

## STAFF PAPER

March 2012

## IFRS Interpretations Committee Meeting

Previous meetings: Nov 2011; Jan 2012

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| Project     | IFRIC 12   |
| Paper topic | Cover note and summary: 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 meetings**

### ***November 2011 Committee meeting***

- 4. The Committee first discussed this issue at the November 2011 meeting<sup>1</sup>. At that meeting, the Committee noted that when the payments are linked to the right of use of a tangible asset, judgement should be used to determine whether the operator obtains *control* of the right of use of the asset, because this would determine whether the arrangement is within the scope of IFRIC 12 or of IAS 17 *Leases*. For example, the Committee noted that when the right of use of a tangible asset is at the direction of the grantor, the operator does not control the right of use and the arrangement is therefore within the scope of IFRIC 12.
- 5. The Committee further tentatively decided that if the payments are part of the service concession arrangement in the scope of IFRIC 12, then whether they are structured as concession fees or right-of-access payments should not impact the accounting for them. Consequently, we have referred collectively to these types of payments as 'concession payments' in the papers.

### ***January 2012 Committee meeting***

- 6. At the January 2012 meeting, we presented a paper to the Committee which proposed that the accounting for the concession payments depends on the type of service concession, ie the financial asset model or intangible asset model. The Committee asked the staff to reconsider the issue and the way in which it should

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

be addressed, focusing on the principles of IAS 18 and multiple element arrangements in order to identify what concession payments represent, before considering if the payments give rise to an asset.

7. The Committee noted that the type of service concession arrangement (whether it gives rise to the recognition of an intangible asset, financial asset or combination of the two) might affect the accounting for the payments made by the operator.

### **Structure of this agenda item**

8. Based on the Committee's feedback from the January 2012 meeting, we have made our analysis of the concession payments in the context of the type of concession arrangement that the operator has with the grantor.
9. Consequently, we have split the analysis into four separate papers:
  - (a) Agenda paper 3 – this paper which covers the background of the issue, summarises the analysis of the other papers and provides the staff recommendation;
  - (b) Agenda paper 3A – analysis of concession payments when the concession arrangement gives the operator a right to receive cash or another financial asset from only the grantor;
  - (c) Agenda paper 3B – analysis of concession payments when the concession arrangement gives the operator a right to only charge users of the public service; and
  - (d) Agenda paper 3C – analysis of concession payments when the concession arrangement gives the operator a right to charge users of the public service as well as a guarantee from the grantor that the operator will receive a minimum amount of cash for the services which would give rise to both an intangible asset and financial asset for the operator's construction services.
10. As part of our analysis, we concluded in certain circumstances that the concession payment represents an incremental payment related to the acquisition of an

intangible asset and that the payment should form part of the cost of the intangible asset in accordance with IAS 38 *Intangible Assets*. However, we think that the initial and subsequent *measurement* of any intangible asset that arises in a service concession arrangement as a result of a payment to the grantor, specifically when the payments are not fixed amounts at contract inception, should be considered when the Committee reconsiders the issue of variable payments for the acquisition of items of PP&E and intangible assets outside of a business combination<sup>2</sup> because we think it is a broader issue. Consequently this set of papers does not address the issue of variable versus fixed concession fee arrangements.

## Summary of analysis

11. In analysing the issue as requested by the Committee, we focused on the concession arrangement as a whole and tried to determine what the concession payments represent.
12. A service concession arrangement may be a multiple element arrangement. We think judgement is required to identify the elements of the arrangement and determine whether they should be accounted for separately. In particular, judgement is required to assess whether by making the concession payments, the operator is acquiring distinct goods or services that are separate from the concession arrangement, in which case they should be separated from the service concession arrangement and accounted for in accordance with the relevant IFRSs.
13. Where concession payments cannot be associated with an element of the arrangement that is distinct and that can be accounted for separately, they should be analysed together with the other elements of the service concession arrangement. When this is the case, we think that the type of service concession arrangement impacts the accounting for the concession payments as follows:

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<sup>2</sup> Refer to May 2011 IFRIC Update - <http://media.ifrs.org/IFRICUpdateMay11.html#3>

***Service concession arrangement gives the operator a right to receive cash from only the grantor (refer to agenda paper 3A)***

14. We think one of the key assumptions in our analysis is that in a service concession arrangement that gives the operator a right to receive cash or another financial instrument from only the grantor, there is only one customer for the operator's services and that customer is the grantor.
15. We think that a service concession arrangement that gives the operator a right to receive cash or another financial instrument from only the grantor is in substance no different from any revenue contract with a customer because:
  - (a) IFRIC 12 paragraph 13 explicitly refers to IAS 18 and IAS 11 to account for the operator's services in the service concession arrangement; and
  - (b) This type of arrangement (where a customer receives a payment from the entity providing the customer with services) is not unique to service concession arrangements in the scope of IFRIC 12, for example certain outsourcing arrangements also have payments from the service provider to the customer.
16. Consequently, in a multiple element arrangement with a single customer, when the entity providing the services also makes a payment to the customer, the payment is accounted for as a reduction in the overall consideration.

***Applicability to concession payments***

17. In considering the two types of concession payments that the submitter presented in their submission, ie concession fees and right-of-use payments, we think that:
  - (a) concession fees, which the submitter describes as "a right to operate the concession", cannot represent an intangible asset because we think that this is analogous to an entity saying that the payment to a customer represents a right to provide service to the customer. We think that these fees would represent a reduction in the overall

consideration as part of a revenue arrangement assuming that they do not represent a separate element in a multiple element arrangement.

- (b) right-of-use payments, which were discussed by the Committee in its November 2011 meeting, either represent a lease or should be treated in the same way as concession fees based on whether the operator *controls* the right-of-use.

***Service concession arrangement only gives the operator a right to charge the public (refer to agenda paper 3B)***

18. We think one of the key assumptions in our analysis is that in a service concession arrangement that results in the operator obtaining a right to charge the public, the customer of the operation services is the public and the customer for any construction services is the grantor (as explained in more detail in agenda paper 3B).
19. Where there is no construction service provided by the operator, the only customer is the public. Consequently, in this circumstance we think that the concession payment is not linked to the revenue contract and instead represents the acquisition of a distinct good, ie a license to operate the concession. We think this payment is analogous to any example where Entity A (eg the grantor) sells a license that must be obtained before Entity B (eg the operator) can proceed with Entity B's revenue generating activity, for example
  - (a) 3G licenses in the telecommunications industry;
  - (b) Exploration rights in certain mining operations; or
  - (c) Franchise licenses before a franchisee can begin trading.
20. Where the operator provides construction services which give rise to an intangible asset, we think that the arrangement represents a barter transaction of non-cash consideration where a service (the operator's construction services) is exchanged for an intangible asset (the grantor's concession right). However, as part of the barter transaction, the operator might also be required to pay the grantor a concession payment in order to make up the difference in the relative fair values

of the items that are exchanged. For example, if the construction or upgrade services have a fair value of CU1,500 but the fair value of the right to charge the public is worth CU1,700, then the grantor would require something more than the construction services in exchange for the right to charge the public, ie a concession payment of CU200.

### *Applicability to concession payments*

21. In considering the two types of payments from the operator to the grantor that the submitter presented in their submission, ie concession fees and right-of-use payments, where the concession arrangement gives the operator a right to only charge the public users of the service, we think that:
  - (a) concession fees, which the submitter describes as “a right to operate the concession”, represent a payment by the operator to the grantor to obtain the right to operate the concession, ie a “top up” payment to cover the shortfall of the fair value of the operator construction services provided over the fair value of the concession right received if construction services were provided, or if no construction services were provided, a payment for the concession right. Assuming that the concession fees are a right to operate the concession and not in exchange for a distinct good or service, we think this payment should form part of the cost of the intangible asset in accordance with IAS 38.
  - (b) right-of-use payments, which were discussed by the Committee in its November 2011 meeting, either represent a lease or should be treated in the same way as concession fees based on whether the operator *controls* the right-of-use.

### ***Service concession arrangement results a guaranteed amount from the grantor as well as the right to charge the public (refer to agenda paper 3C)***

22. We think one of the key assumptions in our analysis is that in a service concession arrangement that results in a guaranteed amount from the grantor as well as the

right to charge the public, the arrangement represents a collaboration agreement between the operator and the grantor where the operator and grantor share the demand risk. This makes the analysis of the revenue arrangement more difficult because there is not a clear customer for the operation services (which was a key basis for us in determining the accounting for the concession payments in the other types of service concession arrangements).

23. Consequently, assuming that the concession payment does not represent a good or service that is distinct from the concession arrangement, we think that the substance of the arrangement needs to be analysed to determine if the concession payment is an incremental payment in exchange for a right to charge users of the public or a reduction in the overall consideration with the grantor.
24. In applying judgement to determine the substance of the arrangement, we think that the level of guarantee provided by the grantor to the operator (which results in the recognition of a financial asset for construction services in this type of service concession arrangement) is useful in deciding if the concession payments represent an incremental payment in exchange for a right to charge users of the public or a reduction in the overall consideration with the grantor (as illustrated in paper 3C). Specifically:
  - (a) if the fair value of the operator's services exceeds the guaranteed amount, this indicates that the accounting should follow that explained in the application of the intangible asset only approach, ie the payment is either for a separate good or service (eg a lease), or it represents a "top up" payment to cover the shortfall between the fair value of the construction services provided and the fair value of the concession right received; however
  - (b) if the fair value of the operator's services is less than the guaranteed amount, this indicates that the accounting should follow that explained in the application of the financial asset only approach, ie the payment is either for a separate good or service (eg a lease), or the payment represents a reduction in the overall consideration.



### *Applicability to concession payments*

25. In considering the two types of payments from the operator to the grantor that the submitter presented in their submission, ie concession fees and right-of-use payments, where the construction or upgrade services give rise to both an intangible asset and financial asset, we think that:
- (a) concession fees, which the submitter describes as “a right to operate the concession”, would represent an incremental payment by the operator to the grantor to obtain the right to operate the concession if the fair value of the operation and construction services is greater than the value of the amount of the guarantee from the grantor. We think that the requirements of IAS 38 would apply to these types of payments from the operator to the grantor. If however the fair value of the operator’s services was less than the value of the guarantee from the grantor, then we think that the concession fee should be treated as a reduction in the overall consideration.
  - (b) right-of-use payments, which were discussed by the Committee in its November 2011 meeting, either represent a lease or should be treated in the same way as concession fees based on whether the operator *controls* the right-of-use.

### **Staff recommendation**

26. The submitter’s original question was asking the Committee to provide guidance on how an operator in a service concession arrangement would account for certain types of payments to the grantor.
27. We do not think that the Committee will be able to provide a single answer to the question that was asked, because we think that the accounting will depend on the substance of what the concession payment is exchanged for, which in turn will depend on facts and circumstances.

28. However, we do think that in analysing the issue over several meetings, the Committee is in a position to provide guidance to preparers to help them to identify what factors they should consider when determining what the concession payments represent.
29. We think that the key principles that the Committee could clarify in the context of concession payments are:
- (a) if the concession fee arrangement gives the operator a right to a good or service that is distinct from the service concession arrangement, the operator should account for that distinct good or service in accordance with the applicable IFRS;
  - (b) when the payments are linked to the right of use of a tangible asset, judgement should be used to determine whether the operator obtains control of the right of use of the asset. If the operator controls the right of use the arrangement would be considered to be an embedded lease within the scope of IAS 17 *Leases* (as discussed by the Committee in the November 2011 Committee meeting);
  - (c) when the payments are linked to the right of use of a tangible asset, but the arrangement does not represent an embedded lease, the payment should be analysed in the same way as a concession fee arrangement discussed in (d) below (as discussed by the Committee in the November 2011 Committee meeting); and
  - (d) if the concession fee arrangement does not give the operator a right to a distinct good or service that is separate from the concession arrangement, the type of service concession arrangement should be taken into account:
    - (i) if the service concession results in the operator having a contractual right to receive cash from only the grantor, then the concession payment is a reduction in the overall consideration;

- (ii) if the service concession arrangement results in the operator having only a right to charge users of the public service, then the concession payment represents consideration for the concession right (ie an intangible asset); and
- (iii) If the operator has both a right to charge users of the public service and a contractual right to receive cash from the grantor (ie the in-substance guarantee from the grantor for the operator's services), then the amount of the contractual right to receive cash from the grantor needs to be compared to the fair value of the operator's services to help determine whether the concession payment represents either a reduction of the overall consideration or consideration for the concession right.

30. We have included a summary of the above in a flow chart in Appendix A to this paper.
31. We think that IFRIC 12 should be amended to incorporate the principles described above. However, as explained in paragraph 10 above, because the issue of variable payments for the acquisition of items of PP&E and intangible assets outside of a business combination significantly impacts this issue, we recommend that the Committee only amend IFRIC 12 once the Committee reaches a conclusion on the variable payments issue.

#### Question for the Committee

1. Does the Committee agree with the principles described in paragraph 29 above?
2. Does the Committee agree that IFRIC 12 should be amended to incorporate the principles described in paragraph 29?
3. Does the Committee agree that IFRIC 12 should only be amended once the Committee has reached a conclusion on the related topic of variable payments for the acquisition of items of PP&E and intangible assets outside of a business combination?

## Appendix A – summary of thought process for concession payments

