



**ACT**  
Government

Chief Minister, Treasury and  
Economic Development

Ms Kris Peach  
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Dear Ms Peach, <sup>Kris</sup>

## **Australian Fatal-Flaw Review Draft on AASB 10XY *Service Concession Arrangements: Grantors***

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) appreciates the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the Australian Fatal-Flaw Review Draft on AASB 10XY *Service Concession Arrangements: Grantors* (the 'proposed Standard').

HoTARAC supports an approach in which the AASB more fully articulated the principles and concepts that support the rules embodied in the proposed standard. This would allow preparers to more consistently and appropriately extrapolate these to new, innovative arrangements.

### **Overall Comments**

There are a number of criteria in determining whether an arrangement is in the scope of the proposed Standard. However many arrangements are complex and contain features that make a clear binary assessment of each criteria extremely challenging. For example, it is not clear whether the public service criterion has: any element of public service; a majority public service element; or whether the arrangement should be primarily providing public services.

While we understand that the application of these criteria should be subject to the application of judgement, the proposed Standard should explain the extent to which each criterion affects the assessment. The proposed Standard should also explain the conceptual links between each criterion, and explain the rationale for treating arrangements as service concession arrangements, leases, privatisations etc. This is critical to assessing substance over form.

With the existing drafting, there is a risk that arrangements will be accounted for in a manner not consistent with their economic substance (see page 4). Therefore HoTARAC recommends this should be addressed before AASB 10XY is issued. In particular, the following matters for your consideration:

- Public service;
- Regulation, including third-party regulation;
- Service concession vs. lease vs. privatisation;
- Residual interest;
- Grantor involvement in specifications of assets constructed by operators;
- Demand risk; and
- The relationship between grantor compensation and the expected fair value of assets constructed by operators.

Where appropriate, examples would assist in understanding the relationship between these characteristics.

We have discussed the criteria in more detail under the relevant topics below.

### **Recognition of Previously Unrecognised Intangible Assets**

- Paragraph B34 requires recognition of intangible assets of the grantor used in a service concession arrangement, even where the grantor has not recognised these previously. This is not consistent with AASB 138 *Intangible Assets*. Recognising such intangible assets and related amortisation will result in a lack of comparability with intangible assets not used in service concession arrangements. This will increase future revenues across the service concession period under the grant of rights to the operator (GORTO) model.
- A further practical issue arises when service concession arrangements that relate primarily to tangible assets, also contain internally generated intangible assets, e.g. customer lists, brands, publishing titles etc. This implies preparers will need to potentially determine values and recognise multiple intangible assets for each service concession arrangement. It may be particularly difficult to determine values for such intangible assets, where multiple assets are used as part of a GORTO model.
- It is not clear what is intended to be recognised in respect of internally generated intangible assets at the end of the concession period, or the appropriate period of amortisation. For instance, where an internally generated intangible asset has a remaining economic life of 40 years and the concession period is only 20 years. If internally generated intangible assets continue to be recognised after the end of the concession period, this would again contradict AASB 138.

### **Definition of a Public Service**

The proposed Standard applies only where there is a 'public service'. We note this term is not defined in Appendix A. We anticipate preparers will have difficulties in determining whether complex arrangements fall in scope without a clear definition. Any definition should be supported by detailed guidance and examples. For example, arrangements may include an element of public service, but also contain non-public service elements. In this case, it is not clear whether the existence of any public service component would bring the entire arrangement into the proposed Standard, or whether an assessment is required based on the significance of the public service to the entire arrangement.

### **Residual Interest**

It is not clear what level of interest in the residual asset is necessary to bring an arrangement in the scope of the AASB 10XY. For instance, does the interest need to be significant in the context of the total fair value or term of the arrangement? It would seem appropriate that any grantor involvement in the residual asset should be considered in the context of other substantive terms in an arrangement, including an assessment of the likelihood of the involvement occurring. However, this is not considered in the proposed Standard.

## Effect of Regulation on Control

- The proposed Standard is not clear on when and why regulation of prices by a third-party constitutes control by the grantor of a service concession asset. For instance, paragraph (para) B17 prescribes that regulation of prices by a third-party gives the grantor control of prices. The conceptual basis for this prescription should be explained, as should whether and why control of prices by the grantor also means the grantor controls a service concession asset. It is not clear why an operator's obligation to abide by industry regulation should lead to control of an asset by another party (the grantor). Without a comprehensive conceptual rationale for the impact of regulation, there is a risk complex transactions would be in or out of scope of the proposed Standard contrary to their substance.

In contrast, para B19 appears to provide an example where regulation of prices by a government does not lead to control, because the regulation is 'broad' and applies to the industry 'as a whole'. This would appear to contradict paras B16 and B17. Specifically B16 implies a grantor could control a service concession asset via third-party regulation of other entities that operate in the same industry.

Taking paras B17 and B19 together it is difficult to envisage a situation where a government's regulations, let alone a third party's regulations, would not apply to a whole industry. Para B21 implies that an arrangement that caps returns to an operator gives the grantor control of a service concession asset. The conceptual basis for this is not explained. It is also not clear whether this relates to regulation only. If it does, the proposed Standard should explain how this requirement relates to the concepts discussed in paragraphs B16 to B20.

- More guidance is necessary on how to determine whether the grantor controls an asset where an arrangement has a sizeable 'unregulated' component, e.g. shared facility arrangements. Paragraph B23 states "...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." The Standard should identify the types of factors relevant to this judgement, e.g. which party bears demand risk, construction and financing risk, significant operational discretion etc.

## Recognition of Service Concession Assets

- Para 9 states "references to fair value in other Standards shall be interpreted as references to current replacement cost for service concession assets". The rationale for not permitting alternative approaches should be more clearly explained.
- The notion of current replacement cost (CRC) is central to the proposed standard. The AASB should consider providing clarity on the relationship between CRC and costs that can be capitalised under AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*. For instance, AASB 138 paragraph 54 precludes research costs from capitalisation. Conversely, members of HoTARAC have noted instances where Valuers appeared to exclude borrowing costs, architectural fees and site-works (including utility connections) in deriving CRC, on the basis that market participants would not factor these costs in determining a viable market value for the asset.

### **Grant of Right to the Operator Liability**

- Paragraph 21 requires a GORTO liability to be subsequently reduced as revenue is recognised according to the economic substance of the arrangement. However, it is not clear whether there are circumstances in which the initial GORTO liability (para 20) should be subsequently remeasured.
- The final sentence of paragraph B64 appears to refer to a hybrid financial liability and GORTO model; this should be more clearly acknowledged. It is not clear whether the reference to 'liability' being re-assessed is: financial, GORTO, or both. Further, why does the reduction/elimination of the estimated financial liability affect the timing of reducing the GORTO liability? This seems to suggest that such hybrid models could bring forward revenue recognition substantially.

### **Measurement of Service Concession Asset**

- Further guidance is required on when the reliable measurement criteria might not be met for service concession assets. In particular, preparers are concerned about their ability to reliably measure the fair value of assets as they are constructed i.e. work-in-progress (para B42) and to obtain sufficient appropriate audit evidence to support a valuation.

Existing service concession contracts may not give the grantor access to sufficient information of auditable quality to determine a fair value. In these circumstances, there is a risk therefore that service concession assets may be not recognised because they do not meet the recognition criteria in AASB 116 or AASB 138 (para B39).

- Para B41 discusses recognition of a service concession asset during the construction or development phase if 'the economic benefits embodied in the service concession asset flow to the grantor at that time'. This implies that if no benefits flow during the construction/development phase, then the recognition criteria are not met. This contradicts the notion of future economic benefits.

### **Long-term Leases, Outsourcing and Privatisation**

Notwithstanding paragraph IG4, the proposed Standard does not sufficiently explain the difference between long-term leases, outsourcing and privatisation. Where arrangements contain a complex mix of responsibilities between the parties, it will be necessary to assess the extent each of the relevant criteria effect this determination, such that the determination reflects the substance of the arrangement.

Para B26 indicates that an arrangement may be a lease under AASB 16 *Leases*, and not a service concession under the proposed Standard, where the grantor retains control of an existing asset and gives the operator the right of use. However, grantor control with an operator right to use is both characteristics of a service concession. The proposed Standard should explain those features that distinguish between a service concession and a lease. HoTARAC recommends an example to clarify this.

## Other Comments

- Hybrid financial liability/GORTO models are discussed throughout the proposed Standard, in some instances not explicitly. It might be clearer to cover hybrid models in a single section. For example, the content of paras B66 and B67 have already been largely covered in para B57 and B64.
- Arrangements often contain licenses. The difference between service concession arrangements and licensing should be clearly explained. HoTARAC notes that there are various treatments of licenses under Government Finance Statistics (GFS).
- HoTARAC notes measurement of service concession assets at CRC may result in non-compliance with International Financial reporting Standards: IFRS 13 *Fair Value Measurement*. As a consequence, for-profit grantors (and those not-for-profit grantors that otherwise comply with IFRS) would not be able to state compliance with IFRS in accordance with AASB 101 *Presentation of Financial Statements* paragraph 16.
- Paragraph 8 requires an existing asset of the grantor to be remeasured at CRC at the point it is classified as a service concession asset. The change in carrying value is treated as a revaluation. Where assets are measured using the income approach, this will lead to revaluation increments and decrements when these assets enter and leave service concession arrangements.
- Paragraph 13 discusses a form of compensation to operator by providing access to another revenue generating asset. This appears to contradict the principle of measuring and disclosing gross transaction flows (as opposed to netting flows for a singular disclosure). It is also not clear in what circumstances such an asset would be treated as a service concession asset in its own right, and when it would be treated as a component of compensation.

If you have any queries regarding HoTARAC's comments, please contact Sean Osborn from the New South Wales Treasury on (02) 9228 5932.

Yours sincerely,



David Nicol

CHAIR

HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

21 March 2017

