

Accounting update

28 July 2017

At a glance

- ▶ The AASB has issued AASB 1059 *Service Concession Arrangements: Grantors*, a new Standard which prescribes the accounting for SCAs from a public sector grantor perspective
- ▶ AASB 1059 represents a major shift in accounting from a 'risks and rewards' to a 'control' approach
- ▶ More service concession assets and related liabilities will be recognised on government balance sheets and generally will be recognised earlier, impacting net debt and forward estimates
- ▶ AASB 1059 is effective for annual reporting periods beginning on or after 1 January 2019

Accounting for service concession arrangements by public sector grantors

Currently, there is no Australian Accounting Standard or Interpretation which prescribes the accounting for service concession arrangements (SCAs), including Public to Private Partnership (PPP) arrangements, from the perspective of the public sector grantor. In its absence, a number of Australian State and Territory governments have adopted an accounting policy based on a risks and rewards approach to the accounting for SCAs.

To provide guidance on the accounting for SCAs from the grantor's perspective, the Australian Accounting Standards Board (AASB) released AASB 1059 *Service Concession Arrangements: Grantors* (AASB 1059) on 20 July 2017. Unlike current practice, AASB 1059 adopts a control approach in accounting for SCAs by grantors and will potentially result in more SCAs being recognised on balance sheet.

AASB 1059 approach

AASB 1059 is based on the International Public Sector Accounting Standard IPSAS 32 *Service Concession Arrangements: Grantor* (IPSAS 32) and is broadly consistent with AASB Interpretation 12 *Service Concession Arrangements* (Interpretation 12) which sets out the accounting for operators of such arrangements, in relation to its principles for recognising service concession assets.

SCAs are arrangements that public sector entities enter into with a private sector operator for the delivery of public services. Such arrangements normally involve the operator designing, constructing or upgrading the assets used to provide the public services and operating and maintaining these assets for a specified period of time. Assets may include toll roads, bridges, tunnels, hospitals, prisons, schools, airports, registries, student accommodation and databases. In return the operator is compensated either directly by the grantor or by collecting payments from the public, such as road tolls.

Scope

To be in the scope of AASB 1059, the arrangement must involve an operator:

- (a) providing public services related to the service concession asset on behalf of the public sector grantor for a specified period of time and
- (b) managing at least some of those services under its own direction, rather than at the direction of the grantor

Arrangements outside the scope of this Standard are those that do not involve the delivery of public service (e.g. assets used for commercial purposes), those where the operator manages the public services merely as an agent of the grantor (e.g. assets used to provide outsourced services) and arrangements that involve service and management components where the asset is not controlled by the grantor (e.g. privatised assets subject to price regulation where other control criteria are not met).

Service Concession Assets

Recognition

For arrangements which are in scope, AASB 1059 adopts a control approach to recognising a service concession asset. A service concession asset which is constructed, developed or acquired by the operator (including an upgrade to an existing asset of the grantor) is required to be recognised when the grantor controls the asset. The grantor will control the asset if:

- ▶ the grantor controls or regulates:
 - ▶ what services the operator must provide with the asset
 - ▶ to whom it must provide them and
 - ▶ at what price and
- ▶ the grantor controls any residual interest in the asset at the end of the arrangement (If the asset is not going to be used in a SCA for its entire economic life).

Any existing assets of the grantor to which the operator is provided access for the purposes of the arrangement (including any previously unrecognised intangibles and land under roads) are also assessed to determine if they meet the above control criteria. Where this is the case, such assets are reclassified to service concession assets.

Initial Measurement

If the control criteria are met, the grantor recognises the assets subject to the arrangement as service concession assets at their fair value. This includes existing assets of the grantor (both tangible and intangible) which are required to be measured at fair value at the date of reclassification.

The fair value of the service concession asset must be determined using current replacement cost under the cost approach to fair value in AASB 13 *Fair Value Measurement*. The AASB considered that the cost approach to fair value was the most appropriate on the basis that the capacity or service potential of the asset is used to achieve the public service objectives of the grantor regardless of whether the cost of the asset would be recovered through the expected cash flows that the asset may generate or otherwise.

Subsequent Measurement

After initial recognition or reclassification, each component of the service concession assets is required to be accounted for in accordance with owned assets of the grantor and subject to the depreciation, impairment and derecognition requirements as set out in AASB 116 *Property, Plant and Equipment*, AASB 138 *Intangible Assets* and AASB 136 *Impairment of Assets*.

Liabilities

Initial Measurement

Upon recognition of the service concession asset, a corresponding liability is also recognised, measured at the fair value of the service concession assets, being current replacement cost. The nature of the liability and its subsequent accounting however will depend on the consideration given by the grantor to the operator.

Financial Liability Model: Where the grantor compensates the operator by making payments to the operator (also commonly known as availability payments), a financial liability is recognised.

Grant of a right to the operator (GORTO) Model: Where the grantor compensates the operator by granting the operator the right to earn revenue from third-party users of the service concession asset (also commonly known to as user pays arrangements e.g. road tolls) or by providing access to another revenue generating asset, a non-financial liability is recognised.

Hybrid Model: Where the operator is compensated partly by payment(s) from the grantor and partly by receiving the right to earn revenue from third-party users of the service concession asset or providing access to another revenue generating asset, each portion of the liability is accounted for separately.

Subsequent Measurement

The below table summarises the subsequent liability measurement under each model:

Financial liability model	The financial liability is increased by the finance charge determined using the effective interest method and reduced by the payments made to the operator.
GORTO model	The liability is reduced and revenue recognised based on the economic substance of the arrangement. Revenue is usually recognised as access to the service concession asset is provided to the operator.
Hybrid model	The financial liability is measured first, with the remainder of the fair value of the service concession asset allocated to the GORTO liability. The financial liability and GORTO liability are subsequently measured separately in accordance with each respective measurement model.

Other considerations

Public service

While AASB 1059 provides guidance in assessing whether an asset provides public services, this will involve judgement and will depend on the nature and relative significance of the services provided by the asset. An asset will generally not be considered to provide a public service when its primary purpose is commercial in nature. In addition, judgement will need to be applied in determining whether a secondary asset provides a public service principally through a primary asset which largely provides a public service (such as a carpark constructed alongside a hospital which, in the main, provides public services).

Operator manages at least some of the public services

To be in scope, the operator must be responsible for providing public services through the service concession asset and for managing at least some of the public services and not merely acting as an agent of the grantor, as would be the case in an outsourcing arrangement. For example, where an operator constructs a toll road and is then responsible for its maintenance, this criterion would be met since maintenance in this case, contributes significantly to the public services provided by the toll road.

Control or regulation

The fundamental principle for recognition under this Standard is that control of the service concession asset rests with the grantor. Control or regulation of what services the operator must provide with the asset, to whom it must provide them, and at what price, are collectively a means by which a grantor can exercise and demonstrate control over the assets. However, the grantor does not need to have complete control over the service concession asset's use or price, it is sufficient for the use or price to be regulated by the grantor or a third-party regulator. Judgement will need to be applied when a service concession asset is partly regulated and partly unregulated. In such circumstances, a

grantor will need to consider whether the unregulated services are separable or whether they are ancillary.

Effective date and transition

AASB 1059 is effective for annual reporting periods beginning on or after 1 January 2019, with early application permitted. The standard permits adoption using one of two approaches:

- ▶ retrospectively to each prior period presented in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*; or
- ▶ retrospectively by recognising and measuring services concession assets and related liabilities at the date of initial application, where the date of initial application is the beginning of the earliest comparative period.

How we see it

Public sector grantors will need to evaluate the specific terms and conditions of existing arrangements with private sector operators to determine whether they are SCAs which fall within scope of the Standard and meet the control criteria for recognition or whether they are outsourcing, leasing or privatisation arrangements.

The new Standard will generally result in more SCAs being recognised on grantor balance sheets, as SCAs will be accounted for consistently regardless of how they are financed. Under the current risks and rewards approach, arrangements where the operator receives availability payments from the grantor are generally on balance sheet while those where the operator has a right to charge users such as toll roads, are off balance sheet.

Service concession assets and related liabilities will also be recognised earlier under the new Standard, potentially from the date of financial close of the arrangement, impacting the net debt and forward estimates of the government from an earlier date. This will be a significant difference to the current approach where service concession assets and liabilities are only recognised at the end of the construction period.

On transition, grantors will also need to undertake valuations using a current cost approach for assets which are subject to SCAs but which were previously unrecognised on balance sheet such as toll roads, intangibles and land under roads in order to be able to recognise them on balance sheet as required by the new Standard.

Next steps

The unique nature of SCAs and the structure and dynamic nature of their service payments will create a number of challenges in applying the new accounting requirements for such arrangements from a public sector grantor perspective. EY can help grantors transition to the new requirements.

To discuss further please contact one of our EY advisers below:

Oceania Frank Palmer EY Oceania IFRS Leader Tel: +61 2 8265 6264	Melbourne Georgina Dellaportas Tel: +61 3 9288 8621
Adelaide Peter Gerhardy Tel: +61 8 8417 2057	Brisbane Kellie McKenzie Tel: +61 7 3243 3643
Perth John Virgo Tel: +61 8 9429 2206	Sydney Melissa Sim Tel: +61 2 9276 9965
Canberra Ben Tansley Tel: +61 2 6267 3933	

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