

# Service Concession Arrangements: Grantors

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This compiled Standard applies to annual periods beginning on or after 1 January 2022. Earlier application is permitted for annual periods beginning before 1 January 2022. It incorporates relevant amendments made up to and including 20 December 2021.

Prepared on 7 April 2022 by the staff of the Australian Accounting Standards Board.

Compilation no. 5

Compilation date: 31 December 2021



**Australian Government**

**Australian Accounting  
Standards Board**

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Australian Accounting Standards Board  
PO Box 204  
Collins Street West  
Victoria 8007  
AUSTRALIA

Phone: (03) 9617 7600  
E-mail: [standard@aaasb.gov.au](mailto:standard@aaasb.gov.au)  
Website: [www.aasb.gov.au](http://www.aasb.gov.au)

## Other enquiries

Phone: (03) 9617 7600  
E-mail: [standard@aaasb.gov.au](mailto:standard@aaasb.gov.au)

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Australian Accounting Standard AASB 1059 *Service Concession Arrangements: Grantors* (as amended) is set out in paragraphs 1 – 29 and Appendices A – E. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. AASB 1059 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation of Standards*, which identifies the Australian Accounting Interpretations, and AASB 1057 *Application of Australian Accounting Standards*. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

## Comparison with international pronouncements

AASB 1059 *Service Concession Arrangements: Grantors* as amended applies to all public sector entities, irrespective of whether they are for-profit or not-for-profit entities.

### AASB 1059 and IPSAS

AASB 1059 is based on IPSAS 32 *Service Concession Arrangements: Grantor*. However, public sector entities that comply with AASB 1059 may not be in compliance with IPSAS 32 because of differences between the Standards. The more significant differences include the following:

- (a) AASB 1059 applies to public sector entities in both the for-profit and not-for-profit sectors, whereas IPSAS 32 applies only to not-for-profit public sector entities;
- (b) AASB 1059 requires the grantor to initially measure a service concession asset provided by the operator at current replacement cost in accordance with the cost approach to fair value in AASB 13 *Fair Value Measurement*. IPSAS 32 specifies measurement at fair value generally;
- (c) an existing asset of the grantor, including a previously unrecognised identifiable intangible asset or land under roads, that is reclassified as a service concession asset is measured at fair value (current replacement cost) at the date of reclassification under AASB 1059. IPSAS 32 does not permit such remeasurement or the recognition of previously unrecognised identifiable intangible assets or land under roads;
- (d) AASB 1059 requires the grantor to recognise a financial liability where the grantor has a contractual obligation to pay cash to the operator for third-party usage of a service concession asset, with or without guaranteeing a minimum amount to the operator. IPSAS 32 refers to such an arrangement as a ‘shadow toll’ arrangement and requires the grantor to account for the payments as an expense when paid instead of recognising a financial liability at the commencement of the arrangement;
- (e) AASB 1059 provides more guidance on the term ‘public service’ than IPSAS 32; and
- (f) IPSAS 32 includes additional application guidance for other revenues. Other revenues relate to compensation by the operator to the grantor for access to the service concession asset by providing the grantor with a series of predetermined inflows of resources such as an upfront payment or a stream of payments (eg rent payments) and revenue-sharing provisions.

### AASB 1059 and IFRS Standards

Public sector entities, including for-profit entities, that comply with AASB 1059 may not be in compliance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB). The IASB has issued an IFRIC Interpretation addressing the accounting by private sector operators of service concession arrangements but has not issued a pronouncement regarding the accounting by grantors.

AASB 1059 requires a grantor to initially measure a service concession asset at current replacement cost in accordance with the cost approach to fair value in AASB 13. However, AASB 13 and the corresponding IFRS 13 *Fair Value Measurement* do not specify which valuation technique to use. Instead IFRS 13 requires the use of valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Three widely used valuation techniques set out in IFRS 13 are the market approach, the cost approach and the income approach. The requirement of AASB 1059 to initially measure a service concession asset at current replacement cost in accordance with the cost approach may not be compliant with IFRS 13.

AASB 1059 requires a grantor to recognise an identifiable intangible asset as a service concession asset where the grantor controls the asset as set out in paragraph 5 or 6, even if the asset does not qualify for recognition under AASB 138/IAS 38 *Intangible Assets*. This Standard also permits revaluation of the asset in the absence of an active market.

AASB 15 *Revenue from Contracts with Customers* requires a licensor of intellectual property to recognise revenue from granting the licence using either the right-to-use or right-to-access methods, depending on the specific facts and circumstances. The general requirement in AASB 1059 to recognise revenue from granting a right to the operator over the term of the service concession arrangement on an appropriate basis may not be compliant with IFRS 15 *Revenue from Contracts with Customers*.

Consequently, a public sector grantor that is a for-profit entity may not be able to state that its financial statements comply with IFRS Standards.

## Accounting Standard AASB 1059

The Australian Accounting Standards Board made Accounting Standard AASB 1059 *Service Concession Arrangements: Grantors* under section 334 of the *Corporations Act 2001* on 14 July 2017.

This compiled version of AASB 1059 applies to annual reporting periods beginning on or after 1 January 2022. It incorporates relevant amendments contained in other AASB Standards made by the AASB up to and including 20 December 2021 (see Compilation Details).

## Accounting Standard AASB 1059 *Service Concession Arrangements: Grantors*

### Objective

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- 1 The objective of this Standard is to prescribe the accounting for a *service concession arrangement* by a *grantor* that is a public sector entity.

### Scope (paragraphs B1–B3)

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- 2 This Standard shall be applied to service concession arrangements, which involve an *operator*:
- (a) providing public services related to a *service concession asset* on behalf of a grantor; and
  - (b) managing at least some of those services under its own discretion, rather than at the direction of the grantor.
- 3 Arrangements outside the scope of this Standard include those that do not involve the delivery of a public service, those where the operator manages the public services merely as an agent of the grantor, and those that involve service and management components where the asset is not controlled by the grantor as described in paragraph 5, or paragraph 6 for a whole-of-life asset.
- 4 This Standard does not specify the accounting by operators. Guidance on accounting for service concession arrangements by private sector operators can be found in AASB Interpretation 12 *Service Concession Arrangements*.

### Recognition and measurement of service concession assets (paragraphs B14–B59)

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- 5 The grantor shall recognise an asset provided by the operator and an upgrade to or a major component replacement for 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.
- 6 The grantor shall recognise an asset that will be used in a service concession arrangement for its entire economic life (a ‘whole-of-life’ asset) if the conditions in paragraph 5(a) are met. In this case, the condition in paragraph 5(b) is not relevant and therefore the grantor controls the whole-of-life asset if the conditions in paragraph 5(a) are met.
- 7 The grantor shall initially measure the service concession asset recognised in accordance with paragraph 5 (or paragraph 6 for a whole-of-life asset) at current replacement cost in accordance with the cost approach to fair value in AASB 13 *Fair Value Measurement*.
- 8 Where an existing asset of the grantor meets the conditions specified in paragraph 5 (or paragraph 6 for a whole-of-life asset), the grantor shall reclassify the existing asset as a service concession asset and shall measure the asset at current replacement cost in accordance with the cost approach to fair value in AASB 13 as at the date of reclassification. The grantor shall recognise any difference at that

date between the carrying amount of the asset and its fair value (current replacement cost) as if it is a revaluation of the asset. This approach does not mean that the grantor has adopted the revaluation model.

- 9 After initial recognition or reclassification, the grantor shall account for a service concession asset during the term of the service concession arrangement as follows:
- (a) depreciate or amortise the depreciable amount of the asset over the useful life in accordance with AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets*, as appropriate, with any impairment recognised in accordance with AASB 136 *Impairment of Assets*; and
  - (b) references to fair value in other Standards shall be read as references to current replacement cost for service concession assets. For example, this means that current replacement cost is the basis for fair value measurement of service concession assets under a revaluation model. Furthermore, the active market requirements in AASB 138 for the revaluation of an intangible asset shall not apply.
- 10 The grantor shall account for a service concession asset after the end of the term of the service concession arrangement in accordance with other Accounting Standards and as specified below. In particular:
- (a) the grantor reclassifies the asset based on its nature or function;
  - (b) references to fair value in other Standards shall no longer be read as references to current replacement cost. For example, any of the approaches in AASB 13 to fair value measurement may be applied to the asset under a revaluation model, as appropriate. Furthermore, the active market requirements in AASB 138 for the revaluation of an intangible asset shall apply; and
  - (c) the grantor derecognises the asset in accordance with AASB 116 or AASB 138, as appropriate, only when the grantor loses control of the asset. For example, internally generated intangible assets that were recognised as service concession assets (including those that do not qualify for recognition under AASB 138) are not derecognised at the end of the term of the service concession arrangement, unless the grantor loses control of the asset at that time.

## **Recognition and measurement of liabilities (paragraphs B60–B74)**

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- 11 Where the grantor recognises a service concession asset in accordance with paragraph 5 (or paragraph 6 for a whole-of-life asset), the grantor shall also recognise a liability. The grantor shall not recognise a liability when an existing asset of the grantor is reclassified as a service concession asset in accordance with paragraph 8, except in circumstances where additional consideration is provided by the operator, as noted in paragraph 12.
- 12 The liability recognised in accordance with paragraph 11 shall be initially measured at the same amount as the service concession asset, adjusted by the amount of any other consideration (eg the transfer of an existing asset) from the grantor to the operator, or from the operator to the grantor.
- 13 The nature of the liability recognised is based on the nature of the consideration exchanged between the grantor and the operator. The nature of the consideration given by the grantor to the operator is determined by reference to the terms of the *contract*.
- 14 In exchange for the service concession asset, the grantor might compensate the operator for the service concession asset by any combination of:
- (a) making payments to the operator (the ‘financial liability’ model); and
  - (b) compensating the operator by other means (the ‘grant of a right to the operator’ model), such as granting the operator:
    - (i) the right to earn revenue from third-party users of the service concession asset; or
    - (ii) access to another revenue-generating asset for the operator’s use (eg a private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients or a private parking facility adjacent to a public facility).

## Financial liability model

- 15 **Where the grantor has a contractual obligation to deliver cash or another financial asset to the operator for the construction, development, acquisition or upgrade of a service concession asset, the grantor shall account for the liability recognised in accordance with paragraph 11 as a financial liability.**
- 16 The grantor has a contractual obligation to pay cash if it has agreed to pay the operator specified or determinable amounts, such as payments relating to the following:
- (a) third-party usage of a service concession asset, with or without guaranteeing a minimum amount to the operator; or
  - (b) the shortfall, if any, between amounts received by the operator from users of the service concession asset and any other specified or determinable amounts payable by the grantor, even if the payment is contingent on the operator ensuring that the service concession asset meets specified quality or efficiency requirements.
- 17 *AASB 9 Financial Instruments, AASB 132 Financial Instruments: Presentation and AASB 7 Financial Instruments: Disclosures* apply to the financial liability recognised under paragraph 11, except where this Standard specifies otherwise.
- 18 **The grantor shall allocate the payments to the operator under the contract and account for them according to their substance as payments relating to the liability recognised in accordance with paragraph 11 or charges for services provided by or to be provided by the operator (including the future replacement of components of the service concession asset).**
- 19 **Charges for services provided by the operator (other than replacement components) in a service concession arrangement determined in accordance with paragraph 18 shall be accounted for in accordance with other relevant Standards.**
- 20 **Where the asset and service components of a service concession arrangement are separately identifiable, the service component of payments from the grantor to the operator shall be allocated accordingly (see paragraph B53). Where the asset and service components are not separately identifiable, the service component of payments from the grantor to the operator shall be determined using estimation techniques (see paragraph B54).**

## Grant of a right to the operator model

- 21 **Where the grantor does not have a contractual obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, and instead grants the operator the right to earn revenue from third-party users or access to another revenue-generating asset, the grantor shall account for the liability recognised in accordance with paragraph 11 as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.**
- 22 **The grantor shall recognise revenue, and accordingly reduce the liability noted in paragraph 21, according to the economic substance of the service concession arrangement (see paragraph B71).**
- 23 Where the grantor compensates the operator for the service concession asset and the provision of services by granting the operator the right to earn revenue from third-party users of the service concession asset or access to another revenue-generating asset, the exchange is regarded as a transaction that will generate revenue for the grantor. As the right granted to the operator to access the grantor's underlying service concession asset is effective for the period of the service concession arrangement, the grantor does not recognise revenue from the exchange immediately. Instead, a liability is recognised for revenue that is not yet earned. The revenue is then recognised according to the economic substance of the service concession arrangement, and the liability is reduced as revenue is recognised.

## Dividing the arrangement

- 24 **If the grantor compensates the operator for the provision of a service concession asset partly by incurring a financial liability and partly by the grant of a right to the operator, it is necessary to account separately for each part of the total liability recognised in accordance with paragraph 11. The amount initially recognised for the total liability shall be the same amount as that specified in paragraph 12.**

- 25 The grantor shall account for each part of the liability referred to in paragraph 24 in accordance with paragraphs 15–23. The financial liability part shall be measured first, and the remainder of the total liability allocated to the part related to the grant of the right to the operator (see paragraphs B73 and B74).

## **Other liabilities, commitments, contingent liabilities and contingent assets (paragraphs B75–B78)**

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- 26 The grantor shall account for other liabilities, commitments, contingent liabilities and contingent assets arising from a service concession arrangement in accordance with AASB 9, AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, and any other relevant Standards.

## **Other revenues**

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- 27 The grantor shall account for revenues arising from a service concession arrangement, other than those specified in paragraphs 21–23, in accordance with AASB 15 *Revenue from Contracts with Customers* or AASB 1058 *Income of Not-for-Profit Entities*, as appropriate.

## **Presentation and disclosure (paragraphs B79–B80)**

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- 28 The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of assets, liabilities, revenue and cash flows arising from service concession arrangements. To achieve this, an entity shall consider disclosing qualitative and quantitative information about its service concession arrangements, including the following:

- (a) a description of the arrangements;
- (b) significant terms of the arrangements that may affect the amount, timing and uncertainty of future cash flows (eg the period of the arrangement, re-pricing dates and the basis upon which re-pricing or renegotiation is determined);
- (c) the nature and extent (eg quantity, time period, or amount, as appropriate) of:
  - (i) rights to receive specified services from the operator;
  - (ii) the carrying amount of service concession assets as at the end of the reporting period, including separate disclosure for existing assets of the grantor reclassified as service concession assets during the reporting period;
  - (iii) rights to receive specified assets at the end of an arrangement;
  - (iv) renewal and termination options;
  - (v) other rights and obligations (eg major overhaul of service concession assets); and
  - (vi) obligations to provide the operator with access to service concession assets or other revenue-generating assets; and
- (d) changes in arrangements occurring during the reporting period.

- 29 The disclosures provided by an entity in accordance with paragraph 28 are provided individually for each material service concession arrangement or in aggregate for service concession arrangements involving services of a similar nature, in addition to disclosures required by AASB 116 and AASB 138. Service concession assets of a similar nature may form a subset of a class of assets disclosed in accordance with AASB 116 or AASB 138 or may be included in more than one class of assets disclosed in accordance with AASB 116 or AASB 138. For example, for the purposes of AASB 116, a toll bridge may be included in the same class as other bridges, and for the purposes of paragraph 28 may be included with service concession assets reported in aggregate as toll roads.

## **Commencement of the legislative instrument**

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- 30 [Repealed]



## Appendix A Defined terms (paragraphs B4–B13)

*This appendix is an integral part of the Standard.*

<b>contract</b>	An agreement between two or more parties that creates enforceable rights and obligations.
<b>grantor</b>	The entity that grants the right to access the <b>service concession asset</b> to the <b>operator</b> .
<b>operator</b>	The entity that has a right of access to the <b>service concession asset</b> to provide public services.
<b>service concession arrangement</b>	<p>A <b>contract</b> effective during the reporting period between a <b>grantor</b> and an <b>operator</b> in which:</p> <ul style="list-style-type: none"><li>(a) the <b>operator</b> has the right of access to the <b>service concession asset</b> (or assets) to provide public services on behalf of the <b>grantor</b> for a specified period of time;</li><li>(b) the <b>operator</b> is responsible for at least some of the management of the public services provided through the asset and does not act merely as an agent on behalf of the grantor; and</li><li>(c) the <b>operator</b> is compensated for its services over the period of the <b>service concession arrangement</b>.</li></ul>
<b>service concession asset</b>	<p>An asset (other than goodwill) to which the <b>operator</b> has the right of access to provide public services on behalf of the <b>grantor</b> in a <b>service concession arrangement</b> that:</p> <ul style="list-style-type: none"><li>(a) the <b>operator</b> constructs, develops, upgrades or replaces major components, or acquires from a third party or is an existing asset of the <b>operator</b>; or</li><li>(b) is an existing asset of the <b>grantor</b>, including a previously unrecognised identifiable intangible asset and land under roads, or an upgrade to or replacement of a major component of an existing asset of the <b>grantor</b>.</li></ul>

## Appendix B

### Application guidance

*This appendix is an integral part of the Standard.*

#### Scope (paragraphs 2–4)

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- B1 This Standard is informed by AASB Interpretation 12, which sets out the accounting requirements for the private sector operator in a service concession arrangement. For example, the principles for recognition of a service concession asset are broadly consistent with AASB Interpretation 12. However, because this Standard deals with the accounting by the public sector grantor, this Standard addresses the issues identified in AASB Interpretation 12 from the grantor’s point of view, as follows:
- (a) the grantor recognises a financial liability when it is obliged to make a payment or series of payments to the operator for provision of a service concession asset (ie constructed, developed, acquired or upgraded). Under paragraphs 12, 14 and 20 of AASB Interpretation 12, the operator recognises revenue for the construction, development, acquisition, upgrade and operation services it provides. Under paragraph 16 of AASB Interpretation 12, the operator recognises a financial asset;
  - (b) the grantor recognises a liability when it grants the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset. Under paragraph 17 of AASB Interpretation 12, the operator recognises an intangible asset; and
  - (c) the grantor derecognises an asset it grants to the operator and over which it no longer has control and reduces the liability recognised under paragraph 11 of this Standard. Under paragraph 27 of AASB Interpretation 12, the operator accounts for the asset as part of the transaction price if the asset forms part of the consideration payable by the grantor for the services.
- B2 Paragraph 2 of this Standard specifies that an arrangement within the scope of this Standard involves an operator providing a public service related to a service concession asset on behalf of a grantor. In many jurisdictions, governments have introduced contractual service arrangements to attract private sector participation in the development, financing, operation and maintenance of infrastructure and other assets used to provide public services. The assets may already exist, or may be constructed or upgraded during the period of the service arrangement. An arrangement within the scope of this Standard typically involves an operator constructing the assets used to provide the public services or upgrading the assets (for example, by increasing their capacity) and operating and maintaining the assets for a specified period of time. Such arrangements are often described as build-operate-transfer or rehabilitate-operate-transfer service concession arrangements or public-private partnerships (PPPs).
- B3 Paragraph 3 of the Standard illustrates the types of arrangements that are outside the scope of this Standard, such as arrangements that do not deliver a public service (for example, assets used for commercial purposes), arrangements where the operator does not provide and manage at least some of the public services under its own discretion (for example, outsourcing service agreements where the public sector entity has control of the asset) and arrangements that involve service and management components where the asset is not controlled by the grantor (for example, privatised assets that are subject to price regulation).

#### Definitions (Appendix A)

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##### Public service

- B4 Appendix A defines a service concession arrangement. A feature of a service concession arrangement is the public service nature of the obligation to be undertaken by the operator in a commercial transaction. The public service nature of the services to be provided using the service concession asset is assessed irrespective of the identity of the party that operates the services. A service concession arrangement contractually obliges the operator to provide some, if not all, of the services to the public on behalf of the public sector entity. Other common features of a service concession arrangement within the scope of this Standard are:
- (a) the grantor is a public sector entity;

- (b) the operator is responsible for at least some of the management of the service concession asset and related services and does not merely act as an agent on behalf of the grantor;
- (c) the arrangement sets or limits the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement;
- (d) the operator is obliged to hand over the service concession asset to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it; and
- (e) the arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.

B5 Appendix A defines a service concession asset. Examples of service concession assets include roads (and land under roads), bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, registries and databases, and other tangible or intangible assets that are expected to be used during more than one reporting period in delivering public services.

### **Asset provides public services**

B6 Assessing whether an asset provides public services requires judgement, taking into account the nature and relative significance of each component and the services provided. For example, a courthouse building provides multiple services, such as courts, administrative offices and associated services. However, the primary purpose of the building is to provide court services, which are considered to be public services. The court services are necessary or essential to the general public and are generally expected to be provided by a public sector entity in accordance with government policy or regulation. The court services are accessible to the public, even if it is a subset of the community that uses the services. The services provided by the administrative offices may be unrelated to the court services and therefore considered ancillary if they are insignificant to the arrangement as a whole, and in that case would not affect the assessment that the building provides public services. However, if the unrelated administrative services were significant to the arrangement as a whole, the courthouse building might be assessed as not providing public services.

B7 If an arrangement provides public services principally through a primary asset, and a secondary asset is used or is mainly used to complement the primary asset, such as student accommodation for a public university, the secondary asset would be regarded as providing public services as well. As another example, a hospital car park constructed by an operator as part of the arrangement to construct a hospital that largely provides public services would be considered part of the hospital service concession arrangement. The car park may provide limited ancillary services without affecting the assessment that the car park is used to provide public services. However, if the car park was not constructed as part of the hospital service concession arrangement (eg subsequent to the construction of the hospital or with a different party) and is largely of a commercial nature (eg car parking is available to the general public, including hospital patrons), the car park would be regarded as an asset that does not provide public services, and therefore outside the scope of this Standard.

B8 Where the services provided by an asset are used wholly internally by a public sector entity for the purpose of assisting the public sector entity to deliver public services, but managed by an external party, the arrangement is likely to be an outsourcing arrangement or a lease, rather than a service concession arrangement. For example, the provision of information technology services to a government department providing emergency services to the public is likely to be an outsourcing contract, which may contain a lease of the information technology hardware. The accompanying Implementation Guidance also illustrates common types of arrangements.

B9 For an asset to provide public services, it is not necessary for the public to have physical access to the asset. For example, a military base provides public services (defence activities) even though the public is unlikely to have physical access to the military base.

### **Operator manages at least some of the public services**

B10 For an arrangement to be within the scope of this Standard, the operator must be responsible for providing public services through the service concession asset and for managing at least some of the public services and related services, and not act merely as an agent on behalf of the grantor through an outsourcing arrangement. For example, an operator in an arrangement to construct and operate a hospital in accordance with the grantor's directions would need to provide services more managerial in nature than cleaning, building maintenance and security services for the hospital after its construction in order for the arrangement to be considered a service concession arrangement. Cleaning, building maintenance and security services would generally be regarded as relatively insignificant to the public services provided by

the hospital. Therefore, if the operator is responsible only for constructing the hospital and then providing all or any of those services, the operator is unlikely to be considered to be responsible for some of the management of the public services provided by the hospital. However, if after constructing the hospital the operator also provides scheduling of staff and resources (even if provided by the grantor), the operator is likely to be responsible for some of the management of the hospital public services, and not acting like an agent of the grantor. In contrast, if the maintenance contributes significantly to the public services provided by the asset, then the operator would be responsible for at least some of the management of the public services provided by the asset. For example, this would be the case for an arrangement where an operator constructs and maintains (at its discretion) a toll road on behalf of the grantor, because maintenance services are a significant component of the public services provided by the toll road.

### **Changes in an arrangement**

- B11 A grantor assesses at the commencement of an arrangement whether an asset provides public services and whether the operator is responsible for providing and managing at least some of the public services provided through the asset and does not act merely as an agent on behalf of the grantor. The initial assessment applies for the duration of the service concession arrangement. Where there is a significant modification to the terms and conditions of the arrangement, the arrangement should be reassessed to determine whether the asset still provides public services, and whether the operator is responsible for providing and managing at least some of the public services provided through the asset under its own discretion – and therefore whether the arrangement is still within the scope of this Standard. If service concession accounting is no longer appropriate, the grantor determines whether the service concession asset and liabilities continue to be recognised and accounted for under other Accounting Standards or else derecognised.

### **Contracts**

- B12 Appendix A also defines a contract. The term ‘agreement’ in the definition of a ‘contract’ encompasses an arrangement entered into under the direction of another party (eg when assets are transferred to an entity with a directive that they be deployed to provide specified services).
- B13 Contracts can be written, oral or implied by an entity’s customary practices in performing or conducting its activities. For not-for-profit entities, Appendix F to AASB 15 includes guidance regarding when an agreement creates enforceable rights and obligations.

## **Recognition and initial measurement of service concession assets (paragraphs 5–10)**

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### **Recognition of service concession assets**

- B14 A service concession arrangement typically includes many assets, rather than one asset. References in this Standard to a service concession asset apply to all of the assets encompassed by the arrangement. If a service concession arrangement encompasses a business as defined in AASB 3 *Business Combinations*, the grantor shall recognise the assets (including any identifiable intangible assets) and liabilities of the business when the conditions in paragraph 5 or 6 are satisfied. Goodwill shall not be recognised by the grantor.

### **Control**

- B15 Paragraph 5 of this Standard specifies the conditions under which an asset, other than a whole-of-life asset, is recognised by the grantor. Paragraph 6 of the Standard specifies the condition under which a whole-of-life asset is recognised by the grantor. The assessment of whether a service concession asset should be recognised in accordance with paragraph 5 (or paragraph 6 for a whole-of-life asset) is made on the basis of all of the facts and circumstances of the arrangement.
- B16 The fundamental principle reflected in paragraphs 5 and 6 is determining whether the grantor controls the underlying asset or assets of a service concession arrangement. 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 public goods that all entities can access and benefit from. If the service concession arrangement provides for the grantor to control the price (for example, the contract may set the initial prices to be levied by the operator and regulate price revisions over the period of the service concession arrangement), the services to be provided and to whom the services must be provided, then the grantor controls the service concession asset regardless of whether there is any regulation by a third-party regulator.

- B17 Control should be distinguished from management. If the grantor has both the degree of control described in paragraph 5(a) and any significant residual interest in the asset (as noted in paragraph 5(b)), the operator is only managing the asset on the grantor's behalf – even though, in many cases, it may have wide managerial discretion.
- B18 The control or regulation referred to in paragraph 5(a) could be by contract, or otherwise. If the contract specifies that the grantor controls or regulates the price, the services to be provided and to whom the operator must provide the services, the conditions specified in paragraph 5(a) are met.

## **Regulation**

- B19 If a service concession contract by itself does not result in the grantor having explicit control over the services and/or pricing of the services, the grantor might still have control of the service concession asset as a result of regulation by a third party. Regulation of what services the operator must provide, to whom it must provide them, and at what price, in the manner specified in paragraph 5(a), is a means by which a grantor can demonstrate control of the substantive benefits of the service concession asset. Grantor control of a service concession asset through regulation does not require the contract to refer to the regulation or the grantor to control or be related to the regulator. The third-party regulator might, for example, regulate other entities that operate in the same industry or sector as the grantor. This 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.

### *Regulation of pricing*

- B20 Control or regulation of the pricing of the services is one of the three factors set out in paragraph 5(a) to be considered in determining whether the grantor controls an asset and should recognise it as a service concession asset. For example, a regulated price includes a specified price, which may be zero, that the operator can charge for the services of the asset. The grantor would also have to control the services to be provided and the recipients of the services in order to recognise a service concession asset. This approach is consistent with the fundamental principle in paragraph B16 of an entity controlling an asset if it has the ability to exclude or regulate the access of others to the benefits of the asset. For example, for the purpose of paragraph 5(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 by a third-party regulator (eg by a capping mechanism). Prices are regarded as controlled by the grantor in a regulated environment when a third-party regulator regulates the pricing of the services provided with a service concession asset. The regulation removes the ability of the operator to determine the price and, for the purpose of paragraph 5(a), the pricing of the services is considered to be set implicitly by the grantor as the contract between the grantor and the operator effectively incorporates the price regulation. In some cases, the grantor could have specified an alternative pricing regime but has chosen not to do so, effectively asserting 'passive' control of the pricing. If the contract specifies the grantor controls the services and the recipients of the services, the third-party regulation of the pricing of the services means that the operator does not control the pricing or the other criteria specified in paragraph 5(a), and accordingly the grantor controls the asset. If the operator is able to determine to whom the services are provided, but is subject to grantor control over what services may be provided and the pricing, the grantor does not control the asset. The accompanying Implementation Guidance illustrates common types of arrangements where the grantor or the operator might control the various factors.
- B21 Where a third-party regulator regulates the pricing or the services that the asset must provide (as specified in paragraph 5(a)), it is not essential for the grantor to control or 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 regulated pricing condition specified in paragraph 5(a) even though the relevant regulation is carried out by an independent Commonwealth regulator. Furthermore, 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 applicable to the regulator at the inception of the contract.
- B22 Governments often 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 5(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 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 pricing of the service concession asset is derived from either the contract or the specific regulation applicable to rail services, without considering whether the grantor is related to the regulator of rail services.

- B23 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 contract will need to incorporate the specific regulatory framework that stipulates the services, the users and/or the pricing to be charged for the services in order for the requirements of paragraph 5(a) to be met.
- B24 For a grantor to control any of the factors listed in paragraph 5(a) through third-party regulation, the regulation must be substantive. 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.

### ***Partly regulated asset***

- B25 Sometimes the use of a service concession asset is partly regulated in the manner described in paragraph 5(a) and partly unregulated. These arrangements may take a variety of forms, such as:
- (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 is analysed separately to determine whether the conditions set out in paragraph 5(a) are 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 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 5(a), the existence of ancillary activities does not detract from the grantor's control of the service concession asset.
- B26 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, prices could be regulated by the grantor for services provided at certain times of the day rather than for different classes of users. 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.
- B27 The operator may have a right to use the separable asset described in paragraph B25(a), or the facilities used to provide ancillary unregulated services described in paragraph B25(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 16 *Leases*.

### **Control concept in other Australian Accounting Standards**

- B28 If an asset meets the conditions in paragraph 5 (or paragraph 6), the grantor controls the use of the asset and therefore recognises the asset in accordance with this Standard. An asset that does not meet the control criteria of this Standard is assessed to determine whether it is recognised under another Accounting Standard, such as AASB 16, AASB 116 or AASB 138. The Implementation Guidance accompanying this Standard contains a table that highlights the continuum of typical arrangements and relevant accounting requirements.

### **Long-term leases, outsourcing or privatisation**

- B29 Assessment of whether long-term leasing, outsourcing, service and privatisation arrangements are within the scope of this Standard addresses whether the 'grantor' entity controls the underlying asset(s) of the arrangement in accordance with the control criteria of paragraph 5 (or paragraph 6). For example:
- (a) if the grantor does not retain control of an existing asset under such an arrangement, the grantor considers whether to derecognise the asset as a sale or privatisation; or
  - (b) if the grantor retains control of an existing asset and gives the 'operator' the right to use the asset, or the operator controls an asset and gives the grantor the right to use the asset, the grantor considers whether to recognise a lease in relation to the asset as lessor or lessee respectively. This contrasts with a service concession arrangement, where the grantor provides the operator with the right to access the service concession asset, rather than a right to use the asset.

## Changes in control

- B30 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 changes in the terms of the service concession contract, or changes in third-party regulation of the price and/or services.
- B31 Where there is a change in facts or circumstances that indicate the grantor's control of the asset may have changed, the grantor assesses whether the asset is still within the scope of this Standard or should be reclassified within the scope of another Standard. Where the grantor no longer has control of the asset in accordance with this Standard, the grantor determines whether the asset continues to be recognised and accounted for under other Accounting Standards or else derecognised, except internally generated identifiable intangible assets initially recognised by the grantor under a service concession arrangement continue to be recognised by the grantor while control is retained, rather than derecognised under AASB 138.

## Residual interest

- B32 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 (paragraph 5(b)).
- B33 For the purpose of paragraph 5(b), the grantor's control over any significant residual interest would both restrict the operator's practical ability to sell or pledge the asset (by acknowledging the grantor's residual interest in the asset) and effectively give the grantor control of the asset throughout the period of the service concession arrangement. Consequently, where the grantor has substantive, rather than merely protective, rights to prevent the operator selling or pledging the asset during the service concession arrangement (eg the grantor must formally approve the transferee, rather than being able to refuse merely on the grounds that the transferee is not fit and proper), then the grantor is likely to have control of any significant residual interest in the asset.
- B34 The residual interest in the asset is the estimated fair value (current replacement cost) 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 service concession arrangement.
- B35 Paragraph 5 identifies whether the asset, including any replacements required, is controlled by the grantor for the whole of its economic life, beyond the term of the service concession arrangement. 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 5(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. However, replacements of major components are treated as a separate service concession asset (see paragraphs B38 and B48).

## Whole-of-life assets

- B36 For the purpose of paragraph 6, a whole-of-life asset is an asset that will be used in a service concession arrangement for either its entire economic life or the major part of its economic life. In both cases, there is no significant residual interest in the asset at the end of the arrangement, so that the condition in paragraph 5(b) is not relevant.

## Existing assets of the grantor

- B37 The arrangement may involve an existing asset (tangible or intangible) of the grantor:
- (a) to which the grantor gives the operator access for the purpose of the service concession arrangement; or
  - (b) to which the grantor gives the operator access for the purpose of the operator generating revenues as compensation for the service concession asset.
- B38 Existing assets of the grantor used in the service concession arrangement shall be classified under this Standard (paragraph 8) as service concession assets. This includes identifiable intangible assets and land under roads of the grantor that have not been recognised previously by the grantor. The grantor shall recognise the upgrade of an existing asset of the grantor (eg an increase in capacity) or the replacement of a major component of an asset as a service concession asset in accordance with paragraph 5 (or paragraph 6 for a whole-of-life asset). The grantor also recognises a corresponding liability, when the upgrade or replacement occurs.

### *Intangible assets and land under roads*

- B39 In applying paragraphs 8–10 and B38 to an identifiable intangible asset or land under roads that has not been recognised previously by the grantor, the grantor shall:
- (a) initially recognise the asset as a service concession asset, measured at current replacement cost in accordance with the cost approach to fair value in AASB 13. In accordance with paragraphs 8 and 11, the grantor shall account for the recognition of the asset at fair value (current replacement cost) as if it is a revaluation of the asset (ie as a revaluation surplus) and shall recognise a liability only to the extent of additional consideration provided by the operator;
  - (b) after initial recognition of the asset and while controlled by the grantor, account for the asset in accordance with AASB 116 or AASB 138, as appropriate, subject to paragraph 9, as follows:
    - (i) depreciate or amortise the depreciable amount of the asset over its useful life; and
    - (ii) if applying the revaluation model to the asset, current replacement cost continues to be used as the basis for fair value measurement without applying, in the case of an intangible asset, the active market requirements in AASB 138; and
  - (c) after the end of the service concession arrangement, account for the asset in accordance with other Accounting Standards. This requires the grantor to reclassify the asset, continue to recognise the intangible asset while controlled by the grantor, and account for depreciation or amortisation over its useful life and revaluation in accordance with the other Standards and derecognise the asset in accordance with AASB 116 or AASB 138 only when control is lost. For example, this means that an internally generated intangible asset is not derecognised under AASB 138 until control is lost, even if the asset would not have satisfied the initial recognition criteria in AASB 138.

### **Impairment and loss of control**

- B40 In applying the impairment tests to service concession assets accounted for under the cost model in AASB 116 or AASB 138, as appropriate, the grantor does not necessarily consider the granting of the service concession to the operator as a circumstance that causes impairment, unless there has been a change in use of the asset that affects its future economic benefits or service potential. The grantor shall refer to AASB 136 to determine whether any of the indicators of impairment have been triggered under such circumstances. AASB 136 does not apply to primarily non-cash-generating specialised assets of not-for-profit entities that are regularly revalued to fair value (current replacement cost) under the revaluation model in AASB 116 or AASB 138.
- B41 Subject to paragraph B39(c), if the asset no longer meets the conditions for recognition in paragraph 5 (or paragraph 6 for a whole-of-life asset), the grantor shall follow the principles in AASB 116 or AASB 138, as appropriate. For example, if control of the asset is transferred to the operator on a permanent basis, it shall be derecognised. Alternatively, the grantor may be required to derecognise the asset when it or a third-party regulator no longer regulates the pricing, but rather allows the operator to freely set prices for the services provided through the service concession asset.
- B42 If control of the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognised. In such cases, the grantor shall also consider whether the arrangement is a lease transaction or a sale and leaseback transaction that should be accounted for in accordance with AASB 16.

### **Existing assets of the operator**

- B43 The operator may provide an asset for use in the service concession arrangement that it has not constructed, developed, or acquired for the purpose of the arrangement. If the arrangement involves an existing asset of the operator that the operator uses for the purpose of the service concession arrangement, the grantor shall determine whether the asset meets the conditions in paragraph 5 (or paragraph 6 for a whole-of-life asset). If the conditions for recognition are met, the grantor shall recognise the asset as a service concession asset and account for it in accordance with this Standard.

### **Constructed or developed assets**

- B44 When a constructed or developed asset meets the conditions in paragraph 5 (or paragraph 6 for a whole-of-life asset), the grantor shall recognise and measure the asset in accordance with this Standard. This recognition also depends on the asset meeting the recognition criteria in AASB 116 or AASB 138:



- (a) AASB 116 requires that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:
  - (i) it is probable that future economic benefits associated with the asset will flow to the entity; and
  - (ii) the cost of the item can be measured reliably;
- (b) AASB 138 requires that an intangible asset shall be recognised if, and only if:
  - (i) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
  - (ii) the cost of the asset can be measured reliably.

B45 Those criteria, together with the terms and conditions of the contract, need to be considered by the grantor in determining whether to recognise the service concession asset during the period in which the asset is constructed or developed. For property, plant and equipment and intangible assets, if the recognition criteria are met during the construction or development period, the grantor recognises the service concession asset to the appropriate extent during that period.

B46 The first recognition criterion requires the flow of economic benefits to the grantor. According to the *Framework for the Preparation and Presentation of Financial Statements*, as identified in AASB 1048 *Interpretation of Standards*, for not-for-profit entities, future economic benefits are synonymous with the notion of service potential. From the grantor's point of view, the primary purpose of a service concession asset is to provide service potential on behalf of the public sector grantor. Similar to an asset the grantor constructs or develops for its own use, the grantor would assess, at the time the costs of construction or development are incurred, the terms of the contract to determine whether, in addition to retaining control of the land on which the service concession asset is being developed, economic benefits embodied in the service concession asset are controlled by the grantor at that time.

B47 The second recognition criterion requires that the cost of the asset can be measured reliably. Accordingly, to meet the recognition criteria in AASB 116 or AASB 138, as appropriate, the grantor must have reliable information about the cost of the asset during its construction or development. For example, if the service concession arrangement requires the operator to provide the grantor with progress reports during the asset's construction or development, the costs incurred may be measurable, and would therefore meet the recognition criteria in AASB 116 for constructed assets or in AASB 138 for developed intangible assets. Also, where the grantor has little ability to avoid accepting an asset constructed or developed to meet the specifications of the service concession arrangement, the costs shall be recognised as progress is made towards completion of the asset. Thus, the grantor shall recognise a service concession asset and an associated liability.

### **Upgrades or replacement of major components**

B48 The grantor shall recognise an upgrade, or the replacement of a major component, of (1) an existing asset of the grantor, or (2) an asset constructed, developed, acquired or otherwise provided by the operator, as a separate service concession asset in accordance with paragraph 5 (or paragraph 6 for a whole-of-life asset). The grantor shall also recognise the related liability in accordance with paragraph 11 when the upgrade or replacement occurs.

### **Measurement of service concession assets**

B49 Paragraph 7 requires service concession assets recognised in accordance with paragraph 5 (or paragraph 6 for a whole-of-life asset) to be measured initially at current replacement cost. This is in accordance with the cost approach to fair value in AASB 13. In particular, the cost approach is used to determine the cost of a constructed or developed service concession asset or the cost of any upgrades to existing assets, on initial recognition. The requirement to measure the asset at current replacement cost also applies to existing assets, both tangible and intangible, of the grantor that are reclassified as service concession assets, in accordance with paragraph 8 of this Standard. The use of fair value (current replacement cost) on initial recognition or reclassification of a service concession asset does not constitute a revaluation under AASB 116 or AASB 138. Therefore, future revaluations of the asset are not required unless the entity adopts the revaluation model under the relevant Standard.

## **Types of compensation**

- B50 Service concession arrangements are rarely, if ever, the same: technical requirements vary by sector and by jurisdiction. Furthermore, the terms of the arrangement may also depend on the specific features of the overall legal framework, including contract law, of the particular jurisdiction.
- B51 Depending on the terms of the service concession arrangement, the grantor may compensate the operator for the service concession asset and service provision by any combination of the following:
- (a) making payments (eg cash) to the operator; and
  - (b) compensating the operator by other means, such as:
    - (i) granting the operator the right to earn revenue from third-party users of the service concession asset; or
    - (ii) granting the operator access to another revenue-generating asset for its use.
- B52 When the grantor compensates the operator for the service concession asset by making payments to the operator, the asset and service components of the payments may be separately identifiable (eg the contract specifies the amount of the predetermined payment or series of payments to be allocated to the service concession asset). The asset and service components of the service concession arrangement are accounted for separately, in accordance with paragraph 20.

### ***Separately identifiable payments***

- B53 A service concession arrangement may have separately identifiable asset and service components of the payments in a variety of circumstances, including, but not limited to, the following:
- (a) part of a payment stream that varies according to the availability of the service concession asset itself and another part that varies according to usage or performance of certain services can be identified;
  - (b) different components of the service concession arrangement run for different periods or can be terminated separately. For example, an individual service component can be terminated without affecting the continuation of the rest of the arrangement; or
  - (c) different components of the service concession arrangement can be renegotiated separately. For example, the upgrade or replacement of major components of a service concession asset are addressed separately, or a service component is market tested and some or all of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified.

### ***Payments not separately identifiable***

- B54 For the purpose of applying the requirements of this Standard, payments and other consideration required by the arrangement are allocated at the inception of the arrangement or upon a reassessment of the arrangement into those for the service concession asset and those for other components of the service concession arrangement (eg maintenance and operation services) on the basis of their relative fair values. The fair value (current replacement cost) of the service concession asset represents amounts related to the asset and excludes other components of the service concession arrangement. In some cases, identifying payments for the asset and payments for other components of the service concession arrangement will require the grantor to use an estimation technique. For example, a grantor may estimate the payments related to the asset by reference to the fair value of a comparable asset in an agreement that contains no other components, or by estimating the payments for the other components in the service concession arrangement by reference to comparable arrangements and then deducting these payments from the total payments under the arrangement.

### ***Operator receives other forms of compensation***

- B55 The types of compensation transactions referred to in paragraph 14(b) are non-monetary exchange transactions. Paragraph 24 of AASB 116 and paragraph 45 of AASB 138, as appropriate, provide guidance on these circumstances.
- B56 When the operator is granted the right to earn revenue from third-party users of the service concession asset, or from another revenue-generating asset, or receives non-cash compensation from the grantor, the grantor does not incur a cost directly for acquiring the service concession asset. These forms of consideration to the operator may be intended to compensate the operator both for the cost of the service concession asset and

for operating it during the term of the service concession arrangement. The grantor therefore needs to initially measure the asset component in a manner consistent with paragraph 7.

## **Fair value measurement**

- B57 A service concession asset is an asset that is obtained through construction, development, upgrade, major component replacement or acquisition, an existing asset or upgrade or major component replacement of an existing asset, to provide public services in a service concession arrangement. The capacity or service potential of the asset is used to achieve public service objectives irrespective of whether the cost of the asset will be recovered by the expected cash flows that the asset may generate. The asset is initially measured at fair value, which is the current replacement cost under the cost approach. The current replacement cost reflects the amount that would be required at the time to replace the service capacity of an asset. The asset is measured at current replacement cost whether the related liability is measured under the financial liability model, the grant of the right to the operator model, or both.

## **Subsequent measurement**

- B58 For consistency with the approach to the initial measurement of service concession assets recognised in accordance with this Standard, references to fair value in other Standards shall be read as references to current replacement cost for service concession assets, during the term of the service concession arrangement. If the grantor retains control of the asset after the end of the service concession arrangement, any fair value measurement of the asset is no longer restricted to the cost approach in AASB 13.
- B59 After initial recognition, a grantor applies AASB 116 or AASB 138 to the subsequent measurement and derecognition of a service concession asset and to subsequent costs incurred. For the purposes of applying AASB 116 or AASB 138, service concession assets of a similar nature may form a subset of a class, or classes, of assets. Subsequent costs include lifecycle costs incurred to maintain the asset during the operating and maintenance phase of the service concession arrangement. However, upgrades or replacements of major components of service concession assets would be recognised as service concession assets in accordance with paragraph B48. AASB 136 is also applied in considering whether there is any indication that a service concession asset is impaired. The reference to fair value in AASB 136 for such assets refers to the current replacement cost of the asset.

## **Recognition and measurement of liabilities (paragraphs 11–25)**

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- B60 The grantor recognises a liability in accordance with paragraph 11 when a service concession asset is recognised in accordance with paragraph 5 (or paragraph 6 for a whole-of-life asset). The nature of the liability recognised in accordance with paragraph 11 differs in the circumstances described in paragraphs B51(a) and B51(b) according to their substance. However, in each case, the liability recognised in accordance with paragraph 11 shall be initially measured at the same amount as the service concession asset, being the fair value (current replacement cost) of the asset in accordance with AASB 13.
- B61 The grantor also recognises a liability in accordance with paragraph 11 when an existing asset of the grantor is reclassified as a service concession asset and the operator provides additional consideration to the grantor. The grantor first recognises the reclassification of its existing asset as a service concession asset in accordance with paragraph 8, treating any difference between the carrying amount of the asset and its fair value (current replacement cost) as if it is a revaluation of the asset. The second step for the grantor is to recognise the additional consideration provided by the operator (cash or other assets), and a financial liability or a liability under the grant of a right to the operator model or both, depending on the nature of the service concession arrangement.
- B62 Payments made by an operator to a grantor that are separate from the service concession arrangement are accounted for based on the nature of the payments. If the payments are:
- (a) for a right to goods or services, the grantor accounts for the payments as other revenues in accordance with AASB 15 or AASB 1058, as appropriate; or
  - (b) for the right to use an asset, the grantor assesses whether the arrangement contains a lease. If the arrangement contains a lease, the grantor accounts for the payments in accordance with AASB 16 (paragraph B29(b)).

## Financial liability model

- B63 When the grantor has a contractual obligation to make a predetermined series of payments to the operator, the liability is a financial liability as defined in AASB 9. The grantor has a contractual obligation if it has little, if any, discretion to avoid the obligation, which is usually the case because a contract with an operator normally is enforceable by law. For example, when an arrangement involves the grantor making payments to the operator for third-party usage of the service concession asset, the grantor accounts for the liability in the arrangement as a financial liability, regardless of whether the grantor has contractually agreed to provide a minimum guaranteed amount to the operator.

### Initial measurement

- B64 When the grantor provides compensation to the operator for the cost of the service concession asset and service provision in the form of a predetermined payment or series of payments, an amount reflecting the fair value (current replacement cost) of the service concession asset is recognised as a liability in accordance with paragraph 11. The grantor shall use the contractually specified interest rate in the arrangement to initially measure the financial liability component of a hybrid arrangement in accordance with AASB 9. If it is not practicable to determine the contractually specified interest rate, the grantor shall determine an appropriate rate using the prevailing market rate(s) of interest for a similar instrument with a similar credit rating. Examples of rates for a similar instrument include the operator's cost of capital specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement.

### Subsequent measurement

- B65 After initial recognition, the grantor applies AASB 9 to the subsequent measurement of a financial liability. For example, when the financial liability is measured at amortised cost and there is a difference between the expected payments and the actual payments by the grantor to the operator based on third-party usage of the service concession asset, the amortised cost is recalculated based on revised estimated cash flows discounted at the original effective interest rate. The adjustment is recognised in profit or loss as income or expense.
- B66 When the grantor makes any payments to the operator in advance of the service concession asset being recognised, the grantor accounts for those payments as prepayments.
- B67 When the financial liability is subsequently measured at amortised cost in accordance with AASB 9, the finance charge is determined based on the effective interest method. When the financial liability is subsequently measured at fair value through profit or loss, AASB 9 requires the fair value movements in the financial liability to be recognised as a gain or loss in profit or loss.
- B68 The finance charge (if any) related to the liability in a service concession arrangement is presented consistently with other finance charges in accordance with AASB 101 *Presentation of Financial Statements*, AASB 123 *Borrowing Costs* and AASB 7 *Financial Instruments: Disclosures*.
- B69 The financial liability does not include the grantor's payments to the operator for service components identified in paragraph 18. The service component of payments is normally recognised as expenses (and as liabilities prior to payment) as the services are provided.

## Grant of a right to the operator model

- B70 Under the grant of a right to the operator model, the grantor compensates the operator for the service concession asset and service provision by granting the operator the right to earn revenue from third-party users of the service concession asset.
- B71 Revenue is not recognised immediately by the grantor at the inception of the service concession arrangement. Instead, a liability is recognised (as noted in paragraph 21) and subsequently reduced as revenue is recognised in accordance with paragraph 22 based on the economic substance of the service concession arrangement. Revenue is usually recognised as access to the service concession asset is provided to the operator over the term of the service concession arrangement. Paragraph B51 states that the grantor may compensate the operator by a combination of payments and granting a right to earn revenue directly from third-party users. In cases where the operator's right to earn third-party revenues significantly reduces or eliminates the grantor's predetermined series of payments to the operator, the liability related to the grant of the right to the operator usually would still be reduced (and revenue recognised) over the term of the arrangement as access is provided to the operator.

- B72 When the grantor compensates the operator for the service concession asset and services by the provision of a revenue-generating asset, other than the service concession asset, the liability related to the grant of the right to the operator is reduced and revenue relating to the remaining liability is recognised in a manner similar to that described in the previous paragraph. In such cases, the grantor also considers the derecognition requirements in AASB 116 or AASB 138, as appropriate. If the grantor derecognises the revenue-generating asset, the grantor recognises a gain or loss for the difference between the carrying amount of the asset and its fair value (current replacement cost), and reduces the service concession liability accordingly.

### **Dividing the arrangement**

- B73 If the operator is compensated for the service concession asset partly by a predetermined payment or series of payments and partly by receiving the right to earn revenue from third-party use of either the service concession asset or another revenue-generating asset, it is necessary to account separately for each portion of the total liability related to the grantor's consideration. In these circumstances, the consideration to the operator is divided into a financial liability portion for the payments and a liability portion for the right granted to the operator to earn revenue from third-party use of the service concession asset or another revenue-generating asset.
- B74 Arrangements described in paragraph B73 are commonly referred to as hybrid arrangements. Consistent with paragraph 12, the total liability recognised for a hybrid arrangement is initially measured at the same amount as the fair value (current replacement cost) of the service concession asset. The financial liability portion of the liability under the hybrid arrangement is measured first, with the remainder of the fair value (current replacement cost) of the service concession asset allocated to the portion of the liability relating to the grant of the right to the operator model. The financial liability portion is measured initially in accordance with paragraph B64.

### **Other liabilities, commitments, contingent liabilities and contingent assets (paragraph 26)**

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- B75 Service concession arrangements may include various forms of financial guarantees (eg a guarantee, security, or indemnity related to the debt incurred by the operator to finance construction, development, acquisition or upgrade of a service concession asset) or performance guarantees (eg a guarantee of minimum revenue streams, including compensation for shortfalls).
- B76 The grantor determines whether guarantees provided by the grantor as part of a service concession arrangement meet the definition of a financial guarantee contract. If so, the grantor applies AASB 7, AASB 9 and AASB 132 in accounting for the financial guarantee. Where the financial guarantee is regarded as an insurance contract, the grantor can elect to apply AASB 4 *Insurance Contracts* or AASB 1023 *General Insurance Contracts* instead if it has previously used accounting applicable to insurance contracts for such guarantees.
- B77 Guarantees and commitments that do not meet the requirements in AASB 9 and AASB 132 relating to financial guarantee contracts and are not accounted for as insurance contracts are accounted for in accordance with AASB 137.
- B78 Contingent assets or liabilities may arise from disputes over the terms of the service concession arrangement. Such contingencies are accounted for in accordance with AASB 137.

### **Presentation and disclosure (paragraphs 28–29)**

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- B79 Disclosures relating to various aspects of service concession arrangements may be addressed in other Standards. This Standard addresses only the additional disclosures relating to service concession arrangements. Where the accounting for a particular aspect of a service concession arrangement is addressed in another Standard, the grantor follows the relevant disclosure requirements of that Standard in addition to those set out in paragraphs 28 and 29. The grantor also applies the relevant presentation and disclosure requirements in other Standards as they pertain to assets, liabilities, revenues, and expenses recognised under this Standard.
- B80 AASB 101 requires finance costs (if any) to be presented separately in the statement of profit and loss and other comprehensive income. Finance charges (if any) determined in accordance with paragraph B67 that are expensed are included in this item.

## Appendix C

### Effective date and transition

*This appendix is an integral part of the Standard.*

#### Effective date

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- C1 An entity shall apply this Standard for annual reporting periods beginning on or after 1 January 2020. Earlier application is permitted for periods beginning before 1 January 2020. If an entity applies this Standard for an earlier period, it shall disclose that fact.

#### Transition

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- C2 For the purposes of the transition requirements, the date of initial application is the beginning of the earliest reporting period for which comparative information is presented in the financial statements.
- C3 A grantor shall apply this Standard either:
- (a) retrospectively to each prior period presented in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*; or
  - (b) retrospectively by recognising and measuring service concession assets and related liabilities at the date of initial application.
- C4 If a grantor elects to apply this Standard retrospectively in accordance with paragraph C3(b), the grantor shall:
- (a) measure the deemed cost of a service concession asset (including an existing asset of the grantor reclassified as a service concession asset) at fair value (current replacement cost) at the date of initial application;
  - (b) measure a financial liability arising under a service concession arrangement at fair value at the date of initial application;
  - (c) measure a liability representing the unearned portion of any revenue arising from the receipt of a service concession asset under the grant of a right to the operator model at the fair value (current replacement cost) of the related service concession asset at the date of initial application, adjusted by:
    - (i) deducting the carrying amount of any consideration transferred by the grantor to the operator recognised as an asset;
    - (ii) adjusting the resulting amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement; and then
    - (iii) deducting any related financial liabilities measured in accordance with paragraph (b);
  - (d) measure a liability representing the unearned portion of any revenue arising from the receipt of additional consideration from the operator for access to an existing asset of the grantor that has been reclassified as a service concession asset at the proceeds received, adjusted to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement;
  - (e) recognise any net adjustments to the amounts of assets and liabilities as an adjustment to the opening balance of accumulated surplus (deficiency) at the date of initial application; and
  - (f) disclose that it has applied this transition approach and information relating to the measurement of the assets and liabilities in support of the disclosure objective in paragraph 28.
- C5 Retrospective application of this Standard in accordance with either paragraph C3(a) or C3(b) may require the derecognition or adjustment of any service concession assets and liabilities recognised under previous accounting policies or the initial recognition of service concession assets and liabilities. Any net adjustment on initial application of this Standard is recognised as an adjustment to the opening balance of accumulated surplus (deficiency). If the grantor applies the revaluation model in AASB 116 or AASB 138 as its accounting policy, the net adjustment is included in accumulated surplus (deficiency) and not revaluation surplus.

- C6 The initial measurement of service concession assets at fair value (current replacement cost) does not mean that the assets are measured under the revaluation model. Subsequent revaluations are not required unless the grantor applies the revaluation model as its accounting policy.
- C7 If a grantor applies this Standard retrospectively in accordance with paragraph C3(b), the measurement of liabilities arising under the financial liability model at the date of initial application is addressed in paragraph C4(b). Paragraph C4(c) addresses liability measurement under both the grant of a right to the operator model and hybrid arrangements, as it requires the measurement of the liability relating to the grant of a right to the operator to exclude any related financial liabilities.

### **References to superseded Standards**

- C8 If an entity applies this Standard but does not yet apply AASB 9, any reference in this Standard to AASB 9 shall be read as a reference to AASB 139 *Financial Instruments: Recognition and Measurement*.
- C9 If an entity applies this Standard but does not yet apply AASB 15 or AASB 1058, any reference in this Standard to those Standards shall be read as a reference to AASB 118 *Revenue* or AASB 1004 *Contributions*, as appropriate.
- C10 If an entity applies this Standard but does not yet apply AASB 16, any reference in this Standard to AASB 16 shall be read as a reference to AASB 117 *Leases*.

## **Appendix D**

### **Amendments to other Standards**

*This appendix sets out the amendments to other Australian Accounting Standards that are a consequence of the AASB issuing this Standard.*

[Deleted by the AASB – the amendments have been incorporated into the text of the relevant pronouncements.]



## **Appendix E**

### **Australian simplified disclosures for Tier 2 entities**

*This appendix is an integral part of the Standard.*

**AusE1** Paragraphs 28, 29, B79 and B80 do not apply to entities preparing general purpose financial statements that apply AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*.

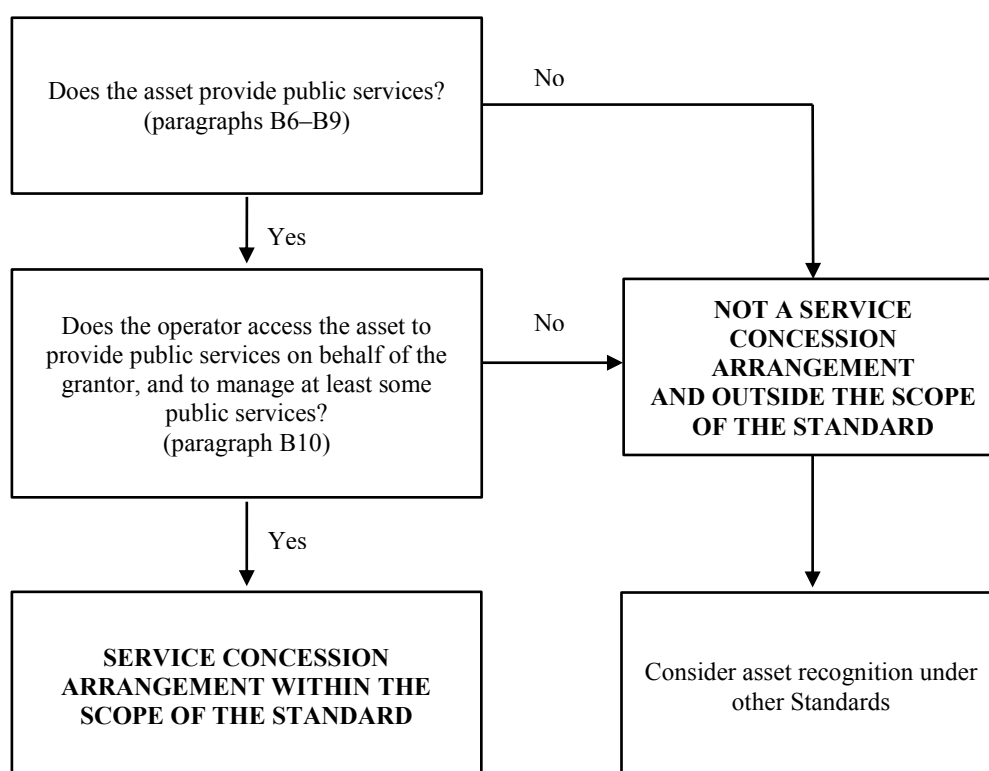
## Implementation guidance

*This implementation guidance accompanies, but is not part of, AASB 1059.*

IG1 The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of AASB 1059. Except in respect of arrangements that are concluded to be service concession arrangements, the implementation guidance identifies the parties to an arrangement as the grantor and the operator for convenience, without reference to the definitions in Appendix A.

## Accounting framework for service concession arrangements

IG2 The diagram below summarises some of the key decisions in determining whether an arrangement is a service concession arrangement within the scope of AASB 1059. It does not address the period of time or operator compensation requirements of the definition of a service concession arrangement.



## Guidance examples

IG3 The guidance examples below illustrate the key decisions outlined in the diagram in paragraph IG2 for assessing whether an arrangement is a service concession arrangement – and therefore within the scope of AASB 1059, assuming that the period of time and operator compensation requirements are met – in the following circumstances:

- (a) the operator provides limited services for the asset; and
- (b) the operator has management responsibilities for some services.

### Example 1: Limited operator services

IG4 In this example, the relevant terms of the arrangement for assessing whether it is within the scope of AASB 1059 are:

- (a) a grantor enters into an arrangement that involves the operator constructing a school;

- (b) the school provides public services as the basic purpose of the school is to provide education services that are necessary or essential to the general public. The education services provided by the school are accessible to the public, even if it is a subset of the community that uses the services. The assessment of the public service nature of the school is consistent with paragraph B6;
- (c) the grantor is responsible for the services relating to the delivery of education and operational services such as the recruitment of teachers and administration staff, and the maintenance of the school facilities; and
- (d) the operator is responsible for cleaning and security services for the school.

IG5 Based on these facts and circumstances, the grantor concludes the operator does not access the school to provide public services as its provision of cleaning and security services does not constitute management of at least some of the public services provided by the school (refer paragraph B10). Accordingly, the arrangement is not a service concession arrangement and is outside the scope of AASB 1059 (paragraph 2). The cleaning and security services represent an outsourced service to the grantor to enable it to provide the public services through the school.

### **Example 2(a): Facility maintenance at discretion of operator**

IG6 In this example, the facts in Example 1 apply, except that the operator is also responsible for maintenance of the school facilities by maintaining the school to a specified condition. The operator has discretion as to when and how it conducts maintenance of the school facilities.

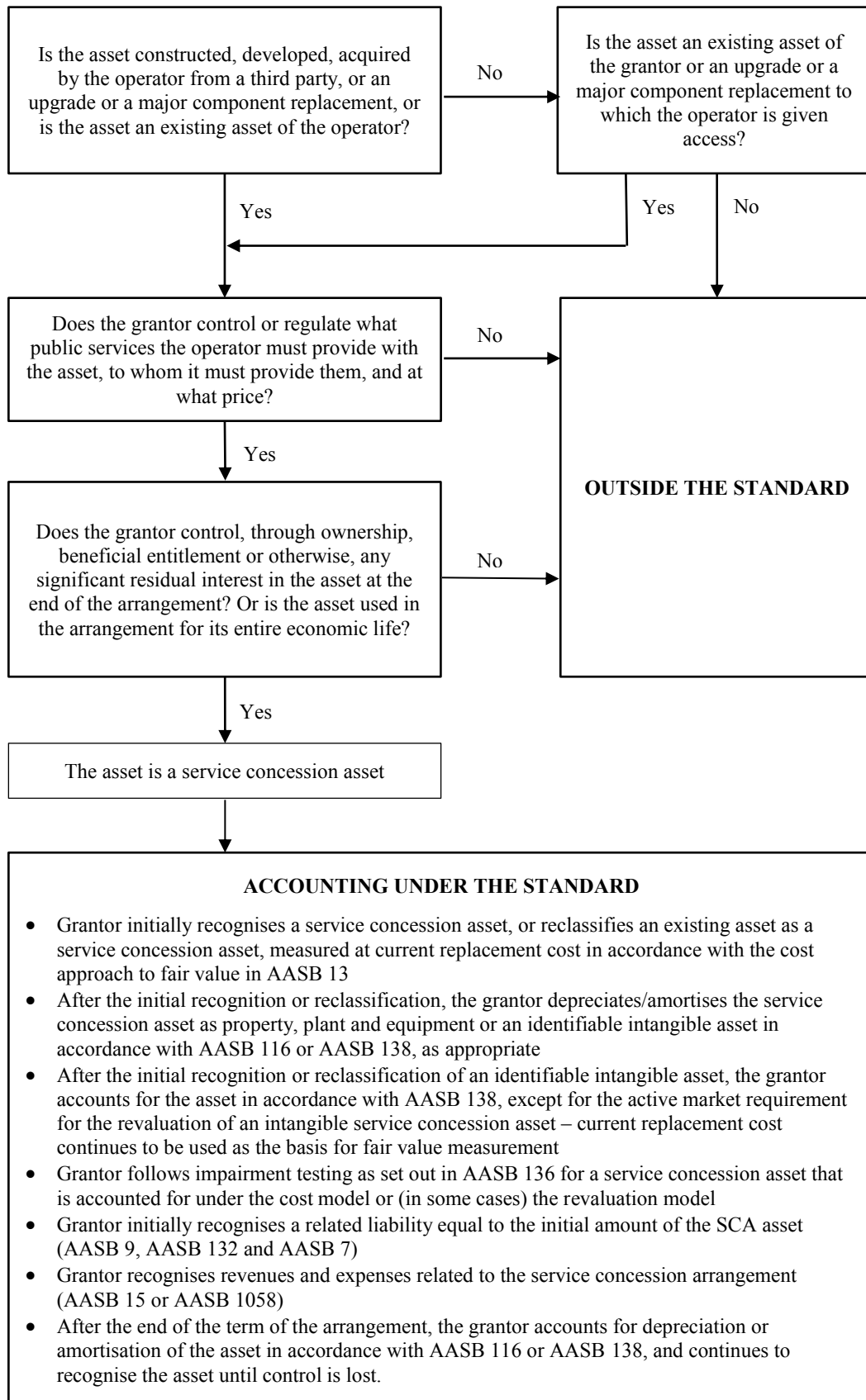
IG7 Based on the facts and circumstances, whilst the operator provides maintenance of the school facilities, facility maintenance does not represent a significant component of the public services provided by the school. Therefore, the operator's responsibility for maintenance does not involve the operator in managing the school services (refer paragraph B10). Accordingly, the arrangement is not a service concession arrangement and is outside the scope of AASB 1059 (paragraph 2). The maintenance services represent an outsourced service to the grantor to enable it to provide the public services through the school.

### **Example 2(b): Operator has management responsibilities**

IG8 In this example, the facts in Example 1 apply, except that the operator is also responsible for certain operational services, in determining how many staff are required and organising classes, teachers and administrative staff, and for maintenance of the school facilities by providing upgrades and maintaining the school to a specified condition. The operator has discretion as to when and how it carries out these responsibilities.

IG9 Based on these facts and circumstances, the grantor concludes the operator accesses the school to provide public services and is responsible for at least some of the management of the school services. The operator fulfils this management responsibility through its significant operational and maintenance responsibilities, even though the staff are provided by the grantor (refer paragraph B10). Accordingly, the arrangement is a service concession arrangement within the scope of AASB 1059.

IG10 The diagram below summarises the recognition and measurement requirements for assets (other than goodwill) and service concession arrangements subject to AASB 1059.



## References to Australian Accounting Standards that apply to typical types of arrangements involving an asset combined with provision of a service

IG11 The table below 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.

IG12 The shaded text shows arrangements within the scope of AASB 1059.

Category	Lease	Service provision			Sale	
Typical arrangement types	Lease (e.g. operator leases asset from grantor)	Service outsourcing contract (specific tasks eg debt collection)	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)	
Significant residual interest	Grantor			Operator		
Relevant Accounting Standards	AASB 16	AASB 101	This Standard/ AASB 116/ AASB 138		AASB 116/ AASB 138 (derecognition)	

IG13 The table below compares the key features of various common types of arrangements for private sector participation in the provision of public services. This table presents simple arrangements, however the classification of an arrangement as a construction contract with a service outsourcing contract, lease, service concession arrangement, or sale or privatisation will depend on the specific terms and conditions of the arrangement.

Features	Construction contract with service outsourcing contract <sup>1</sup>	Lease <sup>2</sup> (grantor is lessor)	Service concession arrangement <sup>3</sup>	Sale/Privatisation <sup>4</sup>
<b>Determining whether arrangement is within the scope of AASB 1059 (paragraphs 2, IG2)</b>	<i>Conclusion</i> (based on analysis below) – <b>Outside</b> the scope of AASB 1059 and grantor controls the asset.	<i>Conclusion</i> (based on analysis below) – <b>Depending</b> on terms of arrangement, can be outside or within the scope of AASB 1059.	<i>Conclusion</i> (based on analysis below) – <b>Within</b> the scope of AASB 1059 and grantor controls the asset.	<i>Conclusion</i> (based on analysis below) – <b>Outside</b> the scope of AASB 1059 and grantor does not control the asset.
Operator provides public services related to the asset on behalf of the grantor and is responsible for the management of at least some of the public services (paragraph B10)?	Operator provides construction services. Operator acts as an agent in providing public services and related services as <b>predetermined by the grantor</b>	Operator involvement in the management of the public services and related services <b>varies</b> , depending on the lease terms (ie operator may have <b>full involvement or be limited</b> to facility management that is not a significant component of the public services provided by the asset).	Operator involved in management of public services provided by the asset that is <b>not predetermined by grantor</b> (ie operator has discretion as to how the public services are provided and managed).	Operator <b>does not</b> provide public services <b>on behalf of the grantor</b> , despite any protective rights of the grantor.

Features	Construction contract with service outsourcing contract <sup>1</sup>	Lease <sup>2</sup> (grantor is lessor)	Service concession arrangement <sup>3</sup>	Sale/Privatisation <sup>4</sup>
<b>Determining whether grantor controls the asset for recognition as service concession asset (paragraph 5(a))</b>	<b>Grantor</b> controls or regulates all three aspects.	<b>Operator</b> typically controls all three aspects in a lease, but <b>grantor might</b> control or regulate some.	<b>Grantor</b> controls or regulates all three aspects.	<b>Grantor might</b> control or regulate any of these aspects (especially pricing) but not all three aspects.
Grantor controls or regulates <u>services</u> provided by operator with the asset?	<b>Grantor</b> controls or regulates services.	<b>Operator</b> typically controls services.	<b>Grantor</b> controls or regulates services.	<b>Operator</b> typically controls services.
Grantor controls or regulates <u>recipients</u> of services?	<b>Grantor</b> controls recipients of services.	<b>Operator</b> typically controls recipients of services.	<b>Grantor</b> controls recipients of services.	<b>Operator</b> typically controls recipients of services.
Grantor controls or regulates <u>pricing</u> of services?	<b>Grantor</b> controls pricing of services.	<b>Operator</b> typically controls pricing of services.	<b>Grantor</b> controls pricing of services.	<b>Operator</b> might not control pricing of services.
Grantor controls <u>underlying use</u> of the asset?	<b>Grantor</b> controls the asset and the right to use the asset.	<b>Operating lease:</b> <u>Grantor</u> (lessor) retains control of the asset and operator (lessee) has right-of-use asset. <b>Finance lease:</b> Grantor (lessor) relinquishes control of asset to <u>operator</u> (lessee): <ul style="list-style-type: none"> <li>• lessor derecognises asset and recognises receivable</li> <li>• lessee recognises right-of-use asset.</li> </ul>	<b>Grantor</b> retains control of asset and the right to use the asset. <b>Operator</b> only has a right to access the asset.	<b>Operator</b> controls the asset and the right to use the asset.
<b>Determining whether grantor controls any significant residual interest in the asset at the end of the arrangement (paragraph 5(b))</b>	<b>Grantor</b> controls any significant residual interest at end of arrangement.	<b>Depending</b> on terms of arrangement, grantor or operator might control residual interest in the asset.	<b>Grantor</b> controls any significant residual interest at end of arrangement.	<b>Depending</b> on terms of arrangement, grantor or operator might control residual interest in the asset.
Grantor controls any <u>significant residual interest</u> at end of arrangement?	<b>Grantor</b> controls any significant residual interest at end of arrangement.	<b>Operating lease:</b> <u>Grantor</u> (lessor) controls significant residual interest. <b>Finance lease:</b> <u>No significant residual interest</u> expected.	<b>Grantor</b> controls any significant residual interest at end of arrangement.	<b>Sale:</b> <u>No significant residual interest</u> expected. <b>Privatisation:</b> Grantor may control any significant residual interest.
Grantor's interest <u>restricts operator's practical ability</u> to sell or pledge asset (paragraph B33)?	Operator has no ability to sell or pledge the asset.	<b>Operating lease:</b> Grantor's (lessor's) interest <b>restricts operator's (lessee's) practical ability</b> to sell or pledge asset. <b>Finance lease:</b> Protective rights of the grantor (lessor) typically define the scope of the operator's (lessee's) right of use.	Grantor's interest <b>restricts operator's practical ability</b> to sell or pledge asset.	<b>Sale:</b> Not applicable. <b>Privatisation:</b> Grantor's interest <b>restricts operator's practical ability</b> to sell or pledge asset.
<b>Relevant Accounting Standards</b>	AASB 116 AASB 101	AASB 16	AASB 1059	AASB 116 / AASB 138

**NOTES:**

1 A construction contract with a service outsourcing contract is a contract for the construction of an asset or a combination of assets with provision of services over a specified period.

- 2 A lease is a contract that conveys the right to use a specified asset for a period of time in exchange for consideration (as defined in AASB 16).
- 3 A service concession arrangement is a contract between a grantor and an operator in which the operator has the right to access the service concession asset to provide public services on behalf of the grantor, the operator is responsible for at least some of the management of the public services, and the operator is compensated for the services over the period of the service concession arrangement (as defined in AASB 1059).
- 4 A sale or privatisation is an arrangement that transfers the asset and its related services from public to private ownership/ control.

## Guidance examples

IG14 The guidance examples below illustrate the features of the types of arrangements for private sector participation in the provision of public services that are outlined in the table in paragraph IG13:

- (a) an arrangement that is a construction contract with a service contract;
- (b) an arrangement that contains a lease;
- (c) an arrangement that contains a service concession arrangement that is partly regulated and partly unregulated; and
- (d) an arrangement that is a sale or privatisation.

### Example 3: Construction contract with limited operator services

IG15 This example illustrates an arrangement that involves the operator agreeing to construct an asset or group of assets (a school) for the grantor with a contract for the provision of cleaning and security services over a specified period of time. The example is based on the facts and circumstances in Example 1 (paragraphs IG4–IG5). The grantor:

- (a) in accordance with paragraph 2 – determines the arrangement for the construction of the school and the provision of the services is outside the scope of AASB 1059, consistent with paragraphs IG4–IG5; and
- (b) assesses whether it controls the school or has a right to use the school for recognition under another Accounting Standard. In making this assessment, the grantor considers that:
  - the services the operator provides with the school would be based on the service contract agreed by the grantor and the operator; and
  - the control of or right to use the asset would depend on the service contract, including who has title to the land on which the school is built, the terms of the arrangement and the disposition of any residual interest.

### Example 4: Lease and service concession arrangement – regulated and unregulated

IG16 Example 4 illustrates an arrangement that involves the operator agreeing to construct an asset or group of assets for the grantor with a contract for the provision of services or maintenance (including facilities maintenance) of the asset(s) over a specified period of time. The arrangement is partly regulated and unregulated by the grantor. The relevant terms of the arrangement are:

- (a) a grantor enters into an arrangement that involves the operator constructing a hospital and then maintaining the hospital buildings. The grantor determines the hospital is capable of being operated with separately identifiable public and private wings;
- (b) the public wing of the hospital is expected to provide health services to the general public for no cost to the patients. The grantor is responsible for the services relating to the delivery of medical services and operational services, including setting key performance requirements, but the operator is responsible for the employment of the doctors, nurses and administration staff and scheduling the various services;
- (c) the private wing of the hospital is expected to provide health services to private patients of the hospital. The operator is responsible for the services relating to the delivery of medical services and operational services, including the employment of doctors, nurses and administration staff. The operator also determines the pricing of the services charged to patients;

- (d) the hospital is considered to provide public services, as the basic purpose of the hospital is to provide health services that are necessary or essential to the general public. The health services provided by the hospital are accessible to the public, even if it is a subset of the community that uses the services and notwithstanding that the private wing of the hospital is to be used by private patients. The assessment of the public service nature of the hospital is consistent with paragraph B6;
- (e) the operator is responsible for the cleaning and security services and facility maintenance of both the public wing and the private wing of the hospital. The operator has discretion as to when and how it conducts the facility maintenance of providing upgrades and maintenance of the hospital to a specified condition;
- (f) the grantor is entitled to the residual interest in both the public wing and the private wing of the hospital at the end of the term of the arrangement, as both wings will transfer to the grantor. During the term of the arrangement, the grantor's residual interest and the requirement for the grantor to specifically approve any transferee restricts the operator from selling or pledging the hospital; and
- (g) both the public and private wings are built on government land, leased to the operator for a nominal fee.

IG17 The grantor assesses separately (consistent with paragraphs B6–B7) whether the public wing and the private wing are within the scope of AASB 1059.

### *Hospital – Public wing (regulated)*

#### **Scope**

IG18 Based on the facts and circumstances, the grantor determines:

- (a) the operator accesses the public wing of the hospital to provide public services and is responsible for at least some of the management of the hospital services. The operator fulfils this management responsibility by employing the staff and scheduling services; and
- (b) the public wing of the hospital is a service concession arrangement that is within the scope of AASB 1059, in accordance with paragraph 2.

#### **Grantor's control of asset for recognition under paragraph 5**

IG19 Based on the facts and circumstances, the grantor determines it controls the underlying asset (the public wing of the hospital) in the service concession arrangement, as the arrangement entered into by the grantor and the operator specifies:

- (a) the grantor controls or regulates (as required by paragraph 5(a)):
  - the services provided by the public wing of the hospital – the grantor is responsible for the delivery and standard of performance of the medical and operational services;
  - the recipients of the services – the public wing of the hospital is expected to provide health services to the general public; and
  - the pricing of the services – the public wing of the hospital is to provide health services at no cost to the patients; and
- (b) the grantor controls the significant residual interest in the asset (the public wing of the hospital) at the end of the arrangement in accordance with paragraph 5(b), as the grantor is entitled to this residual interest. Additionally, during the term of the arrangement, the operator is restricted from selling or pledging the public wing of the hospital (refer paragraphs B32–B33).

#### **Recognition of arrangement**

IG20 Given the public wing of the hospital is within the scope of AASB 1059 (paragraph 2) and the grantor controls the asset in accordance with paragraphs 5(a) and (b), the grantor recognises the public wing of the hospital provided by the operator as a service concession asset.



## *Hospital – Private wing (unregulated)*

### **Scope**

- IG21 Based on the facts and circumstances, the grantor determines:
- (a) the operator uses the private wing of the hospital to provide services to private patients of the hospital. The operator is also responsible for the management of the private wing by providing the medical and operational services and staff; and
  - (b) the private wing of the hospital is not a service concession arrangement, in accordance with paragraph 2, because the services in the private wing are not being provided to the public on behalf of a public sector entity.

### **Recognition of arrangement**

- IG22 Notwithstanding the grantor cannot recognise the private wing of the hospital as a service concession asset, the grantor assesses whether it controls the asset (the private wing of the hospital) under another Accounting Standard, such as AASB 16. In this example, as the grantor controls the land on which the private wing is located, which provides legal control of the private wing, and the operator is prevented from selling or pledging its interest in the private wing, the grantor controls the private wing. However, the arrangement provides the operator with the right to use the private wing, because the private wing is a separately identifiable asset and the operator controls the services provided, which patients will be admitted, and the prices to be charged during the specified arrangement term. Accordingly:
- (a) where the grantor retains substantially all the risks and rewards incidental to ownership, the grantor is the lessor in an operating lease; or
  - (b) where the operator has substantially all the risks and rewards incidental to ownership, the grantor derecognises the asset and recognises a receivable in accordance with the accounting for a finance lease.
- IG23 In this example, the wings of the hospital are capable of being separated into a public wing (regulated portion) and a private wing (unregulated portion). However, some service concession arrangements may involve a hospital that is partly regulated and partly unregulated based on the number of patients that are admitted as a public patient or a private patient, instead of being physically separate as per paragraph IG16(a). In such circumstances, judgement will be required as to the relative significance of the regulated versus unregulated activities in order to determine whether the grantor has control of the asset and/or has granted a right of use to the operator. For example, if the hospital admissions are expected to comprise substantially public patients, then the admission of private patients would be considered as ancillary (unregulated) activities of the hospital and the hospital considered to be used wholly for regulated purposes in addressing the accounting for the service concession asset. In addition, a lease from the grantor to the operator requires a specifically identifiable asset with a right of use granted for a specified time, so in these circumstances it is unlikely a lease could be identified.

### **Example 5(a): Sale**

- IG24 This example illustrates an arrangement that involves a public sector entity (a State Government – the grantor) selling an asset (electricity distribution business) to a private sector entity (the operator). The relevant terms of the arrangement are:
- (a) in exchange for the sale of the electricity distribution business, the grantor receives cash relating to the sale of its interest in the net assets of the business, and settlement by the operator of the liabilities of the business;
  - (b) the operator is able to operate the electricity distribution business subject to regulation by a third-party regulator of electricity distributors. Additionally, although the operator has discretion to set the prices of the electricity services, the operator must seek the third-party regulator's approval for changes in pricing; and
  - (c) the operator controls:
    - the operating activities of the electricity distribution business, including decisions to expand or modify the distribution network or to continue providing electricity services, subject to protective rights of the grantor to ensure electricity supply in certain circumstances. If the operator decides to discontinue providing electricity services, the grantor has an option to buy back the business from the operator at fair value; and

- the recipients of the services – the operator can expand the distribution network beyond the network existing at the time of entering the contract without requiring the grantor’s approval.

### **Scope**

IG25 Based on the facts and circumstances, the grantor concludes the arrangement for the electricity distribution business is outside the scope of AASB 1059 (paragraph 2) – although electricity distribution would be regarded as public services, the operator does not provide the services on behalf of the grantor and the arrangement is not for a specific period of time. The grantor’s protective rights do not mean that the operator provides the services on behalf of the grantor. The protective rights would have the same impact as for an operator that had developed its own electricity network rather than purchasing it from a grantor – the rights do not give the grantor control of the distribution network.

### ***Grantor’s control of asset for recognition***

IG26 The grantor would also be unable to recognise a service concession asset in these circumstances, because the grantor is able to control or regulate only some of the aspects addressed in paragraph 5(a), as follows:

- (a) the grantor controls the pricing of the services provided by the operator, as the requirement for the operator to seek approval from the third-party regulator removes the operator’s ability to regulate the pricing and, for the purpose of paragraph 5(a), the pricing of the services is therefore considered to be set implicitly by the grantor (refer paragraph B20);
- (b) the operator controls the services to be provided by the business. The grantor’s protective rights and option to buy back the business from the operator, in the event the operator decides to discontinue the provision of electricity services, do not prevent the operator determining the services to be provided; and
- (c) the operator controls the recipients of the services as outlined in paragraph IG24(c).

IG27 There is no residual interest in the arrangement, as the sale is not limited to a specified period, and so the grantor would also not satisfy the requirements of paragraph 5(b). Furthermore, the grantor’s buy-back option is exercisable only at fair value and so does not give the grantor any significant residual interest. As the asset need not be used for the provision of public services for its entire remaining economic life (the operator has discretion as to how to use the asset) and the criteria in paragraph 5(a) are not met, the conditions in paragraph 6 for a whole-of-life asset are not met.

IG28 Although the grantor cannot recognise a service concession asset, the grantor assesses whether it controls the electricity distribution network, has the right to use the network, or controls any other rights requiring recognition under another Accounting Standard. In making this assessment, the grantor takes into account the factors noted in the previous paragraphs.

### ***Recognition of arrangement***

IG29 Based on the assessment in paragraphs IG26–IG27, the grantor determines that it does not control the asset or have a right to use the asset subsequent to the sale of the electricity distribution business. The grantor therefore derecognises the asset under another Accounting Standard, such as AASB 116.

### **Example 5(b): Privatisation**

IG30 In this example, the facts in Example 5(a) apply, except that:

- (a) the State Government (the grantor) enters into an arrangement with a private sector entity (the operator) to operate the electricity distribution business for 100 years, instead of the operator purchasing the business from the grantor; and
- (b) at the end of the arrangement (ie in 100 years’ time), the distribution network reverts to the grantor. The operator must maintain the electricity distribution network to the specified age and condition at the end of the arrangement.

IG31 Based on the facts and circumstances, the grantor determines:

- (a) the arrangement for the operator to operate the electricity distribution network is outside the scope of AASB 1059, as the grantor’s protective rights to ensure electricity supply in certain circumstances do not mean that the operator provides the services on behalf of the grantor;
- (b) even if the arrangement was a service concession arrangement, it does not control the asset for recognition under paragraph 5(a), for the reasons outlined in paragraphs IG26(a)–(c); and

- (c) it controls the significant residual interest at the end of the arrangement, as the electricity distribution network reverts to the grantor at the end of the arrangement. Accordingly, the arrangement is a privatisation and not a sale.

IG32 Based on the assessment in the previous paragraph, the grantor determines that it does not control the asset (the electricity distribution network) or have a right to use the asset under the arrangement. The grantor's protective rights do not give the grantor any more significant interest in the distribution network than it would have with those same rights in relation to an operator that had developed its own network. The grantor therefore derecognises the asset under another Accounting Standard, such as AASB 116, and determines whether it controls any other rights requiring recognition under another Accounting Standard.

## Illustrative examples

*These illustrative examples accompany, but are not part of, AASB 1059.*

- IE1 These examples consider only three of many possible types of service concession arrangements. Their purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustrations as clear as possible:
- (a) It is assumed in Examples 6–7 that the term of the service concession arrangement is only ten years and that the operator’s annual receipts are constant over that period. In practice, terms may be much longer and annual revenues may increase over time;
  - (b) Examples 6 and 7 do not illustrate the accounting by the grantor for existing assets of the grantor used in the service concession arrangement, such as land under roads; and
  - (c) Example 8 presents only relevant terms of the arrangement that illustrate the requirements for dividing the liability under a hybrid service concession arrangement into the financial liability and the grant of the right to the operator liability.
- IE2 In these examples, monetary amounts are denominated in ‘currency units’ (CU) – rounded to the nearest unit.

### **Arrangement terms and assumptions (common to Examples 6–7)**

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- IE3 These terms are common to the two examples that follow.
- IE4 The terms of the arrangement require an operator to construct a road on land owned by the grantor – completing construction within two years – and maintain and operate the road to a specified standard for eight years (ie years 3–10). The arrangement is within the scope of this Standard and the road meets the conditions for recognition of a service concession asset in paragraph 5.
- IE5 The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8 at a fair value (current replacement cost) of CU110. The compensation to the operator for this service is included in the predetermined series of payments and/or the revenue the operator has the right to earn from the service concession asset or another revenue-generating asset granted to the operator by the grantor. The compensation to the operator also covers the annual operating costs of CU12.
- IE6 It is assumed that the original road surface is a separate component of the service concession asset and meets the criteria for recognition specified in AASB 116 when the service concession asset is initially recognised. The road surface is therefore recognised as a separate component of the initial fair value (current replacement cost) of the service concession asset and depreciated over years 3–8. This depreciation period is shorter than that for the road base, and takes into account that resurfacing would ordinarily occur every six years, compared with replacing the road base in 25 years. During the construction phase, it is assumed that only the road base is constructed in year 1, and that the road only becomes ready to use at the end of year 2.
- IE7 The replacement of a major component of the road as a separate component of the service concession asset occurs in year 8, and is recognised as a new service concession asset when the resurfacing work is performed. This also results in an increase in the liability recognised by the grantor, in accordance with paragraph B48. Where the liability relates to the grant of a right to the operator model, additional revenue in respect of this increase is recognised evenly over the remaining term of the arrangement. However, if the expenditure represented an improvement in service potential such as a new traffic lane rather than restoration to original service capability then it would be appropriate to instead recognise revenue relevant to that improvement only once it has occurred.
- IE8 At the beginning of year 3, the total fair value (current replacement cost) of the road is CU1,082, comprised of CU972 related to the base layers (including implied funding costs due to the extended construction period) and CU110 related to the surface layers. The fair value of the surface layers is used to estimate the fair value of the resurfacing (which is treated as a replacement component in accordance with AASB 116). The estimated life of surface layers (ie six years) is also used to estimate the depreciation of the replacement component in years 9 and 10.
- IE9 The road base has an economic life of 25 years. Annual depreciation is recognised by the grantor on a straight-line basis. It is therefore CU39 (CU972/25) for the base layers. The surface layers are depreciated

over 6 years (years 3–8 for the original component, and starting in year 9 for the replacement component). Annual depreciation related to the original surface layers and the replacement surface layers is CU18 (CU110/6).

- IE10 The effective interest rate in the service concession arrangement is 6.18 per cent per year.
- IE11 It is assumed that all cash flows take place at the end of the year.
- IE12 It is assumed that the time value of money is not significant.
- IE13 At the end of year 10, the arrangement will end and the operator will transfer the operation of the road to the grantor.
- IE14 The total compensation to the operator under each of the two examples is inclusive of each of the components of the service concession arrangement and reflects the fair values (current replacement cost) for each of the assets and services, which are set out in Table 6.
- IE15 The grantor’s accounting policies include:
- (a) service concession assets (property, plant, and equipment) – measured initially at fair value (current replacement cost) and subsequently in accordance with the cost model. Impairment is recognised when the carrying amount exceeds the current replacement cost;
  - (b) financial liabilities – subsequently measured at amortised cost using the effective interest method; and
  - (c) borrowing costs – expensed in the period incurred regardless of how the borrowings are applied.

**Table 6 Fair values of the components of the arrangement (currency units)**

Contract component	Fair value
Road – base layers	972
Road – original surface layers	110
Total fair value of road	1,082
Annual service component	12
Effective interest rate	6.18%

## **Example 6: The grantor makes a predetermined series of payments to the operator (paragraphs 15–20)**

### **Additional arrangement terms**

- IE16 The terms of the arrangement require the grantor to pay the operator CU200 per year in years 3–10 for making the road available to the public. The total consideration (payment of CU200 in each of years 3–10) reflects the fair values (current replacement cost) for each of the assets and services indicated in Table 6. These payments are intended to cover the cost of constructing the road, annual operating costs of CU12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of CU110.

### **Financial statement impact**

- IE17 The grantor initially recognises the service concession asset as property, plant, and equipment at its fair value, measured at current replacement cost (total CU1,082, determined as CU940 related to construction of the base layers, CU110 related to construction of the original surface layers and CU32 for funding costs related to the costs incurred in year 1 for base layers). The asset is recognised as it is constructed (CU525 in year 1 and CU557 in year 2). Depreciation is recognised annually (CU57, comprised of CU39 (CU972/25) for the base layers and CU18 (CU110/6) for the surface layers), starting from year 3.
- IE18 The grantor initially recognises a financial liability equal to the fair value (current replacement cost) of the service concession asset under construction at the end of year 1 (CU525). The liability is increased at the end of year 2 to reflect both the fair value of the additional construction (CU525) and the finance charge (CU32) on the outstanding financial liability. Because the amount of the predetermined payment related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the annual payment that reduces the liability each period. A finance charge at the effective

interest rate of 6.18 per cent is recognised annually. The liability is subsequently measured at amortised cost, that is, the amount initially recognised plus the finance charge on that amount calculated using the effective interest method, minus repayments. The initial liability excludes the annual operating costs of CU12 and the compensation for the road resurfacing, as these components of the arrangement represent equally proportionately unperformed contracts.

- IE19 The compensation for the road resurfacing is included in the predetermined series of payments. There is no additional direct cash flow impact related to the road resurfacing beyond the predetermined payments; however, the grantor recognises the resurfacing as an asset when the work is undertaken and recognises depreciation expense of CU110/6 = CU18, beginning in year 9. When the resurfacing occurs, the grantor also recognises the related liability.
- IE20 The compensation for maintenance and operating the road (CU12) is also included in the predetermined series of payments. There is no additional cash flow impact related to this service expense beyond those payments; however, the grantor recognises an expense annually.

## Overview of cash flows, statement of profit and loss and other comprehensive income, and statement of financial position

- IE21 The grantor's cash flows, statement of profit and loss and other comprehensive income, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 6.1 to 6.3. In addition, Table 6.4 shows the changes in the financial liability.

**Table 6.1 Cash flows (currency units)**

Year	1	2	3	4	5	6	7	8	9	10	Total
Predetermined series of payments	–	–	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(1,600)
Net inflow/(outflow)	–	–	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(1,600)

**Table 6.2 Statement of profit and loss and other comprehensive income (currency units)**

Year	1	2	3	4	5	6	7	8	9	10	Total
Service expense	–	–	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(96)
Finance charge *	–	(32)	(67)	(59)	(51)	(43)	(34)	(25)	(22)	(11)	(344)
Depreciation – base layers	–	–	(39)	(39)	(39)	(39)	(39)	(39)	(39)	(39)	(312)
Depreciation – original surface layers	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layers	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(57)	(58)	(57)	(57)	(58)	(57)	(57)	(58)	(459)
Annual surplus/(deficit)	–	(32)	(136)	(129)	(120)	(112)	(104)	(94)	(91)	(81)	(899)
Revaluation surplus †	–	32	–	–	–	–	–	–	–	–	32

**NOTES:**

- Depreciation in years 3–8 reflects the depreciation on the original road. The road surface is fully depreciated over that period. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (the replacement surface) recognised in year 8. The depreciation calculations are set out in paragraph IE9.
  - Although these Illustrative Examples use a straight-line depreciation method, it is not intended that this method be used in all cases. Paragraph 60 of AASB 116 requires that, “The depreciation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity.” Likewise, for intangible assets, paragraph 97 of AASB 138 requires that, “The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.”
- \* Financial liability at start of year (Table 6.4) x 6.18%.
- † Adjustment of current replacement cost to include funding cost in measuring the service concession asset in year 2, since the grantor’s accounting policy is to expense borrowing costs.

**Table 6.3 Statement of financial position (currency units)**

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers *	525	972	933	894	855	816	777	738	699	660
Service concession asset – original surface layers *	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layers	–	–	–	–	–	–	–	110	92	73
Total service concession asset	525	1,082	1,025	967	910	853	795	848	791	733
Cash (Table 6.1)	–	–	(200)	(400)	(600)	(800)	(1,000)	(1,200)	(1,400)	(1,600)
Financial liability (Table 6.4)	(525)	(1,082)	(961)	(832)	(695)	(550)	(396)	(343)	(177)	–
Cumulative surplus/(deficit)	–	(32)	(168)	(297)	(417)	(529)	(633)	(727)	(818)	(899)
Revaluation surplus (Table 6.2)	–	32	32	32	32	32	32	32	32	32

**NOTES:**

- In this example, the resurfacing occurs as expected in year 8, when the original road surface is fully depreciated. If the resurfacing occurred earlier, the original road surface would not be fully depreciated, and would need to be derecognised in accordance with AASB 116 before the new component of the service concession asset related to the resurfacing is recognised.
- The new component of the service concession asset related to the resurfacing is recognised in year 8. Years 9–10 reflect depreciation on this additional component (Table 6.2).
- The financial liability is increased in year 8 for the recognition of the new component of the service concession asset.

\* From year 3, opening balance less depreciation for the year (Table 6.2).

**Table 6.4 Changes in the financial liability (currency units)**

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,082	961	832	695	550	396	343	177
Liability recognised along with initial service concession asset *	525	525	–	–	–	–	–	–	–	–
Finance charge added to liability prior to payments being made *	–	32	–	–	–	–	–	–	–	–
Portion of predetermined series of payments that reduces the liability †	–	–	(121)	(129)	(137)	(145)	(154)	(163)	(166)	(177)
Liability recognised along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,082	961	832	695	550	396	343	177	–

**NOTES:**

\* See paragraph IE18.

† Annual payment (Table 6.1) less service payment and finance charge payment (Table 6.2).

## Example 7: The grantor grants the operator the right to charge users a toll for use of the road (paragraphs 21–23)

### Additional arrangement terms

IE22 The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of CU200 in each of years 3–10. The total consideration (tolls of CU200 in each of years 3–10) reflects the fair values (current replacement cost) for each of the assets and services indicated in Table 6, and is intended to cover the cost of constructing the road, annual operating costs of CU12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of CU110.

### Financial statement impact

IE23 The grantor initially recognises the service concession asset as property, plant, and equipment at its fair value (current replacement cost) (total CU1,082, determined as CU940 related to construction of the base layers, CU110 related to construction of the original surface layers and CU32 for implied funding costs

related to the costs incurred in year 1 for base layers). The asset is recognised as it is constructed (CU525 in year 1 and CU557 in year 2). Depreciation is recognised annually (CU57, comprised of CU39 (CU972/25) for the base layers and CU18 (CU110/6) for the surface layers), starting from year 3.

- IE24 As consideration for the service concession asset, the grantor recognises a liability under the grant of a right to the operator model for granting the operator the right to collect tolls of CU200 in years 3–10. The liability is recognised as the asset is recognised. The liability is measured initially at the same amount as the asset, which includes an implied funding cost in the measurement of the current replacement cost.
- IE25 The liability is reduced over years 3–10, and the grantor recognises revenue on that basis because access to the service concession asset is expected to be provided evenly over the term of the service concession arrangement from the point at which the asset is capable of providing economic benefits.
- IE26 The compensation for the road resurfacing is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no additional cash flow impact related to the road resurfacing; however, the grantor recognises the resurfacing (the replacement of a major component of the road) as a service concession asset when the work is undertaken and recognises depreciation expense of CU110/6 = CU18, beginning in year 9. When the resurfacing occurs, the grantor also recognises the related liability.
- IE27 The compensation for maintenance and operating the road (CU12) is also included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no financial statement impact related to this service expense. It does not affect cash flow because the grantor has no cash inflow or outflow. It is not recognised as an operating expense because the fair value (current replacement cost) of the asset and liability initially recognised do not include any service costs the operator may incur.

## Overview of cash flows, statement of profit or loss and other comprehensive income, and statement of financial position

- IE28 The grantor's cash flows, statement of profit and loss and other comprehensive income, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 7.1 to 7.2. In addition, Table 7.3 shows the changes in the liability.
- IE29 Because no payments are made by the grantor to the operator, there are no cash flow impacts for this example.

**Table 7.1 Statement of profit and loss and other comprehensive income (currency units)**

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability) (Table 7.3)	–	–	135	135	135	136	135	135	190	191	1,192
Depreciation – base layers	–	–	(39)	(39)	(39)	(39)	(39)	(39)	(39)	(39)	(312)
Depreciation – original surface layers	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layers	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(57)	(58)	(57)	(57)	(58)	(57)	(57)	(58)	(459)
Annual surplus/(deficit)	–	–	78	77	78	79	77	78	133	133	733
<b>NOTES:</b>											
1. Depreciation in years 3–8 reflects the depreciation on the original road. The road surface is fully depreciated over that period. The depreciation calculations are set out in paragraph IE23.											
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognised in year 8, as set out in paragraph IE26.											
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 7.3).											
4. All revenue is recognised evenly over the remaining term of the arrangement, once the liability has been recognised and the service concession asset is operating.											



**Table 7.2 Statement of financial position (currency units)**

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers *	525	972	933	894	855	816	777	738	699	660
Service concession asset – original surface layers *	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layers	–	–	–	–	–	–	–	110	92	73
Total service concession asset	525	1,082	1,025	967	910	853	795	848	791	733
Cash	–	–	–	–	–	–	–	–	–	–
Liability (Table 7.3)	(525)	(1,082)	(947)	(812)	(677)	(541)	(406)	(381)	(191)	–
Cumulative surplus/(deficit)	–	–	78	155	233	312	389	467	600	733

**NOTES:**

- In this example, the resurfacing occurs as expected in year 8, when the original road surface is fully depreciated. If the resurfacing occurred earlier, the original road surface would not be fully depreciated, and would need to be derecognised in accordance with AASB 116 before the new component of the service concession asset related to the resurfacing is recognised.
- The new component of the service concession asset related to the resurfacing is recognised in year 8. Years 9–10 reflect depreciation on this additional component (Table 7.1).
- The liability is increased in year 8 for the recognition of the new component of the service concession asset.

\* From year 3, opening balance less depreciation for the year (Table 7.1).

**Table 7.3 Changes in the liability (currency units)**

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,082	947	812	677	541	406	381	191
Liability recognised along with initial service concession asset *	525	525	–	–	–	–	–	–	–	–
Implied funding cost included in current replacement cost of asset *	–	32	–	–	–	–	–	–	–	–
Revenue (reduction of liability) †	–	–	(135)	(135)	(135)	(136)	(135)	(135)	(190)	(191)
Liability recognised along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,082	947	812	677	541	406	381	191	–

**NOTES:**

\* See paragraph IE24.

† Revenue related to the initial liability of CU135 (CU1,082/8) in years 3–10, plus revenue related to the resurfacing liability of CU55 (CU110/2) in years 9–10.

## Example 8: Allocation of liabilities in a hybrid arrangement

IE30 Example 8 illustrates the requirements in paragraphs 24–25 and B73–B74 for dividing a hybrid service concession arrangement by measuring the financial liability part first and then allocating the remainder of the total liability to the part related to the grant of the right to the operator.

### Arrangement terms

IE31 The relevant terms of the arrangement in the example are:

- the operator is required to construct a road on land owned by the grantor – completing construction within two years – and maintain and operate the road to a specified standard for eighteen years (ie years 3–20);
- the grantor is required to pay the operator CU100 each year for eight years (ie years 3–10) for making the road available to the public. These payments are intended to partially cover the cost of constructing the road. It is assumed all cash flows take place at the end of the year. The contractually specified interest rate in the arrangement is 4% per annum. The present value of the payments is CU673. However, unlike a typical loan, the grantor incurs the liability two years

before cash payments commence from year 3. Consequently, the effective interest rate for the financial liability is 3.2% per annum, reflecting this timing difference. The grantor's accounting policy for the financial liability is to subsequently measure the financial liability at amortised cost using the effective interest method;

- (c) the operator is permitted to collect tolls from drivers using the road for eighteen years (ie years 3–20);
- (d) the initial fair value (current replacement cost) of the construction cost of the service concession asset is CU1,800, once construction is complete at the end of the second year; and
- (e) at the end of year 20, the arrangement will end, and the operator will transfer the operation of the road to the grantor.

IE32 The arrangement is within the scope of this Standard and the road meets the conditions for recognition as a service concession asset in paragraph 5 (or paragraph 6 for a whole-of-life asset).

## Financial statement impact

IE33 It is necessary to divide the grantor's consideration to the operator into two parts – the financial liability for the predetermined payments and the liability related to the grant of the right to the operator to charge tolls.

IE34 The grantor recognises:

- (a) the service concession asset as property, plant and equipment at current replacement cost in accordance with the cost approach to fair value (current replacement cost) in AASB 13 totalling CU1,822 at the end of year 2, related to construction of the road (CU900 in both year 1 and year 2) and funding costs related to the financial liability recognised in year 1 (CU22 in year 2);
- (b) the total liability equal to the same amount as the current replacement cost of the service concession asset (total CU1,822). The total liability is allocated:
  - (i) in year 1 – first to the financial liability measured at present value under AASB 9. In this example, the present value of the grantor's payments to the operator is CU673. Second, the remainder of the CU900 is allocated to the liability under the grant of the right to the operator model for the right to collect tolls (CU227);
  - (ii) in year 2 – to the liability under the grant of the right to the operator model for the right to collect tolls (CU900) as the remainder of the liability related to the construction costs; and
  - (iii) in year 2 – the borrowing costs of CU22 are allocated to the financial liability;
- (c) a finance charge expense (CU22) in year 2 relating to the financial liability in year 1, in accordance with the grantor's accounting policy; and
- (d) a revaluation surplus of CU22 to reflect the inclusion of funding costs relating to the construction period in the current replacement cost of the service concession asset.

IE35 The journal entries for the accounting treatment set out in paragraph IE34 are:

	<b>Debit</b>	<b>Credit</b>
<b>End of year 1</b>	CU	CU
Service concession asset – PPE	900	
Financial liability		673
Liability		227
<b>End of year 2</b>		
Service concession asset – PPE	922	
Liability		900
Revaluation surplus		22
Finance charge	22	
Financial liability		22

## Example 9: Initial recognition of intangible assets in a business

IE36 Example 9 illustrates the requirements in paragraphs B14 and B39(a) for the initial recognition of the assets of a business that is subject to a service concession arrangement, including identifiable intangible assets.

### Arrangement terms

IE37 The relevant terms of the arrangement in the example are:

- (a) a grantor enters into an arrangement that involves an operator providing public services related to a business, on behalf of the grantor. The business is a business as defined in AASB 3 *Business Combinations*, with customer lists and property, plant and equipment. The customer lists are intangible assets as they would meet the separability criterion in AASB 3. They were developed and are owned by the grantor;
- (b) the initial fair value (current replacement cost) of the business and the identifiable assets of the business are set out in Table 9;
- (c) the operator has the right to collect revenue in relation to updating the customer lists; and
- (d) at the commencement of the arrangement, the operator provides the grantor with cash consideration of CU300.

**Table 9 Fair values of the components of the arrangement (currency units)**

Contract component	Carrying amount	Fair value
Business	n/a	300
Property, plant and equipment	60	100
Customer lists	–	150

IE38 The arrangement is within the scope of this Standard and, as existing assets of the grantor, the property, plant and equipment and customer lists meet the conditions for a service concession asset in paragraph 5 (or paragraph 6 for a whole-of-life asset).

### Financial statement impact

IE39 The grantor has not previously recognised the customer lists as an intangible asset as they are precluded from recognition as an intangible asset under AASB 138. As a result of entering into the service concession arrangement, the grantor recognises the assets of the business, excluding any internally generated goodwill, as service concession assets. Therefore the grantor initially:

- (a) reclassifies the property, plant and equipment as a service concession asset and recognises the asset at fair value (current replacement cost) (CU100), representing a revaluation surplus of CU40 over the carrying amount of CU60;
- (b) reclassifies the customer lists as an intangible service concession asset and recognises the asset at fair value (current replacement cost) (CU150) and a corresponding amount as revaluation surplus; and
- (c) recognises a liability under the grant of a right to the operator model for the additional consideration (CU300) provided by the operator.

IE40 The journal entries for the accounting treatment set out in paragraph IE39 are:

	Debit	Credit
<b>Year 1</b>	CU	CU
Service concession asset – PPE	60	
Property, plant and equipment		60
Service concession asset – PPE	40	
Service concession asset – Customer lists	150	
Revaluation surplus		190
Cash	300	
Liability		300

## Example 10: Transition – measuring the liability under the grant of a right to the operator model at the date of initial application

- IE41 In accordance with the transition requirements set out in Appendix C of the Standard, a grantor may elect to apply the Standard retrospectively by recognising and measuring service concession assets and related liabilities at the date of initial application (paragraph C3(b)). The date of initial application is the beginning of the earliest reporting period for which comparative information is presented in the financial statements.
- IE42 This example illustrates the approach set out in paragraph C4(c) to measuring a liability under the grant of a right to the operator model at the date of initial application. The liability related to the grant of a right to the operator is required to be measured at the fair value (current replacement cost) of the related service concession asset at the date of initial application, adjusted (1) for any consideration transferred by the grantor to the operator that is recognised as an asset and (2) to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement, (3) less any related financial liabilities.
- IE43 Assuming that the service concession arrangement in this example has not required any payments or other consideration from the grantor to the operator and does not give rise to a financial liability for the grantor, the information needed for measuring the liability is illustrated in the following table:

**Table 10 Estimates at the date of initial application**

Parameter	Amount or period
Fair value (current replacement cost) of the service concession asset	CU1,200
Total period of the arrangement	20 years
Remaining service concession period	10 years
Apportionment for the liability re grant of rights to the operator	$CU1,200 \times 10/20 = CU600$

- IE44 If the service concession arrangement is a hybrid arrangement, the carrying amount of any consideration transferred by the grantor to the operator that has been recognised as an asset is first deducted from the fair value (current replacement cost) of the service concession asset. The resulting amount is then apportioned for the remaining service concession period. Any outstanding financial liability (measured separately under the financial liability model at fair value at the date of initial application) would then be deducted from the apportioned amount for the liability re the grant of rights to the operator in order to derive the amount to be recognised for the liability.
- IE45 The measurement approach illustrated in this example is a simplified transition method, as it does not require the service concession asset or the liability to be measured at the inception of the service concession arrangement, as would be required under the full retrospective transition method in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

## Compilation details

### Accounting Standard AASB 1059 Service Concession Arrangements: Grantors (as amended)

Compilation details are not part of AASB 1059.

This compiled Standard applies to annual reporting periods beginning on or after 1 January 2022. It takes into account amendments up to and including 20 December 2021 and was prepared on 7 April 2022 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Accounting Standard made by the AASB. Instead, it is a representation of AASB 1059 (July 2017) as amended by other Accounting Standards, which are listed in the table below.

### Table of Standards

Standard	Date made	FRL identifier	Commence-ment date	Effective date (annual periods ... on or after ...)	Application, saving or transitional provisions
AASB 1059	14 Jul 2017	F2017L01183	31 Dec 2018	(beginning) 1 Jan 2020	see (a) below
AASB 2018-5	31 Oct 2018	F2018L01620	31 Dec 2018	(beginning) 1 Jan 2019	see (b) below
AASB 2019-2	18 Sep 2019	F2019L01441	31 Dec 2019	(beginning) 1 Jan 2020	see (a) below
AASB 1060	6 Mar 2020	F2020L00288	30 Jun 2021	(beginning) 1 Jul 2021	see (c) below
AASB 2021-4	21 Jun 2021	F2021L00953	29 Jun 2021	(ending) 30 Jun 2021	see (d) below
AASB 2021-7	20 Dec 2021	F2021L01883	31 Dec 2021	(beginning) 1 Jan 2022	see (e) below

- (a) Entities may elect to apply this Standard to annual periods beginning before 1 January 2020.
- (b) This Standard defers the effective date of AASB 1059 so that it applies to annual reporting periods beginning on or after 1 January 2020, instead of 1 January 2019. However, earlier application is permitted.
- (c) Entities may elect to apply this Standard to annual periods beginning before 1 July 2021.
- (d) Entities may elect to apply this Standard to annual periods ending before 30 June 2021.
- (e) Entities may elect to apply this Standard to annual periods beginning before 1 January 2022.

### Table of amendments to Standard

Paragraph affected	How affected	By ... [paragraph/page]
30	repealed	Legislation Act 2003, s. 48D
B76	amended	AASB 2019-2 [6]
C1	amended	AASB 2018-5 [4]
C4	amended amended	AASB 2019-2 [6] AASB 2021-4 [5]
Appendix D	deleted	AASB 2021-7 [50]
Appendix E	added	AASB 1060 [page 67]

### Table of amendments to guidance

Paragraph affected	How affected	By ... [paragraph]
IG10	amended	AASB 2019-2 [6]
IG13	amended	AASB 2019-2 [6]
IE42-IE43	amended amended	AASB 2019-2 [6] AASB 2021-4 [5]
IE44	amended	AASB 2021-4 [5]

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, AASB 1059.*

### Introduction

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BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in AASB 1059. In making decisions, individual Board members gave greater weight to some factors than to others.

### Background

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#### Reasons for issuing this Standard

BC2 In Australia, public sector entities enter into service concession arrangements (also called public-private partnerships (PPPs), build-own-operate-transfer (BOOT) arrangements and other similar names) as a means of developing and delivering infrastructure and other assets for public services such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, registries and databases, and other tangible or intangible assets that are expected to be used during more than one reporting period in delivering public services. The public sector entity (the grantor) typically engages another entity (the operator) to construct or otherwise provide the underlying infrastructure and other assets through which the operator will provide public services on behalf of the grantor. In exchange for the asset (or assets) and services, the grantor makes payments to the operator or grants the operator a right to charge users of the service concession asset (or assets).

BC3 Prior to the issue of this Standard, there was no specific Australian Accounting Standard that prescribed the accounting for service concession arrangements from the grantor’s perspective.

BC4 In determining an accounting policy for service concession arrangements in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, in the absence of AASB 1059, an Australian public sector entity might consider existing accounting requirements for service concession arrangements, including:

- (a) AASB Interpretation 12 *Service Concession Arrangements* – AASB Interpretation 12 (which incorporates IFRIC 12 *Service Concession Arrangements*) provides the accounting requirements for service concession arrangements by the operator of a service concession arrangement. AASB Interpretation 12 does not apply to a grantor;
- (b) AASB 16 *Leases* – AASB 16 provides guidance where the grantor makes payments to the operator, but does not provide guidance where the grantor grants the operator a right to charge users of the service concession asset;
- (c) AASB Interpretation 4 *Determining whether an Arrangement contains a Lease* – AASB Interpretation 4 provides guidance for the application of AASB 16; and
- (d) IPSAS 32 *Service Concession Arrangements: Grantor* – the International Public Sector Accounting Standards Board (IPSASB) published IPSAS 32 in October 2011. IPSAS 32 prescribes the accounting for service concession assets, liabilities, revenues and expenses by grantors. IPSAS 32 mirrors IFRIC 12 in most aspects.

Australian public sector entities had also considered previous requirements in the United Kingdom set out in Financial Reporting Standard FRS 5 *Reporting the Substance of Transactions*, issued by the UK Accounting Standard Board. FRS 5 required an entity to recognise an asset and a liability where the entity had substantially all or the majority of risks and rewards incident to the ownership of a service concession asset.

BC5 The lack of a specific Australian Accounting Standard that prescribed the accounting for a service concession arrangement from the grantor’s perspective resulted in divergence in the accounting for such arrangements. For example, some grantors recognised service concession assets and liabilities in their statement of financial position while others did not. Given the significance of service concession arrangements to the Australian economy, it is important that the AASB issue an Accounting Standard to address the lack of explicit requirements for accounting for such arrangements. Recognition of service

concession assets and related liabilities is important in assisting users of financial statements to understand the resources and obligations of a grantor involved in the provision of public services.

- BC6 The Board considered a range of alternatives for the accounting for service concession arrangements by a grantor. This included consideration of:
- (a) whether under the hierarchy for selecting accounting policies set out in AASB 108, the grantor could apply AASB Interpretation 12 by analogy. The Board (in December 2007) noted that, in accordance with AASB 108, the management of an entity must use its judgement in developing and applying an accounting policy that results in information that is both relevant and reliable to the economic decision-making needs of users, including that the financial statements reflect the economic substance of the transaction or event. In making this judgement, management must refer to, and consider the applicability of, the requirements and guidance in Australian Accounting Standards (including Interpretations) dealing with similar and related issues, and the definitions, recognition criteria and measurement concepts in the *Framework for the Preparation and Presentation of Financial Statements*. The Board concluded public sector grantors are required to consider Interpretation 12 in developing their accounting policy for service concession arrangements, and could choose to follow the Interpretation, although it does not apply mandatorily;
  - (b) the IPSASB's project on grantor accounting for service concession arrangements, which the Board followed closely by issuing the IPSASB's consultation documents in Australia as Invitation to Comment ITC 16 *Request for Comment on IPSASB Consultation Paper Accounting and Financial Reporting for Service Concession Arrangements* (April 2008) and Exposure Draft ED 194 *Request for Comment on IPSASB Exposure Draft Service Concession Arrangements: Grantor* (April 2010). The Board considered the feedback from constituents in preparing its submissions on the IPSASB proposals; and
  - (c) other approaches to the accounting for service concession arrangements, which are identified further in this Basis for Conclusions.

## Issue of ED 261 and additional public versions

- BC7 After considering the alternatives, the Board decided to develop an Australian Accounting Standard on grantor accounting for service concession arrangements, based on IPSAS 32, to address the lack of guidance. The Board issued Exposure Draft ED 261 *Service Concession Arrangements: Grantor* in May 2015. The Board took into account its policy of making Australian Accounting Standards with a view to requiring like transactions and events to be accounted for in a like manner by all types of entities, referred to as 'transaction neutrality', in restricting the scope of ED 261 to a grantor that is a public sector entity. The Board noted that it is highly unlikely that a service concession arrangement would involve a grantor that is a private sector entity. Consequently, only in rare instances would a private sector grantor require specific guidance on the accounting for a service concession arrangement.
- BC8 The Board conducted extensive outreach on the proposals in ED 261, including roundtable discussions in Melbourne, Brisbane and Sydney, field tests in a number of Australian jurisdictions and other targeted outreach.
- BC9 The Board received ten comment letters in response to ED 261. The key responses to ED 261 were:
- (a) all respondents were supportive of the proposals set out in ED 261 on the basis that the proposals would provide a consistent approach to the accounting for service concession arrangements from a public sector grantor perspective;
  - (b) some respondents commented that the proposals were more rule-based than principle-based. These respondents recommended that a principle-based Standard be developed so that the Standard could address emerging innovative service concession arrangements that perhaps a rule-based Standard would not be able to adequately address; and
  - (c) overall, respondents requested additional guidance and examples on the concept of control, fair value measurement of service concession assets and liabilities, and accounting for the arrangements when transitioning to the Standard.
- BC10 As the Board considered a broad range of issues in developing this Standard following the ED 261 exposure process, numerous issues papers and draft wording for paragraphs of the Standard were published as Board agenda papers. This gave constituents the opportunity to follow the debate and to provide comments on the issues and drafting contemporaneously.
- BC11 In February 2017, the Board also issued a Fatal-Flaw Review version of the Standard for public comment. Submissions were received from seven constituents. The majority of the respondents were supportive of

the Board's approach in the Fatal-Flaw Review version. However, some respondents had concerns particularly over the proposed requirement for a grantor to recognise as a service concession asset an intangible asset that the grantor had not been previously recognised and the proposed guidance on public services. Single respondents also objected strongly to (1) the approach to determining the grantor's control or regulation of the pricing of the services of a service concession asset and (2) the proposed requirement to recognise a service concession arrangement that involves the grant of a right to the operator.

- BC12 The Board considered these issues and the comments received at its March and May 2017 meetings. In particular, the Board added additional implementation guidance to illustrate the differences between service concession arrangements and other types of arrangements (construction and service contracts, leases, and sale and privatisation arrangements). The Board also clarified the treatment of previously unrecognised intangible service concession assets and the application guidance regarding public services, for example.
- BC13 The proposed requirements were then finalised in June 2017 in the form of a Pre-Ballot Draft of the Standard. This version, which typically is distributed only to Board members, was also circulated to the respondents to the Fatal-Flaw Review version that had provided substantive comments. Further comments were received from those respondents and were considered by the Board in finalising the Standard. As a result of those comments, for example, the definition of 'service concession arrangement' was extended to refer to the operator being responsible for at least some of the management of the public services provided through the service concession asset, which had featured in the application guidance and in some of the implementation guidance examples. References to land under roads as service concession assets were also added, and the accounting for upgrades and the replacement of major components of service concession assets clarified.

## Scope

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- BC14 The Board considered various types of arrangements involving public and private sector entities and deliberated whether the Standard should be consistent with IPSAS 32 by applying only to not-for-profit public sector entities.
- BC15 The Board decided that ED 261 should propose application to all public sector entities, rather than being limited to not-for-profit public sector entities, consistent with the Board's policy of transaction neutrality, as applied to public sector grantors of service concession arrangements. The Board noted that this scope would be wider than that of IPSAS 32 as International Public Sector Accounting Standards do not apply to for-profit entities.
- BC16 The Board considered the constituents' feedback on ED 261 and additional outreach, in particular some constituents' concerns that a for-profit grantor applying this Standard may not be able to state that its financial statements comply with International Financial Reporting Standards (IFRS Standards) issued by the International Accounting Standards Board (IASB) (see paragraphs BC124–BC127 for a comparison with IFRS Standards). The Board also noted the constituents' feedback that although they prefer a for-profit entity to be able to state compliance with IFRS Standards when applying this Standard, transaction neutrality across the entire public sector is more important in this instance. The Board therefore reaffirmed its view that the Standard should apply to all public sector entities, whether for-profit or not-for-profit. The Board concluded that this was an appropriate, limited exception to its general policy that compliance with Australian Accounting Standards by for-profit entities would result in compliance with IFRS Standards. The Board noted this approach would reduce or eliminate any incentive for structuring service concession arrangements through for-profit public sector grantors.

## Terminology

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- BC17 IPSAS 32 is expressed in jurisdiction-neutral language. The Board considered that some of the terminology in IPSAS 32 does not readily translate to the Australian environment and decided that different terms and phrases would be appropriate for entities applying Australian Accounting Standards. For example, consistent with the terminology used in other Australian Accounting Standards, the Standard adopts the term 'contract' rather than the term 'binding arrangement', and the Standard refers to operator 'access' rather than 'use' as in the definitions of a 'grantor' and an 'operator' in IPSAS 32.
- BC18 ED 261 proposed defining the term 'public service' as "A service that is provided by government or one of its controlled entities, as part of the usual government function, to the community, either directly (through the public sector) or by financing the provision of services". Constituents in their feedback on ED 261 stated that although they supported the inclusion of a 'public service' definition, the proposed definition was



unclear. The Board concluded that any definition of ‘public service’ would result in similar interpretative issues as those raised by constituents in relation to the definition proposed in ED 261. The Board therefore decided, instead of providing a definition, the Standard should include guidance on ‘public service’ for assessing whether an arrangement is within the scope of the Standard. The Board also noted this approach is consistent with IPSAS 32 and AASB Interpretation 12, which do not contain a definition of ‘public service’. The Board decided that the guidance should be in the form of examples and features to be considered, such as:

- (a) an operator must be responsible for at least some of the management of the service concession asset and related services, and not act merely as an agent of the grantor; and
- (b) services that are insignificant to the arrangement as a whole may be ancillary services.

BC19 The Board also decided to amend the ‘service concession asset’ definition (as proposed in ED 261) so that it refers to an asset accessed by the operator to provide public services on behalf of the grantor, for consistency with the public service guidance.

## **Recognition of service concession assets**

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### **Control**

BC20 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*.

BC21 The Board decided to adopt the IPSAS 32 concept of control (the control or regulation approach) for the following reasons.

BC22 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 and not to provide economic benefits such as revenue generated by such assets (eg from user fees). A control-based approach focuses on control over the service potential of the service concession asset.

BC23 Service concession arrangements are often entered into to share the risks between the grantor and the operator. The Board questioned whether objective criteria could be established as the basis for consistent assessments of the risks and rewards. In addition, the weighting of various risks and rewards was seen to be problematic. The Board also noted the IASB has progressively been moving away from the risks and rewards approach to focus on the concept of control when determining what assets should be recognised (eg AASB 10 and AASB 16 have a primary focus on control, with risks and rewards a secondary consideration). The Board also considered its transaction neutrality approach and noted the risks and rewards approach would be inconsistent with the principles in AASB Interpretation 12. The Board concluded that the risks and rewards approach was not appropriate for an Australian Accounting Standard addressing grantor accounting for service concession arrangements.

BC24 In considering the rights and obligations approach, the Board noted that although this could have conceptual merit, it would represent a significant change in the accounting for and financial reporting of assets and liabilities for public sector entities that could have implications beyond service concession arrangements. The Board concluded that the rights and obligations approach was not appropriate at this time for an Australian Accounting Standard addressing grantor accounting for service concession arrangements.

BC25 The Board discussed application of the concept of control in AASB 10 by analogous interpretation, and decided that the principles for assessing control of an entity may not necessarily be appropriate for assessing control of an individual asset.

BC26 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 greater consistency in the accounting requirements for the operator and the grantor. The Board noted

that this approach would require both the operator and the grantor under a service concession arrangement to apply the same principles in determining which party should recognise the asset in the arrangement. The Board considered that this approach would reduce the possibility of an asset being recognised by both parties, or by neither party to the arrangement.

- BC27 The Board noted that the IPSASB confirmed the control approach in IPSAS 32 in the Basis for Conclusions to *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” (paragraph BC5.14).
- BC28 In considering the concept of control for the recognition of service concession assets, the Board decided that the grantor recognises an asset provided by the operator and an upgrade to or major component replacement of an existing asset of the grantor provided by the operator as a service concession asset if the grantor controls the asset. The grantor essentially controls the asset if the grantor satisfies the specific control criteria in paragraphs 5(a) and (b): 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 controls the residual value (if significant), thus controlling the asset for the majority of its economic life. This mirrors the control concept in AASB Interpretation 12. The Board noted that a broader concept of control currently applies in other Accounting Standards and that an asset that does not meet the control definition of this Standard may still need to be recognised under other Accounting Standards. The Board decided to include application guidance to make explicit the requirement to apply the broader concept of control.

## Regulation

- BC29 In developing the Application Guidance for the control concept, the Board formed the view that there are three main circumstances in which a grantor controls or regulates the price, the services and/or to whom the services must be provided in accordance with paragraph 5(a). The three main circumstances are where the service concession contract:
- (a) *specifies that the grantor controls or regulates* the price, the services and/or to whom the services must be provided;
  - (b) *specifies that a third-party regulator regulates* the price, the 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, the services and/or to whom the services must be provided and the regulation is considered to be set implicitly 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 B20); and
  - (c) *does not specify that a third-party regulator regulates* the price, the 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 5(a), such broad regulatory powers do not constitute control without a specific arrangement or contract (paragraph B21). 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 services, 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 B22).
- BC30 The Board decided that the circumstances noted in the preceding paragraph should form part of the application guidance to assist entities in assessing whether the service concession asset is controlled by the grantor.
- BC31 The Board deliberated whether long-term arrangements, privatisation and outsourcing arrangements should be scoped out of the requirements of the Standard, or whether they should be assessed to determine whether they meet the control criteria of paragraphs 5 or 6 of the Standard. The Board decided that where the arrangements meet the criteria of paragraphs 5 or 6, the arrangements should be accounted for as service concession arrangements. This approach would ensure the substance of an arrangement determines whether the arrangement is subject to this Standard.

## Changes in control

- BC32 The Board considered whether the Application Guidance should require that where there is a change in facts and circumstances indicating the grantor's control of the asset may have changed, the arrangement should be reassessed to determine whether it is still within the scope of the Standard. The Board concluded that the Standard should include such Application Guidance, similar to existing requirements in AASB 16 and AASB Interpretation 4. The Application Guidance should also require that where the grantor no longer controls the asset, as specified in the Standard, the grantor assesses whether the asset should be recognised under another Accounting Standard.

## Residual interest and whole-of-life assets

- BC33 The Board considered whether the Application Guidance should provide guidance on what constitutes a 'significant residual interest', including the determination of 'fair value' and its relationship with a 'whole-of-life' asset, in addressing whether the grantor controls a significant residual interest as set out in paragraph 5(b).

- BC34 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. The judgement should be based on substance rather than form: for example, any residual interest is not necessarily a significant residual interest; and
- (b) the term 'significant' is used in numerous Standards without specific guidance as to what would constitute 'significant'. The Board did not consider specific guidance on the term would be appropriate in this Standard. If the Board were to provide guidance on the term, the Board may need to refer the matter to the IASB for consideration with reference to maintaining compliance with IFRS Standards. Consideration by the IASB on this issue would most likely have implications beyond service concession arrangements.

- BC35 This Standard requires the residual interest in the asset to be measured as the estimated fair value (current replacement cost) of the asset as if it were already of the age and in the condition expected at the end of the service concession arrangement. The Board considered whether guidance should be provided in determining 'fair value' and its relationship to the asset's residual interest, and concluded it was not necessary to provide additional guidance (see paragraph BC69).

- BC36 The Board also considered the relationship between 'significant residual interest' and a 'whole-of-life' asset in determining whether the grantor has control of an asset. The Board decided that if the term of the service concession arrangement:

- (a) is not the economic life of the asset, then paragraph 5 of the Standard applies; or
- (b) is the economic life of the asset, then paragraph 6 of the Standard applies.

The Board noted this is consistent with the general observation that the amount of residual interest at the end of an arrangement is inversely related to the term of the service concession arrangement relative to the economic life of the asset. That is, the residual interest at the end of the arrangement is likely to be significant if the term of the arrangement is not at least the majority portion of the economic life of the asset. Consequently, such an arrangement would be subject to paragraphs 5(a) and (b). Alternatively, where the residual interest is insignificant, the arrangement would be subject either to paragraph 5(a) or, for a whole-of-life asset, paragraph 6.

- BC37 Paragraph 6 of this Standard requires the grantor to recognise an asset that will be used in a service concession arrangement for its economic life (a whole-of-life asset) if the conditions in paragraph 5(a) are met. The Board decided to use the term 'economic life' instead of 'useful life' as proposed in ED 261 (paragraph 9). The economic life of an asset is the period over which future economic benefits are expected from all possible users of the asset, and may be the entire physical life of the asset. Consequently, an asset used in a service concession arrangement for its economic life will not have a significant residual interest at the end of the arrangement, and the condition in paragraph 5(b) will not be relevant. This contrasts with the term 'useful life', which is defined in AASB 116 *Property, Plant and Equipment* as the period over which an asset is expected to be available for use by an entity. An asset used in a service concession arrangement for its useful life (to the grantor) could have a significant residual interest at the end of the arrangement if the arrangement is not for all or the major part of its economic life. In this case, the condition in paragraph 5(b) would be relevant, and paragraph 6 is not applicable.

## Upgrades or replacement of major components

- BC38 The Board extended the definition of ‘service concession asset’ to refer explicitly to upgrades and to replacements of major components of assets, whether of assets provided by the operator or existing assets of the grantor. The Board clarified that upgrades and major component replacements of service concession assets would be recognised by the grantor when the upgrade or replacement occurs, provided that the control criteria in paragraphs 5 or 6 were satisfied. The Board concluded that such upgrades and major component replacements are treated as service concession assets in their own right, and consequently the grantor also recognises a related liability in accordance with paragraph 11.

## Intangible assets

- BC39 The Board considered whether the requirement in paragraph 8 that the grantor reclassify and measure an existing asset that is used in a service concession arrangement should apply to an identifiable intangible asset that has not been recognised previously by the grantor. The intangible asset would not have been recognised previously if the asset did not meet the criteria of AASB 138 *Intangible Assets* for recognition as an intangible asset. The Board decided that AASB 1059 should override AASB 138 and require a grantor to recognise and measure an existing but unrecognised identifiable intangible asset when the conditions in paragraph 5 or 6 for recognition as a service concession asset are met. This would apply even to intangible assets that are specifically precluded from recognition under paragraph 63 of AASB 138: internally generated brands, mastheads, publishing titles, customer lists and items similar in substance. The accounting for intangible assets of the grantor that are part of a service concession arrangement is set out in paragraphs B38–B39.
- BC40 The Board took the view that a service concession arrangement represents a transaction with an external party that identifies and values all identifiable assets involved in the arrangement. Therefore, with the exception of goodwill (see paragraph BC42), the accounting should be similar to that for business combinations under AASB 3 *Business Combinations*, in which all assets and liabilities acquired are recognised, including those not previously recognised by the acquiree. This approach means that intangible assets encompassed by a service concession arrangement should be recognised by the grantor as intangible service concession assets (when the conditions in paragraph 5 or 6 are met), regardless of whether the assets were already recognised by the grantor as intangible assets.
- BC41 The Board considered whether the recognition of previously unrecognised intangible assets as service concession assets should result in revenue for the grantor. The Board decided that the recognition of revenue would not be appropriate since the grantor is not obtaining control of such assets for the first time, but continues to control such assets. Instead, the Board concluded that the recognition is like a remeasurement of the assets, with a corresponding adjustment to revaluation surplus. This aligns with the grantor recognising a liability in respect of service concession assets provided by the operator, since the grantor obtains control of those assets only through the service concession arrangement. Those liabilities are reduced as revenue is recognised in accordance with the substance of the arrangement.
- BC42 The Board noted that a service concession arrangement might encompass a business of the grantor, as defined in AASB 3. This raised the issue of whether the grantor should recognise internally generated goodwill as an asset of the business. The Board considered whether to follow the approach in AASB 3 and require goodwill to be recognised by the grantor. Under this approach, the grantor would measure the business at fair value (current replacement cost) and allocate this amount to the identifiable assets (such as property, plant and equipment and identifiable intangible assets) in the business, measured at their fair value (current replacement cost), with the remaining amount allocated to internally generated goodwill after recognising any liabilities of the business.
- BC43 The Board acknowledged the conceptual merit in applying the AASB 3 approach to identify the assets for recognition in a service concession arrangement, in that the grantor has provided the operator with the right to access the whole business (including any goodwill) for the purpose of providing public services. However, the Board noted that this approach would give rise to difficulties in subsequently assessing goodwill annually for impairment under AASB 136 *Impairment of Assets*, since the revenue to be recognised by the grantor under the service concession arrangement would be limited to the related liabilities recognised, rather than reflecting cash flows of the service concession assets. The Board concluded that the approach in AASB 3 would be difficult to apply in practice, with the costs likely to outweigh the benefits. Consequently, the Board decided not to apply the approach in AASB 3. Instead, the grantor is required by AASB 1059 to recognise only the tangible assets and intangible assets in the business, measured at fair value (current replacement cost) and liabilities of the business. Goodwill is not permitted to be recognised.

- BC44 The Board considered that at the end of a service concession arrangement an intangible service concession asset should continue to be recognised as an intangible asset and accounted for in accordance with AASB 138, excluding the recognition criteria of AASB 138. The Board decided that AASB 1059 would override the recognition criteria of AASB 138, so that an intangible asset would not be derecognised at the end of the service concession arrangement merely because it could not satisfy the recognition requirements of AASB 138. However, the derecognition criteria in AASB 138 would apply, so that the grantor would be required to derecognise the intangible asset if the grantor loses control of the asset.

## Land under roads

- BC45 The Board noted that a service concession arrangement might involve land under roads. AASB 1051 *Land Under Roads* requires land under roads to be recognised as an asset only by local governments, government departments, General Government Sectors and whole of governments, and only in respect of land under roads acquired after the end of the first reporting period that ended on or after 31 December 2007. AASB 1051 notes that AASB 116 applies to land under roads when recognised. The Board concluded that, to be consistent with the requirement in this Standard for a grantor to recognise previously unrecognised identifiable intangible assets that are controlled by the grantor as service concession assets, grantors would also be required to recognise land under roads as service concession assets when the control criteria in paragraphs 5 or 6 were satisfied. The Board decided that this requirement would apply to all grantors, not just grantors that were subject to AASB 1051.

## Measurement of service concession assets

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- BC46 The Standard addresses subsequent measurement of service concession assets by reference to AASB 116 and AASB 138, on the grounds that service concession arrangements relating to other types of assets are unlikely. That does not prevent application of this Standard to other types of assets included within a service concession arrangement.
- BC47 The Board considered the measurement of a service concession asset at fair value in accordance with AASB 13 in relation to the characteristics of the asset and valuation techniques for measuring the fair value of the asset.

## Characteristics of the asset

- BC48 In considering the characteristics of the asset when measuring fair value, the Board noted AASB 13 requires the grantor to consider the characteristics of the service concession asset that market participants would take into account when pricing the asset at the measurement date. Characteristics include the condition and location of the asset as well as any restrictions on the sale, transfer or use of the asset. The effect of restrictions on the sale, transfer or use of the service concession asset depends on whether the restriction is deemed to be a characteristic of the asset or a characteristic of the grantor that controls the asset. Where a restriction would transfer with the asset in an assumed sale or transfer, the restriction would generally be regarded as a characteristic of the asset and likely to be considered by a market participant in pricing the asset. On the other hand, a restriction that is specific to the grantor and that would not transfer with the asset in an assumed sale would not be considered in measuring the fair value of the asset. Whether a restriction is a characteristic of the service concession asset or specific to the grantor requires judgement based on the specific facts and circumstances of the arrangement.
- BC49 A market participant may consider that the right of access provided by the grantor to the operator does not represent a restriction on the grantor's use of the asset. In a service concession arrangement, control of the asset and therefore the right to use the asset is retained by the grantor (and transferred to the market participant in a hypothetical transaction). Under this view, the right of access provided to the operator would not represent a restriction on the use of the asset.
- BC50 The assessment of restrictions is important for service concession arrangements involving the grant of a right to the operator (GORTO) model, where the grantor provides the operator with a right to charge the users of the service concession asset. To the extent that a market participant (acting in its economic best interest) would take into account in measuring the fair value of the asset the fact that a third-party operator has been granted a right to charge users, this could result in a different fair value compared to that for an equivalent asset without such a characteristic, such as the service concession asset under an arrangement that involves only the financial liability model. In the latter case, any obligation to pay the operator under the financial liability model that would be transferred to the market participant would be separately recognised, not netted against the asset.

- BC51 The Board discussed the unit of account in AASB 13, which defines it as the level at which an asset or a liability is aggregated or disaggregated in a Standard for recognition purposes. The Board noted there are three possible bases for identifying a service concession asset: the service concession period, the economic life after the end of the arrangement (the residual), or both the concession period and any remaining economic life.
- BC52 The Board noted some may view the grant of a right to the operator to earn revenue from third-party users of the asset means that the grantor's service concession asset is only the residual interest in the asset after the service concession period. Under this view, the grantor's interest in the service concession period component of the asset is effectively derecognised, consistent with a rights and obligations approach.
- BC53 In the development of IFRIC 12, the IFRIC decided that when the operator in a service concession arrangement does not have the right to control the underlying use of the asset, the operator instead has access to operate the asset to provide a service on behalf of the grantor. In essence, the operator acts as a service provider (IFRIC 12, paragraphs BC24–BC25). Accordingly, it is the grantor that has control of the underlying use of the asset during both the service concession period and any residual period thereafter. The Board therefore concluded the unit of account is the entire service concession asset, not just the residual interest after the service concession arrangement ends.

## Valuation techniques for measuring fair value

- BC54 AASB 13 outlines three 'widely used' valuation techniques for measuring fair value (paragraph 62): the market approach, the income approach and the cost approach. AASB 13 does not specify which valuation technique is more appropriate. Instead, AASB 13 states that:
- (a) an entity uses the valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs;
  - (b) the inputs selected should be consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability; and
  - (c) the fair value hierarchy (Level 1, 2 and 3 inputs) prioritises the inputs to the valuation techniques, not the valuation techniques used to measure fair value.

### Market approach

- BC55 The Board noted service concession assets are subject to terms and conditions determined on a project by project basis and are rarely exchanged between willing sellers and buyers. Accordingly, it is highly unlikely that the market approach would be applicable to measuring service concession assets, although this would depend on the facts and circumstances.

### Income approach

- BC56 The income approach converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts (AASB 13, paragraph B10).
- BC57 Service concession assets are used to provide goods or services to achieve public service objectives and consequently the prices that might be charged for those goods or services may be regulated. Price regulation would have the effect of restricting the future cash flows that could be obtained from the assets. The fees the operator can charge users may be at a significant discount and hence this would not reflect the fair value of the asset based on what a market participant may choose to charge under commercial terms. Service potential (ie capacity to provide future services) rather than future economic benefits (ie future cash flows) is likely to drive decisions regarding service concession assets.
- BC58 The Board considered whether the grantor's contractual obligation to make a predetermined payment or series of payments to the operator under the financial liability model could be a measure of the fair value of the asset. Where the grantor's payments to the operator represent the price that the operator expects for the construction, development, acquisition or upgrade of a service concession asset based on the expectations of the cash flows which could be generated by the asset, this method may be appropriate for determining fair value at initial recognition as a surrogate for the income approach. However, the cash payments promised to the operator under the financial liability model might have no direct relationship to the cash flows expected to be generated from the asset (for example, the grantor may choose not to charge users) and the income approach would not be appropriate.

- BC59 The Board noted some may view the grant of a right to the operator to earn revenue from third-party users of the asset as a restriction that a market participant would recognise when using the income approach (see also paragraph BC50). Under this view, the asset should be measured only in relation to the service potential of the asset after the service concession period has expired, ie at the fair value of the residual interest in the asset (see also paragraphs BC52–BC53). This is on the basis that the market participant buyer will not have the right to all the cash flows that could be generated by the asset as the right to the cash flows for the service concession period has been granted to the operator (effectively the service concession period component of the asset would be derecognised). Under this view, the service concession asset’s fair value relates only to the cash flows that can be directly generated for the grantor by the asset. Consequently, the fair value of the asset would be measured at the asset’s residual value.
- BC60 However, the Board noted a public sector entity uses a service concession asset’s capacity or service potential to provide goods or services to achieve public service objectives, replacing the asset irrespective of whether the replacement cost will be recovered by the expected cash flows that the asset may generate. The Board also noted the view that the service potential of a service concession asset (such as a road) under a service concession arrangement involving the financial liability model and the service potential of an identical asset (such as a toll road) under a service concession arrangement involving the GORTO model is the same from the grantor’s perspective as both assets will provide the same utility to the public. Under this view, the fair value of these assets should therefore be measured consistently. The Board concluded that the fair value of the asset would be understated if it was measured at the fair value of the residual interest in the asset.
- BC61 The Board also noted its decision to recognise, under the GORTO model, a contract liability that is initially recognised and then reduced as revenue is recognised (see paragraphs B71–B72 and BC80). The Board considered whether the amortisation profile of the contract liability should be determined so that the net balance of the service concession asset and the contract liability approximates the fair value of the residual interest in the asset. Whilst this would effectively mean a more consistent outcome with the financial liability model, the Board considered this approach would be practically difficult, with the costs likely to outweigh the benefits. The Board also expected that in many instances there would not be a material difference between this net approach and amortisation of the liability on a time basis. The Board therefore concluded that this approach was not appropriate.

### **Cost approach**

- BC62 The cost approach “reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost)” (AASB 13, paragraph B8). This approach uses Level 2 and/or Level 3 inputs, which are observable or unobservable inputs. Current replacement cost is the “cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence” (AASB 13, paragraph B9). The Board noted that current replacement cost is often used to measure the fair value of assets that are used in combination with other assets or with other assets and liabilities. This is particularly relevant if the service concession asset is part of an integrated network of assets, such as the provision of a transport network.
- BC63 The Board noted (in paragraph BC60) a public sector entity uses a service concession asset’s capacity or service potential to provide goods or services to achieve public service objectives, replacing the asset irrespective of whether the replacement cost will be recovered by the expected cash flows that the asset may generate. This view would be consistent with measuring the asset using current replacement cost under the cost approach in AASB 13.
- BC64 Additionally the Board’s view (in paragraph BC60) is that the service potential of a service concession asset under a service concession arrangement involving the financial liability model and the service potential of an identical asset involving the GORTO model is the same from the grantor’s perspective, as both assets will provide the same utility to the public. The fair value of these assets should therefore be measured consistently.
- BC65 Unlike the other valuation methodologies, current replacement cost would result in the same value under both the financial liability model and the GORTO model. Current replacement cost would not include the restriction on the asset (see paragraph BC49) of the grantor having granted the operator the right to charge users as the restriction relates to future cash flows from the asset rather than the costs to replace the asset to provide its current service potential. The Board’s considerations of whether the granting of the right to future cash flows should be recognised as a separate liability are set out in paragraphs BC79–BC80.
- BC66 The Board concluded a service concession asset is an asset that is obtained through construction, development, acquisition, upgrade or replacement of a major component of an asset. The asset’s capacity or service potential is used to achieve public service objectives irrespective of whether the cost of the asset will be recovered by the expected cash flows that the asset may generate. The Board therefore concluded

that it is appropriate to initially measure service concession assets at fair value using only current replacement cost under the cost approach to fair value. The Board noted that this approach applies to for-profit public sector grantors as well as to not-for-profit public sector grantors, given the objective of the Standard. The Board preferred the same measurement basis for all public sector grantors, even though it is possible that a for-profit grantor might hold service concession assets for both their service potential and their future cash flows.

## Measuring reclassified assets at fair value

- BC67 The Board deliberated whether an existing asset of a grantor that is reclassified as a service concession asset should be measured at current replacement cost in accordance with the cost approach to fair value in AASB 13. The Board concluded the reclassification of the grantor's existing asset represents a change in the nature of the asset (even an intangible asset) to a service concession asset and should therefore be measured on the same basis as a service concession asset acquired through the operator.
- BC68 The Board acknowledged the requirement for a grantor to initially measure a service concession asset at fair value (current replacement cost) in accordance with the cost approach in AASB 13 may result in a for-profit grantor not being able to state that its financial statements comply with IFRS Standards. This is because AASB 13 (and the corresponding IFRS 13 *Fair Value Measurement*) permits other valuation techniques (see paragraphs BC124–BC125).
- BC69 The Board decided not to provide additional guidance on the measurement of a service concession asset on the grounds that this would best be developed in the future through a separate project on the measurement of public sector assets. The Board also considered whether the Standard should include additional guidance in the following areas and decided there is sufficient guidance in the Standard and/or other Standards:
- (a) determination of the fair value of a partly constructed asset – the Board noted there is a broad range of techniques in AASB 15 *Revenue from Contracts with Customers* that, depending on the nature of the contract, could be used to establish the fair value of a partly constructed asset;
  - (b) the valuation approach for intangible service concession assets – the Board decided intangible service concession assets should not be treated differently from tangible service concession assets on initial recognition. In both cases, the asset's capacity or service potential is used to achieve public service objectives irrespective of whether the cost of the asset will be recovered by the expected cash flows that the asset may generate. Consequently, the measurement of the asset at initial recognition should not be affected by whether the service concession asset is a tangible or intangible asset; and
  - (c) accounting for economic obsolescence in determining the fair value of the asset – as noted in paragraph BC66, the Board concluded that the fair value of a service concession asset should be measured using the cost approach. The cost approach (the current replacement cost) reflects the amount required currently to replace the service capacity of an asset. Current replacement cost takes obsolescence into consideration. AASB 13 provides examples of obsolescence, such as physical deterioration, functional (technological) obsolescence and economic (external) obsolescence, and notes that it is broader than depreciation.

## Intangible assets

- BC70 The Board decided that after the initial recognition of an intangible service concession asset, it should be accounted for in accordance with AASB 138, subject to the provisos in paragraph 9 of this Standard. The depreciable amount of the intangible asset would be amortised over its useful life. However, if the grantor elected (or was required) to measure the asset under the revaluation model, current replacement cost would continue to be used as the basis for fair value measurement, overriding the active market requirements in AASB 138 for the revaluation of intangible assets. The Board noted this approach is consistent with its decision to measure an asset at fair value (current replacement cost) on the basis of the asset's service potential, rather than on the basis of whether there is an active market for the fair value of the asset.

## Recognition and measurement of a liability

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### Financial liability model

- BC71 The Board considered issues relating to the recognition of a financial liability and, consistent with the key principles of IPSAS 32, decided that a financial liability should be recognised when the grantor has a contractual obligation to deliver cash or another financial asset to the operator.



- BC72 A financial liability arises when the grantor is obligated to make a determinable payment or series of payments to the operator. The Board agreed with the IPSASB conclusion that when there is a determinable payment or series of payments of cash or cash equivalents, the payments should be allocated as a reduction of the liability, an imputed finance charge (if any), and charges for services provided by the operator under the service concession arrangement. The Board determined that wherever possible the existing guidance in AASB 9 *Financial Instruments* should apply.
- BC73 The Board considered whether a financial liability arises when an arrangement requires the grantor to make payments to the operator based on third-party usage of the service concession asset without guaranteeing a minimum amount to the operator. The Board considered the application of the financial liability model to this case by assessing the notion that the grantor may not have a contractual obligation to pay the operator specified or determinable amounts at the inception of the arrangement as specified in paragraph 15. As noted in paragraph B63, the grantor has a financial liability if it does not have an unconditional ability to avoid the obligation to make the payments to the operator. The grantor is not able to avoid the payments as it cannot control the usage of the service concession asset by third parties, and any attempt to restrict usage may result in penalties under the arrangement. The amounts payable by the grantor to the operator are contingent upon the level of third-party usage of the service concession asset. Paragraph 25 of AASB 132 *Financial Instruments: Presentation* affirms this view that a grantor may have a contractual obligation in the form of a financial liability when the amounts are not specified or determinable at inception but are contingent on the occurrence or non-occurrence of uncertain future events. The Board also decided that AASB 9 should be applied to the accounting for the financial liability subsequent to its initial recognition. Accordingly, the Board decided that, for the arrangement under consideration, the financial liability model should be applied (as set out in paragraph 16(a)), with the financial liability initially recognised at the same amount as the fair value of the service concession asset, and the grantor applying AASB 9 subsequently to the accounting for the financial liability. The Board noted this view is consistent with its decision to not include in ED 261 or AASB 1059 the guidance in paragraph AG49 of IPSAS 32 relating to treating shadow tolls payable by the grantor as payments for the usage and not the acquisition of the service concession asset.
- BC74 The Board noted that the approach described in paragraph BC73 may result in asymmetry in accounting for the same arrangement by the operator. This is due to AASB Interpretation 12 (paragraph 16) permitting the operator to recognise a financial asset only to the extent that it has an unconditional present right to receive cash from or at the direction of the grantor. The operator has an unconditional contractual right to receive cash if the grantor contractually guarantees the operator's cash flows. In the absence of a guarantee from the grantor, the operator's contractual right is conditional on third-party usage of the service concession asset, and the operator recognises an intangible asset rather than a financial asset. The Board concluded the principles appropriate to this Standard are more important than achieving symmetry in accounting by the parties to the service concession arrangement.
- BC75 Consistent with AASB Interpretation 12, this Standard requires the application of the financial instrument Standards to the financial liability recognised under paragraph 11, except where this Standard requires otherwise. In deliberating the application of the financial instrument Standards to the recognition of a financial liability, the Board considered the following:
- (a) whether the financial liability should be measured in accordance with AASB 9 rather than measured initially at the same amount as the service concession asset (current replacement cost). The Board noted that consistent with AASB 9 there is no day-one gain or loss to be recognised, and concluded that the costs of separately measuring the fair value of the financial liability would outweigh the benefits of doing so;
  - (b) whether to retain, in paragraph 18, the requirement proposed in ED 261 that the grantor allocates the payments to the operator under the contract and accounts separately for the finance charge. The Board noted this proposed requirement would apply if the financial liability is subsequently measured at amortised cost in accordance with AASB 9. However, AASB 9 permits other methods in the subsequent measurement of a financial liability, such as fair value through profit or loss. The subsequent measurement of a financial liability at fair value through profit or loss would not require separate accounting for a finance charge. The Board decided, given AASB 9 addresses the separate accounting for a finance charge, it is sufficient for AASB 1059 to refer to the financial instrument Standards in this respect without providing additional guidance;
  - (c) whether to retain the guidance proposed in ED 261 relating to the appropriate interest rate for determining the finance charge (if any). The Board decided to replace the reference in ED 261 to determining the finance charge using the rate implicit in the arrangement. The Standard (paragraph B67) instead refers to determining the finance charge using the effective interest method when the financial liability is subsequently measured at amortised cost in accordance with AASB 9; and

- (d) whether to include guidance relating to the appropriate interest rate for initially measuring the financial liability component in a hybrid arrangement, since the financial liability component is measured first, and an interest rate is needed in order to discount the expected future cash flows to a present value. The Board decided to include application guidance (see paragraph B64) that the grantor shall, in the first instance, use the contractually specified interest rate in the arrangement to initially measure the financial liability component of a hybrid arrangement in accordance with AASB 9. If it is not practicable to determine the contractually specified interest rate, the grantor would determine the appropriate rate using the prevailing market rate(s) of interest for a similar instrument with a similar credit rating, following the requirements of AASB 9. Examples of rates for a similar instrument include the operator's cost of capital specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement.

## **Grant of a right to the operator (GORTO) model**

- BC76 The GORTO model applies when the grantor grants the operator the right to earn revenue from third-party users of the service concession asset. Under the GORTO model, the grantor transfers to the operator an intangible asset (being a right to charge users of the service concession asset) in exchange for the construction, development, acquisition or upgrade of a service concession asset and the provision of related future services. The Board considered whether the grantor should initially recognise revenue or a liability when it obtains control of the service concession asset arising from a service concession arrangement. The Board noted that IPSAS 32 requires a grantor to initially recognise a liability when the grantor recognises the service concession asset. Given its policy of transaction neutrality, the Board considered whether the requirements of Australian Accounting Standards, specifically the application of AASB 15 either directly or by analogy, would support:
- (a) the recognition of a liability (consistent with IPSAS 32); or
  - (b) the recognition of revenue on the basis that the grantor has no remaining obligations to the operator once it has transferred to the operator the right to charge users.
- BC77 The Board concluded that, from a grantor's perspective, the application of AASB 15 without further guidance may lead to divergence in accounting for a service concession arrangement, as significant judgement would be required to determine whether a service concession arrangement in which the grantor transfers an intangible asset to the operator is within the scope of AASB 15. The Board noted differing views on whether a service concession arrangement involves a contract with a customer (ie whether the right to charge users is considered a licence, whether the operator is considered a customer, or whether the ordinary activities of government include undertaking service concession arrangements as a grantor), and depending on the specific facts and circumstances some service concession arrangements might be a right-of-use licence and others a right of access. The Board preferred the view that the substance of the transaction appears more akin to financing the construction of the service concession asset, rather than a contract with a customer.
- BC78 The Board also noted, in a service concession arrangement, the grantor makes promises, either explicitly or implicitly, to undertake activities in relation to the service concession asset that will benefit the operator. This reflects the fact that a service concession asset is controlled and managed by the grantor to provide public services. The Board acknowledged that the grantor's promise, or the operator's expectation, that the grantor will undertake activities that benefit the operator may in some instances be comparable to promises made by a licensor or expectations of a licensee that the licensor will undertake activities in relation to intellectual property that will benefit the licensee. AASB 15 identifies such licences as licences that provide the licensee with a right to access the underlying intellectual property. AASB 15 specifies that the promise of a right to access intellectual property is a performance obligation that is satisfied over time and the licensor would recognise a contract liability for its remaining performance obligation to provide access.
- BC79 The Board decided that facts and circumstances would need to be assessed for each arrangement to determine whether the arrangement represented a right-of-access licence or a right-of-use licence. The Board preferred all service concession arrangements to be treated the same way, as it did not see the substance of service concession arrangements being different in respect to commitments under the arrangements. The Board also noted that recognising revenue immediately on a service concession asset that would otherwise be considered loss making from a cashflow perspective would not reflect the economic substance of the arrangement and would overstate current year financial performance. The Board further noted that immediate recognition of revenue (rather than a liability) would result in overstatement of the financial position as the requirement to use current replacement cost as fair value recognises the asset in full, even though the right to charge users of the asset has been transferred to the operator.

- BC80 Consequently, the Board concluded the grantor's promises to undertake activities in relation to the service concession asset that will benefit the operator should also be accounted similarly to a contract liability. The grantor would subsequently recognise revenue as the 'access' is provided to the operator over the service concession period.
- BC81 In some service concession arrangements, the right to charge users is described as a licence. The Board noted that accounting for licences other than those relating to service concession arrangements should be subject to further research to inform the Board as to whether a separate project would be required. Determining whether a particular licence granted by a government is within the scope of AASB 15 would depend on the facts and circumstances.
- BC82 Given the importance of service concession arrangements to governments and the lack of accounting guidance for such arrangements in the absence of AASB 1059, the Board decided that service concession arrangements should be treated separately from other licences granted by governments.
- BC83 The Board considered whether the Standard should include additional guidance on the principle-based approach to recognising revenue under the GORTO model. The Standard (paragraph 22) specifies that the grantor recognises revenue and reduces the GORTO liability according to the economic substance of the arrangement. The Board assessed the following options of whether to:
- (a) require revenue to be recognised on a systematic and rational basis using the straight-line method. This option would eliminate divergent approaches to recognising revenue but would not be consistent with the objective of the Board to develop a principle-based accounting standard; or
  - (b) not provide additional guidance in the final Standard on the basis there is sufficient guidance in the Standard. Paragraph B71 requires revenue to be recognised and the liability reduced based on the economic substance of the arrangement, usually as access to the service concession asset is provided to the operator over the term of the service concession arrangement.
- BC84 The Board decided not to add additional guidance. Revenue recognition should be based on the economic substance of the specific arrangement as assessed by the grantor and should not be prescribed by the Board.

## Other liability recognition and measurement models

- BC85 The Board considered the following alternative recognition and measurement models to the GORTO model:
- (a) applying the financial liability model to all service concession arrangements;
  - (b) accounting for the assets of the arrangement and not the right to charge users for the use of the service concession asset that has been granted by the grantor to the operator; and
  - (c) application of AASB 140 *Investment Property* by analogy.
- BC86 In analysing whether the financial liability model could be applied to all service concession arrangements, the Board considered:
- (a) whether the nature of the party (the grantor or the users of the service concession asset) that makes the payment to the operator determines the accounting model for the grantor to recognise a service concession liability. Consistent with AASB Interpretation 12, the Board concluded the party that has the responsibility to make payments to the operator is important in determining the accounting model for the grantor's recognition of the liability. This view takes into account who bears the demand risk (ie the ability and willingness of the users to use and pay for the services). This view is consistent with the models in this Standard and mirrors the requirements of AASB Interpretation 12. That is, under the financial liability model, the grantor is the party with the primary responsibility to make payments to the operator for the services. This contrasts with the GORTO model, where the operator is the party that bears the demand risks. Accordingly, the use of different models (ie the financial liability model and the GORTO model) to account for the liability is more appropriate; and
  - (b) whether the grantor has a financial liability when the operator has been granted the right to charge third-party users for the use of the asset. The Board concluded that the grantor does not have a financial liability under GORTO arrangements. That is, the grantor does not have a contractual obligation to deliver cash or another financial asset to the operator nor exchange financial assets or financial liabilities with the operator under potentially unfavourable conditions.
- BC87 The Board considered whether the more appropriate approach under the GORTO model is to recognise only the cash flows that the service concession asset can generate directly (the residual cash flows to the grantor). The implication is that the fair value of the asset could be measured at the asset's residual value (which could be zero), excluding the cash flows generated by the asset that have been granted to the operator. However, the Board concluded that the fair value of the asset should be measured using the current

replacement cost under the cost approach irrespective of whether the cost of replacing the asset will be recovered by the expected cash flows that the asset may generate (see paragraphs BC63–BC66). In addition, the grantor would recognise a GORTO contract liability (see paragraphs BC79–BC80).

- BC88 The Board also considered the application of AASB 140 by analogy to address the implication of measuring the asset's fair value based on only the cash flows that are directly generated by the service concession asset for the grantor. Although this approach might be appropriate under AASB 13, the resulting fair value of the service concession asset would be understated in relation to the service concession arrangement. The application of AASB 140 by analogy attempts to overcome this.
- BC89 Under AASB 140, the fair value of investment property reflects expected future cash flows, including any future rental receipts. AASB 140 (paragraph 50) makes clear that in determining the carrying amount of investment property under the fair value model, it is necessary to avoid double-counting assets or liabilities that are recognised separately, such as prepaid or accrued rental income and lease incentives. In such cases, the fair value (carrying amount) of the investment property is adjusted so that in total the combination of all related amounts gives the fair value of the investment property.
- BC90 The Board considered that to apply the AASB 140 approach to the GORTO model, the fair value of the service concession asset would first be determined on a gross basis (ie current replacement cost for the full service potential of the asset). Then a GORTO contract liability would be recognised, so that in total the combination of the service concession asset and the liability would give on a net basis the appropriate measure of the service concession asset, reflecting the cash flows expected to be generated for the grantor. This approach would avoid measuring the service concession asset at a net amount, such as the residual value of the asset.
- BC91 However, the Board decided that the investment property model should not be applied by analogy. The Board concluded (see paragraph BC66) that service concession assets should be measured at fair value (current replacement cost) in relation to the service potential of the asset, rather than reflecting only the expected future cash flows for the grantor.

## Dividing an arrangement

- BC92 In response to constituents' comments, the Board decided to revise the approach to dividing a hybrid arrangement that had been proposed in ED 261. Instead of noting that each component of the service concession liability should be measured at fair value, the Standard requires that:
- (a) the liability recognised under a hybrid arrangement is initially measured at the same amount as the fair value (current replacement cost) of the service concession asset; and
  - (b) the method for dividing the liability under a hybrid arrangement is to determine the financial liability part of the liability first, with the remainder of the fair value (current replacement cost) of the service concession asset allocated to the part related to the grant of the right to the operator.
- BC93 The Board, in making the decision in paragraph BC92(b), considered whether the amounts allocated to the financial liability and the GORTO liability should depend on the entity's ability to determine the fair value of the service concession asset to be accounted for in relation to each liability model in the hybrid arrangement. For example, if the fair value of the service concession asset related to the grant of the right to the operator could be reliably determined, a method of dividing the hybrid arrangement might be to allocate this amount to the GORTO liability, with the remainder of the total liability to be allocated to the financial liability. However, the Board took the view that it would be difficult to determine fair values for the portions of a service concession asset related to each of the two liabilities, if it were possible. Similarly, it would be difficult to determine fair values for both liabilities directly, to allow the fair value (current replacement cost) of the service concession asset to be allocated to each liability based on their relative fair values, following the approach in AASB 15 to allocating the transaction price to performance obligations. Furthermore, since the liability is not measured directly at fair value under the financial liability model (see paragraph BC75), it would be inappropriate to require such measurement in relation to recognising a hybrid arrangement.
- BC94 The Board concluded the appropriate approach would be to measure the financial liability part of the total liability first, with the remainder of the total liability allocated to the GORTO part of the liability. This approach avoids understating the financial liability, which might occur if the GORTO liability is measured first. Overstatement of the GORTO liability would mean overstatement of the revenues recognised by the grantor under the service concession arrangement. The financial liability is measured and recognised first, even where the service concession asset is under construction. This is illustrated in Example 8 of the Illustrative Examples accompanying this Standard.

## **Accounting issues addressed in other Australian Accounting Standards**

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BC95 Due to the complexity of many service concession arrangements, there may be additional accounting issues related to certain terms in the contract (for example, revenues, expenses, guarantees and contingencies). The Board decided that it was not necessary to repeat in this Standard guidance that appears in other Standards. Accordingly, when another Australian Accounting Standard specifies the accounting and reporting for a component of a service concession arrangement, this Standard references the specific Standard without necessarily providing additional guidance. However, the Board noted some cases (for example, revenue recognition) when the application of another Standard might be difficult, given certain unique features in service concession arrangements. To facilitate consistent implementation of this Standard, the Board decided to provide additional guidance on applying the principles in other Standards when appropriate.

### **Other revenues**

BC96 The Board considered whether to include in this Standard the Application Guidance paragraphs AG55–AG64 of IPSAS 32 for other revenues. Other revenues relate to compensation by the operator to the grantor for access to the service concession asset by providing the grantor with a series of predetermined inflows of resources, including the following:

- (a) an upfront payment or a stream of payments;
- (b) revenue-sharing provisions;
- (c) a reduction in a predetermined series of payments the grantor is required to make to the operator; and
- (d) rent payments for providing the operator access to a revenue-generating asset.

BC97 The Board decided this guidance was not necessary in the Australian context as the existing revenue recognition guidance in Australian Accounting Standards was sufficient.

BC98 In setting the requirement in paragraph 12, the Board noted deliberations by the IFRS Interpretations Committee on IFRIC 12 with respect to payments by the operator to the grantor. The Board concluded no additional guidance was necessary in relation to the requirement that the grantor recognise the liability initially at the same amount as the service concession asset, adjusted by the amount of any other consideration from the grantor to the operator, or from the operator to the grantor.

BC99 The Board observed that adjusting the liability for additional consideration from the operator to the grantor differed from the approach set out in an IFRIC agenda decision (July 2016). The IFRIC agenda decision noted that where the operator recognised a financial asset under a service concession arrangement, the operator would account for the payments to the grantor as a reduction of the transaction price, reducing the operator's revenue. Under this Standard, the payments from the operator would increase the grantor's liability, rather than reduce the carrying amount of the service concession asset. The asset is measured at fair value (current replacement cost) as a fundamental principle of this Standard, in order to reflect the service potential of the asset rather than future cash flows. The adjustment to the liability affects the grantor's revenue based on the pattern of revenue recognition during the period of the service concession arrangement.

## **Disclosures**

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BC100 The Board proposed in ED 261 only minor changes to the disclosure requirements in IPSAS 32. In finalising the Standard, the Board added the objective of the disclosure requirements to paragraph 28, and clarified in paragraph 29 the flexibility for a grantor to classify service concession assets across more than one class of assets for the purposes of AASB 116 or AASB 138, as appropriate, and for the disclosures required by this Standard.

## **Transition**

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BC101 This Standard requires an entity to apply the Standard retrospectively either in accordance with AASB 108 or under a simplified approach from the beginning of the earliest period for which comparative information is presented in the financial statements (the date of initial application). The modified retrospective approach requires a grantor to recognise and measure service concession assets and related liabilities at the date of initial application, rather than at an earlier date.

- BC102 The general requirement in AASB 108 is that accounting policy changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable. The Board noted that there are two aspects to retrospective application: reclassification and measurement. The Board took a similar view to the IPSASB that it will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in a grantor's statement of financial position, but that retrospective measurement of service concession assets might not always be practicable, particularly if an entity has not previously recognised service concession assets and related liabilities, revenues and expenses.
- BC103 As proposed in ED 261, the Board decided that the modified retrospective approach should be available to grantors that have previously recognised service concession assets and related liabilities, as well as to grantors that have not done so. This contrasts with IPSAS 32, which limits this option to grantors that have not previously recognised service concession assets and liabilities. The Board concluded that since the retrospective restatement of service concession assets might not always be practicable, the modified approach would be made available to all grantors.
- BC104 Under the modified retrospective approach (see paragraph C4 of the Standard), the deemed cost of service concession assets is measured at fair value (current replacement cost) at the date of initial application. The Board decided this measurement basis should also apply to assets of the grantor that are reclassified as service concession assets on initial application of the Standard, thus requiring the remeasurement of such assets. The Board noted that this would be consistent with the requirement in paragraph 8 for grantors to measure existing assets that are reclassified as service concession assets at current replacement cost in accordance with the cost approach to fair value at the date of reclassification. ED 261 had not proposed any remeasurement for reclassified assets.
- BC105 The Board considered the approach to the initial recognition by a grantor of previously unrecognised identifiable intangible assets and land under roads as service concession assets on transition, and concluded that no additional transition relief was required. A grantor may elect to apply the modified retrospective approach, requiring measurement of service concession assets at the date of initial application of the Standard, to simplify the measurement of such assets.
- BC106 The Board decided to clarify in the Standard the approach to measuring a liability under the GORTO model when the grantor adopts the modified retrospective transition approach. The starting point is to measure the fair value (current replacement cost) of the service concession asset at the date of initial application, and then adjust that measure to reflect that part of the term of the service concession arrangement has passed. There were different views as to how to make that adjustment. The Board concluded that the adjustment should reflect the remaining service concession period relative to the remaining economic life of the service concession asset, on the grounds that the current measurement of the asset represented the future benefits inherent in the asset. The Board decided to include an example to illustrate the adjustment required.
- BC107 The Standard requires that any net adjustment to the carrying amounts of assets and liabilities is recognised as an adjustment to the opening balance of accumulated surplus (deficiency) at the date of initial application. Accordingly, the Standard requires that if the grantor elects as its accounting policy the revaluation model in AASB 116 or AASB 138 (or is required to adopt that policy), any relevant adjustment is included in accumulated surplus (deficiency) and not revaluation surplus. The Board noted that the amount of such an adjustment could not be used to offset future changes in the values of an asset or liability. This is consistent with the treatment in AASB 108 for a change in accounting policy. However, this differs from the approach permitted by IPSAS 32, where such an adjustment would be included in revaluation surplus.

## **Effective date**

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- BC108 The Board noted that ED 261 had proposed an effective date of annual reporting periods beginning on or after 1 January 2017, which was no longer feasible. The Board decided the effective date of the Standard should be annual reporting periods beginning on or after 1 January 2019, on the basis that that date would:
- (a) effectively provide two years, from the issue date, for implementing the Standard for entities that have a 30 June reporting date. This aligns with constituents' comments that this Standard will need a significant amount of time to implement; and
  - (b) align with the effective date of AASB 15 and AASB 1058 *Income of Not-for-Profit Entities*, which this Standard cross-references (see paragraph 27). Although the effective date of this Standard need not align with those Standards, the Board considered having the same effective date would assist grantors in the overall implementation of the Standards.

## GAAP/GFS convergence

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- BC109 The Board discussed implications of its decisions on GAAP/GFS harmonisation. The Board noted that key differences between Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS) may arise in relation to the following:
- (a) service concession arrangement terminology – GFS refers to such arrangements as ‘Public Private Partnerships’ (PPP);
  - (b) assessment of whether the grantor recognises a service concession asset – assessment is based on the risks and rewards approach under GFS rather than the control and regulation approach in this Standard;
  - (c) accounting for a service concession arrangement – the arrangement is accounted for as a finance lease under GFS, but with some differences to AASB 16. The difference in accounting will likely result in differences between GAAP and GFS in the amounts of the assets and liabilities recognised both initially and during the term of the arrangement;
  - (d) revaluation of service concession assets – GFS requires the asset to be measured using the revaluation model. This Standard references AASB 116 and AASB 138, which permit the cost and revaluation models. AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires fair value measurement and the revaluation of assets consistent with the market value measurement requirements of GFS; and
  - (e) the liability recognised under the GORTO model – GFS acknowledges the GORTO model but does not provide specific accounting requirements. Instead, GFS notes most PPPs are unique and the accounting is to be considered on a case by case basis.
- BC110 The Board weighed its policy on GAAP/GFS harmonisation against its policy of transaction neutrality. The Board observed that some areas of potential difference were known when developing AASB 1049. Others are driven by a difference in the underlying principles. Further, some differences could only be addressed by making changes to the underlying principles in AASB 1059.
- BC111 On balance, the Board considered that it was not necessary to amend its decisions reflected in AASB 1059 in order to better achieve GAAP/GFS harmonisation. The Board noted that AASB 1049 will require entities to identify and explain any material differences arising from different requirements in GAAP as compared with GFS.

## Comparison with IPSAS 32

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- BC112 This Standard incorporates the key requirements of IPSAS 32, with the main differences detailed in the paragraphs below.

### Scope

- BC113 This Standard applies to all public sector entities in both the for-profit and not-for-profit sectors. This is wider than the scope of IPSAS 32, which applies to public sector not-for-profit entities.

### Recognition and measurement of service concession assets

- BC114 This Standard includes Application Guidance on the following matters, which is additional to that in IPSAS 32:
- (a) the fundamental principle of control of a service concession asset, including guidance on:
    - (i) when the grantor would control the service concession asset in an environment where the services provided and/or the service pricing is regulated by a third-party regulator;
    - (ii) the need to assess whether long-term leases, outsourcing or privatisation arrangements are within the scope of this Standard; and
    - (iii) changes in the grantor’s control of the service concession asset; and
  - (b) the relationship between the residual interest of the asset at the end of the service concession arrangement and a whole-of-life asset.

- BC115 This Standard requires the grantor to initially measure the service concession asset at current replacement cost in accordance with the cost approach to fair value in AASB 13. IPSAS 32 instead specifies measurement of fair value generally – there is no IPSAS corresponding to AASB 13.
- BC116 This Standard requires an existing asset of the grantor, including a previously unrecognised identifiable intangible asset or land under roads, that is reclassified as a service concession asset to be measured at fair value (current replacement cost) at the date of reclassification. IPSAS 32 does not permit such measurement or the recognition of previously unrecognised identifiable intangible assets or land under roads.

## Recognition and measurement of liabilities

- BC117 This Standard requires the grantor to recognise a financial liability when the grantor has a contractual obligation to pay cash to the operator for third-party usage of a service concession asset, with or without guaranteeing a minimum amount to the operator. IPSAS 32 refers to such an arrangement as a ‘shadow toll’ arrangement and requires the grantor to account for the payments as an expense when paid instead of recognising a financial liability at the commencement of the service concession arrangement.
- BC118 This Standard references the application of the financial instrument Standards to a financial liability, while IPSAS 32 explicitly requires the grantor to allocate the payments to the operator under the contract as a reduction in the liability recognised, a finance charge and charges for services. Additionally, IPSAS 32 provides guidance that the finance charge is determined based on the operator’s cost of capital specific to the service concession asset, if this is practicable to determine. If this is not practicable, the rate implicit in the arrangement, the grantor’s incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement is used. In contrast, this Standard provides guidance that the grantor uses the contractually specified interest rate in the arrangement to initially measure the financial liability component for the purpose of dividing a hybrid arrangement. Where this is not practicable, prevailing market rate(s) of interest for a similar instrument with similar credit ratings are applied, as required by the financial instrument Standards.
- BC119 This Standard requires the grantor in a hybrid arrangement to measure the financial liability first, with the remainder of the total liability allocated to the liability related to the grant of the right to the operator. IPSAS 32 requires the grantor to account for the liability in a hybrid arrangement in accordance with the liability recognition requirements in IPSAS 32 generally.

## Other revenues

- BC120 IPSAS 32 includes additional application guidance for other revenues, which is not included in this Standard. Other revenues relate to compensation by the operator to the grantor for access to the service concession asset by providing the grantor with a series of predetermined inflows of resources such as an upfront payment or a stream of payments (eg rent payments) and revenue-sharing provisions. This Standard instead references AASB 15 and AASB 1058 for application.

## Definitions

- BC121 This Standard modifies the defined terms of IPSAS 32. This Standard:
- (a) replaces the IPSAS 32 term ‘binding arrangement’, which “describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract”, with the term ‘contract’, which is defined as an “agreement between two or more parties that creates enforceable rights and obligations”. This Standard also provides Application Guidance on the term ‘contract’;
  - (b) modifies the IPSAS 32 definition of a ‘grantor’ to refer to the grantor granting a ‘right to access’ the service concession asset to the operator, rather than a ‘right to use’ the asset;
  - (c) modifies the IPSAS 32 definition of an ‘operator’ from an entity that “uses the service concession asset” to an entity that has a “right of access to the service concession asset”;
  - (d) modifies the IPSAS 32 definition of ‘service concession arrangement’ to require the operator to be responsible for at least some of the management of the public services provided through the service concession asset and not act merely as an agent on behalf of the grantor. IPSAS 32 identifies this only as a common feature of a service concession arrangement;
  - (e) modifies the IPSAS 32 definition of ‘service concession asset’ to expressly include major component replacements and previously unrecognised identifiable intangible assets and land under roads, and to exclude goodwill; and



- (f) provides guidance on the term ‘public service’ that is not in IPSAS 32.

## Transition

- BC122 This Standard modifies the transition approach of IPSAS 32 to require any net adjustment on transition to be included as an adjustment to the opening balance of accumulated surplus (deficiency) at the date of initial application. IPSAS 32 requires a relevant adjustment to be included in revaluation surplus when the revaluation model is applied. Unlike IPSAS 32, this Standard also permits a grantor that has previously recognised service concession assets and related liabilities to apply the Standard retrospectively in accordance with the modified retrospective approach.

## Illustrative examples

- BC123 This Standard includes some differences in the illustrative examples based on those in IPSAS 32, such as:
- (a) the examples of the financial liability model (Example 6) and the grant of a right to the operator model (Example 7) both include a funding cost in the measurement of the service concession asset at fair value (current replacement cost), whereas the corresponding IPSAS 32 examples do not. Consequently, Examples 6 and 7 in this Standard both show the service concession asset and the liability measured initially at the same amount, which is not the case for the financial liability example (Example 1) in IPSAS 32; and
  - (b) in Example 7, no revenue is recognised by the grantor in relation to the replacement of a major component of the service concession asset until the replacement occurs. The corresponding IPSAS 32 example (Example 2) allocates all revenue evenly over the term of the service concession arrangement.

The Standard also includes additional implementation guidance examples to illustrate the differences between service concession arrangements and other types of arrangements.

## Comparison with IFRS Standards

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- BC124 Entities that comply with this Standard may not be in compliance with IFRS Standards issued by the IASB. The IASB has issued IFRIC Interpretation 12 addressing the accounting by operators of public-to-private service concession arrangements but has not issued a pronouncement regarding the accounting by grantors. The following paragraphs set out requirements in this Standard for the accounting by grantors that may not be compliant with IFRS Standards. A grantor that is a for-profit entity would not be able to state that its financial statements comply with IFRS Standards if it applies requirements that are not compliant with IFRS Standards.
- BC125 This Standard requires a grantor to initially measure a service concession asset at current replacement cost in accordance with the cost approach to fair value in AASB 13. However, AASB 13 and the corresponding IFRS 13 do not specify which valuation technique to use. Instead IFRS 13 requires the use of valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Three widely used valuation techniques set out in IFRS 13 are the market approach, the cost approach and the income approach. The requirement of this Standard to initially measure a service concession asset at current replacement cost in accordance with the cost approach may not be compliant with IFRS 13.
- BC126 This Standard requires a grantor to recognise an identifiable intangible asset as a service concession asset where the grantor controls the asset as set out in paragraph 5 or 6, even if the asset does not qualify for recognition under AASB 138/IAS 38 *Intangible Assets*. This approach is explained in paragraph BC39.
- BC127 Under this Standard, a grantor recognises revenue from granting a right to the operator over the term of the service concession arrangement on an appropriate basis. This may not be compliant with the permitted approaches to revenue recognition for licences of intellectual property, if IFRS 15 *Revenue from Contracts with Customers* applied in the absence of grantor accounting requirements. In developing this Standard, the Board decided not to apply the licence revenue requirements of AASB 15 by analogy.

## Comparison with AASB Interpretation 12

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- BC128 This Standard addresses the key requirements of AASB Interpretation 12 from a grantor’s perspective, in particular the criteria for the recognition of a service concession asset in paragraphs 5 and 6. The main differences between this Standard and AASB Interpretation 12 are detailed in the paragraphs below.

- BC129 The scope of this Standard does not explicitly state whether the operator should be a public or private sector entity. This contrasts with AASB Interpretation 12, which states that the Interpretation gives guidance on the accounting by operators for public-to-private service concession arrangements (paragraph 4).
- BC130 This Standard applies to arrangements involving a ‘service concession asset’, including intangible assets and land under roads. This is broader than AASB Interpretation 12, which is applicable to infrastructure but does not refer explicitly to such assets.
- BC131 This Standard requires the grantor to recognise a financial liability when the grantor has a contractual obligation to pay cash to the operator for third-party usage of a service concession asset, with or without guaranteeing a minimum amount to the operator. This contrasts with AASB Interpretation 12, which links the recognition of a financial asset by an operator to a guarantee of the cash flows by the grantor. Under Interpretation 12, the operator’s cash flows are conditional on usage when it has no such guarantee.

## Basis for Conclusions on AASB 2019-2

*This Basis for Conclusions accompanies, but is not part of, AASB 1059. The Basis for Conclusions was originally published with AASB 2019-2 Amendments to Australian Accounting Standards – Implementation of AASB 1059.*

### Introduction

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BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in this Standard. It sets out the reasons why the Board developed the Standard, the approach taken to developing the Standard and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

### Background

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#### Reasons for issuing this Standard

BC2 The Board received feedback from some public sector stakeholders regarding issues applying the modified retrospective method to measure the Grant of a Right to the Operator (GORTO) liability stated in paragraph C4(c) of AASB 1059 *Service Concession Arrangements: Grantors*. Stakeholders also commented that, since mandatory application of AASB 1059 has been deferred by one year to annual periods beginning on or after 1 January 2020, it would be possible for some service concession arrangements to be captured by AASB 16 *Leases* prior to the application of AASB 1059. Stakeholders expressed a view that applying AASB 16 for one year to service concession arrangements could be onerous. The Board considered stakeholders’ feedback and decided to propose amendments to AASB 16 and AASB 1059 to address these issues. The Board also decided to make editorial amendments to the implementation guidance accompanying AASB 1059.

#### Issue of Fatal-Flaw Review version of the Standard

BC3 In June 2019, the Board issued a Fatal-Flaw Review version of the Standard for public comment. Submissions were received from four stakeholders. All respondents were supportive of the Board changing the modified retrospective method to measure the GORTO liability stated in paragraph C4(c) of AASB 1059 and providing a practical expedient to grantors of service concession arrangements to not apply AASB 16 to assets that would be recognised as service concession assets under AASB 1059.

BC4 These respondents also provided feedback on additional issues in applying the modified retrospective method stated in paragraph C4 of AASB 1059 in relation to:

- measurement of the financial liability set out in paragraph C4(b); and
- measurement of the liability representing the unearned revenue arising from the receipt of additional consideration from the operator for access to an existing asset of the grantor that has been reclassified as a service concession asset.

BC5 The Board considered stakeholders’ feedback and decided to amend AASB 16 and AASB 1059 to address these issues.

### Modified retrospective method to measure the financial liability

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BC6 The Board received comments from stakeholders that AASB 1059 was not clear whether the financial liability should be measured under the modified retrospective approach at the same amount as the fair value (current replacement cost) of the service concession asset received (similar to the initial recognition requirement); or in accordance with AASB 9 *Financial Instruments* (similar to the subsequent measurement requirement). The Board decided to amend paragraph C4(b) to clarify the measurement of the financial liability at fair value on the date of initial application.

BC7 The Board noted that paragraphs 5.1.1A and B5.1.2A of AASB 9 require entities to recognise a financial liability at fair value at initial recognition and the difference between the fair value at initial recognition and the transaction price. The Board considered that, for the purpose of the modified retrospective method, the grantor of a service concession arrangement would not be required to identify the difference between the

fair value of the financial liability on the date of initial recognition and the historical transaction price, and so referred directly to measurement at fair value rather than in accordance with AASB 9.

## **Modified retrospective method to measure the GORTO liability resulting from receipt of a service concession asset**

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BC8 Under the modified retrospective method in AASB 1059 paragraph C4(c), a grantor measures a GORTO liability resulting from receipt of a service concession asset based on the “fair value (current replacement cost) of the related service concession asset received at the date of initial application, adjusted to reflect the remaining period of the service concession arrangement **relative to the remaining economic life of the asset ...**” (emphasis added). Stakeholders indicated two issues in applying the calculation: (1) anomalous outcomes when a service concession asset has an indefinite economic life; and (2) a significantly lower GORTO liability compared to the asset if the remaining economic life of the service concession asset is significantly greater than the remaining concession period on transition to AASB 1059.

### **Extent of the issues and *The AASB’s Not-for-Profit Entity Standard-Setting Framework***

BC9 In discussions with the Treasury/Finance departments and/or Audit Offices in four jurisdictions, it was noted that some agencies in two States and some local councils in one State are experiencing the issues described in paragraph BC8. Representatives of these jurisdictions also commented that there would likely be a significant number of service concession assets with an indefinite useful life, such as earthworks. They also suggested that the GORTO liability calculated under paragraph C4(c) would be significantly smaller compared to the asset in some arrangements, particularly those in the early stages. Moreover, they believe the full retrospective method (the only alternative method) could not be applied as some agencies might not be able to obtain sufficient historical data to perform the full retrospective calculations.

BC10 The Board considered there is merit in changing the modified retrospective GORTO liability calculation method set out in paragraph C4(c). Even if entities could choose to apply the full retrospective model – if the necessary historical information was available – the Board was of the view that it would not be appropriate to completely remove the modified retrospective method at this stage of implementation of the Standard, as such an approach would require entities to apply the full retrospective method.

BC11 The Board also considered that changing the modified retrospective method is justified under *The AASB’s Not-for-Profit Entity Standard-Setting Framework* paragraph 28(a)<sup>1</sup>, as the existing modified retrospective GORTO liability calculation would appear to result in reported performance or financial position not reflecting economic reality, particularly when the service concession asset has an indefinite useful life.

### **Options for addressing the issues**

BC12 The Board considered four possible options for resolving the issues:

- Option 1 – change the modified retrospective GORTO liability calculation method so that the liability is initially measured based on the current replacement cost of the service concession asset received at the date of initial application adjusted to reflect the remaining concession period **relative to the total period of the arrangement**, rather than relative to the remaining economic life of the service concession asset. Since this approach does not consider the economic life of the asset, this option would address the two issues noted in paragraph BC8;
- Option 2 – amend AASB 1059 to introduce a proxy for the ‘remaining economic life’ of the asset, for example 99 years, to use in the existing modified retrospective GORTO liability calculation for assets with an indefinite economic life. The Board considered that determining a proxy would be difficult and could result in a rule-of-thumb that might not be a faithful representation of the substance of an arrangement. Moreover, this option would not address the issue that for some arrangements the GORTO liability calculated under the modified retrospective approach might be significantly smaller compared to the asset;

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<sup>1</sup> Note that there are two paragraphs 28(a) in *The AASB’s Not-for-Profit Entity Standard-Setting Framework*. The reference here is to the second paragraph 28(a), which states “the prevalence and magnitude of NFP-specific transactions, circumstances and events results in NFP entities’ reported performance or financial position not reflecting economic reality (eg transfers of assets at significantly less than fair value primarily to enable a NFP entity to achieve its objectives, and for public sector entities, the provision of social benefits and related sustainability and sovereign power issues)”.

- Option 3 – include the calculation proposed in Option 1 as an accounting policy choice for entities. That is, make available both the current modified retrospective method and the calculation proposed in Option 1, and provide guidance to illustrate which option to apply under which circumstances. The Board noted that in finalising AASB 1059 it had mandated one calculation method so that the modified retrospective method would be applied consistently across entities. Introducing an optional alternative for the modified retrospective method could remove that consistency and permit entities to choose a method for the purpose of achieving better budget or actual results rather than the method that best reflects the economic substance of the transaction; and
- Option 4 – to recognise a GORTO liability at the same amount as the current replacement cost of the asset received on transition to AASB 1059. This method is similar to the modified transitional approach in transitioning operating leases under AASB 117 *Leases* to AASB 16. Under paragraph C8 of AASB 16, a lessee recognises a lease liability under the Standard and has an option to recognise a right-of-use asset based on the amount of the lease liability on transition to AASB 16. However, the Board considered that the modified retrospective method should reflect that part of the service concession period has already passed.

BC13 The Board considered the advantages and disadvantages of each option and decided to adopt Option 1 – change the modified retrospective GORTO liability calculation method so that it is initially measured based on the current replacement cost of the service concession asset at the date of initial application adjusted to reflect the remaining concession period **relative to the total period of the arrangement**, rather than relative to the remaining economic life of the service concession asset.

BC14 Option 1 would result in a larger GORTO liability compared to the current modified retrospective calculation method when the service concession asset has a remaining economic life longer than the total concession period. The Board considered that this larger GORTO liability calculated under Option 1 better reflects the grantor’s unearned revenue on transition date, under a short-cut method, compared to the current calculation method. This is because the grantor would be able to continue to benefit from the asset after the service concession arrangement has ended, and would then recognise income based on the grantor’s future use of the asset. The unearned revenue to be recognised under the service concession arrangement at the date of transition in the form of the GORTO liability therefore relates to the remaining service concession period and should be recognised as revenue over that period.

## **Modified retrospective method to measure the liability arising from the receipt of additional consideration from the operator for access to an existing asset of the grantor**

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BC15 Some stakeholders commented that AASB 1059 did not specify the recognition and measurement of additional consideration given by the operator to the grantor for access to an existing asset of the grantor that has been reclassified as a service concession asset, on transition to the Standard under the modified retrospective approach.

BC16 Consistent with paragraph 11 of AASB 1059, the Board considered that a liability should be recognised by the grantor where additional consideration is provided by the operator for access to an existing asset of the grantor that has been reclassified as a service concession asset. Consequently, a new paragraph C4(d) was added to specify the measurement requirement. For consistency, the Board decided that the same proportion used in measuring the GORTO liability resulting from receipt of a service concession asset – the remaining period of the service concession arrangement relative to the total period of the arrangement – should be applied to the amount of the proceeds received in measuring this liability under the modified retrospective approach.

## **Non-application of AASB 16 to assets that would be recognised as service concession assets**

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BC17 AASB 1059 was originally effective for annual reporting periods beginning on or after 1 January 2019, which was the same effective date as AASB 16. Subsequently, the mandatory effective date of AASB 1059 was deferred by one year to reporting periods beginning on or after 1 January 2020 by AASB 2018-5 *Amendments to Australian Accounting Standards – Deferral of AASB 1059*. Stakeholders noted that it would be possible for some service concession arrangements to be captured by AASB 16 prior to the application of AASB 1059. Stakeholders expressed a view that applying AASB 16 for one year could be onerous, requiring another change in accounting policy for service concession assets in the following year.

- BC18 The Board considered whether changing the date of initial application of AASB 1059 – from the beginning of the earliest reporting period for which comparative information is presented in the financial statements to the beginning of the annual reporting period in which an entity first applies AASB 1059 – would avoid applying AASB 16 for one year to service concession arrangements. However, the Board noted that an entity would need to early adopt AASB 1059 in order to avoid applying AASB 16 to service concession arrangements. Changing the date of initial application as indicated would not change this need, but could make it more feasible for entities to early adopt AASB 1059.
- BC19 The Board decided instead to modify AASB 16 to provide a practical expedient to public sector grantors of service concession arrangements so that AASB 16 would not need to be applied to assets that would be recognised as service concession assets under AASB 1059. Entities would be permitted to continue applying their existing accounting policy to these assets until AASB 1059 is applied. The Board had proposed in the Fatal-Flaw Review version limiting this practical expedient to assets recognised under AASB 117, but extended the scope to all assets that would be recognised under AASB 1059 following comments from respondents that some assets might be subject to AASB 16 without having been accounted for explicitly under AASB 117.

## **Editorial amendments**

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- BC20 The Board decided to amend paragraph B76 of the application guidance to clarify that the grantor’s policy choice of continuing to apply insurance accounting is limited to contracts that meet the definition of a financial guarantee under AASB 9, if they had previously been accounted for as insurance contracts. The Board considered that compensation of revenue shortfalls in the context of AASB 1059 paragraph 16(b) would not meet the definition of a financial guarantee under AASB 9 for the grantor where the grantor is guaranteeing payments to the operator to cover lower usage of service concession assets than expected. Therefore, insurance accounting would not be appropriate in measuring the liability to the operator in the case of such revenue shortfalls. On the other hand, if the grantor guarantees to make payments to the operator in the event of users of the service concession assets defaulting on usage payments to the operator, then the grantor would assess whether it has a financial guarantee contract and would be eligible for continued insurance accounting, if previously applied.
- BC21 A stakeholder expressed the view that the flowchart in paragraph IG10 of the implementation guidance in its current form could be misinterpreted – if either of the top two boxes is ‘Yes’, then the arrangement would automatically be a service concession arrangement without considering the two criteria in paragraph 2 of AASB 1059: whether the operator provides public services on behalf of the grantor, and whether the operator manages at least some of those services under its own discretion. The Board decided to amend the flowchart for the avoidance of doubt.
- BC22 The Board also decided to amend the table in paragraph IG13 of the implementation guidance to be more consistent with paragraph B10, to indicate that the operator must be responsible for managing at least some of the public services provided through the asset, rather than being responsible for at least some of the management of the asset, for a transaction to be a service concession arrangement.

## Basis for Conclusions on AASB 2021-4

*This Basis for Conclusions accompanies, but is not part of, AASB 1059. The Basis for Conclusions was originally published with AASB 2021-4 Amendments to Australian Accounting Standards – Modified Retrospective Transition Approach for Service Concession Grantors.*

### Introduction

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- BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in this Standard. It sets out the reasons why the Board developed the Standard, the approach taken to developing the Standard and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

### Background

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#### Reasons for issuing this Standard

- BC2 The Board received comments from the Treasury office in one jurisdiction regarding an issue applying the modified retrospective method to measure the Grant of a Right to the Operator (GORTO) liability, as stated in paragraph C4(c) of AASB 1059 *Service Concession Arrangements: Grantors*. The Board considered the stakeholder’s comments and decided to propose amendments to AASB 1059 to address the issue.

#### Issue of Fatal-Flaw Review version of the Standard

- BC3 In May 2021, the Board issued a Fatal-Flaw Review version of the Standard for public comment. The Board received three submissions and informal comments from another stakeholder. All respondents were supportive of the Board changing the modified retrospective method to measure the GORTO liability stated in paragraph C4(c) of AASB 1059.
- BC4 One stakeholder noted that the changes to AASB 1059 paragraph C4(c) proposed in the Fatal-Flaw Review version of the Standard specifically addressed only financial consideration paid by the grantor to the operator prior to the date of initial application of the Standard. The stakeholder commented that the GORTO liability and subsequent revenue would also be likely to be overstated if the grantor had provided non-financial consideration prior to the date of initial application that was not adjusted in determining the grantor’s GORTO liability.
- BC5 The Board considered the feedback received and decided to amend AASB 1059 to address the issues. The Board decided that expanding the scope of the amendments to include non-financial consideration was appropriate, based on the principles and approach proposed in the Fatal-Flaw Review version.

#### Consideration transferred to the operator prior to the date of initial application

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- BC6 The Treasury office commented in raising the issue for the AASB’s consideration that AASB 1059 did not specify how consideration paid by the grantor to the operator prior to the date of initial application (i.e. that was not a financial liability at the date of initial application) should be treated under the modified retrospective transition approach. The stakeholder noted that if such consideration is not adjusted in the grantor’s GORTO liability calculation, the GORTO liability at the date of initial application would be likely to be overstated, which in turn would lead to the overstatement of revenue in subsequent periods as the GORTO liability is unwound over the period of the service concession arrangement. The Board concluded that the GORTO liability and subsequent revenue would be overstated whether the grantor had provided financial or non-financial consideration prior to the date of initial application that was not adjusted in determining the grantor’s GORTO liability.
- BC7 The Board noted that consideration transferred by the grantor to the operator in respect of a service concession asset does not represent a liability or revenue for the grantor and therefore would not be recognised appropriately as part of the GORTO liability on transition. Under paragraph 12 of AASB 1059, such consideration is required to be adjusted when measuring the grantor’s liability at initial recognition

based on the current replacement cost of the service concession asset. This requirement is also applicable for entities applying the full retrospective transition approach to the implementation of AASB 1059.

- BC8 The Board considered amending the GORTO liability calculation under the modified retrospective transition approach has merit. The current drafting of the modified retrospective transition approach could result in overstatement of the GORTO liability for affected grantors at the initial application date and of the subsequent revenue recognition, which would continue throughout the remaining period of the affected service concession arrangements. Considering the potential public interest in and user information needs regarding service concession arrangements, these overstatements could be considered qualitatively material and might mislead users of the financial statements for a long period of time.
- BC9 The Board decided that changing the modified retrospective transition approach is justified under the *AASB Not-for-Profit Entity Standard-Setting Framework* (October 2020), paragraph 30(e). This is because the existing modified retrospective GORTO liability calculation – which would make no adjustment for the grantor’s own contributions to a service concession asset prior to the initial application date – would appear to result in reported financial performance or financial position not reflecting economic reality.

## Options for addressing the issue

- BC10 The stakeholder advised that, prior to application of AASB 1059, grantor financial contributions to service concession arrangements have been capitalised as a prepayment, which is recognised as an expense over the concession periods.
- BC11 The Board considered four possible options for amending the modified retrospective GORTO liability calculation in relation to grantor contributions prior to the initial application date. Options 1–3 differ only in what is first deducted from the fair value (current replacement cost) of the service concession asset in calculating the liability.
- Option 1 – measure the GORTO liability by deducting the **carrying amount** of capitalised grantor contributions from the current replacement cost of the service concession asset as at the date of initial application; then adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement; and finally deducting the fair value of any related financial liability as at the date of initial application;
  - Option 2 – measure the GORTO liability by deducting the **historical amounts** of grantor contributions from the current replacement cost of the service concession asset as at the date of initial application; then adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement; and finally deducting the fair value of any related financial liability as at the date of initial application;
  - Option 3 – measure the GORTO liability by deducting the **fair value** of grantor contributions from the current replacement cost of the service concession asset as at the date of initial application; then adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement; and finally deducting the fair value of any related financial liability as at the date of initial application; and
  - Option 4 – measure the GORTO liability by applying the proportion of the GORTO liability relative to the total liability calculated at the inception of the service concession arrangement to the current replacement cost of the service concession asset as at the initial application date; and then adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement.
- BC12 The Board was concerned that if a contribution was made close to the inception of the arrangement and the capitalised grantor contribution has a low carrying amount on the initial application date because it has been amortised over a number of periods, Option 1 could result in a similar outcome to the current modified retrospective transition approach. However, this effect would be moderated since the higher the number of years of amortisation to the date of initial application, the smaller the remaining period of the arrangement, which would reduce the calculated GORTO liability.
- BC13 The Board rejected Option 2. This is because the modified retrospective transition approach requires the service concession asset and any outstanding financial liability to be measured at fair value as at the initial application date. Deducting the sum of historical amounts – ignoring the time value of money for the consideration paid prior to the initial application date – from the fair value of the asset might not result in an appropriate GORTO liability amount. The time value of money would be particularly relevant for consideration paid by instalments under the arrangement.
- BC14 The Board decided against Option 3 because estimation of the fair value of historical consideration transferred might not be a straightforward exercise and further guidance might be required to assist grantors



in identifying the factors a market participant would consider when pricing such historical consideration, such as the appropriate interest rate. Such guidance would be unlikely to be finalised in time for entities applying AASB 1059 to the annual reporting period ending 30 June 2021, which is the initial mandatory application of the Standard for most (if not all) Australian public sector grantors.

- BC15 Under Option 4, applying the proportion of the GORTO liability relative to the total liability calculated at the inception of the service concession arrangement would limit the basic GORTO liability amount at the date of initial application, which is then apportioned again to reflect the remaining period of the arrangement. However, in order to calculate the proportion of the GORTO liability relative to the total liability at inception, an entity would need to know the estimated value of the service concession asset that the operator agreed to provide, as well as the contributions that the grantor agreed to provide to the operator. The Board was concerned that it might be difficult for auditors to obtain sufficient appropriate audit evidence to support the estimation of the fair value of the service concession asset at inception. Option 4 also does not factor in any changes to the service concession asset, such as improvements or additions to the asset between inception and the date of initial application of AASB 1059.
- BC16 The Board considered the advantages and disadvantages of each option and decided to adopt Option 1. This is because:
- (a) the stakeholder advised that most of the affected hybrid service concession arrangements would still be in the construction phase as at the date of initial application, so that the capitalised grantor contributions would not yet have been amortised. Therefore, the concern described in paragraph BC12 would not be a significant issue in practice;
  - (b) deducting the carrying amount of the capitalised grantor contributions from the current replacement cost of the service concession asset conceptually is similar to the way other existing assets of the grantor are treated when calculating the grantor's liability under the general requirements in AASB 1059 paragraph 11 – when existing assets of the grantor are reclassified as service concession assets, the grantor does not recognise a liability in relation to the reclassified assets; and
  - (c) it is the most straightforward option to apply out of the four options considered. Since the carrying amount of the capitalised contributions typically would have been subject to audit in prior periods, it is expected that affected grantors would be able to provide sufficient evidence (based on their accounting policy) to support the carrying amount of the capitalised contributions as at the date of initial application.
- BC17 The Board acknowledged that, on conceptual grounds, Option 1 might not be the most appropriate option to apply due to the concern described in paragraph BC12. However, it noted that this is not an ongoing issue, as paragraph C4(c) is not expected to be applied in any period later than the annual reporting period ending 30 June 2021, and the stakeholder advised that the concern described in paragraph BC12 does not appear to be a significant issue in practice. Since there was a need to amend the current GORTO liability calculation in paragraph C4(c) promptly prior to the preparation of grantors' 30 June 2021 financial statements, for practical reasons the Board decided to amend paragraph C4(c) based on Option 1.