



Project:	AASB 1059 <i>Service Concession Arrangements: Grantors</i>	Meeting:	M170 (April 2019)
		Date:	16 April 2019
Topic:	Implementation issues	Agenda Item:	7.1
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		Decision-Making:	High
		Project Status:	Consider constituents' feedback

Objective of this paper

- 1 The objective of this paper is for the Board to consider implementation issues raised by constituents preparing for the application of AASB 1059 *Service Concession Arrangements: Grantors* and **decide** on the amendments to AASB 1059.

Reasons for the Board to consider this paper at this meeting

- 2 The Board received feedback from public sector constituents that they are encountering issues implementing AASB 1059 and are requesting further clarification from the AASB. In the September 2018 Board meeting, the Board decided to defer the mandatory effective date of AASB 1059 by 12 months and to consider these implementation issues at a later meeting.
- 3 In this meeting, staff ask the Board to consider the issues raised by constituents and staff recommendations.

Summary of staff recommendations

- 4 Staff recommend the following:
 - (a) changing the modified retrospective method in measuring the Grant of a Right to the Operator (GORTO) liability to Method 1 originally considered by the Board (Issue 1);
 - (b) changing the initial date of application of AASB 1059 to the start of the current period, rather than the start of the earliest comparative period presented (Issue 2); and
 - (c) including editorial amendments to paragraphs IG10 and IG13 of AASB 1059 (Issue 3).

Attachments

- 7.2 Submissions received on the Fatal Flaw Review version of *AASB 2018-X Amendments to Australian Accounting Standards – Deferral of AASB 1059* (for reference)

Structure

- 5 This staff paper is set out as follows:
- (a) Background (paragraphs 6–10)
 - (b) Key issues for consideration (paragraphs 11–64)
 - (c) Next steps (paragraphs 65–66)
 - (d) [Appendix A](#): Suggested editorial amendments to Illustrative Guidance in AASB 1059
 - (e) [Appendix B](#): Other implementation issues
 - (f) [Appendix C](#): Extracts of AASB 1059 and International Valuation Standards IVS 210 *Intangible Assets* (for reference)

Background

- 6 AASB 1059 was originally effective for annual reporting periods beginning on or after 1 January 2019. In the September 2018 Board meeting, the Board decided to issue a consultation document proposing the deferral of the mandatory effective date by 12 months to reporting periods beginning on or after 1 January 2020, to assist constituents with their implementation efforts.
- 7 Consequently, the Fatal Flaw Review version of the then proposed Amending Standard *Amendments to Australian Accounting Standards – Deferral of AASB 1059* was released on 10 September 2018 for public comment. Three submissions were received. The respondents were the Australasian Council of Auditors-General (ACAG), the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) and Queensland Treasury. In addition, Queensland Audit Office (QAO) and Department of Finance, Services & Innovation in NSW (DFSI) also provided informal feedback to the AASB.
- 8 These constituents have explained some implementation issues regarding AASB 1059 and request that the AASB consider these issues. Staff have considered constituents' comments and have identified two key issues that require the Board's decision in this meeting. These two issues are addressed in this staff paper.
- 9 [Appendix A](#) contains analysis of minor amendments to the Implementation Guidance paragraphs IG10 and IG13 of AASB 1059 proposed by Queensland Treasury. For the reasons set out in the Appendix, staff recommend that the Board approve amendments to AASB 1059.
- 10 [Appendix B](#) contains analysis of other issues raised by constituents. For the reasons set out in the Appendix, staff do not believe these issues require any changes to AASB 1059.

Key issues for consideration

Issue 1: Propose changing the modified retrospective method in calculating GORTO liability

Summary of issues

- 11 AASB 1059 provides two transition models in applying the Standard: (a) retrospectively to each prior period presented in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* (the full retrospective method); and (b) retrospectively by recognising and measuring service concession assets and related liabilities at the date of initial application – the start of the earliest comparative period presented (the modified retrospective method).
- 12 Constituents have indicated that entities are experiencing two issues in 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:
- Issue 1A – ACAG has noted anomalous outcomes when applying the modified retrospective method to measure the GORTO liability when a service concession asset includes assets with an indefinite economic life (see paragraphs 15–17 below); and
 - Issue 1B – HoTARAC and QAO have noted the modified retrospective method would result in 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 (see paragraphs 18–25 below).

HoTARAC, ACAG and QAO have noted that because of the above issues, agencies are likely to choose to adopt the full retrospective method, which could be a costly approach.

- 13 Under the modified retrospective method in AASB 1059 paragraph C4(c), a grantor shall measure a GORTO liability at “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 remaining economic life of the asset...”(emphasis added). The following example, adapted from AASB 1059 paragraph IE43 (Example 10), illustrates the modified retrospective method in measuring a GORTO liability:

Table 1	Parameter – Modified retrospective method	Amount or period
A	CRC of the service concession asset at initial application date	CU1,200
B	Remaining economic life of the asset	20 years
C	Remaining service concession period	10 years
GORTO liability = A x C/B	GORTO liability = CRC of service concession asset at initial application date <i>Multiply by</i> Remaining service concession period <i>Divide by</i> Remaining economic life of service concession asset	GORTO liability at initial application date = CU600 [CU1,200 x 10/20]

Staff analysis

14 Paragraphs 15–48 below contains staff analysis of Issue 1A and Issue 1B. Staff have adopted the following steps in analysing the two issues:

- Step 1: Analyse Issue 1A – assets with indefinite useful life
- Step 2: Analyse Issue 1B – remaining economic life of the asset significantly greater than the remaining concession period
- Step 3: Extent of the issues and *The AASB’s Not-for-Profit Entity Standard-Setting Framework*
- Step 4: Overview of the alternative method previously considered by the Panel and the Board
- Step 5: Further analysis of ‘Method 1’ originally considered by the Board
- Step 6: Staff’s proposed options in addressing the issues

Step 1: Analyse Issue 1A – assets with indefinite useful life

15 ACAG and QAO have noted that under the modified retrospective method, the resulting GORTO liability may be very small when the liability is adjusted ‘relative to the remaining economic life of the asset’ if the asset has an indefinite useful life. The following example illustrates this issue.

Table 2	Parameter – Modified retrospective method	Amount or period
A	CRC of the service concession asset at initial application date	CU1,200
B	Remaining economic life of the asset	indefinite
C	Remaining service concession period	10 years
GORTO liability = A x C/B	GORTO liability = CRC of service concession asset at initial application date <i>Multiply by</i> Remaining service concession period <i>Divide by</i> Remaining economic life of service concession asset	Indefinable/ very small [CU1,200 x 10/indefinite years]

16 As illustrated above, mathematically the modified retrospective method calculation cannot be performed if a service concession asset has indefinite useful life. Staff have heard that some agencies considered using 99 years as the denominator for assets with indefinite economic life, resulting in a very small GORTO liability, which is similar to Issue 1B below. Moreover, constituents expressed that it would be beneficial for the Board to provide guidance if it was intended that entities assume a number of years for the economic life of an asset in order to apply the modified retrospective GORTO liability calculation when an asset has indefinite economic life.

17 Staff have held discussions with the Treasury departments and/or Audit Offices in NSW, Victoria, Queensland and South Australia to get an understanding of the issues. Staff have been informed that even though AASB 1059 provides an option for entities to elect to apply the Standard using the full retrospective method under AASB 108, some jurisdictions would not be able to apply the full retrospective method. The respondents suggested that this is because, in some arrangements, not

all of the required historical data about the asset can be obtained to perform the full retrospective calculation, and their preliminary discussions with auditors indicate that using estimates in full retrospective calculations would likely create audit issues.

Step 2: Issue 1B – Remaining economic life of asset is significantly greater than remaining concession period

- 18 HoTARAC and QAO have noted that, if the remaining economic life of the asset is significantly greater than the remaining concession period on transition to AASB 1059, the calculation would result in a significantly lower GORTO liability compared to the asset under the modified transition method. This is particularly apparent when the transition to AASB 1059 occurs at the early-stage of an arrangement.
- 19 The example below illustrates the calculation of the GORTO liability, under the modified retrospective method, for a fictitious arrangement where the remaining economic life of the asset is significantly greater than the remaining concession period on transition to AASB 1059. In this example, the initial application of AASB 1059 is at the start of the 3rd year of a 20 year concession period and the service concession asset has a total economic life of 40 years.

Table 3	Parameter – Modified retrospective method	Amount or period
A	CRC of the service concession asset at initial application date	CU1,200
B	Remaining economic life of the asset	38 years
C	Remaining service concession period	18 years
GORTO liability = A x C/B	GORTO liability = CRC of service concession asset at initial application date <i>Multiply by</i> Remaining service concession period <i>Divide by</i> Remaining economic life of service concession asset	CU568 [CU1,200 x 18/38]
GORTO liability/A	GORTO liability as a percentage of service concession asset at the initial application date	47% of the fair value of the service concession asset [CU568/CU1,200]

- 20 The above calculation illustrates that, in this example, under the modified retrospective method, the entity would recognise a GORTO liability of CU568 and a service concession asset of CU1,200 on the initial date of application. That is, a GORTO liability of 47% of the value of the asset recognised on transition to AASB 1059. The difference of CU632 would be adjusted against opening accumulated surplus/deficiency.
- 21 For discussion purposes, the calculation below illustrates the calculation of the GORTO liability using the full retrospective method, using the same fact pattern as Table 3 above. That is, the initial application of AASB 1059 is at the start of the 3rd year of a 20 year concession period and the service concession asset has a total economic life of 40 years.

Table 4	Parameter – Full retrospective method	Amount or period
A	CRC of the service concession asset at initial application date	CU1,200
B	Remaining economic life of the asset	38 years
C	Remaining service concession period	18 years
D	GORTO liability at inception = CRC of the service concession asset at inception (year 0) In this example, assume the fair value of the asset at inception is not materially different to the value at the start of year 3, and assume there is no other consideration to be adjusted.	CU1,200
E	Total contracted service concession period	20 years
F = D/E	Revenue recognised each year (reducing the liability)	CU60 [CU1,200/20]
GORTO liability = D – (F x number of years passed)	GORTO liability at initial application date = GORTO liability at inception <i>Less</i> Amount of revenue already recognised (in year 1 and year 2)	CU1,080 [CU1,200 – (CU60 x 2)]
GORTO liability/A	GORTO liability as a percentage of service concession asset at the initial application date	90% of the fair value of the service concession asset [CU1,080/CU1,200]

- 22 In this example, under the full retrospective method, the entity would recognise a GORTO liability of CU1,080 and asset of CU1,200 on transition to AASB 1059. That is, a GORTO liability of 90% of the value of the asset recognised on transition to AASB 1059. The difference of CU120 would be adjusted against accumulated surplus/deficiency.
- 23 Based on the calculation above, staff believe the modified retrospective GORTO liability calculation could create significant disparity between the asset and the GORTO liability recognised on initial recognition where the remaining economic life of the asset is significantly greater than the remaining concession period. Moreover, in this example, recognising a GORTO liability at only 47% of the asset when the arrangement is only 10% completed (2 years completed out of 20 year concession) does not appear to faithfully represent the unearned revenue liability of the grantor, particularly if a straight-line revenue recognition basis was considered appropriate for the arrangement. The lower GORTO liability under the modified retrospective method would also mean that the entity would recognise less income in future periods.
- 24 Staff note that even though a short-cut modified approach is not expected to result in the same amount as the full retrospective approach, the above example illustrates that the modified retrospective method could result in a very different GORTO liability compared to the full retrospective method, if the remaining economic life of the asset is significantly greater than the remaining concession period.
- 25 ACAG, HoTARAC and QAO believe the anomalous outcomes in the modified retrospective method, as explained in Issue 1A and Issue 1B above, would effectively require entities to undertake a

costly, full retrospective method to overcome flaws in the modified retrospective method. Moreover, as mentioned in paragraph 17 above, some entities believe they would not be able to apply the full retrospective method; and therefore, would like the AASB to provide guidance in how the modified retrospective approach can be applied when there are service concession assets with indefinite economic life (Issue 1A).

Step 3: Extent of the issues and the AASB's Not-for-Profit Entity Standard-Setting Framework

- 26 In the preliminary discussions with the Treasury departments and/or Audit Offices in four jurisdictions, it was explained to staff that some agencies in two states and some local councils in one state are experiencing the issues described in Issue 1A and Issue 1B.
- 27 Jurisdiction 1 – Representatives of the Treasury department and Audit Office of this jurisdiction have informed staff that their agencies would not be impacted by Issue 1A or Issue 1B, as the Treasury department has mandated their agencies to adopt the full retrospective method; and therefore did not come across issues with the modified retrospective method. The representatives of the Treasury department also mentioned that they are expecting only a few service concession arrangements to result in a GORTO liability and believed that applying the full retrospective method for the few arrangements would not be too onerous. This jurisdiction has also decided to early adopt AASB 1059 from 1 July 2019 (i.e. for the 2019/20 financial year).
- 28 Jurisdiction 2 – In contrast, representatives of the Treasury department of this jurisdiction informed staff that their agencies are having issues with the modified retrospective approach. The representatives expressed that there would likely be a significant number of assets with an indefinite useful life (Issue 1A), such as earthworks. They also expressed that their preliminary calculations indicated that the GORTO liability calculated under the modified retrospective approach is significantly small compared to the asset in some arrangements, particularly those in the early-stage of the arrangement. Moreover, they believe the full retrospective method could not be applied as their initial testing showed that some of their agencies might not be able to obtain sufficient historical data to perform the full retrospective calculations, and their preliminary discussions with auditors indicate that using estimates in full retrospective calculation would likely create audit issues.
- 29 Jurisdiction 3 – The representatives of the Treasury department in this jurisdiction also expressed that they are experiencing the issues described in Issue 1A and Issue 1B. Some of their agencies have considered using 99 years as the denominator for assets with indefinite economic life, which resulted in a very small GORTO liability. They are of the view that, depending on when the transition to AASB 1059 occur in the arrangement, the GORTO liability calculated under the modified retrospective approach might not faithfully represent the unearned revenue liability of the grantor. Similar to Jurisdiction 2, they believe they would not be able to apply the full retrospective method as some of their agencies are not able to obtain all the necessary historical data to perform the full retrospective calculations. Therefore, the representatives of this jurisdiction suggested the Board consider providing another short-cut retrospective method for entities to choose.
- 30 Jurisdiction 4 – The Audit Office of this jurisdiction has noted that there are local councils, which are outside of Treasury's mandate, that would be applying AASB 1059. These entities have some service concession assets that have an indefinite useful life and as such cannot apply the modified retrospective method, as explained in Issue 1A.
- 31 Based on the issues noted by constituents, staff believe there is merit in changing the modified retrospective GORTO liability. Even if entities could choose to apply the full retrospective model – if the necessary historical information was available – staff are of the view that it would not be

appropriate to completely remove the modified retrospective method at this stage of implementation of the Standard, which would require entities to apply the full retrospective method.

- 32 Changing the modified retrospective method is also justified under *The AASB's Not-for-Profit Entity Standard-Setting Framework* (the Framework) paragraph 28(a)¹, as the existing modified retrospective GORTO liability calculation appears to result in 'reported performance or financial position not reflecting economic reality', particularly when the service concession asset has an indefinite useful life.

Step 4: Overview of the alternative method considered by the Panel and the Board

- 33 ACAG and QAO have noted that both Issue 1A and Issue 1B could be resolved if the modified retrospective method is changed to the alternative method (Method 1 below) originally considered by the Service Concession Arrangement Project Advisory Panel (the Panel) and the Board.

- 34 Prior to issuing AASB 1059, the Panel and the Board considered two approaches for the modified retrospective method in measuring the GORTO liability on transition:

- Method 1 – adjust the fair value of the asset over the remaining concession period; and
- Method 2 – adjust the fair value of the asset over the remaining concession period relative to the remaining economic life of the asset.

- 35 In 2016, the Panel and the Board considered the following example, illustrating the calculation under Method 1 and Method 2. In this example, the transition to AASB 1059 was at a later stage of the arrangement (year 21 of a 25 year arrangement), and the remaining economic life of the asset was double the remaining concession period (10 years of economic life remaining and 5 years of remaining concession period).

Table 5	Method 1	Method 2
Fair value of asset at beginning of year 21	\$1,200	\$1,200
Remaining life of asset at year 21		30 years
Reduction in asset per year		\$40 (over 30 years)
Total concession period	25 years	
Reduction in liability per year	\$48 (over 25 years)	
Liability for remaining period of 5 years	\$240 (5 x \$48)	\$200 (5 x \$40)

- 36 The example showed that the GORTO liability calculated under the two methods were not significantly different. After discussion, the Panel did not have a preference for either Method 1 or Method 2. The Panel only requested that the Standard prescribe a particular transition method in order to reduce divergence between entities.

¹ Note that there are two paragraphs 28(a) in the Framework, the reference here is to the second paragraph 28(a). This paragraph 28(a) 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)".

Previous staff recommendation and Board decision

- 37 At the time of drafting AASB 1059, staff were of the view that the fair value of the asset at the transition date could be regarded as representing the future revenue to the grantor; and therefore recommended Method 2 to the Board. Method 2 would allocate the ‘future revenue’ over the remaining life of the asset to give an amount of ‘revenue per year’ (assuming a straight-line basis is appropriate). This revenue per year is then applied to the remaining concession period in order to measure the GORTO unearned revenue liability. In contrast, Method 1 seemed to apportion all of the transition-date fair value of the asset backwards over the whole concession period.
- 38 Consequently, the Board decided in the November 2016 Board meeting that the modified retrospective method in calculating GORTO liability “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” (AASB 1059 paragraph BC106).

Step 5: Further analysis of ‘Method 1’ originally considered by the Board

- 39 Staff note that when the Panel and the Board were considering the modified retrospective method in calculating the GORTO liability, it was not apparent that there could be significant differences between the results calculated under Method 1 and Method 2 when service concession assets had an economic life significantly longer than the remaining concession period or that there would be service concession assets with an indefinite economic life.
- 40 Staff are of the view that the Method 1 that was originally considered by the Panel and the Board could resolve the Issue 1A and Issue 1B described above. Paragraph 41 illustrates the calculation under both Method 1 and Method 2 using the same fact pattern as Table 3 and Table 4 above (paragraphs 19 and 21), where the remaining economic life of the asset is significantly greater than the remaining concession period on transition to AASB 1059.
- 41 As above, in this example, the initial application of AASB 1059 is at the start of the 3rd year of a 20 year concession period and the service concession asset has a total economic life of 40 years.

Table 6	Parameter	Amount or period	Method 1	Method 2 (same as Table 3)
A	CRC of the service concession asset at initial application date	CU1,200		
B	Remaining economic life of the asset	38 years		
C	Remaining service concession period	18 years		
D	Total service concession period	20 years		
E = A/D	Reduction in unearned revenue liability per year = CRC of the service concession asset <i>Divide by</i> Total service concession period		CU60 [CU1,200/20]	
GORTO liability	GORTO liability = Reduction in liability per year		CU1,080 [CU60 x 18]	

Table 6	Parameter	Amount or period	Method 1	Method 2 (same as Table 3)
(Method 1) = E x C	<i>Multiply by</i> Remaining service concession period			
GORTO liability (Method2) = A x C/B	GORTO liability = CRC of service concession asset at initial application date <i>Multiply by</i> Remaining service concession period <i>Divide by</i> Remaining economic life of service concession asset			CU568 [CU1,200 x 18/38]
	GORTO liability as a percentage of service concession asset at the initial application date		90% [CU1,080/ CU1,200]	47% [CU568/ CU1,200]

42 In this example, Method 1 would result in a grantor recognising a GORTO liability that is 90% of the service concession asset on initial application of AASB 1059; whereas the GORTO liability under Method 2 would be 47% of the asset.

43 Moreover, some entities have expressed that the current modified GORTO liability calculation (Method 2) could be complex in some arrangements where different components of the service concession arrangement assets have different economic lives as the calculation reflects the remaining economic lives. Under Method 1, the calculation of the GORTO liability does not use the economic life of the asset or components (although that information would still be needed for depreciating the service concession asset or components of the asset).

Step 6: Staff's proposed options in addressing the issues

44 Staff have considered the following options in addressing both Issue 1A and Issue 1B:

- Option 1 – change the modified retrospective GORTO liability calculation to Method 1 originally considered by the Board;
- 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 indefinite economic life;
- Option 3 – include Method 1 as a selection choice for entities to choose. That is, made available the current retrospective method (Method 2) and Method 1 as well as the full retrospective method, and provide guidance to illustrate which option to apply under different circumstances; and
- Option 4 – introduce a new short-cut method – to recognise a GORTO liability at the same amount as the CRC of the asset on transition of AASB 1059.

45 The table below summarises the potential advantages and disadvantages of each of the option.

Table 7	Advantages	Disadvantages
<p>Option 1 Change the calculation to Method 1</p>	<ul style="list-style-type: none"> • Since Method 1 does not consider the economic life of the asset, this would address Issue 1A. • Some entities believe Method 1 addresses Issue 1B in that it would reflect the economic substance of the unearned revenue liability better than the current method. • Based on preliminary discussions with Treasuries and Audit Offices, it appears that some jurisdictions support this Option. 	<p>One jurisdiction believes the GORTO liability calculated under Method 1, for arrangements that are at the final stage, which would result in a larger GORTO liability compared to the current modified calculation, might not be a faithful representation of the grantor’s unearned revenue.</p> <p>This is because service concession assets are often required to be maintained at a specified level and therefore their fair value might not have diminished significantly, even though the arrangement is due to end soon. Representatives of this jurisdiction believe it might not be appropriate to recognise a larger GORTO liability (and therefore higher revenue for the rest of the arrangement) when the grantor has already consumed a majority of the revenue from the asset over the service concession period.</p> <p>This jurisdiction would likely support Option 3.</p>
<p>Option 2 Introduce a proxy for economic life of assets with indefinite life</p>	<ul style="list-style-type: none"> • Addresses Issue 1A and the current model could still be used. 	<ul style="list-style-type: none"> • Does not address Issue 1B. • Determining a proxy would be a difficult exercise and result in a rule-of-thumb that might not be a faithful representation of the substance of an arrangement.
<p>Option 3 Provide an option for entities to choose between the current method and Method 1, and provide guidance</p>	<ul style="list-style-type: none"> • Addresses both Issue 1A and Issue 1B 	<ul style="list-style-type: none"> • This option is against the Panel’s original recommendation of mandating one calculation method so that the short-cut method can be applied consistently across entities. • There is a risk that entities might 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.

Table 7	Advantages	Disadvantages
		<ul style="list-style-type: none"> Additional research and testing would be required to develop guidance in deliberation with stakeholders and the Board.
<p>Option 4 Recognising a GORTO liability at the same amount as the CRC of the service concession asset</p>	<ul style="list-style-type: none"> Addresses Issue 1A and, in some situations, addresses Issue 1B as well. No separate GORTO liability calculation required. This method is similar to the modified transitional approach in transitioning operating leases under AASB 117 <i>Leases</i> to AASB 16 <i>Leases</i>. 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. This method might be appropriate for arrangements where the grantor currently does not recognise a service concession asset, based on the view that the unearned revenue of the grantor is equivalent to the CRC of the asset that it recognises for the first time. 	<ul style="list-style-type: none"> As explained in the disadvantages of Option 1, service concession assets often required to be maintained at a specified level and therefore their fair value might not have diminished significantly, even if the arrangement is due to end soon. Therefore, similar to Option 1, this option would create a larger GORTO liability, compared to the current retrospective method, for an arrangement that is at the final stage of the term. The approach appears more akin to a prospective application of the Standard rather than a retrospective approach, and therefore inappropriate for a short-cut retrospective calculation.

Staff recommendation

- 46 Based on Table 7 in paragraph 45 above, staff believe Option 1 – change the modified retrospective GORTO liability calculation to Method 1 originally considered by the Board – is the best option in addressing Issue 1A and Issue 1B. Even though Method 1 would result in a larger GORTO liability compared to Method 2 whenever the service concession asset has a remaining economic life longer than the remaining service concession period, staff are of the view that this larger GORTO liability better reflects the grantor’s unearned revenue on transition date, in a short-cut method. This is because the grantor would be able to continue to benefit from the assets after the arrangement has ended, and would then recognise income based on the grantor’s future use of the assets. 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.
- 47 In the discussions with jurisdictions, two jurisdictions have expressed a preliminary view that they would support the AASB changing the modified retrospective approach to Method 1 considered by the Panel and the Board. However, one jurisdiction has expressed that they would support Option

3 – Provide an option for entities to choose between the current method and Method 1, and provide guidance as to when to apply the methods.

- 48 Staff recommend the Board change the modified retrospective method in measuring the GORTO liability, in paragraph C4(c) of AASB 1059, to Method 1. If Board members agree with the staff recommendation, staff recommend revising the wording of paragraph C4(c) of AASB 1059 as follows (new text underlined and deleted text struck through):

C4 If a grantor elects to apply this Standard retrospectively in accordance with paragraph C3(b), the grantor shall:

...

- (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 remaining economic life of the asset~~ relative to the total period of the arrangement, less any related financial liabilities measured in accordance with paragraph (b);

(d) ...

Questions to the Board:

Q1: Do Board members agree with the staff recommendation in paragraph 48 to change the modified retrospective method in measuring GORTO liability, in paragraph C4(c) of AASB 1059, to Method 1?

Q2: Do Board members agree with the staff recommendation for revising the wording of paragraph C4(c) of AASB 1059?

Issue 2: Propose changing the initial application date of AASB 1059

Summary of issues

- 49 AASB 1059 was originally effective for annual reporting periods beginning on or after 1 January 2019. In the September 2018 Board meeting, the Board decided to defer the mandatory effective date by 12 months to reporting periods beginning on or after 1 January 2020. This makes 2020/21 the first year of mandatory application for the typical financial years.
- 50 The date of initial application of AASB 1059 is ‘the beginning of the earliest reporting period for which comparative information is presented in the financial statements’ (paragraph C2 of AASB 1059). ACAG has requested the AASB consider changing it to the start of the year in which AASB 1059 is first applied. That is, requesting to make 1 July 2020 the date of initial application rather than 1 July 2019 for an entity that has a 30 June year end, thus removing the need to restate comparative information.
- 51 ACAG has noted that, since AASB 1059 has been deferred by 12 months to reporting periods beginning on or after 1 January 2020, it is possible for some service concession arrangements to be captured by AASB 16 *Leases* prior to the application of AASB 1059. It would be desirable to avoid accounting for an arrangement under three different Standards in three years, for example, AASB 117 *Leases* for the year ending 30 June 2019, AASB 16 for the year ending 30 June 2020 and AASB 1059 for the year ending 30 June 2021.

- 52 ACAG has also noted that the suggested change would allow entities to early adopt AASB 1059 for 2019/20 financial reports even if they have not measured service concession assets at 1 July 2018, so that AASB 16 did not have to be applied to any service concession assets for one year. Changing the initial application date to the start of the year in which the Standard is first applied would mean that entities would be measuring service concession assets at 1 July 2019 instead of 1 July 2018 if they early adopt AASB 1059 for 2019/20 and apply the modified retrospective method.

Previous decision by the Board and due process

- 53 Staff note that AASB 1059 was based on IPSAS 32 *Service Concession Arrangements: Grantor*, and adopted the same initial application date as IPSAS 32 of ‘the beginning of the earliest reporting period for which comparative information is presented in the financial statements’. Staff note that the Board did not specifically discuss the date of initial application when finalising AASB 1059, and did not specifically discuss whether comparative information about service concession arrangements would be desirable to users of financial statements.
- 54 Staff note that accounting standards traditionally have the initial retrospective adjustments at the beginning of the earliest comparative year, requiring comparative information to be restated under AASB 108. It is only recent IFRS Standards, namely AASB 9 *Financial Instruments*, AASB 15 *Revenue from Contracts with Customers* and AASB 16, that have a modified retrospective approach where the initial date of application is at the beginning of the current year instead of the comparative year; and therefore not requiring to restate comparative information. Staff note that if an entity applies the full retrospective method in applying a new Standard, then they would be required to restate comparative information under AASB 108.
- 55 Before issuing AASB 1059, the Board exposed an Exposure Draft ED 261 *Service Concession Arrangements: Grantors* for comment. However, the initial application date approach was not proposed in the Exposure Draft. The date of initial application was included in the Fatal-Flaw Review version of AASB 1059, which was exposed for 30 days. Seven written submissions were received but none commented on the initial application date.
- 56 Timeline 1 below presents the sequence of events when an entity applies AASB 1059 in accordance with the mandatory effective date, and the effect of changing the date of initial application to the start of the current year rather than the start of the comparative year. Timeline 2 shows the sequence of events if an entity adopts AASB 1059 early on 1 July 2019. In these timelines, it is assumed that the entity has a 30 June year end and will apply the modified retrospective method stated in paragraph C4 of AASB 1059.

Timeline 1 – Entity not early adopting AASB 1059

	1 July 2019	30 June 2020 Financial statements	1 July 2020	30 June 2021 Financial statements
The date of initial application of AASB 1059 is the start of the comparative year	<p>Initial application date of AASB 1059: measure service concession asset and liability for the first time</p> <p>Apply AASB 15, AASB 16 and AASB 1058 for the first time</p>	<p>No impact arising from service concession arrangements as AASB 1059 not yet applied</p> <p>Reflect accounting under AASB 15, AASB 16 and AASB 1058 in the current year</p>		<p>First year of applying AASB 1059: restate 2019/20 comparative information in 2020/21 financial statements</p> <p>Reflect accounting under AASB 1059 in the current year</p>
If the date of initial application of AASB 1059 is changed to the start of the current year	<p>Apply AASB 15, AASB 16 and AASB 1058 for the first time</p>	<p>No impact arising from service concession arrangements as AASB 1059 not yet applied</p> <p>Reflect accounting under AASB 15, AASB 16 and AASB 1058 in the current year</p>	<p>Initial application date of AASB 1059: measure and recognise service concession asset and liability for the first time</p>	<p>First year of applying AASB 1059: reflect accounting under AASB 1059 in current year</p>

Timeline 2 – Entity early adopting AASB 1059 on 1 July 2019

	1 July 2018	1 July 2019	30 June 2020 Financial statements
The date of initial application of AASB 1059 is the start of the comparative year	<p>Initial application date of AASB 1059: measure service concession asset and liability for the first time</p>	<p>Apply AASB 1059 to service concession arrangements</p> <p>Apply AASB 15, AASB 16 and AASB 1058 for the first time</p>	<p>First year of applying AASB 1059: restate 2018/19 comparative information in 2019/20 financial statements</p> <p>Reflect accounting under AASB 15, AASB 16, AASB 1058 and AASB 1059 in the current year.</p>

	1 July 2018	1 July 2019	30 June 2020 Financial statements
If the date of initial application of AASB 1059 is changed to the start of the current year		Initial application date of AASB 1059: measure and recognise service concession asset and liability for the first time Apply AASB 15, AASB 16 and AASB 1058 for the first time	First year of applying AASB 1059: reflect accounting under AASB 1059 as well as accounting under AASB 15, AASB 16 and AASB 1058 in the current year

Staff analysis

- 57 To avoid applying AASB 16 for one year for service concession arrangements, an entity needs to early adopt AASB 1059. Changing the date of initial application would not change this need; and if an entity is currently preparing to apply AASB 1059 early in the 2019/20 year, staff are of the view that it would have already started preparing service concession arrangements information as at 1 July 2018 to apply the requirements in the comparative period (assuming only one comparative year presented). If the date of initial application is now changed to the start of the first year, i.e. 1 July 2019, the entity would have to roll forward the opening balances for service concession arrangements by one year.
- 58 Staff have heard from the Treasury departments of a few jurisdictions, and it appears that currently only one jurisdiction is planning to early adopt AASB 1059 (for 2019/20). Moreover, this jurisdiction that is planning to early adopt AASB 1059 on 1 July 2019, has no issue with the initial application date at the start of the comparative year since it will be adopting the full retrospective method.
- 59 Staff note that if an entity applies the full retrospective method in AASB 1059, then it would be required to restate comparative information under AASB 108 even if the date of initial application is changed to the start of the current year. Therefore, if an entity does not early adopt AASB 1059, changing the date of initial application to the start of the current year would only benefit those entities that are applying the modified retrospective approach as they would no longer be required to restate comparative information for service concession arrangements.
- 60 However, staff have also heard that some jurisdictions would benefit from additional time in obtaining information about their service concession arrangements and to prepare for the implementation of the Standard; particularly if the Board decides to change the modified retrospective GORTO liability calculation. These jurisdictions would support ACAG's suggestion in changing the date of initial application to the start of the current year so that they can focus their efforts in applying AASB 1059 to the implementation year rather than to the comparative year as well.

Pros and cons of changing the initial application date

- 61 Staff have considered the following pros and cons of changing the initial application date of AASB 1059 to the start of the current year, instead of the start of the comparative year. Staff are of the view that the pros outweigh the cons.

62 Arguments for changing the initial application date:

- Changing the date of initial application would allow those entities that are adequately prepared for application of AASB 1059 to early adopt AASB 1059 without estimating the fair value of assets at the beginning of the comparative year (1 July 2018), if they are applying the modified retrospective method, and eliminate the need to apply AASB 16 for one year for service concession assets.
- Removing the need to obtain information for the comparative year, for entities that elect to apply the modified retrospective approach, would provide additional time for entities to obtain information about service concession arrangements and to prepare for the implementation of the Standard. This would also provide extra time for entities to consider the new retrospective modified GORTO liability calculation, if the Board decides to change this calculation.
- Reduce costs of implementing AASB 1059. If an entity chooses to apply the modified retrospective method in AASB 1059, then changing the initial application date of AASB 1059 to the start of the current year would mean that entities do not need to restate comparative information. This could reduce the costs and time required to implement the Standard and would also reduce the cost of auditing the financial statements.

63 Arguments against changing the initial application date:

- Changing the initial application date could affect those entities that have already started preparing the implementation of AASB 1059, especially if they are planning early application to 2019/20. These entities may have obtained information as at 1 July 2018 and would have to roll forward that information by one year.
- Financial statements would be more understandable if comparative information is adjusted for the application of a new Standard.

Staff recommendation

64 Based on the above, staff are of the view constituents would benefit from additional time to prepare for the implementation of AASB 1059, particularly if the Board decides to change the modified retrospective GORTO liability calculation method. Moreover, requiring comparative information to be restated when implementing AASB 1059 under the modified retrospective method would increase the cost and time of implementing the Standard that may outweigh the benefits. Based on paragraph 28(d)² of *The AASB's Not-for-Profit Entity Standard-Setting Framework*, staff recommend the Board change the initial application date of AASB 1059 to the beginning of the annual reporting period in which an entity first applies the Standard.

Question to the Board:

Q3: Do Board members agree with Staff recommendation in paragraph 64 to change the initial application date of AASB 1059 to the beginning of the annual reporting period in which an entity first applies the Standard?

² Paragraph 28(d) of *The AASB's Not-for-Profit Entity Standard-Setting Framework* states that a justifiable circumstance that the Board would consider developing NFP guidance is "undue cost or effort of preparing and disclosing information outweigh the benefits".

Next steps

- 65 If the Board agrees with staff recommendations to amend AASB 1059, the proposed amendments need to be exposed for public comment. Given AASB 1059 only applies to public sector grantors of service concession arrangements, and staff have had discussions with major jurisdictions, staff recommend issuing a Fatal-Flaw Review draft of the amending Standard with a short comment period of 30 days.
- 66 The table below provides a draft timeline of the due process.

Date	Task
15 May 2019	Circulate ballot draft of Fatal-Flaw Review version to Board for voting out-of-session. Propose two weeks to vote until 29 May 2019.
30 May 2019	Issue Fatal-Flaw Review version for comments with a 30-day comment period (comments due 28 June 2019)
1–17 July 2019	Staff to collate comments and prepare ballot draft Amending Standard (if appropriate)
17 July 2019	Board to consider comments on Fatal-Flaw Review version and vote on ballot draft Amending Standard out-of-session. Propose two weeks to vote until 31 July 2019.
31 July 2019	Final Standard issued

Question to the Board:

Q4: Do Board members agree with staff's proposed next steps in paragraphs 65–66?

Appendix A: Suggested editorial amendments to Illustrative Guidance

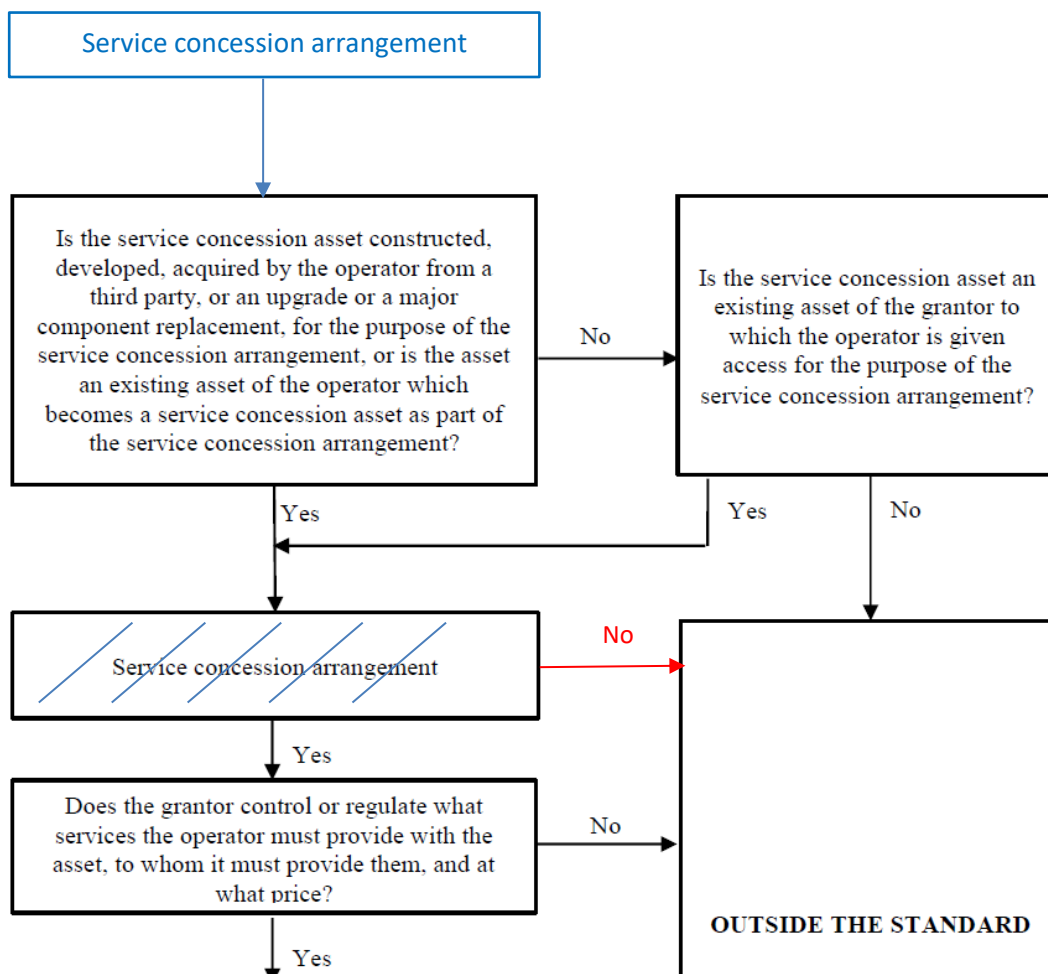
This Appendix contains analysis of the suggested editorial amendments to paragraphs IG10 and IG13 of AASB 1059 proposed by Queensland Treasury.

Issue 3: Suggested editorial amendments to paragraphs IG10 and IG13

- 1 In the flowchart in paragraph IG10, Queensland Treasury believe there should be a 'No' arrow going from the 'Service concession arrangement' box to the 'Outside the Standard' box, as indicated in red text below. They are of the view that the flowchart in its current form can be misinterpreted – if either of the top two boxes is 'Yes', then the arrangement is automatically a service concession arrangement without considering the two criteria in paragraph 2 of AASB 1059: whether the operator provides public services on behalf of a grantor, and whether the operator manages at least some of those services under its own discretion. [The full flowchart in paragraph IG10 of AASB 1059 has been included in [Appendix C](#) for the Board's reference].

Staff recommendation

- 2 Staff agree with Queensland Treasury that the current flowchart could be changed to avoid any confusion. However, staff disagree with Queensland Treasury's recommendation of adding a 'No' arrow going from the 'Service concession arrangement' box to the 'Outside the Standard' box. Instead, staff are proposing moving the 'Service concession arrangement' box to the start of the flowchart, as indicated in blue text below.



- 3 Queensland Treasury commented that after the Fatal-Flaw Review version was released, the Board decided to change the scope of the Standard in paragraph 2 of AASB 1059 so that the operator must be responsible for managing at least some of the public services provided through the asset, instead of the previous proposed scope of being responsible for at least some of the management of the asset. As a result, Queensland Treasury considers the second row of the table in paragraph IG13 of AASB 1059 is not reflective of this change. They suggested the following amendments to the second row of the table in paragraph IG13 to be more consistent with paragraph B10 of AASB 1059. The amendments are shown with new text underlined and deleted text struck through.

Features	Construction contract with service outsourcing contract	Lease (grantor is lessor)	Service concession arrangement	Sale/Privatisation
Operator provides public services related to the asset on behalf of the grantor and is responsible for at least some of the management of the asset <u>the management of at least some of the public services</u> (paragraph B10)?	Operator provides construction services, not public services . Operator provides management of asset <u>public services</u> and related services as predetermined by the grantor .	Operator involvement in the management of the asset <u>public services</u> and related services varies , depending on the lease terms (i.e. operator may have full involvement or be limited to facility management <u>that is not a significant component of the public services provided by the asset</u>).	Operator involved in management of service concession asset that is public services provided <u>by the asset that is not predetermined by the grantor</u> (i.e. operator has discretion <u>as to how the asset is managed the public services are provided and managed</u>)	Operator does not provide public services on behalf of the grantor , despite any protective rights of the grantor.

Staff recommendation

- 4 Staff agree with Queensland Treasury's suggested amendments here and recommend the Board make these changes in AASB 1059.

Question to the Board:

Q5: Do Board members agree with the Staff recommendation in paragraph 2 to change the flowchart in paragraph IG10 of AASB 1059?

Q6: Do Board members agree with the Staff recommendation in paragraph 4 to amend the wording in the table in paragraph IG13 of AASB 1059?

Appendix B: Other implementation issues

- 1 This Appendix summarises other implementation issues raised by constituents for which staff do not believe an amendment to AASB 1059 is required.

Issue 4: Current replacement cost of previously unrecognised intangible assets

Summary of issue

- 2 ACAG has commented that the cost of previously unrecognised intangible assets of the grantor, such as registers of data, is not readily determinable and could be difficult to reliably measure under the current replacement cost (CRC) model. This could contribute to a large disparity between service concession asset valuations, that includes such intangible assets, and the liability. ACAG also questioned the Board's intention of requiring such intangible assets to be recognised under the CRC model.

Staff analysis

- 3 When issuing AASB 1059, the Board considered that service concession arrangements represent a transaction with an external party that identifies and values all identifiable assets involved in the arrangement. Therefore, 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 acquirer (except for goodwill) (AASB 1059 paragraph BC40).
- 4 The Board also considered that a service concession 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. This view would be consistent with measuring the asset using the CRC model under the cost approach in AASB 13 *Fair Value Measurement*. The Board therefore concluded that it would be appropriate to value service concession assets using only the CRC approach. The Board extended this measurement basis to previously unrecognised intangible assets (AASB 1059 paragraphs BC63, BC66 and BC70) [[Appendix C](#) includes an extract of the Basis for Conclusions for the Board's reference].
- 5 Although staff agree with ACAG that the costs of previously unrecognised intangible assets might not be readily determinable, staff are of the view that qualified valuers would be able to provide a valuation of such intangible assets using the CRC approach. Staff have spoken to valuers in the large accounting firms, who have advised that valuers have methodologies in estimating the replacement cost of internally generated intangible assets. This may include estimating the costs of labour and tools required to replace the asset.
- 6 This is consistent with the guidance in the International Valuation Standards IVS 210 *Intangible Assets*. IVS 210 states that the replacement cost is most commonly applied to the valuation of intangible *assets* (IVS 210 paragraph 70.5), and that a valuer would consider "the direct and indirect costs of replacing the utility of the *asset*, including labour, materials and overhead" in applying the replacement cost method (IVS 210 paragraph 70.7) [[Appendix C](#) includes an extract of IVS 210 for the Board's reference].

Staff comment

- 7 Staff continue to believe that public sector grantors use the service concession assets to provide public services rather than to generate cash flows; and therefore, measuring the asset using the cost approach under AASB 13 remains appropriate. Staff are of the view that, if necessary, public sector grantors would be able to engage a qualified valuer to estimate the fair value of previously unrecognised intangible assets using the CRC approach. Therefore, Staff do not consider any amendments to AASB 1059 or additional guidance are required in this respect.

Issue 5: Clarify the type of costs included in a Current Replacement Cost calculation

Summary of issue

- 8 ACAG has commented that AASB 1059 is not clear what type of costs should be included in the CRC for service concession assets. Specifically, whether borrowing costs and design costs should be included in the measurement.

Staff comment

- 9 The Board had previously decided not to provide additional guidance in AASB 1059 on measurement of service concession assets as it believed that this would be best developed as part of the Fair Value Measurement for Public Sector Entities project (AASB 1059 paragraph BC69). Staff have recently resumed this project and have commenced considering the type of costs that should be included in the CRC of assets. Guidance, mostly in the form of Illustrative Examples, is expected to be drafted by the end of 2019. Therefore, amendments to AASB 1059 are not required.

Issue 6: Clarify the types of arrangements in the scope of AASB 1059

Summary of issue

- 10 ACAG has commented that it is unclear whether an arrangement that meets all criteria of a service concession arrangement but does not provide a public service (e.g. public hospital carparks) is in the scope of AASB 1059. ACAG also noted that some entities are proposing not to recognise such assets on the balance sheet (if it is considered that the grantor has granted a 'right-of-access' of the asset to the operator), or not to accrue for the right to receive the building at the end of the arrangement (if it is considered that the operator has granted a 'right-of-use' to the operator), based on the fact that the asset does not involve a public service.
- 11 ACAG commented that it would be beneficial to confirm whether right-of-access accounting is required for arrangements that meet the recognition criteria of a right-of-access arrangement but the asset is not providing a public service.

Staff comment

- 12 Staff are of the view that the Application Guidance and Illustrative Guidance in AASB 1059 provide sufficient guidance and explanation on how the principles in AASB 1059 are to be applied in situations where a secondary asset might be used to complement the primary asset that is providing a public service, or when an asset provides ancillary services that is not considered a public service. Therefore, staff do not believe additional guidance would be necessary.
- 13 Specifically, AASB 1059 paragraph B7 describes a situation where a secondary asset that is used or mainly used to complement the primary asset, that is providing a public service, would be regarded as providing public service as well. Moreover, AASB 1059 paragraph IG21 clarifies that if a grantor determines that it cannot recognise an asset as a service concession asset under AASB 1059 it would still need to assess whether it controls the asset under other Accounting Standards. AASB 1059 paragraphs IG21–IG23 also illustrates that there might be situations where, as part of a service concession arrangement, the grantor grants a 'right-to-use' an asset to the operator to provide ancillary services or non-public service, it would be appropriate to recognise the transaction under other Accounting Standards, such as AASB 16 [[Appendix C](#) includes an extract of paragraphs B6-B7 and IG21–23 of AASB 1059 for the Board's reference].

Issue 7: Clarify how a transfer of liabilities from grantor to operator should be treated

Summary of issue

- 14 The NSW DFSI commented that it is not clear in AASB 1059 whether “additional or other consideration” (AASB 1059 paragraphs 11–14) includes a transfer of liabilities. For example, a service concession arrangement may involve an existing business, which includes employee liabilities. In this situation, the consideration given for the business could include the employee liabilities or be adjusted for the changes in the employee liabilities between contract signing and the settlement date. However, it is not stated in AASB 1059 whether the transfer of employee liabilities should be considered as additional or other consideration.

Staff comment

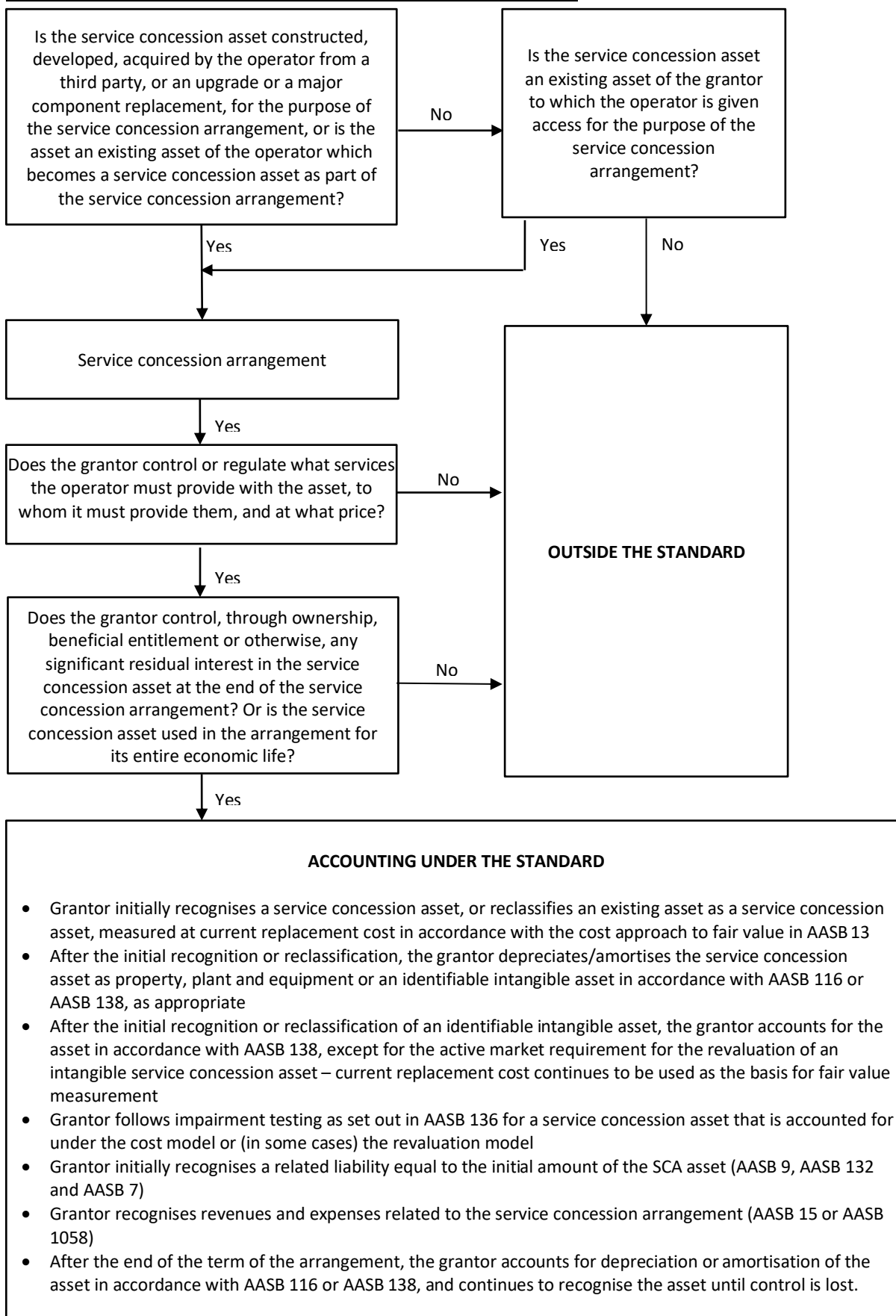
- 15 Paragraph B14 of AASB 1059 states that if a service concession arrangement encompasses a business as defined in AASB 3 *Business Combinations*, the grantor shall recognise the assets and liabilities of the business. The Board also believed that the accounting for service concession arrangements should be similar to that for business combinations under AASB 3 (AASB 1059 paragraph BC40).
- 16 Staff believe that, if the accounting for service concession arrangements should be similar to that for business combination, then liabilities transferred between grantor and operator should be considered as part of the consideration paid in a service concession arrangement. AASB 3 paragraph 37 states that “The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer...” (emphasis added).
- 17 Staff do not consider any amendments to AASB 1059 or additional guidance are required. The assumption of liabilities is generally understood to be a component of consideration provided in a transaction.

Question to the Board:

Q7: Do Board members agree that amendments to AASB 1059 are not required in respect of issues 4–7?

Appendix C: Extracts of AASB 1059 and IVS 210

Flowchart in paragraph IG10 of AASB 1059 (relevant to Issue 3)



Paragraphs BC62–BC70 of AASB 1059 (relevant to Issue 4)

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.

Paragraphs 70–70.7 of IVS 210 *Intangible Assets* (relevant to Issue 4)

70. Cost Approach

70.1. Under the cost approach, the value of an intangible *asset* is determined based on the replacement cost of a similar *asset* or an *asset* providing similar service potential or utility.

70.2. *Valuers must* comply with paras 60.2 and 60.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the cost approach to the valuation of intangible *assets*.

70.3. Consistent with these criteria, the cost approach is commonly used for intangible *assets* such as the following:

- (a) acquired third-party software,

- (b) internally-developed and internally-used, non-marketable software, and
- (c) assembled workforce.

70.4. The cost approach *may* be used when no other approach is able to be applied; however, a *valuer should* attempt to identify an alternative method before applying the cost approach in situations where the subject *asset* does not meet the criteria in paras 60.2 and 60.3 of IVS 105 *Valuation Approaches and Methods*.

70.5. There are broadly two main methods that fall under the cost approach: replacement cost and reproduction cost. However, many intangible *assets* do not have physical form that can be reproduced and *assets* such as software, which can be reproduced, generally derive value from their function/utility rather than their exact lines of code. As such, the replacement cost is most commonly applied to the valuation of intangible *assets*.

70.6. The replacement cost method assumes that a *participant* would pay no more for the *asset* than the cost that would be incurred to replace the *asset* with a substitute of comparable utility or functionality.

70.7. *Valuers should* consider the following when applying the replacement cost method:

(a) the direct and indirect costs of replacing the utility of the *asset*, including labour, materials and overhead,

(b) whether the subject intangible *asset* is subject to obsolescence. While intangible *assets* do not become functionally or physically obsolete, they can be subject to economic obsolescence,

(c) whether it is appropriate to include a profit mark-up on the included costs. An *asset* acquired from a third party would presumably reflect their costs associated with creating the *asset* as well as some form of profit to provide a return on investment. As such, under bases of value (see IVS 104 Bases of Value) that assume a hypothetical transaction, it *may* be appropriate to include an assumed profit mark-up on costs. As noted in IVS 105 *Valuation Approaches and Methods*, costs developed based on estimates from third parties would be presumed to already reflect a profit mark-up, and

(d) opportunity costs *may* also be included, which reflect costs associated with not having the subject intangible *asset* in place for some period of time during its creation.

Paragraphs B6–B9 and IG21–IG23 of AASB 1059 (relevant to Issue 6)

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.

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:
- (c) where the grantor retains substantially all the risks and rewards incidental to ownership, the grantor is the lessor in an operating lease; or
 - (d) 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.