IFRS

STAFF PAPER

November 2015

IFRS Interpretations Committee Meeting

Project	**IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IFRIC 12 *Service Concession Arrangements***
Paper topic	Variable payments for asset purchases and payments made by an operator to a grantor in a service concession arrangement – Cover Memo

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Background

1. The IFRS Interpretations Committee (the ‘Interpretations Committee’) received a request to address the accounting for contractual payments to be made by an operator under a service concession arrangement within the scope of IFRIC 12 *Service Concession Arrangements*. 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 accounting for variable payments for the purchase of property, plant and equipment and intangible assets outside of a business combination (hereafter referred to as ‘variable payments for asset purchases’).

2. The discussion on both these issues was put on hold pending completion of the redeliberations on the 2013 Exposure Draft *Leases*. The Interpretations Committee resumed its discussions on these issues at its meeting in September 2015.

3. At that meeting, the Interpretations Committee discussed the implications of applying the principles proposed for accounting for variable payments in the Leases project (hereafter referred to as the ‘leasing principles’) to the accounting for variable payments for asset purchases. Members of the Interpretations Committee expressed mixed views on applying the leasing principles. Some members of the Interpretations Committee expressed concerns with applying the leasing principles and noted that

lease accounting is a specific accounting regime and that the rationale may not be directly applicable to asset purchases.

4. The Interpretations Committee directed the staff to analyse the conceptual arguments underlying the leasing principles and their applicability to account for variable payments for asset purchases. The Interpretations Committee also asked the staff to consider whether service concession arrangements represented a distinct and specific type of transaction that could be analysed separately.

Structure of the papers

5. Agenda Paper 02A discusses the initial recognition and measurement of variable payments for asset purchases. In particular it provides:

   (a) a summary of previous discussions and tentative decisions of the Interpretations Committee;

   (b) an analysis of applying the leasing principles to the initial recognition and measurement of variable payments for asset purchases;

   (c) an analysis of applying the business combination principles to the initial recognition and measurement of variable payments for asset purchases;

   (d) other considerations; and

   (e) staff conclusion and recommendation.

6. Agenda Paper 02B discusses the subsequent recognition and measurement of variable payments for asset purchases. In particular it provides:

   (a) a summary of previous discussions and tentative decisions of the Interpretations Committee;

   (b) an analysis of applying the business combination principles to the subsequent recognition and measurement of variable payments for asset purchases; and

   (c) an analysis of applying the leasing principles to the subsequent recognition and measurement of variable payments for asset purchases.

7. Agenda Paper 02C discusses payments made by an operator to a grantor in a service concession arrangement. In particular it provides:

   (a) a summary of previous discussions and tentative decisions of the Interpretations Committee; and

   (b) an assessment of the key characteristics of a service concession arrangement and explores whether it would be possible to develop a solution for accounting for payments to be made by an operator to a grantor without addressing the broader issues of accounting for variable payments for asset purchases.

8. A summary of our conclusions and recommendations have been presented in the following section.

Summary of conclusions and recommendations

Initial recognition and measurement of variable payments for asset purchases (Agenda Paper 02A)

9. We recommend applying the business combination principles to the initial accounting for variable payments for asset purchases. We think that applying the business combinations principles provides a more conceptually robust solution and leads to a more faithful representation of the economic consideration exchanged between the parties at the date of purchase of the asset.

10. We acknowledge the concerns of constituents who note that the costs of applying the business combination principles are significant, but on balance we think that the advantages of this approach outweigh the costs and disadvantages. We also think that applying the business combinations principles will reduce the pressure on the distinction between an asset and a business, which was one of the concerns noted by constituents in the Post-implementation Review of IFRS 3 *Business Combinations*.

Subsequent recognition and measurement of variable payments for asset purchases (Agenda Paper 02B)

11. If the business combination principles are applied to the initial accounting for variable payments, we think that the Interpretations Committee should retain its previous tentative decisions on subsequent accounting. Previously, the Interpretations Committee has tentatively decided that:

    (a) the remeasurement of the liability, in accordance with paragraph AG7 of IAS 39 *Financial Instruments: Recognition and Measurement*, corresponds entirely to an interest expense (calculated using the revised effective interest rate) that should be recognised in profit or loss. Paragraph AG7 applies to the accounting for floating rate instruments. It would therefore apply, for example, to the accounting for liabilities to make variable payments that are dependent on an interest rate (such as LIBOR).

    (b) for other liabilities (ie those that are not floating rate liabilities):

        (i) adjustments of the financial liability resulting from the amortisation of the financial liability (using the original effective interest rate) correspond to an interest expense that is recognised in profit or loss; and

        (ii) adjustments of the financial liability that result from the revision of the estimates of payments that were included in the initial measurement of the financial liability should be recognised as an adjustment to the cost of the corresponding asset.

12. However, if the leasing principles are applied to the initial accounting for variable payments to make asset purchases, we recommend that:

    (a) for subsequent accounting for variable payments based on an index or a rate, the Interpretations Committee should adopt the principles developed in the Leases project (ie adjustments should be recorded against the cost of the asset); and

    (b) for subsequent accounting for variable payments that are not dependent on an index or a rate (such as purchaser's future activity), the Interpretations

Committee should retain its previous decision to recognise those payments as corresponding adjustments to the cost of the asset to the extent that those payments are associated with future economic benefits to be derived from the asset.

Service concession arrangements (Agenda Paper 02C)

13. We think that because there is nothing unique about the intangible asset arising from a service concession arrangement (in situations in which the intangible asset model in IFRIC 12 is applicable) when compared to other intangible assets, the ideal solution would be for the Interpretations Committee to resolve the broader issue of accounting for variable payments for an asset purchase. The solution would then be applied to variable payments for intangible assets in a service concession arrangement.

14. However, if the Interpretations Committee cannot resolve this broader issue, we think that it may be possible to develop a solution within the confines of IFRIC 12 for variable payments made by an operator to a grantor when the intangible asset model is used. We think that a reference will need to be made to leasing or other principles to determine the appropriate accounting for these payments. We note that this will create a mixed model for accounting for the intangible asset arising from a service concession arrangement, by which variable payments made by the operator will be accounted for using leasing or other principles while all other aspects of the intangible asset will continue to be accounted for using IAS 38 *Intangible Assets*.