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Kris Peach
Chairman and CEO
Australian Accounting Standards Board
PO Box 204
Collins Street West VICTORIA 8007

Dear Kris,

Request for Comment on Fatal Flaw Review Version - Amendments to Australian Accounting Standards - Implementation of AASB 1059

Ernst & Young Australia is pleased to comment on the above Fatal Flaw Review Version of AASB 1059.

Our detailed responses to the proposed amendments are provided in the appendix to this letter. We would be pleased to discuss our comments further with either yourself or members of your staff. If you wish to do so, please contact Georgina Dellaportas on (03) 9288 8621.

Yours sincerely

A handwritten signature in black ink that reads 'Ernst + Young' in a cursive, script font.

Ernst & Young

Appendix A

1. Modified retrospective method to measure the GORTO liability

We agree with the Board's proposal to change the modified retrospective method for measuring the GORTO liability set out in paragraph C4(c) of AASB 1059 so that the GORTO liability is initially measured by the current replacement cost of the service concession asset at the date of initial application adjusted to reflect the remaining concession period relative to the total period of the service concession arrangement, rather than relative to the remaining economic life of the service concession asset.

This would address the anomalous outcomes where the asset has an indefinite or relatively long useful life compared to the remaining concession period.

2. Non-application of AASB 16 to assets that would be captured by AASB 1059

We agree with the Board's proposal to modify AASB 16 to provide a practical expedient to grantors of service concession arrangements so that AASB 16 would not need to be applied to assets that would be recognised as service concession assets under AASB 1059. This would enable grantors to continue their existing accounting policy to service concession assets until AASB 1059 was applied.

We do note however that some Treasury policies may not have specifically referred to the application of AASB 117 but rather to a risks and rewards approach eg under the UK FRS 5. We therefore recommend the Board remove the words "previously accounted for under AASB 117".

In addition, BC12 should be amended to be consistent with Aus C4.1.

We also note that BC 12 currently refers to assets recognised under AASB 117 while the words "accounted for" are used in Aus C4.1.

3. Editorial amendments to paragraphs IG10 and IG13 in the implementation guidance

While we agree that editorial amendments are required to the above paragraphs, we do not agree with some of the changes proposed. In particular:

- IG10 - this flowchart provides guidance in respect of paragraphs 5 and 6 of the Standard which relate to the recognition of a service concession asset, once it is determined that an arrangement falls into scope under para 2. Hence the first sentence should be amended as follows:

“The diagram below summarises the recognition and measurement for assets in respect of service concession arrangements that fall in the scope of AASB 1059”

The last box in the flowchart should also be amended as follows:

“The asset is a service concession asset recognised and measured under AASB 1059.”

- IG13- second column second row - as amended is contradictory - we recommend changing as follows: *“Operator provides construction services, Operator provides public services and related services as agent of the grantor.”*

4 Other comments

We would also like to take this opportunity to raise with the AASB some additional implementation issues which should be addressed as part of the review of AASB 1059 including:

4.1 Recognition of financial liability or hybrid model?

Paragraphs 15 and 16 state as follows:

“Where the grantor has a contractual obligation to deliver cash or another financial asset to the operator for the construction, development, acquisition or upgrade of a service concession asset, the grantor shall account for the liability recognised in accordance with paragraph 11 as a **financial liability**.”

The grantor has a contractual obligation to pay cash if it has agreed to pay the operator specified or determinable amounts, such as payments relating to the following:

- (a) third-party usage of a service concession asset, with or without guaranteeing a minimum amount to the operator; or
- (b) the shortfall, if any, between amounts received by the operator from users of the service concession asset and any other specified or determinable amounts payable by the grantor, even if the payment is contingent on the operator ensuring that the service concession asset meets specified quality or efficiency requirements.

Application of the strict reading of Para 16(b) may result in the requirement for a grantor to recognise a financial liability for the entire arrangement (ie equal to the fair value of the service concession asset) rather than the recognition of a financial liability for only the “expected shortfall” and a GORTO liability for the balance as would arise under the application of a hybrid model approach - which is considered the correct outcome for such arrangement. The Board should consider moving the example related to the shortfall into the section on “Dividing the arrangement” paras 24 and 25, which provide guidance on the hybrid model to clarify the application of the standard in such circumstances.

4.2 Financial liability or insurance contract?

There is conflict between paras 15/16 and 26/B75/B76 where the grantor agrees to compensate the operator for shortfalls in revenue and whether this should be accounted for as a financial liability or an insurance contract.

Paras 15 and 16	Paras 26 and B75 and B76
<p>Under the financial liability model, the grantor has a financial liability where the grantor has a contractual obligation to pay cash. This includes payments relating to “the shortfall, if any, between amounts received by the operator from users of the service concession asset and any other specified or determinable amounts payable by the grantor... requirements.”</p> <p>In this case, AASB 9 Financial Instruments would apply (except where this standard specifies otherwise).</p>	<p>Service concession arrangements may include performance guarantees (eg a guarantee of minimum revenue streams, including compensation for shortfalls).</p> <p>Where the guarantee is regarded as an insurance contract, the grantor can elect to apply AASB 4 Insurance Contracts or AASB 1023 General Insurance Contracts instead if it has previously used accounting applicable to insurance contracts for such guarantees.</p>

- Given the conflict in the standard, and the fact that insurance liabilities are scoped out of AASB 9 where certain conditions are met, the above may cause confusion. We therefore recommend that the Board clarify the application of the above paragraphs.
- We also recommend that the Board replace the reference to “performance guarantee” with “guarantee”. We also note that a more appropriate example of a performance guarantee would be a performance bond.