FAQ – How do I calculate the financial liability on transition to AASB 1059?

What are the AASB 1059 transition requirements to measure the financial liability?

In accordance with **TC 20-03 Accounting Policy - Transition requirements for *AASB 1059 Service Concession Arrangements: Grantors*** NSW public sector agencies, including State Owned Corporations, shall apply the transition requirements set out in **AASB 1059.C3(b).**

This transition election is referred to as the "modified retrospective approach"[1], which means agencies shall apply AASB 1059 retrospectively by recognising and measuring service concession assets and related liabilities at the date of initial application. The date of initial application is the beginning of the earliest reporting period for which comparative information is presented in the financial statements. For financial years ending 30 June, the date of initial application is therefore **1 July 2019**, being the beginning of the comparative period in financial reports prepared for FY2020/21.

In applying these transition elections to arrangements that exist at 1 July 2019, AASB 1059 further specifies that any **financial liability** must be recognised at <u>fair value</u> at the date of initial application[2].

We expect the majority of financial liabilities in service concession arrangements will already be recognised under existing accounting treatments. Often these existing financial liabilities will be measured at amortised cost in accordance with the subsequent measurement requirements of AASB 9 *Financial Instruments*. Therefore, the AASB requirement to remeasure these financial liabilities at fair value on 1 July 2019 will likely result in significant changes to these financial liabilities.

How do I calculate the fair value of the financial liability on transition?

The fair value of the financial liability is to be determined in accordance with AASB 13 *Fair Value Measurement*. The most appropriate valuation technique will be a present value technique, for which agencies should use their **incremental borrowing rate (IBR)** as the discount rate.

The IBR should be based on TCorp lending rates (which is the rate at which agencies could borrow from TCorp) at 1 July 2019 for arrangements under transition.

No adjustment to the IBR rate of TCorp rates is necessary for agencies that do not borrow from the market. However, it is important to note where the **Government guarantee fee** is paid on the financial liability this <u>should be factored into the rate</u>.

[1] AASB 1059.BC101

[2] AASB 2019-2, amended paragraph AASB 1059.C4(b) to state 'If a grantor elects to apply this Standard retrospectively in accordance with paragraph C3(b), the grantor shall measure a financial liability arising under a service concession arrangement at <u>fair value</u> at the date of initial application;'

Agencies that do not borrow from the market should use **TCorp rates** as their incremental borrowing rates:

Remaining term of financial liability from 1 July 2019	July 2019 discount rates*
For terms up to 5 years	1.42% p.a.
For terms > 5 years up to 10 years	2.00% p.a.
For terms > 10 years	2.42% p.a.

* **For SOCs that use these rates, the Government Guarantee Fee (GGF) is required to be added to these issued rates.**

> **Please note:**
>
> - The above discount rate incorporates the following components of fair value measurement (AASB 13.B13(c), (d) and (f)):
>   - The time value of money
>   - The risk premium
>   - The non-performance risk.
>
> - Your calculation will also need to incorporate the other components of a present value measurement (AASB 13.B13(a), (b) and (e)), including:
>   - The estimate of future cash flows
>   - Expectations about the variations to those expected cash flows
>   - Other factors market participants would take into account in assessing the fair value of the liability.

Other transition considerations

Asset valuation requirements on transition - Refer to FAQ - What are the valuation requirements for service concession assets on transition to AASB 1059? for further guidance.

If you have any questions about measuring your financial liability in a service concession arrangement, please contact the Accounting Policy Team.

Appendix A

AASB 1059 Guidance

Transition measurement

C4 If a grantor elects to apply this Standard retrospectively in accordance with paragraph C3(b), the grantor shall:

a. measure the deemed cost of a service concession asset (including an existing asset of the grantor reclassified as a service concession asset) at fair value (current replacement cost) at the date of initial application;

b. **measure a financial liability arising under a service concession arrangement at fair value at the date of initial application;**

NSW Treasury has engaged the AASB on this matter and any financial liability should be recognised at fair value at the date of initial application (1 July 2019).

Initial measurement

B64 When the grantor provides compensation to the operator for the cost of the service concession asset and service provision in the form of a predetermined payment or series of payments, an amount reflecting the fair value (current replacement cost) of the service concession asset is recognised as a liability in accordance with paragraph 11. The grantor shall 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 shall determine an appropriate rate using the prevailing market rate(s) of interest for a similar instrument with a similar credit rating. 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.