

International Financial Reporting Standards

CMAC/GPF meeting, 11-12 June 2015
Agenda paper 6

IFRS Interpretations Committee *Issues and Update*

The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB or IFRS Foundation.

Purpose of the session

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- Feedback on the information needs of investors and practical experiences of preparers and investors with:
 - IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*
 - Variable payments for the separate acquisition of PP&E and Intangible Assets
 - IFRIC 12 *Service Concession Arrangements*
 - Variable payments by operator to grantor (*time permitting*)
- Update on the Interpretation Committee's activities (*time permitting*)

Variable payments for the acquisition of PP&E and intangible assets

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Variable payments for acquisition of an asset - Background

- Issue: accounting for variable payments for acquisition of an asset (either PPE or intangible asset) outside of a business combination.
- Payments can be subject to different variables such as:
 - indices or rates (eg. LIBOR, CPI)
 - purchaser's future activity derived from asset (eg sales, output produced)
 - compliance with agreed-upon specifications at future dates (eg standard production capacity)
- Example: A pharmaceutical company purchases a drug that is in the early stages of development. The company will pay to the seller some amount upfront plus additional amounts when specific milestones in the development of the drug are successfully reached. There is significant uncertainty about whether those milestones will be successfully reached.

Variable payments for acquisition of an asset - Considerations

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- Initial recognition and measurement:
 - should a liability be recognised on the date of acquisition of the asset?
 - how it should be measured? (see slide 6)
- Subsequent recognition and measurement: to what extent should subsequent adjustments of the liability for the variable payments be recognised:
 - with a corresponding adjustment to the cost of the asset purchased; or
 - through profit or loss?

(see slide 7)
- Note: There is currently no explicit guidance on the accounting for such arrangements and we understand that there are diverse views on how such payments should be accounted for.

Variable payments for acquisition of an asset – initial recognition and measurement

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- Alternatives to consider:
 - Alternative 1: **Recognise a liability** for **all variable payments at the date of acquisition** of the asset **at fair value** (similar to principles in IFRS 3 *Business Combinations* for contingent consideration payable on the acquisition of a business)
 - Alternative 2: **Recognise a liability** for **only certain variable payments at the date of acquisition** of the asset
 - For example:
 - recognise a liability for variable payments based on an index or a rate, measured using the base index/rate at the date of acquisition (ie do not build in future expectations of changes in rate/index); and
 - do not recognise a liability for other variable payments(similar to proposals in the leases project for variable payments in a lease contract)
 - Alternative 3: **Do not recognise a liability** for variable payments **at the date of acquisition** of the asset. Recognise a liability for the variable payments when the ‘event’ that triggers the payment occurs.

Variable payments for acquisition of an asset – subsequent recognition and measurement

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- Alternatives to consider:
 - Alternative 1: Recognise **all** payments/adjustments as part of the **cost of the asset**
 - Alternative 2: Recognise **all** payments/adjustments through **profit or loss**
 - Alternative 3: Recognise **certain adjustments** against the **cost of the asset** and others through **profit or loss**.
 - Alternative 4: The recording of the subsequent recognition/adjustment to cost of the asset/ profit or loss would **differ depending on initial recognition** of the liability.
 - Example:
 - variable payments not recognised as a liability on acquisition of the asset: record payment through profit or loss when incurred; and
 - variable payments recognised as a liability on acquisition of the asset: record subsequent adjustments to the liability against the cost of the asset
- (similar to proposals in the leases project for variable payments in a lease contract).

Variable payments for acquisition of an asset – questions to members

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Question to CMAC members

1. What information would investors need in order to properly understand and analyse the potential effects of a variable payment arrangement for the separate acquisition of an asset, both on initial recognition and subsequently?
2. Which alternative(s), if any, would meet those information needs? Are there any other alternatives which should be considered?
3. Are there any specific disclosures which investors would consider to be useful?

Question to GPF members

1. In your experience, how are such variable payment arrangements recognised, both on initial recognition of an asset and subsequently?
2. Which of the above alternatives, if any, do you consider as being the most feasible to apply in practice, keeping in mind the information needs of the investors? Are there any other alternatives which should be considered?

IFRIC 12 *Service Concession Arrangements*

Future payments by an operator to a grantor

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Service concession arrangements – background

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- IFRIC 12 *Service Concession Arrangements* covers arrangements of a public service nature undertaken by a private sector ‘operator’ on behalf of/for a government entity (grantor)
 - Example – A private sector entity contracts to build and operate a toll road on behalf of the government.
- The operator has access to operate the infrastructure to provide the public service, but control of the infrastructure remains with the government entity. Accordingly, the infrastructure is not recognised as PPE of the operator.
- IFRIC 12 notes that where an operator provides construction/upgrade services, the consideration received in return for those construction/upgrade services represents rights to either:
 - Financial asset – right to receive cash from grantor (either directly or through a minimum payment guarantee)
 - Intangible asset – right to charge the public for the use of services (operator assumes demand risk ie the risk that cash flows generated by users of the service will not be sufficient to recover the investment)

Service concession arrangements – issue

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- The issue is about accounting for future payments to be made by an operator to a grantor in a service concession arrangement.
- Such payments might be fixed or variable in amount.
 - For example: a fee is payable each year of the service concession to the government by the operator for the right to operate the toll road. The fee is CU300,000 for year 1 and increases each year based on inflation. Inflation in the country currently is 15%.
- IFRIC 12 does not provide guidance on accounting for future payments to be paid by an operator to the grantor of a service concession arrangement.
- We understand there is diversity in practice in the accounting for such payments. For payments that are variable in nature, we understand that executory type of accounting is more prevalent (ie recognising the amount when paid as an expense or a contra-revenue)

Service concession arrangements – preliminary Analysis (1/3)

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- Preliminary analysis by the Interpretations Committee:
 - Operator should first analyse the substance of the payment made :
 - Does the payment provide the operator with a right to a good or service that is distinct from the service concession arrangement? (if yes, account for the distinct good or service in accordance with the applicable IFRSs); or
 - Is the payment a part of the service concession arrangement?

Service concession arrangements – preliminary Analysis (2/3)

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- If the payment is part of the service concession arrangement, the analysis may differ depending on whether the operator has applied the intangible asset model or the financial asset model under IFRIC 12.
- Intangible asset model:
 - In substance, the payment represents additional consideration paid by the operator to acquire an intangible asset.
 - Accounting considerations (similar to slide 5) include:
 - Initial accounting: Should a liability be recognised at the start of the concession for all future variable payments? If yes, how should they be measured?
 - Subsequent accounting: Should subsequent adjustments of the liability for the variable payments be recognised:
 - a) an adjustment to the cost of the intangible asset purchased; or
 - b) through profit or loss?

Service concession arrangements – preliminary Analysis (3/3)

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- Financial asset model:
 - In substance, the payment represents a reduction of the consideration received by the operator for the services provided.
 - The payment is accounted for as an adjustment to the consideration (ie revenue) when the revenue is recognised. The adjustment to revenue is made in a manner consistent with IFRS 15.

Service concession arrangements – questions to members

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Question to CMAC/GPF members

1. What experience do you have with service concession arrangements in which variable payments are made by an operator to a grantor?
2. In your experience, how are such variable payments normally accounted for?

Question to CMAC members

1. What information would be useful for investors in relation to these transactions?
2. Do you think the preliminary analysis meets investors' needs?

Question to GPF members

1. Do you think the preliminary analysis is feasible to implement keeping in mind the information needs of the investors?

Overview of Interpretations Committee activities

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Activities of the Interpretations Committee

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- Activities of the IFRS Interpretations Committee – An oral update
 - Refer to Appendix of Agenda Paper 1

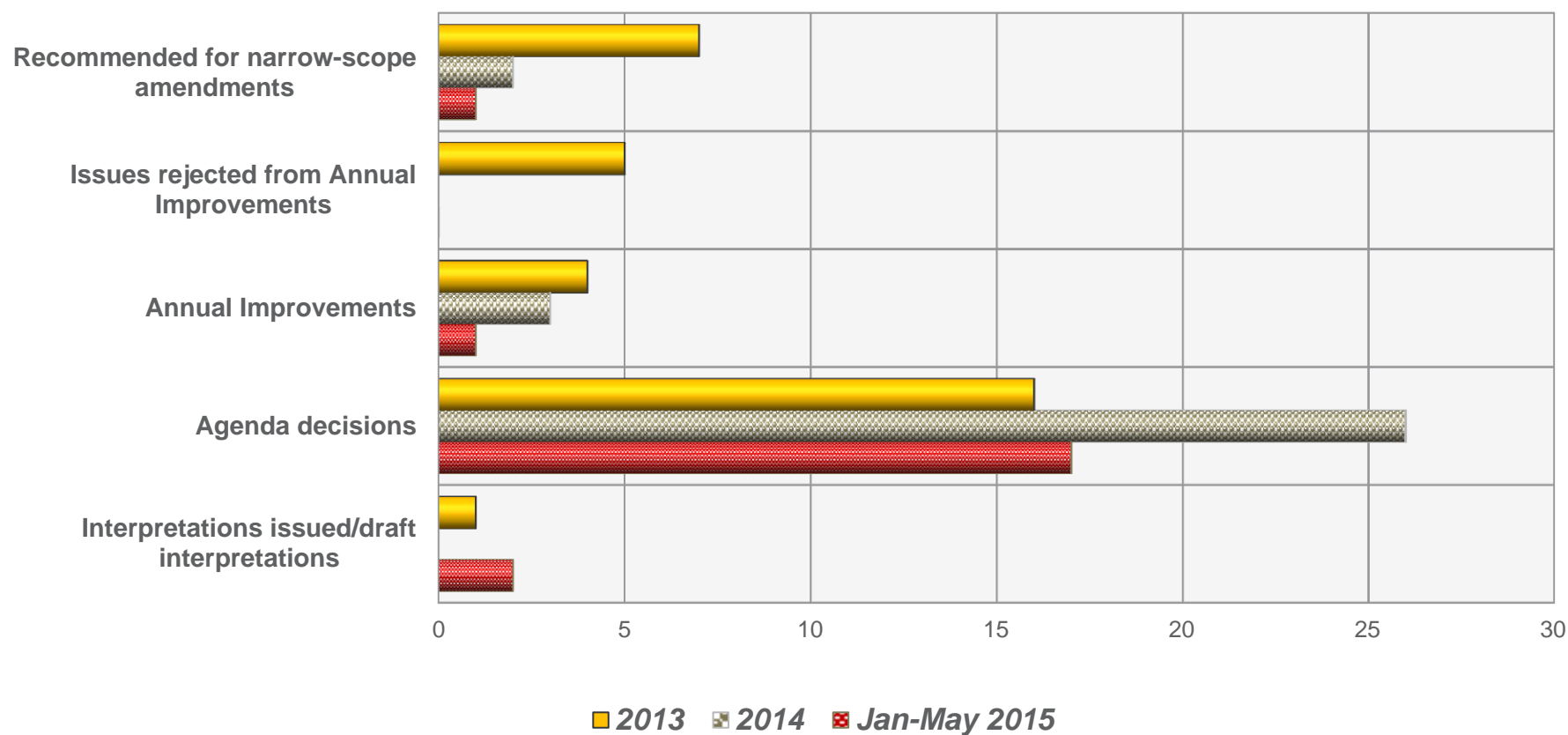
Question to CMAC/GPF members

- Do you have questions about the activities of the Interpretations Committee?

Level of activity (2013-2015)

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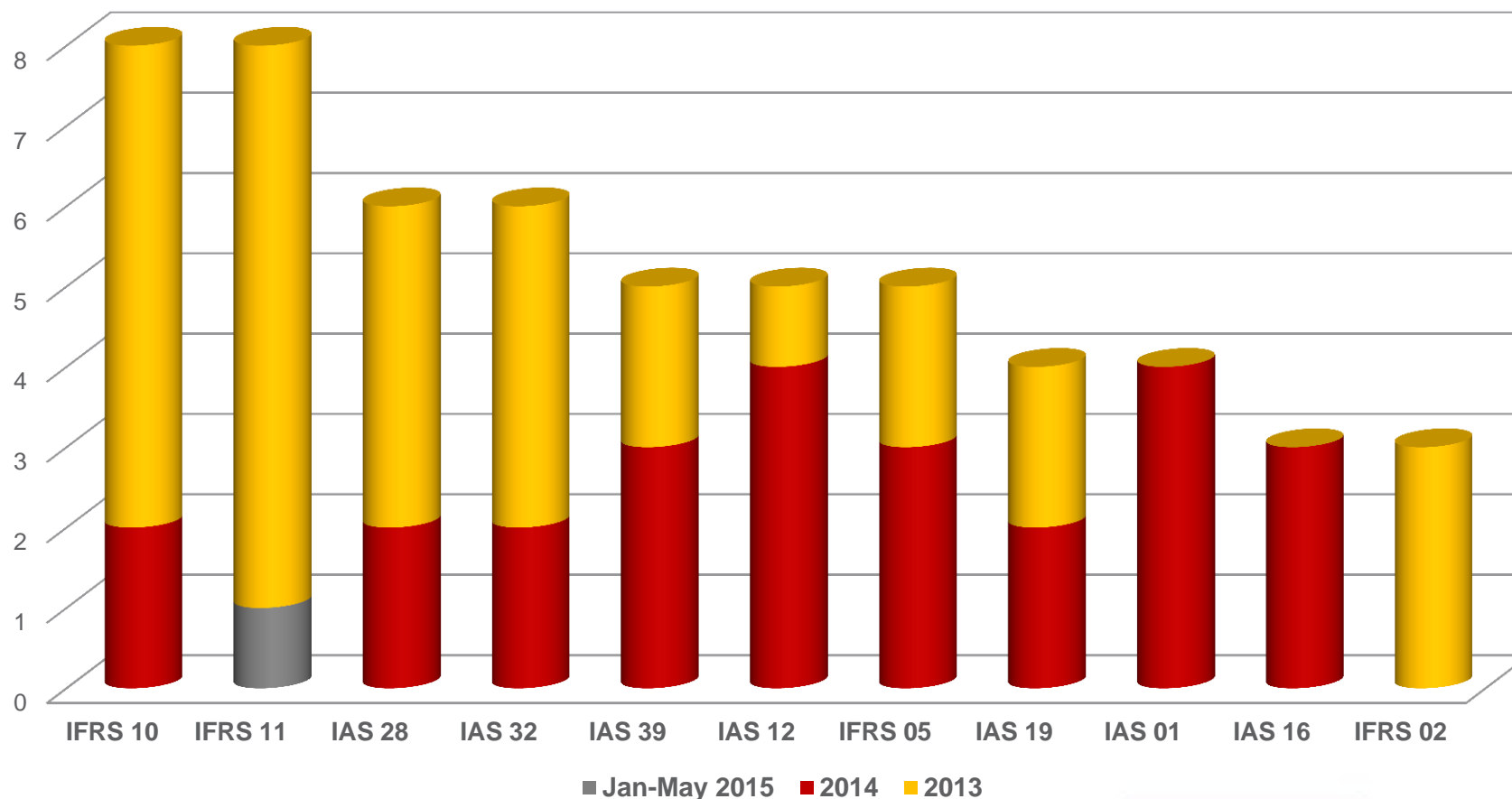
IFRS Interpretations Committee activity 2013-2015 Number of issues resolved by year by form of resolution



Issues analysed per Standard

19

Number of issues per Standard by year of first discussion
(top 11 standards)



Thank you

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