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Chair
Australian Accounting Standards Board
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Our ref AASB 10XY Fatal Flaw Letter

17 March 2017

Dear Kris

Submission - AASB 10XY Fatal Flaw Letter

We are pleased to have the opportunity to comment on AASB 10XY – *Service Concession Arrangements: Grantors (AASB 10XY)*. As previously communicated in our submission on Exposure Draft 261 (**ED**), we support the implementation of a Standard that addresses the accounting for a service concession arrangement by a grantor that is a public sector entity.

However, we do note that this Fatal Flaw Review Version has included some significant changes in relation to the recognition of intangible assets, specifically the requirement to:

- Recognise a previously unrecognised existing intangible of the grantor
- Reflect such recognition as a GORTO liability

These aspects were not included in the ED and have therefore not been exposed to the full Exposure Draft process. Whilst we remain fully supportive of including intangible assets within the scope of the Standard, we believe that there is the potential for alternative interpretations in relation to these aspects, with different accounting outcomes. We discuss these further in the appendix to this letter.

We would be pleased to discuss the content of the Appendix with members of the AASB or its staff.

Yours sincerely

Patricia Stebbens
Partner

Andrew King
Partner

Appendix

Our concern is focused on the guidance contained within Appendix B of the Standard, and in particular the addition of B34 (b) which pertains to the recognition of intangible assets of the grantor which have not been previously recognised.

Paragraph B34 (b)

B33 to B37 of the Application Guidance appended to AASB 10XY deal with Existing Assets of the Grantor. In particular, B34 states that the following should be recognised as a service concession asset in accordance with paragraphs 5 and 6:

- a) *the upgrade of an existing asset of the grantor (e.g. an increase in capacity); and*
- b) *an intangible asset of the grantor that has not been recognised previously by the grantor.*

We have no concerns with B34 (a), which clearly refers to an existing asset of the grantor (i.e. an asset previously recognised by the grantor prior to entering into the service concession) and which is consistent with ED 261.

In contrast, B34 (b) of the fatal flaw version of the standard specifically requires the recognition of “an intangible asset of the grantor that has not been recognised previously by the grantor. AASB 10XY appears to therefore:

- a) acknowledge that this intangible asset is not an existing recognised asset of the grantor, and
- b) require initial recognition of the intangible asset at the point at which the service concession is entered into.

Nature of the intangible asset

When we come to consider practical implementation of B34 (b), we believe that there are possible alternative views in relation to what the intangible asset represents:

View 1 – a pre-existing, but unrecognised intangible asset of the grantor

One view is that the service concession asset that is recognised on commencement of the Service Concession is an “existing” intangible that has not been previously recognised because it failed to meet the criteria for recognition under AASB 138: *Intangible Assets (AASB 138)*. In other words, at the time the asset was being developed, it was considered that:

- The identifiability criterion was not met because the intangible asset was not deemed to be separable and did not arise from a contractual or legal right (AASB 138.12(a)); and/or
- It was not probable that future economic benefits would flow to the grantor (AASB 138.21(a)); and/or
- The cost was not reliably measurable (AASB 138.21(b)).

Proponents of this view may advocate that, upon entering into a service concession with an operator (an operator who has access to the use of this existing intangible asset of the grantor to

fulfil its concession obligations), the identifiability criterion of AASB 138 is deemed to be satisfied because it has been demonstrated that, through the arrangement, the asset is capable of being separated; and the recognition criteria are also deemed to be satisfied because future economic benefits have been proven via the concession arrangement and the costs are deemed to be measurable via application of Current Replacement Cost (**CRC**).

As such, the previously unrecognised intangible asset should now be recognised on the balance sheet of the grantor and measured at CRC.

View 2 – a newly created intangible asset

An alternative view could be that the intangible asset referred to in paragraph B34 (b) is not an “existing but unrecognised” intangible asset of the grantor, but, rather, a new intangible asset for the grantor that has been created by the action of entering into the service concession arrangement itself; in other words, the intangible asset is a form of “Grant of Right to Operate” asset which the grantor has now created for itself by providing the operator with the concession over the grantor’s operations and/or assets. In this case, the measurement (at CRC) of this asset may be minimal, and limited to the costs incurred in transacting the service concession agreement, or less.

We believe that View 1 is the intended view of the Board, but would welcome further clarification on this.

Observations under View 1

If View 1 is the prevailing view, we seek clarification on the following:

1. Is the initial recognition of intangible assets as required in this standard consistent with the general recognition criteria with AASB 138?

Given that these intangible assets have not been recognised before under AASB 138, would it meet the recognition criteria under AASB 10XY when the only apparent change in facts leading to their recognition is the entering into of a Service Concession Arrangement? For example, does the mandate for using CRC overcome/supersede any previous assessment under AASB 138 that recognition is precluded due to an inability to reliably measure the asset?

2. Is the recognition of pre-existing but unrecognised intangible assets under this standard consistent with the specific requirement in AASB 138 that “expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date”¹?
3. Is it intended that intangible assets which are specifically precluded from recognition under AASB 138 (e.g. internally generated brands, mastheads, publishing titles, customer lists and

¹ AASB 138.71

items similar in substance²) are now recognisable under AASB 10XY if they are used in a service concession arrangement?

Potential inconsistency in treatment of existing assets and newly recognised intangible assets

We also see an inconsistency in the treatment of Service Concession Assets, with potentially differing Income Statement impacts, depending on whether they are:

- a) existing assets of the Grantor (and have previously been recognised as such), subsequently reclassified as SCA; or
- b) existing assets of the Grantor, previously unrecognised but now required to be initially recognised by the Grantor as SCA due to their use in the Service Concession.

For existing assets which are reclassified as Service Concession Assets (SCA), paragraph 8 requires that these assets are remeasured at CRC and any difference between the original carrying value and CRC is treated as a revaluation. We would interpret this as meaning that the difference is taken to Asset Revaluation Reserve (or Income Statement if it is a revaluation decrement without sufficient ARR).

For a newly recognised SCA under paragraph B34(b) which was an existing but unrecognised asset of the Grantor (e.g. provided by the Operator), it is unclear whether paragraph 8 or 10 applies.

If paragraph 10 applies, this would result in the recognition of a newly recognised Service Concession Asset and a Service Concession Liability at current replacement cost.

This liability would be released as a credit to the Income Statement over the concession period. This is inconsistent with the measurement of an existing asset under paragraph 8, under which the difference would have been treated as a revaluation of the asset.

Whilst we concur with the rationale for the accounting treatment of the recognition of a GORTO obligation on a new Service Concession Asset which is constructed or provided by the Operator (the simplified rationale being that the Operator is contributing an asset to the Grantor in return for the concession), we do not believe that this rationale should extend to an existing unrecognised intangible asset.

We would welcome further clarification on this matter.

² AASB 138.63