

17 March 2017

Ms Kris Peach  
Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins St West Victoria 8007  
AUSTRALIA

Dear Ms Peach

***AASB 10XY Service Concession Arrangements: Grantors***

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the draft standard. The views expressed in this submission represent those of all Australian members of ACAG.

ACAG considers that the proposed standard for Service Concession Arrangements: Grantors (AASB 10XY) is fatally flawed.

The proposed standard specifies that the grantor must recognise a service concession arrangement (SCA) asset if:

- it controls or regulates the services the operator must provide with the asset, to whom it must provide them and at what price, and
- the grantor either controlling any significant residual interest in the asset, or it being a whole-of-life arrangement.

However, paragraphs B16 to B24 extend the concept of price control beyond the power of the grantor, or any entity in the grantor's jurisdiction. This extension of scope is only apparent in the application guidance and does not align with the stated intent of the proposed standard. Nor does it align with the recognition criteria defined at paragraphs 5 and 6 of the proposed standard. ACAG does not believe the operator's inability to determine the price at which services are offered is analogous to the grantor's ability to control the price at which services are offered.

We have identified some additional areas which could be clearer and refined to assist with a consistent interpretation and implementation.

ACAG appreciates the opportunity to respond and trust that you will find our comments useful.

Yours sincerely



Andrew Greaves

**Chairman**

**ACAG Financial Reporting and Auditing Committee**

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## Matters for comment

### 1. AASB 10XY Service Concession Arrangements: Grantors

Reference	Comment
Standard	
Para 5	<p>ACAG suggests clarifying that the price the grantor controls or regulates for some service concession arrangements (SCA) services may be nil.</p> <p>Paragraph 5(b) refers to a significant residual interest test, but there is no definition or guidance of what is considered to be significant.</p>
Para 7	<p>The AASB have clarified in this version of the Standard that grantors, whether for-profit (FP) or not-for-profit (NFP) will initially recognise SCA assets at current replacement cost (CRC). This is useful to the extent it clarifies the income approach is not appropriate for SCAs. However, in applying CRC to all SCA assets, there is an implicit assumption that all SCA assets are specialised assets.</p> <p>Most SCA assets will be specialised, but this will not be the case in every instance. Where there is market evidence about the prices at which comparable assets trade in an active market, (for instance, student accommodation and buses) is there a reason why that information should be disregarded?</p> <p>AASB 13 <i>Fair Value Measurement</i> would indicate that market information is more relevant as it is a level 2, rather than a level 3 input. For a FP grantor, the result may be particularly problematic, particularly upon impairment within a cash generating unit (CGU) (see comments on B35 and B54).</p>
Para 8	<p>ACAG is unclear why an existing intangible asset of the grantor reclassified as an SCA asset <u>must</u> be remeasured using the cost approach under AASB 13.</p> <p>AASB 138 <i>Intangible assets</i> requires assets to be carried at cost. Fair value may be used but only where there is an active market. It would be useful to understand, if the grantor carries an intangible asset at cost, and that cost information is reliable, why is it necessary to depart from the measurement principles in AASB 138 and revalue upon reclassification as an SCA asset? It would also be useful to understand why market evidence supporting the value of an intangible SCA in an active market should be disregarded.</p> <p>The requirement to remeasure SCA intangible assets to fair value using the cost approach may also involve recognition of an intangible SCA asset where an intangible asset would not have been recognised under the existing framework. For instance, internally developed databases of historical information, if offered to an operator as part of an SCA would not previously have qualified for recognition. Databases are generally kept to record information that a government, through its own legislation has required an agency to maintain. The nature of these assets presents challenges in relation to both recognition and reliable measurement.</p> <p>Where a public sector grantor recognises an intangible SCA asset that would not have qualified for recognition under AASB 138, it would be useful to understand how the asset is treated at the end of the SCA. Is the asset derecognised through profit and loss, since it no longer qualifies for recognition under AASB 138? Or should the former SCA asset be recognised as an intangible asset at the carrying amount of the former SCA asset. If the latter is the case, the public sector will end up permanently bringing on balance sheet intangible assets that would never otherwise have qualified for recognition.</p> <p>ACAG suggests that if the AASB supports recognition of intangible SCA assets that would not have qualified for recognition under AASB 138, that guidance be provided to specifically address the circumstances where it is appropriate, and how it is to be treated in the grantor's financial statements.</p> <p>ACAG is also unclear whether an existing asset of a FP grantor currently measured at fair value via the income approach and reclassified as an SCA asset needs to change its fair value approach from Income to CRC. The consideration received for the 'right of use' sold to the operator is effectively its fair value in an</p>



Reference	Comment
	active market transaction. It would also be useful to understand why market evidence supporting the value of an asset in an active market should be disregarded.
Para 9	<p>Paragraph 9 requires SCAs after initial recognition or reclassification to be accounted for "in accordance with AASB 116 <i>Property, Plant and Equipment</i> or AASB 138 <i>Intangible Assets</i>, as appropriate."</p> <p>ACAG suggests clarifying the words "as appropriate" to ensure users do not misinterpret these words as meaning that they can selectively apply elements of AASB 116 or AASB 138 rather than the relevant standard in its entirety.</p>
Para 11	<p>ACAG recommends that further guidance and illustrative examples are needed to show how the paragraph 10 and 11 requirements are applied to the situation when future variable consideration is receivable by the grantor. Examples include revenue and profit sharing (e.g. based on usage over a threshold), and sharing of debt refinancing gains.</p> <p>In a Queensland SCA, the operator paid the grantor an upfront payment, with additional future payments made based on actual traffic and toll revenue outcomes. This raises issues such as which standard should be used for variable future payments made by the operator to the grantor? Should it be AASB 16 <i>Leases</i>, AASB 15 <i>Revenue from Contracts with Customers</i> or a new approach under AASB 10XY?</p>
<b>Appendix B – Application Guidance</b>	
Para B5 - B9	<p>Paragraphs 2 and B2 state that for an arrangement to be in scope of the proposed standard, the operator has to provide a public service related to a service concession asset. Para B5 and the first sentence in B6 reiterate the requirement in respect of the operator. However, the rest of para B6 and B7 to B9 discuss whether the asset (as opposed to the operator) provides public services.</p> <p>ACAG believes that the discussion on the public service aspect is lopsided. While both the asset and the operator have to provide a public service, the discussion on the courthouse building (B6), hospital (B7), military base (B8) does not include any details about the service provided by the operator. It is not clear whether the operator has to provide the same public service as the asset (court, health and defense services respectively) or not.</p> <p>ACAG recommends the AASB clarify in para B5 what they consider to be "some of the management of the service concession asset and related services". Para B5 states that cleaning and security are not enough, but what about maintenance and repairs, cyclical upgrades?</p> <p>In many PPPs (e.g. schools), the operator provides facilities management services in respect of the asset. Does this meet the requirement in para B5, even though the asset (school) definitely provides a public service (education)?</p> <p>Excluding facilities management and maintenance could potentially scope out many social PPPs (hospitals, courts, schools). If so, does AASB 16 <i>Leases</i> apply?</p>
Para B6 and B8	<p>ACAG suggests clarifying the price the grantor controls or regulates in the SCA examples of the courthouse and military base is likely to be nil, as unlike toll roads and hospitals the public would generally not be charged to access these services.</p> <p>ACAG also suggests clarifying that:</p> <ul style="list-style-type: none"> <li>the standard is not intended to only capture SCAs where a price is charged to third party (i.e. the public)</li> <li>where the operator cannot charge the public, the grantor nonetheless controls the price if access is free, it is not feasible to charge a price for public access, or physical access is not possible.</li> </ul> <p>In these instances, the price the grantor controls is the price the operator charges the grantor.</p>



Reference	Comment
Para B9	ACAG suggests the commentary in B9 would be better placed in the Standard rather than in the Application Guidance because determining whether an asset provides a public service when terms and conditions of the arrangement change during the term is a key requirement.
B16 – B24	<p>The application guidance extends the scope of the original requirements where it deals with third-party regulation as to price. This extension of scope undermines the concept of control, upon which the standard is predicated, and is likely to have some unintended consequences.</p> <p>For example, in South Australia, transmission and distribution electricity assets were transferred to the private sector in the late 1990s through 200 year lease arrangements. The Australian Energy Regulator regulates the price that the private sector operator charges for the service. Accordingly, price setting is outside of the control of the grantor or any agency within the grantor's jurisdiction.</p> <p>At a conceptual level, it is not tenable that with price control outside even the influence of the grantor, that control rests with the South Australian Government. Nor is it tenable that over the 200 year term of the agreement that the national regulator will still regulate the price in the same way, or at all.</p> <p>Where price regulation is outside of the control of the grantor, and the arrangements change, relax or are removed altogether, would the board propose the SCA asset be derecognised or re-recognised on that basis?</p> <p>ACAG suggests the proposed standard deal with derecognition issues, which will inevitably arise where the grantor is unable to directly or indirectly control the price setting mechanism.</p>
Para B35 and B54	<p>Paragraph B35 states that "AASB 136 does not apply to service concession assets that are regularly revalued to fair value (current replacement cost) under the revaluation model in AASB 116 or AASB 138". This is reinforced by B54 which only requires grantors to consider impairment for assets recognised at cost.</p> <p>ACAG does not believe it is appropriate to state impairment (AASB 136) will never apply to a service concession asset regularly revalued to fair value, particularly in the FP context.</p> <p>An asset may become impaired after it (and the class of assets it is in) has been revalued. For example, a service concession asset (SCA) may be revalued during the year, but damaged before year end. Consequently, the SCA's carrying value will no longer represent its fair value. In a recent example, storm damage resulted in a Force Majeure event suspending payments to the operator under the SCA until the asset could be repaired (at the grantor's expense).</p> <p>If the grantor is unable to impair the SCA under AASB 136 then the grantor will need to revalue the entire class of SCAs to determine fair value. This would involve significant cost.</p> <p>ACAG believes impairment for FP grantors will be problematic particularly allocating impairment to a SCA assets within a CGU.</p> <p>AASB 136 requires impairment losses for CGUs to be allocated to all assets within the CGU pro rata on the basis of the carrying amount of assets within the unit. AASB10XY states that SCA assets that are regularly revalued are not subject to impairment.</p> <p>ACAG believes the AASB needs to:</p> <ul style="list-style-type: none"> <li>• clarify whether B35 only applies to NFP entities</li> <li>• provide guidance on how to allocate impairment to SCA assets within a CGU. It would be beneficial to include a practical example of how impairment should be allocated in this situation.</li> </ul>

Reference	Comment
B52	<p>Where the financial liability model is used for the liability, B52 allows the CRC of the SCA asset to be assessed by reference to the payments that the grantor is contractually obliged to pay the operator in exchange for the asset, instead of the usual amount required to construct/acquire the asset. Where the payments to the operator include variable future payments, there may be a difference between these two methods.</p> <p>Also, in subsequent periods, the measurement of the SCA asset at CRC (based on the cost to construct/acquire) will result in a change in valuation basis. Is this the AASB's intention?</p>
B58	<p>Under AASB 9 <i>Financial Instruments</i>, the effective interest method requires the future cash flows to be re-estimated every year to determine the new amortised cost for the liability, with any adjustment going to profit or loss. However, B58 states that only the difference between expected payments and actual payments (i.e. when actual cash flows take place) is recognised.</p> <p>ACAG recommends the AASB clarify this inconsistency between paragraph B58 and references to AASB 9.</p> <p>ACAG also notes that IFRIC rejected taking onto its agenda the accounting for a liability recognised at the date of purchasing an asset for variable payments that depend on its future activity.</p> <p>ACAG does not recommend AASB 10XY includes requirements referring to AASB 9 and capitalising changes in estimates to the SCA asset's carrying value.</p>

#### Appendix D – Amendments to other Standards

Appendix D states that "No necessary amendments to other Standards have been identified".

ACAG recommends clarifying how AASB 10XY interacts with AASB 16 *Leases*. Currently AASB 16 only scopes out service concession arrangements in Interpretation 12 *Service Concession Arrangements* which applies to operators and not grantors. Without excluding SCAs from AASB 16, it may be possible for the same transaction to be captured by AASB 10XY and AASB 16.

#### Illustrative Examples

Arrangement terms	ACAG suggests including the assumption that borrowing costs are expenses as incurred.
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