

Basis for Conclusions on AASB 2021-4

This Basis for Conclusions accompanies, but is not part of, AASB 1059. The Basis for Conclusions was originally published with AASB 2021-4 Amendments to Australian Accounting Standards – Modified Retrospective Transition Approach for Service Concession Grantors.

Introduction

- BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in this Standard. It sets out the reasons why the Board developed the Standard, the approach taken to developing the Standard and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Background

Reasons for issuing this Standard

- BC2 The Board received comments from the Treasury office in one jurisdiction regarding an issue applying the modified retrospective method to measure the Grant of a Right to the Operator (GORTO) liability, as stated in paragraph C4(c) of AASB 1059 *Service Concession Arrangements: Grantors*. The Board considered the stakeholder’s comments and decided to propose amendments to AASB 1059 to address the issue.

Issue of Fatal-Flaw Review version of the Standard

- BC3 In May 2021, the Board issued a Fatal-Flaw Review version of the Standard for public comment. The Board received three submissions and informal comments from another stakeholder. All respondents were supportive of the Board changing the modified retrospective method to measure the GORTO liability stated in paragraph C4(c) of AASB 1059.
- BC4 One stakeholder noted that the changes to AASB 1059 paragraph C4(c) proposed in the Fatal-Flaw Review version of the Standard specifically addressed only financial consideration paid by the grantor to the operator prior to the date of initial application of the Standard. The stakeholder commented that the GORTO liability and subsequent revenue would also be likely to be overstated if the grantor had provided non-financial consideration prior to the date of initial application that was not adjusted in determining the grantor’s GORTO liability.
- BC5 The Board considered the feedback received and decided to amend AASB 1059 to address the issues. The Board decided that expanding the scope of the amendments to include non-financial consideration was appropriate, based on the principles and approach proposed in the Fatal-Flaw Review version.

Consideration transferred to the operator prior to the date of initial application

- BC6 The Treasury office commented in raising the issue for the AASB’s consideration that AASB 1059 did not specify how consideration paid by the grantor to the operator prior to the date of initial application (i.e. that was not a financial liability at the date of initial application) should be treated under the modified retrospective transition approach. The stakeholder noted that if such consideration is not adjusted in the grantor’s GORTO liability calculation, the GORTO liability at the date of initial application would be likely to be overstated, which in turn would lead to the overstatement of revenue in subsequent periods as the GORTO liability is unwound over the period of the service concession arrangement. The Board concluded that the GORTO liability and subsequent revenue would be overstated whether the grantor had provided financial or non-financial consideration prior to the date of initial application that was not adjusted in determining the grantor’s GORTO liability.
- BC7 The Board noted that consideration transferred by the grantor to the operator in respect of a service concession asset does not represent a liability or revenue for the grantor and therefore would not be recognised appropriately as part of the GORTO liability on transition. Under paragraph 12 of AASB 1059, such consideration is required to be adjusted when measuring the grantor’s liability at initial recognition based on

the current replacement cost of the service concession asset. This requirement is also applicable for entities applying the full retrospective transition approach to the implementation of AASB 1059.

- BC8 The Board considered amending the GORTO liability calculation under the modified retrospective transition approach has merit. The current drafting of the modified retrospective transition approach could result in overstatement of the GORTO liability for affected grantors at the initial application date and of the subsequent revenue recognition, which would continue throughout the remaining period of the affected service concession arrangements. Considering the potential public interest in and user information needs regarding service concession arrangements, these overstatements could be considered qualitatively material and might mislead users of the financial statements for a long period of time.
- BC9 The Board decided that changing the modified retrospective transition approach is justified under the *AASB Not-for-Profit Entity Standard-Setting Framework* (October 2020), paragraph 30(e). This is because the existing modified retrospective GORTO liability calculation – which would make no adjustment for the grantor’s own contributions to a service concession asset prior to the initial application date – would appear to result in reported financial performance or financial position not reflecting economic reality.

Options for addressing the issue

- BC10 The stakeholder advised that, prior to application of AASB 1059, grantor financial contributions to service concession arrangements have been capitalised as a prepayment, which is recognised as an expense over the concession periods.
- BC11 The Board considered four possible options for amending the modified retrospective GORTO liability calculation in relation to grantor contributions prior to the initial application date. Options 1–3 differ only in what is first deducted from the fair value (current replacement cost) of the service concession asset in calculating the liability.
- Option 1 – measure the GORTO liability by deducting the **carrying amount** of capitalised grantor contributions from the current replacement cost of the service concession asset as at the date of initial application; then adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement; and finally deducting the fair value of any related financial liability as at the date of initial application;
 - Option 2 – measure the GORTO liability by deducting the **historical amounts** of grantor contributions from the current replacement cost of the service concession asset as at the date of initial application; then adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement; and finally deducting the fair value of any related financial liability as at the date of initial application;
 - Option 3 – measure the GORTO liability by deducting the **fair value** of grantor contributions from the current replacement cost of the service concession asset as at the date of initial application; then adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement; and finally deducting the fair value of any related financial liability as at the date of initial application; and
 - Option 4 – measure the GORTO liability by applying the proportion of the GORTO liability relative to the total liability calculated at the inception of the service concession arrangement to the current replacement cost of the service concession asset as at the initial application date; and then adjusting this amount to reflect the remaining period of the service concession arrangement relative to the total period of the arrangement.
- BC12 The Board was concerned that if a contribution was made close to the inception of the arrangement and the capitalised grantor contribution has a low carrying amount on the initial application date because it has been amortised over a number of periods, Option 1 could result in a similar outcome to the current modified retrospective transition approach. However, this effect would be moderated since the higher the number of years of amortisation to the date of initial application, the smaller the remaining period of the arrangement, which would reduce the calculated GORTO liability.
- BC13 The Board rejected Option 2. This is because the modified retrospective transition approach requires the service concession asset and any outstanding financial liability to be measured at fair value as at the initial application date. Deducting the sum of historical amounts – ignoring the time value of money for the consideration paid prior to the initial application date – from the fair value of the asset might not result in an appropriate GORTO liability amount. The time value of money would be particularly relevant for consideration paid by instalments under the arrangement.
- BC14 The Board decided against Option 3 because estimation of the fair value of historical consideration transferred might not be a straightforward exercise and further guidance might be required to assist grantors in identifying

the factors a market participant would consider when pricing such historical consideration, such as the appropriate interest rate. Such guidance would be unlikely to be finalised in time for entities applying AASB 1059 to the annual reporting period ending 30 June 2021, which is the initial mandatory application of the Standard for most (if not all) Australian public sector grantors.

- BC15 Under Option 4, applying the proportion of the GORTO liability relative to the total liability calculated at the inception of the service concession arrangement would limit the basic GORTO liability amount at the date of initial application, which is then apportioned again to reflect the remaining period of the arrangement. However, in order to calculate the proportion of the GORTO liability relative to the total liability at inception, an entity would need to know the estimated value of the service concession asset that the operator agreed to provide, as well as the contributions that the grantor agreed to provide to the operator. The Board was concerned that it might be difficult for auditors to obtain sufficient appropriate audit evidence to support the estimation of the fair value of the service concession asset at inception. Option 4 also does not factor in any changes to the service concession asset, such as improvements or additions to the asset between inception and the date of initial application of AASB 1059.
- BC16 The Board considered the advantages and disadvantages of each option and decided to adopt Option 1. This is because:
- (a) the stakeholder advised that most of the affected hybrid service concession arrangements would still be in the construction phase as at the date of initial application, so that the capitalised grantor contributions would not yet have been amortised. Therefore, the concern described in paragraph BC12 would not be a significant issue in practice;
 - (b) deducting the carrying amount of the capitalised grantor contributions from the current replacement cost of the service concession asset conceptually is similar to the way other existing assets of the grantor are treated when calculating the grantor's liability under the general requirements in AASB 1059 paragraph 11 – when existing assets of the grantor are reclassified as service concession assets, the grantor does not recognise a liability in relation to the reclassified assets; and
 - (c) it is the most straightforward option to apply out of the four options considered. Since the carrying amount of the capitalised contributions typically would have been subject to audit in prior periods, it is expected that affected grantors would be able to provide sufficient evidence (based on their accounting policy) to support the carrying amount of the capitalised contributions as at the date of initial application.
- BC17 The Board acknowledged that, on conceptual grounds, Option 1 might not be the most appropriate option to apply due to the concern described in paragraph BC12. However, it noted that this is not an ongoing issue, as paragraph C4(c) is not expected to be applied in any period later than the annual reporting period ending 30 June 2021, and the stakeholder advised that the concern described in paragraph BC12 does not appear to be a significant issue in practice. Since there was a need to amend the current GORTO liability calculation in paragraph C4(c) promptly prior to the preparation of grantors' 30 June 2021 financial statements, for practical reasons the Board decided to amend paragraph C4(c) based on Option 1.