Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**AASB 1059 *Service Concession Arrangements: Grantors***	**Meeting:**	AASB April 2021 (M180)
		Agenda Item:	7.1
Topic:	**Measurement of GORTO liability under the modified retrospective transition approach**	**Date of Agenda Paper:**	6 April 2021
Contact(s):	Patricia Au pau@aasb.gov.au 03 9617 7621 Clark Anstis canstis@aasb.gov.au 03 9617 7616	**Project Priority:**	High
		Decision-Making:	High
		Project Status:	Consider issue raised by a stakeholder

Objectives of this agenda item

1. The objectives of this agenda item are for the Board to:

   (a) consider an issue raised by NSW Treasury regarding the measurement of the Grant of a Right to the Operator (GORTO) liability, in a hybrid arrangement, under the modified retrospective transition approach in AASB 1059 *Service Concession Arrangements: Grantors*;

   (b) decide whether any standard-setting action is needed; and

   (c) if so, decide the next steps in addressing the issue.

Reasons for the Board to consider this paper at this meeting

2. Paragraph 25 of the *AASB Not-for-Profit Entity Standard-Setting Framework* states the circumstances that would trigger the AASB to consider the need for NFP-specific Standards, amendments, guidance or examples. This includes Australian constituents raising the need with the AASB via written or verbal submissions (paragraph 25(d)).

3. NSW Treasury considers the issue will have a material effect on the financial statements of the NSW Department of Transport. The issue would affect applicable grantors of service concession arrangements in the Department of Transport, in the year of transition (overstating the GORTO liability initially recognised), as well as throughout the concession period (overstating revenue as the GORTO liability is unwound).

4. Although this issue is expected to affect only entities in the NSW Department of Transport, staff consider amending the GORTO liability calculation under the modified retrospective transition approach has merit. The current drafting of the modified retrospective transition approach in AASB 1059 can result in significant overstatement of the GORTO liability at the transition date and of the subsequent revenue recognition, which will continue throughout the remaining period of the affected service concession arrangements (up to 33 years). Considering the potential public interest in and user information needs regarding service concession arrangements, these

overstatements might be considered qualitatively material and might mislead users of the financial statements for a long period of time.

5. After an initial one-year deferral by the Board, AASB 1059 applies mandatorily to reporting periods beginning on or after 1 January 2020. Consequently, 30 June 2021 is the first applicable annual reporting year end for AASB 1059, unless adopted earlier. Therefore, it would be desirable for any standard-setting action required on AASB 1059 to be completed before this date or at least in a timeframe that would permit adoption for 2020-21 financial statements.

Summary of staff recommendation

6. Staff recommend amending the GORTO liability calculation under the modified retrospective transition approach in AASB 1059 as set out in Option 1 in Section 4 of this paper. This would require estimating the GORTO liability by:

    (1) deducting the carrying amount of any capitalised grantor financial contributions from the current replacement cost (CRC) of the service concession asset as at the date of initial application; then

    (2) adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement; and finally

    (3) deducting the fair value of any related financial liability as at the date of initial application.

Attachment

Agenda Paper 7.2 Correspondence, principally from NSW Treasury (Board Only)

Structure of this paper

7. This staff paper is set out as follows:

    (a) Section 1: Introduction – Grantor's liability arising from a service concession arrangement

    (b) Section 2: Issue with the modified retrospective transition approach in AASB 1059

    (c) Section 3: The Board's objectives in developing Accounting Standards for the public sector

    (d) Section 4: Possible options in amending the GORTO liability calculation

    (e) Section 5: Due process and next steps

    (f) Appendix: Extracts of AASB 1059 (for reference only)

Section 1: Introduction – Grantor's liability arising from a service concession arrangement

8. A service concession arrangement involves:

    (a) the operator providing an asset (the service concession asset) to the grantor (therefore, the grantor recognises the asset) – the asset could be a new asset or an upgrade to or a major component replacement for an existing asset of the grantor; and

(b) the grantor granting the right to access the service concession asset to the operator to provide public services on behalf of the grantor for a specified period of time.

9. Because the operator provides the asset to the grantor, when the grantor recognises the service concession asset, AASB 1059 requires the grantor to recognise a liability for the compensation to the operator. The liability is initially measured at the same amount as the current replacement cost of the asset, subject to some adjustments. The liability is recognised under one of the following three models, as appropriate:

   (a) financial liability model – the grantor recognises a financial liability under AASB 9 *Financial Instruments* when it has a contractual obligation to deliver cash or another financial asset to the operator for the asset (AASB 1059 paragraph 15);

   (b) GORTO liability model (similar to unearned revenue) – instead of delivering cash or another financial asset, the grantor grants the operator the right to earn revenue from third-party users of the service concession asset. Under this 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 (AASB 1059 paragraph 21); or

   (c) hybrid model – the operator is compensated for the provision of a service concession asset partly by a predetermined payment or series of payments (a financial liability) and partly by receiving the right to earn revenue from third-party users of the service concession asset (a GORTO liability). The grantor measures the financial liability portion of the liability 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 GORTO liability (AASB 1059 paragraphs 24–25 and B74).

10. The subject of this paper is the measurement of the GORTO liability in a hybrid arrangement under the modified retrospective transition approach, where the financial liability portion of the grantor's total liability has already been settled prior to the transition date (i.e. there is no remaining financial liability at the date of initial application of AASB 1059) or else partly settled prior to transition. This is discussed in Section 2 of the paper. The present requirement is set out in paragraph C4(c) of AASB 1059 (refer to the Appendix to this paper for relevant extracts from AASB 1059).

Section 2: Issue with the modified retrospective transition approach in AASB 1059

11. NSW Treasury considers there is an inconsistency in how contributions made by a grantor to a service concession arrangement are treated – in measuring the grantor's total liability in a hybrid arrangement – between the general recognition and measurement requirements in AASB 1059 (which are also the requirements under the full retrospective transition approach) and the modified retrospective transition approach.

Full retrospective transition approach versus the modified retrospective transition approach

12. Table 1 provides a high-level summary of the initial recognition and measurement requirements in AASB 1059 (paragraphs 7, 11–15 and 21–25) for recognising a hybrid service concession arrangement (SCA) – that is also the full retrospective transition approach – and the requirements for recognising hybrid arrangements under the modified retrospective transition approach (paragraph C4).

Table 1: Accounting requirements for a hybrid service concession arrangement		
Elements of a hybrid arrangement	**Full retrospective transition approach**	**Modified retrospective transition approach**
Service concession asset	**[A1]** Current replacement cost (CRC) of the asset when acquired	**[A2]** CRC of the asset at the date of initial application
Liability (split into a financial liability portion and a GORTO liability portion)	**[B1]** Total liability equals the amount measured in [A1], adjusted for: (a) any other consideration (e.g. the transfer of an existing asset) from the grantor to the operator; and (b) any other consideration from the operator to the grantor.	**[B2]** Total liability on transition equals: $[A2] \times \frac{\text{Remaining period of SCA}}{\text{Total period of SCA}}$
Financial liability	**[C1]** Measure and recognise the financial liability in accordance with AASB 9	**[C2]** Measure and recognise the financial liability at fair value at the date of initial application
GORTO liability	**[D1]** = [B1] – [C1]	**[D2]** = [B2] – [C2]

NSW Treasury's issue – Treatment of financial liabilities that had been settled prior to transition date

13. NSW Treasury notes the difference in how financial contributions made by a grantor to the operator under the service concession arrangement are to be treated under the two retrospective transition approaches:

    - under the full retrospective transition approach, the total liability [B1] of a hybrid arrangement is adjusted for (reduced by) consideration paid by the grantor to the operator, as highlighted in blue text in Table 1; however,

    - under the modified retrospective transition approach, such consideration – if settled prior to the transition date and resulting in a financial liability [C2] of $0 at the transition date, as highlighted in green text in Table 1 – is effectively not deducted from the total liability balance.

    This would lead to the entire liability balance [B2] being recognised as a GORTO liability [D2] on transition. NSW Treasury regards this approach as overstating the estimation of the GORTO liability on transition.

14. The example below seeks to illustrate how the GORTO liability would be overstated under the modified retrospective transition approach, compared with the GORTO liability amount estimated under the full retrospective transition approach. In this example:

    - The SCA has a term of 30 years, with the operator responsible for constructing, operating and maintaining the service concession asset
    - The construction of the asset is completed at the end of year 2, with a fair value (CRC) of $1,000
    - The grantor applies the revaluation model in AASB 116 *Property, Plant and Equipment* to service concession assets
    - The grantor paid $800 (i.e. a hybrid arrangement with 80% financial liability and 20% GORTO liability) towards the construction of the service concession asset at construction completion

- No further payment is required from the grantor (i.e. financial liability is nil after year 2)
- The operator receives the right to charge third-party users of the service concession asset for 28 years, when the asset is ready for operation at the start of year 3
- The date of initial application of AASB 1059 is at the start of year 11 of the SCA (i.e. the remaining period of the arrangement is 20 years)
- The CRC of the asset is $600 at the start of year 11
- The GORTO liability is unwound as revenue on a straight-line basis
- All balances have been rounded to the nearest dollar.

Table 2: Example illustrating overstatement of GORTO liability under modified transitional approach		
Elements of a hybrid service concession arrangement	**Full retrospective transition approach**	**Modified retrospective transition approach**
Service concession asset	CRC of the asset at the end of construction (year 2) **[A1] = $1,000**	CRC of the asset at the date of initial application (year 11) **[A2] = $600**
Recognition of liability (split into a financial liability portion and a GORTO portion)	Total liability equals the amount measured in [A1], adjusted for: (a) any other consideration (e.g. the transfer of an existing asset) from the grantor to the operator; and (b) any other consideration from the operator to the grantor. **[B1] = $1,000 – $800 = $200**	Total liability on transition equals: $[A2] \times \frac{\text{Remaining period of SCA}}{\text{Total period of SCA}}$ **[B2] = $600 x 20 / 30 = $400**
Financial liability	Measure and recognise the financial liability in accordance with AASB 9 **[C1] = $0**	Measure and recognise the financial liability at fair value at the date of initial application **[C2] = $0**
GORTO liability (initial measurement)	[B1] – [C1] **$200**	N/A
Unwind GORTO liability for years 3–10 of 30 ($200/28 x 8 = $57)	DR GORTO liability $57 CR Revenue $57	N/A
GORTO liability (at initial application date)	**[D1] = $200 – $57 = $143**	[D2] = [B2] – [C2] **[D2] = $400**

15. In the extreme example in Table 2 (where the grantor has paid 80% of the fair value of the service concession asset to the operator), the GORTO liability is almost three times higher when measured under the modified retrospective transition approach compared with the full retrospective transition approach, even with the decline in the CRC of the service concession asset from $1,000 at the start of year 3 to $600 at the start of year 11 (the date of initial application).

16. NSW Treasury estimated that the modified retrospective transition approach would lead to the total GORTO liability being overstated by $2.3bn for the NSW Department of Transport at the date of initial application (which affects the adjustment to retained earnings at that date), with revenue

being overstated by $68m per year over 33 years as the GORTO liability is unwound. The NSW Whole of Government consolidated financial statements would also be affected.

17. NSW Treasury considers it is inappropriate for a grantor to recognise a GORTO liability, and subsequently revenue over the remaining SCA period, in relation to its own consideration contributed previously to acquiring an asset that it controls (the service concession asset provided by an operator). The consideration paid by the grantor to the operator is no longer a liability for the grantor if the amount has been settled.

Staff view

18. Staff agree with NSW Treasury's view noted in paragraph 17 that a contribution paid by the grantor to the operator is no longer a liability for the grantor. Therefore, staff agree that the grantor's total liability arising from an SCA on the transition date should not include an amount relating to financial liabilities that have already been settled.

19. Staff agree with NSW Treasury's observation that the modified retrospective transition approach would lead to a larger measurement of the GORTO liability in a hybrid arrangement, where the financial liability portion of the total liability has already been settled (or partly settled) prior to the transition date. Staff note that the modified retrospective transition approach is a short-cut method that should not be expected to result in the same outcome as the full retrospective transition method. However, the current specification of the modified retrospective transition approach does appear to overstate the initial GORTO liability in these particular circumstances.

Question to the Board

Q1 Do Board members agree with the staff view in paragraphs 18–19 that the modified retrospective transition approach in paragraph C4 of AASB 1059 would lead to inappropriate measurement of the GORTO liability in a hybrid arrangement, where the financial liability portion of the total liability has already been settled (or partly settled) prior to transition date?

Section 3: The Board's objectives in developing Accounting Standards for the public sector

20. Paragraph 24 of the *AASB Not-for-Profit Entity Standard-Setting Framework* sets out the Board's objectives in developing Accounting Standards for not-for-profit (NFP) entities in the private and public sectors, which include addressing:

(a) user needs or public interest issues relevant to financial reporting; and

(b) issues specific to the NFP sector of such prevalence and magnitude that the objectives and qualitative characteristics of financial reporting would not be met.

User needs and public interest

21. NSW Treasury has indicated that users of financial statements of the NSW Department of Transport and the NSW Government would be interested in the amount of the GORTO liability recognised, and the subsequent revenue recognition, arising from service concession arrangements. It considers that the GORTO liability recognised under the modified retrospective transition approach would lead to the objectives and qualitative characteristics of financial reporting not being met.

22. NSW Treasury commented that overstating the GORTO liability and subsequent revenue recognition throughout the remaining concession period would make it difficult for users of the financial statements to understand the economics of those service concession arrangements.

The prevalence and magnitude of the issue

23. Staff note that this issue is not likely to be prevalent in the Australian public sector because:

    (a) no jurisdictions other than NSW have raised concerns with the GORTO liability calculation under the modified retrospective transition approach; and

    (b) NSW Treasury advises that to date only some entities in the NSW Department of Transport have been identified as being potentially affected.

24. Staff note that the magnitude of the issue would likely be considered significant to the financial statements of the NSW Department of Transport in the year of initial application of AASB 1059, but not from a Whole of Government perspective. This is based on NSW Treasury's estimation of:

    (a) $2.3bn overstatement of the GORTO liability at the date of initial application – this equates to about 13.9% of the department's total liabilities of $16.6bn and 0.9% of the NSW Government's total liabilities of $255.9bn reported for the 2019-20 financial year; and

    (b) $68m overstatement of revenue per year over 33 years as the GORTO liability is unwound – this equates to about 0.34% of the department's total revenue of $19.9bn and 0.08% of the NSW Government's total revenue of $86.3bn reported for the 2019-20 financial year.

Staff view

25. On balance, even though the issue is not prevalent and unlikely to cause a significant impact on the NSW Government's financial statements, staff consider the issue could be considered quantitatively material for the NSW Department of Transport, which is one of the key departments in NSW. The GORTO liability might provide useful information for users of grantors' financial statements about how effective grantors have been at protecting public sector resources (including contributions paid by the grantor to the operator and forgoing the right to charge users of service concession assets).

26. Given the potential public interest in and user information needs regarding service concession arrangements, overstatement of the GORTO liability and subsequent revenue recognition might be considered qualitatively material. Significant overstatement may mislead users of the financial statements.

Staff recommendation

27. Staff asked whether NSW entities could apply the full retrospective approach instead of the modified retrospective transition approach. However, NSW Treasury has advised that the full retrospective approach could not be applied as some historical data is not available to perform the full retrospective calculations, and discussions with auditors indicate that using estimates in full retrospective calculation would likely create audit issues if the necessary historical information was not available.

28. Therefore, staff recommend amending the GORTO liability calculation under the modified retrospective transition approach. This can be justified under the *AASB Not-for-Profit Entity Standard-Setting Framework* paragraph 30(e), as the existing modified retrospective GORTO liability calculation would result in the financial statements of the NSW Department of Transport

'not reflecting economic reality' in relation to hybrid service concession arrangements, where the financial liability portion of the liability had been settled (or partly settled) prior to the date of initial application of AASB 1059.

Question to the Board
Q2 Do Board members agree with the staff recommendation in paragraph 28 to amend the GORTO liability calculation under the modified retrospective transition approach?
[If Board members disagree with amending the GORTO liability calculation under the modified retrospective transition approach, Section 4 of the paper does not need to be discussed at the AASB meeting.]

If Board members decide not to amend the GORTO liability calculation under the modified retrospective transition approach

29. Paragraph 7.3.6 of the *AASB Due Process Framework for Setting Standards* (September 2019) states that "A decision to retain the status quo is noted in Board meeting minutes, **formal agenda decisions** which are exposed for comment or other communications, depending on the **importance and urgency** of the issue." [emphasis added] If Board members decide not to amend the GORTO liability calculation under the modified retrospective transition approach, and consider the matter important and urgent, the Board can decide to publish a formal agenda decision to state its reasons for retaining the status quo.

30. Paragraphs 9.2.1–9.2.3 of the *Due Process Framework* further describe the use of Agenda Decisions, by reference to addressing diversity in practice, the adequacy of the principles and requirements in a pronouncement, and the provision of new or clarifying explanatory materials. As the requirements for the GORTO liability calculation appear to be inadequate, and diversity in practice is not expected given that only one jurisdiction is known to be affected, an Agenda Decision is unlikely to be of much assistance to stakeholders.

31. Alternatively, the Board can decide not to issue any consultation document. In this case, the Board's decision to retain the status quo would be documented in the Board meeting minutes. Staff would recommend this approach if the Board decides not to amend the GORTO liability calculation.

Question to the Board
Q3 If the Board decides not to amend the GORTO liability calculation, do Board members consider that a formal Agenda Decision should be published?

Section 4: Possible options in amending the GORTO liability calculation

32. NSW Treasury has advised that, prior to application of AASB 1059, grantor contributions to service concession arrangements have been capitalised as a prepayment[1], which is unwound as an expense over the concession period.

1 Section 3.1 of NSW Treasury Accounting Policy TPP 06-8 *Accounting for Privately Financed Projects* states that "… If the contribution … by the purchaser [the grantor] results in lower service payments, the carrying amount of the contributed property should be reclassified as a **prepayment** and subsequently charged as an operating cost over the period of the reduced payments." [clarification and emphasis added]

33. NSW Treasury suggested four alternate GORTO liability calculations for possible adoption under the modified retrospective transition approach (at paragraph C4(c)). These four options are illustrated in this paper using the following example:

- CRC of the service concession asset as at the date of initial application is $1,000
- Total period of the arrangement is 20 years and the remaining period is 10 years
- The grantor contributed $500 (i.e. a hybrid arrangement with 50% financial liability and 50% GORTO liability), which was paid at inception and recognised by the grantor as a prepayment
- No related financial liability at the date of initial application as the grantor contribution has been paid in full
- The prepayment is being amortised on a straight-line basis over the concession period, with a carrying amount of $250 at the date of initial application
- Assume the fair value of the $500 historical grantor contribution is $814 as at the date of initial application.

Current GORTO liability calculation under the modified retrospective transition approach

$$\text{CRC of asset} \times \frac{\text{Remaining period of SCA}}{\text{Total period of SCA}} - \text{Outstanding financial liability measured at fair value at the date of initial application under paragraph C4(b)}$$

GORTO liability at the date of initial application under the current paragraph C4(c):

$1,000 x 10/20 – $0 = $500

Option 1: Adjusting CRC of the asset by the carrying amount of capitalised grantor contributions

$$\left[\text{CRC of asset} - \text{Carrying amount of capitalised grantor contributions at the date of initial application (amortised amount)}\right] \times \frac{\text{Remaining period of SCA}}{\text{Total period of SCA}} - \text{Outstanding financial liability measured at fair value at the date of initial application}$$

GORTO liability at the date of initial application:

[$1,000 – $250] x 10/20 – $0 = $375

Staff analysis

Advantages:

- This option is the most straightforward option to apply out of the four options suggested.
- Since the carrying amount of the capitalised contributions would have been subject to audit in prior periods, it is expected that affected grantors would be able to provide sufficient evidence to support the carrying amount of the capitalised contributions as at the date of initial application.
- Deducting the carrying amount of the capitalised grantor contributions from the CRC of the service concession asset is conceptually 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.

Option 1: Adjusting CRC of the asset by the carrying amount of capitalised grantor contributions
Disadvantage: • Because grantor contributions have been recognised as a prepayment and are being amortised over the concession period, if a contribution was made close to the inception of the arrangement – and the prepayment has a low carrying amount on the transition date because it has been amortised over a number of periods – this option 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 SCA, which reduces the calculated GORTO liability. In this example, Option 1 would result in a higher GORTO liability than the other options. NSW Treasury has advised that their estimation of the effect of this option would result in a more appropriate GORTO balance at the date of initial application than the calculation under the current modified retrospective transition approach. Factoring in the advantages of this option and the issues with the other options, this is the staff's preferred option of the four.

Option 2: Adjusting CRC of the asset by the historical amounts of capitalised grantor contributions
$$\left[\text{CRC of asset} - \begin{array}{l}\text{Historical amount of}\\ \text{grantor contributions}\\ \text{(unamortised amount)}\end{array}\right] \times \frac{\text{Remaining period of SCA}}{\text{Total period of SCA}} - \begin{array}{l}\text{Outstanding financial}\\ \text{liability measured at fair}\\ \text{value at the date of initial}\\ \text{application}\end{array}$$ GORTO liability at the date of initial application: [$1,000 – $500] x 10/20 – $0 = $250
Staff analysis This option proposes to deduct the historical amount (or the sum of all historical amounts) of contributions paid by the grantor to the operator prior to transition date from the CRC of the service concession asset. Since the modified retrospective transition approach in paragraph C4 of AASB 1059 requires the service concession asset and any outstanding financial liability to be measured at fair value on the transition date, staff consider that deducting the sum of historical amounts – and ignoring the time value of money for those contributions paid prior to transition date – from the fair value of the asset might not result in an appropriate GORTO liability amount. The time value of money is particularly relevant for contributions paid by instalments under the arrangement.

Option 3: Adjusting CRC of the asset by the fair value of capitalised grantor contributions
$$\left[\text{CRC of asset} - \text{Fair value of the capitalised contributions at the date of initial application}\right] \times \frac{\text{Remaining period of SCA}}{\text{Total period of SCA}} - \text{Outstanding financial liability measured at fair value at the date of initial application}$$ GORTO liability at the date of initial application: [$1,000 – $814] x 10/20 – $0 = $93
Staff analysis Since the current modified retrospective transition approach requires the service concession asset and any outstanding financial liability to be measured at fair value at the date of initial application, one possible alternative GORTO liability calculation would also require measuring the capitalised contributions at fair value at that date. That amount is then deducted from the CRC of the service concession asset, before adjusting the balance for the remaining period of the SCA. Any outstanding financial liability would still be deducted as well. Staff note that estimation of the fair value of such grantor contributions 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 contributions; and • the appropriate interest rate to apply.

Option 4: Apportioning CRC of the asset based on the GORTO liability relative to the total liability calculated at inception
$$\text{CRC of asset} \times \text{GORTO liability relative to the total liability calculated at inception} \times \frac{\text{Remaining period of SCA}}{\text{Total period of SCA}}$$ GORTO liability at the date of initial application: $1,000 x 50% x 10/20 = $250 Any outstanding financial liability would still be measured and recognised at fair value at the date of initial application under paragraph C4(b), but it is not required to be deducted from the GORTO liability balance calculated under this proposed calculation.
Staff analysis Advantages: • Applying the proportion of the GORTO liability relative to the total liability calculated at inception to the CRC of the asset as at the transition date would reflect the portion of the liability related to the granting of the right to the operator to charge third-party users for the remaining period for the arrangement. • This option does not require estimation of the value of grantor contributions that have been paid as at the date of initial application. Disadvantages: • To calculate the proportion of the GORTO liability relative to the total liability at contract inception, an entity would need to know the estimated value of the service concession asset that

Option 4: Apportioning CRC of the asset based on the GORTO liability relative to the total liability calculated at inception
the operator has agreed to provide at contract inception as well as the financial contribution that the grantor has agreed to pay. If this information is not clearly stated in the contract or accompanying documentation, 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 as at contract inception. • This option does not factor in changes to the service concession asset if additional improvements or additions were made to the service concession asset between inception and the date of initial application of AASB 1059. NSW Treasury is of the opinion that this option would best result in a GORTO balance at the date of initial application reflecting the economic substance of the service concession arrangements, compared with the other three options. This is because the grantor and the operator would have negotiated the financing of the service concession asset (i.e. the proportion of a grant of rights to the operator versus cash contributions by the grantor) at the inception of the arrangement. Two other jurisdictions that are not affected by this issue have provided feedback to NSW Treasury that they think this option is the most reasonable option out of the four alternatives. It is not clear whether they had considered the disadvantages noted above.

Staff recommendation

34. Based on the above analysis, staff recommend amending the GORTO liability calculation under the modified retrospective transition approach in accordance with Option 1 – (1) deducting the carrying amount of any capitalised grantor financial contributions from the current replacement cost (CRC) of the service concession asset as at the date of initial application, then (2) adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement, and finally (3) deducting the fair value of any financial liability as at the date of initial application.

35. Consequently, staff recommend amending paragraph C4(c) in AASB 1059 as follows (new text is underlined and deleted text struck through). Other subparagraphs in paragraph C4 are included here only for reference.

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 paid 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 ~~less~~ 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.

Questions to the Board

Q4 Do Board members agree with the staff recommendation in paragraph 34 to amend the modified retrospective transition approach so that the GORTO liability is estimated by: (1) deducting the carrying amount of any capitalised grantor contributions at the date of initial application from the CRC of the service concession asset, then (2) adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement, and finally (3) deducting the fair value of any outstanding financial liability as at the date of initial application?

Q5 If so, do Board members agree with the staff recommendation in paragraph 35 for revising the wording of paragraph C4(c) of AASB 1059?

Section 5: Due process and next steps

36. This transition issue has been discussed numerous times with NSW Treasury and NSW Audit Office staff since it was first raised with AASB staff in October 2020. The issue was also referred to HoTARAC for consideration, as a result of which staff have also had discussions with Treasury staff from two other major jurisdictions with service concession arrangements. NSW Treasury has also forwarded information received from four other jurisdictions. That leaves only two jurisdictions where no information has been obtained to date.

37. In accordance with paragraph 6.5 of the *Due Process Framework*, if the Board agrees with the staff recommendations to amend AASB 1059, the proposed amendments need to be exposed for public comment. Given that AASB 1059 applies only to public sector grantors of service concession arrangements, NSW Treasury has advised that it is likely that only entities in the NSW Department of Transport will be affected by this matter, and five other jurisdictions have advised that they are not affected by this issue, staff recommend issuing a Fatal-Flaw Review draft of an amending Standard with a comment period of 30 days.

38. If the Board decides to publish a formal Agenda Decision (per Question 3), the draft Agenda Decision will also need to be exposed for comment. Staff consider the timing and exposure period

could be the same as that for a Fatal-Flaw Review draft of an amending Standard. Paragraph 6.6 of the *Due Process Framework* states that the exposure period for other requests for information (such as an agenda decision) is *generally* 60 days. In this case, the longer period would not be helpful.

39. The table below provides a draft timeline for the required due process.

Date	Task
28 April 2021	Circulate ballot draft of Fatal-Flaw Review version/draft Agenda Decision to Board members for voting out of session. Propose one week to vote until 5 May 2021.
6 May 2021	Issue Fatal-Flaw Review version/draft Agenda Decision for comment with a 30-day comment period (comments due 4 June 2021).
7–11 June 2021	Staff collate comments received and prepare the ballot draft of an amending Standard or an Agenda Decision, if appropriate.
11 June 2021	Ballot draft of an amending Standard or Agenda Decision and comments received circulated to Board members for out-of-session consideration. Propose ten days to vote, until 21 June 2021.
24 June 2021	Final amending Standard or Agenda Decision issued, if approved by the Board.

Question to the Board

Q6 Do Board members agree with staff's proposed next steps and the timeline?

Appendix: Extracts from AASB 1059

This Appendix contains extracts from AASB 1059 that staff consider useful for Board members in considering the issue raised by NSW Treasury regarding the measurement of the GORTO liability, in a hybrid arrangement, under the modified retrospective transition approach.

Recognition and measurement requirements in AASB 1059 for recognising hybrid arrangements

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*.

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).

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.

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).

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).

Modified retrospective transition approach

[This wording incorporates amendments made by AASB 2019-2 *Amendments to Australian Accounting Standards – Implementation of AASB 1059* (September 2019) to paragraph C4]

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 to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement, less 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.