IFRS

STAFF PAPER

March 2013

IFRS Interpretations Committee Meeting

Project	**IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets***		
Paper topic	Variable payments for the separate acquisition of property, plant and equipment and intangible assets		
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Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to address an issue that is related to contractual payments to be made by an operator under a service concession arrangement within the scope of IFRIC 12 *Service Concession Arrangements*. Specifically, the submitter requested that the Interpretations Committee should clarify in what circumstances (if any) those payments should:
   - (a) be included in the measurement of an asset and liability at the start of the concession; or
   - (b) be accounted for as executory in nature (ie be recognised as expenses as they are incurred over the term of the concession arrangement).
2. The Interpretations Committee noted that the issue of variable concession fees payable by an operator under a service concession arrangement is linked to the broader issue of variable payments for the separate acquisition of property, plant and equipment and intangible assets outside of a business combination. This broader issue was previously discussed, but not concluded on, by the Interpretations Committee in 2011.

3. At the November 2012 meeting, the Interpretations Committee discussed the initial accounting for variable payments. It could not reach a consensus on whether the variable payments that are dependent on the purchaser's future activity should be excluded from the initial measurement of the liability until that activity is performed. In all other cases (ie where the variable payments are not dependent on the purchaser's future activity), it tentatively agreed that the fair value of those variable payments should be included in the initial measurement of the liability on the date of purchase of the asset.

4. At the January 2013 meeting, the Interpretations Committee continued its discussions about the subsequent accounting for a financial liability to make variable payments. After reviewing some examples that illustrate cases in which the cost of the asset would be adjusted, it tentatively decided to recommend the IASB that it should amend IAS 16, IAS 38 and IAS 39 *Financial Instruments: Recognition and Measurement* to require that the adjustment of the amount of a financial liability, which is not a floating rate instrument, is recognised as a corresponding adjustment to the cost of the asset to the extent that IAS 16 or IAS 38 requires so.

5. The Interpretations Committee also decided to proceed with the proposed amendments to IFRIC 12, which were previously discussed during its March and May 2012 meetings.

Objective of the paper

6. The objective of this paper is:

    (a) to summarise the Interpretations Committee's discussions and tentative decisions;

    (b) to propose draft amendments to IAS 16, IAS 38, IAS 39 and IFRIC 12 as part of a narrow-scope project; and

    (c) to ask the Interpretations Committee whether they think that examples illustrating the proposed amendments should accompany IAS 16, IAS 38 and IFRIC 12.

Structure of the paper

7. The structure of the paper is as follows:

   (a) summary of the Interpretations Committee's discussions and tentative decisions regarding the subsequent accounting for variable payments for the separate purchase of assets;

   (b) summary of the Interpretations Committee's discussions and tentative decisions regarding the accounting for payments made by an operator to a grantor as part of a service concession arrangement;

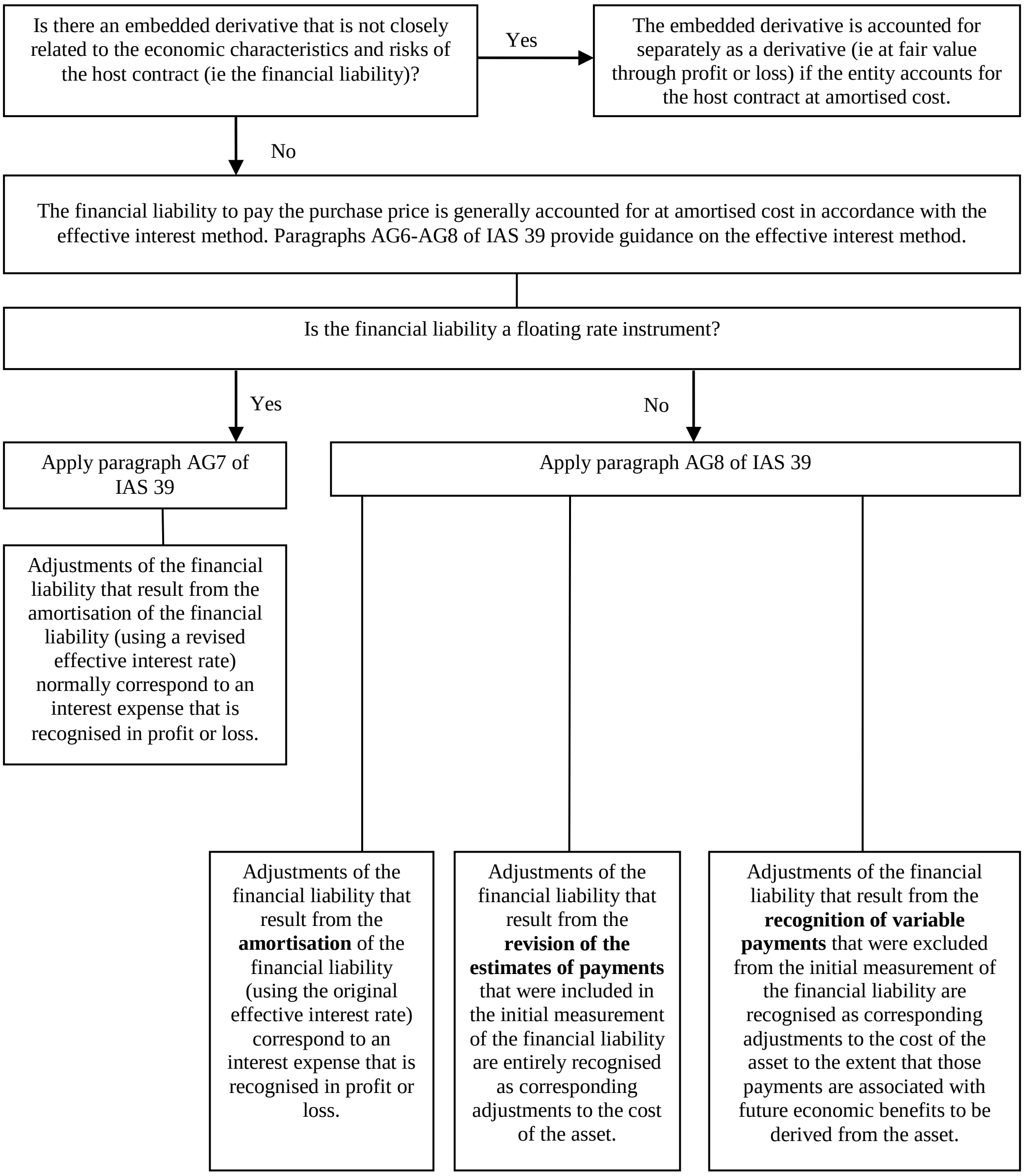
   (c) proposed amendments to IAS 39, IAS 16, IAS 38 and IFRIC 12;

   (d) Illustrative Examples accompanying IAS 16, IAS 38 and IFRIC 12; and

   (e) next steps.

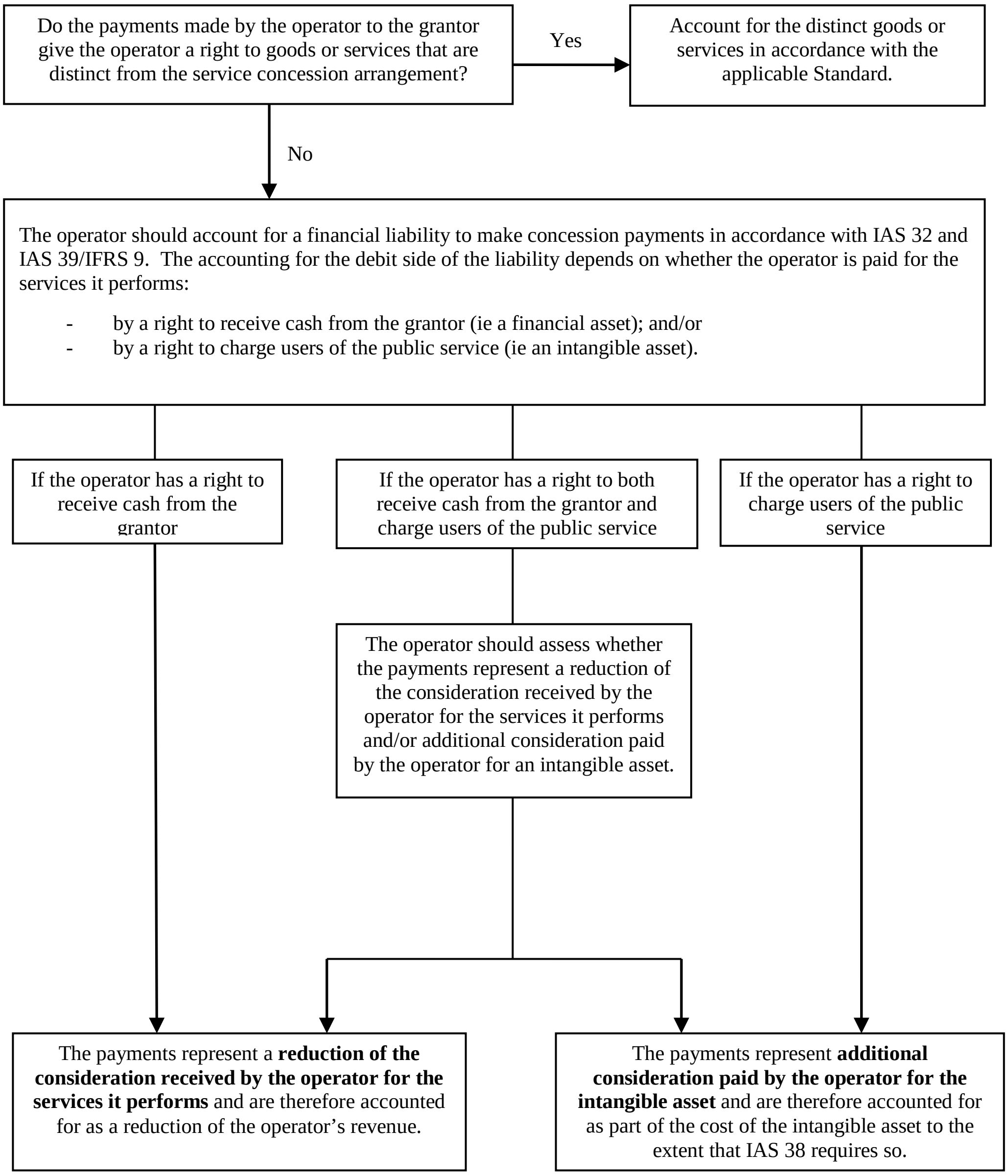
Summary of the Interpretations Committee's discussions and tentative decisions regarding the subsequent accounting for variable payments for the separate purchase of assets

8. We present below a summary of the Interpretations Committee's discussions and tentative decisions taken during its January 2013 meeting:



Summary of Interpretations Committee's discussions and tentative decisions regarding the accounting for payments made by an operator to a grantor as part of a service concession arrangement

9. We present below a summary of the Interpretations Committee's discussions and tentative decisions taken during its March and May 2012 meetings:



Amendments to IAS 39

10. We present below the proposed amendments to IAS 39 as discussed by the Interpretations Committee during its January 2013 meeting.

Paragraph AG8 of IAS 39 is amended as follows (new text is underlined):

Effective interest rate

…

AG8 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate or, when applicable, the revised effective interest rate calculated in accordance with paragraph 92. The adjustment is recognised in profit or loss as income or expense <u>unless another Standard (such as IAS 16 or IAS 38) requires otherwise</u>.

Amendments to IAS 16 and IAS 38

11. We present below the proposed amendments to IAS 16 and IAS 38. We note that the Interpretations Committee tentatively agreed that adjustments to the financial liability other than those corresponding to finance costs should be recognised as a corresponding adjustment to the cost of the asset acquired to the extent that IAS 16 or IAS 38 require so. In particular, the Interpretations Committee tentatively agreed that the adjustment of the amount of the financial liability that results from the application of paragraph AG8 of IAS 39 would be recognised as a corresponding adjustment to the cost of the asset acquired:

   (a) entirely when it is a change of the estimates of payments that were included in the initial measurement of the financial liability. This proposal is consistent with IFRIC 1 *Changes in Existing Decommissioning Restoration and Similar Liabilities*; or

   (b) to the extent that it is associated with future economic benefits to be derived from the underlying asset when the adjustment results from the recognition of variable payments that were excluded from the initial measurement of the financial liability. This proposal is consistent with the definition of an 'asset'.

12. We note that subparagraph (b) deals with situations where the variable payments were excluded from the initial measurement of the financial liability. This is because the Interpretations Committee could not reach a consensus on whether all variable payments should be included in the initial measurement of the financial liability. In particular, the Interpretations Committee could not reach a consensus on whether the variable payments that are dependent on the purchaser's future activity should be included in the initial measurement of the financial liability. In all other cases (ie where the variable payments are not dependent on the purchaser's future activity), the Interpretations Committee tentatively agreed that those variable payments should be included in the initial measurement of the financial liability on the date of purchase of the asset.

13. Although we agree with the Interpretations Committee's tentative decision that the accounting described in (b) above would apply to variable payments that would be excluded from the initial measurement of the financial liability, we do not think that the Interpretations Committee should propose to introduce new amendments in current Standards that seem to acknowledge that the initial measurement of a financial liability could exclude some variable payments. Indeed, the Interpretations Committee could not reach a consensus on this issue and we do not think that it should pre-empt the IASB's discussions on this issue.

14. As a result, we think that the proposed amendments should only address the accounting for the revision of the estimates of payments (ie the estimates of payments that were included in the initial measurement of the financial liability) in accordance with paragraph AG8 of IAS 39. The proposed amendments should not address issues that are linked to the initial accounting for variable payments that are dependent on the purchaser's future activity. The Basis for Conclusions of the proposed amendments would however present the Interpretations Committee's discussions on this issue. The proposed amendments as recommended by the staff are shown under Alternative A below.

15. If the Interpretations Committee disagrees with the staff's proposals and thinks that the proposed amendments should address the subsequent accounting for

variable payments that are dependent on the purchaser's future activity, we propose an alternative drafting in Alternative B below.

Amendments to IAS 16 (Alternative A as recommended by the staff)

Paragraphs 23A and 23B are added. Paragraph 23 is not proposed for amendment but is included for ease of reference. New text is underlined.

Measurement of cost

23 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with IAS 23.

23A The purchase price of an item of property, plant and equipment may comprise fixed or variable payments, or both. Variable payments are contractual payments for an item of property, plant and equipment that vary if facts or circumstances change after the acquisition date. Examples of variable payments include payments that are made if the item of property, plant and equipment acquired meets specified conditions at specified dates in the future, payments that are dependent on the purchaser's future activity derived from the underlying item of property, plant and equipment (such as payments based on sales, revenues or outputs produced) and payments that vary according to an index or a rate (such as inflation or a consumer price index).

23B The cost of an item of property, plant and equipment is subsequently revised when an entity revises its estimates of variable payments that were included in the initial measurement of the financial liability in accordance with paragraph AG8 of IAS 39. Finance costs do not form part of the cost of the item of property, plant and equipment unless IAS 23 requires so.

Amendments to IAS 16 (Alternative B)

16. Same amendments as above, except for the last paragraph:

23B The cost of an item of property, plant and equipment is subsequently revised when an entity:

(a) revises its estimates of variable payments that were included in the initial measurement of the financial liability in accordance with paragraph AG8 of IAS 39; and

(b) recognises variable payments that were excluded from the initial measurement of the financial liability to the extent that those payments are associated with future economic benefits to be derived from the item of property, plant and equipment.

Finance costs do not form part of the cost of the item of property, plant and equipment unless IAS 23 requires so.

Amendments to IAS 38 (Alternative A as recommended by the staff)

Paragraphs 32A and 32B are added. Paragraph 32 is not proposed for amendment but is included for ease of reference. New text is underlined.

Separate acquisition

…

32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with IAS 23 *Borrowing Costs*.

32A The purchase price of a separately acquired intangible asset may comprise fixed or variable payments, or both. Variable payments are contractual payments for an intangible asset that vary if facts or circumstances change after the acquisition date. Examples of variable payments include payments that are made if the separately acquired intangible asset meets specified conditions at specified dates in the future, payments that are dependent on the purchaser's future activity derived from the underlying intangible asset (such as payments based on sales or revenues) and payments that vary according to an index or a rate (such as inflation or a consumer price index).

32B The cost of a separately acquired intangible asset is subsequently revised when an entity revises its estimates of variable payments that were included in the initial measurement of the financial liability in accordance with paragraph AG8 of IAS 39. Finance costs do not form part of the cost of the separately acquired intangible asset unless IAS 23 requires so.

Amendments to IAS 38 (Alternative B)

17. Same amendments as above, except for the last paragraph:

32B The cost of a separately acquired intangible asset is subsequently revised when an entity:

(a) revises its estimates of variable payments that were included in the initial measurement of the financial liability in accordance with paragraph AG8 of IAS 39; and

(b) recognises variable payments that were excluded from the initial measurement of the financial liability to the extent that those payments are associated with future economic benefits to be derived from the separately acquired intangible asset.

Finance costs do not form part of the cost of the separately acquired intangible asset unless IAS 23 requires so.

Amendments to IFRIC 12

18. We present below the proposed amendments to IFRIC 12 as discussed by the Interpretations Committee during its March and May 2012 meetings. It should be noted that according to the proposed amendments below:

    (a) IFRIC 12 would refer to IAS 32 and IAS 39/IFRS 9 for the accounting for the liability to make concession payments. As a result, IFRIC 12 would not address the timing of recognition of the financial liability;

    (b) IFRIC 12 would refer to IAS 38 when the payments made by the operator to the grantor represent additional consideration paid by the operator for an intangible asset.

Paragraphs 7, 10 and 27 are amended and paragraph 27A is added. New text is underlined and deleted text is struck through.

Scope

…

7 This Interpretation applies to both:

(a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and

(b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement <u>(in exchange for payments or not)</u>.

Issues

10 This Interpretation sets out general principles on recognising and measuring the obligations and related rights in service concession arrangements. Requirements for disclosing information about service concession arrangements are in SIC-29. The issues addressed in this Interpretation are:

(a) treatment of the operator's rights over the infrastructure;

…

(f) subsequent accounting treatment of a financial asset and an intangible asset; ~~and~~

(g) items provided to the operator by the grantor~~.~~<u>; and</u>

<u>(h) payments made by the operator to the grantor.</u>

Items provided by the operator to the grantor

…

27 In accordance with paragraph 11, infrastructure items to which the operator is given access by the grantor for the purposes of the service arrangement are not recognised as property, plant and equipment of the operator. <u>If the operator is given access to</u>

infrastructure items in exchange for payments, the operator shall account for those payments in accordance with paragraph 27A of this Standard. The grantor may also provide other items to the operator that the operator can keep or deal with as it wishes. If such assets form part of the consideration payable by the grantor for the services, they are not government grants as defined in IAS 20. They are recognised as assets of the operator, measured at fair value on initial recognition. The operator shall recognise a liability in respect of unfulfilled obligations it has assumed in exchange for the assets.

Payments made by the operator to the grantor

27A As part of a service concession arrangement, the operator may be required to make payments to the grantor.

If the payments give the operator a right to goods or services that are distinct from the service concession arrangement, the operator shall account for those distinct goods or services (and the corresponding liability) in accordance with the applicable Standard. For example, lease payments made by the operator to the grantor that give the operator the right to control the use of assets are accounted for in accordance with IAS 17 *Leases*.

If the payments do not give the operator a right to distinct goods or services, the payments made by the operator to the grantor are part of the service concession arrangement. In that case, the operator shall account for a financial liability to make concession payments in accordance with IAS 32 and IAS 39/IFRS 9. The corresponding accounting entry is as follows:

(a) if the operator recognises a financial asset as required in paragraph 16, then the payments represent a reduction of the consideration received by the operator for the operation and construction services (if any) it performs and are therefore accounted for as a reduction of the operator's revenue (see paragraph 13);

(b) if the operator recognises an intangible asset as required in paragraph 17, then the payments represent additional consideration paid by the operator for that intangible asset and are therefore accounted for as part of the cost of that intangible asset to the extent that IAS 38 requires so; and

(c) if the operator recognises both a financial asset and an intangible asset as required in paragraph 18, then the operator shall:

   i. assess whether the payments represent a reduction of the consideration received by the operator for the services it performs and/or an additional consideration paid by the operator for the intangible asset. This assessment is made by comparing the amount of the right to receive cash from the grantor with the fair value of the operation and construction services (if any) performed by the operator ; and

   ii. account for those payments in accordance with subparagraphs (a) and/or (b).

Illustrative Examples in IAS 16, IAS 38 and IFRIC 12

19. We think that examples illustrating the proposed amendments could accompany IAS 16, IAS 38 and IFRIC 12. If the Interpretations Committee thinks that

guidance should be provided, the following Illustrative Examples included in the January 2013 Agenda Paper could accompany IAS 16 and IAS 38:

(a) Example 1: variable payments that are made if a tangible asset acquired complies with agreed-upon specifications at specified dates in the future. This example would accompany IAS 16; and

(b) Example 4: accounting for variable payments that are dependent on a rate analysed as a floating rate (such as LIBOR). This example addresses the accounting for payments made under a licence agreement and would accompany IAS 38.

20. An example similar to Example 4 could be added to IFRIC 12. This example would address the accounting for variable payments (that are dependent on a floating rate, such as LIBOR) that are made under a service concession arrangement.

21. It should be noted that in all of those examples, the payments are not dependent on the purchaser's future activity and are therefore included in the initial measurement of the financial liability at the date of acquisition of the asset.

22. We do not think that examples illustrating the accounting for variable payments that are dependent on the purchaser's future activity should be included. The Interpretations Committee could not reach a consensus on this issue. As a result, those examples would have to present two different ways to account for those variable payments, and we do not think that this is the right path to follow. We think that such examples should be included only when the IASB has decided how to account for those variable payments.

Next steps

23. If the Interpretations Committee agrees with the staff's proposals, we would ask the IASB whether they agree to propose amendments to IAS 16, IAS 38, IAS 39 and IFRIC 12 as part of a narrow-scope project on the basis of the proposed amendments presented in this paper (subject to drafting amendments).

24. As explained above, we do not think that the proposed amendments (and the corresponding Illustrative Examples) should address the initial accounting for variable payments that are dependent on the purchaser's future activity or other related issues. But we think that the Interpretations Committee could provide useful guidance on how to account for:

    (a) variable payments that are not dependent on the purchaser's future activity;

    (b) subsequent adjustments to the financial liability to pay the purchase price resulting from the revision of the estimates of payments in accordance with paragraph AG8 of IAS 39; and

    (c) payments made by an operator to a grantor as part of a service concession arrangement.

25. We do not think that the Interpretations Committee should postpone the proposed amendments until the IASB has discussed the initial accounting for variable payments because the final decisions on this issue will not be taken in the short term.

Questions to the Interpretations Committee
1. Does the Interpretations Committee agree to recommend to the IASB that it should amend IAS 39 and IFRIC 12 as recommended in this paper (subject to minor drafting amendments)? 2. Does the Interpretations Committee agree to recommend to the IASB that it should amend IAS 16 and IAS 38 as recommended in Alternative A of this paper (subject to minor drafting amendments)? If not, does the Interpretations Committee think that Alternative B should be applied (subject to minor drafting amendments)? 3. Does the Interpretations Committee think that Illustrative Examples should accompany IAS 16, IAS 38 and IFRIC 12? If so, does the Interpretations Committee agree to use Examples 1 and 4 presented in the January 2013 Agenda Paper?