

27 July 2015

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

Dear Ms Peach

Kris

**ACAG submission on Exposure Draft ED 261 - Service Concession Arrangements:  
Grantors**

The Australasian Council of Auditors-General (ACAG) would like to express our support for the proposed new Australian Accounting Standard aimed at the recognition and measurement requirements as contained in Exposure Draft ED 261 *Service Concession Arrangements: Grantors*.

ACAG particularly supports the intention of the standard to provide a consistent approach to the recording of service concession assets and liabilities.

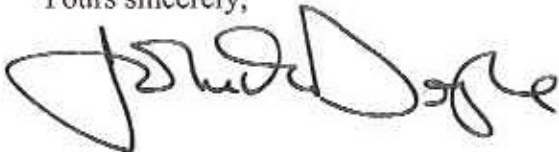
However, ACAG recommends that further clarification of the application of the standard to all public sector entities, the interpretation of control and clearer definitions be included in the standard.

The view expressed in this submission represents that of all Australian members of ACAG.

Please find attached our responses to the specific matters for comment outlined in the Exposure Draft.

The opportunity to comment is appreciated and I trust you will find our feedback useful.

Yours sincerely,



John Doyle

**Chairman**

**ACAG Financial Reporting and Auditing Committee**

## Specific Matters for Comment

### Question 1

The proposed application to all public sector entities is wider than IPSAS 32 *Service Concession Arrangements: Grantor*, upon which the [draft] Standard is based. IPSAS 32 applies to all public sector entities other than Government Business Enterprises (GBE). A GBE is akin to a for-profit public sector entity. The proposed approach is consistent with the AASB's policy of making accounting Standards that require like transactions and events to be accounted for in a like manner for all types of entities, which is referred to as transaction neutrality. Do you agree with the proposed application to all public sector entities? Why or why not?

### Response:

The remit of the AASB is to take IFRS standards for application to for-profit (FP) entities and create standards for not-for-profit (NFP) and government entities.

If the AASB were to create a transaction neutral standard it would force FP entities into a position where they may not be able to comply with other AIFRS standards. Should this standard be extended to the FP sector, ACAG recommends the AASB assess the impact of the proposed standard on IFRS compliance and clarify and specifically address potential compliance issues.

Most service concession assets relate to specialised assets, which generally are measured initially at cost and subsequently at depreciated replacement cost (DRC) in NFP entities. Government business enterprises (GBEs) would experience issues with impairment of service concession assets both individually and within cash generating units (CGUs). Including a service concession asset in the asset base of a CGU which is valued using discounted cash flows will trigger impairment, as the service concession asset will inflate the asset base of the public sector grantor, without a corresponding increase in cash flows in the grantor entity.

The AASB will also need to clarify the order in which these CGU assets attract impairment and the treatment of any subsequent recoupment of impairment decrements, including where the recoupment relates to a service concession asset where the underlying asset is an intangible asset.

As both public and private sector entities can contract using service concession arrangements to provide public benefits, ACAG believes there is merit in the AASB considering application beyond the government to the NFP sector. This will help in ensuring consistent application across the NFP space.

However, ACAG believes that while transaction neutrality is generally desirable, in this instance the concepts in this standard would be difficult to apply in FP entities. ACAG therefore supports the exclusion of GBEs and restriction of the application of the proposed standard to the NFP sector.

**Question 2**

The proposed scope in paragraph 5 applies to arrangements involving a 'service concession asset', which would include intangible assets and land. This is consistent with the scope of IPSAS 32 but broader than the scope of AASB Interpretation 12 *Service Concession Arrangements*. AASB Interpretation 12 applies to 'infrastructure' of a service concession arrangement, which would exclude intangible assets and land. AASB Interpretation 12 is applicable to infrastructure assets that the private sector operator constructed or acquired from a third-party, or to which it was given access by the grantor, for the purpose of the arrangement. Consequently, the intangible assets or land that has been granted by the grantor is outside the scope of AASB Interpretation 12. Do you agree with the proposed scope of the [draft] Standard? Why or why not?

**Response:**

ACAG is supportive of the service concession asset including intangible assets and land which will reflect the total value of the asset to the grantor.

**Question 3.**

The [draft] Standard proposes the specific control concept in paragraph 8(a) that a grantor controls the asset if the "grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them and at what price". This mirrors the control concept in AASB Interpretation 12. The AASB notes that a broader concept of control currently applies in other Australian Accounting Standards. An asset that does not meet the control and regulation definition of this [draft] Standard may still need to be recognised under other accounting Standards. Do you agree with the proposed specific control concept in paragraph 8(a) of the [draft] Standard? That is, applying a narrower concept of control in the [draft] Standard than other accounting Standards. Why or why not?

**Response:**

ACAG recognises the definition of control is narrower than that of other accounting standards. ACAG supports this view, as a definition based on risk and reward is likely to be problematic given the shared allocation of risk and reward for service concession arrangements. ACAG acknowledges arrangements which may not meet this narrower definition of control, would be accounted for under other accounting standards.

ACAG has the following concerns regarding the interpretation of regulating both services to be provided and the price:

1. The AASB should consider additional guidance on the significance of arrangements to provide services to certain classes of users at unregulated prices, and how to exercise judgement in these instances. It may also be useful for the AASB to provide guidance where service concession arrangements also provide for the operator to be compensated for ancillary services such as cleaning and maintenance of the service concession asset, either by the grantor or by another party.
2. There may be circumstances where the regulator or regulatory environment may change, for example the asset is regulated for only part of its life. ACAG encourages the AASB to consider the accounting implications and provide guidance where a

change in the regulatory environment, or the terms of the service concession contract results in the recognition or derecognition of an asset.

3. ACAG understands it is the intention of the AASB that control of a service concession asset is derived from regulation of the price, not from the fact the grantor is a public sector entity that is related to the third-party price regulator. In other words, price regulation can be achieved regardless of whether the third-party regulator is related to the grantor. However, ACAG does not consider that this principle is clear in the exposure draft and recommends that this principle is clearly articulated in the proposed standard to avoid any misinterpretation.

The second control criteria in para 8(b) requires that the “*grantor controls any significant residual interest in the asset at the end of the term of the arrangement*”. ACAG recommends the AASB defines and/or provides further guidance on what is meant by “significant residual interest” as this will be a key judgement area when applying the definition. Given the long term nature of service concession arrangements, it may be impractical to estimate the value of an asset, particularly an intangible asset, in 20 or 40 years when the asset returns to the grantor.

ACAG recommends the illustrative example provided in the proposed standard includes an analysis of the control concept, including the judgements made about regulation.

#### Question 4

**The [draft] Standard proposes that the grantor initially measures the service concession asset at its fair value unless the service concession asset is an existing asset of the grantor. Do you agree that the proposed requirements and guidance appropriately explain the application of fair value to a service concession asset? Why or why not?**

#### Response:

The information contained in the draft standard requires the recognition of a service concession asset at fair value and in paragraph AG31 appears to require the use of the cost approach to fair value. For specialised assets, DRC is likely to be appropriate. There may however be instances where for non-specialised assets, an income approach would be used and therefore there may be differences in the application of fair value under AASB 13 ‘Fair Value Measurement’ upon application of the proposed standard.

Where service concession assets are not currently reported in the grantor’s financial statements and fair values are not readily available, there will be significant valuation costs and potentially issues with the grantor getting access to asset records to determine fair value.

In some instances, the grantor may not have access to fair value information, particularly where an operator constructs an asset for a right to earn revenue from a third party, or earns revenue from the grantor which represents both asset and service payments which are inseparable. ACAG believes it would be useful to explore instances where it is not feasible to impute or determine a reliable measurement in relation to a service concession asset within the proposed standard.

Where the service concession asset relates to an intangible asset, ACAG believes it would be useful for the AASB to specifically clarify arrangements regarding their initial valuation. Fair value is not generally an option for intangible assets under the existing framework as few such assets have a market value. It is possible a perverse outcome may arise where the valuation of a service concession asset uses a basis that could not have been used in valuing the underlying asset.

ACAG recommends the illustrative example provided in the proposed standard includes an explanation of how the fair value of the road was determined, including whether a cost approach or income based approach was used.

#### Question 5

The [draft] Standard proposes that:

(a) where the grantor recognises a service concession asset, the grantor also recognises a liability measured at the same amount as the service concession asset adjusted for other consideration between the grantor and operator. Do you agree that the proposed requirements and guidance appropriately measure the consideration between the grantor and the operator of the service concession arrangement? Why or why not?

(b) the measurement of a service concession liability using the 'financial liability model' and/or the 'grant of a right to the operator model'. Do you agree with the proposed models? Why or why not? If you do not agree with the proposed models, what alternative model(s) would you recommend?

#### Response:

ACAG supports the recognition of a liability measured at the same amount as the service concession asset, avoiding day one gains impacting on the operating result. To avoid conceptual doubt, ACAG supports prescribing the recording of the liability within the standard.

ACAG supports the proposed measurement of a service concession liability using the financial liability model and/or grant of a right to the operator model. The proposed measurement categories cover the current scenarios for service concession arrangements.

In Illustrative Example 2 under the 'grant of a right to the operator model', it is not clear whether the grantor's constant revenue recognition in Years 3-10 is due to the expectation of constant vehicle numbers and therefore constant revenue stream for the operator (paragraph IE23), or due to the expectation of even provision of access to the service concession asset (paragraph IE26). ACAG believes a clarification on how revenue is recognised would be useful.

#### Question 6

The [draft] Standard proposes that the grantor account separately for each part of the total liability recognised for the service concession arrangement where the arrangement involves the grantor both incurring a financial liability and granting a right to the operator. Do you agree that the [draft] Standard provides appropriate guidance for the separate recognition of the liability? Why or why not?

Response:

ACAG supports the requirement to initially recognise the same total liability as the service concession asset as this avoids any doubt over the total measurement.

ACAG believes additional guidance is needed on how to allocate the fair value of an asset in hybrid arrangements between the financial liability and grant of a right to the operator liability components.

Illustrative Example 3 includes a 50:50 split between the liability models. ACAG believes users would benefit from the inclusion of a more complex example of a hybrid arrangement. ACAG also believes it would be useful for the AASB to provide guidance on the accounting when, depending on the actual toll revenue earned by the operator, the actual proportion of revenue of the operator differs from the original 50:50 expectation from year to year (e.g. 75:25 in Year 3, 60:40 in Year 4, etc.).

**Question 7**

**IPSAS 32 includes guidance in relation to other revenues in paragraphs AG55 – AG64. Other revenues relate to compensation by the operator to the grantor for access to the service concession asset by providing the grantor with a series of pre-determined inflows of resources. The [draft] Standard does not include this guidance, for the reasons outlined in paragraphs BC27 and BC28. Do you agree that guidance on the accounting treatment of other revenues from a service concession arrangement is not required? Why or why not?**

Response:

ACAG supports accounting for other revenues by not-for-profit entities in accordance with the proposed AASB '10XX Income of Not-for-Profit Entities'. ACAG believes this approach will lead to consistent accounting treatment.

ACAG believes it would be useful for the draft standard to include guidance that other standards should be applied if they are relevant to the income. For example, where there is a contractual right to the income stream, AASB 15 'Revenue from Contracts with Customers' may be more appropriate than AASB 10XX.

ACAG also believes that if the application of either or both of the proposed revenue recognition standards is delayed, the AASB should reconsider the proposed application date of this standard.

Whilst BC27 lists a few examples of revenue items for the grantor, ACAG recommends the AASB provide guidance on how a grantor should recognise and measure debt refinancing gains (when they are shared between the operator and grantor).

**Question 8**

The [draft] Standard includes defined terms in Appendix A. Do you agree that the proposed defined terms in Appendix A appropriately explain the significant terms in the [draft] Standard? Why or why not?

In particular, do you agree with the proposed definition of a ‘public service’ as a “service that is provided by government or one of its controlled entities, as part of the usual government function, to the community, either directly (through the public sector) or by financing the provision of services”? Why or why not?

Are there additional terms that should be defined in Appendix A to assist application of the [draft] Standard?

Response:

ACAG supports including a definition of a ‘public service’. However, ACAG has concerns regarding the proposed definition, in particular:

- (a) “*service that is provided by government or one of its controlled entities*”- this wording would scope out universities that are not controlled by the government. Some universities are directly controlled by (and are consolidated into) government. However in most jurisdictions universities are set up under their own acts and are controlled by independent senates, councils or trustees. ACAG recommends further clarification on whether and in what circumstances universities and other NFP entities are intended to be within the scope of the proposed standard.
- (b) “*service provided as part of usual government function*” – usual government function will change over time and depending on government philosophy. ACAG believes this will potentially lead to application issues where the concept of ‘usual government function’ becomes increasingly difficult to define. Increasingly government commissions its services to the private sector. A few years ago ports, ferries, electricity, prisons and detention centres were all government services. Now these services are provided wholly or partially by FP private sector operators. Hence an issue arises that what may be considered a service concession asset today may not be in the future. Jurisdictional interpretation inconsistencies may also arise depending on differing government approaches, including differing budget and policy measures.
- (c) “*community*” – this term is open to interpretation. For example:
  - it is difficult to determine whether this incorporates inter/intra government services which may ultimately be a service to the general public.
  - services provided to a subset of the community, rather than the whole community. Are these intended to be captured?
 ACAG recommends additional guidance on this term is provided.
- (d) “*public service*” – this term in the draft standard is different from that in Interpretation 12 Service Concession Arrangements, which uses ‘*services to the public*’. This inconsistency may lead to differences in the interpretation of what a service concession asset is for the purposes of these standards. This terminology is fundamental to the intended scope of the new standard. ‘*Services to the public*’ may be delivered by private and public sectors, FP and NFP entities alike. Even ‘Public services’ traditionally delivered by government are increasingly being delivered by the private sector FP and NFP entities.

ACAG recommends the definition of a “grantor” requires clarification when a Minister or Treasurer grants the access to the service concession asset to the operator via signing the contract. There are jurisdictional differences with how Minister’s transactions are recognised and recorded.

ACAG’s interpretation of the “operator” definition, together with the “service concession arrangement” and “public service” definitions, is that only private sector operators will be captured by the standard. However, the standard as drafted is not explicit in this regard. The following example demonstrates the potential for differing interpretations.

*A government enters in to an agreement with a private sector consortium where:*

- *a school is financed and constructed by the consortium*
- *the consortium is responsible for maintaining the school, and cleaning the school for the next 20 years*
- *the government is responsible for delivering education*
- *payment for the construction of the school, maintenance and cleaning is over the next 20 years.*

In this example, significant interpretation is required as to whether the consortium is providing a public service, and therefore whether such an arrangement would be captured by the proposed standard. Would the exclusion of the key public service, being delivery of education, preclude such an arrangement from being captured? Or are ancillary services such as cleaning considered to be a public service, if delivered in relation to an asset such as a government school? Alternatively, is making the school infrastructure available (through its construction) sufficient for the entire arrangement to be captured by the proposed standard?

ACAG recommends that the standard and related guidance covers these issues more explicitly.

ACAG considers other definitions provided within the draft standard are sufficient.

### Question 9

**The [draft] Standard includes examples on the accounting treatment of lifecycle costs of a service concession asset that might be a benefit to the grantor. Lifecycle costs are costs incurred by the operator to maintain the asset during the service concession period. An example of a lifecycle cost is the cost to periodically resurface a road during the operating and maintenance phase of the service concession arrangement. Do you agree that the examples in the [draft] Standard provide sufficient guidance on the accounting treatment of lifecycle costs of a service concession asset that might be a benefit to the grantor? Why or why not?**

#### Response:

ACAG agrees the example provides sufficient guidance on the treatment of lifecycle costs. The costs are componentised and depreciated according to other accounting standards. However, users may benefit from a more complex example where the replacement component is not easily separable from the whole asset. For example, system assets are generally depreciated as a single item as it is difficult to define the boundaries.



**Question 10**

**Do you agree with the proposed disclosures for a service concession arrangement set out in paragraphs 30 to 32? Why or why not?**

**In particular, do you agree with the proposed disclosure of paragraph 31 applying individually for each material service concession arrangement or in aggregate for each class of service concession arrangements?**

**Response:**

ACAG supports the disclosures required by paragraph 31 as all key features of these arrangements which would be of interest to users are required to be disclosed.

ACAG believes the requirements in paragraph 32 in relation to disclosures are unclear and may result in misinterpretation. Does the AASB intend for disclosures only about material service concession arrangements? Or does the AASB want disclosures about individually significant service concession arrangements as well as aggregated information about total service concession arrangements? ACAG interprets paragraph 32 to mean, where material service concession arrangements must be separately disclosed, aggregated disclosures are not necessary. ACAG recommends this paragraph is revisited to ensure the AASB's intention is clear. Aggregation issues may arise given that each arrangement contains its own specific contractual obligations making it difficult for grantors to aggregate the disclosures to present information that is relevant and easily understood by users.

**Question 11**

**In relation to the proposed application date and transitional requirements:**

**(a) Do you agree the proposed application date is appropriate, and if not, what further considerations should be taken into account to determine the application date of the [draft] Standard?**

**(b) Do you agree with the proposed transitional provisions set out in paragraph 33? Why or why not? The transitional provisions permit the grantor to apply the [draft] Standard retrospectively or elect to recognise and measure the service concession asset and liabilities at the beginning of earliest period for which comparative information is presented using deemed cost.**

**Response:**

ACAG supports the proposed application date of 1 January 2017. ACAG recognises there will be significant effort required to review current service concession arrangements, particularly long standing arrangements for which grantors have insufficient asset and valuation records. If the application date is changed to 1 January 2018, ACAG recommends early adoption of the standard is permitted.

The transitional provisions for deemed cost includes guidance on accounting for the difference between the fair value of an asset and the liability as an adjustment to equity under the financial liability model.

However, the transitional provisions for deemed cost under the grant of a right to the operator model are not clear on the measurement of the liability.

Does the AASB intend that the liability should be equal to the deemed cost i.e. the fair value of the service concession asset as at the beginning of the comparative period? If this is the case, why does paragraph AG65(b) include the wording 'adjusted to reflect the remaining period of the service concession arrangement'?

Or is the AASB's intent that the liability should be the remaining value at that date of the deferred revenue liability determined as at the inception date of the service concession arrangement? If this is the case, should this be calculated on a straight-line basis, the substance of the transaction or another method?

If the AASB contemplates that the value of the asset and the liability on transition may be different, ACAG recommends a statement that any difference in applying deemed cost should be recognised in equity under the grant of a right to the operator model, similar to the financial liability model.

ACAG believes users would benefit from an example on how to apply these transitional provisions.

**The AASB would particularly value comments on the following:**

**12 Whether:**

**(a) there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including any GAAP/GFS implications?**

**(b) overall, the proposals would result in financial statements that would be useful to users?**

**(c) the proposals are in the best interests of the Australian economy?**

Response:

ACAG supports the development of an accounting standard for service concession arrangements from a grantor perspective. The proposals will result in information which is useful to the users of grantors' financial statements, reflecting the substance of service concession arrangements.

**13 Unless already provided in response to the matters for comment 1 – 12 above, the costs and benefits of the proposals relative to the current Australian Accounting Standards, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.**

Response:

ACAG believes the proposals in the draft standard are likely to result in a significant increase in costs for both preparers and auditors.

For example additional costs will be incurred when:

- reviewing complex service concession arrangement contracts
- re-negotiating service concession arrangement contracts
- determining the fair value of the service concession asset on transition. Both the transitional provisions of retrospective restatement and deemed cost will result in grantors needing to obtain information to determine the fair value of the asset. This may be difficult if the grantor does not have access to information required to determine a reliable fair value measurement
- auditing the accounting for and disclosure of service concession arrangement(s) by the grantor. The proposed standard requires the grantor to exercise a great deal of professional judgement and estimation (e.g. determining control, fair value of the asset, calculation of the liability, etc.) when accounting for the service concession arrangement. These judgements and estimates will need to be audited.