

Ms Kris Peach
The Chair
Australian Accounting Standards Board
PO BOX 204
Collins Street West
Victoria 8007

7 August 2015

Dear Kris

Re: Exposure Draft ED 261 - Service Concession Arrangements: Grantor

Thank you for the opportunity to respond to the Australian Accounting Standard Board's (the AASB's) Exposure Draft *ED 261 - Service Concession Arrangements: Grantor* (the Exposure Draft).

We welcome the AASB's initiative in developing an accounting standard for grantors to account for service concession arrangements for which there is currently no specific Australian Accounting Standard. We believe that an accounting standard for these arrangements will help in addressing the divergence in accounting that has evolved, whereby some public sector entities recognise service concession assets and liabilities on their balance sheet while others do not.

However we would urge the AASB to consider further certain aspects of the Exposure Draft and to consider providing further guidance and clarity to ensure consistent understanding and application of the standard when it is issued. We have discussed these while providing our detailed responses to the questions in the invitation to comment which are included in the Appendix to this letter.

Our main concern relates to the application of the definition of 'public service' in practice since we have been provided with scenarios where the definition contained within the Exposure Draft proves inadequate in assessing definitively whether the arrangement is one of service concession. We have discussed this further under Question 8 in the Appendix to this letter.

If you have any questions concerning our comments, please contact me at 08 9365 7077 or Indrani Pal at 02 9322 5103.

Yours sincerely



Philip Teale
Partner
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Appendix 1: Specific and general matters for comment

Question 1: Application to all public sector entities including both for-profit and not-for-profit entities

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?

We agree that the [draft] Standard should be applicable to both for profit and not-for-profit public sector entities.

Whilst currently our experience suggests that grantors of service concession arrangements are primarily not-for-profit public sector entities as and when more of these arrangements are entered into or existing arrangements amended there is a possibility that some service concession arrangements may be held in a separate vehicle within the public sector which will be in the nature of a 'for profit' vehicle. Extending the [draft] Standard now to all public sector entities, whether for-profit or not-for-profit will result in the applicability of the [draft] Standard being determined by the nature of the transaction rather than by the nature of the entity granting the service concession which we consider to be a more appropriate conceptual underpinning.

Question 2: Scope to potentially include intangible asset and land as service concession asset

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 12 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?

AASB Interpretation 12 paragraph 7(b) states that the Interpretation applies to "existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement". We believe that the concept of 'the grantor giving the operator access to the existing infrastructure' under Interpretation 12 will be akin to 'the grantor providing an asset to the operator' under the [draft] Standard paragraph 8.

Further AASB Interpretation 12 does not define 'infrastructure' rather provides examples of 'infrastructure' in paragraph 1 contained within the background section as "roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks". Currently in typical service concession arrangements, the grantor retains ownership of the land and transfers the infrastructure asset to the operator or grants the operator the right to construct the infrastructure asset. Intangible assets in public sector are not typically transferred to an operator in a service concession arrangement. However as and when different types of service concession arrangements will emerge, land and intangible assets, could be subject to concession arrangements as well.

If the AASB is concerned that the operators will not view these as 'infrastructure' then our suggestion is that the AASB request the IASB to make a limited scope amendment to Interpretation 12 to clarify this matter.

Question 3: Application of the concept of ‘control’

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?

We agree with the concept of ‘control’ as discussed in paragraph 8(a) of the [draft] Standard since this concept mirrors that included in AASB Interpretation 12 paragraph 5 for defining the scope of that Interpretation and is consistent with IPSAS 32.

We have been made aware that there may be situations where over the course of the service concession arrangement a regulated public service becomes de-regulated, i.e. the conditions leading to ‘control’ are no longer met. Further the conditions leading to ‘control’ at the beginning of the arrangement may change over the course of the arrangement, e.g. there is a change in the regulator or the services. We encourage the AASB to consider including additional guidance in Appendix B to the [draft] Standard to address such scenarios.

Question 4: Measurement of service concession asset at fair value

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?

We agree with the proposed measurement of service concession assets at fair value in accordance with AASB 13 Fair Value Measurement (AASB 13). However, we understand that there are practical issues arising in the application of AASB 13 in the public sector, specifically in respect of determining fair value for infrastructure assets for which no active market exists and, therefore, recommend that the AASB specifically re-assesses as part of a Post Implementation review of AASB 13 in the not-for-profit sector whether additional guidance may be appropriate on the application of AASB 13 in the not-for-profit sector.

Question 5: Measurement of service concession liability using dual model

The [draft] Standard proposes that 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?

The [draft] Standard proposes that 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?

We concur with recognising a liability at the fair value of the service concession asset as it mirrors the requirements of AASB Interpretation 12 and is consistent with IPSAS 32. Furthermore, we believe that there can be practical difficulties associated with determining the fair value of a liability arising under a service concession arrangement, especially a ‘grant of a right to the operator model’ liability.

We support the concept of the dual models for classification and measurement of the liability reflecting the differing substance of service concession arrangements in place.

Question 6: Splitting the service concession liability

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?

We support the concept of applying both the models for hybrid arrangements as reflective of the substance of the underlying arrangements.

Question 7: Other revenue

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?

Whilst we support the conclusion of the AASB that further guidance is not required, we suggest that the AASB move the content of BC27 to the main body of the Standard under paragraph 29 of the [draft] Standard, i.e. provide some examples and context to the discussion of ‘Other Revenue’.

Question 8: Defined terms

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?

We support the definitions of individual terms in Appendix A in principle.

We agree with the concept of ‘public service’ that the AASB has referred to in the definition but we believe that more clarity is required around the definition of ‘public service’. There needs to be further thought given to what is meant by ‘service’ and whether service includes the provision of an asset for public use or only when there is a service element in the transaction or when there is a combination of both.

We understand that entities may find it difficult to apply the definition of ‘public service’ in practice and have been provided with a number of scenarios where constituents believe that it is unclear as to how the definition of public service is to be applied. These examples include:

- Ports - whether ports which have both passenger terminals and cargo terminals be considered to be providing public service;
- Hospital management facilities - if car parks, equipment management and replacement, facility and utility management in a public sector hospital is to be construed as a public service;

- Housing - whether provision of accommodation to students and nurses in public sector universities and hospitals respectively can be considered public service and whether this is different to housing provided to defence personnel.

We, therefore, recommend that the AASB consider whether additional clarifying guidance should be provided on how to apply the definition of 'public service'.

We have not identified any additional terms that may need to be defined separately in Appendix A.

Question 9: Lifecycle costs of a service concession asset

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?

We agree in principle with the concept as explained in the Illustrative Examples 1 and 2 of the [draft] Standard. However we believe that this concept should be explained within the Application Guidance under 'Recognition of a Service Concession Asset'. It is not adequately clear from the discussion in Illustrative Examples 1 and 2 that the grantor should recognise a new service concession asset and a corresponding liability when the operator incurs the lifecycle costs over the course of the service concession arrangement.

Question 10: Disclosures

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?

We agree with the disclosure requirements contained with paragraphs 30 to 32 of the [draft] Standard and consider it appropriate to require disclosure of material arrangements on an individual basis with the other similar arrangements disclosed in aggregate.

Question 11: Application date and transitional requirements

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

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

We believe that the [draft] Standard will have widespread impact which will vary across different states in Australia and the Commonwealth since there is considerable diversity in practice in accounting of service concession arrangements. Furthermore the impact will be dependent on each arrangement and whether the

public sector entity can demonstrate the ‘control’ criteria under paragraph 8(a). The review and assessment of existing service concession arrangements under the [draft] Standard may take considerable time and may require changes to be made to systems in order to capture appropriate information. In view of this, we believe that the AASB should provide longer transition period, with the effective date moved to 1 January 2018.

We support the proposed transitional provisions in paragraph 33 and AG64 and AG65. However we consider that the liability under the ‘grant of a right to the operator’ model should equate to the fair value of the service concession asset less any amount recognised as a financial liability without any further adjustment. Hence we could not understand the reasoning behind including the last part of the final sentence in AG65(b), i.e. “...,adjusted to reflect the remaining period of the service concession arrangement”.

Question 12: General comments

The AASB would particularly value comments on the following:

- (a) Whether 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) Whether 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?*

We believe the [draft] Standard will remove diversity in practice and improve the relevance and comparability of the financial statements of the public sector entities.

Question 13: General comments

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.

Whilst the first time adoption will require the public sector entities to incur certain costs and perhaps changes to their information systems around and accounting, we do not believe that the costs will be so significant that it will surpass the benefits of implementing this [draft] Standard.