

Your ref:
Our ref: Mr David Hardidge – 3149 6010

24 March 2017

Ms K Peach
Chair
Australian Accounting Standards Board
PO Box 204
COLLINS ST WEST VICTORIA 8007

Dear Ms ^{Kris}Peach

AASB 10XY Service Concession Arrangements: Grantors – Fatal-Flaw Review

The Queensland Audit Office (QAO) welcomes the opportunity to comment on the draft standard. The views expressed in this submission are in addition to those we made as part of the submission by all Australian members of the Australasian Council of Auditors-General (ACAG) dated 17 March 2017.

QAO considers that the draft standard for Service Concession Arrangements: Grantors (AASB 10XY) includes fatal flaws and should not be issued until those flaws are remedied.

Issues identified are explained in attachment one and include:

- Section 1 – Control - apparent departures from the definition of an asset under the conceptual framework.
- Section 2 – Regulation - apparent departures from the definition of an asset under the conceptual framework.
- Section 3 – Public service - Additional guidance needed when the private sector provides similar services.
- Section 4 – Procurement - QAO believes that existing accounting standards are adequate for such arrangements, and that the draft standard does not provide better reporting.
- Section 5 – Existing asset used in a service concession arrangement and apparent departures from existing accounting standards.
- Section 6 – Future replacements – The provisions in the draft standard are not adequate to apply the standard consistently.
- Section 7 – Amortisation of unearned revenue - The draft standard needs further guidance, particularly in relation to expectations on the use of the straight-line method of amortisation.
- Section 8 – Liability for future payments - QAO does not agree that accounting under AASB 9 provides the best reporting.
- Section 9 – Variable consideration receivable - QAO does not agree that accounting under AASB 9 provides the best reporting.
- Section 10 – Operator charges grantor for usage – further guidance is needed to determine if such arrangements are within the scope of the draft standard.
- Section 11 – Transition – fully retrospective method - QAO disagrees with the prohibition to retrospectively adjust the asset revaluation reserve.

We have identified some additional areas that could be clearer and refined to assist with a consistent interpretation and implementation (Section 12).

QAO appreciates the opportunity to respond and trust that you find our comments useful. Mr David Hardidge, Technical Director would be pleased to assist in providing comments on any proposed revisions to the draft standard.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'A. Close', with a stylized flourish at the end.

Anthony Close
Auditor-General (acting)

Enc.

Attachment 1

1. Control

This section is an expansion of the fatal flaw issue included in the ACAG submission (page 1).

1.1. Introduction

QAO believes that for the underlying assets of a service concession arrangement to be “on-balance sheet”, then the reporting entity must control those underlying assets.

The draft standard includes requirements for recognising underlying assets when a body external to the reporting entity determines the pricing. QAO disagrees with this apparent departure from the definition of an asset under the conceptual framework.

QAO requests the AASB to either explain why a departure from the conceptual framework is warranted, or how the definition of an asset is met when a third-party has control over pricing.

1.2. Background

The draft standard (paragraph 5) includes the requirement that the grantor controls or regulates the price of the services provided. Paragraph B17 expands on this requirement to potentially require recognition of the underlying assets if prices are regulated by a third-party regulator (e.g. by a capping mechanism).

QAO believes that if the regulator is outside the grantor reporting entity then the grantor does not control the price, and therefore the reporting entity should not recognise the underlying assets. Specifically, QAO disagrees with the example in paragraph B18 where a Commonwealth regulator can set the price, yet application of the standard results in a determination that the State controls the asset.

Paragraph B17 appears to be based on the reverse requirements of AASB Interpretation 12 *Service Concession Arrangements*. AASB Interpretation 12 prevents private sector operators from recognising the underlying property, plant and equipment if they do not control the pricing of the assets. Instead, the operator recognises a right-to-use asset, i.e. the right to use someone else’s property, plant and equipment.

QAO agrees with this approach, i.e. if the operator does not control the pricing, they do not control the underlying asset. QAO agrees that the inability to control pricing does not have to be imposed by the grantor; a third party can impose the inability. In either situation, the operator does not control pricing, and consequently does not control the underlying assets.

QAO does not believe that the reverse automatically applies, i.e. if the operator does not control the pricing, then the grantor has that control. QAO believes that the power to control pricing must be within the control of the grantor reporting entity.

Implications of the above QAO reasoning include:

- States would not recognise electricity transmission and distributions assets where the Australian Energy Regulator (a commonwealth entity) regulates pricing.
- Individual main roads departments would not recognise toll roads if the pricing is controlled by a separate entity within the state controlled entity (i.e. by the treasury department). The toll roads would be expected to be recognised at a whole of government level.

2. Regulation

This section is an expansion of the issue included in the ACAG submission (Para B16 – B24, page 4).

2.1. Introduction

The draft standard (paragraph 5) includes the requirement that the grantor recognises the underlying assets of a service concession arrangement when the grantor controls or regulates the price the services are to be provided.

QAO believes that these requirements can be interpreted as requiring the recognition of the underlying assets when the definition of an asset is not met. Specifically, when regulation over pricing is involved, but the grantor reporting entity does not have sufficient discretion over pricing to meet the control criteria for the definition of an asset.

QAO requests the AASB to either explain why a departure from the conceptual framework is warranted, or how the definition of an asset is met in these circumstances.

2.2. Background

QAO believes that the draft standard can be interpreted such that many privatised assets on long-term leases (e.g. 99 years) are within the scope of the draft standard. This interpretation is based on price setting regimes for monopoly assets being set with reference to those individual assets. Specifically, such regimes often set the prices (revenue caps) to be charged based on asset specific factors (i.e. the Regulatory Asset Base).

Because the draft standard refers to regulate, it can be argued that such long-term leases are within the scope of the standard. QAO believes that the price regulation (revenue capping) is substantive under proposed paragraph B21.

While paragraph B19 excludes industry wide regulation, QAO believes this is not sufficient to exclude such monopoly pricing regulatory regimes as they are based on the asset's specific factors.

QAO believes these type of regulatory regimes do not constitute control (specifically the discretion to set prices) as it is essentially a protective regime for monopoly assets. Consequently, the draft standard should not require the grantor to recognise the underlying assets.

Examples of long-term leases include:

- privatisation of the electricity transmission and distribution infrastructure (e.g. South Australia on a 200 year lease – SA Power Networks, formerly ETSA Utilities)
- the Central Queensland Coal Network (operated and maintained by Aurizon on a 99 year lease).

2.3. Other price regulation

If the grantor is required to recognise the underlying assets for monopoly pricing regimes described above, then it can be argued that other assets subject to Australian Competition and Consumer Commission (ACCC) regulation may also be required to be recognised by the grantor.

Examples include airports and ports where the ACCC has powers to be involved in price setting. For ports, it can be argued that the ACCC regulates prices, through its role in authorising agreements amongst parties in some circumstances. Any involvement by the ACCC is expected to link the prices to the underlying asset. Therefore, the industry wide price setting exemption in paragraph B19 would not be met. QAO believes that the remote exemption in paragraph B21 does not apply, and that it can be argued that the price regulation may be considered substantive. Based on this reasoning the regulatory criteria of paragraph 5 is met.

Based on the ACCCs powers, it can be argued a similar situation applies to airports.

Similar to long-term leases, QAO believes these type of regulatory regimes do not constitute control (specifically the discretion to set prices) as it is essentially a protective regime. Consequently, the draft standard should not require the grantor to recognise the underlying assets.

3. Scope – Public Service – car parks and accommodation

This section is an expansion of the issue included in the ACAG submission (Para 5 – B9, page 3).

3.1 Fatal flaw

The draft standard is not sufficiently clear as to whether services provided by both the private sector and public sector are included within the scope of the standard. Consequently, it is not sufficiently clear whether such arrangements will be on-balance sheet or off-balance sheet. The lack of clarity is likely to lead to diversity of application.

QAO requests the AASB to provide further guidance in these situations.

3.2 Background

Examples where similar services are provided by both the private sector and public sector are for car parks at hospitals and accommodation for teachers, defence personnel and students.

The definition of service concession arrangement requires that public services are provided on behalf of the grantor. For a car park linked to a hospital, are the car park services assessed solely as car park services? If so, the services are likely not to be considered public services as car park services are also provided by the private sector. Consequently, the definition of service concession arrangement would not be met and the asset would be considered off-balance sheet. Or is the car park assessed as being linked to the hospital such that the services are considered to be hospital car park services and therefore public services? Consequently, that part of the definition of service concession arrangement would be met and the asset potentially recognised on-balance sheet.

Paragraph B7 (reference to hospital car park) is in the context of the car park being built at the same time as a hospital. The example is not helpful when a car park is being built for an existing hospital. While paragraph B7 refers to separate assessment of the car park, it does not provide assistance in determining whether car park services are a public service.

4 Scope – Public Service - Procurement

4.1 Fatal flaw

QAO believes that the draft standard can be interpreted as applying to procurement arrangements involving the construction and maintenance of assets that are already on-balance sheet under existing standards.

QAO believes that existing accounting standards are adequate for such arrangements, and that the draft standard does not provide better reporting.

QAO requests the AASB to either clarify that such arrangements are outside the scope of the standard, or explain why the draft standard provides better reporting.

4.2 Background

Paragraphs B4 to B9 include examples of a courthouse and a military base. In practice, public sector staff (and judges) would make the services to the public from a court and military base. The private sector involvement would often be the construction of a building and related maintenance services (of the asset).

Consequently, by referring to the above examples, the standard can be interpreted as applying to arrangements limited to procurement involving the construction and maintenance services.

As noted above, these arrangements would be expected to be on-balance sheet under existing standards.

5 Service Concession Asset – Existing Asset – No upgrade

This section is an expansion of the issue included in the ACAG submission (Para 8, page 2).

5.1 Fatal flaw

When an existing asset is involved in a service concession arrangement, paragraph 8 requires the revaluation of that asset to fair value (current replacement cost).

This requirement may cause departures from other Australian accounting standards, including those equivalent to International Financial Reporting Standards.

QAO does not agree with these departures, and believes that the departures are unnecessary.

The draft standard does not justify these departures.

The departures are:

- a revaluation, not otherwise required by an accounting standard (e.g. property, plant and equipment measured at cost under AASB 116 *Property, Plant and Equipment*)
- a revaluation of intangibles that is otherwise prohibited by AASB 138 *Intangible Assets*.

QAO requests the AASB to remove the departures from other standards, or explain why the departures are required.

QAO identified three situations when an existing asset is involved in a service concession arrangement.

- an existing asset that is substantially all of the service concession arrangement
- an existing asset that is a minor component of the service concession arrangement

- an existing asset that is not a component of the service concession arrangement.

5.2 An existing asset that is substantially all of the service concession arrangement

Examples of where an existing asset is substantially all of the service concession arrangement include an existing road (property, plant and equipment) and a land titles registry (intangible, if recognised).

QAO believes the accounting should be:

- reclassify the asset to service concession asset at existing carrying value (Dr Service concession asset, Cr Property, Plant and equipment (or intangible))
- recognise the consideration payable (Dr Cash, Cr Service concession liability / unearned revenue).

As an existing asset, the asset was already on-balance sheet, and will remain on-balance sheet under the draft standard. QAO does not believe there is a need to reset the carrying value of the service concession assets to fair value. Consequently, QAO does not agree with the departure from other accounting standards.

5.3 An existing asset that is a minor component of the service concession arrangement

An example of where an existing asset is a minor component of the service concession arrangement includes land on which the service concession assets will be constructed.

As an existing asset, the asset was already on-balance sheet, and will remain on-balance sheet under the draft standard. QAO does not believe there is a need to reset the carrying value of the component (e.g. land) to fair value. Consequently, QAO does not agree with the departure from other accounting standards.

To illustrate the accounting, we have used the following assumptions:

- Completed service concession asset – fair value of CU 900.
- Grantor contributes land (fair value CU 100).
- Grantor existing carrying value of land (cost CU 60).

Therefore, the operator is contributing assets with a fair value of CU 800 (total completed fair value of CU 900 less the grantor contribution fair value of CU 100).

QAO believes the accounting should be:

Dr Service concession asset (Land)	60	
Dr Service concession asset (Plant & equipment)	800	
Cr Land		60
Cr Service concession liability / unearned revenue		800

5.4 An existing asset that is not a component of the service concession arrangement

An example of where an existing asset is not a component of the service concession arrangement includes a land swap, e.g. land owned by the grantor is given to the operator, and the operator constructs the service concession arrangement on land the operator acquires.

As an asset that is not a component of the service concession arrangement, it will not remain on-balance sheet, and should be derecognised (as though it was disposed of). QAO does not believe there is a need to reset the carrying value of the asset given to the operator (e.g. land) to fair value immediately before derecognition. Consequently, QAO does not agree with the departure from other accounting standards.

QAO believes that the asset should be derecognised for the fair value of the consideration received, and profit recognised on the disposal. QAO does not agree with the requirements to prohibit the gain recognised on disposal, by effectively recognising the profit on disposal in the asset revaluation reserve.

To illustrate the accounting, we have used the following assumptions:

- Completed service concession asset – fair value of CU 900.
- Grantor contributes land (fair value CU 100).
- Grantor existing carrying value (cost CU 60).

Therefore, the operator is contributing assets with a fair value of CU 800 (total completed fair value of CU 900 less the grantor contribution fair value of CU 100).

QAO believes the accounting should be:

Dr Service concession asset (Property, plant & equipment)	900	
Cr Land		60
Cr Profit on disposal of land		40
Cr Service concession liability / unearned revenue		800

6 Recognition of future replacements

6.1 Fatal flaw

QAO agrees that the draft standard should include requirements in relation to future replacements by the operator of service concession asset components e.g. the replacement of a toll road's surface layer. The requirements should comprise issues relating to the change in the underlying asset when the replacement occurs and the benefit to the grantor of not having to pay for the replacement.

QAO was not able to locate the provisions in the draft standard that would result in a reader arriving at the methodology used in the illustrative example. QAO notes that the illustrative example is technically not part of the draft standard.

QAO believes that the provisions in the draft standard are not adequate to apply the standard consistently. We highlight below issues relating to

- how future replacements are accounted for
- whether the future replacements should be estimated at current or future costs
- how to account for changes in estimates of future replacements.

QAO requests the AASB include its reasoning, and detailing the required accounting.

6.2 Accounting for the benefit of not paying for replacements

The illustrative example spreads the benefit of the expected replacement of the toll road surface layer over the life of the service concession arrangement. In the example, there is one replacement of CU110 on an original fair value of CU1 050.

In practice, there will be many replacements and the volume and amount of these replacements will significantly affect the accounting for the unearned revenue of the service concession arrangement.

QAO expanded the illustrative example for more realistic assumptions to demonstrate possible effects. QAO has used an example of a toll road with an initial fair value (current replacement cost) of CU1 050, comprised of CU790 related to the construction of the base layers, CU150 for a sub-surface layer and CU110 for the surface layer. The surface layer is assumed to be replaced every six years, and the sub-surface layer every 12 years, after the initial construction period of two years. QAO have also included an obligation of the operator to make-good the toll road to original specification. The make good obligation would represent usage since the last replacement. QAO have used a term of 55 years.

Using constant currency units (CUs), the replacement amounts would be:

Year	Current CU
8	110.0
14	260.0
20	110.0
26	260.0
32	110.0
38	260.0
44	110.0
50	260.0
55	154.2
	1 634.2

As can be seen, the total of the replacements (CU1 634) exceeds the original fair value of CU1 050.

6.3 Lack of guidance for inflation for cost of replacements

QAO requests that the AASB include requirements or guidance relating to whether the accounting for the future replacements uses discounted or future cash flows.

Using the above example prepared by QAO, the following are the replacement amounts based on a constant inflation rate of 2.5 per cent and of 5.0 per cent:

Year	Price 2.5%			Price 5.0%		
	Inflation Index	Current CU	Future CU	Inflation Index	Current CU	Future CU
0	100.0			100.0		
8	121.9	110.0	134.1	147.8	110.0	162.6
14	141.3	260.0	367.4	198.2	260.0	515.3
20	163.8	110.0	180.2	265.5	110.0	292.1
26	189.9	260.0	493.7	355.7	260.0	924.8
32	220.2	110.0	242.2	476.7	110.0	524.4
38	255.3	260.0	663.8	638.8	260.0	1 660.9
44	296.0	110.0	325.6	856.0	110.0	941.6
50	343.4	260.0	892.8	1 147.0	260.0	2 982.2
55	388.5	154.2	598.9	1 463.9	154.2	2 256.8
		1 634.2	3 898.7		1 634.2	10 260.7

Using the methodology in the illustrative example to the above amounts, QAO calculated that the unearned revenue balance would become negative and mainly stay negative after year 18 for 2.5 per cent inflation and year seven for 5.0 per cent inflation.

QAO requests that the AASB include requirements or guidance relating to negative unearned revenue.

If the AASB decides to use current cash flows, QAO requests that the AASB include guidance on accounting for the difference between expected amounts based on current values and the actual amount paid based on future cash flows.

6.4 Lack of guidance for changes in estimates

QAO requests that the AASB include requirements or guidance relating to changes in estimates of future replacements. Specifically, whether changes in estimates need to be recognised, and if so, whether changes are made retrospectively, or prospectively.

Using the illustrative example in the draft standard, what is the accounting (say) at the end of year five, if the replacement surface layer is estimated to be CU140 rather than CU110 in year eight?

At the end of year five, unearned revenue has a balance of CU615.

This is calculated based on

- total unearned revenue CU1 160 (CU1 050 for the initial fair value and CU110 for the replacement surface layer)
- less accumulated amortisation of CU435 (three years of amortisation of CU145 per year (CU 1 160 / 8 years = CU145 pa))
- = CU615

If the estimate of the replacement changes to (say) 140, possible accounting methods include:

- No change in year five – therefore the draft standard would need to include requirements and guidance relating to year eight for the difference between the original estimate of CU110 and the actual replacement value of CU140.
- Prospective change - amortise the additional CU30 (CU140 revised estimate less CU110 original estimate) over the remaining five years of the arrangement.
- Retrospective change - Adjust the unamortised unearned revenue to CU603.25 (CU1 150 less CU1 190 for 3/8 years). We presume the difference of CU11.25 (CU30 for 3/8 years) is recognised in net profit.

QAO notes that in practice the calculation would be extremely complex, with multiple replacements for multiple layers for multiple locations of the road. This complexity increases for replacements of other assets associated with the toll roads, e.g. gantries. Further complexity, and volatility in net profit, would arise for changes in estimates of future inflation rates.

QAO notes that a significant factor as to when replacements of road layers are required is usage, particularly usage by heavy vehicles. Therefore, changing the carrying value of unearned revenue for changes in estimates of replacements effectively results in unearned revenue being adjusted for changes in usage.

7 Recognition of revenue (unearned revenue) - Amortisation based on usage

7.1 Fatal flaw

Amortisation of unearned revenue of service concession arrangements will be a significant amount. As outlined above, the accounting for the benefit for future upgrades may exceed the initial fair value of the service concession asset.

The draft standard has very little guidance on the amortisation of unearned revenue under the grant of a right to the operator model.

QAO requests that the AASB clarify if the AASB expects that the straight-line method will be usually used, or if the AASB is essentially requiring the straight-line method to be used.

7.2 Background

Relevant paragraphs on the amortisation of unearned revenue include:

- 21 The grantor shall recognise revenue, and accordingly reduce the liability noted in paragraph 20, according to the economic substance of the service concession arrangement (see paragraph B64).
- B64 "... Revenue is usually recognised as access to the service concession asset is provided to the operator over the term of the service concession arrangement ..."

QAO believes that it can be argued that the economic substance of the agreement (e.g. for a toll road) is based on provision of services based on expected usage. Toll roads often have ramp-up periods, and are designed to cater for future increased vehicle usage, and for population increases. Therefore, on this reasoning, an amortisation method based on expected usage would be permitted under the draft standard.

QAO notes the issue of AASB 2014-4 *Amendments to Australian Accounting Standards – Clarification of Acceptable Methods of Depreciation and Amortisation*. That amendment restricts the use of revenue based depreciation for property, plant and equipment and for intangibles.

QAO noted above that changing the carrying value of unearned revenue for changes in estimates of replacements effectively results in unearned revenue being adjusted for changes in usage.

If the AASB restricts the use of usage or revenue based methods of amortisation, then QAO requests the AASB to address the apparent inconsistency between the restriction and accounting for changes to estimates of replacements.

8 Liability for future variable payments

This section is an expansion of the issue included in the ACAG submission (Para 52 and Para 58, page 5).

8.1 Fatal flaw

The draft standard requires the use of the financial liability method under AASB 9 *Financial Instruments* to account for future variable payments.

QAO does not agree that accounting under AASB 9 provides the best reporting. QAO requests the AASB adopt accounting similar to that in AASB 16 *Leases*.

Under AASB 16 changes in future payments are recognised:

- when they occur (not progressively through changes in estimates), and
- as an adjustment to the respective assets and liabilities (not through net profit).

8.2 Background

Paragraph 15 notes that a grantor may have a contractual obligation to pay cash based on third-party usage of a service concession asset (meeting the definition of a financial liability).

QAO notes that IFRIC rejected taking onto its agenda the accounting for a liability recognised at the date of purchasing an asset for variable payments that depend on its future activity.

QAO notes that the draft standard is based on ED261 *Service Concession Arrangements: Grantor*, which was issued in May 2015. This was before IFRS 16 / AASB 16 was issued.

QAO believes that IFRS 16 / AASB 16 provides better reporting for changes in variable payments based on usage.

8.3 Apparent departure from AASB 9

QAO notes that paragraph B58 requires the difference between the expected payments and the actual payments should be recognised in the period they arise. This appears to be a departure from AASB 9.

While QAO agrees with the timing recognition requirements of paragraph B58, QAO disagrees with the recognition of changes in net profit.

9 Variable consideration receivable

This section is an expansion of the issue included in the ACAG submission (Para 11, page 3).

9.1 Existing asset - Fatal flaw

Paragraph 15 requires that for a service concession arrangement over an existing asset, that a liability is recognised for the additional consideration provided by the operator.

The draft standard does not specify the accounting for the additional consideration asset. Given that the draft standard refers to AASB 9 for future payments, QAO has assumed that AASB 9 is intended to be required to be applied for future payments receivable.

QAO does not agree that accounting under AASB 9 provides the best reporting. QAO requests the AASB adopt accounting similar to that in AASB 16 *Leases*.

Under AASB 16 changes in future payments are recognised:

- when they occur (not progressively through changes in estimates), and
- as an adjustment to the respective assets and liabilities (not through net profit).

Using the AASB 16 methodology, the changes to the receivable would be recognised when they occur, with a corresponding adjustment to the service concession liability.

The final standard will need to include requirements and guidance on accounting for changes in the service concession liability / unearned revenue. We have highlighted above some of the issues that will need to be addressed, including catch-up adjustments for amortisation of unearned revenue.

9.2 Background

An example of a service concession arrangement over an existing asset with future payments to be made by the operator is that involving Legacy Way and Go Between Bridge. Brisbane City Council granted these arrangements to Queensland Motorways (now owned by Transurban).

An upfront payment was made at financial close, with additional future payments to be made based on actual traffic and toll revenue outcomes.

When the arrangements were announced, total payments under the arrangements were projected to potentially vary between \$273 million (operator case) and \$763 million (grantor case).

QAO believes that the subsequent payments represent adjustments to the original "purchase price" made by the operator to the grantor.

9.3 Classification of AASB 9 receivable

It is not clear whether the AASB believes that future payments based on usage meets the solely payments of principal and interest (SPPI) test under AASB 9 to be accounted for using the amortised cost method (i.e. a normal loan). If the SPPI test is not met the liability is expected to be classified as fair value through profit or loss (FVTPL). Classification as FVTPL might result in a significantly different value, because of how the probability of future payments is measured.

QAO believes that when payments are received under these arrangements they should be adjusted against the service concession liability as they represent adjustments to the original purchase price. QAO does not believe it appropriate to recognise these types of additional payments in net profit.

9.4 Potential consideration receivable – gain sharing

The draft standard does not provide guidance on potential future consideration receivable. In particular, gain sharing. Examples include revenue share (e.g. based on usage over a threshold), and share of debt refinancing gains.

Currently, these items are usually not recognised until they occur. The reasoning is often based either on the unreliability of the measurement, or that they are assessed as not being probable of being received.

There would also be significant implications for the accounting for these items under AASB 9 if the SPPI test is not met, and they had to be measured using FVTPL.

QAO requests that the AASB include guidance for the accounting for these commonly found features of service concession arrangements.

10 Operator charges Grantor for usage

10.1 Fatal flaw

The application of the standard is not clear for arrangements where the operator charges the grantor for usage.

QAO requests the AASB to provide further guidance in these situations.

10.2 Background

The standard refers to the grant of a right to the operator model as relating to the operator having the right to earn revenue from third-party users.

It is not clear what the accounting is for arrangements where the operator charges the grantor for usage, and the operator does not charge third parties (to a substantial extent). An example is a public hospital and charges are based on patients treated using a pre-agreed price list.

As the predominant source of revenue is from the operator, it appears that the requirements for the grant of a right to the operator model (paragraph 20) are not met.

It might be argued that the financial liability model (paragraph 15) should be applied on the basis that the grantor has a contractual obligation to pay cash based on third-party usage. However, there are significant implications in applying the financial liability model to such arrangements. These include forecasting future usage, future payments, and accounting for changes in estimates.

11 Transition – Fully retrospective method

11.1 Fatal flaw

QAO agrees with the two transition methods – fully retrospective, and commencing from the start of the comparative prior period.

QAO disagrees with the prohibition in paragraph C5 on retrospectively adjusting the asset revaluation reserve if the fully retrospective approach under paragraph C3(a) is used.

QAO requests the AASB to remove the prohibition and require retrospective application similar to other standards.

11.2 Background

If the standard is retrospectively applied, then carrying values should be recognised as if the underlying property, plant and equipment was initially recognised with the associated liability. It is common for public service grantors to revalue property, plant and equipment under AASB 116. Therefore, retrospective application would involve retrospective revaluations, including a transition adjustment to the asset revaluation reserve.

12 Suggestions for improvement

12.1 Financial liability - Asset under construction

QAO believes that the illustrative example for the financial liability model (Table 1.3 and Table 1.4) does not comply with accounting standards.

The definition of a financial liability requires a contractual obligation to pay cash. It is common under PPP arrangements that construction risk is passed to the private sector / operator. Consequently, there is often no contractual obligation by the grantor to pay cash until it accepts handover of the completed asset. Therefore, a financial liability only exists at the date of handover / completion.

QAO recommends updating the illustrative examples to accrue a liability (non-financial) during construction (consistent with paragraph B42). Then, on completion when the contractual obligation arises, the accrued liability is reclassified as a financial liability.

12.2 Round-robin transactions

QAO requests that the AASB include requirements or guidance on “round robin” transactions within a service concession arrangement. These arrangements may also be referred to as securitisation arrangements.

An example is a payment by the operator to use the grantor’s land to provide the services under the service concession arrangement. The effect of this transaction is to increase the payments by the grantor to the operator.

QAO believes that the obligation for the operator to make payments is not a financial liability of the operator, or receivable by the grantor, and that these transactions would normally be offset when determining the liability of the grantor.

12.3 Application to not-for-profit private sector organisations

Some respondents to the exposure draft ED261 questioned whether it would apply to not-for-profit private sector organisations. Respondents include HoTARAC (responses to questions 1 and 8) and Institute of Public Accountants (response to question 1.)

Examples respondents gave included:

- social housing providers
- a church or charity engages an operator to build and run an aged care facility in exchange for either a financial liability or a right to charge tenant of the facility.

The standard specifically states that it applies to public sector entities. Does the AASB intend not-for-profit private sector entities to apply the draft standard by analogy?

If the draft standard is to be applied by analogy, it can be argued that these arrangements provide a public benefit, and therefore a public service, and consequently they are potentially within the scope of the draft standard. Alternatively, it can be argued that the entities arranging these services (the grantors) are not public sector entities, and therefore the services are not public services, and consequently they will not be within the scope of the draft standard.

QAO requests that the AASB clarify whether not-for-profit private sector entities should apply the draft standard by analogy.