

STAFF PAPER

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Project	IFRIC 12
Paper topic	Payments made by an operator in a service concession arrangement
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Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to address an issue related to payments made by an operator in a service concession arrangement within the scope of IFRIC 12 *Service Concession Arrangements*.
2. Specifically, the submitter requested that the Committee clarify in what circumstances (if any) certain contractual costs to be incurred by the operator under the service concession arrangement should:
 - (a) be recognised at the start of the concession as an asset with an obligation to make the related payments; or
 - (b) be treated as executory in nature, to be recognised over the term of the concession arrangement.
3. There are a number of examples of contractual payments that operators are obliged to make in order to fulfil their obligations under service concession arrangements. These include, but are not limited to:
 - (a) Payments to the grantor or third parties for the use of tangible assets ('right-of-access payments'); and

- (b) Fees payable to the grantor by the operator for the right to operate the concession ('concession fees'). The concession fees can be fixed or variable depending on the specific terms of the service concession arrangement.

Tentative decisions taken in the previous meeting

4. The Committee first discussed this issue at the November 2011 meeting¹. At that meeting, the Committee noted that when the payments are right-of-access payments, judgement should be used to determine whether the operator obtains *control* over the right of use of the tangible asset or whether the operator is given a right to access the infrastructure on behalf of the grantor. This would determine whether the arrangement is within the scope of IAS 17 *Leases* or IFRIC 12 respectively.
5. The Committee noted that if right-of-access or concession fee arrangements are within the scope of IFRIC 12, further analysis would need to be performed before the Committee could make a decision on how to proceed with the recognition and measurement aspects of the issue. The Committee therefore asked the staff to:
 - (a) **Question 1:** analyse the arrangements and focus on whether the arrangements represent the acquisition of an asset;
 - (b) **Question 2:** consider, if the arrangements do represent the acquisition of an asset, whether the asset could be classified as a financial asset or intangible asset based on the principles in IFRIC 12;
 - (c) **Question 3:** consider, if an asset is recognised, what amount the asset should initially be measured at and how any subsequent measurement of the asset would interact with IAS 39 *Financial Instruments: Recognition and Measurement* if the requirement to make payments is a financial liability, both in relation to fixed and variable payments; and

¹ Refer to agenda paper 10 - <http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm>

- (d) **Question 4:** analyse what the accounting would be if the operator could cancel the arrangement without penalty.
6. In developing the analysis that follows, the structure of the paper is broken down as follows:
- (a) Question 1: Conceptual analysis of whether an asset exists in right-of-access and concession fee arrangements;
 - (b) Question 2: Classification of the asset as financial or intangible;
 - (c) Question 3.1: Initial measurement of the asset and liability depending on the type of arrangement;
 - (d) Question 3.2: Subsequent measurement of the asset and liability depending on the type of arrangement;
 - (e) Question 4: impact of cancellation options depending on the type of arrangement.

Staff analysis

Question 1: Do the arrangements represent the acquisition of an asset?

7. Paragraph 4.4 of the *Conceptual Framework for Financial Reporting* defines an asset as:
- (a) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
8. When the operator and the grantor enter into a service concession contract that includes right-of-access or concession fee arrangements, we think that the future payments are promised in exchange:
- a) for right-of-access payments, the contractual right of the operator to access the infrastructure for the purposes of providing the public service on behalf of the grantor; or

- b) for concession fee payments, the contractual right of the operator to represent the grantor as the entity which delivers the public service, thereby earning a fee.

This is based on the view that the rights are distinct from the service concession revenue arrangement (this is considered further in Question 3.1 below).

9. We think that in both cases, the key characteristics of an asset are met because:

- (a) for right-of-access payments, the operator has a currently enforceable right to access the infrastructure to provide the public service and in doing so the grantor cannot give the right of access over the infrastructure to another entity (controlled resource). The right of access will be available at a point in time based on the contract (past event) from which the operator will, in conjunction with other assets, generate revenue from operating the concession (future economic benefits). We think that the control in this case is over the *access to operate* the infrastructure and not control over the *right of use* of the underlying asset. Consequently we think this logic does not contradict our previous thinking from the November Committee meeting that right-of-access payments are within the scope of IFRIC 12 when the operator does not control the right-of-use;
- (b) for concession fees, the operator has a currently enforceable right to act as the operator on behalf of the grantor and can prevent other entities from providing the service concession services (controlled resource). The right to act on the grantor's behalf is the result of signing the contract (past event) from which the operator will, in conjunction with other assets, generate revenue from operating the concession (future economic benefits); and
- (c) it may be difficult in practice to determine what portion of the future payments represent concession fees and what portion represent right-of-access payments where both features are present in a service concession arrangement. We think that both arrangements are the

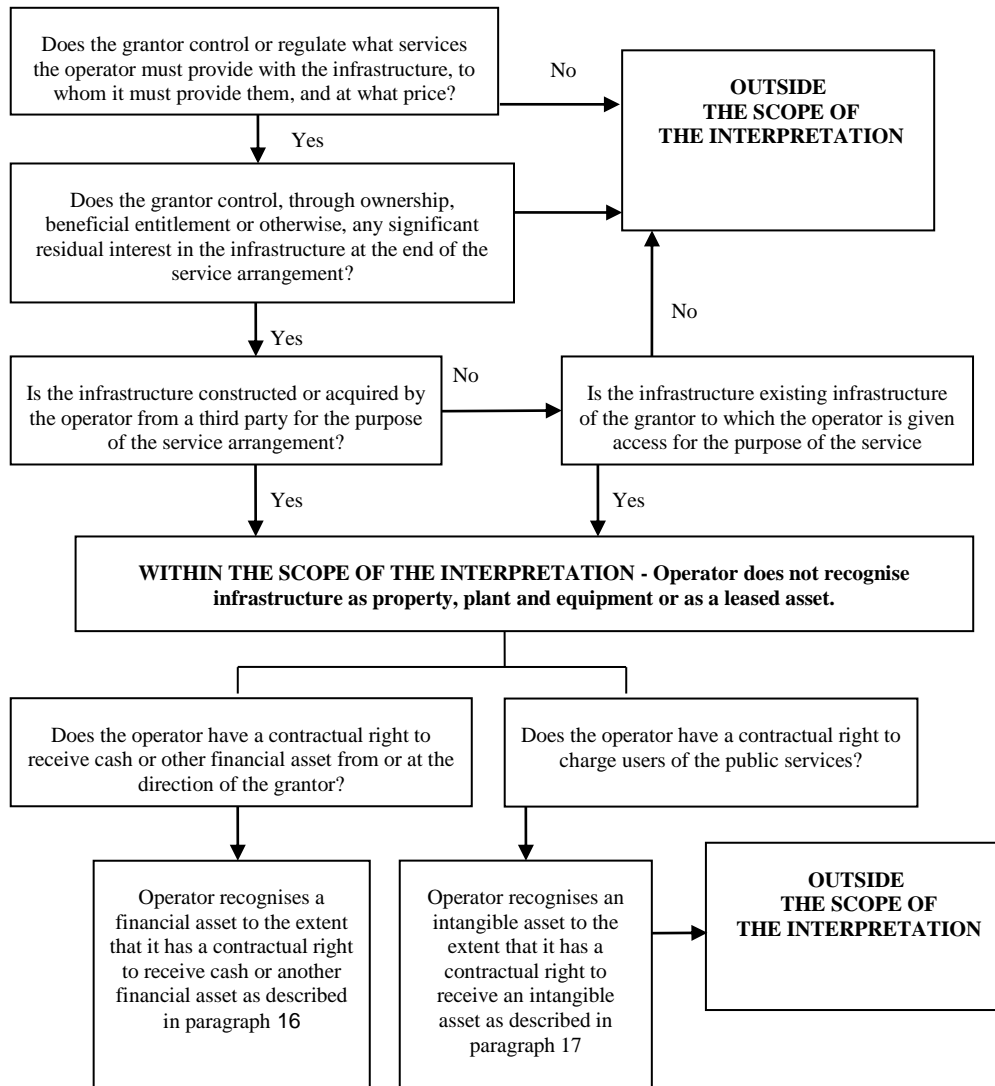
result of an arm's length contractual arrangement (indicating control through a contract), from which identifiable future economic benefits, embodied in the overall concession arrangement, are expected to flow to the operator, and that control of the resource generally occurs at the signing of the service concession contract (past event).

10. Based on the above rationale, we think that right-of-access and concession fee arrangements represent the acquisition of assets by the operator.

Question for the Committee
<ol style="list-style-type: none"> 1. Does the Committee agree that right-of-access and concession fee arrangements represent the acquisition of assets by the operator when the benefits are distinct?

Question 2: Should the asset be classified as a financial asset or intangible asset based on the principles in IFRIC 12?

11. Assuming that the answer to Question 1 above is yes, ie that right-of-access and concession arrangements do represent the acquisition of an asset, this second question needs to be considered.
12. Before considering Question 2, we think it is helpful to reproduce the high-level decision tree from IFRIC 12 Information Note 1 which summarises when the different models in IFRIC 12 are applicable:



13. Paragraphs 15 to 17 of IFRIC 12 state:

Consideration given by the grantor to the operator

15. If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognised at its fair value. The consideration may be rights to:

- a) a financial asset, or
- b) an intangible asset.

16. The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to

receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

17. The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.

14. In considering Question 2, we think that there are two possible views:

- (a) **View 1 ‘intangible asset only’:** Proponents of this view think that the asset acquired will always be an intangible asset. Proponents of this view think that the guidance in IFRIC 12 regarding the financial asset and intangible asset models are only applicable for *construction or upgrade services* provided by the operator because this guidance is included under the sub-heading in IFRIC 12 for construction and upgrade services. Payments made by the operator to the grantor are not related to the construction or upgrade services. Consequently, payments by the operator to the grantor should be accounted for based on other IFRS standards. Proponents of this view think that the arrangements represent the acquisition of either a right to operate the

concession or a right of access to a tangible asset, ie in both cases, the asset is an intangible asset.

- (b) **View 2 ‘financial or intangible asset’:** Proponents of this view agree that payments made by the operator to the grantor are not related to the construction or upgrade services. However, proponents of this view think that the principles in IFRIC 12 paragraphs 16 and 17 for determining the appropriate model for construction and upgrade services should be applied to the arrangements where the operator is required to make payments to the grantor. In other words, regardless of whether the operator provides construction and upgrade services or only operation services, when analysing how the right-of-access or concession fee arrangements should be accounted for, an entity should consider whether it has:

- (i) an unconditional contractual right to receive cash or another financial asset from the grantor as described in paragraph 16 of IFRIC 12 (either for construction/upgrade services *or* operation services). If this is the case, then the right-of-access or concession fee arrangements should be analysed under the financial asset model; or
- (ii) a right to charge users of the public service as described in paragraph 17 of IFRIC 12. If this is the case, then the right-of-access or concession fee arrangements should be analysed under the intangible asset model.

15. At the November 2011 Committee meeting², we presented the view that the right-of-access and concession fee arrangements could only represent the acquisition of an intangible asset (View 1 above) for the following reason:

We do not think that the recognition of a financial asset or intangible asset for construction or upgrade services should affect the recognition treatment proposed in view 2

² Refer to agenda paper 10 paragraph 32
<http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm>

(‘concession fees treated as consideration for an intangible asset’) for the concession fees because:

- a) The recognition of a financial asset or intangible asset for construction or upgrade services (‘services’) is a result of the consideration provided by the grantor to the operator for the services transaction; whereas
- b) The recognition of any liability and related intangible asset in respect of the concession fees is a result of the consideration provided by the operator to the grantor for the right to operate the concession.

Therefore, the two transactions are mutually exclusive.

16. However, in considering this issue further, we think that the ‘financial or intangible asset’ view is more appropriate, ie any recognised asset as a result of the payment arrangement by the operator to the grantor could be either an intangible asset or financial asset based on the principles in IFRIC 12 paragraphs 16 - 18.
17. We think the financial or intangible asset view is more appropriate because we think that there may be situations where the payments made by the operator to the grantor represent in substance a financing arrangement. For example:
 - (a) assume that an operator has concluded that it would apply the financial asset model for the construction services based on the principles in paragraph 16 of IFRIC 12;
 - (b) in addition to the operator having a contractual right to receive cash from the grantor in the future, the operator is contractually committed to pay cash to the grantor, ie the concession fee arrangement. In other words, the operator has a contractual right to receive cash from the grantor *but also* has a contractual obligation to pay cash to the grantor.
 - (c) the fact that the operator pays a stream of cash flows to the grantor in exchange for the grantor to pay a stream of cash flows to the operator indicates a financing arrangement. Depending on the timing of the

cash flows, either the grantor could be providing financing to the operator or vice-versa.

18. Consequently, if the operator would apply the financial asset model to the construction, upgrade or operation services based on the guidance in IFRIC 12 paragraph 16 and the operator also has an obligation to make future payments to the grantor, we think this arrangement represents a form of financing as the cash flows between the operator and the grantor flow in both directions but are dependent on the same overall transaction. Accounting for the payments by the operator as the acquisition of an intangible asset when in substance they represent a financing arrangement would not provide a faithful representation of the substance of the transaction.

Question for the Committee

2. Does the Committee agree that payments made by the operator to the grantor should be assessed under the existing principles of IFRIC 12 paragraph 16 – 18 to determine if the arrangement represents the acquisition of an intangible asset or a financing arrangement or both?

Question 3.1: Initial recognition and measurement of the asset and liability

19. Assuming that the financial or intangible asset view is applied as explained in Question 2 above, IFRIC 12 paragraph 24 and 26 require an entity to apply IFRS 9 and IAS 38 to the measurement of a financial asset and intangible asset respectively. Consequently we think that the initial and subsequent measurement needs to be considered for each model as the requirements for financial assets and intangible assets are different in this respect.
20. For either model, the arrangements we considered are either:
 - (a) The operator providing construction or upgrade services and subsequent operation services. In addition, the operator is required to

make either fixed or variable future payments to the grantor over the life of the arrangement; or

- (b) The operator providing only operation services and the operator is required to make either fixed or variable future payments to the grantor over the life of the arrangement.

When the arrangement represents the acquisition of a financial asset

- 21. At the date that the operator and grantor sign the contract, the parties have in substance entered into a financing arrangement. This is because over the term of the concession arrangement, the amount of financing will be repaid depending on the timing of the cash flows:

For example, consider the following two concession arrangements:

Example 1 – Operator finances the Grantor

- Entity O is the operator and Entity G is the grantor in a 10 year service concession arrangement within the scope of IFRIC 12.
- Entity O has not provided any construction or upgrade services to Entity G, but Entity O has agreed to operate a public toll road on behalf of Entity G during the concession.
- The terms of the agreement state that Entity O is required to make three annual payments of CU7,000 in each of the first three years to Entity G for the right to operate the concession.
- The terms of the agreement also state that Entity G will contractually guarantee Entity O's revenue per year, such that Entity O will always be paid at least CU5,000 per year for the service concession services.

In substance, Entity O has provided financing to Entity G over the first three years of the concession arrangement.

Example 2 – Grantor finances the Operator

- Entity O is the operator and Entity G is the grantor in a 10 year service concession arrangement within the scope of IFRIC 12.
- Entity O has not provided any construction or upgrade services to Entity G, but Entity O has agreed to operate the public toll road on behalf of Entity G.

- The terms of the agreement state that Entity G will contractually guarantee Entity O's minimum revenue per year. In the first year, entity G agrees to make up any shortfall to ensure that Entity O receives at least CU20,000 in year one of the concession term. In the remaining nine years of the concession term, Entity G guarantees that Entity O will always be paid at least CU5,000 per year for the service concession services.
- The terms of the agreement further state that Entity O is required to make a one off payment to Entity G of CU25,000 at the end of the concession arrangement.

In substance, Entity G has provided financing to Entity O over the term of the concession arrangement.

22. We discussed the above fact patterns with a limited number of interested parties and based on this limited outreach, we understand that these types of financing arrangements do indeed occur in certain service concession arrangements.
23. We think that there are two possible alternatives in accounting for the right-of-access and concession fee arrangements if the financial asset model applies:
- (a) **View 1 'gross up approach':** Under this view, the operator would initially recognise the financial liability representing its obligation to pay cash to the grantor in the future. At the same time, the operator would recognise a financial asset representing the contractual right to receive cash in the future, but with its measurement limited to the financial liability so as not to record a day one gain for services that have not yet been provided, consistent with the approach that would be taken in a multiple element arrangement under IAS 18 paragraph 13. In other words, this view would result in a day one gross up of the balance sheet for the financial liability with a corresponding financial asset.

Example 3 – Gross up approach

- Entity O is the operator and Entity G is the grantor in a 10 year service concession arrangement within the scope of IFRIC 12.

- Entity O constructs a toll road on behalf of Entity G at the beginning of year 1, and following this Entity O will operate the public toll road on behalf of Entity G for the 10 year concession period.
- The terms of the agreement state that Entity G will contractually guarantee Entity O's minimum revenue per year (financial asset model). At the end of year 2 of the arrangement, entity G agrees to make up any shortfall to ensure that Entity O receives at least CU26,500 in year 2 of the concession term. For the other nine years of the concession term, Entity G guarantees that Entity O will always be paid at least CU6,500 per year for the service concession services. The reason why Entity O receives such a relatively large payment in the second year is because Entity O requires new financing to repay the borrowings it incurred to build the toll road initially.
- The terms of the agreement further state that Entity O is required to make a one off payment to Entity G of CU29,500 at the end of the concession arrangement. This payment is intended to represent the settlement of the financing provided to Entity O.
- The interest rate applicable to Entity O and Entity G's borrowings is approximately 5 per cent per annum.
- The relative fair value of the construction services is measured at CU50,000.

In substance, Entity G has provided financing of CU20,000 to Entity O at the end of the second year of the arrangement. The following journal entries for Entity O would result from applying the gross approach to the above fact pattern:

Year 1:

Dr Receivable CU50,000

Cr Revenue CU50,000

Recognition of the relative fair value of the construction services in accordance with IFRIC 12 paragraph 13.

Dr Financial asset CU18,140

Cr Financial liability CU18,140

Recognition of the contractual payment that entity O is required to make, as well as the corresponding asset in accordance with View 1, ie the present value of the CU29,500 that will be repaid at the end of the concession arrangement

Dr Financial asset CU905

Cr Interest income CU905

Dr Interest expense CU905

Cr Financial liability CU905

Recognition of the time value of money of 5 per cent for year 1 on both the financial asset and liability.

Dr Cash CU6,500

Cr Receivable CU4,000

Cr Interest income CU2,500

Recognition of the cash received for year 1, as well as the interest income on the CU50,000 receivable of CU2,500, ie application of the effective interest rate method in accordance with IFRIC 12 paragraph 25 .

Year 2:

Dr Cash CU6,500

Cr Receivable CU4,200

Cr Interest income CU2,300

Recognition of the cash received for year 2, as well as the interest income on the CU46,000 receivable of CU2,300, ie application of the effective interest rate method in accordance with IFRIC 12 paragraph 25 .

Dr Financial asset CU955

Cr Interest income CU955

Dr Interest expense CU955

Cr Financial liability CU955

Accretion of the time value of money of 5 per cent on the financial asset and corresponding liability for year 2.

Dr Cash CU20,000

Cr Financial asset CU20,000

Cash received by entity O of CU20,000, resulting in derecognition of the financial asset. The CU20,000 financial liability will continue to accrete interest expense until the end of year 10, when Entity O will repay the CU29,500.

(b) **View 2 ‘net financing approach’:** Proponents of this view also think that any contractual future payments that are required to be made by the operator to the grantor represent a financing arrangement and are not part of the revenue arrangement for operation or construction services. However, proponents of this view think that any financial asset or financial liability should only be recognised once the financing has actually been provided in cash. The level of financing provided would be determined by comparing the cumulative net cash received by the operator to the cumulative related revenue that has been earned at that point in time. In other words, at any point in time during the arrangement:

- (i) If the operator has earned more revenue than the related net cash received from the grantor, a financial asset would be recognised by the operator; and
- (ii) If the operator has earned less revenue than the related net cash received from the grantor, a financial liability would be recognised by the operator.

Example 4: Net approach

Assume the same fact pattern as that provided in the gross up approach in the preceding paragraph. However, in this example, Entity O applies the net financing approach. The following journal entries for Entity O would result from applying the net financing approach (the journal entry highlighted in bold represents the difference in this approach compared to the gross up approach):

Year 1:

Dr Receivable CU50,000

Cr Revenue CU50,000

Recognition of the relative fair value of the construction services in accordance with IFRIC 12 paragraph 13.

Dr Cash CU6,500

Cr Receivable CU4,000

Cr Interest income CU2,500

Recognition of the cash received for year 1, as well as the interest income on the CU50,000 receivable of CU2,500, ie application of the effective interest rate method in accordance with IFRIC 12 paragraph 25 .

Year 2:

Dr Cash	CU6,500	
	Cr Receivable	CU4,200
	Cr Interest income	CU2,300

Recognition of the cash received for year 2, as well as the interest income on the CU46,000 receivable of CU2,300, ie application of the effective interest rate method in accordance with IFRIC 12 paragraph 25 .

Dr Cash	CU20,000	
	Cr Financial liability	CU20,000

Cash received by Entity O of CU 20,000, which is not recognised as revenue. At the time that the cash is received by Entity O, this is treated as a loan that will be repaid by Entity O at the end of the concession arrangement.

24. We think that the net financing approach is the more appropriate accounting treatment because:

- (a) we think that this type of arrangement is the same as a revenue contract in which the customer finances the entity providing the services, and the finance must be repaid at some later point in time. In that situation, we think that IAS 18 paragraph 13 would apply and that any consideration that did not represent revenue would need to be accounted for based on the substance of the transaction, ie a loan:

13. The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction...

- (b) at the date that the operator and grantor sign the contract, we think one way of looking at the financing element of the transaction is that the future payments or receipts represent a loan commitment. Because this type of loan commitment would not be in the scope of IAS 39 based on paragraphs 2(h) and 4 of IAS 39, the loan commitment would be within the scope of IAS 37 *Provisions, contingent liabilities and contingent assets*. Consequently, until one of the parties performs and provides the financing, the contract is executory in the same way as a ‘normal’ loan commitment.

Question for the Committee

3. Does the Committee agree that if the service concession arrangement is within the financial asset model, then the payments made by the operator to the grantor represent a financing arrangement and should be accounted for as a receivable or payable when the related financing is provided? (In other words, there would be no recognition of any asset or liability on day one of a service concession that included a right-of-access or concession fee arrangement if the financial asset model is applicable. The financial asset or liability would be recorded by the operator at the time that the financing payment or receipt is incurred).

The arrangement represents the acquisition of an intangible asset

25. At the date that the operator and grantor sign the contract, the operator has in substance obtained a right to act to provide the public service to third parties. This is different from the financial asset model for the same reasons provided in paragraph 17 of IFRIC 12, ie the payment made by the grantor gives the grantor a right (a license) to charge users of the public service and is not an unconditional right to receive cash from the grantor.

26. As discussed in agenda paper 10 from the November 2010 Committee Meeting³, we previously considered several potential views for the accounting treatment of the right-of-access and concession fee arrangements. We think that these views are relevant when the arrangement represents the acquisition of an intangible asset. For ease of reference, we have reproduced the relevant extracts from agenda paper 10 from the November 2010. Although the extract below refers only to ‘concession fees’, the accounting treatment would apply equally to right-of-access arrangements within the scope of IFRIC 12 as explained elsewhere in the November 2010 paper:

29. We think that there are four possible views in accounting for concession fees:

a) View 1 – Concession fees should be treated as annual license fees:

The concession fees are no different to royalty or franchise payments for a right of use for an intangible asset. The right granted here is akin to a franchise license and should be recorded in a similar manner, ie as incurred. Whether the license fee is fixed or variable should not impact the accounting treatment. Although IFRIC 12 paragraph 17 refers to the guidance in IAS 38 *Intangible assets* for the concession right, this is only relevant when the intangible is recognised over time as a consequence of construction or upgrade services because this paragraph is written under the heading of ‘Construction or upgrade services’. Therefore the intangible model in IFRIC 12 does not apply to *payments* for the concession right. Under this view, the concession fee payments would be treated as executory.

b) View 2 – Concession fees should be treated as consideration for an intangible asset:

³ The full paper can be obtained from the IASB website from the November 2011 Committee meeting - <http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm>.

Concession fees with minimum contractual payments should be capitalised and the related liability recorded when the operator obtains control of the right. However, variable payments based on, for example, revenue or profit share are akin to contingent consideration payments for the acquisition of an intangible asset. We note that the Committee currently has an outstanding issue relating to contingent consideration payments for the acquisition of tangible and intangible assets (Refer to the May IFRIC Update). The treatment of the variable portion of any payment for the concession asset should be consistent with the Committee's conclusion on this outstanding issue.

c) View 3 – Concession fees should be presented as contra-revenue:

Concession fees should be netted against the total consideration received from customers of the public services. IFRIC 12 paragraph BC 13 explains that the IFRIC decided that the Interpretation could provide references to relevant standards that apply to arrangements outside of the scope of the Interpretation. To determine if the concession fees should be recorded net of the related service concession revenue, IAS 18 *Revenue* paragraph IE 21 provides the relevant gross versus net guidance in the form of indicators. One of these indicators is the power to determine selling price and because the operator has limited or no discretion in setting prices, the operator is in substance acting as an agent on behalf of the grantor. Therefore regardless of whether the concession fee is fixed or variable, the amount paid to the grantor should be accounted for as a reduction of revenue when the related revenue is recognised.

d) View 4 – Concession fees treatment depends on the underlying asset as intangible or tangible:

Concession fees that are linked to the right-of-use of a tangible asset meet the definition of an intangible asset. However, concession fees that do not give a right to an identifiable asset are akin to a form of tax and are not intangible assets. Therefore the accounting for concession fees depends on what the payment is for:

- i) If the payment is linked to the right of use of a tangible asset, then view 2 would be followed as there is an identifiable benefit. An entity should capitalise the right-of-use asset and recognise the related obligation to make payments if the payments are fixed. If the payments are variable then the treatment would depend on the outcome of the related IFRIC outstanding issue on contingent payments;
- ii) If the payment is not linked to the right-of-use of a tangible asset, then concession fees should be recognised as period costs when they are incurred. The concession fees do not represent part of the acquisition cost of an intangible asset. They do not provide any additional rights to the operator, particularly when construction services have already been provided as part of the arrangement. The concession fees are akin to a tax that the operator must pay in order to operate the concession.

30. We think that View 2 is the more appropriate view for the following reasons:

- i) We disagree with View 1. Although we agree that concession fees are no different to royalty or franchise payments for the right of use of an intangible asset, we think that the license fee being

fixed or variable is relevant. We think a *fixed* contractual minimum payment over time for the right of use of an intangible asset is no different to deferred payment terms. In addition this conclusion appears to be consistent with the previous staff position as explained in paragraph 26. In most cases royalty payments are variable (e.g. based on sales, output or net profit). We think that variable royalty payments and their interaction with variable concession fees should be considered further when the Committee considers the issue of contingent pricing of property, plant and equipment and intangible assets.

- ii) We do not agree with the second argument in View 1. Although IFRIC 12 paragraph 17 is written in the context of construction or upgrade services, we think the principle in that paragraph can also apply to concession rights paid for by the operator with cash rather than the operator's services. Under IFRIC 12's intangible asset model, the intangible asset is recognised over the period in which the construction services are provided because it is the satisfaction of the performance obligation over time which provides the operator with the concession right. If the operator obtains the concession right through payment rather than service, this impacts the timing of recognition and type of consideration provided by the operator to obtain the concession asset, but it does not alter the fact that the operator has obtained an intangible asset.
- iii) We do not think that view 3 is appropriate. The payments made to the grantor should not be recognised as a reduction of revenue for the following reasons:

- a) When the payments are fixed, this is not a revenue sharing arrangement and there is no clear link between the revenue earned by the operator and the payment made to the grantor. In other words, the operator cannot be paying over a portion of the revenue to the grantor because the payment is unrelated to the revenue if the payment is fixed.
- b) If the payments are variable and based on a revenue or profit sharing arrangement:
 - 1. We agree that concession arrangements limit operators' latitude in establishing prices. However, when considering the other relevant criteria in IAS 18 paragraph IE 21, we think that the fact that the operator has the primary responsibility for providing the services is the more relevant criterion in this case.
 - 2. In most service concession arrangements, the percentage that the operator retains is significant in relation to the overall consideration collected from users of the infrastructure, analogous to a franchisee's royalty payment. We think that this indicates that the operator is acting as principal rather than agent.
- c) In many service concession arrangements, the operator is exposed to the demand risk of the users of the infrastructure because the operator has incurred costs to construct the infrastructure. Therefore unlike a 'normal' agent principal relationship, the operator has significant risk in delivering the services.

- iv) We think View 4 is not appropriate because the concession fees are not akin to taxes or similar type payments to the government (eg. levies to operate within an industry). The payment of the concession fee is contractual, unlike a tax or a levy. There is an implicit assumption in a contractual relationship that the exchange is arm's length, ie the operator must be receiving something of equal value for the payment that they are expected to make, otherwise they would not enter into the contract.
- v) We acknowledge that the issue of 'contingent consideration in exchange for an asset outside of a business combination' is a complex issue. However, the Committee is currently considering this issue as explained in paragraph 29(b). We think that a principle for determining the accounting of 'contingent consideration in exchange for an asset outside of a business combination' would be preferable to developing specific guidance for these types of payments in a service concession arrangement. We note that the submitter believes these types of variable payments are different from the contingent pricing arrangements previously considered because:

'...in a service concession arrangement falling within the scope of IFRIC 12, unlike in a contingent pricing arrangement, the recipient of the variable payment controls or regulates the activities of the payer.'

We do not agree that the two issues should be considered independently of each other. In both cases, the ultimate consideration paid for an asset is variable. We think that it would be more useful to

develop a principle for variable payments to acquire assets (both tangible and intangible) outside of a business combination, than address these issues separately. It may be that during the development of this principle, the nature of the variable payments influences the accounting as the submitter suggests.

27. Our thinking and rationale is mostly unchanged from that provided in the preceding paragraph. In other words, we think:

- (a) when the intangible asset model in IFRIC 12 applies, the arrangements will generally represent the acquisition of an intangible asset. However, following discussion with certain interested parties, we understand that in certain circumstances, the revenue sharing arrangement can result in the operator paying over a relatively significant portion of the cash that it collects for operating the concession. Because service concession arrangements can take on various forms, we think that in certain circumstances, the right-of-access and concession fee arrangements can represent a principal-agent relationship ('View 3 contra-revenue' in the preceding paragraph). For example, in a variable revenue sharing arrangement, where the grantor is entitled to 80% of the cash collected by the operator, we think this could indicate that the operator was acting as an agent for the grantor and the relatively small percentage of the cash retained by the operator would need to be considered together with all the other relevant facts and circumstances to determine if the operator was acting as an agent or principal for the arrangement.
- (b) consistent with the requirements of IFRIC 12 paragraph 26 for the intangible asset model, if an intangible asset is acquired, this would initially be recognised and measured in accordance with IAS 38 *Intangible Assets*.

- (c) a *fixed* contractual minimum payment over time for the right-of-use of an intangible asset represents deferred payment terms. By fixed payments, we mean payments that are specified or determinable at the initial recognition date. If a portion of the future payments become known at a later point in time, for the purposes of this paper we do not consider that portion to become fixed at that point in time, for example, future payments that change based on an inflation index are not considered to be fixed for the purposes of this paper.
- (d) We think that *variable* payments by the operator to the grantor should be considered further when the Committee considers the issue of contingent pricing of property, plant and equipment and intangible assets because we think that the principles under discussion in that issue are similar to the variable payments scenario in this paper. At the May 2011 Committee meeting, the Committee decided to defer further work on the contingent pricing project until the Board concludes its discussions on the accounting for the liability for variable payments as part of the leases project.

Question for the Committee

4. Does the Committee agree that if the service concession construction, upgrade or operation services are within the intangible asset model as described in IFRIC 12 paragraph 17, then the payments made by the operator to the grantor represent the acquisition of an intangible asset or an agency relationship depending on the facts and circumstances?
5. Does the Committee agree that for arrangements reflecting the acquisition of an intangible asset by the operator, where the future payments in exchange for the intangible asset are a *specified minimum contractual amount* at the inception of the contract, the intangible asset should be initially recognised at the present value of the minimum contractual amount (ie, the same amount as the financial liability)?
6. Does the Committee agree that for arrangements reflecting the acquisition of an intangible asset by the operator, where the future payments in exchange for

the intangible asset are a *variable contractual amount* at the contract inception date, the discussion regarding the initial recognition and measurement of the intangible asset and corresponding financial liability should be deferred until the Board completes its Leases project?

Question 3.2: Subsequent measurement of the asset and liability

28. Because we think that the asset can represent either an intangible asset or financial asset, we think the subsequent measurement needs to be considered separately for each model as the requirements for financial assets and intangible assets are different.
29. For either model, the arrangements we considered are either:
 - (a) The operator providing construction or upgrade services and subsequent operation services. In addition, the operator is required to make either fixed or variable future payments to the grantor over the life of the arrangement; or
 - (b) The operator providing only operation services and the operator is required to make either fixed or variable future payments to the grantor over the life of the arrangement.

The arrangement represents the acquisition of a financial asset

30. As explained when addressing Question 3.1 above, if the arrangement for future payments by the operator to the grantor is within the financial asset model of IFRIC 12, then we think there is no financial asset or corresponding financial liability recognition on inception relating to the right of access or concession fee arrangement.
31. Subsequent measurement would therefore be determined by reference to the services performed compared to the level of cash payments made by the operator to the grantor:

- (a) If the cumulative consideration *earned* for the services performed at a point in time, measured in accordance with IAS 18, is less than the related cash retained by the operator, then a financial liability would need to be recorded with a corresponding reduction in revenue. In substance, the grantor has financed the operator by allowing the operator to make the cash payments at a later point in time than the related consideration is collected by the operator.

For example, assume that the consideration for the operator's services over the term of the concession is measured at CU1000 and the payments required to be made by the operator to the grantor over the concession are CU300. At the end of year one, the operator has earned CU50 of the total consideration and collected this amount in cash but has only paid over CU10 to the grantor. Ignoring the time value of money, the operator would record a financial liability of CU5 and reduce revenue by CU5. In this way, the operator has recorded the appropriate amount of revenue and presented the future obligation to settle the related payment to the grantor of CU5.

- (b) If the consideration *earned* for the services performed at a point in time, measured in accordance with IAS 18, is greater than the related cash retained by the operator, then a financial asset would need to be recorded for a portion of the cash paid to the grantor. In substance, the operator has financed the grantor by making advance payments that will be 'reimbursed' by the grantor at a later point in time.

For example, assume that the total consideration for the operator's services over the term of the concession is CU1000 and the payments required to be made by the operator to the grantor over the concession are CU300. At the end of year one, the operator has earned CU50 of the total consideration and has paid over CU40 to the grantor. Ignoring the time value of money, the payment of CU40 would be split to record a financial asset of CU25 and reduction of revenue of CU 15. In this way, the operator has recorded the appropriate amount of revenue and presented the future right to recover the financing of CU 25 that it has provided to the grantor.

Question for the Committee

7. Does the Committee agree that if the service concession arrangement is within the financial asset model, then the subsequent measurement of any financial asset or financial liability would depend on the consideration earned by the operator relative to the cash retained by the operator at the reporting period?

The arrangement represents the acquisition of an intangible asset

32. As explained when addressing Question 3.1 above, if the right-of-access or concession fee arrangement is within the intangible asset model of IFRIC 12 and results in the recognition of an intangible asset, then the subsequent measurement of the intangible asset would be in accordance with IAS 38 (Refer to IFRIC 12 paragraph 26). The subsequent accounting for the financial liability would depend on the arrangement:

- (a) If the arrangement represents the acquisition of an intangible asset and the payment terms are a specified fixed minimum contractual amount at the acquisition date, then we think that the liability would be subsequently measured at amortised cost in accordance with IAS 39 (or IFRS 9).
- (b) If the arrangement represents the acquisition of an intangible asset but the payment terms are a variable contractual amount, then consistently with our rationale in Question 3.1 above, we think that the accounting for subsequent measurement should be redeliberated when the Committee reconsiders the ‘contingent pricing for acquisitions of PP&E and intangibles’ issue.

The arrangement represents an agent-principal relationship

33. As explained when addressing Question 3.1 above, if the right-of-access or concession fee arrangement represents in substance an agent-principal

relationship, then the operator should record the amounts that it collects on behalf of the grantor on a net basis.

34. Depending on the timing of the payments by the operator and the related collection of the cash, a financial asset or financial liability may need to be recorded. In other words, the accounting treatment that would follow would be the same as that described above in paragraph 31 when 'the arrangement represents the acquisition of a financial asset'.

Question for the Committee

8. Does the Committee agree that if the service concession arrangement is within the intangible asset model, then any recognised intangible asset's subsequent measurement should be in accordance with IAS 38?

9. Does the Committee agree that for arrangements reflecting the acquisition of an intangible asset by the operator, where the future payments in exchange for the intangible asset are a *specified fixed minimum contractual amount* at the acquisition date, the subsequent measurement of the financial liability should follow that in IAS 39 / IFRS 9?

10. Does the Committee agree that for arrangements reflecting the acquisition of an intangible asset by the operator, where the future payments in exchange for the intangible asset are a *variable contractual amount* at the acquisition date, the discussion regarding the subsequent measurement of the financial liability should be deferred until the Board completes its Leases project?

11. Does the Committee agree that for service concessions within the intangible asset model that include right-of-access or concession fee arrangements, where the right-of-access or concession fee arrangement is in substance an agent-principal relationship, the subsequent measurement of any financial asset or financial liability would depend on the consideration earned by the operator relative to the cash retained by the operator at the reporting period?

Question 4: what would the accounting be if the operator could cancel the arrangement without penalty?

35. We think that the asset can represent either an intangible asset or financial asset, therefore we think the subsequent measurement needs to be considered for each model as the requirements for financial assets and intangible assets are different.

The arrangement represents the acquisition of a financial asset

36. At the date that the operator and grantor sign the contract, we think that the existence of a cancellation option for only the operator means that the definition of a financial asset in IFRIC 12 paragraph 16 is met. The operator still has an unconditional right to receive cash because only the operator can cancel the arrangement.
37. However, the financial asset model, as explained above in Question 3.1 and 3.2, can result in the recognition of a financial liability if the operator has been financed by the grantor. The impact of a cancellation option held by the operator would mean that the financial liability would not be recognised if the operator could cancel the entire arrangement without penalty. If the operator could only cancel after a period of time, then a financial liability would be recorded for the portion of the liability that could not be avoided. We think that commercially this is not a realistic fact pattern though, because it would mean that the operator could in theory obtain financing risk-free. This would be analogous to a bank providing an entity with a loan but the entity could cancel the arrangement without needing to repay the loan or financing thereon.

Question for the Committee

12. Does the Committee agree that if the service concession arrangement is within the financial asset model, then the existence of a cancellation option (without penalty) held by the operator would mean that a financial liability would only be recorded to the extent that it could not be avoided if the timing of the payments indicated that the grantor had financed the operator?

The arrangement represents the acquisition of an intangible asset

38. At the date that the operator and grantor sign the contract, we think that the existence of a cancellation option affects the measurement of the intangible asset.
39. We think that concession arrangements that are cancellable at any point by the operator could be looked at as containing perpetual options to extend the concession arrangement, which should be accounted for consistently with all other options to extend that exist in lease contracts, because the operator is in substance leasing the right to operate the concession from the grantor.
40. Consequently, we think the operator should determine whether it has a significant economic incentive to exercise its option to 'extend' the arrangement at any point over the concession term. If there is a significant economic incentive present, then a liability would be recorded, which is consistent with the guidance in IAS 17 paragraph 4 in the definition of the 'lease term'. However, if the operator has a no-penalty cancellation option, then unless there were other facts and circumstances to the contrary, we think no liability would be recognised at the time that the operator enters into the concession arrangement. Because the corresponding asset is measured with reference to the liability as explained in paragraph 27 above, no amount would be recorded for the intangible asset, ie the concession right or right-of-access.

Question for the Committee

13. Does the Committee agree that if the service concession arrangement is within the intangible asset model, then the existence of a current cancellation option (without penalty) held by the operator would mean that no financial liability or intangible asset would be recorded?

41. We have included a high-level summary of our staff analysis in the form of a decision tree in Appendix A to this paper.

Staff recommendation

42. Our recommendation is based on whether the Committee agrees with our analysis:

- (a) Assuming that the Committee agrees with the main principles of the staff analysis, we recommend amending IFRIC 12 to provide guidance for preparers on how to account for service concessions that include right-of-use or concession fee arrangements. If the Committee agrees with this recommendation, we propose that the Committee take the issue onto its agenda and that we bring the issue back to the Committee at the next Committee meeting to discuss:
 - (i) the strategy for the amendment, for example when and how the amendment should be made bearing in mind that a portion of the accounting may be influenced by the conclusions reached in the Leases project and the current Committee issue on contingent pricing for asset acquisitions outside of a business combination;
 - (ii) draft wording for the amendment to illustrate the sections of IFRIC 12 that may need to be amended.
- (b) If the Committee does not agree with the main principles of the staff analysis, we would be looking to the Committee to provide us with sufficient guidance to perform a revised staff analysis.

Question for the Committee

14. How would the Committee like the staff to take this issue forward?

Appendix A—Summary of staff proposals

