

27 February 2023

Australian Accounting Standards Board
Podium Level 14,
530 Collins Street,
Melbourne VIC 3000

Dear Board Members

RESPONSE TO AASB – PIR OF AASB 1059

We would like to take the opportunity to comment on some of the technical issues that we encountered in implementation of AASB 1059 as part of this post-implementation review by AASB.

Issue 1: Accounting for occupancy guarantees.

In practice, a lot of service concession agreements that we review, provide for an 'occupancy guarantee' by the grantor to the operator in relation to the service concession asset involved. Typically, the occupancy guarantee takes the form of a promise to pay a deficiency in revenue in a certain period of the arrangement. The deficiency is determined as difference between a certain % of return from the asset and the actual return to the operator.

The issue we face here is the interpretation of paragraphs 15-16 read along with the related guidance in paragraphs B75-B78 in AASB 1059.

- Paragraphs 15-16 require that 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 **is to be accounted as a financial liability** since it represents a contractual obligation to deliver cash. Further, paragraph B63 appears to assert that any contractual obligation that cannot be discretionarily avoided is to be recognised as a financial liability.
- However, the impression we get from paragraphs B75-B76 (which term such commitments to pay revenue shortfall as a performance guarantee) is that the entity should assess **whether such guarantees are financial guarantees to be accounted as per AASB 9 or insurance contract (AASB 17) or provision as per AASB 137.**
- Adding an element of confusion is paragraph BC20 which states as below:
"The Board considered that compensation of revenue shortfalls in the context of AASB 1059 paragraph 16(b) would not meet the definition of a financial guarantee under AASB 9 for the grantor where the grantor is guaranteeing payments to the operator to cover lower usage of service concession assets than expected. Therefore, insurance accounting would not be appropriate in measuring the liability to the operator in the case of such revenue shortfalls."

Prima facie, the relatively straightforward requirement set out by paragraph 15 to recognise a financial liability appears to be contradicted by the requirement in paragraphs B75-B76 to recognise a financial guarantee or provision or as an insurance contract. We are at times made to suspect, whether the term 'financial liability' used in paragraph 15 is a generic term including 'financial guarantee' as well. But as we already know that AASB 9 and AASB 132 uses different definitions for these two terms, that view is not supported.



We would therefore request a clarification as to what is the exact expectation of AASB with regard to recognising such occupancy guarantees and if required make editorial corrections to ensure consistency. We feel, if AASB does not believe such revenue shortfalls are financial guarantee contracts or insurance contracts, then it would be better to be more explicit on the accounting requirement rather than directing the entity to assess further as per B75-B76 which prolongs the accounting process.

Issue 2: Explanation of the phrase ‘contractual obligation to pay cash’ – paragraph 15 and 16.

Paragraph 16 categorically states “*The grantor has a contractual obligation to pay cash if it has agreed to pay the operator specified or determinable amounts.....*”

We faced a couple of interpretational issues as below:

- Firstly, it is not clear what the paragraph means by the term ‘determinable’. Is there a limitation to this determinability? For e.g., if a clause states that the shortfall is determined with reference to a market rate which is only derived by valuation techniques using unobservable inputs (as in AASB 13) or independent valuation by an expert, can these amounts be regarded as ‘determinable’ or should such rates be readily available/observable from externally published data. Some examples in this regard would be helpful to implement the standard in future.
- Secondly, as a matter of academic interest to us professionals, is AASB 1059 carving out a slightly different definition of financial liability from what we see in AASB 132? This is because AASB 132 contains no such additional phrase as ‘*if it is agreed to pay a specified or determinable amounts*’; it only requires determining whether there is a contractual obligation to deliver cash. Also, paragraph B63 does not contain the phrase “*if it is agreed to pay a specified or determinable amounts*” but instead uses the phrase “*to make a **predetermined** series of payments to the operator*” rather than ‘determinable’ amounts. Thus, apparently there is an inconsistency in the use of language across these paragraphs which requires clarification.
- If AASB does clarify what ‘determinable’ means in the context, it would be a relevant question as to what should be the accounting treatment of amounts that **are not ‘determinable’**.

Issue 3: Insurance accounting of performance guarantees under AASB 17.

Clearly, the insurance accounting requirements were relatively primitive when AASB 1059 was first implemented. With AASB 17 becoming effective, the accounting requirements for insurance contracts are more detailed and disclosure requirements are significantly high. With that being the case, can there be an exemption for service concession arrangements from applying AASB 17 or perhaps more simpler requirements if they include a component of performance guarantee that meet the definition of an insurance contract. This is because we are of the following views:

- The core objective of the contract is to provide a service concession asset to an operator while providing insurance to the operator from specific uncertain event is only incidental. Requiring the grantor to recognise various components of insurance accounting may potentially obscure the main components recognised through the service concession arrangement and complicated for user who tend to be focussed on the economics of the service concession.



- The quid pro quo arrangement in these agreements can be unstructured and entirely different from typical insurance contracts where a premium is collected by the insurer as a compensation. This makes it onerous to apply AASB 17 in general.
- Being the simplest approach under AASB 17, the premium allocation method cannot be used in these arrangements since invariably all the service concession arrangements are for a term more than one year (one of the qualifying criteria for applying this method).

Thanking hereby for this opportunity, we would request AASB to take cognizance of some of the issues raised by us above and make suitable amendments and clarifications for a smoother implementation of AASB 1059 in future.

Kind Regards

A handwritten signature in black ink, appearing to read "Hayley Underwood".

Hayley Underwood