Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007
Australia

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Exposure Draft ED 261 – Service Concession Arrangements: Grantor

We are pleased to respond, on behalf of PricewaterhouseCoopers, to the invitation by the AASB to comment on the Exposure Draft ED 261, Service Concession Arrangements: Grantor.

We support the AASB undertaking a project on service concession arrangements from the grantor's perspective. We note that the International Public Sector Accounting Standards Board issued a standard on this topic in 2011 with an operative date of 1 January 2014. The existence of the international standard together with diversity in practice across jurisdictions in Australia has raised valid questions as to the appropriate accounting for these arrangements.

We support the broad thrust of the exposure draft in recognising a service concession asset and related liability in the financial statements of the grantor. Practice in Australia at the present time is inconsistent as to the timing of recognition of a service concession asset in the financial statements of the grantor, particularly for those arrangements involving the granting of a right to the operator to earn revenue from third party users of the service concession asset.

We believe the following matters require further consideration by the Board:

- Fair value measurement –the guidance relating to fair value measurement could be enhanced to better guide and explain its application to service concession assets (and indeed many other non-current assets of public sector reporting entities). We do not have a strong view as to whether the additional guidance should be included in a service concessions standard or as an amendment to AASB 13 *Fair Value Measurement*. However, we do believe strongly that the guidance should be developed as soon as possible and certainly no later than the effective date of the new service concessions standard.
- Entities covered by the standard – our preference would be for the Board to establish that revenue (or gains) arising from service concession arrangements are outside the scope of the IFRS 15 *Revenue from Contracts with Customers*, thereby enabling the Board to apply the service concessions standard to all public sector entities. If the Board decides that it would be problematic to establish that this is the case, we would support an alternative approach that would see Government Business Enterprises (GBEs) scoped out of the service concessions standard.
- Transitional provisions – without more explicit guidance we have concerns about their practicality.

Our answers to the specific questions in the Exposure Draft provide more detail on the views expressed above and are included in the Appendix.

PricewaterhouseCoopers, ABN 52 780 433 757
Freshwater Place, 2 Southbank Boulevard, SOUTHBANK VIC 3006, GPO Box 1331, MELBOURNE VIC 3001
T: 61 3 8603 1000, F: 61 3 8603 1999, www.pwc.com.au

If you have any questions on this letter, please contact me on (o2) 8266 0309.

Yours sincerely

Sean Rugers
Partner, PricewaterhouseCoopers

APPENDIX

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?

We agree the ED should be applicable to all public sector entities in order to preserve the transaction neutrality of AASB standards. However, we acknowledge that concerns exist about whether an entity complying with the service concessions standard could claim compliance with IFRSs. Specifically, we understand that some would question whether the ED's proposed treatment of revenue (or gains) arising in service concession arrangements is consistent with IFRS 15.

Our preference is for the Board to assess, and if appropriate determine that revenue (or gains) arising from service concession arrangements are outside the scope of IFRS 15 *Revenue from Contracts with Customers*, thereby enabling the Board to apply the service concessions standard to all public sector entities. If the Board decides that it would be problematic to establish that this is the case and that if it were to try to deal with this matter before it issued the standard the completion date could be significantly delayed, then we would support an alternative approach of scoping Government Business Enterprises (GBEs) out of the service concessions standard.

If the Board decides to pursue the alternative approach, we believe commentary should be provided in the standard, possibly in the Basis for Conclusions, explaining the implications of such a decision for entities scoped out of the standard. For example, the commentary could note that the entities would need to apply AASB 108 in determining appropriate accounting policies. In addition, the commentary could indicate that the Board would expect that in that process the entities would likely refer to the service concessions standard, to determine an appropriate accounting policy for service concession assets, and to the revenue recognition standard, to determine appropriate revenue recognition policies.

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?

We agree with the proposed scope. We see no reason why only those assets within the scope of AASB Interpretation 12 should be subject to the requirements of the proposed standard. We aren't aware of any assets that the proposed standard would apply to that are considered to be categorically in scope of other standards. Moreover, we believe that were they to be excluded from the scope of the proposed standard they would effectively be brought back into the proposed standard's scope by the operation of paragraph 11 (a) of AASB 108.

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?

We believe the control approach is the most appropriate grantor accounting model for service concession arrangements as its focus is on whether the grantor controls the service concession asset, not whether the grantor is obligated to make payments to the operator.

We note the AASB's acknowledgement that application of the mirror concept of control in AASB Interpretation 12 is used in the ED, and is a narrow definition of control when compared to the broader concept of control in other AASB standards. We concur with the definition of control in paragraph 8(a) of the ED. In our view there are greater benefits associated with applying a definition of control that is consistent with AASB Interpretation 12 rather than applying a broader concept. When considering the nature of service concession assets we do not believe that applying the narrower definition would result in a significant difference in application to the transactions that are most in need of the standard.

We encourage the Board to include application guidance in the standard that outlines how the narrow definition of control would be applied. We believe it would be beneficial to include an example addressing how 'regulated pricing' would be interpreted under this definition of control. An asset that could be used in the example is port infrastructure.

We would also encourage the board to include guidance on other considerations that an entity should make when the assessment of control is highly judgemental or is driven principally by the form of the criteria rather than the underlying principles of control. For example, it would be prudent to be explicit that if it was determined that an arrangement was not in the scope of the proposed standard, an assessment under AASB10 or more directly under AASB116 may be necessary.

Finally, we believe the standard should deal explicitly with changes in circumstances. In our view, if circumstances change, entities should be required to reassess whether the arrangement is now within or outside the scope of the standard, and account for any change in accordance with the applicable requirements.

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?

We agree with the proposal that the grantor should initially measure the service concession asset at its fair value unless the service concession asset is an existing asset of the grantor. The grantor will have entered into an exchange transaction with the operator and measuring the asset acquired at fair value will provide the most faithful representation of the value of the service potential now under the control of the grantor. The proposed requirement is consistent with the requirements of AASB 116 *Property, Plant and Equipment* relating to the initial measurement of an item of property, plant and equipment.

We note that the proposed standard defers to AASB 13 *Fair Value Measurement* for guidance in measuring the fair value of a service concession asset. We agree that it is appropriate to refer to AASB 13 for guidance. However, we believe AASB 13 does not contain adequate guidance at present for measuring service concession assets at fair value, particularly when the asset is acquired by transferring to the operator a right to earn revenue from third party users of the service concession asset.

We specifically addressed this issue in a recent PwC publication, *Accounting for Service Concession Arrangements*. The document is accessible at:
http://www.pwc.com.au/assurance/ifrs/assets/Spotlight-Accounting-Service-Concession-Arrangements-Jan15.pdf

A relevant extract from the paper is provided below:

5.2.1 Initial measurement of the service concession asset

Although the AASB, and the IPSASB before it, identified initial measurement of service concession assets held by grantors in service concession arrangements as an issue, we believe it has not been given the degree of scrutiny or level of analysis it warrants. In our view, initial measurement is a critical issue that potentially has broader implications for the measurement of non-financial assets controlled by public sector entities and, possibly, by regulated entities.

IPSAS 32 requires service concession assets to be measured initially at fair value. The AASB has tentatively decided to agree with this approach. We too agree that fair value is the appropriate basis for measuring the service concession assets at initial recognition because we believe this measurement basis will provide a faithful representation of the value of the service potential controlled by the grantor. However, we believe application of the definition of fair value in IFRS 13 to service concession assets is unclear, particularly in circumstances where a user pay concession has been transferred to the operator.

Fair value is defined in IFRS 13 as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”. The question at issue is: to what extent, if any, would the price a market participant is prepared to pay the grantor for a service concession asset be affected by the transfer of a user pay concession to the operator of the concession?

View 1: Fair value of the service concession asset is directly affected by the value of any user pay concession

One view is that the price would be impacted significantly, assuming the market participant buyer is unable to access other cash generating sources to compensate it for the inability to charge users for the use of the asset. A rationale for this view is that the unit of account under IFRS 13 is an individual asset (although it should be noted that a larger unit of account may be specified in specific standards) and only cash flows directly attributable to the asset would be taken into account in determining fair value. The price a market participant buyer of the service concession asset would pay for the asset would be determined by the highest and best use of the asset. If it is not legally permissible for the market participant buyer to charge customers for the use of the asset during the period of the service concession then this cash flow source would not be included in the buyer's cash flow estimates. If other cash flow sources, for example sale to other parties for property development, are not accessible to the market participant buyer then the price the market participant buyer would be prepared to pay for the service concession asset would be limited to the asset's residual value. While this may be a material amount at initial recognition it would typically be significantly less than the price a market participant buyer would be prepared to pay for the same asset with a user pay concession attached. In this view, the fair value of the service concession is directly affected by the value of any user pay concession that may be related to it.

The implications of this 'narrow' view of the fair value of a service concession asset for the valuation of other non-financial assets controlled by public sector reporting entities would seem to be profound. At present the valuation methodology employed by these entities is typically depreciated replacement cost (DRC), i.e. the current cost of the remaining service potential attributable to the asset. This valuation methodology is used even where the DRC is not recoverable in whole or in part by directly attributable expected future cash flows, on the grounds that the carrying amount represents the value of the asset's current capacity to provide goods or services in accordance with the specified public service objective and the entity intends to deploy the asset in the future in providing the needed goods and services. Applying the above interpretation of fair value to such assets may result in significant write downs, potentially to zero in many cases.

View 2: Fair value of the service concession asset is independent of the value of any user pay concession

An alternative view is that if a market participant buyer of a service concession asset is prepared to pay a price for the asset that reflects the costs that would be incurred to construct the asset, then the best estimate of the asset's fair value may be the asset's current replacement cost. This would be the case if the market participant buyer is a government entity (including the grantor entity itself) that needs the asset in order to achieve a public service objective, for example, the provision of an integrated transport network, and the only way in which the asset can be acquired is if it is reconstructed. In this view, the fair value of the service concession asset would be independent of the value of any user pay concession that may be related to it because the market participant buyer must pay a price equal to the asset's current reconstruction cost in order to access the asset's service potential.

This view would seem to avoid the concern referred to under View1about the implications of that View for the valuation of other non-financial assets controlled by public sector reporting entities; provided a market participant buyer (which may be a government) would be prepared to pay a price equal the non-financial asset's current DRC in order to acquire the asset's service potential, the asset's fair value would be equal to at least the current DRC.

This alternative view of the concept of fair value would seem to be consistent with the principle underpinning the requirements developed by standard setters relating to the impairment of non-financial assets deployed by entities whose principal objective is not the generation of profit. These standards typically require assets to be carried at not more than their recoverable amount and define that amount as the higher of fair value and value in use. Value in use is, in turn, defined in a manner that reflects the intention of the entity to continue to use the asset's remaining service potential to provided needed goods or services in accordance with the entity's mission. For example, AASB 136 *Impairment of assets* paragraph Aus32.1 states: "Where the future economic benefits of an asset held by such entities are not primarily dependent on the asset's ability to generate net cash inflows and where the entity would, if deprived of the asset, replace its remaining future economic benefits, value in use shall be determined as the depreciated replacement cost of the asset". The rationale underpinning these requirements is that even if the asset will not generate directly sufficient net cash inflows to recover its carrying amount (and therefore fair value (as narrowly defined) would be less than carrying amount), the asset may have an economic value to the entity that is higher than the cash flow driven amount. That economic value is represented by the asset's DRC because that is the amount the entity would need to pay, were it deprived of the asset, in order to acquire the service potential necessary to provide the needed goods or services.

Our view

View 1 would appear to be a more technically correct interpretation of the precise wording of IFRS 13 and the IASB's apparent rationale underpinning the standard, i.e. the focus on identifiable cash flows. However, the financial reporting outcome of adopting View 1 seems to us to be incompatible with the concept of an asset as defined by accounting standard setters in the context of not-for-profit entities in the private or public sectors and with the economic substance of the resources used by those entities to achieve their objectives.

An asset is defined by the IPSASB in its recently issued conceptual framework as *a resource presently controlled by the entity as a result of a past event* and a 'resource' is described *as an item with service potential or the ability to generate economic benefits*[8]. Similarly, the AASB (together with the now superseded Public Sector Accounting Standards Board) in its transaction-neutral conceptual framework, defined assets as future economic benefits controlled by the entity as a result of past transactions or other past events and stated that the term 'future economic benefits' is synonymous with the notion of service potential[9]. Both conceptual frameworks state that service potential is the capacity to provide services to customers or beneficiaries that contribute to achieving an entity's objectives and make it clear that this capacity can exist irrespective of whether the item generates net cash inflows[1].

With this analysis of the nature of assets controlled by not-for-profit entities in mind it seems incongruous to us that a fair value measurement of such assets under View 1 may result in them being

[1] The following excerpt from SAC 4 provides a succinct explanation of this phenomenon:
"The fact that not-for-profit entities do not charge, or do not charge fully, their beneficiaries or customers for the goods and services they provide does not deprive those outputs of utility or value; nor does it preclude the entities from benefiting from the assets used to provide the goods and services. For example, assets such as monuments, museums, cathedrals and historical treasures provide needed or desired services to beneficiaries, typically at little or no direct cost to the beneficiaries. These assets benefit the entities by enabling them to meet their objectives of providing needed services to beneficiaries". SAC 4, paragraph 21.

valued at negligible amounts or zero. In our view, only if the measurement basis reflects the assets' remaining service potential, such as would be the case using DRC as the valuation methodology, would the basis faithfully portray the assets' economic substance.

What is clear to us is that the appropriate application of IFRS 13 to non-financial public sector assets is unclear. Whether the AASB can address such concerns by providing explanatory guidance to AASB 13 Fair value measurement, perhaps based on the rationale set out in View 2, or by specifying a more appropriate measurement basis, such as DRC, is an open question. Irrespective of the course of action it decides to pursue, we believe the AASB needs to resolve the issue as soon as possible.

Based on our experience there are a number of conceptual and practical challenges in applying IFRS 13 to non-financial assets controlled by public sector entities. The acceptance of DRC as an appropriate methodology is well endorsed by IFRS 13 but as there is no public sector guidance available it can be difficult to conceptualise how public service benefit (used predominantly when there are no cash flows associated with an asset) should intersect with assets that do have cash flows attributable to them. The extract above identifies this conceptual issue in the context of service concession arrangements. An example of a live practical issue that is applicable to a wide range of non-financial public sector assets is whether financing costs are a component of fair value when using the depreciated replacement cost methodology to estimate fair value.

If guidance is developed by the Board it would also be useful to explicitly address how a for-profit public sector entity might approach the assessment of fair value given that there is an explicit requirement in AASB 136 to limit values to cash flows. For example, should the asset and liability (deferred revenue) be measured initially using the DRC methodology and then be impaired in accordance with AASB 136, or should initial recognition be based directly on the 'impaired value'?

We believe the AASB needs to provide guidance in this area because the issues are pervasive, practice is diverse, the amounts are material and, in our view, neither the IPSASB nor the IASB will provide guidance in the foreseeable future.

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?

We agree with the proposals in the ED with respect to both initial and subsequent measurement of the liability under both the 'financial liability model' and the 'grant of a right to the operator model'.

We note that the ED characterises the liability recognised under the 'grant of a right to the operator model' as unearned revenue. We agree with this characterisation. However, we do not find convincing the rationale provided for deferring the recognition of revenue nor do we find helpful the guidance provided for determining the amount of revenue to be recognised in subsequent reporting periods.

We note that the IPSASB did not attempt to rationalise the deferral of revenue in IPSAS 32 and we believe the Board should adopt the same approach. We are concerned that attempts to do otherwise will at best be superficial and at worst demonstrably inconsistent with the conceptual framework.

With respect to the recognition 'principle' set out in paragraph 24 – ie recognise revenue in accordance with the economic substance of the service concession arrangement – we note that the Board has replicated the approach developed by the IPSASB. While we commend the Board for its efforts to harmonise with IPSASs where possible, we find in this instance to do so would not be helpful. We are concerned that without appropriate guidance the principle as stated is meaningless and may lead to significant divergence in practice. However, we cannot envisage the type of guidance that would make the 'principle' operational.

In view of our concerns we believe the best course of action for the Board is to simply state that revenue should not be recognised at inception but should be allocated to subsequent reporting periods on systematic and rational basis.

While we agree with the accounting proposed, we note that it may result in the understatement of assets and liabilities at initial recognition. This may arise in the 'grant of a right to the operator model' where the value of the right transferred to the operator exceeds the fair value of the service concession asset. This would be the case where the operator is able to include in the user charge a component relating to ongoing operating and maintenance costs. From the grantor perspective, these costs will have been prepaid. We do not believe that this is an executory contract as the grantor will have performed by transferring the intangible asset to the operator.

Although not suggesting that the Board should require recognition of the prepayment asset and the related unearned revenue, we believe the Basis for Conclusions should acknowledge all aspects of the economics of the transaction.

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?

The proposed guidance for the separate recognition of the financial liability and the granting of a right to the operator, in our view, is appropriate. We believe separate recognition of each part of the total liability is important in ensuring the economics of the transaction are appropriately reflected within the public sector net debt calculation. In the calculation of net debt only the financial liability portion is expected to be included.

We do have concerns around the application guidance for the separate recognition of each liability on transition, most notably the measurement of the liability related to the granting of a right to the operator. Please see our comments under question 11.

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?

We agree with the Board's decision not to replicate the guidance in IPSAS 32 in relation to the recognition of other revenues by the grantor and we agree with the rationale given in BC 28.

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?

We believe the definitions in Appendix A of the ED are robust and appropriately include the key terms requiring explanation. We have no concerns over the definition of public service; however we feel strongly that there should be more application guidance around how the definition might be applied in practice. A question we have is how the term 'usual government function' would be applied. The inclusion of illustrative examples, such as a port, where application of the definition is more challenging than a toll road, would be helpful to those applying the definition.

Whilst we have no significant concerns over the definition of public service, we do question the purpose of the definition given that a definition is not included in AASB Interpretation 12. One challenge that exists with applying Interpretation 12 is that without a definition of public service, scope judgements will typically default to the criteria in paragraph 5 of the draft standard. If the grantor providing a public service is meant to be substantive in determining whether an asset is in scope, then the definitions should assist an entity in making this determination. For example, there will be circumstances where the criteria in paragraph 5 are met, but the government function is as regulator of the market, not as a 'provider of services'. It would be useful if the definition was more specific about when an asset was considered out of scope even though the criteria in paragraph 5 may be met.

We also believe it would be helpful to include in the guidance a comment that public perception of what is a public service may change over time. For example, insurance and banking may previously have been considered a public service.

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?

There is currently divergence in practice around how lifecycle costs should be accounted for during the operating and maintenance phase of a service concession arrangement. Accordingly, we concur with the proposal that guidance be included in the standard.

We support the inclusion of an example, and we agree with the accounting approach adopted. We suggest that the example be amended to include application guidance on how IFRS 15 would be applied in relation to lifecycle costs. We believe the accounting approach should be included in the standard itself.

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?

We have no specific concerns around the proposed disclosures in the ED.

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?

We agree with the proposed application date, although we believe the Board should acknowledge that some jurisdictions will face practical challenges in meeting the timetable.

(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.

Our comments on fair value measurement under question 4 above apply equally to the use of fair value in measuring the service concession asset on initial application of the standard.

We believe more guidance is needed to explain the intended application of AG65 (b) in respect of the initial measurement of any unrecognised revenue. The following example highlights the practical challenges:

Calculation of liability on transition under the Grant of a Right to the Operator Model
The transitional requirement of ED 261 *Grantor Accounting* permits the grantor to apply the standard retrospectively or elect to recognise and measure the service concession assets and liabilities using deemed cost at the beginning of earliest period for which comparative information is presented in the financial statements. The application guidance provides the following:

AG65 Where the grantor uses deemed cost under the grant of a right to the operator model, it measures:

(a) the service concession asset at fair value; and

(b) the liability representing the unearned portion of any revenue arising from the receipt of the service concession asset. This amount should be determined as the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement.

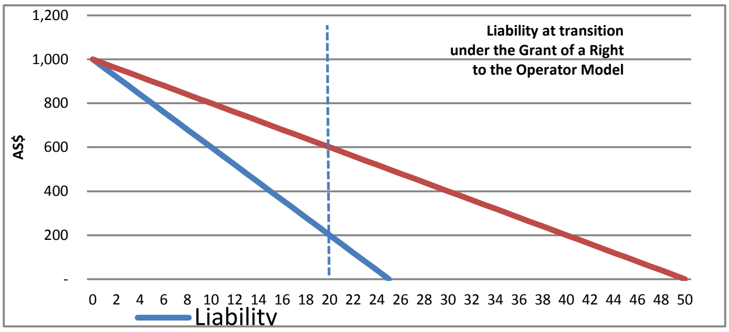
Under the proposed guidance, upon transition, the liability under deemed cost would be the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement.

For many entities, applying the standard retrospectively will be impracticable and so will be reliant on the deemed cost approach. As written, it is unclear on exactly how to interpret the requirements of AG 65 (b).

We would like to clarify whether the following values in the example below may be used as the basis for the liability at the date of transition under the grant of a right to the operator model.

Example: Toll road service concession arrangement where operator collects tolls from users of the road:

Period of the service concession arrangement	25 years
Economic life of asset	50 years
Transition year	End of year 20
Remaining period of arrangement at transition	5 years
Fair value of assets at year 0	1,000
Fair value of assets at beginning of year 21	1,200



The graph shows the asset and liability values as if the draft standard had applied from inception of the arrangement.

Retrospective approach in accordance with para 33(a): - Fair value of assets at year 0, adjusted to reflect the remaining period

		Amount in A$	
A		Fair value of asset at year 0	1,000
B		Reduction in liability per year (A/25 years)	40
C		Liability based on remaining period (B*5 years)	**200**

If the fair value of the asset at year 0 or inception is known, the liability is measured as the fair value of the asset at inception (A$1,000) adjusted to reflect the unearned portion of the toll fee revenue for the remaining period of the arrangement (5 years), resulting in a liability of A$200. The difference between the fair value of the asset on transition of A$1,200 and the liability (A$200) would be recognised as an adjustment to opening retained earnings (A$1,000).

Deemed cost in accordance with para 33(b): Fair value of assets at year 21, adjusted to reflect the remaining period

		Amount in AS$
A	Fair value of asset at beginning of year 21	1,200
B	Reduction in liability per year (A/25)	48
C	Financial liabilities	Nil
D	Liability based on remaining period (B*5)	**240**

Our presumed interpretation of AG65 (b) is to adjust the current fair value of the asset in direct proportion to the remaining period in the service concession. With 5 years left, one fifth of the asset's current fair value is recorded as a liability. While the fair value of the asset on inception can be objectively derived, it is not necessarily representative of the value of the liability as the fair value of the asset includes the residual asset value beyond the life of the concession. The difference of $960 is recorded in opening retained earnings.

The point of clarification would be whether this is seen as the only way to adjust the asset value to reflect the remaining service potential or if there is some other methodology that could achieve it. Given the issue noted above about the asset value inherently including the residual value would suggest it optimal to find a way to back out the residual value component from the liability. Being clear on this point would help to reduce diversity in practice in the event that alternate methodologies are identified to "adjust to reflect the remaining service period" of the concession arrangement.

We note that the guidance in AG 65 does not make reference to any difference between the initially recognised asset and liability being recognised directly in equity/net assets, whereas AG 64 does. We presume that the AG 64 wording should be replicated or does it imply that the asset and liability will always be equal 0n initial application?

Question 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?*

We are not aware of any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

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

Subject to our specific concerns raised above, we believe a standard based on the Exposure Draft would result in financial statements that are useful to users.

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

Overall we believe that a standard based on the principles in the Exposure Draft would be in the best interests of the Australian economy.

Question 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.

We are unable to provide feedback on the specific costs and benefits of the proposals. However, we would expect the benefits of the proposals to outweigh the related costs. In the majority of cases sufficient information should be provided by prospective bidders as part of the competitive tender process for service concession arrangements. The submissions are usually very comprehensive in terms of technical and financial detail in order for the Government Agency to make a fully informed decision when comparing bids. Transition may be more challenging as there is not necessarily any obligation on operators to provide historical or current information about the assets.