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19 July 2019

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.

14 August 2019

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

Dear Kris

Fatal Flaw Review—AASB 2019-X: *Amendments to Australian Accounting Standards – Implementation of AASB 1059*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to provide comments on the fatal flaw review of AASB 2019-X *Amendments to Australian Accounting Standards – Implementation of AASB 1059* (the Standard). The views expressed in this submission represent those of all Australian members of ACAG.

ACAG supports the amendment to AASB 16 to provide a practical expedient to grantors of service concession arrangements so that AASB 16 does not need to be applied to assets that would be recognised as service concession assets under AASB 1059.

We are pleased that the AASB is considering amendments to the transitional provisions of AASB 1059. However, we do not believe that the proposals will address service concession arrangements where existing assets have been contributed by the grantor.

For these situations, the amount of the proceeds received is not linked to the current replacement cost (CRC) of the asset. The asset already exists, and the proceeds are linked to the operator's earning potential of the asset. For example, for toll roads, the proceeds are linked to the amount of the tolls and the length of the service concession offered.

Therefore, the transition calculation of the GORTO liability, linked to the CRC of the asset (whether apportioned to the length of the service concession arrangement or the length of the remaining economic life of the asset), results in an anomalous outcome.

An alternative interpretation of paragraph C4(c) is that because no service concession asset was initially received where a service concession arrangement is over existing assets, then no liability for unearned revenue is recognised. This approach also does not seem appropriate.

ACAG has not been able to identify any easy solutions, however we present the following suggestion, which draws upon the principles in paragraphs 11-12 when accounting for new service concession arrangements, for the AASB's consideration as a possible solution to address the anomalies highlighted above.

ACAG suggest that the GORTO liability at the date of initial application be calculated based on the following calculation for the total service concession liability:

The CRC at the date of initial application of the service concession asset received (if any), plus or minus the value of any other consideration received from the operator or given by the grantor. x $\frac{\text{Remaining service concession period}}{\text{Total period of the arrangement}}$

The GORTO liability will then be the above total service concession liability amount less any related financial liability.

It may not be possible to identify from the CRC of a self-constructed asset at the date of initial application the portion of the asset that relates to the self-constructed portion (original grant of concession) and the service concession asset received (i.e. the subsequent capital replacements), without applying some sort of retrospective assessment.

To address this issue another possible solution is to permit entities to retrospectively apply the standard on a service concession-by-service concession basis.

We would be happy to discuss possible suggestions to avoid anomalous accounting outcomes.

ACAG appreciates the opportunity to comment and trusts the above comments are useful.

Yours sincerely



Rod Whitehead
Chairman
ACAG Financial Reporting and Accounting Committee



ACT
Government

Chief Minister, Treasury and
Economic Development

Ms Kris Peach
The Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Dear Ms Peach

Kris

Invitation to Comment – Amendments to Australian Accounting Standards – Implementation of AASB 1059

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the fatal-flaw review proposing amendments to AASB 1059 *Service Concession Arrangements: Grantors* (AASB 1059) and AASB 16 *Leases* (AASB 16).

Amendments to AASB 16

Paragraph AusC4.1 is added as follows:

Notwithstanding paragraphs C3 and C4, a public sector entity is not required to apply this Standard to assets previously accounted for under AASB 117 that would be classified as service concession assets in accordance with AASB 1059 Service Concession Arrangements: Grantors. The entity shall continue to apply its existing accounting policy to these assets until AASB 1059 is applied.

Challenge identifying those assets that would be classified as SCAs

HoTARAC observes that the proposed practical expedient is only applicable to arrangements that would be classified as service concession assets in accordance with AASB 1059. To apply this practical expedient, entities are required to have completed their scoping assessments of arrangements under AASB 1059 despite the standard having been deferred until annual reporting periods beginning on or after 1 July 2020. Given the complexity of the scoping requirements and practical implications of AASB 1059, which resulted in its deferral by 12 months, it is unlikely that all public sector entities will have completed their scoping assessments by 1 July 2019 in order to utilise this practical expedient.

HoTARAC recommends clarifying that the practical expedient can be applied on an asset by asset or arrangement by arrangement basis. This would allow agencies to apply the practical expedient as and when the scoping assessment for AASB 1059 is completed throughout 2019-20.

Clarify how to account for those arrangements where practical expedient is applied

HoTARAC requests that the AASB clarify how those assets to which the practical expedient is applied should be accounted for and presented. Should assets to which the practical expedient is applied be a treated as a separate class of assets for the purposes of presentation and valuation?

Amendments to AASB 1059

Amendments to paragraph C4(c)

HoTARAC supports the proposed change to the calculation of the Grant of a Right to the Operator (GORTO) liability under the modified retrospective approach, such that the liability is initially measured based on 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 arrangement, rather than relative to the remaining economic life of the service concession asset.

The GORTO liability represents unearned revenue specific to the service concession arrangement, it does not reflect unearned revenue beyond the term of the arrangement e.g. where the grantor continues to benefit from the asset after the service concession arrangement. The unearned revenue from the GORTO liability should therefore be recognised over the period of the service concession arrangement and the proposed changes support this view.

Clarification where existing assets of the grantor are used in the arrangement

C4(c) appears to specifically address GORTO liabilities that arise from the receipt of a service concession asset, but not those that arise from situations where existing assets of the grantor are used, and additional consideration is received from the operator:

“measure a liability representing the unearned portion of any revenue arising from the receipt of a service concession asset under the grant of a right to the operator model at...”

HoTARAC requests clarification over the application of paragraph C4(c) on arrangements where existing assets of the Grantor are used and for which the Grantor has received additional consideration from the operator. An example of this type of arrangement is presented in Illustrative Examples, Example 9 of AASB 1059. In HoTARAC’s view, for these situations, the GORTO liability at inception or on transition should not be linked to the CRC of the asset as the proceeds received bear no economic relationship to the CRC of the asset. The GORTO liability on transition should instead reflect the total proceeds received from the operator, adjusted to reflect the remaining period of the service concession arrangement relative to the total service concession period.

Amendments to paragraph IG10

It is unclear why this decision tree does not include the criteria in AASB 1059 paragraph 2. Our interpretation of AASB 1059 is that an arrangement must first satisfy the criteria of a service concession arrangement in AASB 1059 paragraph 2 before the assets in the arrangement are assessed against the recognition criteria of service concession assets.

Amendments to paragraphs IG13, IE42 and IE43

No comments.

If you have any queries regarding HoTARAC’s comments, please contact Sean Osborn from the New South Wales Treasury on (02) 9228 5932 or by email to sean.osborn@treasury.nsw.gov.au.

Yours sincerely



David Nicol

CHAIR

Heads of Treasuries Accounting and Reporting Advisory Committee

26 August 2019