Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, AASB 1059.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in AASB 1059. In making decisions, individual Board members gave greater weight to some factors than to others.

Background

Reasons for issuing this Standard

BC2 In Australia, public sector entities enter into service concession arrangements (also called public-private partnerships (PPPs), build-own-operate-transfer (BOOT) arrangements and other similar names) as a means of developing and delivering infrastructure and other assets for public services such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, registries and databases, and other tangible or intangible assets that are expected to be used during more than one reporting period in delivering public services. The public sector entity (the grantor) typically engages another entity (the operator) to construct or otherwise provide the underlying infrastructure and other assets through which the operator will provide public services on behalf of the grantor. In exchange for the asset (or assets) and services, the grantor makes payments to the operator or grants the operator a right to charge users of the service concession asset (or assets).

BC3 Prior to the issue of this Standard, there was no specific Australian Accounting Standard that prescribed the accounting for service concession arrangements from the grantor's perspective.

BC4 In determining an accounting policy for service concession arrangements in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, in the absence of AASB 1059, an Australian public sector entity might consider existing accounting requirements for service concession arrangements, including:

(a) AASB Interpretation 12 *Service Concession Arrangements* – AASB Interpretation 12 (which incorporates IFRIC 12 *Service Concession Arrangements*) provides the accounting requirements for service concession arrangements by the operator of a service concession arrangement. AASB Interpretation 12 does not apply to a grantor;

(b) AASB 16 *Leases* – AASB 16 provides guidance where the grantor makes payments to the operator, but does not provide guidance where the grantor grants the operator a right to charge users of the service concession asset;

(c) AASB Interpretation 4 *Determining whether an Arrangement contains a Lease* – AASB Interpretation 4 provides guidance for the application of AASB 16; and

(d) IPSAS 32 *Service Concession Arrangements: Grantor* – the International Public Sector Accounting Standards Board (IPSASB) published IPSAS 32 in October 2011. IPSAS 32 prescribes the accounting for service concession assets, liabilities, revenues and expenses by grantors. IPSAS 32 mirrors IFRIC 12 in most aspects.

Australian public sector entities had also considered previous requirements in the United Kingdom set out in Financial Reporting Standard FRS 5 *Reporting the Substance of Transactions*, issued by the UK Accounting Standard Board. FRS 5 required an entity to recognise an asset and a liability where the entity had substantially all or the majority of risks and rewards incident to the ownership of a service concession asset.

BC5 The lack of a specific Australian Accounting Standard that prescribed the accounting for a service concession arrangement from the grantor's perspective resulted in divergence in the accounting for such arrangements. For example, some grantors recognised service concession assets and liabilities in their statement of financial position while others did not. Given the significance of service concession arrangements to the Australian economy, it is important that the AASB issue an Accounting Standard to address the lack of explicit requirements for accounting for such arrangements. Recognition of service concession assets and related liabilities is important in assisting users of financial statements to understand the resources and obligations of a grantor involved in the provision of public services.

BC6 The Board considered a range of alternatives for the accounting for service concession arrangements by a grantor. This included consideration of:

(a) whether under the hierarchy for selecting accounting policies set out in AASB 108, the grantor could apply AASB Interpretation 12 by analogy. The Board (in December 2007) noted that, in accordance with AASB 108, the management of an entity must use its judgement in developing and applying an accounting policy that results in information that is both relevant and reliable to the economic decision-making needs of users, including that the financial statements reflect the economic substance of the transaction or event. In making this judgement, management must refer to, and consider the applicability of, the requirements and guidance in Australian Accounting Standards (including Interpretations) dealing with similar and related issues, and the definitions, recognition criteria and measurement concepts in the *Framework for the Preparation and Presentation of Financial Statements*. The Board concluded public sector grantors are required to consider Interpretation 12 in developing their accounting policy for service concession arrangements, and could choose to follow the Interpretation, although it does not apply mandatorily;

(b) the IPSASB's project on grantor accounting for service concession arrangements, which the Board followed closely by issuing the IPSASB's consultation documents in Australia as Invitation to Comment ITC 16 *Request for Comment on IPSASB Consultation Paper* Accounting and Financial Reporting for Service Concession Arrangements (April 2008) and Exposure Draft ED 194 *Request for Comment on IPSASB Exposure Draft* Service Concession Arrangements: Grantor (April 2010). The Board considered the feedback from constituents in preparing its submissions on the IPSASB proposals; and

(c) other approaches to the accounting for service concession arrangements, which are identified further in this Basis for Conclusions.

Issue of ED 261 and additional public versions

BC7 After considering the alternatives, the Board decided to develop an Australian Accounting Standard on grantor accounting for service concession arrangements, based on IPSAS 32, to address the lack of guidance. The Board issued Exposure Draft ED 261 *Service Concession Arrangements: Grantor* in May 2015. The Board took into account its policy of making Australian Accounting Standards with a view to requiring like transactions and events to be accounted for in a like manner by all types of entities, referred to as 'transaction neutrality', in restricting the scope of ED 261 to a grantor that is a public sector entity. The Board noted that it is highly unlikely that a service concession arrangement would involve a grantor that is a private sector entity. Consequently, only in rare instances would a private sector grantor require specific guidance on the accounting for a service concession arrangement.

BC8 The Board conducted extensive outreach on the proposals in ED 261, including roundtable discussions in Melbourne, Brisbane and Sydney, field tests in a number of Australian jurisdictions and other targeted outreach.

BC9 The Board received ten comment letters in response to ED 261. The key responses to ED 261 were:

(a) all respondents were supportive of the proposals set out in ED 261 on the basis that the proposals would provide a consistent approach to the accounting for service concession arrangements from a public sector grantor perspective;

(b) some respondents commented that the proposals were more rule-based than principle-based. These respondents recommended that a principle-based Standard be developed so that the Standard could address emerging innovative service concession arrangements that perhaps a rule-based Standard would not be able to adequately address; and

(c) overall, respondents requested additional guidance and examples on the concept of control, fair value measurement of service concession assets and liabilities, and accounting for the arrangements when transitioning to the Standard.

BC10 As the Board considered a broad range of issues in developing this Standard following the ED 261 exposure process, numerous issues papers and draft wording for paragraphs of the Standard were published as Board agenda papers. This gave constituents the opportunity to follow the debate and to provide comments on the issues and drafting contemporaneously.

BC11 In February 2017, the Board also issued a Fatal-Flaw Review version of the Standard for public comment. Submissions were received from seven constituents. The majority of the respondents were supportive of the Board's approach in the Fatal-Flaw Review version. However, some respondents had concerns particularly over the proposed requirement for a grantor to recognise as a service concession asset an intangible asset that the grantor had not been previously recognised and the proposed guidance on public services. Single respondents also objected strongly to (1) the approach to determining the grantor's control or regulation of the pricing of the services of a service concession asset and (2) the proposed requirement to recognise a service concession arrangement that involves the grant of a right to the operator.

BC12 The Board considered these issues and the comments received at its March and May 2017 meetings. In particular, the Board added additional implementation guidance to illustrate the differences between service concession arrangements and other types of arrangements (construction and service contracts, leases, and sale and privatisation arrangements). The Board also clarified the treatment of previously unrecognised intangible service concession assets and the application guidance regarding public services, for example.

BC13 The proposed requirements were then finalised in June 2017 in the form of a Pre-Ballot Draft of the Standard. This version, which typically is distributed only to Board members, was also circulated to the respondents to the Fatal-Flaw Review version that had provided substantive comments. Further comments were received from those respondents and were considered by the Board in finalising the Standard. As a result of those comments, for example, the definition of 'service concession arrangement' was extended to refer to the operator being responsible for at least some of the management of the public services provided through the service concession asset, which had featured in the application guidance and in some of the implementation guidance examples. References to land under roads as service concession assets were also added, and the accounting for upgrades and the replacement of major components of service concession assets clarified.

Scope

BC14 The Board considered various types of arrangements involving public and private sector entities and deliberated whether the Standard should be consistent with IPSAS 32 by applying only to not-for-profit public sector entities.

BC15 The Board decided that ED 261 should propose application to all public sector entities, rather than being limited to not-for-profit public sector entities, consistent with the Board's policy of transaction neutrality, as applied to public sector grantors of service concession arrangements. The Board noted that this scope would be wider than that of IPSAS 32 as International Public Sector Accounting Standards do not apply to for-profit entities.

BC16 The Board considered the constituents' feedback on ED 261 and additional outreach, in particular some constituents' concerns that a for-profit grantor applying this Standard may not be able to state that its financial statements comply with International Financial Reporting Standards (IFRS Standards) issued by the International Accounting Standards Board (IASB) (see paragraphs BC124–BC127 for a comparison with IFRS Standards). The Board also noted the constituents' feedback that although they prefer a for-profit entity to be able to state compliance with IFRS Standards when applying this Standard, transaction neutrality across the entire public sector is more important in this instance. The Board therefore reaffirmed its view that the Standard should apply to all public sector entities, whether for-profit or not-for-profit. The Board concluded that this was an appropriate, limited exception to its general policy that compliance with Australian Accounting Standards by for-profit entities would result in compliance with IFRS Standards. The Board noted this approach would reduce or eliminate any incentive for structuring service concession arrangements through for-profit public sector grantors.

Terminology

BC17 IPSAS 32 is expressed in jurisdiction-neutral language. The Board considered that some of the terminology in IPSAS 32 does not readily translate to the Australian environment and decided that different terms and phrases would be appropriate for entities applying Australian Accounting Standards. For example, consistent with the terminology used in other Australian Accounting Standards, the Standard adopts the term 'contract' rather than the term 'binding arrangement', and the Standard refers to operator 'access' rather than 'use' as in the definitions of a 'grantor' and an 'operator' in IPSAS 32.

BC18 ED 261 proposed defining the term '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". Constituents in their feedback on ED 261 stated that although they supported the inclusion of a 'public service' definition, the proposed definition was unclear. The Board concluded that any definition of 'public service' would result in similar interpretative issues as those raised by constituents in relation to the definition proposed in ED 261. The Board therefore decided, instead of providing a definition, the Standard should include guidance on 'public service' for assessing whether an arrangement is within the scope of the Standard. The Board also noted this approach is consistent with IPSAS 32 and AASB Interpretation 12, which do not contain a definition of 'public service'. The Board decided that the guidance should be in the form of examples and features to be considered, such as:

(a) an operator must be responsible for at least some of the management of the service concession asset and related services, and not act merely as an agent of the grantor; and

(b) services that are insignificant to the arrangement as a whole may be ancillary services.

BC19 The Board also decided to amend the 'service concession asset' definition (as proposed in ED 261) so that it refers to an asset accessed by the operator to provide public services on behalf of the grantor, for consistency with the public service guidance.

Recognition of service concession assets

Control

BC20 The Board considered a number of alternative approaches in developing the proposed guidance for assessing whether a grantor controls the service concession asset, including:

(a) the risks and rewards approach;

(b) the rights and obligations approach;

(c) the control or regulation approach (the IPSAS 32 concept of control); and

(d) an approach analogous to the principles of control specified in AASB 10 *Consolidated Financial Statements*.

BC21 The Board decided to adopt the IPSAS 32 concept of control (the control or regulation approach) for the following reasons.

BC22 In considering the merits of the risks and rewards and the control-based approach to assess whether the grantor should recognise the asset, the Board noted that the risks and rewards approach focuses on the economic aspects of the terms and conditions in the arrangement. The Board did not consider this focus to be appropriate for service concession arrangements in the Australian public sector. This is because the primary purpose of a service concession asset, from the grantor's point of view, is to provide specified public services on behalf of the grantor and not to provide economic benefits such as revenue generated by such assets (eg from user fees). A control-based approach focuses on control over the service potential of the service concession asset.

BC23 Service concession arrangements are often entered into to share the risks between the grantor and the operator. The Board questioned whether objective criteria could be established as the basis for consistent assessments of the risks and rewards. In addition, the weighting of various risks and rewards was seen to be problematic. The Board also noted the IASB has progressively been moving away from the risks and rewards approach to focus on the concept of control when determining what assets should be recognised (eg AASB 10 and AASB 16 have a primary focus on control, with risks and rewards a secondary consideration). The Board also considered its transaction neutrality approach and noted the risks and rewards approach would be inconsistent with the principles in AASB Interpretation 12. The Board concluded that the risks and rewards approach was not appropriate for an Australian Accounting Standard addressing grantor accounting for service concession arrangements.

BC24 In considering the rights and obligations approach, the Board noted that although this could have conceptual merit, it would represent a significant change in the accounting for and financial reporting of assets and liabilities for public sector entities that could have implications beyond service concession arrangements. The Board concluded that the rights and obligations approach was not appropriate at this time for an Australian Accounting Standard addressing grantor accounting for service concession arrangements.

BC25 The Board discussed application of the concept of control in AASB 10 by analogous interpretation, and decided that the principles for assessing control of an entity may not necessarily be appropriate for assessing control of an individual asset.

BC26 The Board concluded that the IPSAS 32 approach (the control or regulation approach) was the most appropriate approach as it is consistent with AASB Interpretation 12. Accordingly, this approach would lead to greater consistency in the accounting requirements for the operator and the grantor. The Board noted that this approach would require both the operator and the grantor under a service concession arrangement to apply the same principles in determining which party should recognise the asset in the arrangement. The

Board considered that this approach would reduce the possibility of an asset being recognised by both parties, or by neither party to the arrangement.

BC27 The Board noted that the IPSASB confirmed the control approach in IPSAS 32 in the Basis for Conclusions to *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (October 2014), where the IPSASB concluded that consideration of "the risks and rewards associated with particular transactions and events, and which party to any transaction or event bears the majority of those risks and rewards, may be relevant and useful in identifying the nature of the asset controlled by parties to the transaction or event. It may also be useful in determining how to quantify and associate the economic rights and obligations with particular parties. However, it is not of itself an indicator of the party that controls an asset. The IPSASB therefore decided not to include the risks and rewards of ownership as an indicator of control" (paragraph BC5.14).

BC28 In considering the concept of control for the recognition of service concession assets, the Board decided that the grantor recognises an asset provided by the operator and an upgrade to or major component replacement of an existing asset of the grantor provided by the operator as a service concession asset if the grantor controls the asset. The grantor essentially controls the asset if the grantor satisfies the specific control criteria in paragraphs 5(a) and (b): the grantor "controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price" and controls the residual value (if significant), thus controlling the asset for the majority of its economic life. This mirrors the control concept in AASB Interpretation 12. The Board noted that a broader concept of control currently applies in other Accounting Standards and that an asset that does not meet the control definition of this Standard may still need to be recognised under other Accounting Standards. The Board decided to include application guidance to make explicit the requirement to apply the broader concept of control.

Regulation

BC29 In developing the Application Guidance for the control concept, the Board formed the view that there are three main circumstances in which a grantor controls or regulates the price, the services and/or to whom the services must be provided in accordance with paragraph 5(a). The three main circumstances are where the service concession contract:

(a) *specifies that the grantor controls or regulates* the price, the services and/or to whom the services must be provided;

(b) *specifies that a third-party regulator regulates* the price, the services and/or to whom the services must be provided – under this circumstance, the regulation by the third-party regulator removes the ability of the operator to set or regulate the price, the services and/or to whom the services must be provided and the regulation is considered to be set implicitly by the grantor. Additionally, it is not essential for the grantor to direct the activities of the third-party regulator for the grantor to have control over the service concession arrangements (paragraph B20); and

(c) *does not specify that a third-party regulator regulates* the price, the services and/or to whom the services must be provided – under these circumstances, many governments have the power to regulate the behaviour of entities operating in certain sectors of the economy, either directly or through specifically created agencies. For the purpose of paragraph 5(a), such broad regulatory powers do not constitute control without a specific arrangement or contract (paragraph B21). Instead the grantor, operating under such a regulatory framework, derives control of the service concession asset either from the contract or the specific regulation applicable to the industry or service. However, where a service concession arrangement does not clearly fall within an existing regulatory framework (eg where there is more than one possible source of regulation), the arrangement will need to incorporate the specific regulatory framework that stipulates the services, the users and/or the pricing to be charged for the services in order for the grantor to have control of the service concession asset (paragraph B22).

BC30 The Board decided that the circumstances noted in the preceding paragraph should form part of the application guidance to assist entities in assessing whether the service concession asset is controlled by the grantor.

BC31 The Board deliberated whether long-term arrangements, privatisation and outsourcing arrangements should be scoped out of the requirements of the Standard, or whether they should be assessed to determine whether they meet the control criteria of paragraphs 5 or 6 of the Standard. The Board decided that where the arrangements meet the criteria of paragraphs 5 or 6, the arrangements should be accounted for as service concession arrangements. This approach would ensure the substance of an arrangement determines whether the arrangement is subject to this Standard.

Changes in control

BC32 The Board considered whether the Application Guidance should require that where there is a change in facts and circumstances indicating the grantor's control of the asset may have changed, the arrangement should be reassessed to determine whether it is still within the scope of the Standard. The Board concluded that the Standard should include such Application Guidance, similar to existing requirements in AASB 16 and AASB Interpretation 4. The Application Guidance should also require that where the grantor no longer controls the asset, as specified in the Standard, the grantor assesses whether the asset should be recognised under another Accounting Standard.

Residual interest and whole-of-life assets

BC33 The Board considered whether the Application Guidance should provide guidance on what constitutes a 'significant residual interest', including the determination of 'fair value' and its relationship with a 'whole-of-life' asset, in addressing whether the grantor controls a significant residual interest as set out in paragraph 5(b).

BC34 The Board decided that:

(a) what constitutes 'significant' varies from one entity to another and is a matter of judgement for the individual entity and not a decision for the Board. The judgement should be based on substance rather than form: for example, any residual interest is not necessarily a significant residual interest; and

(b) the term 'significant' is used in numerous Standards without specific guidance as to what would constitute 'significant'. The Board did not consider specific guidance on the term would be appropriate in this Standard. If the Board were to provide guidance on the term, the Board may need to refer the matter to the IASB for consideration with reference to maintaining compliance with IFRS Standards. Consideration by the IASB on this issue would most likely have implications beyond service concession arrangements.

BC35 This Standard requires the residual interest in the asset to be measured as the estimated fair value (current replacement cost) of the asset as if it were already of the age and in the condition expected at the end of the service concession arrangement. The Board considered whether guidance should be provided in determining 'fair value' and its relationship to the asset's residual interest, and concluded it was not necessary to provide additional guidance (see paragraph BC69).

BC36 The Board also considered the relationship between 'significant residual interest' and a 'whole-of-life' asset in determining whether the grantor has control of an asset. The Board decided that if the term of the service concession arrangement:

(a) is not the economic life of the asset, then paragraph 5 of the Standard applies; or

(b) is the economic life of the asset, then paragraph 6 of the Standard applies.

The Board noted this is consistent with the general observation that the amount of residual interest at the end of an arrangement is inversely related to the term of the service concession arrangement relative to the economic life of the asset. That is, the residual interest at the end of the arrangement is likely to be significant if the term of the arrangement is not at least the majority portion of the economic life of the asset. Consequently, such an arrangement would be subject to paragraphs 5(a) and (b). Alternatively, where the residual interest is insignificant, the arrangement would be subject either to paragraph 5(a) or, for a whole-of-life asset, paragraph 6.

BC37 Paragraph 6 of this Standard requires the grantor to recognise an asset that will be used in a service concession arrangement for its economic life (a whole-of-life asset) if the conditions in paragraph 5(a) are met. The Board decided to use the term 'economic life' instead of 'useful life' as proposed in ED 261 (paragraph 9). The economic life of an asset is the period over which future economic benefits are expected from all possible users of the asset, and may be the entire physical life of the asset. Consequently, an asset used in a service concession arrangement for its economic life will not have a significant residual interest at the end of the arrangement, and the condition in paragraph 5(b) will not be relevant. This contrasts with the term 'useful life', which is defined in AASB 116 *Property, Plant and Equipment* as the period over which an asset is expected to be available for use by an entity. An asset used in a service concession arrangement for its useful life (to the grantor) could have a significant residual interest at the end of the arrangement if the arrangement is not for all or the major part of its economic life. In this case, the condition in paragraph 5(b) would be relevant, and paragraph 6 is not applicable.

Upgrades or replacement of major components

BC38 The Board extended the definition of 'service concession asset' to refer explicitly to upgrades and to replacements of major components of assets, whether of assets provided by the operator or existing assets of the grantor. The Board clarified that upgrades and major component replacements of service concession assets would be recognised by the grantor when the upgrade or replacement occurs, provided that the control criteria in paragraphs 5 or 6 were satisfied. The Board concluded that such upgrades and major component replacements are treated as service concession assets in their own right, and consequently the grantor also recognises a related liability in accordance with paragraph 11.

Intangible assets

BC39 The Board considered whether the requirement in paragraph 8 that the grantor reclassify and measure an existing asset that is used in a service concession arrangement should apply to an identifiable intangible asset that has not been recognised previously by the grantor. The intangible asset would not have been recognised previously if the asset did not meet the criteria of AASB 138 *Intangible Assets* for recognition as an intangible asset. The Board decided that AASB 1059 should override AASB 138 and require a grantor to recognise and measure an existing but unrecognised identifiable intangible asset when the conditions in paragraph 5 or 6 for recognition as a service concession asset are met. This would apply even to intangible assets that are specifically precluded from recognition under paragraph 63 of AASB 138: internally generated brands, mastheads, publishing titles, customer lists and items similar in substance. The accounting for intangible assets of the grantor that are part of a service concession arrangement is set out in paragraphs B38–B39.

BC40 The Board took the view that a service concession arrangement represents a transaction with an external party that identifies and values all identifiable assets involved in the arrangement. Therefore, with the exception of goodwill (see paragraph BC42), the accounting should be similar to that for business combinations under AASB 3 *Business Combinations*, in which all assets and liabilities acquired are recognised, including those not previously recognised by the acquiree. This approach means that intangible assets encompassed by a service concession arrangement should be recognised by the grantor as intangible service concession assets (when the conditions in paragraph 5 or 6 are met), regardless of whether the assets were already recognised by the grantor as intangible assets.

BC41 The Board considered whether the recognition of previously unrecognised intangible assets as service concession assets should result in revenue for the grantor. The Board decided that the recognition of revenue would not be appropriate since the grantor is not obtaining control of such assets for the first time, but continues to control such assets. Instead, the Board concluded that the recognition is like a remeasurement of the assets, with a corresponding adjustment to revaluation surplus. This aligns with the grantor recognising a liability in respect of service concession assets provided by the operator, since the grantor obtains control of those assets only through the service concession arrangement. Those liabilities are reduced as revenue is recognised in accordance with the substance of the arrangement.

BC42 The Board noted that a service concession arrangement might encompass a business of the grantor, as defined in AASB 3. This raised the issue of whether the grantor should recognise internally generated goodwill as an asset of the business. The Board considered whether to follow the approach in AASB 3 and require goodwill to be recognised by the grantor. Under this approach, the grantor would measure the business at fair value (current replacement cost) and allocate this amount to the identifiable assets (such as property, plant and equipment and identifiable intangible assets) in the business, measured at their fair value (current replacement cost), with the remaining amount allocated to internally generated goodwill after recognising any liabilities of the business.

BC43 The Board acknowledged the conceptual merit in applying the AASB 3 approach to identify the assets for recognition in a service concession arrangement, in that the grantor has provided the operator with the right to access the whole business (including any goodwill) for the purpose of providing public services. However, the Board noted that this approach would give rise to difficulties in subsequently assessing goodwill annually for impairment under AASB 136 *Impairment of Assets*, since the revenue to be recognised by the grantor under the service concession arrangement would be limited to the related liabilities recognised, rather than reflecting cash flows of the service concession assets. The Board concluded that the approach in AASB 3 would be difficult to apply in practice, with the costs likely to outweigh the benefits. Consequently, the Board decided not to apply the approach in AASB 3. Instead, the grantor is required by AASB 1059 to recognise only the tangible assets and intangible assets in the business, measured at fair value (current replacement cost) and liabilities of the business. Goodwill is not permitted to be recognised.

BC44 The Board considered that at the end of a service concession arrangement an intangible service concession asset should continue to be recognised as an intangible asset and accounted for in accordance with AASB 138, excluding the recognition criteria of AASB 138. The Board decided that AASB 1059 would override the recognition criteria of AASB 138, so that an intangible asset would not be derecognised at the end of the service concession arrangement merely because it could not satisfy the recognition requirements of AASB 138. However, the derecognition criteria in AASB 138 would apply, so that the grantor would be required to derecognise the intangible asset if the grantor loses control of the asset.

Land under roads

BC45 The Board noted that a service concession arrangement might involve land under roads. AASB 1051 *Land Under Roads* requires land under roads to be recognised as an asset only by local governments, government departments, General Government Sectors and whole of governments, and only in respect of land under roads acquired after the end of the first reporting period that ended on or after 31 December 2007. AASB 1051 notes that AASB 116 applies to land under roads when recognised. The Board concluded that, to be consistent with the requirement in this Standard for a grantor to recognise previously unrecognised identifiable intangible assets that are controlled by the grantor as service concession assets, grantors would also be required to recognise land under roads as service concession assets when the control criteria in paragraphs 5 or 6 were satisfied. The Board decided that this requirement would apply to all grantors, not just grantors that were subject to AASB 1051.

Measurement of service concession assets

BC46 The Standard addresses subsequent measurement of service concession assets by reference to AASB 116 and AASB 138, on the grounds that service concession arrangements relating to other types of assets are unlikely. That does not prevent application of this Standard to other types of assets included within a service concession arrangement.

BC47 The Board considered the measurement of a service concession asset at fair value in accordance with AASB 13 in relation to the characteristics of the asset and valuation techniques for measuring the fair value of the asset.

Characteristics of the asset

BC48 In considering the characteristics of the asset when measuring fair value, the Board noted AASB 13 requires the grantor to consider the characteristics of the service concession asset that market participants would take into account when pricing the asset at the measurement date. Characteristics include the condition and location of the asset as well as any restrictions on the sale, transfer or use of the asset. The effect of restrictions on the sale, transfer or use of the service concession asset depends on whether the restriction is deemed to be a characteristic of the asset or a characteristic of the grantor that controls the asset. Where a restriction would transfer with the asset in an assumed sale or transfer, the restriction would generally be regarded as a characteristic of the asset and likely to be considered by a market participant in pricing the asset. On the other hand, a restriction that is specific to the grantor and that would not transfer with the asset in an assumed sale would not be considered in measuring the fair value of the asset. Whether a restriction is a characteristic of the service concession asset or specific to the grantor requires judgement based on the specific facts and circumstances of the arrangement.

BC49 A market participant may consider that the right of access provided by the grantor to the operator does not represent a restriction on the grantor's use of the asset. In a service concession arrangement, control of the asset and therefore the right to use the asset is retained by the grantor (and transferred to the market participant in a hypothetical transaction). Under this view, the right of access provided to the operator would not represent a restriction on the use of the asset.

BC50 The assessment of restrictions is important for service concession arrangements involving the grant of a right to the operator (GORTO) model, where the grantor provides the operator with a right to charge the users of the service concession asset. To the extent that a market participant (acting in its economic best interest) would take into account in measuring the fair value of the asset the fact that a third-party operator has been granted a right to charge users, this could result in a different fair value compared to that for an equivalent asset without such a characteristic, such as the service concession asset under an arrangement that involves only the financial liability model. In the latter case, any obligation to pay the operator under the financial liability model that would be transferred to the market participant would be separately recognised, not netted against the asset.

BC51 The Board discussed the unit of account in AASB 13, which defines it as the level at which an asset or a liability is aggregated or disaggregated in a Standard for recognition purposes. The Board noted there are three possible bases for identifying a service concession asset: the service concession period, the economic life after the end of the arrangement (the residual), or both the concession period and any remaining economic life.

BC52 The Board noted some may view the grant of a right to the operator to earn revenue from third-party users of the asset means that the grantor's service concession asset is only the residual interest in the asset after the service concession period. Under this view, the grantor's interest in the service concession period component of the asset is effectively derecognised, consistent with a rights and obligations approach.

BC53 In the development of IFRIC 12, the IFRIC decided that when the operator in a service concession arrangement does not have the right to control the underlying use of the asset, the operator instead has access to operate the asset to provide a service on behalf of the grantor. In essence, the operator acts as a service provider (IFRIC 12, paragraphs BC24–BC25). Accordingly, it is the grantor that has control of the underlying use of the asset during both the service concession period and any residual period thereafter. The Board therefore concluded the unit of account is the entire service concession asset, not just the residual interest after the service concession arrangement ends.

Valuation techniques for measuring fair value

BC54 AASB 13 outlines three 'widely used' valuation techniques for measuring fair value (paragraph 62): the market approach, the income approach and the cost approach. AASB 13 does not specify which valuation technique is more appropriate. Instead, AASB 13 states that:

(a) an entity uses the valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs;

(b) the inputs selected should be consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability; and

(c) the fair value hierarchy (Level 1, 2 and 3 inputs) prioritises the inputs to the valuation techniques, not the valuation techniques used to measure fair value.

Market approach

BC55 The Board noted service concession assets are subject to terms and conditions determined on a project by project basis and are rarely exchanged between willing sellers and buyers. Accordingly, it is highly unlikely that the market approach would be applicable to measuring service concession assets, although this would depend on the facts and circumstances.

Income approach

BC56 The income approach converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts (AASB 13, paragraph B10).

BC57 Service concession assets are used to provide goods or services to achieve public service objectives and consequently the prices that might be charged for those goods or services may be regulated. Price regulation would have the effect of restricting the future cash flows that could be obtained from the assets. The fees the operator can charge users may be at a significant discount and hence this would not reflect the fair value of the asset based on what a market participant may choose to charge under commercial terms. Service potential (ie capacity to provide future services) rather than future economic benefits (ie future cash flows) is likely to drive decisions regarding service concession assets.

BC58 The Board considered whether the grantor's contractual obligation to make a predetermined payment or series of payments to the operator under the financial liability model could be a measure of the fair value of the asset. Where the grantor's payments to the operator represent the price that the operator expects for the construction, development, acquisition or upgrade of a service concession asset based on the expectations of the cash flows which could be generated by the asset, this method may be appropriate for determining fair value at initial recognition as a surrogate for the income approach. However, the cash payments promised to the operator under the financial liability model might have no direct relationship to the cash flows expected to be generated from the asset (for example, the grantor may choose not to charge users) and the income approach would not be appropriate.

BC59 The Board noted some may view the grant of a right to the operator to earn revenue from third-party users of the asset as a restriction that a market participant would recognise when using the income approach (see also paragraph BC50). Under this view, the asset should be measured only in relation to the service potential of the asset after the service concession period has expired, ie at the fair value of the residual interest in the asset (see also paragraphs BC52–BC53). This is on the basis that the market participant buyer will not have the right to all the cash flows that could be generated by the asset as the right to the cash flows for the service concession period has been granted to the operator (effectively the service concession period component of the asset would be derecognised). Under this view, the service concession asset's fair value relates only to the cash flows that can be directly generated for the grantor by the asset. Consequently, the fair value of the asset would be measured at the asset's residual value.

BC60 However, the Board noted a public sector entity uses a service concession asset's capacity or service potential to provide goods or services to achieve public service objectives, replacing the asset irrespective of whether the replacement cost will be recovered by the expected cash flows that the asset may generate. The Board also noted the view that the service potential of a service concession asset (such as a road) under a service concession arrangement involving the financial liability model and the service potential of an identical asset (such as a toll road) under a service concession arrangement involving the GORTO model is the same from the grantor's perspective as both assets will provide the same utility to the public. Under this view, the fair value of these assets should therefore be measured consistently. The Board concluded that the fair value of the asset would be understated if it was measured at the fair value of the residual interest in the asset.

BC61 The Board also noted its decision to recognise, under the GORTO model, a contract liability that is initially recognised and then reduced as revenue is recognised (see paragraphs B71–B72 and BC80). The Board considered whether the amortisation profile of the contract liability should be determined so that the net balance of the service concession asset and the contract liability approximates the fair value of the residual interest in the asset. Whilst this would effectively mean a more consistent outcome with the financial liability model, the Board considered this approach would be practically difficult, with the costs likely to outweigh the benefits. The Board also expected that in many instances there would not be a material difference between this net approach and amortisation of the liability on a time basis. The Board therefore concluded that this approach was not appropriate.

Cost approach

BC62 The cost approach "reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost)" (AASB 13, paragraph B8). This approach uses Level 2 and/or Level 3 inputs, which are observable or unobservable inputs. Current replacement cost is the "cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence" (AASB 13, paragraph B9). The Board noted that current replacement cost is often used to measure the fair value of assets that are used in combination with other assets or with other assets and liabilities. This is particularly relevant if the service concession asset is part of an integrated network of assets, such as the provision of a transport network.

BC63 The Board noted (in paragraph BC60) a public sector entity uses a service concession asset's capacity or service potential to provide goods or services to achieve public service objectives, replacing the asset irrespective of whether the replacement cost will be recovered by the expected cash flows that the asset may generate. This view would be consistent with measuring the asset using current replacement cost under the cost approach in AASB 13.

BC64 Additionally the Board's view (in paragraph BC60) is that the service potential of a service concession asset under a service concession arrangement involving the financial liability model and the service potential of an identical asset involving the GORTO model is the same from the grantor's perspective, as both assets will provide the same utility to the public. The fair value of these assets should therefore be measured consistently.

BC65 Unlike the other valuation methodologies, current replacement cost would result in the same value under both the financial liability model and the GORTO model. Current replacement cost would not include the restriction on the asset (see paragraph BC49) of the grantor having granted the operator the right to charge users as the restriction relates to future cash flows from the asset rather than the costs to replace the asset to provide its current service potential. The Board's considerations of whether the granting of the right to future cash flows should be recognised as a separate liability are set out in paragraphs BC79–BC80.

BC66 The Board concluded a service concession asset is an asset that is obtained through construction, development, acquisition, upgrade or replacement of a major component of an asset. The asset's capacity or service potential is used to achieve public service objectives irrespective of whether the cost of the asset will be recovered by the expected cash flows that the asset may generate. The Board therefore concluded that it is appropriate to initially measure service concession assets at fair value using only current replacement cost under the cost approach to fair value. The Board noted that this approach applies to for-profit public sector grantors as well as to not-for-profit public sector grantors, given the objective of the Standard. The Board preferred the same measurement basis for all public sector grantors, even though it is possible that a for-profit grantor might hold service concession assets for both their service potential and their future cash flows.

Measuring reclassified assets at fair value

BC67 The Board deliberated whether an existing asset of a grantor that is reclassified as a service concession asset should be measured at current replacement cost in accordance with the cost approach to fair value in AASB 13. The Board concluded the reclassification of the grantor's existing asset represents a change in the nature of the asset (even an intangible asset) to a service concession asset and should therefore be measured on the same basis as a service concession asset acquired through the operator.

BC68 The Board acknowledged the requirement for a grantor to initially measure a service concession asset at fair value (current replacement cost) in accordance with the cost approach in AASB 13 may result in a for-profit grantor not being able to state that its financial statements comply with IFRS Standards. This is because AASB 13 (and the corresponding IFRS 13 *Fair Value Measurement*) permits other valuation techniques (see paragraphs BC124–BC125).

BC69 The Board decided not to provide additional guidance on the measurement of a service concession asset on the grounds that this would best be developed in the future through a separate project on the measurement of public sector assets. The Board also considered whether the Standard should include additional guidance in the following areas and decided there is sufficient guidance in the Standard and/or other Standards:

(a) determination of the fair value of a partly constructed asset – the Board noted there is a broad range of techniques in AASB 15 *Revenue from Contracts with Customers* that, depending on the nature of the contract, could be used to establish the fair value of a partly constructed asset;

(b) the valuation approach for intangible service concession assets – the Board decided intangible service concession assets should not be treated differently from tangible service concession assets on initial recognition. In both cases, the asset's capacity or service potential is used to achieve public service objectives irrespective of whether the cost of the asset will be recovered by the expected cash flows that the asset may generate. Consequently, the measurement of the asset at initial recognition should not be affected by whether the service concession asset is a tangible or intangible asset; and

(c) accounting for economic obsolescence in determining the fair value of the asset – as noted in paragraph BC66, the Board concluded that the fair value of a service concession asset should be measured using the cost approach. The cost approach (the current replacement cost) reflects the amount required currently to replace the service capacity of an asset. Current replacement cost takes obsolescence into consideration. AASB 13 provides examples of obsolescence, such as physical deterioration, functional (technological) obsolescence and economic (external) obsolescence, and notes that it is broader than depreciation.

Intangible assets

BC70 The Board decided that after the initial recognition of an intangible service concession asset, it should be accounted for in accordance with AASB 138, subject to the provisos in paragraph 9 of this Standard. The depreciable amount of the intangible asset would be amortised over its useful life. However, if the grantor elected (or was required) to measure the asset under the revaluation model, current replacement cost would continue to be used as the basis for fair value measurement, overriding the active market requirements in AASB 138 for the revaluation of intangible assets. The Board noted this approach is consistent with its decision to measure an asset at fair value (current replacement cost) on the basis of the asset's service potential, rather than on the basis of whether there is an active market for the fair value of the asset.

Recognition and measurement of a liability

Financial liability model

BC71 The Board considered issues relating to the recognition of a financial liability and, consistent with the key principles of IPSAS 32, decided that a financial liability should be recognised when the grantor has a contractual obligation to deliver cash or another financial asset to the operator.

BC72 A financial liability arises when the grantor is obligated to make a determinable payment or series of payments to the operator. The Board agreed with the IPSASB conclusion that when there is a determinable payment or series of payments of cash or cash equivalents, the payments should be allocated as a reduction of the liability, an imputed finance charge (if any), and charges for services provided by the operator under the service concession arrangement. The Board determined that wherever possible the existing guidance in AASB 9 *Financial Instruments* should apply.

BC73 The Board considered whether a financial liability arises when an arrangement requires the grantor to make payments to the operator based on third-party usage of the service concession asset without guaranteeing a minimum amount to the operator. The Board considered the application of the financial liability model to this case by assessing the notion that the grantor may not have a contractual obligation to pay the operator specified or determinable amounts at the inception of the arrangement as specified in paragraph 15. As noted in paragraph B63, the grantor has a financial liability if it does not have an unconditional ability to avoid the obligation to make the payments to the operator. The grantor is not able to avoid the payments as it cannot control the usage of the service concession asset by third parties, and any attempt to restrict usage may result in penalties under the arrangement. The amounts payable by the grantor to the operator are contingent upon the level of third-party usage of the service concession asset. Paragraph 25 of AASB 132 *Financial Instruments: Presentation* affirms this view that a grantor may have a contractual obligation in the form of a financial liability when the amounts are not specified or determinable at inception but are contingent on the occurrence or non-occurrence of uncertain future events. The Board also decided that AASB 9 should be applied to the accounting for the financial liability subsequent to its initial recognition. Accordingly, the Board decided that, for the arrangement under consideration, the financial liability model should be applied (as set out in paragraph 16(a)), with the financial liability initially recognised at the same amount as the fair value of the service concession asset, and the grantor applying AASB 9 subsequently to the accounting for the financial liability. The Board noted this view is consistent with its decision to not include in ED 261 or AASB 1059 the guidance in paragraph AG49 of IPSAS 32 relating to treating shadow tolls payable by the grantor as payments for the usage and not the acquisition of the service concession asset.

BC74 The Board noted that the approach described in paragraph BC73 may result in asymmetry in accounting for the same arrangement by the operator. This is due to AASB Interpretation 12 (paragraph 16) permitting the operator to recognise a financial asset only to the extent that it has an unconditional present right to receive cash from or at the direction of the grantor. The operator has an unconditional contractual right to receive cash if the grantor contractually guarantees the operator's cash flows. In the absence of a guarantee from the grantor, the operator's contractual right is conditional on third-party usage of the service concession asset, and the operator recognises an intangible asset rather than a financial asset. The Board concluded the principles appropriate to this Standard are more important than achieving symmetry in accounting by the parties to the service concession arrangement.

BC75 Consistent with AASB Interpretation 12, this Standard requires the application of the financial instrument Standards to the financial liability recognised under paragraph 11, except where this Standard requires otherwise. In deliberating the application of the financial instrument Standards to the recognition of a financial liability, the Board considered the following:

(a) whether the financial liability should be measured in accordance with AASB 9 rather than measured initially at the same amount as the service concession asset (current replacement cost). The Board noted that consistent with AASB 9 there is no day-one gain or loss to be recognised, and concluded that the costs of separately measuring the fair value of the financial liability would outweigh the benefits of doing so;

(b) whether to retain, in paragraph 18, the requirement proposed in ED 261 that the grantor allocates the payments to the operator under the contract and accounts separately for the finance charge. The Board noted this proposed requirement would apply if the financial liability is subsequently measured at amortised cost in accordance with AASB 9. However, AASB 9 permits other methods in the subsequent measurement of a financial liability, such as fair value through profit or loss. The subsequent measurement of a financial liability at fair value through profit or loss would not require separate accounting for a finance charge. The Board decided, given AASB 9 addresses the separate accounting for a finance charge, it is sufficient for AASB 1059 to refer to the financial instrument Standards in this respect without providing additional guidance;

(c) whether to retain the guidance proposed in ED 261 relating to the appropriate interest rate for determining the finance charge (if any). The Board decided to replace the reference in ED 261 to determining the finance charge using the rate implicit in the arrangement. The Standard (paragraph B67) instead refers to determining the finance charge using the effective interest method when the financial liability is subsequently measured at amortised cost in accordance with AASB 9; and

(d) whether to include guidance relating to the appropriate interest rate for initially measuring the financial liability component in a hybrid arrangement, since the financial liability component is measured first, and an interest rate is needed in order to discount the expected future cash flows to a present value. The Board decided to include application guidance (see paragraph B64) that the grantor shall, in the first instance, use the contractually specified interest rate in the arrangement to initially measure the financial liability component of a hybrid arrangement in accordance with AASB 9. If it is not practicable to determine the contractually specified interest rate, the grantor would determine the appropriate rate using the prevailing market rate(s) of interest for a similar instrument with a similar credit rating, following the requirements of AASB 9. Examples of rates for a similar instrument include the operator's cost of capital specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement.

Grant of a right to the operator (GORTO) model

BC76 The GORTO model applies when the grantor grants the operator the right to earn revenue from third-party users of the service concession asset. Under the GORTO model, the grantor transfers to the operator an intangible asset (being a right to charge users of the service concession asset) in exchange for the construction, development, acquisition or upgrade of a service concession asset and the provision of related future services. The Board considered whether the grantor should initially recognise revenue or a liability when it obtains control of the service concession asset arising from a service concession arrangement. The Board noted that IPSAS 32 requires a grantor to initially recognise a liability when the grantor recognises the service concession asset. Given its policy of transaction neutrality, the Board considered whether the requirements of Australian Accounting Standards, specifically the application of AASB 15 either directly or by analogy, would support:

(a) the recognition of a liability (consistent with IPSAS 32); or

(b) the recognition of revenue on the basis that the grantor has no remaining obligations to the operator once it has transferred to the operator the right to charge users.

BC77 The Board concluded that, from a grantor's perspective, the application of AASB 15 without further guidance may lead to divergence in accounting for a service concession arrangement, as significant judgement would be required to determine whether a service concession arrangement in which the grantor transfers an intangible asset to the operator is within the scope of AASB 15. The Board noted differing views on whether a service concession arrangement involves a contract with a customer (ie whether the right to charge users is considered a licence, whether the operator is considered a customer, or whether the ordinary activities of government include undertaking service concession arrangements as a grantor), and depending on the specific facts and circumstances some service concession arrangements might be a right-of-use licence and others a right of access. The Board preferred the view that the substance of the transaction appears more akin to financing the construction of the service concession asset, rather than a contract with a customer.

BC78 The Board also noted, in a service concession arrangement, the grantor makes promises, either explicitly or implicitly, to undertake activities in relation to the service concession asset that will benefit the operator. This reflects the fact that a service concession asset is controlled and managed by the grantor to provide public services. The Board acknowledged that the grantor's promise, or the operator's expectation, that the grantor will undertake activities that benefit the operator may in some instances be comparable to promises made by a licensor or expectations of a licensee that the licensor will undertake activities in relation to intellectual property that will benefit the licensee. AASB 15 identifies such licences as licences that provide the licensee with a right to access the underlying intellectual property. AASB 15 specifies that the promise of a right to access intellectual property is a performance obligation that is satisfied over time and the licensor would recognise a contract liability for its remaining performance obligation to provide access.

BC79 The Board decided that facts and circumstances would need to be assessed for each arrangement to determine whether the arrangement represented a right-of-access licence or a right-of-use licence. The Board preferred all service concession arrangements to be treated the same way, as it did not see the substance of service concession arrangements being different in respect to commitments under the arrangements. The Board also noted that recognising revenue immediately on a service concession asset that would otherwise be considered loss making from a cashflow perspective would not reflect the economic substance of the arrangement and would overstate current year financial performance. The Board further noted that immediate recognition of revenue (rather than a liability) would result in overstatement of the financial position as the requirement to use current replacement cost as fair value recognises the asset in full, even though the right to charge users of the asset has been transferred to the operator.

BC80 Consequently, the Board concluded the grantor's promises to undertake activities in relation to the service concession asset that will benefit the operator should also be accounted similarly to a contract liability. The grantor would subsequently recognise revenue as the 'access' is provided to the operator over the service concession period.

BC81 In some service concession arrangements, the right to charge users is described as a licence. The Board noted that accounting for licences other than those relating to service concession arrangements should be subject to further research to inform the Board as to whether a separate project would be required. Determining whether a particular licence granted by a government is within the scope of AASB 15 would depend on the facts and circumstances.

BC82 Given the importance of service concession arrangements to governments and the lack of accounting guidance for such arrangements in the absence of AASB 1059, the Board decided that service concession arrangements should be treated separately from other licences granted by governments.

BC83 The Board considered whether the Standard should include additional guidance on the principle-based approach to recognising revenue under the GORTO model. The Standard (paragraph 22) specifies that the grantor recognises revenue and reduces the GORTO liability according to the economic substance of the arrangement. The Board assessed the following options of whether to:

(a) require revenue to be recognised on a systematic and rational basis using the straight-line method. This option would eliminate divergent approaches to recognising revenue but would not be consistent with the objective of the Board to develop a principle-based accounting standard; or

(b) not provide additional guidance in the final Standard on the basis there is sufficient guidance in the Standard. Paragraph B71 requires revenue to be recognised and the liability reduced based on the economic substance of the arrangement, usually as access to the service concession asset is provided to the operator over the term of the service concession arrangement.

BC84 The Board decided not to add additional guidance. Revenue recognition should be based on the economic substance of the specific arrangement as assessed by the grantor and should not be prescribed by the Board.

Other liability recognition and measurement models

BC85 The Board considered the following alternative recognition and measurement models to the GORTO model:

(a) applying the financial liability model to all service concession arrangements;

(b) accounting for the assets of the arrangement and not the right to charge users for the use of the service concession asset that has been granted by the grantor to the operator; and

(c) application of AASB 140 *Investment Property* by analogy.

BC86 In analysing whether the financial liability model could be applied to all service concession arrangements, the Board considered:

(a) whether the nature of the party (the grantor or the users of the service concession asset) that makes the payment to the operator determines the accounting model for the grantor to recognise a service concession liability. Consistent with AASB Interpretation 12, the Board concluded the party that has the responsibility to make payments to the operator is important in determining the accounting model for the grantor's recognition of the liability. This view takes into account who bears the demand risk (ie the ability and willingness of the users to use and pay for the services). This view is consistent with the models in this Standard and mirrors the requirements of AASB Interpretation 12. That is, under the financial liability model, the grantor is the party with the primary responsibility to make payments to the operator for the services. This contrasts with the GORTO model, where the operator is the party that bears the demand risks. Accordingly, the use of different models (ie the financial liability model and the GORTO model) to account for the liability is more appropriate; and

(b) whether the grantor has a financial liability when the operator has been granted the right to charge third-party users for the use of the asset. The Board concluded that the grantor does not have a financial liability under GORTO arrangements. That is, the grantor does not have a contractual obligation to deliver cash or another financial asset to the operator nor exchange financial assets or financial liabilities with the operator under potentially unfavourable conditions.

BC87 The Board considered whether the more appropriate approach under the GORTO model is to recognise only the cash flows that the service concession asset can generate directly (the residual cash flows to the grantor). The implication is that the fair value of the asset could be measured at the asset's residual value (which could be zero), excluding the cash flows generated by the asset that have been granted to the operator. However, the Board concluded that the fair value of the asset should be measured using the current replacement cost under the cost approach irrespective of whether the cost of replacing the asset will be recovered by the expected cash flows that the asset may generate (see paragraphs BC63–BC66). In addition, the grantor would recognise a GORTO contract liability (see paragraphs BC79–BC80).

BC88 The Board also considered the application of AASB 140 by analogy to address the implication of measuring the asset's fair value based on only the cash flows that are directly generated by the service concession asset for the grantor. Although this approach might be appropriate under AASB 13, the resulting fair value of the service concession asset would be understated in relation to the service concession arrangement. The application of AASB 140 by analogy attempts to overcome this.

BC89 Under AASB 140, the fair value of investment property reflects expected future cash flows, including any future rental receipts. AASB 140 (paragraph 50) makes clear that in determining the carrying amount of investment property under the fair value model, it is necessary to avoid double-counting assets or liabilities that are recognised separately, such as prepaid or accrued rental income and lease incentives. In such cases, the fair value (carrying amount) of the investment property is adjusted so that in total the combination of all related amounts gives the fair value of the investment property.

BC90 The Board considered that to apply the AASB 140 approach to the GORTO model, the fair value of the service concession asset would first be determined on a gross basis (ie current replacement cost for the full service potential of the asset). Then a GORTO contract liability would be recognised, so that in total the combination of the service concession asset and the liability would give on a net basis the appropriate measure of the service concession asset, reflecting the cash flows expected to be generated for the grantor. This approach would avoid measuring the service concession asset at a net amount, such as the residual value of the asset.

BC91 However, the Board decided that the investment property model should not be applied by analogy. The Board concluded (see paragraph BC66) that service concession assets should be measured at fair value (current replacement cost) in relation to the service potential of the asset, rather than reflecting only the expected future cash flows for the grantor.

Dividing an arrangement

BC92 In response to constituents' comments, the Board decided to revise the approach to dividing a hybrid arrangement that had been proposed in ED 261. Instead of noting that each component of the service concession liability should be measured at fair value, the Standard requires that:

(a) the liability recognised under a hybrid arrangement is initially measured at the same amount as the fair value (current replacement cost) of the service concession asset; and

(b) the method for dividing the liability under a hybrid arrangement is to determine the financial liability part of the liability first, with the remainder of the fair value (current replacement cost) of the service concession asset allocated to the part related to the grant of the right to the operator.

BC93 The Board, in making the decision in paragraph BC92(b), considered whether the amounts allocated to the financial liability and the GORTO liability should depend on the entity's ability to determine the fair value of the service concession asset to be accounted for in relation to each liability model in the hybrid arrangement. For example, if the fair value of the service concession asset related to the grant of the right to the operator could be reliably determined, a method of dividing the hybrid arrangement might be to allocate this amount to the GORTO liability, with the remainder of the total liability to be allocated to the financial liability. However, the Board took the view that it would be difficult to determine fair values for the portions of a service concession asset related to each of the two liabilities, if it were possible. Similarly, it would be difficult to determine fair values for both liabilities directly, to allow the fair value (current replacement cost) of the service concession asset to be allocated to each liability based on their relative fair values, following the approach in AASB 15 to allocating the transaction price to performance obligations. Furthermore, since the liability is not measured directly at fair value under the financial liability model (see paragraph BC75), it would be inappropriate to require such measurement in relation to recognising a hybrid arrangement.

BC94 The Board concluded the appropriate approach would be to measure the financial liability part of the total liability first, with the remainder of the total liability allocated to the GORTO part of the liability. This approach avoids understating the financial liability, which might occur if the GORTO liability is measured first. Overstatement of the GORTO liability would mean overstatement of the revenues recognised by the grantor under the service concession arrangement. The financial liability is measured and recognised first, even where the service concession asset is under construction. This is illustrated in Example 8 of the Illustrative Examples accompanying this Standard.

Accounting issues addressed in other Australian Accounting Standards

BC95 Due to the complexity of many service concession arrangements, there may be additional accounting issues related to certain terms in the contract (for example, revenues, expenses, guarantees and contingencies). The Board decided that it was not necessary to repeat in this Standard guidance that appears in other Standards. Accordingly, when another Australian Accounting Standard specifies the accounting and reporting for a component of a service concession arrangement, this Standard references the specific Standard without necessarily providing additional guidance. However, the Board noted some cases (for example, revenue recognition) when the application of another Standard might be difficult, given certain unique features in service concession arrangements. To facilitate consistent implementation of this Standard, the Board decided to provide additional guidance on applying the principles in other Standards when appropriate.

Other revenues

BC96 The Board considered whether to include in this Standard the Application Guidance paragraphs AG55–AG64 of IPSAS 32 for other revenues. 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 predetermined inflows of resources, including the following:

(a) an upfront payment or a stream of payments;

(b) revenue-sharing provisions;

(c) a reduction in a predetermined series of payments the grantor is required to make to the operator; and

(d) rent payments for providing the operator access to a revenue-generating asset.

BC97 The Board decided this guidance was not necessary in the Australian context as the existing revenue recognition guidance in Australian Accounting Standards was sufficient.

BC98 In setting the requirement in paragraph 12, the Board noted deliberations by the IFRS Interpretations Committee on IFRIC 12 with respect to payments by the operator to the grantor. The Board concluded no additional guidance was necessary in relation to the requirement that the grantor recognise the liability initially at the same amount as the service concession asset, adjusted by the amount of any other consideration from the grantor to the operator, or from the operator to the grantor.

BC99 The Board observed that adjusting the liability for additional consideration from the operator to the grantor differed from the approach set out in an IFRIC agenda decision (July 2016). The IFRIC agenda decision noted that where the operator recognised a financial asset under a service concession arrangement, the operator would account for the payments to the grantor as a reduction of the transaction price, reducing the operator's revenue. Under this Standard, the payments from the operator would increase the grantor's liability, rather than reduce the carrying amount of the service concession asset. The asset is measured at fair value (current replacement cost) as a fundamental principle of this Standard, in order to reflect the service potential of the asset rather than future cash flows. The adjustment to the liability affects the grantor's revenue based on the pattern of revenue recognition during the period of the service concession arrangement.

Disclosures

BC100 The Board proposed in ED 261 only minor changes to the disclosure requirements in IPSAS 32. In finalising the Standard, the Board added the objective of the disclosure requirements to paragraph 28, and clarified in paragraph 29 the flexibility for a grantor to classify service concession assets across more than one class of assets for the purposes of AASB 116 or AASB 138, as appropriate, and for the disclosures required by this Standard.

Transition

BC101 This Standard requires an entity to apply the Standard retrospectively either in accordance with AASB 108 or under a simplified approach from the beginning of the earliest period for which comparative information is presented in the financial statements (the date of initial application). The modified retrospective approach requires a grantor to recognise and measure service concession assets and related liabilities at the date of initial application, rather than at an earlier date.

BC102 The general requirement in AASB 108 is that accounting policy changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable. The Board noted that there are two aspects to retrospective application: reclassification and measurement. The Board took a similar view to the IPSASB that it will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in a grantor's statement of financial position, but that retrospective measurement of service concession assets might not always be practicable, particularly if an entity has not previously recognised service concession assets and related liabilities, revenues and expenses.

BC103 As proposed in ED 261, the Board decided that the modified retrospective approach should be available to grantors that have previously recognised service concession assets and related liabilities, as well as to grantors that have not done so. This contrasts with IPSAS 32, which limits this option to grantors that have not previously recognised service concession assets and liabilities. The Board concluded that since the retrospective restatement of service concession assets might not always be practicable, the modified approach would be made available to all grantors.

BC104 Under the modified retrospective approach (see paragraph C4 of the Standard), the deemed cost of service concession assets is measured at fair value (current replacement cost) at the date of initial application. The Board decided this measurement basis should also apply to assets of the grantor that are reclassified as service concession assets on initial application of the Standard, thus requiring the remeasurement of such assets. The Board noted that this would be consistent with the requirement in paragraph 8 for grantors to measure existing assets that are reclassified as service concession assets at current replacement cost in accordance with the cost approach to fair value at the date of reclassification. ED 261 had not proposed any remeasurement for reclassified assets.

BC105 The Board considered the approach to the initial recognition by a grantor of previously unrecognised identifiable intangible assets and land under roads as service concession assets on transition, and concluded that no additional transition relief was required. A grantor may elect to apply the modified retrospective approach, requiring measurement of service concession assets at the date of initial application of the Standard, to simplify the measurement of such assets.

BC106 The Board decided to clarify in the Standard the approach to measuring a liability under the GORTO model when the grantor adopts the modified retrospective transition approach. The starting point is to measure the fair value (current replacement cost) of the service concession asset at the date of initial application, and then adjust that measure to reflect that part of the term of the service concession arrangement has passed. There were different views as to how to make that adjustment. The Board concluded that the adjustment should reflect the remaining service concession period relative to the remaining economic life of the service concession asset, on the grounds that the current measurement of the asset represented the future benefits inherent in the asset. The Board decided to include an example to illustrate the adjustment required.

BC107 The Standard requires that any net adjustment to the carrying amounts of assets and liabilities is recognised as an adjustment to the opening balance of accumulated surplus (deficiency) at the date of initial application. Accordingly, the Standard requires that if the grantor elects as its accounting policy the revaluation model in AASB 116 or AASB 138 (or is required to adopt that policy), any relevant adjustment is included in accumulated surplus (deficiency) and not revaluation surplus. The Board noted that the amount of such an adjustment could not be used to offset future changes in the values of an asset or liability. This is consistent with the treatment in AASB 108 for a change in accounting policy. However, this differs from the approach permitted by IPSAS 32, where such an adjustment would be included in revaluation surplus.

Effective date

BC108 The Board noted that ED 261 had proposed an effective date of annual reporting periods beginning on or after 1 January 2017, which was no longer feasible. The Board decided the effective date of the Standard should be annual reporting periods beginning on or after 1 January 2019, on the basis that that date would:

(a) effectively provide two years, from the issue date, for implementing the Standard for entities that have a 30 June reporting date. This aligns with constituents' comments that this Standard will need a significant amount of time to implement; and

(b) align with the effective date of AASB 15 and AASB 1058 *Income of Not-for-Profit Entities*, which this Standard cross-references (see paragraph 27). Although the effective date of this Standard need not align with those Standards, the Board considered having the same effective date would assist grantors in the overall implementation of the Standards.

GAAP/GFS convergence

BC109 The Board discussed implications of its decisions on GAAP/GFS harmonisation. The Board noted that key differences between Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS) may arise in relation to the following:

(a) service concession arrangement terminology – GFS refers to such arrangements as 'Public Private Partnerships' (PPP);

(b) assessment of whether the grantor recognises a service concession asset – assessment is based on the risks and rewards approach under GFS rather than the control and regulation approach in this Standard;

(c) accounting for a service concession arrangement – the arrangement is accounted for as a finance lease under GFS, but with some differences to AASB 16. The difference in accounting will likely result in differences between GAAP and GFS in the amounts of the assets and liabilities recognised both initially and during the term of the arrangement;

(d) revaluation of service concession assets – GFS requires the asset to be measured using the revaluation model. This Standard references AASB 116 and AASB 138, which permit the cost and revaluation models. AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires fair value measurement and the revaluation of assets consistent with the market value measurement requirements of GFS; and

(e) the liability recognised under the GORTO model – GFS acknowledges the GORTO model but does not provide specific accounting requirements. Instead, GFS notes most PPPs are unique and the accounting is to be considered on a case by case basis.

BC110 The Board weighed its policy on GAAP/GFS harmonisation against its policy of transaction neutrality. The Board observed that some areas of potential difference were known when developing AASB 1049. Others are driven by a difference in the underlying principles. Further, some differences could only be addressed by making changes to the underlying principles in AASB 1059.

BC111 On balance, the Board considered that it was not necessary to amend its decisions reflected in AASB 1059 in order to better achieve GAAP/GFS harmonisation. The Board noted that AASB 1049 will require entities to identify and explain any material differences arising from different requirements in GAAP as compared with GFS.

Comparison with IPSAS 32

BC112 This Standard incorporates the key requirements of IPSAS 32, with the main differences detailed in the paragraphs below.

Scope

BC113 This Standard applies to all public sector entities in both the for-profit and not-for-profit sectors. This is wider than the scope of IPSAS 32, which applies to public sector not-for-profit entities.

Recognition and measurement of service concession assets

BC114 This Standard includes Application Guidance on the following matters, which is additional to that in IPSAS 32:

(a) the fundamental principle of control of a service concession asset, including guidance on:

  (i) when the grantor would control the service concession asset in an environment where the services provided and/or the service pricing is regulated by a third-party regulator;

  (ii) the need to assess whether long-term leases, outsourcing or privatisation arrangements are within the scope of this Standard; and

  (iii) changes in the grantor's control of the service concession asset; and

(b) the relationship between the residual interest of the asset at the end of the service concession arrangement and a whole-of-life asset.

BC115 This Standard requires the grantor to initially measure the service concession asset at current replacement cost in accordance with the cost approach to fair value in AASB 13. IPSAS 32 instead specifies measurement of fair value generally – there is no IPSAS corresponding to AASB 13.

BC116 This Standard requires an existing asset of the grantor, including a previously unrecognised identifiable intangible asset or land under roads, that is reclassified as a service concession asset to be measured at fair value (current replacement cost) at the date of reclassification. IPSAS 32 does not permit such measurement or the recognition of previously unrecognised identifiable intangible assets or land under roads.

Recognition and measurement of liabilities

BC117 This Standard requires the grantor to recognise a financial liability when the grantor has a contractual obligation to pay cash to the operator for third-party usage of a service concession asset, with or without guaranteeing a minimum amount to the operator. IPSAS 32 refers to such an arrangement as a 'shadow toll' arrangement and requires the grantor to account for the payments as an expense when paid instead of recognising a financial liability at the commencement of the service concession arrangement.

BC118 This Standard references the application of the financial instrument Standards to a financial liability, while IPSAS 32 explicitly requires the grantor to allocate the payments to the operator under the contract as a reduction in the liability recognised, a finance charge and charges for services. Additionally, IPSAS 32 provides guidance that the finance charge is determined based on the operator's cost of capital specific to the service concession asset, if this is practicable to determine. If this is not practicable, the rate implicit in the arrangement, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement is used. In contrast, this Standard provides guidance that the grantor uses the contractually specified interest rate in the arrangement to initially measure the financial liability component for the purpose of dividing a hybrid arrangement. Where this is not practicable, prevailing market rate(s) of interest for a similar instrument with similar credit ratings are applied, as required by the financial instrument Standards.

BC119 This Standard requires the grantor in a hybrid arrangement to measure the financial liability first, with the remainder of the total liability allocated to the liability related to the grant of the right to the operator. IPSAS 32 requires the grantor to account for the liability in a hybrid arrangement in accordance with the liability recognition requirements in IPSAS 32 generally.

Other revenues

BC120 IPSAS 32 includes additional application guidance for other revenues, which is not included in this Standard. 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 predetermined inflows of resources such as an upfront payment or a stream of payments (eg rent payments) and revenue-sharing provisions. This Standard instead references AASB 15 and AASB 1058 for application.

Definitions

BC121 This Standard modifies the defined terms of IPSAS 32. This Standard:

(a) replaces the IPSAS 32 term 'binding arrangement', which "describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract", with the term 'contract', which is defined as an "agreement between two or more parties that creates enforceable rights and obligations". This Standard also provides Application Guidance on the term 'contract';

(b) modifies the IPSAS 32 definition of a 'grantor' to refer to the grantor granting a 'right to access' the service concession asset to the operator, rather than a 'right to use' the asset;

(c) modifies the IPSAS 32 definition of an 'operator' from an entity that "uses the service concession asset" to an entity that has a "right of access to the service concession asset";

(d) modifies the IPSAS 32 definition of 'service concession arrangement' to require the operator to be responsible for at least some of the management of the public services provided through the service concession asset and not act merely as an agent on behalf of the grantor. IPSAS 32 identifies this only as a common feature of a service concession arrangement;

(e) modifies the IPSAS 32 definition of 'service concession asset' to expressly include major component replacements and previously unrecognised identifiable intangible assets and land under roads, and to exclude goodwill; and

(f) provides guidance on the term 'public service' that is not in IPSAS 32.

Transition

BC122 This Standard modifies the transition approach of IPSAS 32 to require any net adjustment on transition to be included as an adjustment to the opening balance of accumulated surplus (deficiency) at the date of initial application. IPSAS 32 requires a relevant adjustment to be included in revaluation surplus when the revaluation model is applied. Unlike IPSAS 32, this Standard also permits a grantor that has previously recognised service concession assets and related liabilities to apply the Standard retrospectively in accordance with the modified retrospective approach.

Illustrative examples

BC123 This Standard includes some differences in the illustrative examples based on those in IPSAS 32, such as:

(a) the examples of the financial liability model (Example 6) and the grant of a right to the operator model (Example 7) both include a funding cost in the measurement of the service concession asset at fair value (current replacement cost), whereas the corresponding IPSAS 32 examples do not. Consequently, Examples 6 and 7 in this Standard both show the service concession asset and the liability measured initially at the same amount, which is not the case for the financial liability example (Example 1) in IPSAS 32; and

(b) in Example 7, no revenue is recognised by the grantor in relation to the replacement of a major component of the service concession asset until the replacement occurs. The corresponding IPSAS 32 example (Example 2) allocates all revenue evenly over the term of the service concession arrangement.

The Standard also includes additional implementation guidance examples to illustrate the differences between service concession arrangements and other types of arrangements.

Comparison with IFRS Standards

BC124 Entities that comply with this Standard may not be in compliance with IFRS Standards issued by the IASB. The IASB has issued IFRIC Interpretation 12 addressing the accounting by operators of public-to-private service concession arrangements but has not issued a pronouncement regarding the accounting by grantors. The following paragraphs set out requirements in this Standard for the accounting by grantors that may not be compliant with IFRS Standards. A grantor that is a for-profit entity would not be able to state that its financial statements comply with IFRS Standards if it applies requirements that are not compliant with IFRS Standards.

BC125 This Standard requires a grantor to initially measure a service concession asset at current replacement cost in accordance with the cost approach to fair value in AASB 13. However, AASB 13 and the corresponding IFRS 13 do not specify which valuation technique to use. Instead IFRS 13 requires the use of valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Three widely used valuation techniques set out in IFRS 13 are the market approach, the cost approach and the income approach. The requirement of this Standard to initially measure a service concession asset at current replacement cost in accordance with the cost approach may not be compliant with IFRS 13. .

BC126 This Standard requires a grantor to recognise an identifiable intangible asset as a service concession asset where the grantor controls the asset as set out in paragraph 5 or 6, even if the asset does not qualify for recognition under AASB 138/IAS 38 *Intangible Assets*. This approach is explained in paragraph BC39.

BC127 Under this Standard, a grantor recognises revenue from granting a right to the operator over the term of the service concession arrangement on an appropriate basis. This may not be compliant with the permitted approaches to revenue recognition for licences of intellectual property, if IFRS 15 *Revenue from Contracts with Customers* applied in the absence of grantor accounting requirements. In developing this Standard, the Board decided not to apply the licence revenue requirements of AASB 15 by analogy.

Comparison with AASB Interpretation 12

BC128 This Standard addresses the key requirements of AASB Interpretation 12 from a grantor's perspective, in particular the criteria for the recognition of a service concession asset in paragraphs 5 and 6. The main differences between this Standard and AASB Interpretation 12 are detailed in the paragraphs below.

BC129 The scope of this Standard does not explicitly state whether the operator should be a public or private sector entity. This contrasts with AASB Interpretation 12, which states that the Interpretation gives guidance on the accounting by operators for public-to-private service concession arrangements (paragraph 4).

BC130 This Standard applies to arrangements involving a 'service concession asset', including intangible assets and land under roads. This is broader than AASB Interpretation 12, which is applicable to infrastructure but does not refer explicitly to such assets.

BC131 This Standard requires the grantor to recognise a financial liability when the grantor has a contractual obligation to pay cash to the operator for third-party usage of a service concession asset, with or without guaranteeing a minimum amount to the operator. This contrasts with AASB Interpretation 12, which links the recognition of a financial asset by an operator to a guarantee of the cash flows by the grantor. Under Interpretation 12, the operator's cash flows are conditional on usage when it has no such guarantee.