrangements for private sector participation in the provision of public sector services with references to the relevant Australian Accounting Standards that may apply to those arrangements;
- (c) additional guidance and examples on:
- (i) control or regulation specified in a contract or otherwise – include in the final Standard:
 - an amendment to paragraph AG9 of ED 261 to clarify that a grantor has control of the service concession asset if the contract to the arrangement:
 - specifies that the grantor controls or regulates the price, services and/or to whom the services must provide; or
 - conveys the right to control the use of the asset to the grantor even when a third-party regulator regulates the price, services and/or to whom the services must provide (as per paragraphs AGx1 and AGx2 in Appendix A); and
 - the content of the staff analysis in this area in the Basis for Conclusion paragraphs BCx1 in Appendix C;
 - (ii) long term leases and privatisation and outsourcing – by:
 - removing the words “(eg outsourcing, service contracts, or privatisation)” from the scope in paragraph 6 of the final Standard;
 - including a new application guidance paragraph AGx6 (in Appendix A) clarifying that outsourcing, service or privatisations arrangements may be outside the scope of the final Standard if the arrangement does not meet the control criteria of paragraphs 8 or 9; and the example where the arrangement conveys the right to use the asset from the public sector entity to the private sector purchaser; and
 - include the table in the Implementation Guidance;
 - (iii) regulated public utilities industry (such as the supply of water, sewerage or electricity) – which is addressed under long term leases and privatisation and outsourcing arrangements;
 - (iv) changes in grantor’s control of the asset – include in the final Standard application guidance paragraphs AGx7-AGx9 (in Appendix A) that:

- where there is a change in the grantor’s control of the asset, the arrangement should be assessed to determine whether it is still within the scope of the final Standard; and
 - where the grantor no longer has control of the asset, as specified in paragraph 8(a) of the final Standard, the grantor assesses whether the arrangement shall be recognised under another Accounting Standard;
- (v) determination of ‘significant residual interest, ‘current value’ – include in the final Standard the:
- word ‘fair value’ in place of ‘current value’ in the context of determining an asset’s residual interest in the application guidance paragraph AGx11; and
 - content of Staff analysis in the Basis for Conclusion paragraphs BCx2-BCx7 (in Appendix C) that there are sufficient guidance in existing Standards and pronouncements that do not warrant further guidance in this area;
- (vi) relationship between ‘significant residual interest’, and the ‘whole-of-life’ – in the final Standard amend application guidance paragraph AGx12 to clarify the term whole-of-life asset in relation to the control concept is the entire useful life or the major part of the useful life of the asset.

Background

- 4 ED 261 proposed the application of the control concept where a grantor controls the service concession 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 ... and if the grantor controls ... any significant residual interest in the asset at the end of the term of the arrangement ... or the asset is a whole of life asset”¹.

¹ Paragraph 8 of ED 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.”

Additionally, paragraph 9 of ED 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.

- 5 At its September 2015 meeting, the Board approved the project plan² for progressing the project. The project plan includes redeliberating certain aspects of the proposed application of the control concept in response to feedback received on ED 261. The Board agreed to consider the constituents' request for the inclusion of guidance and examples for the application of the control concept in the final Standard.

Feedback received on ED 261

- 6 The following is a summary of the feedback received³ from constituents on ED 261 in relation to the application of the control concept:
- (a) the majority of constituents agreed with the proposed control concept⁴;
 - (b) some constituents commented that the proposals are more rules-based than principles-based. These constituents recommended that a principles-based approach 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;
 - (c) some constituents requested clarification 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 final Standard may still need to be recognised under other accounting Standards; and
 - (d) some constituents had concerns regarding the practical application of the control concept and requested guidance and examples for arrangements involving:
 - (i) long term leases (such as 99 year leases), privatisations and outsourcing;
 - (ii) regulated public utilities (such as supply of water, sewerage, electricity); and
 - (iii) regulated pricing and services;

² 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

³ 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>

⁴ One constituent, the Australian Bureau of Statistics, 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.

- (e) some constituents commented that the final Standard should provide guidance for circumstances:
 - (i) where the grantor’s ‘control’ of the asset changes during the service concession arrangements. 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;
 - (ii) on what constitutes a ‘significant residual value’, including the determination of the ‘current value’ of the asset, and how this concept is applied in long term arrangements in relation to the control criteria in paragraph 8 of ED 261; and
 - (iii) that clarifies the relationship between the concepts of ‘significant residual interest’ and ‘whole-of-life’ in relation to the control criteria.

Staff analysis

- 7 Staff analysis on the application of the control concept in the final Standard considers the following issues:
- (a) Issue 1: Principles-based approach to guidance on the control concept;
 - (b) Issue 2: Application of broader concept of control; and
 - (c) Issue 3: Additional guidance and examples in the final Standard.

Issue 1: Principles-based approach to guidance on control concept

- 8 ED 261 provides application guidance on the control concept in paragraphs AG7 to AG19. These paragraphs are intertwined with guidance that relate to the principles of control and examples of different types of regulations that may demonstrate the existence of control.
- 9 Staff analysed the relevant sections on the control concept of the following accounting pronouncements in their consideration to amend the application guidance paragraphs:
- (a) *AASB Framework for the Preparation and Presentation of Financial Statements* – states that in determining “the existence of an asset ... if the entity controls the benefits which are expected to flow from the property ... Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control ...”⁵;

⁵ Paragraph 57 of *AASB Framework for the Preparation and Presentation of Financial Statements* states that:

“Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the entity controls the benefits which are expected to flow from the

- (b) AASB 10 *Consolidated Financial Statements* – Staff did not incorporate the control concept in the context of AASB 10, as the Board had previously decided that AASB 10 “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”⁶. Additionally, the Board “agreed that the assessment of control for an entity may not, in certain circumstances, be appropriate when applying the principles to an individual asset.”⁷;
- (c) IASB Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* – states that an entity has control of the asset:
- (i) if the entity has “the ability to direct the use of the economic resource and obtain the economic benefits that flow from it” (paragraph 4.18), which includes allowing another “party to deploy the economic resource in that other party’s activities” (paragraph 4.19); and
 - (ii) that usually “arises from legal rights, it can also arise if an entity has ... the ability to prevent all other parties from directing the use of it and obtaining the benefits ...” (paragraph 4.20)⁸; and
- (d) IPSASB *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* – Paragraph 5.12 states that:
- “...an entity assesses whether the following indicators of control exists:
- Legal ownership;

property. **Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control.** For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.” (emphasis added).

⁶ AASB Staff Issues Paper *Service concession arrangements (Grantor) Project – Potential Issues for Redeliberation* (December 2014) – paragraph 29.

Link to AASB Staff Issues Paper *Service concession arrangements (Grantor) Project – Potential Issues for Redeliberation* (December 2014)
http://www.aasb.gov.au/admin/file/content102/c3/M142_7.2_SCA_Potential_issues_for_redeliberation.pdf

⁷ ED 261, paragraph BC13.

⁸ IASB Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* paragraphs 4.18-4.23 states:

“An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that flow from it.” (paragraph 4.18).

“An entity has the ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party’s activities.” (paragraph 4.19).

“Although control of an economic resource usually arises from legal rights, it can also arise if an entity has the present ability to prevent all other parties from directing the use of it and obtaining the benefits from the economic resource. For example, an entity may control know-how obtained from a development activity by having the present ability to keep that know-how secret.” (paragraph 4.20).

- Access to the resource, or the ability to deny or restrict access to the resource;
 - The means to ensure that the resource is used to achieve its objectives; and
 - The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.”⁹
- 10 Following from the above analysis, Staff are of the view that the principles on which the control concept in paragraph 8 is based are consistent with existing Conceptual Frameworks issued by the AASB, IASB and IPSASB.
- 11 Staff are of the view that while the requirements in ED 261 contain the principles and application guidance for control, the final Standard would be clearer if the application guidance paragraphs are structured and refined by:
- (a) re-ordering and outlining the principles of control under a new heading of ‘Control’ followed by revised paragraphs AGx1-AGx3 (in Appendix A). The revised paragraphs are based on IPSAS 32 and supported by existing Conceptual Frameworks issued by the AASB, the IASB and IPSASB; and
 - (b) including a new heading ‘Regulation’ followed by guidance and/or examples of regulation to illustrate the principles of control in the application guidance.
- 12 The proposed approach in paragraph 11 above would address the concerns raised by constituents in paragraph 6(b) above for the final Standard by structuring and refining the application guidance.

Staff recommendation

- 13 Staff recommend the final Standard:
- (a) retain the requirements of the control concept in paragraph 8, which the majority of the constituents support¹⁰. The control concept is based on IPSAS 32 *Service Concession Arrangements: Grantor*¹¹ and AASB Interpretation 12 *Service Concession Arrangements*. It is also consistent with existing Conceptual Frameworks issued by the AASB, IASB and IPSASB; and
 - (b) structure and refine the application guidance paragraphs AG8-AG19 of ED 261 to clarify the principles of control as proposed in Appendix A.

⁹ Link to IPSASB *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*

<http://www.ifac.org/publications-resources/conceptual-framework-general-purpose-financial-reporting-public-sector-enti-8>

¹⁰ Paragraph 6(a) of this Staff Paper.

¹¹ This is consistent with the Board’s decision to develop an Australian Accounting Standards on grantor accounting for service concession arrangements based on IPSAS 32 as stated in paragraph BC3 of ED 261.

Question 1 to the Board

Does the Board agree with the recommendation that the final Standard:

- (a) retain the requirements of the control concept in paragraph 8 in ED 261; and
- (b) structure and refine the application guidance paragraphs relating to the control concept as proposed in AGx1-AGx3 (in Appendix A)?

Issue 2: Application of broader concept of control

- 14 ED 261 proposes the 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”. Additionally, paragraph BC17 of ED 261 states that “The AASB notes that a broader concept of control currently applies in other Australian Accounting Standards and that an asset that does not meet the control and regulation definition of this Standard may still need to be recognised under other accounting Standards.” Reference to the application of the broader control concept is stated in the Basis for Conclusion and not in the main body of ED 261.
- 15 Staff are of the view that:
- (a) if the final Standard requires the application of the broader concept of control in other Australian Accounting Standards where an asset does not meet the control criteria in the service concession arrangements Standard, commentary or guidance to this effect should be included in the final Standard. This would make the requirement explicit and unambiguous; and
 - (b) guidance to the relevant Australian Accounting Standards that could be considered for application to the different types of public and private sector arrangements would be useful. The relevant Standards are AASB 101 *Presentation of Financial Statements*, AASB 116 *Property, Plant and Equipment*, AASB 138 *Intangible Assets* and AASB 117 *Leases*.

The above approach would be consistent with the feedback received from constituents on ED 261 (paragraph 6(c) above).

- 16 Staff propose the inclusion of the following in the final Standard to clarify the application of the broader control concept:
- (a) a new application guidance paragraph to make explicit the requirement to apply the broader concept of control in other Australian Accounting Standards (refer to proposed AGx5 in Appendix A); and
 - (b) a table, in a new ‘Implementation Guidance’ section, that sets out the typical types of arrangements for private sector participation in the provision of public sector services with references to the relevant Standards, such as AASB 101, AASB 116, AASB 138 and AASB 117, that may apply to those arrangements

(refer to Appendix B). The table is similar to the one contained in IPSAS 32¹² and AASB Interpretation 12¹³.

The table will also address constituents' request for additional guidance on long term arrangements (such as 99 year leases) and privatisations and outsourcing arrangements (refer issue 3.2 below for more detail).

Staff recommendation

- 17 Staff recommend that the final Standard include the requirement to apply the broader concept of control that exists in other Australian Accounting Standards in a new application guidance paragraph along with a table in a new 'Implementation Guidance' section as proposed in paragraph 16 above.

Question 2 to the Board

Does the Board agree with the recommendation to include in the final Standard a new:

- (a) application guidance paragraph AGx5 (in Appendix A) to make explicit the requirement to apply the broader concept of control in other Australian Accounting Standards; and
- (b) a table, in a new 'Implementation Guidance' section (in Appendix B), that sets out the typical types of arrangements for private sector participation in the provision of public sector services with references to the relevant Australian Accounting Standards that may apply to those arrangements?

Issue 3: Additional guidance and examples in the final Standard

Issue 3.1 – Control or regulation specified in a contract or otherwise

- 18 ED 261 provides application guidance on how the grantor determines if it has control of the asset in a service concession arrangement in accordance with paragraph 8 of the Exposure Draft. The areas of guidance include when the control or regulation referred to in paragraph 8(a) could be by contract, or otherwise and when there is a third-party regulator that regulates, the price, services and/or to whom the services must be provided (paragraphs AG9-AG19). Constituents have expressed concerns that the application guidance paragraphs relating to third-party regulation are not always clear¹⁴.
- 19 Staff are of the view that generally there are three main circumstances under which a grantor controls or regulates the price, services and/or to whom the services must be provided in accordance with paragraph 8(a). The three main circumstances are where in the service concession arrangement, the:

¹² IPSAS 32, Implementation Guidance paragraphs IG3 and IG4.

¹³ AASB Interpretation 12, Information Note, page 21.

¹⁴ Paragraph 6(d)(iii) of this Staff Paper.

- (a) *contract specifies that the grantor controls or regulates the price, services and/or to whom the services must be provided;*
- (b) *contract specifies that a third-party regulator regulates the price, services and/or to whom the services must be provided. Under these circumstances, the regulation by the third-party regulator removes the ability of the operator to set or regulate the price, services and/or to whom the services must be provided and the regulation is considered to be implicitly set by the grantor.*

Additionally, “it is not essential for the grantor to direct the activities of the third-party regulator for the grantor to have control over the service concession arrangements” (paragraph AG12); and

- (c) *contract does not specify that a third-party regulator sets or regulates the price, services and/or to whom the services must be provided – under these circumstances, many governments “have the power to regulate the behaviour of entities operating in certain sectors of the economy, either directly or through specifically created agencies. For the purpose of paragraph 8(a), such broad regulatory powers do not constitute control” without a specific arrangement or contract (paragraph AG13). Instead, the grantor, operating under such a regulatory framework derives control of the service concession asset either from the contract or the specific regulation applicable to the industry or service. However, 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” (paragraph AG14).*

- 20 Paragraphs AG10 to AG14 of ED 261 reflect the approaches outlined in paragraphs 19(b) and (c) above.
- 21 Paragraph AG9 of ED 261 however does not fully reflect the approach outlined in paragraph 19(a) above. Staff propose amending paragraph AG9 of ED 261 to clarify the requirements in paragraphs 19(a) above (refer to proposed paragraphs AGx1 and AGx2 in Appendix A).
- 22 Additionally, Staff are of the view that it would be useful for constituents to have an understanding of the considerations that the Board undertook in formulating the application guidance for the application of the control concept. Consequently, Staff propose to include in the Basis for Conclusion to the final Standard the content of the staff analysis in paragraph 19 above.

Staff recommendation

23 Staff recommend that the final Standard:

- (a) amend paragraph AG9 of ED 261 to clarify the requirements in paragraphs 19(a) above (refer to proposed paragraphs AGx1 and AGx2 in Appendix A); and
- (b) include the content of the staff analysis in paragraph 19 above in the Basis for Conclusion to the final Standard (refer paragraphs BCx1 in Appendix C).

Question 3 to the Board

Does the Board agree with the recommendation to include in the final Standard:

- (a) an amendment to paragraph AG9 of ED 261 to clarify that a grantor has control of the service concession asset if the contract to the arrangement:
 - (i) specifies that the grantor controls or regulates the price, services and/or to whom the services must provide; or
 - (ii) conveys the right to control the use of the asset to the grantor when a third-party regulator regulates the price, services and/or to whom the services must provide.

The proposed amendment is contained in paragraphs AGx1 and AGx2 (in Appendix A).

- (b) the content of the staff analysis in paragraph 19 above in Basis for Conclusion paragraphs BCx1 in Appendix C?

Issue 3.2 – Long term leases, privatisation and outsourcing arrangements

- 24 Paragraph 6 of ED 261 excludes arrangements 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)” from the scope of the final Standard. ED 261 does not provide additional guidance on the type of arrangements that would be classified as an outsourcing, service contracts, or privatisation arrangement.
- 25 IPSAS 32¹⁵ contain a similar exclusion to those in paragraph 6 of ED 261 without providing a basis for the decision. However, IPSAS 32 and AASB Interpretation 12 contain, in the Implementation Guidance, a table that sets out the types of arrangements for private sector participation in the provision of public sector services. This table includes long term arrangements that have an indefinite duration and outsourcing, service contracts, or privatisation arrangements. Staff recommended to the Board, the inclusion of this table in the final Standard (refer paragraph 17 above).

¹⁵ IPSAS 32, paragraph 6.

26 Staff are of the view that long term arrangements and privatisation and outsourcing arrangements should not be scoped out of the requirements of ED 261, but should be assessed to determine if they meet the control criteria of paragraphs 8 or 9 of the final Standard. Where the arrangements meet the conditions of paragraphs 8 or 9, the arrangements should be accounted for as service concession arrangements. This approach would ensure that an arrangement is outside the scope of the service concession arrangement Standard based on the substance of the arrangement and not its legal form. Consequently, Staff propose removing the words “(eg outsourcing, service contracts, or privatisation)” from the scope in paragraph 6 of the final Standard as per below:

“6 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~~).”

27 Staff are also of the view that the guidance such as the table in the Implementation Guidance would provide constituents with guidance on when long term arrangements (such as 99 year leases) and privatisation and outsourcing arrangements fall outside the scope of this ED 261.

Staff recommendation

28 Staff recommend the in the final Standard:

- (a) removing the words “(eg outsourcing, service contracts, or privatisation)” from the scope in paragraph 6 of the final Standard;
- (b) including a new application guidance paragraph AGx6 (in Appendix A) clarifying that outsourcing, service or privatisations arrangements may be outside the scope of the final Standard where:
 - (i) they do not meet the control criteria of paragraphs 8 and 9; and
 - (ii) The example where the arrangement conveys the right to use the asset from the public sector entity to the private sector purchaser; and
- (c) the table in the Implementation Guidance (in paragraph 17 above) to address constituents’ request for additional guidance on long term arrangements (such as 99 year leases) and privatisations and outsourcing arrangements that fall out of scope of this Standard.

Question 4 to the Board

Does the Board agree with the recommendation in relation to providing guidance on long term arrangements (such as 99 year leases) and privatisations and outsourcing arrangements by:

- (a) removing the words “(eg outsourcing, service contracts, or privatisation)” from the scope in paragraph 6 of the final Standard;
- (b) including a new application guidance paragraph AGx6 (in Appendix A) clarifying that outsourcing, service or privatisations arrangements may be outside the scope of the final Standard if :
 - (i) the arrangement does not meet the control criteria of paragraphs 8 and 9; and
 - (ii) The example where the arrangement conveys the right to use the asset from the public sector entity to the private sector purchaser; and
- (c) include the table in the Implementation Guidance (in Appendix B)?

Issue 3.3 – Regulated public utilities (such as supply of water, sewerage, electricity)

- 29 ED 261 does not provide specific guidance in relation to entities that operate in the regulated public utilities industry for the supply of water, sewerage, electricity or other public services.
- 30 Staff are of the view that public sector entities that operate in the regulated public utilities industry would account for the arrangement in accordance with the criteria specified in paragraphs 8 (or paragraph 9) and relevant application guidance paragraphs, in particular, AGx6 in the final Standard.

Staff recommendation

- 31 Staff recommend that the guidance for when an arrangement of an entity that operates in the regulated public utilities industry would fall within the scope of the final Standard is addressed in ‘Issue 3.2 – Long term leases, privatisation and outsourcing arrangements’ in paragraphs 24 to 28 above.

Question 5 to the Board

Does the Board agree with the recommendation that paragraph AGx6 (in Appendix A) provides guidance in relation to entities that operate in the regulated public utilities industry for the supply of water, sewerage, electricity or other public services?

Issue 3.4 – Changes in grantor’s control of the asset

- 32 ED 261 does not specify the accounting treatment for when the grantor’s ‘control’ of the asset changes during the term of a service concession arrangement nor does it include guidance for when there is a change in the third party regulation of the price and/or service during the term of the arrangement. Constituents requested guidance to be provided in the final Standard in these areas¹⁶.
- 33 In addressing constituents’ request to provide guidance where the grantor’s control of the asset and changes in the conditions of the service concession arrangement, Staff analysed the relevant sections on the changes in arrangements of the following accounting pronouncements:
- (a) AASB 117 – states that the lease classification is made at the inception of the lease and if at any time the lessee and lessor agrees to change the lease terms that would result in a different lease classification, the revised agreement is regarded as a new agreement over its term. However, changes in estimates, economic life or residual value, or changes in circumstances (eg default by the lessee) does not result in a new lease classification for accounting purposes¹⁷;
 - (b) AASB Interpretation 4 – contains similar reassessment of whether an arrangement contains a lease to that of AASB 117. It also provides specific conditions for when the reassessment shall be made including when there is a substantial change to the asset (eg a substantial physical change to the property, plant and equipment)¹⁸;

¹⁶ Paragraph 6(e)(i) of this Staff Paper.

¹⁷ Paragraph 13 of AASB 117 states that:

“Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 7–12 if the changed terms had been in effect at the inception of the lease, the revised agreement is regarded as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.”

¹⁸ AASB Interpretation 4 *Determining whether an Arrangement contains a Lease* states that:

“The assessment of whether an arrangement contains a lease shall be made at the inception of the arrangement, being the earlier of the date of the arrangement and the date of commitment by the parties to the principal terms of the arrangement, on the basis of all of the facts and circumstances. A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if any one of the following conditions is met:

- (a) There is a change in the contractual terms, unless the change only renews or extends the arrangement.
- (b) A renewal option is exercised or an extension is agreed to by the parties to the arrangement, unless the term of the renewal or extension had initially been included in the lease term in accordance with paragraph 4 of AASB 117. A renewal or extension of the arrangement that does not include modification of any of the terms in the original arrangement before the end of the term of the original arrangement shall be evaluated under paragraphs 6–9 only with respect to the renewal or extension period.
- (c) There is a change in the determination of whether fulfilment is dependent on a specified asset.
- (d) There is a substantial change to the asset, for example a substantial physical change to property, plant or equipment.” (paragraph 10).

- (c) AASB 116 – requires the carrying amount of a property, plant and equipment to be derecognised on disposal or when no future economic benefits are expected from its use or disposal. Additionally, the gain or loss arising from the derecognition is to be included in the profit or loss¹⁹; and
- (d) AASB 10 – states that when a parent loses control of a subsidiary, the parent must derecognise the former subsidiary’s assets and liabilities and recognise the gain or loss associated with the loss of control²⁰.

34 Following from the above analysis, Staff propose the inclusion of application guidance paragraphs AGx7-AGx9 (in Appendix A), in the final Standard, containing similar requirements in the existing accounting pronouncements in paragraph 33 above. That is, where there is a change in the grantor’s control of the asset, the arrangement should be assessed to determine whether it is still within the scope of the final Standard. Additionally, where the grantor no longer has control of the asset, as specified in

“A reassessment of an arrangement shall be based on the facts and circumstances as of the date of reassessment, including the remaining term of the arrangement. Changes in estimate (for example, the estimated amount of output to be delivered to the purchaser or other potential purchasers) would not trigger a reassessment. If an arrangement is reassessed and is determined to contain a lease (or not to contain a lease), lease accounting shall be applied (or cease to apply) from:

- (a) in the case of (a), (c) or (d) in paragraph 10, when the change in circumstances giving rise to the reassessment occurs;
- (b) in the case of (b) in paragraph 10, the inception of the renewal or extension period.” (paragraph 11).

¹⁹ AASB 116 states that:

“The carrying amount of an item of property, plant and equipment shall be derecognised:

- (a) on disposal; or
- (b) when no future economic benefits are expected from its use or disposal.” (paragraph 67).

“The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless AASB 117 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.” (paragraph 68).

²⁰ AASB 10 states that:

“If a parent loses control of a subsidiary, the parent:

- (a) derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position.
- (b) recognises any investment retained in the former subsidiary and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Standards. That retained interest is remeasured, as described in paragraphs B98(b)(iii) and B99A. The remeasured value at the date that control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with AASB 9 or the cost on initial recognition of an investment in an associate or joint venture, if applicable
- (c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest, as specified in paragraphs B98–B99A.” (paragraph 25).

“Paragraphs B97–B99A set out guidance for the accounting for the loss of control of a subsidiary.” (paragraph 26).

paragraph 8(a) of the final Standard, the grantor assesses whether the asset shall be recognised under another Accounting Standard.

Staff recommendation

- 35 Staff recommend the inclusion of new application guidance paragraphs AGx7-AGx9 (in Appendix A), in the final Standard, stating that where there is a change in the grantor's control of the asset, the arrangement should be assessed to determine whether it is still within the scope of the final Standard and where this is no longer the case, whether the asset should be recognised under another Accounting Standard.

Question 6 to the Board

Does the Board agree with the recommendation to include application guidance paragraphs AGx7-AGx9 (in Appendix A), in the final Standard that:

- (a) where there is a change in the grantor's control of the asset, the arrangement should be assessed to determine whether it is still within the scope of the final Standard; and
- (b) where the grantor no longer has control of the asset, as specified in paragraph 8 of the final Standard, the grantor assesses whether the asset shall be recognised under another Accounting Standard?

Issue 3.5 – Determination of 'significant residual interest, 'current value' and whole-of-life asset

- 36 Paragraph 8(b) of ED 261 requires that the grantor must also have control of any significant residual interest in the asset at the end of the term of the arrangement for the grantor to have control of the service concession asset²¹. Additionally ED 261 requires the residual interest in the asset to be the estimated current value of the asset.²²

²¹ 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.”

²² Paragraph AG14 of ED 261

“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**

- 37 ED 261 however, does not provide guidance on what constitutes ‘significant residual interest’, including the determination of ‘current value’ and its relationship with the ‘whole-of-life’ in determining whether the grantor has control of the asset.²³
- 38 The term ‘significant’ is used in numerous Standards without specific guidance to what would constitute ‘significant’. Examples of this include:
- (a) AASB 10 – ‘significant’ is used in the context of significantly affecting the investee’s returns (paragraphs 10 and 13), significant influence (paragraph 14);
 - (b) AASB 128 *Investments in Associates and Joint Ventures* – ‘significant influence’ is used in the context that it is to “be applied by all entities that are investors with joint control of, or significant influence over, an investee.” (paragraph 9); and
 - (c) AASB 116 – ‘significant’ is used to in the context of ‘some ... property, plant and equipment experience significant and volatile changes in fair value” (paragraph 34), in determining the depreciation of property, plant and equipment in paragraphs 43-47, such as “Each part of the property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately” (paragraphs 43).
- 39 Some Standards regard the term ‘significant’ to be associated with ‘material’. For example, AASB 116 states that “The depreciable amount of an asset is determined after deducting its residual value. In practice, the residual value of an asset is often **insignificant and therefore immaterial** in the calculation of the depreciable amount” (paragraph 53, emphasis added).
- 40 Staff are of the view that:
- (a) what constitutes significant varies from one entity to another and is a matter of judgement for the individual entity and not a decision for the Board to make; and
 - (b) to date, the term ‘significant’ is used in numerous Standards without specific guidance to what would constitute ‘significant’. Staff do not believe that specific guidance on the term of ‘significant’ in the service concession arrangement Standard would be appropriate. If the Board were to provide guidance on the term ‘significant’, the Board would need to refer the matter to the International Accounting Standards Board for consideration. The IASB consideration would have implications beyond service concession arrangements.

were already of the age and in the condition expected at the end of the period of the service concession arrangement.” (emphasis added).

²³ Constituents have requested guidance in this is an area as noted in paragraph 6(e)(ii) and (iii) of this Staff Paper.

41 Constituents also requested guidance in the determination of ‘current value’, as ED 261 requires 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 arrangements’²⁴. ED 261 however does not provide any guidance on what constitutes “current value”.

42 Staff noted that:

- (a) ED 261 requires that the grantor shall initially measure the service concession asset in at fair value in accordance with AASB 13 *Fair Value Measurement*²⁵;
- (b) IASB Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting*²⁶ provides guidance of the current value measures for an asset. An extract of this table is provided below.

Table 6.1 – Information provided by various measurement bases

Asset

	Current value (market participant assumptions)	Value in use (entity-specific assumptions)
Statement of financial position	Price that would be received to transfer the asset.	Present value of cash flows estimated to arise from the continuing use of the asset and from its disposal at the end of its useful life (including present value of future costs of transfer).

The guidance above would indicate that the current value would be the asset’s fair value in accordance with AASB 13.

Staff are of the view that the word ‘fair value’ should be used in place of ‘current value’.

- (c) Further guidance on the measurement of an asset, including a service concession asset would need to be part of a separate project on the fair value of public sector assets. The Board at its October 2015 meeting has agreed to await the result of the AASB Agenda Consultation process before making a decision on the fair value project.

²⁴ ED 261, paragraph AG14.

²⁵ Paragraph 10 of ED 261 states that:

“The grantor shall initially measure the service concession asset recognised in accordance with paragraph 8 (or paragraph 9 for a whole-of-life asset) at its fair value in accordance with AASB 13 *Fair Value Measurement*, except as noted in paragraph 11.”

²⁶ IASB Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting*, Table 6.1, page 65

- 43 Constituents requested guidance to clarify the relationship between ‘significant residual interest’, and the ‘whole-of-life’ in determining whether the grantor has control of an asset. The constituents expressed that there are differing interpretations of paragraphs 8 and 9 of ED 261 in determining whether the grantor has control of the asset.
- 44 Paragraph 8 of ED 261 states that the grantor controls the 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.”
- 45 Additionally 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.”
- 46 The possible interpretations²⁷ of paragraphs 8 and 9 are as follows:
- (a) “One interpretation is that paragraph 8(b) deems a grantor controls a service concession asset when it controls *any* significant residual interest. Therefore where there is no significant residual interest the control criteria is considered met. For example, in a 30 year concession arrangement for an asset with a 35 year useful life, the estimated current value of the asset might be considered insignificant, meaning there is no significant residual interest. Assuming the criteria in paragraph 8(a) are also met, the grantor is considered to control the service concession asset. In this interpretation paragraph 9 can be seen as clarifying the requirement in paragraph 8(a) rather than adding a new requirement”;
 - (b) “However, some members ... and other preparers have interpreted the control criteria to be met only where a significant residual interest exists *or* where there is a “whole-of-life” arrangement. For example, in a 30 year concession arrangement for an asset with a 35 year useful life, the estimated current value of the asset might be considered insignificant therefore paragraph 8(b) is not met. In addition the arrangement is not for the entire useful life of the asset thus it would also fail the control criteria in paragraph 9. Such an interpretation would lead preparers to conclude the service concession asset is not controlled by the grantor. This interpretation is supported by the inclusion of paragraph 9 which implies an either/or approach.”

²⁷ Based on the Heads of Treasuries Accounting and Reporting Advisory Committee (HOTARAC) submission to ED 261, page 6.

Link to HOTARAC submission

http://www.aasb.gov.au/admin/file/content106/c2/HoTARAC%20submission%20to%20ED%20261%20service%20concession%2010%20aug%202015_11-08-2015_091729.pdf

- 47 Staff's interpretation of paragraphs 8 and 9 are consistent with the application guidance paragraph AG2 of ED 261, which states that "Paragraph 8 of this [draft] Standard specifies the conditions under which an asset, other than a whole-of-life asset, is within the scope of the [draft] Standard and is recognised by the grantor. Paragraph 9 of the [draft] Standard specifies the condition under which whole-of-life assets are within the scope of the [draft] Standard and are recognised by the grantor." That is, if the term of the service concession arrangement:
- (a) is not the whole-of-life of the asset, then paragraph 8 of the final Standard applies; or
 - (b) is the whole-of-life of the asset, then paragraph 9 of the final Standard applies.
- 48 Staff's interpretation in paragraph 47(a) above is consistent with the general observation that the amount of residual interest at the end of an arrangement is inversely proportional to the term of the service concession arrangement. That is, the residual interest at the end of the arrangement is likely to be significant if the term of the arrangement is not the majority portion of the whole-of-life of the asset. Consequently, such an arrangement would be scoped in the Standard by paragraph 8.
- 49 Staff, however, are of the view that paragraph 9 may only scope in service concession arrangements where the term of the arrangement is the same as the whole-of-life of the asset. This could result in arrangements being structured so that the residual interest of the asset is not significant and the term of the arrangement is not the entire useful life (whole-of-life) of the asset. Such arrangements would be scoped out of paragraphs 8 and 9 and therefore the Standard. Staff are of the view that this may not be the intent of paragraph 9.
- 50 Staff are of the view that a new application guidance paragraph AGx12 would clarify that whole-of-life asset is taken to mean when:
- (a) the term of the arrangement is the same as entire useful life of the asset; or
 - (b) the term of the arrangement is the major part of the useful life of the asset. This approach is similar to the one adopted in AASB 117 in the classification of a finance lease²⁸.

²⁸ Paragraph 10 of AASB 117 states that:

"Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
- (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
- (c) **the lease term is for the major part of the economic life of the asset** even if title is not transferred ..."
(emphasis added).

Staff recommendation

51 Staff recommend that the Board to in the final Standard:

- (a) the word ‘fair value’ be used in place of ‘current value’ in the context of determining an asset’s residual interest (refer application guidance paragraph AGx11 in Appendix A);
- (b) include the content of the Staff analysis in paragraphs 40 and 42 above in the Basis for Conclusion (refer paragraphs BCx2-BCx7 in Appendix C), instead of providing guidance on the term ‘significant’ and ‘current value’; and
- (c) new application guidance paragraph AGx12 to clarify the term whole-of-life asset in relation to the control concept.

Question 7 to the Board

Does the Board agree with the recommendation to include in the final Standard:

- (a) the word ‘fair value’ be used in place of ‘current value’ in the context of determining an asset’s residual interest in paragraph AGx11;
- (b) the content of the Staff analysis in paragraphs 40 and 42 above in the Basis for Conclusion paragraphs BCx2-BCx7, instead of providing guidance on the term ‘significant’ and ‘current value’; and
- (c) application guidance paragraph AGx12 to clarify the term whole-of-life asset in relation to the control concept is the entire useful life or the major part of the useful life of the asset?

Appendix A: Proposed Changes to ED 261 'Application Guidance' Section

Comment [SD1]: Note to Board members:

Staff have retained the existing Application Guidance (AG) paragraph numbers and inserted new AG paragraphs as AGx1, AGx2, etc, as the paragraph numbers in the final Standard will depend on the Board's decisions on Staff recommendations.

Scope (paragraphs 5 – 7)

..

AG2 Paragraph 8 of this [draft] Standard specifies the conditions under which an asset, other than a whole-of-life asset, is within the scope of the [draft] Standard and is recognised by the grantor. Paragraph 9 of the [draft] Standard specifies the condition under which whole-of-life assets are within the scope of the [draft] Standard and are recognised by the grantor.

..

Recognition and Initial Measurement of a Service Concession Asset

Recognition of a Service Concession Asset

Control

AG7 The assessment of whether a service concession asset should be recognised in accordance with paragraph 8 (or paragraph 9 for a whole-of-life asset) is made on the basis of all of the facts and circumstances of the arrangement.

AG8 The fundamental principle reflected in paragraph 8 is determining which entity controls the underlying ~~infrastructure asset~~ of a service concession arrangement.

AGx1 The control or regulation referred to in paragraph 8(a) could be by a contract, or otherwise. If the contract specifies that the grantor controls or regulates the price, services and/or to whom the operator must provide the services, the conditions specified in paragraph 8(a) are met.

AGx2 The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. For example, the contract may set the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement. When the contract conveys the right to control the use of the service concession asset to the grantor, the asset meets the condition specified in paragraph 8(a) regarding control in relation to those to whom the operator must provide services irrespective of the involvement of a third party regulator.

AGx3 Control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 8(a) and any significant residual interest in the asset, the operator is only managing the asset on the grantor's behalf – even though, in many cases, it may have wide managerial discretion.

Regulation

AG8 Regulation of what services the operator must provide, to whom it must provide them, and at what price, in the manner specified in paragraph 8(a), is a means by which a grantor can exercise and demonstrate control of the substantive benefits of the service concession asset.

~~AG9 The control or regulation referred to in paragraph 8(a) could be by a contract, or otherwise. This could be through a third-party regulator that regulates other entities that operate in the same industry or sector as the grantor. It may include circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. The contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement. When the contract conveys the right to control the use of the service concession asset to the grantor, the asset meets the condition specified in paragraph 8(a) regarding control in relation to those to whom the operator must provide services.~~

AGx4 A grantor may have control of a service concession asset in an environment where a third party regulator regulates the price, service and/or to whom the services must be provided. This could be through a third-party regulator that regulates other entities that operate in the same industry or sector as the grantor. It includes circumstances in which the grantor buys all of the services as well as those in which some or all of the services are bought by other users.

AG10 For the purpose of paragraph 8(a), the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, or a third-party regulator (eg by a capping mechanism). However, the condition shall be applied to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, shall be ignored. Conversely, if, for example, an arrangement purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.

AG11 Prices are controlled in a regulated environment when a third-party regulator regulates the pricing of the services provided with a service concession asset. This removes the ability of the operator to regulate the price and, for the purpose of paragraph 8(a), the pricing of the services is considered to be set implicitly by the grantor.

AG12 Where a third-party regulator regulates the services that the asset must provide (as specified in paragraph 8(a)), it is not essential for the grantor to direct the activities of the third-party regulator for the grantor to have control of the service concession asset. For example, a State grantor in a service concession arrangement might meet the condition specified in paragraph 8(a) even though the relevant regulation is carried out by an independent Commonwealth regulator. Furthermore, subject to paragraph AG14, it is not necessary for the grantor to refer to the regulator in the contract. The grantor might rely on the regulator exercising its powers within the parameters set when the regulator was established.

AG13 Many governments have the power to regulate the behaviour of entities operating in certain sectors of the economy, either directly or through specifically created agencies. For the purpose of paragraph 8(a), such broad regulatory powers do not constitute control. In this Standard, the term 'regulate' is intended to be applied only in the context of the specific terms and conditions of the service concession arrangement. For example, a regulator of rail services may determine rates that apply to the rail industry as a whole. Depending on the legal framework in a jurisdiction, such rates may be implicit in the contract governing a service concession arrangement involving the provision of railway transportation, or they may be specifically referred to therein. However, in both cases, the control of the service

concession asset is derived from either the contract or the specific regulation applicable to rail services and not from the fact that the grantor is a public sector entity that is related to the regulator of rail service.

AG14 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 ~~requirements of paragraph 8(a) to be met. 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.~~

~~AG15 Control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 8(a) and any significant residual interest in the asset, the operator is only managing the asset on the grantor's behalf—even though, in many cases, it may have wide managerial discretion.~~

AG17 Sometimes the use of a service concession asset is partly regulated in the manner described in paragraph 8(a) and partly unregulated. However, these arrangements take a variety of forms:

- (a) any asset that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in AASB 136 *Impairment of Assets* is analysed separately to determine whether the condition set out in paragraph 8(a) is met if it is used wholly for unregulated purposes (eg this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients); and
- (b) when purely ancillary activities (such as a hospital shop) are unregulated, the control tests shall be applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in paragraph 8(a), the existence of ancillary activities does not detract from the grantor's control of the service concession asset.

AG18 There may be arrangements that include unregulated services that are neither purely ancillary nor delivered by using a physically separable portion of the total asset. For example, a grantor may control prices charged to children and seniors at a sports facility but the amounts charged to adults are not controlled. The same facilities are being used by all, regardless of the amount they pay. Alternatively, price certain times of the day rather than different classes of user. In such cases, it will be a matter of judgement whether enough of the service is regulated in order to demonstrate that the grantor has control of the asset.

AG19 The operator may have a right to use the separable asset described in paragraph AG17(a), or the facilities used to provide ancillary unregulated services described in paragraph AG17(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it shall be accounted for in accordance with AASB 117 *Leases*.

Control concept in other Australian Accounting Standards

AGx5 To the extent that an asset meets the conditions in paragraph 8 (or paragraph 9), the grantor has the right to control the use of the asset and therefore shall recognise the asset in accordance with this

Standard. An asset that does not meet the control criteria of this Standard should be assessed to determine whether it shall be recognised under another Accounting Standard. This includes the assessment of whether the asset should be accounted for in accordance with AASB 101 *Presentation of Financial Statements*, AASB 116, AASB 138, AASB 117 or any other relevant Standards. The *Implementation Guidance to this Standard contains a table that highlights the continuum of typical arrangements and the relevant accounting requirements.*

Long term leases, outsourcing or privatisation

AGx6 Long term leasing, outsourcing, service or privatisation arrangements may fall outside the scope of this Standard if the arrangement does not meet the control criteria of paragraph 8 (or paragraph 9). For example, such an arrangement may involve a grantor conveying the right to use the asset to another entity (the private sector purchaser). An arrangement that conveys the right to use the asset may also convey to the purchaser the right to control the use of the underlying asset. The asset of such an arrangement shall be assessed as to whether it should be accounted for in accordance with AASB Interpretation 4 *Determining whether an Arrangement contains a Lease.*

Changes in control

AGx7 The grantor's control of the service concession asset may change during the term of the service concession arrangement. The change in the grantor's control of the asset may arise from the change in terms of the service concession contract, or the change in the third party regulation of the price and/or service.

AGx8 Where the grantor's control of the asset changes, the asset should be assessed to determine whether the asset is still within the scope of this Standard.

AGx9 Where the grantor no longer has control of the asset in accordance with this Standard, the asset shall be assessed to determine whether it shall be recognised under other Accounting Standards.

Residual interest

AGx10 The grantor must also control through ownership, beneficial entitlement or otherwise any significant residual interest in the asset at the end of the term of the arrangement for the requirements of paragraph 8(b) to be met.

AGx11 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 fair value of the asset (determined at the inception of the arrangement) as if it were already of the age and in the condition expected at the end of the period of the service concession arrangement.

AG16 Paragraph 8 identifies when the asset, including any replacements required, is controlled by the grantor for the whole of its economic life. For example, if the operator has to replace part of an asset during the period of the arrangement (eg the top layer of a road or the roof of a building), the asset shall be considered as a whole. Thus the condition in paragraph 8(b) is met for the whole of the asset, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part.

Whole-of-life asset

AGx12 For the purpose of paragraph 9, whole-of-life asset is taken to mean when the term of the arrangement is the entire useful life or the major part of the useful life of the asset.

Appendix B: Proposed New “Implementation Guidance” Section to ED 261

Implementation Guidance

This guidance accompanies, but is not part of, AASB XY.

References to Australian Accounting Standards that Apply to Typical Types of Arrangements Involving an Asset Combined with Provision of a Service

The table sets out the typical types of arrangements for private sector participation in the provision of public sector services and provides references to Accounting Standards that may apply to those arrangements. The list of arrangement types is not exhaustive. The purpose of the table is to highlight the continuum of arrangements. It is not the AASB’s intention to convey the impression that bright lines exist between the accounting requirements for various types of arrangements.

Shaded text shows arrangements within the scope of AASB XY.

Comment [SD2]: Note to Board members:

- This Implementation Guidance is adopted from AASB Interpretation 12 and IPSAS 32.
- This section has does not contain track changes for ease of readability.

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (e.g. Operator leases asset from grantor)	Service and/or maintenance contract (specific tasks e.g. debt collection, facility management)	Rehabilitate-operate-transfer	Build-operate-transfer	Build-own-operate	100% Divestment/ Privatisation/ Corporation
Asset ownership	Grantor				Operator	
Capital investment	Grantor		Operator			
Demand risk	Shared	Grantor	Grantor and/or Operator		Operator	
Typical duration	8–20 years	1–5 years	25–30 years		Indefinite (or may be limited by contract or licence)	
<u>Significant</u> R esidual interest	Grantor				Operator	
Relevant Accounting Standard	AASB 117	AASB 101	This Standard/ AASB 116/ AASB 138		AASB 116/ AASB 138 (derecognition)	

Appendix C: Proposed Changes to ED 261 'Basis for Conclusion' Section

Comment [SD3]: Note to Board members:

Consistent with Appendix A above, Staff have retained the existing Basis for Conclusion (BC) paragraph numbers and inserted new BC paragraphs as BCx1, BCx2, etc, as the paragraph numbers in the final Standard will depend on the Board's decisions on Staff recommendations.

Recognition of a Service Concession Asset

- BC8 The Board considered a number of alternative approaches in developing the proposed guidance for assessing whether a grantor controls the service concession asset, including:
- (a) the risks and rewards approach;
 - (b) the rights and obligations approach;
 - (c) the control or regulation approach (the IPSAS 32 concept of control); and
 - (d) an approach analogous to the principles of control specified in AASB 10 *Consolidated Financial Statements*.
- BC9 The Board decided to adopt the IPSAS 32 concept of control (control or regulation approach) for the following reasons.
- BC10 In considering the merits of the risks and rewards and the control-based approach to assess whether the grantor should recognise the asset, the Board noted that the risks and rewards approach focuses on the economic aspects of the terms and conditions in the arrangement. The Board did not consider this focus to be appropriate for service concession arrangements in the Australian public sector. This is because the primary purpose of a service concession asset, from the grantor's point of view, is to provide specified public services on behalf of the grantor using the asset, and not to provide economic benefits such as revenue generated by such assets (eg from user fees). Thus, the service potential of the asset accrues to the grantor. The Board's view is that economic benefits are only likely to arise from a service concession arrangement, from a grantor's perspective, in circumstances where the operator is granted the right to earn revenue from third-party users of either the service concession asset or another revenue-generating asset. A control-based approach focuses on control over the service potential of the service concession asset.
- BC11 Service concession arrangements are often entered into to share the risks between the grantor and the operator. The Board questioned whether objective criteria can be established for assessing risks and rewards to enable consistent results to be determined. In addition, weighting of various risks and rewards was seen to be problematic. The Board concluded, therefore, that the risks and rewards approach was not appropriate for an Australian Standard addressing grantor accounting for service concession arrangements.
- BC12 In considering the rights and obligations approach, the Board noted that while this could have conceptual merit, it would represent a significant change in the accounting and financial reporting of assets and liabilities for public sector entities that could have implications beyond service concession arrangements, and could set an inappropriate precedent.
- BC13 While there was some discussion as to the ability to apply the concept of control in AASB 10 by analogous interpretation, the Board agreed that the assessment of control for an entity may not, in certain circumstances, be appropriate when applying the principles to an individual asset.
- BC14 The Board concluded that the IPSAS 32 approach (the control or regulation approach) was the most appropriate approach as it is consistent with AASB Interpretation 12. Accordingly, this approach

would lead to consistent accounting requirements for the operator and grantor.

BC15 Additionally, the control approach in IPSAS 32 is confirmed in the Basis for Conclusions to IPSAS *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (October 2014), where the IPSASB concluded that consideration of “the risks and rewards associated with particular transactions and events, and which party to any transaction or event bears the majority of those risks and rewards, may be relevant and useful in identifying the nature of the asset controlled by parties to the transaction or event. It may also be useful in determining how to quantify and associate the economic rights and obligations with particular parties. However, it is not of itself an indicator of the party that controls an asset. The IPSASB therefore decided not to include the risks and rewards of ownership as an indicator of control” (BC5.14).

BCx1 The Board in developing the application guidance for the control concept formed the view that there are three main circumstances which a grantor controls or regulates the price, services and/or to whom the services must be provided in accordance with paragraph 8(a). The three main circumstances are where in the service concession arrangement, the:

- (a) contract specifies that the grantor controls or regulates the price, services and/or to whom the services must be provided;
- (b) contract specifies that a third-party regulator regulates the price, services and/or to whom the services must be provided – under this circumstance, the regulation by the third-party regulator removes the ability of the operator to set or regulate the price, services and/or to whom the services must be provided and the regulation is considered to be implicitly set by the grantor. Additionally, it is not essential for the grantor to direct the activities of the third-party regulator for the grantor to have control over the service concession arrangements (paragraph AG12); and
- (c) contract does not specify that a third-party regulator sets or regulates the price, services and/or to whom the services must be provided – under these circumstances, many governments have the power to regulate the behaviour of entities operating in certain sectors of the economy, either directly or through specifically created agencies. For the purpose of paragraph 8(a), such broad regulatory powers do not constitute control without a specific arrangement or contract (paragraph AG13). Instead, the grantor, operating under such a regulatory framework derives control of the service concession asset either from the contract or the specific regulation applicable to the industry or service. However, 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 (paragraph AG14).

BC16 The Board further decided that implementation guidance be included within the [draft] Standard to assist users in assessing whether the service concession asset is controlled by the grantor.

BC17 The Board also considered the concept of control for the recognition of service concession asset. The Board decided that the grantor recognises 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 the grantor exhibits the 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”. This mirrors the control concept in AASB Interpretation 12. The AASB noted that a broader concept of control currently applies in other accounting Standards and that an asset that does not meet the control and regulation definition of this standard, may still need to be recognised under other accounting Standards. The Board noted that entities that are established for service concession arrangements would already need to consider the requirements of AASB 10.

BCx2 The Board considered whether the application guidance should provide guidance on what constitutes ‘significant residual interest’, including the determination of ‘current value’ and its relationship with the ‘whole-of-life’ in determining whether the grantor has control of the asset under paragraph 8(b).

BCx3 The Board decided that:

- (a) what constitutes ‘significant’ varies from one entity to another and is a matter of judgement for the individual entity and not a decision for the Board to make; and
- (b) to date, the term ‘significant’ is used in numerous Standards without specific guidance to what would constitute ‘significant’. The Board did not believe that specific guidance on the term of ‘significant’ in the service concession arrangement Standard would be appropriate. If the Board were to provide guidance on the term ‘significant’, the Board would need to refer the matter to the International Accounting Standards Board for consideration. The IASB consideration would have implications beyond service concession arrangements.

BCx4 This Standard requires the residual interest in the asset to be determined as 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 arrangements. The Board considered whether guidance should be provided in the determination of ‘current value’. The Board noted that the IASB Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* provides guidance that the current value for an asset would be its fair value in accordance with AASB 13.

BCx5 For clarity, the Board decided that the word ‘fair value’ should be used in place of ‘current value’.

BCx6 The Board noted that the view not to provide additional guidance on the determination of ‘fair value’ would be consistent with the Board’s decision in BC29 that when an existing Australian Accounting Standard specifies the accounting and reporting for a component of a service concession arrangement, this Standard references the specific Australian Accounting Standard and no additional guidance are provided.

BCx7 Additionally, the Board decided that guidance on the measurement of an asset, including a service concession asset would need to be part of a separate project on the fair value of public sector assets in the future.