AASB Exposure Draft **ED 261**

May 2015

Service Concession Arrangements: Grantor

Comments to the AASB by 27 July 2015

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by 27 July 2015. Comments should be addressed to:

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All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

While comments may be lodged by email or by post, email lodgement is preferred. To enable the submissions to be accessible to all users of the website, including those with disabilities, please submit comments via email in an accessible Word format. An additional accessible and unsecured PDF version may also be submitted.

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CONTENTS

[Draft] Australian Accounting Standard AASB 10XY *Service Concession Arrangements: Grantor* is set out in paragraphs 1 – 34 and Appendices A and B. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. AASB 10XY is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation of Standards*, which identifies the Australian Accounting Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

PREFACE

Introduction

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards, including Interpretations, to be applied by:

(a) entities required by the *Corporations Act 2001* to prepare financial reports;

(b) governments in preparing financial statements for the whole of government and the General Government Sector (GGS); and

(c) entities in the private or public for-profit or not-for-profit sectors that are reporting entities or that prepare general purpose financial statements.

AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements:

(a) Tier 1: Australian Accounting Standards; and

(b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 1 requirements incorporate International Financial Reporting Standards (IFRSs), including Interpretations, issued by the International Accounting Standards Board (IASB), with the addition of paragraphs on the applicability of each Standard in the Australian environment.

Publicly accountable for-profit private sector entities are required to adopt Tier 1 requirements, and therefore are required to comply with IFRSs. Furthermore, other for-profit private sector entities complying with Tier 1 requirements will simultaneously comply with IFRSs. Some other entities complying with Tier 1 requirements will also simultaneously comply with IFRSs.

Tier 2 requirements comprise the recognition and measurement requirements of Tier 1 but substantially reduced disclosure requirements in comparison with Tier 1.

Australian Accounting Standards also include requirements that are specific to Australian entities. These requirements may be located in Australian

Accounting Standards that incorporate IFRSs or in other Australian Accounting Standards. In most instances, these requirements are either restricted to the not-for-profit or public sectors or include additional disclosures that address domestic, regulatory or other issues. These requirements do not prevent publicly accountable for-profit private sector entities from complying with IFRSs. In developing requirements for public sector entities, the AASB considers the requirements of International Public Sector Accounting Standards (IPSASs), as issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants.

Exposure Drafts

The publication of an Exposure Draft is part of the due process that the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

Reasons for Issuing this Exposure Draft

In Australia, service concession arrangements are entered into by public and private sector entities to develop and deliver major infrastructure assets for public services. A service concession arrangement generally involves an operator (a private sector entity) constructing a public infrastructure asset (a service concession asset) and providing public services, such as operating and maintaining the infrastructure on behalf of the grantor (the public sector entity) for an agreed period. Examples of service concession assets include roads, utilities distribution, prisons and hospitals. The common terms used to describe these arrangements include Public Private Partnerships, Build-Own-Operate arrangements and Build-Own-Operate-Transfer arrangements.

In exchange for the asset and services, the grantor makes payments to the operator or grants the operator a right to charge users of the service concession asset.

Currently, there is no specific Australian Accounting Standard that prescribes the accounting for a service concession arrangement from the grantor's (public sector entity) perspective.

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

(a) AASB Interpretation 12 *Service Concession Arrangements*. AASB Interpretation 12 provides guidance from the operator's perspective. Consequently, a grantor of a service concession arrangement need not apply AASB Interpretation 12;

(b) AASB 117 *Leases*. AASB 117 provides guidance where the grantor makes payments to the operator, but does not provide guidance where the grantor grants the operator a right to charge users of the service concession asset. Additionally, AASB 117 uses a risks and rewards approach to assess whether the grantor should recognise an asset and a liability under a lease;

(c) AASB Interpretation 4 *Determining whether an Arrangement contains a Lease*. AASB Interpretation 4 provides guidance for the application of AASB 117 *Leases*;

(d) Financial Reporting Standard FRS 5 *Reporting the Substance of Transactions* issued by the UK Accounting Standard Board. FRS 5 applies to similar principles to AASB 117. It requires an entity recognise an asset and a liability where the entity has substantially all or the majority of risks and rewards incident to the ownership of the assets; and

(e) IPSAS 32. IPSAS 32 provides guidance on service concession arrangements from a grantor's perspective.

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

The proposed requirements are based on the control or regulation approach of IPSAS 32, consistent with AASB Interpretation 12. This approach is considered to be more conceptual than the risks and rewards approach and would result in similar accounting treatment by the operator and the grantor of the service concession arrangement. The IASB and the IPSASB confirmed the use of the control approach, rather than the risks and rewards approach, for recognising an asset in their recent conceptual frameworks and accounting standards.

Main Features of this Exposure Draft

The proposals in this Exposure Draft are aligned with the requirements of IPSAS 32 for a grantor to recognise an asset provided by an operator that is used in a service concession arrangement and a corresponding liability.

The main impacts of the proposals are potentially:

(a) an increase in the recognition of assets and liabilities associated with a service concession arrangement in the statement of financial position for entities that currently are not recognising service concession assets and liabilities. In particular, this impacts a service concession arrangement that involves the public sector grantor granting the private sector operator a right to earn revenue from a third-party user of the service concession asset. This type of arrangement may not be currently recognised by some grantors. To the extent that such arrangements meet the recognition and measurement criteria of the [draft] Standard, they would need to be recognised in the statement of financial position as a service concession asset and liability; and

(b) earlier recognition of assets and liabilities of a service concession arrangement. That is, assets and liabilities would be recognised during the period in which the assets are constructed or developed. This contrasts to the, current practice of recognising assets and liabilities of a service concession arrangement only at the end of the construction period.

The following outlines the proposals in further detail.

Scope of Proposals

The proposals in this Exposure Draft are applicable to arrangements that involve an operator providing public services related to a service concession asset on behalf of the grantor for a specified period of time.

Recognition and Measurement

The Exposure Draft proposes that the grantor would:

(a) recognise an asset provided by the operator, including an upgrade to an existing asset of the grantor, when the grantor controls the asset. The Exposure Draft proposes the criteria for determining when the grantor has control of the asset;

(b) recognise a service concession asset that is under construction or development when the recognition criteria for the asset is met during the period in which it is constructed or developed;

(c) initially measure the service concession asset provided by the operator at fair value in accordance with AASB 13 *Fair Value Measurement*. Subsequent to the initial recognition of the asset, the service concession asset is accounted for in accordance with AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets*, as appropriate; and

(d) recognise a corresponding liability measured at the fair value of the service concession asset, adjusted for any other consideration between the grantor and the operator. The liability would be recognised using either of the following two models:

    (i) Financial liability model

    This model would apply where the grantor has an obligation to deliver cash or another financial asset to the operator for the delivery of the service concession asset. This model requires the grantor to allocate the payments to the operator under the contract and account for them as a reduction in the liability recognised, a finance charge and charges for services provided by the operator;

    (ii) Grant of a right to the operator model

    This model would apply where the grantor does not have an obligation to deliver cash or another asset to the operator for the delivery of the service concession asset. The grantor instead grants the operator the right to earn revenue from third-party users of the service concession asset. This model requires the grantor to recognise a liability reflecting the unearned portion of the revenue arising from the exchange of the assets between the grantor and the operator. The grantor would recognise the revenue according to the substance of the service concession arrangement and reduce the liability as the revenue is recognised.

Presentation and Disclosure

The Exposure Draft proposes additional disclosures for service concession arrangements that are not addressed in existing Australian Accounting Standards. Where the accounting for a particular aspect of a service concession arrangement is addressed in another Standard, the grantor would follow the disclosure requirements of that Standard in addition to the proposed disclosures in this Exposure Draft of:

(a) a description of the arrangement;

(b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows;

(c) the nature and extent of the rights to access specified assets and services, the service concession asset recognised (including any reclassification of existing assets), the right to receive specified assets at the end of the arrangement, renewal and termination options, other rights and obligations, and obligations to provide the operator with access to the service concession asset or other revenue-generating assets; and

(d) changes in the arrangement during the reporting period.

Transitional Requirements

It is proposed that, in adopting the proposals set out in this Exposure Draft for the first time, a grantor would either:

(a) apply the [draft] Standard retrospectively in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*; or

(b) elect to recognise and measure the service concession assets and related liabilities at the beginning of the earliest period for which comparative information is presented in the financial statements using deemed cost. Deemed cost of the service concession assets is the fair value in accordance with AASB 13.

Application Date

It is proposed that an entity would apply this [draft] Standard to annual reporting periods beginning on or after 1 January 2017, with early adoption permitted.

GAAP/GFS Implications

The Australian Bureau of Statistics (ABS) is in the process of revising its Government Finance Statistics (GFS) Manual and is expected to issue the revised Manual before the proposed application date of the [draft] Standard.

The ABS intends to base its revised GFS Manual on the revised International Monetary Fund (IMF) GFS Manual, which is yet to be published[1].

The GAAP/GFS harmonisation implications of the proposals in the [draft] Standard are based on a comparison with the proposals in the revised IMF GFS Manual Pre-publication Draft (Draft IMF Manual) issued in March 2014. Those GAAP/GFS harmonisation implications are noted below. None of them suggest a fundamental GAAP/GFS difference would arise.

The Draft IMF Manual applies to Public Private Partnerships (PPPs) and adopts the risks and rewards approach in determining the ownership of the assets and therefore the treatment of the assets in the arrangements. The Draft IMF Manual states that the approach is broadly consistent with IPSAS 32 for the recognition and measurement of a service concession asset. The Draft IMF Manual identifies the types of risks to consider when assessing the economic ownership of PPP-related assets. The risks include supply risk, demand risk, residual value and obsolescence risk, and availability risk. These risks are broadly consistent with the considerations for assessing whether a grantor controls a service concession asset proposed in the [draft] Standard, and would be expected to result in a difference in interpretation only in limited circumstances.

The Draft IMF Manual specifies the treatment when the government is considered the economic owner of the service concession asset during the contract period and does not make any explicit payment to the operator at the beginning of the contract. It requires the arrangement to be recorded as either a finance lease or a loan which equals the market value of the acquisition of the asset. This is similar to the 'financial liability' and 'grant of a right to the operator' model in the [draft] Standard.

Request for Comments

Comments are invited on any of the proposals in this Exposure Draft by 27 July 2015. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue.

1 The ABS intends differing from the revised IMF GFS Manual in some respects, but these intended differences relate to issues outside the scope of this Exposure Draft.

Specific Matters for Comment

The AASB would particularly value comments on the following:

1 The proposed application to all public sector entities is wider than IPSAS 32 *Service Concession Arrangements: Grantor*, upon which the [draft] Standard is based. IPSAS 32 applies to all public sector entities other than Government Business Enterprises (GBE). A GBE is akin to a for-profit public sector entity. The proposed approach is consistent with the AASB's policy of making accounting Standards that require like transactions and events to be accounted for in a like manner for all types of entities, which is referred to as transaction neutrality. Do you agree with the proposed application to all public sector entities? Why or why not?

2 The proposed scope in paragraph 5 applies to arrangements involving a 'service concession asset', which would include intangible assets and land. This is consistent with the scope of IPSAS 32 but broader than the scope of AASB Interpretation 2 *Service Concession Arrangements*. AASB Interpretation 12 applies to 'infrastructure' of a service concession arrangement, which would exclude intangible assets and land. AASB Interpretation 12 is applicable to infrastructure assets that the private sector operator constructed or acquired from a third-party, or to which it was given access by the grantor, for the purpose of the arrangement. Consequently, the intangible assets or land that has been granted by the grantor is outside the scope of AASB Interpretation 12. Do you agree with the proposed scope of the [draft] Standard? Why or why not?

3 The [draft] Standard proposes the specific control concept in paragraph 8(a) that a grantor controls the asset if the "grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them and at what price". This mirrors the control concept in AASB Interpretation 12. The AASB notes that a broader concept of control currently applies in other Australian Accounting Standards. An asset that does not meet the control and regulation definition of this [draft] Standard may still need to be recognised under other accounting Standards. Do you agree with the proposed specific control concept in paragraph 8(a) of the [draft] Standard? That is, applying a narrower concept of control in the [draft] Standard than other accounting Standards. Why or why not?

4 The [draft] Standard proposes that the grantor initially measures the service concession asset at its fair value unless the service concession asset is an existing asset of the grantor. Do you agree that the proposed requirements and guidance appropriately explain the application of fair value to a service concession asset? Why or why not?

5 The [draft] Standard proposes that:

(a) where the grantor recognises a service concession asset, the grantor also recognises a liability measured at the same amount as the service concession asset adjusted for other consideration between the grantor and operator. Do you agree that the proposed requirements and guidance appropriately measure the consideration between the grantor and the operator of the service concession arrangement? Why or why not?

(b) the measurement of a service concession liability using the 'financial liability model' and/or the 'grant of a right to the operator model'. Do you agree with the proposed models? Why or why not? If you do not agree with the proposed models, what alternative model(s) would you recommend?

6 The [draft] Standard proposes that the grantor account separately for each part of the total liability recognised for the service concession arrangement where the arrangement involves the grantor both incurring a financial liability and granting a right to the operator. Do you agree that the [draft] Standard provides appropriate guidance for the separate recognition of the liability? Why or why not?

7 IPSAS 32 includes guidance in relation to other revenues in paragraphs AG55 – AG64. Other revenues relate to compensation by the operator to the grantor for access to the service concession asset by providing the grantor with a series of pre-determined inflows of resources. The [draft] Standard does not include this guidance, for the reasons outlined in paragraphs BC27 and BC28. Do you agree that guidance on the accounting treatment of other revenues from a service concession arrangement is not required? Why or why not?

8 The [draft] Standard includes defined terms in Appendix A. Do you agree that the proposed defined terms in Appendix A appropriately explain the significant terms in the [draft] Standard? Why or why not?

In particular, do you agree with the proposed definition of a 'public service' as a "service that is provided by government or one of its controlled entities, as part of the usual government function, to the community, either directly (through the public sector) or by financing the provision of services"? Why or why not?

Are there additional terms that should be defined in Appendix A to assist application of the [draft] Standard?

9 The [draft] Standard includes examples on the accounting treatment of lifecycle costs of a service concession asset that might be a benefit to

the grantor. Lifecycle costs are costs incurred by the operator to maintain the asset during the service concession period. An example of a lifecycle cost is the cost to periodically resurface a road during the operating and maintenance phase of the service concession arrangement. Do you agree that the examples in the [draft] Standard provide sufficient guidance on the accounting treatment of lifecycle costs of a service concession asset that might be a benefit to the grantor? Why or why not?

10 Do you agree with the proposed disclosures for a service concession arrangement set out in paragraphs 30 to 32? Why or why not?

In particular, do you agree with the proposed disclosure of paragraph 31 applying individually for each material service concession arrangement or in aggregate for each class of service concession arrangements?

11 In relation to the proposed application date and transitional requirements:

(a) Do you agree the proposed application date is appropriate, and if not, what further considerations should be taken into account to determine the application date of the [draft] Standard?

(b) Do you agree with the proposed transitional provisions set out in paragraph 33? Why or why not? The transitional provisions permit the grantor to apply the [draft] Standard retrospectively or elect to recognise and measure the service concession asset and liabilities at the beginning of earliest period for which comparative information is presented using deemed cost.

General Matters for Comment

The AASB would particularly value comments on the following:

12 Whether:

(a) there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including any GAAP/GFS implications?

(b) overall, the proposals would result in financial statements that would be useful to users?

(c) the proposals are in the best interests of the Australian economy?

13 Unless already provided in response to the matters for comment 1 – 12 above, the costs and benefits of the proposals relative to the current Australian Accounting Standards, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

[DRAFT] ACCOUNTING STANDARD AASB 10XY

SERVICE CONCESSION ARRANGEMENTS: GRANTOR

Objective

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

Application

2 This [draft] Standard applies to:

(a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the *Corporations Act 2001* and that is a reporting entity;

(b) general purpose financial statements of each other reporting entity; and

(c) financial statements that are, or are held out to be, general purpose financial statements.

3 This [draft] Standard applies to annual reporting periods beginning on or after 1 January 2017.

4 This [draft] Standard may be applied to annual reporting periods beginning before 1 January 2017. When an entity applies this [draft] Standard to such an annual reporting period, it shall disclose that fact.

Scope

5 This [draft] Standard shall be applied to arrangements that involve an *operator* providing a *public service* related to a *service concession asset* on behalf of a grantor.

6 Arrangements outside the scope of this [draft] Standard include those that do not involve the delivery of a public service and arrangements that involve service and management components where the asset is not controlled by the grantor, as described in paragraph 8, or

paragraph 9 for a whole-of-life asset (eg outsourcing, service contracts, or privatisation).

7 This [draft] Standard does not specify the accounting by operators. Guidance on accounting for service concession arrangements by the operator can be found in AASB Interpretation 12 *Service Concession Arrangements*.

Recognition and Measurement of a Service Concession Asset

8 The grantor shall recognise an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if the grantor controls the asset. The grantor controls the asset if, and only if:

(a) the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and

(b) the grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the asset at the end of the term of the arrangement.

9 The grantor shall recognise an asset that will be used in a service concession arrangement for its entire useful life (a 'whole-of-life' asset) if the conditions in paragraph 8(a) are met.

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

11 Where an existing asset of the grantor meets the conditions specified in paragraph 8 (or paragraph 9 for a whole-of-life asset), the grantor shall reclassify the existing asset as a service concession asset. The reclassified service concession asset shall be accounted for in accordance with AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets,* as appropriate, in accordance with this [draft] Standard.

12 After initial recognition or reclassification, service concession assets shall be accounted for as a separate class or, where appropriate, separate classes of assets, in accordance with AASB 116 or AASB 138, as appropriate.

Recognition and Measurement of Liabilities

13 **Where the grantor recognises a service concession asset in accordance with paragraph 8 (or paragraph 9 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 11, except in circumstances where additional consideration is provided by the operator, as noted in paragraph 14.**

14 **The liability recognised in accordance with paragraph 13 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.**

15 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*.

16 In exchange for the service concession asset, the grantor may 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:

(i) granting the operator the right to earn revenue from third-party users of the service concession asset; or

(ii) granting the operator access to another revenue-generating asset for the operator's use (eg a private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients or a private parking facility adjacent to a public facility).

Financial Liability Model

17 **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 13 as a financial liability.

18 The grantor has a contractual obligation to pay cash if it has agreed to pay the operator:

(a) specified or determinable amounts; or

(b) the shortfall, if any, between amounts received by the operator from users of the public service and any specified or determinable amounts referred to in paragraph 18(a) even if the payment is contingent on the operator ensuring that the service concession asset meets specified quality or efficiency requirements.

19 AASB 132 *Financial Instruments: Presentation*, the derecognition requirements in AASB 9 *Financial Instruments*[1] and AASB 7 *Financial Instruments: Disclosures* apply to the financial liability recognised under paragraph 13, except where this [draft] Standard provides requirements and guidance.

20 The grantor shall allocate the payments to the operator under the contract and account for them according to their substance as a reduction in the liability recognised in accordance with paragraph 13, a finance charge and charges for services provided by the operator.

21 The finance charge and charges for services provided by the operator in a service concession arrangement determined in accordance with paragraph 20 shall be accounted for in accordance with other relevant Australian Accounting Standards.

22 Where the asset and service components of a service concession arrangement are separately identifiable, the service components of payments from the grantor to the operator shall be allocated accordingly. Where the asset and service components are not separately identifiable, the service component of payments from the grantor to the operator shall be determined using estimation techniques.

1 If the entity has yet to adopt AASB 9 *Financial Instruments*, references in this [draft] Standard to AASB 9 should be read as AASB 139 *Financial Instruments: Recognition and Measurement.*

Grant of a Right to the Operator Model

23 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 another revenue-generating asset, the grantor shall account for the liability recognised in accordance with paragraph 13 as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.

24 The grantor shall recognise revenue, and accordingly reduce the liability recognised in accordance with paragraph 23, according to the economic substance of the service concession arrangement.

25 Where the grantor compensates the operator for the service concession asset and the provision of services, by granting the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset, the exchange is regarded as a transaction that generates revenue. As the right granted to the operator is effective for the period of the service concession arrangement, the grantor does not recognise revenue from the exchange immediately. Instead, a liability is recognised for revenue that is not yet earned. The revenue is then recognised according to the economic substance of the service concession arrangement, and the liability is reduced as revenue is recognised.

Dividing the Arrangement

26 If the grantor pays for the construction, development, acquisition, or upgrade 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 13. The amount initially recognised for the total liability shall be the same amount as that specified in paragraph 14.

27 The grantor shall account for each part of the liability referred to in paragraph 26 in accordance with paragraphs 17 – 25.

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets

28 The grantor shall account for other liabilities, commitments, contingent liabilities and contingent assets arising from a service concession arrangement in accordance with AASB 137 *Provisions,*

***Contingent Liabilities and Contingent Assets*, AASB 9, and other relevant Australian Accounting Standards.**

Other Revenues

29 The grantor shall account for revenues from a service concession arrangement, other than those specified in paragraphs 23 – 25, in accordance with AASB 10XX *Income of Not-for-Profit Entities*.

Presentation and Disclosure

30 The grantor shall present information in accordance with AASB 101 *Presentation of Financial Statements*.

31 All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. A grantor shall disclose the following information in respect of service concession arrangements in each reporting period:

(a) a description of the arrangement;

(b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);

(c) the nature and extent (eg quantity, time period, or amount, as appropriate) of:

(i) rights to access specified assets;

(ii) rights to receive specified services in relation to the service concession arrangement from the operator;

(iii) service concession assets recognised as assets during the reporting period, including existing assets of the grantor reclassified as service concession assets;

(iv) rights to receive specified assets at the end of the service concession arrangement;

(v) renewal and termination options;

(vi) other rights and obligations (eg major overhaul of service concession assets); and

(vii) obligations to provide the operator with access to service concession assets or other revenue-generating assets; and

(d) changes in the arrangement occurring during the reporting period.

32 The disclosures required in accordance with paragraph 31 are provided individually for each material service concession arrangement or in aggregate for each class of service concession arrangements.

Transition

33 A grantor shall either:

(a) apply this [draft] Standard retrospectively in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*; or

(b) elect to recognise and measure service concession assets and related liabilities at the beginning of the earliest period for which comparative information is presented in the financial statements using deemed cost. Deemed cost for service concession assets is the fair value in accordance with AASB 13.

When the grantor makes an election to apply deemed cost, it shall disclose this fact, along with disclosures relating to the measurement of those assets and liabilities.

Commencement of the Legislative Instrument

34 For legal purposes, this legislative instrument commences on 31 December 2016.

APPENDIX A

DEFINED TERMS

This appendix is an integral part of AASB 10XY.

contract	An agreement between two or more parties that creates enforceable rights and obligations.
grantor	The entity that grants the right to access the **service concession asset** to the **operator**.
operator	The entity that has a right of access to the **service concession asset** to provide **public services** subject to the **grantor**'s control of the asset.
public service	A service that is provided by government or one of its controlled entities, as part of the usual government function, to the community, either directly (through the public sector) or by financing the provision of services.
service concession arrangement	A **contract** between a **grantor** and an **operator** in which: (a) the **operator** has the right of access to the **service concession asset** to provide a **public service** on behalf of the **grantor** for a specified period of time; and (b) the **operator** is compensated for its services over the period of the **service concession arrangement**.

service concession asset An asset used to provide **public services** in a **service concession arrangement** that:

(a) is provided by the **operator** which:

  (i) the **operator** constructs, develops, or acquires from a third party; or

  (ii) is an existing asset of the **operator**; or

(b) is provided by the **grantor** which:

  (i) is an existing asset of the **grantor**; or

  (ii) is an upgrade to an existing asset of the **grantor**.

APPENDIX B

APPLICATION GUIDANCE

This appendix is an integral part of AASB 10XY.

Scope (paragraphs 5 – 7)

AG1 This [draft] Standard is intended to 'mirror' AASB Interpretation 12 *Service Concession Arrangements*, which sets out the accounting requirements for the operator in a service concession arrangement. To do so, the scope, principles for recognition of an asset, and terminology are consistent with the applicable guidance in AASB Interpretation 12. However, because this [draft] Standard deals with the accounting issues of the grantor, this [draft] Standard addresses the issues identified in AASB Interpretation 12 from the grantor's point of view, as follows:

(a) the grantor recognises a financial liability when it is obliged to make a series of payments to the operator for provision of a service concession asset (ie constructed, developed, acquired or upgraded). Under paragraphs 12, 14 and 20 of AASB Interpretation 12, the operator recognises revenue for the construction, development, acquisition, upgrade and operation services it provides. Under paragraph 16 of AASB Interpretation 12, the operator recognises a financial asset;

(b) the grantor recognises a liability when it grants the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset. Under paragraph 26 of AASB Interpretation 12, the operator recognises an intangible asset;

(c) the grantor derecognises an asset it grants to the operator and over which it no longer has control and reduces the liability recognised under paragraph 14. Under paragraph 27 of AASB Interpretation 12, the operator recognises the asset and a liability in respect of any obligations it has assumed in exchange for the asset.

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

Definitions (Appendix A)

AG3 Appendix A defines a service concession arrangement. A feature of a service concession arrangement is the public service nature of the obligation to be undertaken by the operator in a commercial transaction. The public service to be provided by the service concession asset is irrespective of the identity of the party that operates the services. The service concession arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features of a service concession arrangement within the scope of this [draft] Standard are:

(a) the grantor is a public sector entity;

(b) the operator is responsible for at least some of the management of the service concession asset and related services and does not merely act as an agent on behalf of the grantor;

(c) the arrangement sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement;

(d) the operator is obliged to hand over the service concession asset to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it; and

(e) the arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.

AG4 Appendix A defines a service concession asset. Examples of service concession assets are roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, and other tangible or intangible assets that are expected to be used during more than one reporting period in delivering public services.

AG5 The term 'agreement' in the definition of a 'contract' in Appendix A encompasses an arrangement entered into under the direction of another party (for example, when assets are transferred to an entity with a directive that they be deployed to provide specified services, or regulation or legislation is imposed in relation to the assets).

AG6 Contracts can be written, oral or implied by an entity's customary business practices in performing or conducting its activities.

Recognition and Initial Measurement of a Service Concession Asset

Recognition of a Service Concession Asset

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

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

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

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

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

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

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

AG14 Where a service concession arrangement does not clearly fall within an existing regulatory framework (eg where there is more than one possible source of regulation), the arrangement will need to incorporate the specific regulatory framework that stipulates the use, the users and/or the pricing to be charged for the services in order for the grantor to have control of the service concession asset. For the purpose of paragraph 8(b), the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the asset and give the grantor a continuing right of use throughout the period of the service concession arrangement. The residual interest in the asset is the estimated current value of the asset as if it were already of the age and in the condition expected at the end of the period of the service concession arrangement.

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

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

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

(a) any asset that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in AASB 136 *Impairment of Assets* is analysed separately to determine whether the condition set out in paragraph 8(a) is met if it is used wholly for unregulated purposes (eg this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients); and

(b) when purely ancillary activities (such as a hospital shop) are unregulated, the control tests shall be applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in paragraph 8(a), the existence of ancillary activities does not detract from the grantor's control of the service concession asset.

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

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

Existing Asset of the Grantor

AG20 The arrangement may involve an existing asset of the grantor:

(a) to which the grantor gives the operator access for the purpose of the service concession arrangement; or

(b) to which the grantor gives the operator access for the purpose of generating revenues as compensation for the service concession asset.

AG21 The requirement in paragraph 10 is to measure assets recognised in accordance with paragraph 8 (or paragraph 9 for a whole-of-life asset) initially at fair value. Existing assets of the grantor used in the service concession arrangement shall be reclassified rather than recognised under this [draft] Standard. However, when an existing asset of the grantor is upgraded (eg increases in capacity), the upgrade component of the asset shall be recognised as a service concession asset in accordance with paragraph 8 (or paragraph 9 for a whole-of-life asset).

AG22 In applying the impairment tests in AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets*, as appropriate, the grantor does not necessarily consider the granting of the service concession to the operator as a circumstance that causes impairment, unless there has been a change in use of the asset that affects its future economic benefits or service potential. The grantor shall refer to AASB 136 to determine whether any of the indicators of impairment have been triggered under such circumstances.

AG23 If the asset no longer meets the conditions for recognition in paragraph 8 (or paragraph 9 for a whole-of-life asset), the grantor shall follow the derecognition principles in AASB 116 or AASB 138, as appropriate. For example, if the asset is transferred to the operator on a permanent basis, it shall be derecognised. Alternatively, the grantor may be required to derecognise the asset at a point when it or a third-party regulator no longer regulates the pricing, but rather allows the operator to freely set prices for use of the service concession asset.

AG24 If the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognised. In such cases, the grantor shall also consider whether the arrangement is a lease transaction or a sale and leaseback transaction that should be accounted for in accordance with AASB 117.

AG25 When the service concession arrangement involves upgrading an existing asset of the grantor such that the future economic benefits or service potential the asset will provide are increased, the upgrade shall be assessed to determine whether it meets the conditions for recognition in paragraph 8 (or paragraph 9 for a whole-of-life asset). If those conditions are met, the upgrade shall be recognised and measured in accordance with this [draft] Standard.

Existing Asset of the Operator

AG26 The operator may provide an asset for use in the service concession arrangement that it has not constructed, developed, or acquired for the purpose of the arrangement. If the arrangement involves an existing asset of the operator which the operator uses for the purpose of the service concession arrangement, the grantor shall determine whether the asset meets the conditions in paragraph 8 (or paragraph 9 for a whole-of-life asset). If the conditions for recognition are met, the grantor shall recognise the asset as a service concession asset and account for it in accordance with this [draft] Standard.

Constructed or Developed Asset

AG27 Where a constructed or developed asset meets the conditions in paragraph 8 (or paragraph 9 for a whole-of-life asset) the grantor shall recognise and measure the asset in accordance with this [draft] Standard. This recognition is contingent on the asset also meeting the recognition criteria in AASB 116 or AASB 138.

AASB 116 requires that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the asset will flow to the entity; and

(b) the cost of the item can be measured reliably.

AASB 138 requires that an intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

AG28 Those criteria, together with the specific terms and conditions of the contract, need to be considered in determining whether to recognise the service concession asset during the period in which the asset is constructed or developed. For both property, plant, and equipment and intangible assets, the recognition criteria may be met during the construction or development period, and, if so, the grantor will normally recognise the service concession asset during that period.

AG29 The first recognition criterion requires the flow of economic benefits to the grantor. According to the *Framework for the Preparation and Presentation of Financial Statements*, as identified in AASB 1048 *Interpretation of Standards*, for not-for-profit entities, future economic benefits are synonymous with the notion of service potential. From the grantor's point of view, the primary purpose of a service concession asset is to provide service potential on behalf of the public sector grantor. Similar to an asset the grantor constructs or develops for its own use, the grantor would assess, at the time the costs of construction or development are incurred, the terms of the contract to determine whether, in addition to retaining control of the land on which the service concession asset is being developed, economic benefits embodied in the service concession asset would flow to the grantor at that time.

AG30 The second recognition criterion requires that the cost of the asset can be measured reliably. Accordingly, to meet the recognition criteria in AASB 116 or AASB 138, as appropriate, the grantor must have reliable information about the cost of the asset during its construction or development. For example, if the service concession arrangement requires the operator to provide the grantor with progress reports during the asset's construction or development, the costs incurred may be measurable, and would therefore meet the recognition principle in AASB 116 for constructed assets or in AASB 138 for developed assets. Also, where the grantor has little ability to avoid accepting an asset constructed or developed to meet the specifications of the contract, the costs shall be recognised as progress is made towards completion of the asset. Thus, the grantor shall recognise a service concession asset and an associated liability.

Measurement of Service Concession Assets

AG31 Paragraph 10 requires service concession assets recognised in accordance with paragraph 8 (or paragraph 9 for a whole-of-life asset) to be measured initially at fair value. In particular, fair value is used to determine the cost of a constructed or developed service concession asset or the cost of any upgrades to existing assets, on initial recognition. The requirement in paragraph 10 does not apply to existing assets of the grantor that are reclassified as service concession assets in accordance with paragraph 11 of this [draft] Standard. The use of fair value on initial recognition does not constitute a revaluation under AASB 116 or AASB 138.

Types of Compensation

AG32 Service concession arrangements are rarely, if ever, the same; technical requirements vary by sector and by jurisdiction. Furthermore, the terms of the arrangement may also depend on the specific features of the overall legal framework, including contract law, of the particular jurisdiction.

AG33 Depending on the terms of the service concession arrangement, the grantor may compensate the operator for the service concession asset and service provision by any combination of the following:

(a) making payments (eg cash) to the operator; and

(b) compensating the operator by other means, such as:

  (i) granting the operator the right to earn revenue from third-party users of the service concession asset; or

  (ii) granting the operator access to another revenue-generating asset for its use.

AG34 Where the grantor compensates the operator for the service concession asset by making payments to the operator, the asset and service components of the payments may be separable (eg the contract specifies the amount of the predetermined series of payments to be allocated to the service concession asset) or inseparable.

Separable Payments

AG35 A service concession arrangement may have service and asset components of the payments that may be separable in a variety of circumstances, including, but not limited to, the following:

(a) part of a payment stream that varies according to the availability of the service concession asset itself and another part that varies according to usage or performance of certain services are identified;

(b) different components of the service concession arrangement run for different periods or can be terminated separately. For example, an individual service component can be terminated without affecting the continuation of the rest of the arrangement; or

(c) different components of the service concession arrangement can be renegotiated separately. For example, a service component is market tested and some or all of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified.

AG36 AASB 116 requires the initial measurement of an asset acquired in an exchange transaction at cost, which is the cash price equivalent of the asset. For exchange transactions, the entry price is considered to be fair value, unless indicated otherwise. Where the asset and service components of payments are separable, the cash price equivalent of the service concession asset is the present value of the service concession asset component of the payments. However, if the present value of the asset portion of the payments is greater than fair value, the service concession asset is initially measured at its fair value. This is consistent with paragraphs 10 and AG24, which require service concession assets recognised in accordance with paragraph 8 (or paragraph 9 for a whole-of-life asset) to be measured initially at fair value, in accordance with AASB 13 *Fair Value Measurement*.

Inseparable Payments

AG37 Where the asset and service components of payments by the grantor to the operator are not separable, the fair value specified in paragraph 10 is determined using estimation techniques.

AG38 For the purpose of applying the requirements of this [draft] Standard, payments and other consideration required by the arrangement are allocated at the inception of the arrangement or upon a reassessment of the arrangement into those for the service concession asset and those for other components of the service concession arrangement (eg maintenance and operation services) on the basis of their relative fair values. The fair value of the service concession asset includes only amounts related to the asset and excludes amounts for other components of the service concession arrangement. In some cases, allocating the payments for the asset from payments for other components of the service concession arrangement will require the grantor to use an estimation technique. For example, a grantor may estimate the payments related to the asset by reference to the fair value of a comparable asset in an agreement that contains no other components, or by estimating the payments for the other components in the service concession arrangement by reference to comparable arrangements and then deducting these payments from the total payments under the arrangement.

Operator Receives Other Forms of Compensation

AG39 The types of transactions referred to in paragraph 16(b) are non-monetary exchange transactions. Paragraph 24 of AASB 116 and paragraph 45 of AASB 138, as appropriate, provide guidance on these circumstances.

AG40 When the operator is granted the right to earn revenue from third-party users of the service concession asset, or another revenue-generating asset, or receives non-cash compensation from the grantor, the grantor does not incur a cost directly for acquiring the service concession asset. These forms of consideration to the operator are intended to compensate the operator both for the cost of the service concession asset and for operating it during the term of the service concession arrangement. The grantor therefore needs to initially measure the asset component in a manner consistent with paragraph 10.

Subsequent Measurement

AG41 After initial recognition, a grantor applies AASB 116 or AASB 138 to the subsequent measurement and derecognition of a service concession asset. For the purposes of applying AASB 116 or AASB 138, service concession assets should be treated as a separate class, or classes, of assets. AASB 136 is also applied in considering whether there is any indication that a service concession asset is impaired.

Recognition and Measurement of Liabilities

AG42 The grantor recognises a liability in accordance with paragraph 13 only when a service concession asset is recognised in accordance with paragraph 8 (or paragraph 9 for a whole-of-life asset). The nature of the liability recognised in accordance with paragraph 13 differs in each of the circumstances described in paragraph AG33 according to its substance.

The Financial Liability Model

AG43 When the grantor has a contractual obligation to make a predetermined series of payments to the operator, the liability is a financial liability as defined in AASB 9 *Financial Instruments*. The grantor has a contractual obligation if it has little, if any, discretion to avoid the obligation usually because the contract with the operator is enforceable by law.

AG44 When the grantor provides compensation to the operator for the cost of the service concession asset and service provision in the form of a predetermined series of payments, an amount reflecting the fair value of the service concession asset is recognised as a liability in accordance with paragraph 13. This liability does not include the finance charge and service components of the payments specified in paragraph 20.

AG45 Where the grantor makes any payments to the operator in advance of the service concession asset being recognised, the grantor accounts for those payments as prepayments.

AG46 The finance charge specified in paragraph 20 is determined based on the operator's cost of capital specific to the service concession asset, if this is practicable to determine.

AG47 If the operator's cost of capital specific to the service concession asset is not practicable to determine, the rate implicit in the arrangement specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement, is used.

AG48 Where sufficient information is not available, the rate used to determine the finance charge may be estimated by reference to the rate that would be expected on acquiring a similar asset (eg a lease of a similar asset, in a similar location and for a similar term). The estimate of the rate should be reviewed together with:

(a) the present value of the payments;

(b) the assumed fair value of the asset; and

(c) the assumed residual value;

to ensure all figures are reasonable and mutually consistent.

AG49 The finance charge related to the liability in a service concession arrangement is presented consistently with other finance charges in accordance with AASB 101 *Presentation of Financial Instruments* and AASB 123 *Borrowing Costs*.

AG50 The service component of payments determined in accordance with paragraph 20 is ordinarily recognised as expenses and liabilities as the services are provided.

Grant of a Right to the Operator Model

AG51 When the grantor compensates the operator for the service concession asset and service provision by granting the operator the right to earn revenue from third-party users of the service concession asset, the operator is granted the right to earn revenue over the period of the service concession arrangement.

AG52 Revenue is not recognised immediately. Instead, a liability is recognised for any portion of the revenue that is not yet earned. Revenue is recognised and the liability reduced in accordance with paragraph 24 based on the economic substance of the service concession arrangement, usually as access to the service concession asset is provided to the operator over the term of the service concession arrangement. Paragraph AG33 states that the grantor may compensate the operator by a combination of payments and granting a right to earn revenue directly from third-party users. In cases where the operator's right to earn third-party revenues significantly reduces or eliminates the grantor's predetermined series of payments to the operator, another basis may be more appropriate for reducing the liability (eg the term over which the grantor's future predetermined series of payments are reduced or eliminated).

AG53 When the grantor compensates the operator for the service concession asset and service by the provision of a revenue-generating asset, other than the service concession asset, revenue is recognised and the liability recognised in accordance with paragraph 23 is reduced in a manner similar to that described in paragraph AG52. In such cases, the grantor also considers the derecognition requirements in AASB 116 or AASB 138, as appropriate.

Dividing the Arrangement

AG54 If the operator is compensated for the service concession asset partly by a predetermined series of payments and partly by receiving the right to earn revenue from third-party use of either the service concession asset or another revenue-generating asset, it is necessary to account separately for each portion of the liability related to the grantor's consideration. In these circumstances, the consideration to the operator is divided into a financial liability portion for the predetermined series of payments and a liability portion for the right granted to the operator to earn revenue from third-party use of the service concession asset or another revenue-generating asset. Each portion of the liability is recognised initially at the fair value of the consideration paid or payable.

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets

AG55 Service concession arrangements may include various forms of financial guarantees (eg a guarantee, security, or indemnity related to the debt incurred by the operator to finance construction, development, acquisition, or upgrade of a service concession asset), or performance guarantees (eg guarantee of minimum revenue streams, including compensation for shortfalls).

AG56 Certain guarantees made by a grantor may meet the definition of a financial guarantee contract. The grantor determines whether guarantees made by the grantor as part of a service concession arrangement meet the definition of a financial guarantee contract and applies AASB 7 *Financial Instruments: Disclosures*, AASB 9 and AASB 132 *Financial Instruments: Presentation* in accounting for the guarantee. Where the guarantee is an insurance contract, the grantor can elect to apply AASB 4 *Insurance Contracts* or AASB 1023 *General Insurance Contracts* instead.

AG57 Guarantees and commitments that do not meet the requirements in AASB 9 and AASB 132 relating to financial guarantee contracts and are not insurance contracts are accounted for in accordance with AASB 137 *Financial Instruments: Recognition and Measurement*.

AG58 Contingent assets or liabilities may arise from disputes over the terms of the service concession arrangement. Such contingencies are accounted for in accordance with AASB 137.

Presentation and Disclosure

AG59 Disclosures relating to various aspects of service concession arrangements may be addressed in existing Standards. This [draft] Standard addresses only the additional disclosures relating to service concession arrangements. Where the accounting for a particular aspect of a service concession arrangement is addressed in another Standard, the grantor follows the disclosure requirements of that Standard in addition to those set out in paragraph 31.

AG60 AASB 101 requires finance costs to be presented separately in the statement of profit and loss and other comprehensive income. The finance charge determined in accordance with paragraph 20 is included in this item.

AG61 In addition to the disclosures outlined in paragraphs 31 and 32, the grantor also applies the relevant presentation and disclosure requirements in other Australian Accounting Standards as they pertain to assets, liabilities, revenues, and expenses recognised under this [draft] Standard.

Transition

AG62 A grantor may elect under paragraph 33(b) to recognise and measure service concession assets and related liabilities prospectively, using deemed cost. Deemed cost is determined at the beginning of the earliest period for which comparative information is presented in the financial statements.

AG63 The deemed cost for service concession assets is the fair value in accordance with AASB 13.

Use of Deemed Cost under the Financial Liability Model

AG64 Where the grantor uses deemed cost under the financial liability model, it measures:

(a) the service concession asset at fair value (see paragraph 10); and

(b) the financial liability using the remaining contractual cash flows specified in the contract and the rate described in paragraphs AG43 – AG50 at the beginning of the earliest period for which comparative information is presented in the financial statements.

Any difference between the value of the asset and the financial liability is recognised directly in net assets/equity. If the entity chooses as its accounting policy the revaluation model in AASB 116 or AASB 138, this difference is included in equity.

Use of Deemed Cost under the Grant of a Right to the Operator Model

AG65 Where the grantor uses deemed cost under the grant of a right to the operator model, it measures:

(a) the service concession asset at fair value (see paragraph 10); and

(b) the liability representing the unearned portion of any revenue arising from the receipt of the service concession asset. This amount should be determined as the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement.

ILLUSTRATIVE EXAMPLES

These illustrative examples accompany, but are not part of, AASB 10XY.

IE1 These examples consider only three of many possible types of service concession arrangements. Their purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustrations as clear as possible, it has been assumed that the term of the service concession arrangement is only ten years and that the operator's annual receipts are constant over that period. In practice, terms may be much longer and annual revenues may increase over time.

Arrangement Terms (Common to All Three Examples)

IE2 In these examples, monetary amounts are denominated in 'currency units' (CU).

IE3 These terms are common to the three examples that follow:

IE4 The terms of the arrangement require an operator to construct a road – completing construction within two years—and maintain and operate the road to a specified standard for eight years (ie years 3–10). The arrangement is within the scope of this [draft] Standard and the road meets the conditions for recognition of a service concession asset in paragraph 8 (or paragraph 9 for a whole-of-life asset).

IE5 The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8 at a fair value of CU110. The compensation to the operator for this service is included in the predetermined series of payments and/or the revenue the operator has the right to earn from the service concession asset or another revenue-generating asset granted to the operator by the grantor.

IE6 It is assumed that the original road surface is a separate component of the service concession asset and meets the criteria for recognition specified in AASB 116 when the service concession asset is initially recognised. It is further assumed that there is sufficient certainty regarding the timing and amount of the resurfacing work for it to be recognised as a separate component when the resurfacing occurs.[1] It is assumed that the expected cost of the resurfacing can be used to estimate the initial cost of the surface layers recognised as a separate component of the service concession asset. The road surface is therefore recognised as a separate component of the initial fair value of the service concession asset and measured at the estimated fair value of the resurfacing and depreciated over years 3–8. This depreciation period is shorter than that for the road base, and takes into account that resurfacing would ordinarily occur over six years, rather than 25 years. During the construction phase, it is assumed that only the road base is constructed in year 1, and that the road only becomes ready to use at the end of year 2.

IE7 Recognition of the replacement component of the road surface as a separate component of the service concession asset in year 8 also results in an increase in the liability recognised by the grantor. Where the liability relates to the grant of a right to the operator model, additional revenue in respect of this increase is recognised evenly over the term of the arrangement. However, if the expenditure represented an improvement in service potential such as a new traffic lane rather than restoration to original service capability then it would be appropriate to instead recognise revenue relevant to that improvement only once it has occurred.

IE8 At the beginning of year 3, the total fair value of the road is CU1,050, comprised of CU940 related to the construction of the base layers and CU110 related to construction of the surface layers. The fair value of the surface layers is used to estimate the fair value of the resurfacing (which is treated as a replacement component in accordance with AASB 116). The estimated life of surface layers (ie, six years) is also used to estimate the depreciation of the replacement component in years 9 and 10. The total initial fair value of the road is lower than the present value of the series of predetermined payments pertaining to the asset, where applicable.

IE9 The road base has an economic life of 25 years. Annual depreciation is taken by the grantor on a straight-line basis. It is therefore CU38 (CU940/25) for the base layers. The surface layers are depreciated over 6 years (years 3–8 for the original component, and starting in year 9 for the replacement component). Annual depreciation related to the surface layers is CU18 (CU110/6). There is no

1 If this was not the case (eg where the operator might resurface in future, or might incur additional maintenance over the period of the service concession arrangement), it might not be appropriate to recognise a component.

impairment in the value of the road over the term of the service concession arrangement.

IE10 The operator's cost of capital is not practicable to determine. The rate implicit in the service concession arrangement specific to the asset is 6.18 per cent.

IE11 It is assumed that all cash flows take place at the end of the year.

IE12 It is assumed that the time value of money is not significant.

IE13 At the end of year 10, the arrangement will end. At the end of the arrangement, the operator will transfer the operation of the road to the grantor.

IE14 The total compensation to the operator under each of the three examples is inclusive of each of the components of the service concession arrangement and reflects the fair values for each of the services, which are set out in Table 1.

IE15 The grantor's accounting policy for property, plant, and equipment is to recognise such assets using the revaluation model specified in AASB 116. It is assumed that there are no changes in the fair value of the service concession assets during the service concession arrangement.

Table 1: Fair Values of the Components of the Arrangement (Currency Units)

Contact Component	Fair Value
Road – base layers	940
Road – original surface layers	110
Total fair value of road	1,050
Annual service component	12
Effective interest rate	6.18%

Example 1: The Grantor makes a Predetermined Series of Payments to the Operator

Additional Terms

IE16 The terms of the arrangement require the grantor to pay the operator CU200 per year in years 3–10 for making the road available to the public. The total consideration (payment of CU200 in each of years 3–10) reflects the fair values for each of the services indicated in Table 1. These payments are intended to cover the cost of constructing the road, annual operating costs of CU12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of CU110.

Financial Statement Impact

IE17 The grantor initially recognises the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognised as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is taken annually (CU56, comprised of CU38 for the base layers and CU18 for the surface layers), starting from year 3.

IE18 The grantor initially recognises a financial liability at fair value equal to the fair value of the asset under construction at the end of year 1 (CU525). The liability is increased at the end of year 2 to reflect both the fair value of the additional construction (CU525) and the finance charge on the outstanding financial liability. Because the amount of the predetermined payment related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the payment that reduces the liability. A finance charge at the implicit rate of 6.18 per cent is recognised annually. The liability is subsequently measured at amortised cost, that is, the amount initially recognised plus the finance charge on that amount calculated using the effective interest method minus repayments.

IE19 The compensation for the road resurfacing is included in the predetermined series of payments. There is no direct cash flow impact related to the road resurfacing; however, the grantor recognises the resurfacing as an asset when the work is undertaken and recognises depreciation expense of CU110/6 = CU18, beginning in year 9.

IE20 The compensation for maintenance and operating the road (CU12) is included in the predetermined series of payments. There is no cash flow impact related to this service expense; however, the grantor recognises an expense annually.

IE21 The costs of services are accounted for in accordance with AASB 101.

Overview of Cash Flows, Statement of Profit and Loss and Other Comprehensive Income, and Statement of Financial Position

IE22 The grantor's cash flows, statement of profit and loss and other comprehensive income, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 1.1 to 1.3. In addition, Table 1.4 shows the changes in the financial liability.

Table 1.1 Cash Flows (Currency Units)

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

Table 1.2 Statement of Profit and Loss and Other Comprehensive Income (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Service expense	–	–	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(96)
Finance charge	–	(32)	(67)	(59)	(51)	(43)	(34)	(25)	(22)	(11)	(344)
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/ (deficit)	–	(32)	(135)	(128)	(119)	(111)	(103)	(93)	(90)	(80)	(891)

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognised in year 8.
2. Although these Illustrative Examples use a straight-line depreciation method, it is not intended that this method be used in all cases. Paragraph 60 of AASB 116 requires that, "The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity." Likewise, for intangible assets, paragraph 97 of AASB 138 requires that, "The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life…".

Table 1.3 Statement of Financial Position (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – original surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	(200)	(400)	(600)	(800)	(1,000)	(1,200)	(1,400)	(1,600)
Financial liability	(525)	(1,082)	(961)	(832)	(695)	(550)	(396)	(343)	(177)	–
Cumulative surplus/ (deficit)	–	32	167	295	414	525	628	721	811	891

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognised in accordance with AASB 116 before the new component of the service concession asset related to the resurfacing is recognised.
2. The new component of the service concession asset related to the resurfacing is recognised in year 8. Years 9–10 reflect deprecation on this additional component (Table 1.2).
3. The financial liability is increased in year 8 for the recognition of the new component of the service concession asset.

Table 1.4 Changes in Financial Liability (Currency Units)

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

Example 2: The Grantor Gives the Operator the Right to Charge Users a Toll for Use of the Road

Additional Arrangement Terms

IE23 The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of CU200 in each of years 3–10. The total consideration (tolls of CU200 in each of years 3–10) reflects the fair values for each of the services indicated in Table 1, and is intended to cover the cost of constructing the road, annual operating costs of CU12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of CU110.

Financial Statement Impact

IE24 The grantor initially recognises the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognised as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is recognised annually (CU56, comprised of CU38 for the base layers and CU18 for the surface layers, starting in year 3).

IE25 As consideration for the service concession asset, the grantor recognises a liability under the grant of a right to the operator model for granting the operator the right to collect tolls of CU200 in years 3 – 10. The liability is recognised as the asset is recognised.

IE26 The liability is reduced over years 3–10, and the grantor recognises revenue on that basis because access to the service concession asset is expected to be provided evenly over the term of the service concession arrangement from the point at which the asset is capable of providing economic benefits.

IE27 The compensation for the road resurfacing is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no direct cash flow impact related to the road resurfacing; however, the grantor recognises the resurfacing as an asset when the work is undertaken and recognises depreciation expense of CU110/6 = CU18, beginning in year 9.

IE28 The compensation for maintenance and operating the road (CU12) is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no financial statement impact related to this service expense. It does not affect cash flow because the grantor has no cash outflow. It is not recognised as an operating expense because the fair value of the asset and liability initially recognised do not include any service costs the operator may incur.

Overview of Cash Flows, Statement of Profit or Loss and Other Comprehensive Income, and Statement of Financial Position

IE29 The grantor's cash flows, Statement of Profit and Loss and Other Comprehensive Income, and Statement of Financial Position over the duration of the arrangement will be as illustrated in Tables 2.1 to 2.2. In addition, Table 2.3 shows the changes in the liability.

IE30 Because there are no payments made to the operator, there are no cash flow impacts for this example.

Table 2.1 Statement of Profit and Loss and Other Comprehensive Income (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability)	–	–	145	145	145	145	145	145	145	145	1,160
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/(deficit)	–	–	89	88	89	89	88	89	89	88	709

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period.
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognised in year 8.
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 2.2).
4. All revenue is recognised evenly over the term of the arrangement.

Table 2.2 Statement of Financial Position (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – original surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	–	–	–	–	–	–	–	–
Liability	(525)	(1,050)	(905)	(760)	(615)	(470)	(325)	(290)	(145)	–
Cumulative surplus/ (deficit)	–	–	(89)	(177)	(266)	(355)	(443)	(532)	(621)	(709)

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognised in accordance with AASB 116 before the new component of the service concession asset related to the resurfacing is recognised.
2. The new component of the service concession asset related to the resurfacing is recognised in year 8. Years 9–10 reflect deprecation on this additional component (Table 2.1).
3. The liability is increased in year 8 for the recognition of the new component of the service concession asset.

Table 2.3 Changes in Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,050	905	760	615	470	325	290	145
Liability recognised along with initial service concession asset	525	525	–	–	–	–	–	–	–	–
Revenue (reduction of liability)	–	–	(145)	(145)	(145)	(145)	(145)	(145)	(145)	(145)
Liability recognised along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,050	905	760	615	470	325	290	145	–

Example 3: The Grantor Makes a Predetermined Series of Payments to the Operator and Also Grants the Operator the Right to Charge Users a Toll for Use of the Road

Additional Arrangement Terms

IE31 The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of CU100 in each of years 3–10. The arrangement also requires the grantor to make a predetermined series of payments to the operator of CU100 annually. The fair value of the right to collect tolls and the predetermined series of payments are considered to compensate the operator equally (ie 50 per cent from each form of compensation to the operator).

Financial Statement Impact

IE32 The grantor initially recognises the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognised as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is taken annually (CU56, comprised of CU38 for the base layers and CU18 for the surface layers).

IE33 As consideration for the service concession asset, the grantor recognises both a liability under the grant of a right to the operator model by granting the operator the right to collect tolls of CU100 in years 3–10, and a financial liability to make payments of CU100 in years 3–10. A liability and a financial liability are recognised as the asset is recognised at the end of year 1 (CU525). The liability and financial liability are increased at the end of year 2 to reflect both the fair value of the additional construction (CU525) and the finance charge on the outstanding financial liability.

IE34 The grantor's obligation related to the right granted to the operator to charge tolls and the predetermined payments are regarded as two separate items. Therefore in this arrangement it is necessary to divide the grantor's consideration to the operator into two parts—a liability and a financial liability.

IE35 The liability of CU525 (recognised evenly at the end of years 1 and 2) is reduced over years 3–10, and the grantor recognises revenue on the same basis because the tolls are expected to be earned evenly over the term of the service concession arrangement from the point at which the asset is capable of providing service benefits.

IE36 The grantor initially recognises a financial liability at fair value equal to half of the fair value of the asset (CU525), recognised evenly at the end of years 1 and 2; a liability under the grant of a right to the operator model is recognised in an amount equal to the other half of the fair value of the asset. The financial liability is also increased at the end of year 2 by the finance charge on the outstanding financial liability. Because the amount of the predetermined payments related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the payments that reduces the liability. A finance charge at the implicit rate of 6.18 per cent is recognised annually. The liability is subsequently measured at amortized cost, ie the amount initially recognised plus the finance charge on that amount calculated using the effective interest method minus repayments.

IE37 The operator is compensated for the road resurfacing (CU110) equally through the tolls the operator expects to earn over the term of the service concession arrangement and the series of predetermined payments (ie 50 per cent from each). There is no direct cash flow impact related to the road resurfacing; however, the grantor recognises the resurfacing as an asset when the work is undertaken and recognises depreciation expense of CU110/6 = CU18, beginning in year 9.

IE38 The operator is compensated for maintenance and operating the road (CU12) equally through the tolls the operator expects to earn over the term of the service concession arrangement and the predetermined payment (ie 50 per cent from each). There is no direct cash flow impact related to this service expense because the grantor has no cash outflow. However, the grantor recognises an expense annually for the portion of the compensation related to the series of predetermined payments (CU6). There is no financial statement impact for the remaining CU6 of this service expense. It is not recognised as an operating expense because the fair value of the asset and liability initially recognised do not include any service costs the operator may incur.

IE39 The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 3.1 to 3.3. In addition, Table 3.4 shows the changes in the liability and Table 3.5 shows the changes in the financial liability.

Overview of Cash Flows, Statement of Profit and Loss and Other Comprehensive Income, and Statement of Financial Position

Table 3.1 Cash Flows (Currency Units)

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**Total**
Predetermined series of payments	–	–	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(800)
Net inflow/ (outflow)	–	–	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(800)

Table 3.2 Statement of Profit and Loss and Other Comprehensive Income (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability)	–	–	73	72	73	72	73	72	73	72	580
Service expense	–	–	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(48)
Finance charge	–	(16)	(33)	(30)	(26)	(22)	(17)	(12)	(11)	(5)	(172)
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/(deficit)	–	(16)	(22)	(21)	(15)	(12)	(7)	(2)	–	4	(91)

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period.
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognised in year 8.
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 3.3).
4. All revenue is recognised evenly over the term of the arrangement.

Table 3.3 Statement of Financial Position (Currency Units)

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	(100)	(200)	(300)	(400)	(500)	(600)	(700)	(800)
Liability	(262)	(525)	(452)	(380)	(307)	(235)	(162)	(145)	(72)	–
Financial liability	(263)	(541)	(480)	(416)	(348)	(276)	(199)	(172)	(89)	–
Cumulative surplus/(deficit)	–	16	38	59	74	86	93	95	95	91

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognised in accordance with AASB 116 before the new component of the service concession asset related to the resurfacing is recognised.
2. The new component of the service concession asset related to the resurfacing is recognised in year 8. Years 9–10 reflect deprecation on this additional component (Table 3.2).
3. The liability is increased in year 8 for the recognition of 50 per cent of the new component of the service concession asset.
4. The financial liability is increased in year 8 for the recognition of 50 per cent of the new component of the service concession asset.

Table 3.4 Changes in Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	262	525	452	380	307	235	162	145	72
Liability recognised along with initial service concession asset	262	263	–	–	–	–	–	–	–	–
Revenue (reduction of liability)	–	–	(73)	(72)	(73)	(72)	(73)	(72)	(73)	(72)
Liability recognised along with replacement surface layers	–	–	–	–	–	–	–	55	–	–
Balance carried forward	262	525	452	380	307	235	162	145	72	–

Table 3.5 Changes in Financial Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	263	541	480	416	348	276	199	172	89
Liability recognised along with initial service concession asset	263	262	–	–	–	–	–	–	–	–
Finance charge added to liability prior to payments being made	–	16	–	–	–	–	–	–	–	–
Portion of predetermined series of payments that reduces the liability	–	–	(61)	(64)	(68)	(72)	(77)	(82)	(83)	(89)
Liability recognised along with replacement surface layers	–	–	–	–	–	–	–	55	–	–
Balance carried forward	263	541	480	416	348	276	199	172	89	–

BASIS FOR CONCLUSIONS

This Basis for Conclusions accompanies, but is not part of, AASB 10XY.

Background

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in the Exposure Draft. Individual Board members gave greater weight to some factors than to others.

BC2 In Australia, public sector entities enter into service concession arrangements as a means of developing and delivering infrastructure for public services such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply, telecommunication networks and permanent installations for military and other operations. AASB Interpretation 12 *Service Concession Arrangements* (which incorporates IFRIC 12 *Service Concession Arrangements*) provides the accounting requirements for service concession arrangements by the operator of a service concession arrangement. AASB Interpretation 12 does not apply to a grantor. The International Public Sector Accounting Standards Board published IPSAS 32 *Service Concession Arrangements: Grantor* in October 2011. IPSAS 32 prescribes the accounting for service concession assets, liabilities, revenues and expenses by grantors. IPSAS 32 was developed to mirror IFRIC 12 in most aspects.

BC3 After considering a range of alternatives, the Board decided to develop an Australian Accounting Standard on grantor accounting for service concession arrangements, based on IPSAS 32, to address the lack of guidance in Australian Accounting Standards for accounting for service concession arrangements from the grantor perspective.

Significant Issues

Scope

BC4 The Board considered various arrangements involving public and private sector entities and concluded that the scope of IPSAS 32 is an appropriate basis for this [draft] Standard. The Board noted that this approach would require both the operator and the grantor of a service concession arrangement to apply the same principles in determining which party should recognise the asset in the arrangement. The Board considered that this approach would reduce the possibility of an asset being recognised by both parties, or by neither party to the arrangement.

BC5 The Board also considered the types of public sector entities that should apply the proposed [draft] Standard. The Board deliberated on whether to adopt the IPSAS 32 application to all public sector entities other than a Government Business Enterprise (GBE). A GBE is akin to a for-profit public sector entity.

BC6 The Board decided that the Exposure Draft should:

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

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

Terminology

BC7 IPSAS 32 is expressed in jurisdiction-neutral language. The Board considered that some of the terminology in IPSAS 32 does not readily translate to the Australian environment and decided that amendments to certain terms and phrases would be necessary for entities applying Australian Accounting Standards. For example, consistent with the terminology used in other Australian Accounting Standards, the [draft] Standard adopts the term 'contract' rather than the term 'binding arrangement' as used in IPSAS 32.

Recognition of a Service Concession Asset

BC8 The Board considered a number of alternative approaches in developing the proposed guidance for assessing whether a grantor controls the service concession asset, including:

(a) the risks and rewards approach;

(b) the rights and obligations approach;

(c) the control or regulation approach (the IPSAS 32 concept of control); and

(d) an approach analogous to the principles of control specified in AASB 10 *Consolidated Financial Statements*.

BC9 The Board decided to adopt the IPSAS 32 concept of control (control or regulation approach) for the following reasons.

BC10 In considering the merits of the risks and rewards and the control-based approach to assess whether the grantor should recognise the asset, the Board noted that the risks and rewards approach focuses on the economic aspects of the terms and conditions in the arrangement. The Board did not consider this focus to be appropriate for service concession arrangements in the Australian public sector. This is because the primary purpose of a service concession asset, from the grantor's point of view, is to provide specified public services on behalf of the grantor using the asset, and not to provide economic benefits such as revenue generated by such assets (eg from user fees). Thus, the service potential of the asset accrues to the grantor. The Board's view is that economic benefits are only likely to arise from a service concession arrangement, from a grantor's perspective, in circumstances where the operator is granted the right to earn revenue from third-party users of either the service concession asset or another revenue-generating asset. A control-based approach focuses on control over the service potential of the service concession asset.

BC11 Service concession arrangements are often entered into to share the risks between the grantor and the operator. The Board questioned whether objective criteria can be established for assessing risks and rewards to enable consistent results to be determined. In addition, weighting of various risks and rewards was seen to be problematic. The Board concluded, therefore, that the risks and rewards approach was not appropriate for an Australian Standard addressing grantor accounting for service concession arrangements.

BC12 In considering the rights and obligations approach, the Board noted that while this could have conceptual merit, it would represent a significant change in the accounting and financial reporting of assets and liabilities for public sector entities that could have implications beyond service concession arrangements, and could set an inappropriate precedent.

BC13 While there was some discussion as to the ability to apply the concept of control in AASB 10 by analogous interpretation, the Board agreed that the assessment of control for an entity may not, in certain circumstances, be appropriate when applying the principles to an individual asset.

BC14 The Board concluded that the IPSAS 32 approach (the control or regulation approach) was the most appropriate approach as it is consistent with AASB Interpretation 12. Accordingly, this approach would lead to consistent accounting requirements for the operator and grantor.

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

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

BC17 The Board also considered the concept of control for the recognition of service concession asset. The Board decided that the grantor recognises an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if the grantor controls the asset. The grantor controls the asset if the grantor exhibits the specific control concept in paragraph 8(a) that a grantor controls the asset if the "grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them and at what price". This mirrors the control concept in AASB Interpretation 12. The AASB noted that a broader concept of control currently applies in other accounting Standards and that an asset that does not meet the control and regulation definition of this standard, may still need to be recognised under other accounting Standards. The Board noted that entities that are established for service concession arrangements would already need to consider the requirements of AASB 10.

Recognition of a Liability

The Financial Liability Model

BC18 The Board considered issues relating to the recognition of a financial liability and, consistent with IPSAS 32, decided that a financial liability should be recognised when the grantor has to make a determinable series of cash payments of cash or cash equivalents to the operator.

BC19 A financial liability arises in cases when the grantor is obligated to make a determinable series of payments to the operator because the grantor has an obligation as a result of the contract to deliver cash or another financial asset to another entity (the operator). The Board agreed with the IPSASB conclusion that when there is a determinable series of payments of cash or cash equivalents, the payments should be allocated as a reduction of the liability, an imputed finance charge, and charges for services provided by the operator under the service concession arrangement.

BC20 AASB Interpretation 12 requires the financial asset to be accounted for in accordance with the relevant Australian Accounting Standard on financial instruments (AASB 9 *Financial Instruments*, AASB 132 *Financial Instruments: Presentation* or AASB 139 *Financial Instruments: Recognition and Measurement*, as appropriate).

BC21 This [draft] Standard also provides guidance for determining the interest rate to be used to determine the finance charge under the financial liability model. The Board noted the grantor ordinarily would not have sufficient information to determine a market rate. Accordingly, the guidance requires the operator's cost of capital to be used, if that is practicable to determine. It also permits the use of other rates that are appropriate to the specific terms and conditions of the service concession arrangement.

The Grant of a Right to the Operator Model

BC22 The Board considered the application of AASB 15 *Revenue from Contracts with Customers* to a service concession arrangement, as Australia has an accounting Standard on revenue equivalent to that of IFRS 15 *Revenue from Contracts with Customers*, noting that there is no IPSAS that is equivalent to IFRS 15.

BC23 Under the grant of a right to the operator model, the grantor promises to transfer to the operator an intangible asset (being a right to charge users of the service concession asset) in exchange for the acquisition, construction or upgrade of a service concession asset and the provision of related future services. The Board considered whether the grantor should recognise revenue or a liability when it obtains control of the service concession asset arising from a service concession arrangement. The Board noted that IPSAS 32 requires a grantor to recognise a liability when the grantor recognises the service concession asset. However, given its policy of transaction neutrality, the Board considered whether the requirements of Australian Accounting Standards, specifically the application of AASB 15 either directly or by analogy, would support:

(a) the recognition of a liability (consistent with IPSAS 32); or

(b) the recognition of revenue because the grantor has no remaining obligations to the operator once it has transferred to the operator the right to charge users.

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

BC25 The Board noted that, in a service concession arrangement, the grantor makes promises, either explicitly or implicitly, to undertake activities in relation to the service concession asset that will benefit the operator. This reflects the fact that a service concession asset forms part of the overall public infrastructure that is controlled and managed by the government to provide public services. Although a grantor's rights and obligations would not be within the scope of AASB 15, the Board noted that the promise, or the operator's expectation, that the grantor will undertake activities that benefit the operator is comparable to promises made by a licensor or expectations of a licensee that the licensor will undertake activities in relation to intellectual property that will benefit the licensee. AASB 15 identifies that those types of licences are licences that provide the licensee with a right to access the underlying intellectual property. AASB 15 specifies that a promise of a right to access intellectual property is a performance obligation that is satisfied over time and, in the event of the licensee performing in advance of the licensor, the licensor would recognise a contract liability for its remaining performance obligation to provide access. Consequently, given these similarities in the relationships between licensor and licensee and between grantor and operator, the Board concluded that the grantor's obligations to undertake activities in relation to the service concession asset that will benefit the operator should also be accounted similarly to a contract liability. The grantor would subsequently recognise revenue as the 'access' is provided to the operator over the service concession period. The Board also noted that the IASB is reviewing the guidance on such licences and the outcome of the review may further support the Board's views on this matter.

BC26 In some service concession arrangements, the right to charge users is described as a licence. Although a 'licence to charge users' in the context of the service concession arrangement is not within the scope of AASB 15, other licences provided by governments might represent a contract with a customer and therefore be accounted for in accordance with AASB 15. Licences provided by governments that represent a contract with a customer and accounted for in accordance with AASB 15 might require a recognition of a liability for any portion of the revenue that is not yet earned. The Board noted that determining whether a particular licence granted by a government is within the scope of AASB 15 would depend on the facts and circumstances relating to each type of licence.

Other Revenues

BC27 The AASB considered whether to include the Application Guidance paragraphs AG55–AG64 of IPSAS 32 for other revenues in this [draft] Standard. 'Other revenues' relate to compensation by the operator to the grantor for access to the service concession asset by providing the grantor with a series of predetermined inflows of resources, including the following:

(a) an upfront payment or a stream of payments;

(b) revenue-sharing provisions;

(c) a reduction in a predetermined series of payments the grantor is required to make to the operator; and

(d) rent payments for providing the operator access to a revenue-generating asset.

BC28 The Board decided that this guidance was not necessary in the Australian context as the existing revenue recognition guidance in Australian Accounting Standards was sufficient.

Accounting Issues Addressed in Other Australian Accounting Standards

BC29 Because of the complexity of many service concession arrangements, there may be additional accounting issues related to certain terms in the contract (for example, revenues, expenses, guarantees, and contingencies). The Board agreed that it was not necessary to repeat such existing guidance in this [draft] Standard. Accordingly, when an existing Australian Accounting Standard specifies the accounting and reporting for a component of a service concession arrangement, this [draft] Standard references the specific Australian Accounting Standard and no additional guidance is provided. However, the Board noted some cases (for example, revenue recognition) when the application of such an Australian Accounting Standard would be difficult given certain unique features in service concession arrangements. To ensure consistent implementation of this [draft] Standard, the Board decided to provide additional guidance on how the principles in the other Australian Accounting Standards would be applied.

Application of this [draft] Standard to Other Government Licences

BC30 The AASB discussed the potential analogous interpretation of this [draft] Standard to other government licences, in particular the proposed accounting treatment for when a grantor provides consideration in the form of a right to charge third-party users. Given the importance of service concession arrangements to governments and the current lack of accounting guidance for such arrangements, the Board decided that service concession arrangements should be treated separately from other licences granted by governments.

BC31 The Board decided to conduct further research on the nature of, and accounting for, government licences. The purpose of this research is to inform the Board as to whether a separate project may be required to consider the accounting for these types of licences.

Transition

BC32 This [draft] Standard requires an entity to apply this [draft] Standard either retrospectively in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* or prospectively using deemed cost from the beginning of the earliest period for which comparative information is presented in the financial statements. Deemed cost for service concession assets is the fair value in accordance with AASB 13.

BC33 The general requirement in AASB 108 is that accounting policy changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable. The Board noted that there are two aspects to retrospective application: reclassification and remeasurement. The Board took a similar view to the IPSASB that it will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in a grantor's statement of financial position, but that retrospective remeasurement of service concession assets might not always be practicable, particularly if an entity has not previously recognised service concession assets and related liabilities, revenues, and expenses.

BC34 The Board noted that, when retrospective restatement is not practicable, AASB 108 requires prospective application from the earliest practicable date, which could be the start of the current reporting period.

BC35 The [draft] Standard requires that any difference between the value of the asset and the financial liability in the use of deemed cost under the financial liability model is recognised directly in net assets/equity. Additionally, the [draft] Standard requires that if the entity chooses as its accounting policy the revaluation model in AASB 116 or AASB 138, this difference is included in equity. The Board noted that this difference could not be used to offset future changes in the values of an asset or liability. This is consistent with the treatment in AASB 108 for a change in accounting policy. However, this differs from the approach permitted by IPSAS 32, where the difference is included in revaluation surplus.

Comparison with IPSAS 32

BC36 This [draft] Standard incorporates the key requirements of IPSAS 32 with the main differences detailed in the paragraphs below.

Scope

BC37 This [draft] Standard applies to all public sector entities and is wider than the scope of IPSAS 32. IPSAS 32 applies to all public sector entities other than a Government Business Enterprise (GBE). A GBE is akin to a for-profit public sector entity. The approach in this [draft] Standard is consistent with the AASB's policy of making accounting Standards that require like transactions and events to be accounted for in a like manner for all types of entities, which is referred to as transaction neutrality.

Recognition and Measurement of a Service Concession Asset

BC38 This [draft] Standard includes the reference of AASB 13 *Fair Value Measurement* where the grantor initially measures the service concession asset at its fair value. IPSASB 32 does not have a fair value accounting standard similar to AASB 13 and therefore does not include such a reference.

Defined Terms

BC39 This [draft] Standard modifies some of the defined terms of IPSAS 32. This [draft] Standard:

(a) replaces the IPSAS 32 term 'binding arrangement', which "describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract", with the term 'contract', which is defined as an "agreement between two or more parties that creates enforceable rights and obligations";

(b) modifies the IPSAS 32 definition of a 'grantor' to refer to 'right to access' rather than 'right to use';

(c) modifies the IPSAS 32 definition of an 'operator' from an entity that "uses the service concession asset" to an entity that has a "right to access the service concession asset"; and

(d) includes a definition for the term 'public service' that is not in IPSAS 32.

Application Guidance

BC40 This [draft] Standard includes Application Guidance (AG) paragraphs in addition to those of IPSAS 32. The key AG paragraphs added in this [draft] Standard are as follows:

(a) paragraphs AG5 and AG6 provide further clarification of the defined term 'contract';

(b) paragraph AG8 emphasises the fundamental principle of control of a service concession asset; and

(c) paragraphs AG11, AG12, AG14 and AG18 explain when the grantor would control the service concession asset in an environment where the services provided and/or the service pricing is regulated by a third-party regulator.

BC41 This [draft] Standard modifies paragraph AG21 to explicitly require that when an existing asset of the grantor is upgraded (eg increases in capacity) only the upgrade component of the asset is recognised as a service concession asset in accordance with paragraph 8 (or paragraph 9 for a whole-of-life asset).

BC42 This [draft] Standard removes the Application Guidance paragraphs AG55–AG64 of IPSAS 32 for other revenues. The other revenues relate to compensation by the operator to the grantor for the access to the service concession asset by providing the grantor with a series of predetermined inflows of resources. Sufficient revenue recognition guidance for such transaction already exists in Australian Accounting Standards.

BC43 This [draft] Standard modifies paragraph AG72 of IPSAS 32 to require, where the grantor uses deemed cost under the financial liability model, any difference between the value of the asset and the financial liability to be included in equity. IPSAS 32 requires the difference to be included in revaluation surplus when the revaluation model is applied.