



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*

ED 261 Service Concession Arrangements: Grantor

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the Exposure Draft: *ED 261 Service Concession Arrangements: Grantor*.

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee is comprised of the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

HoTARAC strongly supports the AASB's project to develop an accounting standard and guidance on how grantors should account for service concession arrangements. HoTARAC recognises the significant hard work and deliberation that has gone into developing the accounting standard proposed in ED 261.

Members of HoTARAC hold a range of views about whether the AASB's proposed approach to grantor accounting for service concession arrangements is the best approach and will lead to relevant, reliable and understandable information in the financial statements. However, all jurisdictions agree that if the AASB proceeds with the proposed approach, some improvements, additional guidance and clarifications will be needed.

In our submission HoTARAC:

- recommends the mandatory effective date be delayed, while still allowing early adoption, to ensure preparers have sufficient time to identify all relevant arrangements and to gather all necessary information; and
- requests additional guidance to ensure the control criteria, definition of public services and transitional provisions can be applied consistently and appropriately.

If you have any queries regarding HoTARAC's comments, please contact Jeanne Vandenbroek from NSW Treasury by phone on 02 9228 5233 or by email, jeanne.vandenbroek@treasury.nsw.gov.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'David Nicol', written in a cursive style.

David Nicol

Chair

Heads of Treasuries Accounting and Reporting Advisory Committee

10 August 2011

General Comments

As noted in our cover letter, members of HoTARAC hold a range of views on Exposure Draft 261 *Service Concession Arrangements: Grantor* (ED 261). In particular NSW Treasury and Queensland Treasury would prefer the AASB to adopt a more conceptual and principles based approach than the proposed control model. In contrast Victoria and the ACT agree with the proposed approach. Other jurisdictions support the views presented in this submission that additional guidance would be required for the proposed approach to be practically applied, but note that the proposed standard has a limited applicability for them.

NSW Treasury has submitted a separate response, as well as supporting this HoTARAC submission.

All members of HoTARAC agree that if the proposed standard is adopted, additional guidance will be required to ensure ED 261 is applied consistently and in line with the principles the AASB has described. In our submission we have used examples to help illustrate what we perceive to be ambiguities in the proposed standard and our concerns with applying it in practice. HoTARAC acknowledges that guidance should be general and principles based. However we believe further illustrative examples would be appropriate in explaining certain principles.

Due to the relatively short comment period for this ED HoTARAC has not been able to fully assess the impact of the proposed standard on existing and proposed arrangements. HoTARAC is willing to work with the AASB to identify and assess examples of arrangements to help any further decision making.

Specific Matters for Comment

- 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?***

HoTARAC generally agrees with the concept of transaction neutrality and supports the proposal to make the standard transaction neutral. Therefore HoTARAC agrees the proposed standard should apply to for-profit public sector entities as well as not-for-profit public sector entities.

However HoTARAC notes that although the AASB seeks to provide accounting standards that are transaction neutral, the proposed standard applies to the public sector only. This may lead to inconsistent accounting compared to arrangements in the private sector and a departure from transaction neutrality. Some examples of similar arrangements in the private sector include:

- Arrangements in which a University engages an operator to build and operate student accommodation in exchange for the right to charge the tenants¹.
- A not-for-profit non-government organisation (such as a church or charity organisation) 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.
- An IT solutions provider undertaking a build own operate transfer (BOOT) arrangement to transfer IT equipment and software to another company.

Currently such arrangements are accounted for in a variety of ways, including by applying lease accounting principles. If such arrangements are to be excluded from the scope of the proposed standard, it is appropriate that the AASB explain why.

We understand the AASB proposes limiting the scope to public sector entities partly because of uncertainty whether preparers who comply with the proposed standard could continue to include a statement of compliance with IFRS in their financial statements in accordance with paragraph 16 of AASB 101 *Presentation of Financial Statements*. HoTARAC recommends the AASB more completely assess and explain the impact of the proposed standard on IFRS compliance so that for-profit entities can comply with the proposed standard and include the statement compliance with IFRS where appropriate. In doing so the AASB should confirm whether revenue recognition under the proposed standard would be consistent with AASB 15 *Revenue from Contracts with Customers*.

¹ As discussed in our response to Question 8, whether student accommodation is considered a public service is open to interpretation and whether universities are considered "government or one of its controlled entities" is unclear.

- 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 2 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?**

HoTARAC agrees that a service concession asset should not be restricted to infrastructure assets and agrees with the broader definition.

- 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?**

Members of HoTARAC have a range of views on whether the proposed control model is appropriate and will achieve the objectives of this ED. However all members of HoTARAC agree that, if the proposed control model is retained, additional guidance would be necessary.

HoTARAC recommends the AASB provide additional guidance including:

- Illustrative examples to show how the control criteria should be applied. The majority of questions HoTARAC members have received from preparers have been about how the control criteria will be applied to their arrangements, which often do not fit neatly into the control criteria of paragraphs 8 and 9. HoTARAC members would be willing to work with the AASB to provide practical examples to help the AASB to inform their illustrative examples.
- In paragraph 8 the phrase “...the grantor controls the asset if, and only if...” indicates that assets that do not meet the control criteria are not controlled by the grantor. However, paragraph BC17 implies that broader concepts of control may result in the asset still being recognised, but under another standard. Further paragraph AG8 considers the elements in paragraph 8(a) to be “a means by which a grantor can demonstrate control” rather than a conclusive set of criteria.

HoTARAC recommends the AASB reconsider the wording in paragraph 8 and related guidance to better explain how the proposed control model interacts with concepts of control in other standards and whether all the elements of paragraph 8 must be met to demonstrate control.

- How preparers should account for arrangements which are service concession arrangements according to the definition in Appendix A, but that do not meet the control criteria in paragraphs 8 and 9?

Based on discussions with preparers, it is not clear whether the proposed standard could be applied by analogy, because the scope would specifically exclude such transactions. In many cases agencies are likely to continue with the current approach in their jurisdiction. To avoid jurisdictions applying different approaches HoTARAC recommends the AASB provide clearer guidance about what other standards they expect to apply if the arrangement does not meet the control criteria in paragraphs 8 and 9.

The ED suggests the risks and rewards approach (for example lease accounting), rights and obligations approach (for example AASB 15 by analogy) or the control approach (for example AASB 10 by analogy) are considered inappropriate to apply to these arrangements (BC8-BC17). Currently jurisdictions generally apply a risks and rewards approach to account for service concession arrangements and it not clear whether this approach will still be considered appropriate for arrangements which do not meet the control criteria.

The AASB could more clearly explain the reasons for choosing the proposed control model over the alternative approaches described in BC8-BC17. In particular, more explanation as to why the risks and rewards approach is not considered appropriate would help preparers determine whether it would be appropriate in cases where the control criteria are not met.

- In our opinion the application guidance paragraphs relating to the existence of a third-party regulator are not sufficiently understandable and should be redrafted. Ideally this would include reordering and clarifying AG11 – AG13.

Paragraph AG 11 states that third-party regulation *“...removes the ability of the operator to regulate the price and, for the purposes of paragraph 8(a), the pricing of the services is considered to be set implicitly by the grantor.”* This seems to be a clear presumption that third-party regulation of prices will generally lead to control by the grantor, and is further supported by paragraph AG12, which makes it clear third-party regulation need not be referred to in the contract.

This contrasts with paragraph AG13, that states where the government or its agency has the power to regulate the behaviour of entities operating in certain sectors of the economy *“For the purposes of paragraph 8(a), such broad regulatory powers do not constitute control.”* and *“... the term “regulate” is intended to be applied in only the context of the specific terms and conditions of the service concession arrangement”.*

It is not clear why paragraph AG 13 results in an outcome that is different to the proposed rule that third-party regulation results in control by the grantor, or what principles are being applied in making this distinction.

We would expect guidance would be particularly useful for the following types of arrangement:

- natural monopolies, such as electricity distribution and ports operations, where an industry regulator is, by default, the regulator of the concession arrangement; and
 - third-party regulators that are responsible for industry regulation, but which regulate individual assets, entities or areas based on an established pricing methodology.
- Accounting for arrangements that meet the criteria only part way through the arrangement or where the arrangement ceases to meet the control criteria during the arrangement term. This could occur for example, where the grantor or third party regulator determines price regulation needs to be introduced, users of the asset request the government or regulator introduce price regulation or the government decides that prices no longer need to be regulated.

HoTARAC notes the guidance in AG23 in respect of assets that no longer meet the control criteria. However, additional guidance is needed in relation to:

- Circumstances where price regulation is introduced which leads to the service concession asset meeting the control criteria in paragraph 8 and 9 for the first time
 - How to account for the corresponding liability where the control criteria are met for the first time or no longer continue to be met.
- Determining what constitutes a "significant residual interest" (paragraph 8(b)). For example:
 - Whether the "estimated current value" (paragraph AG14) includes an asset's service potential as well as its economic potential.
 - The reference for judging "significance" i.e. whether the residual interest should be compared to the current fair value of the asset to determine whether it is significant.
 - How the concept of "*significant residual interest*" should be applied in long term arrangements. For example, in the case of a 99 year arrangement where the operator's practical ability to sell or pledge the asset (AG14) is restricted, but the estimated "current value of the asset" (AG14) may be considered insignificant given the time value of money (assuming the service potential of the assets are not taken into account).
 - Determining "estimated current value". This is a new term and new concept. There is a risk the term will be confused with existing similar concepts in accounting standards such as residual value in AASB 116 or AASB 117. HoTARAC recommends the AASB provide additional guidance on defining estimated current value, including clarifying the guidance in AG14 to make it clearer that the residual interest is determined at inception. For instance:

"the residual interest in the asset is the estimated current value of the asset, measured as at the inception of the arrangement, as if it were already of the age and in the condition it is expected to be in at the end of the period of the service concession period."

We are aware that some preparers have interpreted the proposed guidance as requiring predictions of a future value which would then be discounted to present value.

Alternatively the AASB could consider using an alternative term that is already in use and readily understood.

- The relationship between the concepts of “significant residual interest” and “whole of life”. HoTARAC is aware some preparers are interpreting the “second arm” of the control criteria (i.e. whether the grantor either controls “any significant residual interest” or it is a “whole-of-life” arrangement) in different ways and recommends the AASB consider redrafting the criteria.

One interpretation is that paragraph 8(b) deems a grantor controls a service concession asset when it controls *any* significant residual interest. Therefore where there is no significant residual interest the control criteria is considered met. For example, in a 30 year concession arrangement for an asset with a 35 year useful life, the estimated current value of the asset might be considered insignificant, meaning there is no significant residual interest. Assuming the criteria in paragraph 8(a) are also met, the grantor is considered to control the service concession asset. In this interpretation paragraph 9 can be seen as clarifying the requirement in paragraph 8(a) rather than adding a new requirement.

However, some members of HoTARAC and other preparers have interpreted the control criteria to be met only where a significant residual interest exists *or* where there is a “whole-of-life” arrangement. For example, in a 30 year concession arrangement for an asset with a 35 year useful life, the estimated current value of the asset might be considered insignificant therefore paragraph 8(b) is not met. In addition the arrangement is not for the entire useful life of the asset thus it would also fail the control criteria in paragraph 9. Such an interpretation would lead preparers to conclude the service concession asset is not controlled by the grantor. This interpretation is supported by the inclusion of paragraph 9 which implies an either/or approach.

HoTARAC recommends the AASB redraft paragraphs 8(b) and 9:

- To clarify how the significant residual interest concept should be interpreted and applied in relation to the control criteria, in particular whether the control criteria are considered met if there is no significant residual interest
 - Replace paragraph 9 with guidance that makes clear how the control criteria applies to “whole-of-life” arrangements.
- How to apply the concept of future economic benefits and service potential where the grantor is a for-profit entity (paragraph AG27-AG29). Although the proposed standard will apply to for-profit public sector entities, this guidance appears to cater only for not-for-profit entities. HoTARAC notes that there is a broader challenge in accounting for public sector assets given that a for-profit entity as a grantor may not consider the public service potential of the asset as a benefit flowing to them, although the state (at a consolidated level), being not-for-profit, would consider the service potential to be an economic benefit flowing to it.

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?

HoTARAC agrees with the proposal to initially measure service concession assets at fair value.

However, HoTARAC recommends the AASB provide guidance on how to apply AASB 13 *Fair Value Measurement* to service concession assets to ensure the proposed standard and AASB 13 can be applied consistently. Such guidance should address:

- The most appropriate valuation methodology for public sector and not-for-profit assets, especially in the absence of an active market.
- Whether fair value should include borrowing costs, in particular where not-for-profit public sector entities do not capitalise borrowing costs in accordance with AASB 123 *Borrowing Costs*.
- How to account for economic obsolescence in the determination of fair value.

HoTARAC notes this is a broader issue about how to apply AASB 13 to not-for-profit and public sector assets rather than an issue specific to service concession assets. We understand the AASB is pursuing a project to provide not-for-profit guidance to AASB 13 and requests the AASB prioritise this project to ensure preparers can value their service concession assets appropriately and consistently.

HoTARAC also recommends the AASB clarify how to account for service concession assets where their fair value cannot be reliably measured. In particular preparers are concerned about their ability to reliably measure the fair value of assets as they are constructed (i.e. WIP) (paragraph AG30) and to obtain sufficient appropriate audit evidence to support the valuation. Grantors will most likely be able to obtain information about historic cost from operators. Therefore HoTARAC recommends the AASB clarify whether historic cost would be an appropriate approximation of fair value for the purposes of the proposed standard. However, HoTARAC notes concerns about whether such historical cost information would be capable of being audited if it is based on information from the operator.

HoTARAC also notes that existing service concession arrangement contracts may not give the grantor access to sufficient information about the components of the infrastructure to determine a fair value of auditable quality. We understand that in cases where such contracts cannot be renegotiated (or where the costs of renegotiating the contracts are prohibitive) and as a consequence the fair value of the asset cannot be reliably measured, the asset will be not recognised because it does not meet the recognition criteria in AASB 116 or AASB 138 (AG27).

HoTARAC notes that where the consideration (i.e a financial liability and/or grant of a right to charge users) is not able to be separated between the asset and the service component (AG35-AG38), the fair value of each component will be difficult to estimate. This is especially likely in a right to charge

users model. The services and assets in service concession arrangements are unique and finding comparable services and assets against which to estimate their fair value is likely to be problematic.

HoTARAC recommends the AASB clarify whether an existing asset of the grantor should be measured at the book value immediately prior to reclassification when reclassified as a service concession asset.

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?

HoTARAC agrees with the proposal to recognise a liability and to measure it at the fair value of the service concession asset, adjusted for other consideration. This recognises that in substance these are exchange transactions.

However, as discussed in our response to question 7, HoTARAC recommends the AASB provide additional guidance on how to account for the grantor's obligations in service concession arrangements where the service concession asset is an existing asset of the grantor.

(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?

HoTARAC agrees with the AASB's proposal to differentiate between a financial liability model and a grant of a right model. This is consistent with how the economic and social objectives of the arrangements are considered and understood by those making decisions about the arrangements. As discussed above, the members of HoTARAC have a range of views on the appropriateness of the control model and the recognition of the financial liability or unearned revenue is intrinsically linked to the recognition of the asset.

HoTARAC notes that the unearned revenue recognised in a "grant of a right" model appears to be a balancing item. HoTARAC recommends the AASB include a clearer explanation of what this unearned revenue liability represents in the application guidance and/or the basis for conclusions. This would help preparers interpret the requirements, especially when trying to apply them to new and unusual arrangements. Such an explanation would include a description of the nature of the liability and why the measurement of the liability is different for service concession arrangements that involve an existing asset of the grantor or an upgrade to an existing asset of the grantor as opposed to a newly constructed asset.

The grant of a right model applies where the operator is granted a right to earn revenue from third-parties (paragraphs 23-25). HoTARAC recommends the AASB consider broadening the scope to

situations where the operator instead charges the grantor for services provided, rather than third-parties. For example a public hospital built and operated by the operator where the operator charges the grantor based on the volume of patients treated and a pre-agreed price list. In this case the grantor does not have a contractual obligation to pay cash or another financial asset, nor does it grant a right to charge third party users (paragraph 23), and therefore does not appear to fall under either model.

As discussed in questions 5(a) and question 7, HoTARAC recommends the AASB provide additional guidance on how to account for service concession arrangements where the asset is an existing asset of the grantor.

HoTARAC also requests the AASB provide guidance about how to apply the proposed revenue recognition to the grant of a right to the operator model (paragraph 23-25 and AG51-AG53) for a very long term arrangement. For example, the grant of a right for 99 years where the criteria in paragraph 8 are met and the operator is restricted in its ability to sell or pledge the asset?

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?*

HoTARAC agrees with the proposal to measure the total liability at the fair value of the service concession asset because it reflects the substance of these arrangements i.e. they are exchange transactions. HoTARAC also agrees with the proposal to account separately for each part of the liability according to whether it is a financial liability or a grant of a right to the operator.

However it may be difficult to allocate fair values to each component. In practice, preparers are likely to determine the fair value of the financial liability by applying financial instruments guidance and the residual will be allocated to the liability under the grant of a right model. As discussed in our response to question 5, HoTARAC is concerned about the unearned revenue portion of the liability being a balancing item and recommends the AASB more fully explain the conceptual basis for the unearned revenue and what the unearned revenue liability represents.

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?*

HoTARAC notes that the requirement in paragraph 29 to apply AASB 10XX does not appear to be appropriate to for-profit grantors in a service concession arrangement and recommends the AASB reconsider this paragraph.

Paragraph BC24 states that "...a service concession arrangement in which a grantor promises to transfer an intangible asset to the operator would not be a contract with a customer within the scope of AASB 15". HoTARAC requests the AASB explain this decision more fully to help preparers understand the principles behind recognising revenue from these arrangements. Potential service concession arrangements often have unique features and preparers will need a firm conceptual basis to apply to each transaction.

HoTARAC also recommends the AASB provide some additional guidance and/or consideration of potential inconsistencies between accounting for service concession arrangements in which the operator builds a new asset and those in which the service concession asset is an existing asset of the grantor. For example where the operator is granted a right to charge users for using an existing asset of the grantor in exchange for upfront cash consideration, paragraph 29 would require the application of AASB 10XX *Income for Not-for-Profit Entities* to this revenue. Under AASB 10XX this revenue may be recognised immediately because any performance obligations are not sufficiently specific to justify deferring the revenue.

In contrast, revenue from a grant of rights where a new asset is constructed would be recognised over the period of the concession, representing the grantor's ongoing obligation to provide the operator with the right to access the asset (paragraphs 23-25 and AG51-AG53). In substance the concession granted is identical, but with different accounting outcomes.

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?*

HoTARAC does not disagree with the individual definitions in Appendix A per se. However, the definitions are dependent on each other and on the control criteria in paragraphs 8 and 9 and it is not easy to understand how the definitions and key requirements relate to each other. This interdependence will lead to difficulties in applying the proposed definitions and scope.

For example the definition of an "operator" includes only operators where the grantor has control of the service concession asset. However, service concession arrangements may involve an asset that is used by an operator to provide public services, but which is not controlled by the grantor. For example where the grantor does not control or regulate the price and to whom the operator must provide the service.

HoTARAC recommends the AASB more clearly distinguish between the recognition criteria for service concession assets and definitions of service concession arrangements, assets and participants.

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?

HoTARAC supports the AASB's efforts to define the concept of public service and recognises this will be amongst the most challenging aspects of the proposed standard to apply.

The proposed definition is drafted broadly and the guidance does not sufficiently explain or justify the proposed definition. There is a risk that this will lead to inconsistent accounting between jurisdictions and even within jurisdictions. For example:

- Universities are neither "government" nor "one of its controlled entities". Further clarification should be provided as to whether it is intended to include universities within the scope of these proposals. HoTARAC recommends the AASB consider using "public sector" instead of "government" in its definition.
- Some services are provided to very specific subsets of "the community" for example, public housing, teacher and defence housing, student accommodation, ports facilities, electricity distribution. Whether or not services provided to these subsets of the community are considered to be "*provided to the community*" is open to interpretation. For example the energy distribution and ports facilities are provided to private companies rather than the public at large.
- Whether the definition would apply to arrangements where the services are provided to the grantor. For example an operator that builds and maintains a public school, but which does not provide the education service for which the school was built (as discussed below).
- Whether the definition would apply to commercial operations such as public car parks (for example for public hospitals and public buildings such as the Sydney Opera House) or child care / after school care facilities on school premises.
- "Financing the provision of services" may capture arrangements with non-government organisations, such as independent social housing providers.
- Further guidance should be provided on how to determine "*the usual government function*". Community expectations of what is a public service changes over time. Political ideologies also evolve and change over time and with each change of government. For example, governments used to provide banks and brickworks. Governments continue to issue and regulate taxi licences. HoTARAC recommends the AASB either provide further guidance or consider excluding the phrase "usual government function" from the definition.
- Service Concession Arrangements tend to have long terms, and whether the community considers those services to be public services may change during the concession term. The proposals should include guidance on when the assessment of a public service is made, at the beginning of the concession or continuously, and the reasons for that approach.

In many cases, the definition of "public services" will require reporting entities to consider a wider range of contractual arrangements than may have been anticipated. This will be the case even if the arrangement is ultimately excluded from the scope of the proposed standard because there is no

asset involved or the asset is not controlled by the public sector. Although this is not a reason to amend the definition, HoTARAC notes that identifying and assessing all those arrangements will be a time and resource intensive process and supports a later mandatory effective date.

HoTARAC also notes that “*public services*” is different to the term “*services to the public*” used in Interpretation 12. This inconsistency is likely to lead to differences between what is considered a service concession arrangement for the purposes of Interpretation 12 and the proposed standard.

For example, we anticipate that some arrangements may not be captured by the proposed standard. It is unclear whether an arrangement in which a contractor builds a school and then maintains it would fall into the standard because the maintenance services could be considered to be a public service because they are part of the usual government function, financed by the government and support the provision of the public service of free education. However, the service is not provided directly to the community and the operator does not use the school to provide the education services (rather the maintenance services are applied to the asset). We note that such an arrangement is considered within the scope of Interpretation 12 from the operator’s point of view.

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

HoTARAC recommends the AASB defines and/or provides additional guidance about what is meant by “privatisation”, “outsourcing” and “service contract” in paragraph 6. There has been significant debate among preparers about how to apply this paragraph and whether arrangements are “outsourcing” arrangements, “privatisations” or a “service contracts” is open to interpretation.

As discussed in our response to question 3, HoTARAC also recommends the AASB consider defining or providing more guidance on the meanings of “significant residual interest” in paragraph 8(b) and “estimated current value” in paragraph AG14.

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?

The illustrative examples sufficiently illustrate how to account for lifecycle costs that represent separable components of an asset and which are certain to occur. HoTARAC notes there is little guidance on how to account for circumstances where a replacement component is not easily separable or where a replacement is not certain to occur. In many service concession arrangements the operator is required to return the asset to the grantor in a specified condition, but is not specifically required to replace components of the asset.

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?

HoTARAC supports an approach to disclosures that avoids disclosure overload, but ensures disclosure of material information that is useful to users of the financial statements. For this reason HoTARAC supports allowing agencies to disclose information for material service concession arrangements or in aggregate for each class of service concession arrangement.

The proposed standard requires a large number of quite specific disclosures in paragraph 31(b) and (c). This approach creates a risk of disclosure overload because the features of service concession arrangements vary and may not be capable of being aggregated in a way that is easy to understand. HoTARAC recommends principles based approach which:

- states the objective of disclosures made under the proposed standard, similar to the objective stated in AASB 15 *Revenue from Contract with Customers* and AASB 13 *Fair Value Measurement*
- requires that to meet the objective of the disclosures, an entity consider all aspects of a service concession arrangement including those listed in paragraph 31(b) and 31(c).

This would ensure all material facts and circumstances are disclosed, but would allow reporting entities sufficient discretion in their disclosures to avoid disclosure overload. This will improve the longevity of the proposed standard, ensuring it remains relevant even as the nature of service concession arrangements evolve.

HoTARAC also recommends the AASB remove paragraph 30 because it is unnecessary. We note the guidance in paragraph AG59-AG61 will be sufficient to remind preparers to comply with other relevant accounting standards, including AASB 101 *Presentation of Financial Statements*.

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?

HoTARAC does not agree with the proposed effective date. A later mandatory effective date is appropriate for service concession arrangements because:

- It may be necessary to renegotiate contracts in order to obtain the information necessary to comply with the proposed standard. For example, in the case of service concession arrangements where the State grants a right to charge users and the operator has significant managerial control, it may be difficult to access information to reliably estimate the fair value of the service concession asset.

- Entities will need sufficient time to identify arrangements that potentially fall under the new standard, assess whether the new standard applies to those arrangements and, where relevant, determine the changes in accounting treatment.

Although we recommend a later mandatory effective date, early adoption should be allowed. This would achieve a balance which would allow those jurisdictions with long-standing service concession arrangements sufficient time to transition to the new requirements, but also provide those jurisdictions with new service concession arrangements with necessary authoritative guidance.

(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.

HoTARAC agrees with the proposed transition relief in the form of allowing partial retrospective application because a full retrospective approach would be impracticable. However, in attempting to understand how the transitional rules will apply in practice, a number of improvements to the drafting are necessary:

- HoTARAC recommends using a term other than “deemed cost”. In trying to interpret the proposed transition requirements we found the term confusing, because the transitional rules replace the initial fair value and not initial cost.
- We did not clearly understand how to calculate a liability at transition for a grant of right to use in accordance with paragraph AG65(b) as discussed below.
- Clarify how to account for any difference between the fair value of the service concession asset and liability under the Grant of a Right model at transition as discussed below.
- There are a number of different interpretations of how the transition provisions would operate in practice and therefore the AASB should consider providing illustrative examples.

HoTARAC recommends the AASB clarify the transition provisions for grant of a right service concession arrangements and explain the reasons for those provisions. HoTARAC members have interpreted the provisions in a number of ways and have different views about the most appropriate approach.

One interpretation is to measure the liability at the same value as the deemed cost of the service concession asset at the transition date. This approach assumes depreciation and revenue recognised pre-transition were identical. For this to be the case:

- the service concession period and useful life of the service concession asset must be identical,
- revenue and depreciation must be recognised in the same pattern,

- the fair value of the asset must be determined using depreciated replacement cost.

However, many service concession arrangements do not meet the above conditions. For example, where the concession term is shorter than the useful life of the asset, or where the pattern of revenue recognition is straight line while depreciation is charged using the diminishing value method. Applying this interpretation, the transition provision may not result in an appropriate estimate of the liability or revenue for the arrangement, for example:

- To the extent the deemed cost at transition exceeds the retrospective liability value, revenue recognised post transition will be inflated, and vice versa.
- Where the useful life of the asset exceeds the term of the service concession arrangement the revenue recognised post-transition will be inflated.
- Where the fair value of the asset at transition date is measured at other than depreciated replacement cost (for example, using an income approach) both the liability and revenue for the remainder of the concession period will not appropriately estimate revenue earned either post or pre-transition.

The alternative interpretation is to measure the liability at transition date by adjusting for revenue already earned. This could be done by assuming the fair value of the asset at transition date is a reasonable approximation of the liability at inception of the arrangement and spreading the value of that liability over the entire concession period to estimate the liability at transition date. This would be more consistent with the substance of the arrangement, especially in cases where the concession term is shorter than the useful life of the asset or where the pattern of revenue recognition does not match the pattern of depreciation of the asset. Were this interpretation to be adopted, more guidance is required about how to account for the difference between the fair value of the asset and the calculated value of the liability at transition date, similar to the guidance in paragraph AG64 for financial liability model service concession arrangements.

General Matters for Comment

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?***

The members of HoTARAC have different views as to whether the proposed standard will result in financial statements that are useful to users. All members agree that if the grantor controls the service concession asset it is appropriate to recognise the asset and a corresponding liability in the financial statements. However, as discussed earlier, jurisdictions differ in their views about whether the criteria to determine whether or not the grantor controls the service concession asset are appropriate.

Some practical concerns raised by HoTARAC members include:

- As discussed in our response to question 4, HoTARAC has concerns about the practical ability to reliably measure the fair value of work-in-progress

- As discussed in our response to question 11, HoTARAC has concerns about the transitional costs where existing arrangements do not contain mechanisms to obtain necessary information for fair value measurement and disclosures.
- Ratings agencies may modify their approach to adjust for the asset and liability recognised under this approach. This would raise concern about whether the information is useful to decision makers.
- The ability to obtain and disclose required information if such information is “commercial in confidence”.
- The accounting under this proposed approach may change the way future public private partnerships and service concession arrangements are negotiated. Members note that while the current off-balance sheet treatment of grant of a right model service concession arrangements does not drive decision making, it is considered to be one of the benefits of this method of delivering infrastructure and services. Further to this, the fact the asset will be recognised and measured on the balance sheet will encourage the grantor to take a more active role in projects they would previously have allowed the operator more managerial discretion.

HoTARAC is uncertain about how the proposed control criteria and revenue recognition matches to GFS treatment. However, we are concerned that for grant of a right model service concession arrangement the revenue will be considered an “other economic flow” and therefore excluded from the net operating balance. In contrast the depreciation charge from the service concession asset will be a “transaction” and therefore included in net operating balance “above” the budget. This would mean that all grant of a right model service concession arrangements will have a net negative result on the net operating balance, which is a key budget aggregate for a number of states.

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.

As noted above, HoTARAC anticipates there will be significant costs to transition to the new standard as it will require, at least in some cases, renegotiating the terms of existing arrangements. In the case of service concession arrangements where we grant a right to users and they have significant managerial control, the grantor may not have access to sufficient information to reliably estimate the fair value of the service concession asset.

Additional Matters not covered above

Illustrative Examples

Although the examples provided illustrate the principles of recognising service concession assets and liabilities under the proposed standard reasonably well, guidance on the following matters is needed:

- Applying the control criteria in paragraphs 8-9 of the proposed standard, including “significant residual interest”.
- Applying the definition of “public services” in Appendix A.
- Transitional requirements

The majority of questions from future preparers have been about these issues.

Modifications to concession arrangements

HoTARAC notes that there have been a number of existing service concession arrangements that have been modified for different reasons. For example, changes are commonly made to concession terms and the revenue sharing provisions. HoTARAC recommends the AASB provide additional guidance on the accounting implications of such modifications on the relevant assets, liabilities, expenses and revenues.

Unusual concession terms

A recent service concession arrangement involved the term of a concession arrangement on one toll road being amended to help the operator fund the building of a second, new and unconnected toll road. The new toll road may not have been possible without the amendments to the concession on the existing toll road. HoTARAC would value additional guidance from the AASB about the appropriate accounting treatment for unusual concession terms, such as this “cross-subsidisation”. In this case a better understanding of how to account for modifications to the service concession arrangements (as mentioned above) and the nature of the unearned revenue liability might help preparers to determine appropriate accounting for unusual concession terms.

Given the relatively short comment period for this ED HoTARAC has not been able to extensively review how the proposed standard would apply to existing and proposed arrangements. However, HoTARAC would welcome the opportunity to work with the AASB to identify and explain unusual arrangements to help inform the AASB’s future decisions.

Unclear or confusing drafting

HoTARAC recommends the AASB consider redrafting aspects of the proposed standard to clarify certain matters, in particular:

- The interaction between paragraph 8 and the definition of “service concession asset” is unclear because paragraph 8 appears to create or duplicate the definition of service concession asset. HoTARAC recommends the AASB replace “The grantor shall recognise as

an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if the grantor controls the asset” with “The grantor shall recognise a service concession asset if the grantor controls the service concession asset.” This would help differentiate between identifying a service concession asset (which may be controlled by either the grantor or operator) and recognition of a service concession asset (which only occurs when the grantor controls the service concession asset). Similarly, HoTARAC recommends the AASB replace “the grantor shall recognise an asset ...” with “the grantor shall recognise a service concession asset ...” in paragraph 9.

- Clarify how paragraph 9 interacts with paragraph 8. HoTARAC understands that paragraph 9 creates an alternative to the second “arm” of the control criteria in paragraph 8 and recommends the AASB reconsider the way the paragraphs are structured to make this clearer. Refer to our response to question 3.
- Paragraphs AG11-AG13 regarding third party regulation. This guidance was difficult to understand and was understood differently by different readers (refer to our response to question 3).
- Paragraphs AG20-AG25 and BC41 address reclassification of an existing asset of the grantor and initial recognition of an upgrade to that service concession asset. HoTARAC recommends the AASB clarify whether the whole asset should be classified as a single service concession asset (i.e. to be consistent with the substance of the asset) or as two separate assets (i.e. to align with the measurement requirements for the newly created improvement and its associated liabilities).
- Paragraph 22 addresses separable components and introduces new concepts of “asset component” and “service component” without explaining what they are. Also, while paragraph 22 introduces these concepts under the heading “Financial Liability Model” the application guidance associated with separating the service and asset component (paragraphs AG35-38) is provided under a different heading.

It is not clear what relationship is intended between these new terms and the requirements in paragraph 20 to allocate payments to finance charges and charges for services.

HoTARAC recommends the proposed standard more clearly articulate the need to identify and separately account for the service and asset components. This should also clarify whether and why this requirement, and the requirement to recognise finance components, is/is not applicable to grant of rights service concession arrangements.

- Paragraph AG65 regarding the transition relief for a grant of a right to the Operator model is difficult to understand. It is not clear whether the intention is to recognise a liability equal to the deemed cost at transition, or to use the deemed cost to estimate the liability by projecting from the inception date (refer to our response to question 11(b)).

- Paragraph IE35 appears to guide preparers to recognise revenue in line with the pattern in which the operator earns toll revenue. This is inconsistent with the proposed standard which requires “... the grantor shall recognise revenue, and ... reduce the liability..., according to the economic substance of the service concession arrangements (paragraph 24)” “... usually as access to the service concession asset is provided to the operator over the term of the service concession asset (paragraph AG52).”

