STAFF PAPER

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Project	**IFRIC 12**
Paper topic	Payments made by an operator in a service concession arrangement: Financial asset only model

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Purpose of this paper

1. This paper sets out two fact patterns for a service concession arrangement under IFRIC 12 that would give rise to the recognition of *only* a financial asset.

2. Both examples are based on the existing illustrative example in paragraphs IE1 – IE3 of IFRIC 12. However, the examples in this paper include a concession payment and analyse what the concession payment might relate to in order to determine what the substance of the concession payment represents.

Illustrative Examples for consideration

Example 1 – operation services only

The terms of the arrangement require an operator to maintain and operate a toll road to a specified standard for eight years. The arrangement is within the scope of IFRIC 12. At the end of year 8, the arrangement will end. The operator estimates that the costs it will incur to fulfil its obligations will be:

Obligations:	Year	CU[1]
Operation services (per year)	1-8	100

The terms of the arrangement require the grantor to pay the operator 200 currency units (CU200) per year for each year for making the road available to the public.

The terms of the arrangement further state that the operator is required to make a once-off payment to the grantor of CU300 at the end of year 2 of the service concession. The operator does not receive any identifiable goods or services for this payment and it is called a concession fee in the concession arrangement contract. The rationale for making the payment is that the grantor requires financing in the short term but assumes that the public fees it will receive from the concession will be sufficient to repay this financing to the operator over the concession arrangement.

Analysis of the arrangement

3. In this example, the operator is providing one service to the grantor, ie operation services. IFRIC 12 paragraph 20 states that:

> The operator shall account for revenue and costs relating to operation services in accordance with IAS 18.

4. Because the operator provides the operation services to only the grantor, the grantor is the operator's customer for the purposes of IAS 18 *Revenue*.

5. With respect to the concession payment of CU300 at the end of year six, IAS 18 does not provide explicit guidance on payments made to customers apart from volume rebates and trade discounts discussed in paragraph 10 of IAS 18:

> The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account

[1] In this example, monetary amounts are denominated in 'currency units (CU)'.

the amount of any trade discounts and volume rebates allowed by the entity.

6. However, in determining the total consideration, the operator would need to determine whether the concession payment of CU300 at the end of year six represents either:

   (a) A payment for a distinct good or service; or

   (b) A reduction in the overall consideration received for the services provided.

7. We consider what the payments might represent after considering an example with operation and construction services in order to determine whether the analysis changes if there are construction services.

Example 2 – operation and construction services

The terms of the arrangement require an operator to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (ie years 3–10). The arrangement is within the scope of IFRIC 12. At the end of year 10, the arrangement will end. The operator estimates that the costs it will incur to fulfil its obligations will be:

Obligations:	*Year*	*CU*
Construction services	1	500
	2	500
Operation services (per year)	3-10	100

The terms of the arrangement require the grantor to pay the operator 300 currency units (CU300) per year in years 3–10 for making the road available to the public. Each month, the operator collects all the cash from the public, and then passes on all of the cash to the grantor after deducting its fee. Should the monthly cash inflow not be sufficient to meet the operator's fee, the grantor will pay the shortfall to the operator.

The terms of the arrangement further state that the operator is required to make annual payments to the grantor of CU50 per year in years 5-10 of the service concession. The operator does not receive any identifiable goods or services for this payment and it is called a concession fee in the concession arrangement contract. The reason for the payments is that the operator needs relatively higher net cash receipts from the grantor in the earlier years to repay the financing that it will incur in constructing the infrastructure for the grantor. The payments in years 5-10 are a repayment of a portion of the cash that the operator received from the grantor in years 1-4.

Analysis of the arrangement

8. In this example, the operator is providing two distinct services to the grantor, ie construction services and operation services. IFRIC 12 paragraph 13 explains that:

> The operator shall recognise and measure revenue in accordance with IASs 11 and 18 for the services it performs. If the operator performs more than one service (ie construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable. The nature of the consideration determines its subsequent accounting treatment. The subsequent accounting for consideration received as a financial asset and as an intangible asset is detailed in paragraphs 23–26 below.

9. Because the operator provides the operation and construction services to the grantor, the grantor is the operator’s only customer for the purposes of IAS 18 and IAS 11 *Construction Contracts* respectively.

10. IAS 18 paragraph 13 states the following (and similar wording is included in IAS 11 paragraph 7):

> 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… Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole…

11. With respect to the concession payments of CU50 in years 5-10, IAS 18 does not provide explicit guidance on payments made to customers apart from volume rebates and trade discounts discussed in paragraph 10 of IAS 18:

> The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.

12. So in determining the total consideration, the operator would need to determine whether the concession payment of CU50 in years 5-10 represents either:

    (a) A payment for a distinct good or service; or

    (b) A reduction in the overall consideration received for the construction and operation services provided.

13. Consequently, we do not think that it makes a difference if the operator provides only operation services, or if the operator provides both construction and operation services because in both cases the operator will need to determine if the payment is for a distinct good/service or a reduction in the overall consideration.

Analysis of possible views based on the fact patterns

14. Based on the fact patterns presented, we think that there are two possible views in accounting for the concession payment when the service concession arrangement indicates that the grantor is the only customer, ie the financial asset model in IFRIC 12:

(a) **View A – reduction in the consideration:** In a service concession arrangement where the grantor is the operator's only customer, this is analogous to any revenue transaction where the customer (grantor) receives a cash rebate from the seller (operator). IAS 18 paragraph 10 indicates that cash rebates are treated as reductions of the total consideration and IAS 18 paragraph 13 requires an entity to consider the substance of the arrangement. Consequently, in the fact patterns provided, these types of payments should be treated as a reduction of the overall consideration because they do not represent a distinct good or service.

(b) **View B – distinct good or service:** Proponents of View B think that the payment must represent a distinct good, even when a distinct good or service cannot be explicitly identified. The substance of the arrangement is that the operator is charging the public users of the infrastructure, as the cash is collected from the public and then passed on to the grantor after the operator retains its portion of the fee. Consequently, the payment represents the amount of consideration in addition to the construction services that the operator is prepared to provide to the grantor in order to obtain the service concession contract. In other words, if an explicit distinct good or service cannot be identified, then the default accounting treatment should be to record an implicit asset, ie an intangible asset.

15. We think that a service concession arrangement where the grantor is the only customer of the operator is in substance no different from any revenue contract with a customer because:

(a) IFRIC 12 explicitly refers to IAS 18 and IAS 11 to account for the revenue from 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. We do not think that View B is an appropriate analysis. We do not think that there can be an intangible asset related to the right to charge users of the public because the operator does not have that right – the operator only has a contractual right to receive cash from the grantor. This would be the same as saying that an entity pays a customer for the right to provide the customer with the services. The fact that the operator collects the cash from the public does not change this fact, as explained in IFRIC 12 BC43(b):

> (b) users or the grantor may pay the contractual amount receivable directly to the operator. The method of payment is a matter of form only. In both cases the operator has a present, unconditional, contractual right to receive the specified or determinable cash flows from or at the direction of the grantor. The nature of the operator's asset is not altered solely because the contractual amount receivable may be paid directly by users of the public service…

17. We think that View A is an appropriate analysis because:

    (a) in this type of service concession arrangement, there is only one customer and that customer is the grantor;

    (b) in the fact pattern provided, the concession payment did not represent a distinct good or service that was separate from the service concession arrangement; and

    (c) consequently, the concession payment was treated like any payment to a customer in a revenue arrangement, ie as a reduction in the overall consideration.

18. We note however, that if the fact pattern was altered, such that the payment was in substance for a distinct good or service that was separate from the service concession arrangement, then that distinct good or service would be separated

from the revenue arrangement and accounted for in accordance with the applicable IFRS.

Applicability to concession payments

19. The analysis below is based on the concepts developed from analysing the example fact patterns above. However we are now considering how our conclusions from analysing the fact patterns above would impact the types of concession payments as described the submitter.

20. 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. We think this is analogous to an entity saying that the payment to a customer represents a right to provide service to the customer.

    (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 the level to which the operator *controls* the right-of-use.

21. Consequently, we think that in a service concession arrangement, where the grantor is the only customer of the operator (ie the financial asset model in IFRIC 12), the two types of concession payments included in the submission would be accounted for as a reduction in the overall consideration of the revenue arrangement unless:

    (a) the concession payment is actually for a distinct good or service that is separate from the concession arrangement, in which case that separate element would be accounted for in accordance with the applicable IFRS; or

(b) the right-of-use payment represents a lease contract, in which case the lease contract would be accounted for in accordance with IAS 17 *Leases*.

22. We think our proposed approach is no different from any arrangement where an entity makes a payment to its customer in a revenue arrangement. The substance of the arrangement would need to be considered to determine whether the entity has acquired any goods or services in exchange for the consideration.

Revenue recognition exposure draft

23. The revenue recognition exposure draft ('the ED') includes guidance on payments made to customers under revenue contracts. If the ED is finalised without any changes to the proposed guidance on payments made to customers, this guidance would be relevant in determining if the concession payments represent a reduction in the transaction price or a distinct good or service. We have included the relevant extracts of the guidance in Appendix A to this paper.

24. The ED provides additional guidance in making the determination of what constitutes a distinct good or service and we think that the overall approach would not differ from that which we have identified under current IFRSs.

Appendix A – extract from Revenue Recognition Exposure Draft (November 2011)

Consideration payable to a customer (see paragraph IE9)

65 Consideration payable to a customer includes amounts that an entity pays, or expects to pay, to a customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash, credit or other items that the customer can apply against amounts owed to the entity. An entity shall account for consideration payable to a customer as a reduction of the transaction price and, hence, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 28 and 29) that the customer transfers to the entity.

66 If the consideration payable to a customer is a payment for a distinct good or service from the customer, then the entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, the entity shall account for all of the consideration payable to the customer as a reduction of the transaction price.