

STAFF PAPER

March 2012

IFRS Interpretations Committee Meeting

Previous meetings: Nov 2011; Jan 2012

Project	IFRIC 12
Paper topic	Payments made by an operator in a service concession arrangement: Intangible 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* an intangible asset.
2. The examples are based on the existing illustrative example in paragraphs IE11 – IE13 of IFRIC 12. However, the examples in this paper include a concession payment in order to determine what the substance of the concession payment might represent as part of a multiple element arrangement.

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:

<i>Obligations:</i>	<i>Year</i>	<i>CU¹</i>
Operation services (per year)	1-8	10
<p>The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of 200 currency units (CU200) in each of years 1-8.</p> <p>The terms of the arrangement further state that the operator is required to make annual payments to the grantor of CU25 in each year of the concession. The concession contract states that this payment is made to compensate the grantor for the use of the land on which the toll road is operated. There are no other identifiable goods or services provided to the operator from the grantor.</p>		

Analysis of the arrangement

3. We think that there are two ways in which the arrangement can be analysed:
 - (a) **View C – The customer for the services is the public:** under this view, the customer for the operation services is the public. The public implicitly enter into a contract with the operator each time they use the public service, the contract agreement being that the public will compensate the operator for the services provided by the operator.
 - (b) **View D – The customer for the services in the grantor:** under this view, the customer for the operation services is the grantor. The operator acts as the grantor’s agent in delivering the public service, but the parties to the revenue contract are in substance the operator and grantor.
4. We do not think that the arrangement is a service to the grantor, because paragraphs BC 32 and BC 34 of the basis of conclusions to IFRIC 12 indicates that when the operator has all of the demand risk for the public services, the revenue arrangement is between the operator and the public:

¹ In this example, monetary amounts are denominated in ‘currency units (CU)’.

BC 32 In some circumstances, the grantor makes a non-cash payment for the construction services, ie it gives the operator an intangible asset (a right to charge users of the public service) in exchange for the operator providing construction services. The operator then uses the intangible asset to generate further revenues **from users of the public service**. [emphasis added]

BC 34 The IFRIC noted that total revenue does not equal total cash inflows. The reason for this outcome is that, when the operator receives an intangible asset in exchange for its construction services, there are two sets of inflows and outflows rather than one. In the first set, the construction services are exchanged for the intangible asset in a barter transaction with the grantor. In the second set, the intangible asset received from the grantor is used up to **generate cash flows from users of the public service**. This result is not unique to service arrangements within the scope of the Interpretation. Any situation in which an entity provides goods or services in exchange for another dissimilar asset that is subsequently used to generate cash revenues would lead to a similar result. [emphasis added]

5. Although the above paragraphs from the basis for conclusions of IFRIC 12 are in the context of construction services, we do not think that the operator providing, or not providing, construction services alters the substance of the arrangement for the operation services. Consequently, we think that the customer in this type of service concession arrangement is the public (View C).
6. Consequently, the payment from the operator to the grantor does not appear to be within the scope of IAS 18 because it is not a payment to the customer of the revenue transaction.

7. Even though the payment from the operator to the grantor is outside of the scope of IAS 18, the payment arrangement still needs to be analysed to determine which IFRS standard therefore applies to this part of the overall arrangement. In this example, although the concession contract states that the concession fee is in exchange for a right to use the land, we do not think that in substance it represents a right of use over the land (ie a lease), because the right of use is not distinct from the overall service concession revenue arrangement and the operator therefore does not control the right of use. Consequently, consistent with the Committee's decision from the November 2011 meeting, the payment should be considered in the same way as if the contract stated that the payment was a concession fee for a right to operate the concession.

8. 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.

In other words, we think that in the example provided, the payment made by the operator to the grantor is in exchange for the right to charge the public because there are no other identifiable goods or services and therefore is a payment towards the intangible asset, ie the right to charge the public.

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:

<i>Obligations:</i>	<i>Year</i>	<i>CU</i>
Construction services	1	500

	2	500
Operation services (per year)	3-10	50
<p>The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of 300 currency units (CU300) in each of years 3–10.</p> <p>The terms of the arrangement further state that the operator is required to make annual payments to the grantor of CU25 in each year of the concession. The concession contract states that this payment is made to compensate the grantor for the use of the land on which the toll road is operated. There are no other identifiable goods or services provided to the operator from the grantor.</p>		

Analysis of the arrangement

9. In this example, we think that the operator is providing two services to two different parties:
 - (a) construction services to the grantor to build the infrastructure; and
 - (b) operation services to the public for which the operator will charge a service fee to the public (as explained in Example 1 above).
10. With respect to the two examples presented in this paper, we think that the payment made by the operator to the grantor is in exchange for the right to charge the public. We do not think that it represents a right of use over the land (ie a lease), because the right of use is not distinct from the overall service concession revenue arrangement and the operator therefore does not control the right of use. Consequently, consistent with the Committee’s decision from the November 2011 meeting, the payment should be considered a concession fee for a right to operate the concession.
11. In the fact pattern provided, the construction services give rise to only an intangible asset. In addition in the fact pattern provided there are no other identifiable goods or services. Consequently, we think that the arrangement represents a barter of non-cash consideration where a service (the operator’s

construction services) is exchanged for an intangible asset (the grantor's concession right).

12. Based on the fact pattern provided, we think that the concession payment represents the incremental amount that the operator needs to pay the grantor for the concession license. 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 CU1,750, then the grantor would require something more than the construction services in exchange for the right to charge the public, ie the concession payment of CU250.
13. 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 accounted for in accordance with the applicable IFRS. Consequently, we do not think that an entity can always assume that the concession payment represents an incremental payment for the licence when the operator's construction services give rise to only an intangible asset, ie the operator only has a right to charge users of the public service.

Applicability to concession payments

14. 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 by the submitter when the concession arrangement indicates that the operator has only a right to charge users of the public service.
15. 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", meet the definition of an intangible asset. We think

that the requirements of IAS 38 *Intangible Assets* would apply to these types of payments from the operator to the grantor.

- (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.

16. Consequently, we think that in a service concession arrangement, where the grantor is not the operator's customer for the operation services (in other words the operator has only a right to charge users of the public service), the two types of concession payments included in the submission would be accounted for as part of the cost of an intangible asset 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*.

17. We think our proposed approach is no different from any arrangement where an entity acquires a bundle of goods and/or services from a third party. The substance of the arrangement would need to be considered to determine what the entity has acquired in exchange for the consideration.

Revenue recognition exposure draft

18. Because the revenue recognition exposure draft ('the ED') has not yet been finalised, we have considered the draft guidance in the ED at a relatively high level in order to determine if the principles explained above would alter based on the proposed guidance.

19. The ED introduces guidance regarding contract costs in paragraphs 91 – 97 (reproduced in Appendix A to this paper). Assuming that the payment did not represent an asset within the scope of another applicable IFRS, the guidance in the ED would need to be considered to determine whether the costs would qualify for capitalisation. However, as explained above, we think that in an arrangement within the scope of IFRIC 12:

- (a) where only operation services are provided, the payment will represent the acquisition of an intangible asset, ie a right to charge the public users of the service; and
- (b) where construction and operation services are provided, the payment will represent an incremental payment for the intangible asset.

Consequently we think it will be unlikely that the guidance in the ED regarding contract costs would need to be considered.

20. The ED includes guidance on non-cash consideration as well as payments made to customers in paragraphs 63 to 67 (reproduced in Appendix A to this paper). If the ED is issued without any changes to the guidance on non-cash consideration and payments made to customers, we think an entity would apply this guidance, if it provided construction services to the grantor, in determining if the concession payment represents:

- (a) an incremental payment for the asset received (ie the concession license) in an exchange of non-cash consideration; or
- (b) a distinct good or service, to be accounted for under the applicable IFRS.

This is not different from the proposed analysis explained above.

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

Contract costs

Costs to fulfil a contract (see paragraph IE14)

- 91 If the costs incurred in fulfilling a contract with a customer are in the scope of another IFRS (for example, IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*), an entity shall account for those costs in accordance with those other IFRSs. Otherwise, an entity shall recognise an asset from the costs to fulfil a contract only if those costs meet all of the following criteria:
- (a) **the costs relate directly to a contract (or a specific anticipated contract);**
 - (b) **the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and**
 - (c) **the costs are expected to be recovered.**
- 92 Costs that relate directly to a contract (or a specific anticipated contract) include the following:
- (a) direct labour (for example, salaries and wages of employees who provide services directly to the customer);
 - (b) direct materials (for example, supplies used in providing services to the customer);
 - (c) allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract);
 - (d) costs that are explicitly chargeable to the customer under the contract; and
 - (e) other costs that are incurred only because the entity entered into the contract (for example, payments to subcontractors).
- 93 An entity shall recognise the following costs as expenses when incurred:
- (a) general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with the criteria in paragraph 91);
 - (b) costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;
 - (c) costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (ie costs that relate to past performance); and
 - (d) costs that relate to remaining performance obligations but that the entity cannot distinguish from costs that relate to satisfied performance obligations.

Incremental costs of obtaining a contract

- 94 **An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs, subject to the practical expedient in paragraph 97.**
- 95 The incremental costs of obtaining a contract are those costs that an entity incurs in its efforts to obtain a contract with a customer and that it would not have incurred if the contract had not been obtained (for example, a sales commission).
- 96 Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.
- 97 As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that an entity otherwise would have recognised is one year or less.

Non-cash consideration

- 63 To determine the transaction price for contracts in which the customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value. If an entity cannot reasonably estimate the fair value of the non-cash consideration, it shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration.
- 64 If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.

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.

67 Accordingly, if consideration payable to a customer is a reduction of the transaction price, an entity shall recognise the reduction of revenue when (or as) the later of either of the following occurs:

- (a) the entity recognises revenue for the transfer of the related goods or services to the customer; and
- (b) the entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.