FAQ – How do you remeasure WIP assets to CRC using the interest accretion method under AASB 1059?

Introduction

AASB 1059 *Service Concession Arrangements: Grantors* (AASB 1059) addresses the accounting for service concession arrangements by public sector grantors. Under AASB 1059, service concession assets are initially measured at current replacement cost (CRC)[1]. This includes service concession work in progress (WIP).[2] AASB 1059.B45 states, 'for property, plant and equipment and intangible assets, if the recognition criteria are met during the construction or development period, the grantor recognises the service concession asset to the appropriate extent during that period.'

AASB 1059 Illustrative Examples, Examples 6-8, illustrate what will be referred to as the 'interest accretion' method to recognise a fair value uplift in WIP assets in order to continue to reflect those assets at CRC. The CRC of an asset reflects the amount that would be required to replace the service capacity of an asset[3].

This FAQ aims to address NSW Treasury's approach to:

1. The Interest Accretion method under AASB 1059
2. AASB 1059 WIP balances that are funded upfront by the Operator
3. AASB 1059 WIP balances on transition to AASB 1059:
    a. AASB 1059 WIP balances at 1 July 2019 where a professional valuation has been obtained on completion of the asset prior to 30 June 2021
    b. AASB 1059 WIP balances at 1 July 2019 that are still WIP assets at 30 June 2021
4. AASB 116 *Property, Plant and Equipment* WIP

1. The Interest Accretion method under AASB 1059

AASB 1059 clearly prescribes when the grantor must initially recognise an asset and a corresponding liability.[4] It also prescribes when assets under construction should be recognised[5], and when to recognise the financial and GORTO components of the liability during construction in a hybrid arrangement.[6] From this, it is clear that, AASB 1059 may require initial recognition of an asset and liability during the construction period. Therefore, it follows that any change to the asset subsequent to initial recognition, must be a remeasurement of the asset.

AASB 1059 Examples 6-8 illustrate what will be referred to as the 'interest accretion' method. The interest accretion method is used to recognise a fair value uplift in WIP assets in order to continue to reflect those assets at CRC i.e. a remeasurement of the asset.

Drawing from the concepts in Illustrative Examples 6-8 of AASB 1059, NSW Treasury's interpretation of the interest accretion method is as follows:

[1] AASB 1059.7
[2] AASB 1059.B44-B47
[3] AASB 13.B8
[4] AASB 1059.11-12
[5] AASB 1059.B45
[6] AASB 1059.BC94

- AASB 1059 requires service concession WIP assets to undergo a FV uplift in order to continue to reflect those WIP assets at CRC over the extended construction period.
- AASB 1059 uses the interest calculated using the EIR method on the financial liability (or implied EIR on the GORTO liability) as a proxy for the FV uplift. Where the EIR cannot be determined, the grantor's incremental borrowing rate or the operator's cost of capital can be used as a proxy for fair value uplift instead.[7]

On the basis that interest accretion is a method for revaluing service concession WIP assets:

- The FV uplift should be calculated on the opening value of the service concession liability regardless of the funding model (i.e. GORTO, financial liability or hybrid).

FV uplift in any given period = Current period opening service concession liability x Applicable Interest Rate[8]

- The uplift in the WIP asset should be recognised in the ARR regardless of the funding model (i.e. GORTO, financial liability or hybrid).

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2. AASB 1059 WIP balances that are funded upfront by the Operator

Under a service concession arrangement, an operator may incur funding costs where they fund the construction of assets upfront under both the GORTO and financial liability models (depending on the timing of Grantor contributions).

In these circumstances, the total project costs or total amounts advised by an operator may include their compounding funding costs. If you believe that the WIP balances booked by your Agency are already inclusive of the operator's compounding funding cost, you will need to contact Treasury for further advice.

3. AASB 1059 WIP balances on transition to AASB 1059

a. AASB 1059 WIP balances at 1 July 2019 where a professional valuation has been obtained on completion of the asset prior to 30 June 2021

This applies to service concession assets that were still under construction at 1 July 2019 but, were completed prior to 30 June 2021. Where the agency has obtained a professional valuation on completion of the asset on or before 30 June 2021, no further action should be required by the agency in respect of that financial year, (i.e. it is not necessary to apply the interest accretion method in section 1 above.)

b. AASB 1059 WIP balances at 1 July 2019 that are still WIP at 30 June 2021

[7] AASB 1059.B64

[8] Where the EIR cannot be determined, the grantor's incremental borrowing rate or the operator's cost of capital can be used as a proxy for fair value uplift instead.

Agencies will need to refer to sections 1 and 2 above to comply with the requirements of AASB 1059.

4. AASB 116 Property, Plant and Equipment WIP

AASB 116 WIP (that are not under a service concession arrangement) are either constructed by the State or acquired through Design & Construct (D&C) contracts. There are no specific requirements in AASB 116 nor AASB 13 *Fair Value Measurement* to apply the interest accretion method of fair value uplift for WIP that is accounted for under AASB 116.

Agencies should continue to comply with *TPP 21-09 Accounting Policy: Valuation of Physical Non-Current Assets at Fair Value* which requires:

- A comprehensive revaluation using external professionally qualified valuers either to conduct the revaluation or to review the revaluation every 5 years, and
- Interim revaluations between comprehensive revaluations, where cumulative changes to indicators/indices suggest fair value may differ materially from carrying value.