STAFF PAPER

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Project	IFRIC 12
Paper topic	Payments made by an operator in a service concession arrangement: Intangible asset and financial asset model

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Purpose of this paper

1. This paper sets out three fact patterns for a service concession arrangement under IFRIC 12. The fact patterns include the operator having a guaranteed amount from the grantor as well as the right to charge the public.

2. The examples are based on the existing illustrative example in paragraphs IE23 – IE25 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.

3. As explained in agenda paper 7A and 7B, we think that an operator's accounting treatment of concession payments may differ depending on whether the operator's customer is the public or the grantor.

4. In agenda paper 7A and 7B, one of the key assessments of the analysis is the determination of which party is the operator's customer in the revenue arrangement. In a service concession arrangement that includes a guaranteed amount from the grantor as well as the right to charge the public ("hybrid

concession arrangement"), the issue of payments from the operator to the grantor is more difficult to analyse because it is not clear who the operator's customer is.

5. Consequently, in the two examples, we include fact patterns that are similar. However, we have modified the examples in a way that helps to demonstrate how an entity might go about determining who the customer is in the arrangement and consequently which accounting principles to apply to the overall revenue arrangement, consistently with those developed in agenda papers 7A and 7B.

Illustrative Example for consideration – operation and construction services

Example 1 – fact pattern indicates the concession payment represents an incremental payment for the concession right

The terms of a service arrangement require an operator to construct a road—completing construction within two years—and to operate the road and maintain it to a specified standard for eight years (ie years 3–10). 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*[1]
Construction services	1	500
	2	500
Operation services (per year)	3-10	100

Based on similar transactions, the operator estimates the fair value of the construction services as CU1,400 and the fair value of the operation services as CU1,000.

The terms of the arrangement allow the operator to collect tolls from drivers using the road. In addition, the grantor guarantees the operator a minimum amount of CU1,000 spread evenly over years 3–10. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of CU400 in each of years 3–10.

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

The terms of the arrangement further state that the operator is required to make annual payments to the grantor of CU50 in each of years 3–10 of the concession. The concession contract states that this payment is made by the operator for the concession right and there are no other identifiable goods or service being provided by the grantor to the operator.

For the purposes of this example, the time value of money has been ignored.

Example 2 – fact pattern indicates the concession payment represents a financing arrangement

The facts are the same as in Example 1 above, except for the following:

a) the grantor guarantees the operator a minimum amount of CU2,900 by the end of the concession, rather than CU1,000. The timing of the payment of the CU2,900 will be CU843 in year 3 with the remaining CU2,057 spread evenly over years 4–10 (ie CU343 per year) of the concession arrangement; and

b) The terms of the arrangement state that the operator is required to make annual payments to the grantor of CU100 in each of years 6–10 (no payments are required in years 1–5).

The reason for the payments from the operator to the grantor is that the operator needs to ensure that it receives relatively higher cash receipts in the earlier years to repay the financing that it will incur in constructing the infrastructure for the grantor. The payments in years 6-10 are a repayment of a portion of the cash that the operator received from the grantor in year 3, ie CU500.

Analysis of the arrangements

6. In both of the fact patterns, the transactions are similar to any arrangement where a bundle of goods or services are exchanged between parties. As such, the starting point of the analysis would be to determine if there were separate goods or services that should be accounted for in accordance with the applicable IFRS. However, in these fact patterns, the assumption is that the payment is not for a

distinct good or service that is separate from the concession arrangement. Consequently, the substance of the concession payments needs to be analysed to determine what this payment might relate to as part of the service concession arrangement:

Analysis of Example 1

7. In this example, we think that the economic substance of the arrangement is:

   (a) the operator requires total cash inflows of CU2400 (CU1,400 for the construction services and CU1,000 for the operation services) from its investment in the construction and operation services and the grantor is prepared to guarantee a portion of this return;

   (b) however, the grantor and operator think that the concession will generate cash inflows of CU2,800 in total (CU400 for each of the years 3-10), which is greater than the fair value of the operator's services;

   (c) in other words, the grantor is saying to the operator that if the concession is really worth CU2,800, the operator needs to give CU400 to the grantor for the concession contract (CU50 for each year of the concession). In this way, although the operator pays CU400 for the concession, this payment is required in order to ensure that the arrangement is arm's length based on the relative fair values of the goods and services that are exchange

Analysis of Example 2

8. In this example, we think that the economic substance of the arrangement is:

   (a) the operator requires total cash inflows of CU2400 from its investment in the construction and operation services (being the fair value of those services) and the grantor is prepared to guarantee an amount in excess of the fair value of the overall services provided by the operator. In other words, the *grantor* will compensate the operator in full for its services *in cash*;

(b) In addition, the operator requires financing from the grantor of CU500, the reason provided in the example is that this financing from the grantor is required to repay external financing that the operator incurred in providing the construction services. Over the term of the arrangement, the operator will repay the financing provided by the grantor via the CU100 repayments from years 6-10;

Factors to consider in analysing the revenue arrangements

9. In the two examples, we think that the revenue arrangement can be viewed in one of the following ways:

(a) **View F – collaboration agreement:** the operator is providing operation services to the public for which the operator will receive a service fee from the public. Some of this fee has been guaranteed by the grantor so that the grantor and operator shares the risks, but the grantor is not the operator's customer for the operation services; or

(b) **View G – two customers**: the operator is providing operation services to the grantor up to a specific threshold and then to the public for services above the threshold.

10. We think that this type of arrangement is a collaboration agreement (View F). IFRIC 12 paragraph BC53 explains the rationale for a type of service concession where the operator and grantor share the demand risk:

> The IFRIC concluded that if the operator is paid for its construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The IFRIC included the requirement to account separately for each component (sometimes known as a bifurcated arrangement) of the operator's consideration in response

> to a concern raised on the draft Interpretations. **The concern was that, in some arrangements, both parties to the contract share the risk (demand risk) that the cash flows generated by users of the public service will not be sufficient to recover the operator's investment.** In order to achieve the desired sharing of risk, the parties often agree to arrangements under which the grantor pays the operator for its services partly by a financial asset and partly by granting a right to charge users of the public service (an intangible asset). The IFRIC concluded that in these circumstances it would be necessary to divide the operator's consideration into a financial asset component for any guaranteed amount of cash or other financial asset and an intangible asset for the remainder. [emphasis added]

11. IAS 18 does not provide explicit guidance with respect to collaboration agreements. Similarly, paragraph 10 of the 2011 exposure draft *Revenue from Contracts with Customers* does not address collaborative agreements:

> A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities. An entity shall apply this [draft] IFRS to a contract (other than a contract listed in paragraph 9) only if the counterparty to the contract is a customer. **For some contracts, the counterparty to the contract might not be a customer but rather a collaborator or a partner that shares with the entity the risks and benefits of developing a product to be marketed. Such contracts are not in the scope of this [draft] IFRS.** [emphasis added]

12. In other words, in the examples above, we think that the operator has entered into two arrangements within the scope of IFRIC 12:

    (a) construction services to the grantor to build the infrastructure; and

(b) a collaboration agreement with the grantor for operation services to the public for which the operator will charge a service fee to the public.

13. Because there is no explicit guidance on accounting for these types of collaborative agreements, we think that there are several possible views in accounting for the payments from operator to the grantor in the examples provided. As explained in the fact patterns, the assumption in the examples is that the payment from the operator to the grantor is not in exchange for an unrelated distinct good or service:

(a) **View H – incremental payment for intangible asset**: The arrangement between the operator and the grantor is not a revenue contract. Consequently, the operator's revenue is derived from a transaction between only the operator and the public. The accounting for the payments to the grantor should therefore follow the treatment as explained in paper 3B - *Payments made by an operator in a service concession arrangement: Intangible asset only model*, ie as an incremental payment for an intangible asset.

(b) **View I – reduction in the overall consideration**: The grantor has agreed to make payments to the operator in exchange for the operator providing the services and repayment of implicit financing. Because the cash flows are going from the grantor to the operator for the guaranteed amount, but at the same time, the operator is required to make cash payments to the grantor for the concession fee, this indicates that the concession fee together with the minimum guarantee represent a financing arrangement. Consequently, the accounting for the payments to the grantor should follow the treatment as explained in paper 3A - *Payments made by an operator in a service concession arrangement: Financial asset only model*, ie as a reduction in the overall consideration.

(c) **View J – level of guarantee determines the accounting:** In Example 1, the economics of the arrangement indicate that the concession payments are required in order to ensure that the barter transaction of non-cash consideration between the operator and the grantor is at arm's length, ie construction and operation services in exchange for the concession right. Consequently the substance of the arrangement in Example 1 indicates that the operator's services *together with the concession payment*, is in exchange for a right to charge users of the public service. We think this rationale is analogous to the accounting proposed in Agenda Paper 3B, because the substance of the transactions are the same, ie a barter transaction including non-cash consideration where one party needs to make a cash payment to ensure that the overall values exchanged are equal.

In Example 2 however, the guaranteed amount is in excess of the fair value of the operator's services of CU2,400. Consequently, this indicates that a financing arrangement has been put in place between the grantor and the operator, because economically it would not make sense for the grantor to guarantee something in excess of the services that are to be provided, unless this related in part to a financing transaction. We think this rationale is analogous to the accounting proposed in Agenda Paper 3A, because the substance of the transactions are the same, ie the payment from the operator to the grantor does not represent the acquisition of a good or service and should therefore be accounted for as a reduction in the overall consideration.

14. We think that View J is the most appropriate view for the reasons explained above. Applying either View H or View I may under certain circumstances not be indicative of the substance of the arrangement.

Applicability to concession payments

15. 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.

16. 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", would meet the definition of an intangible asset if the guarantee from the grantor was less than the fair value of the operator's services. We think that the requirements of IAS 38 *Intangible Assets* would apply to these types of payments from the operator to the grantor. If however the guarantee from the grantor was in excess of the fair value of the operator's services, then we think that the concession fee should be treated as a reduction of 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 depending on whether the operator *controls* the right-of-use.

17. Consequently, we think that in a service concession arrangement, where the operator has a right to charge the public and in addition has an amount of consideration guaranteed by the grantor, the two types of concession payments included in the submission would be accounted for as follows:

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

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

    (c) if the concession payment is not for a distinct good or service, the accounting treatment would depend on the economic substance of the arrangement taking into account the fair values of the guarantee versus the operator's services. Specifically

(i) if the fair value of the operator's services exceeds the guaranteed amount, this indicates that the payment 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

(ii) if the fair value of the operator's services is less than the guaranteed amount, this indicates that the payment represents a reduction in the overall consideration.

18. As explained above in paragraph 6, 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.