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	Payments made by an operator to a grantor in a service concession arrangement

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Background and objective

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 Interpretations Committee has previously discussed the accounting for fixed and variable payments made by an operator to a grantor in a service concession arrangement within the scope of IFRIC 12. In situations in which the intangible asset model is applicable, and the payments to be made by the grantor are variable, the Interpretations Committee noted that the issue of concession fees is linked to the broader issue of variable payments made for asset purchases. This is because the Interpretations Committee thinks that the operator has, in substance, made a payment to acquire an intangible asset (ie the right to charge users of the public service).

3. A summary of the discussions and previous tentative decisions of the Interpretations Committee can be found in Appendix A of this paper. At the Interpretations

Committee's meeting in September 2015, several members expressed a preference for retaining the previous tentative decisions on the accounting for payments made by an operator to a grantor, subject to resolving the broader issue of accounting 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.

4. In this paper, we have provided an assessment of the key characteristics of a service concession arrangement and explored 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.

5. We think it may be possible to develop a solution for accounting for payments by an operator to a grantor without considering the broader issue of variable payments for asset purchases. However, in cases in which the intangible asset model in IFRIC 12 is applicable and the payments to be made by the operator are variable, we think that a specific scope exemption from IAS 38 *Intangible Assets* will be required and a reference will need to be made to the leasing principles to determine the appropriate accounting for these payments (if the Interpretations Committee concludes that the leasing principles should be applied to the accounting for these payments). Our rationale and analysis are presented in the following section.

Key characteristics of a service concession arrangement

6. Paragraph 2 of IFRIC 12 describes a public-to-private service concession arrangement and states that:

> An arrangement within the scope of this Interpretation typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. Such an

arrangement is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

7. Some key characteristics of service concession arrangements within the scope of IFRIC 12 that differentiate them from other types of arrangements (such as asset purchases or lease contracts) are:

   (a) the operator in a service concession arrangement acts as a service provider. The grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them and at what price. The grantor also controls any significant residual interest in the infrastructure at the end of the arrangement.

   (b) in a typical arrangement, the operator both receives a right and incurs an obligation to provide public services.

   (c) these arrangements are typically longer-term in nature (based on prior experience and outreach, we understand that these contracts generally range from 10–30 years although they can also be for shorter or longer durations).

8. We think that these arrangements have some characteristics that are similar to leasing arrangements in that both types of arrangements create ongoing rights and obligations. In a lease contract, a lessee obtains a right to use an asset and, if the lease payments are made over time, it incurs an obligation to make lease payments. There is a linkage between the right-of-use asset and the lease liability in a lease contract. Similarly, in a service concession arrangement, an operator obtains a right to access infrastructure and incurs an obligation to provide services using that infrastructure. There is also a link between the access right obtained and the obligation incurred by the operator.

Can a solution be developed for service concession arrangements without addressing the accounting for variable payments in an asset purchase?

9. The Interpretations Committee noted that in cases in which the intangible asset model is used and the payments to be made by the operator are variable; the issue of concession fees is linked to the broader issue of variable payments made for asset purchases. This is because the Interpretations Committee thinks that the operator has,

in substance, made a payment to acquire an intangible asset (ie the right to operate and charge users of the public service).

10. The intangible asset arising under a service concession arrangement represents a right (a licence) to charge users of the public service. This right is acquired only for a finite period (the duration of the contract) and the pricing is controlled by the grantor.

11. While a service concession arrangement has unique characteristics, as noted in paragraph 7, the guidance in IFRIC 12 requires an entity to account for an intangible asset recognised in a service concession arrangement in accordance with IAS 38.

12. While developing the guidance, the Interpretations Committee considered whether a special amortisation method should be permitted for the intangible asset. Paragraph BC64 of IFRIC 12 notes that (emphasis added):

> However, the IFRIC concluded that there was *nothing unique about these intangible assets* that would justify the use of depreciation different from that used for other tangible assets.

13. We think that because there is nothing unique about the intangible asset arising from a service concession arrangement 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.

14. However, if the Interpretations Committee cannot resolve this 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.

15. If the Interpretations Committee decides to pursue this option, we think that because of the similarities between a lease arrangement and a service concession arrangement, as noted in paragraph 8, the Interpretations Committee should consider applying the leasing principles to these payments. The implications of applying these principles are similar to those discussed earlier in the paper when considering the appropriate accounting for variable payments for asset purchases earlier in this paper. In summary we think that:

    (a) variable payments that are dependent on an index or a rate or are, in-substance fixed payments, will be included in the initial measurement of the liability at the start of the service concession arrangement. These payments would be measured using the index or rate at the start of the service concession arrangement. Subsequent adjustments would be recorded against the cost of the asset.

(b) other variable payments (such as those dependent on future activity of the purchaser) would not be included in the initial measurement of the liability at the start of the service concession arrangement.

16. However, as the intangible asset in a service concession arrangement is accounted for in accordance with IAS 38, we think that a scope exemption will be needed in IAS 38 for variable payments that are to be made for an intangible asset in a service concession arrangement. This is because IAS 38 does not provide guidance on accounting for variable payments made to acquire an intangible asset. We think that a reference will need to be made to the leasing 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 the variable payments made by the operator will be accounted for using the leasing principles while all other aspects of the intangible asset will continue to be accounted for using IAS 38.

17. We think that the tentative decisions previously reached by the Interpretations Committee on other aspects of accounting for payments by an operator to a grantor continue to be applicable. This includes:

(a) assessing whether the payment provides the operator with a distinct good or service, or a right to use a tangible asset, in which case it should be accounted for under the respective Standards;

(b) treating the concession payment as a reduction in the overall consideration when the financial asset model under IFRIC 12 is applicable; and

(c) when a hybrid model is applicable under IFRIC 12, evaluating the substance of the payment to determine whether the concession payment represents an adjustment to the overall revenue consideration or whether it represents consideration for the concession right intangible asset.

Questions to the Interpretations Committee	
1.	If the Interpretations Committee cannot reach a consensus on the appropriate accounting for variable payments in an asset purchase, does it think that it should continue to work on developing a solution for accounting for payments made by an operator to a grantor within the confines of IFRIC 12?
2.	If the answer to the Question 1 is yes, does the Interpretations Committee agree that it should consider applying the leasing principles to payments made by an operator to a grantor in a service concession arrangement when the intangible asset model is applicable?
3.	Does the Interpretations Committee confirm its previous tentative decisions on accounting for payments to be made by an operator to a grantor in a service concession arrangement in cases other than when the intangible asset model is applicable and the payments to be made by the operator are variable?

Appendix A
Prior discussions[1]

Summary of the Interpretations Committee's prior discussions and tentative decisions regarding payments made by an operator to a grantor in a service concession arrangement

A1. In its previous meetings, the Interpretations Committee has discussed the accounting for fixed and variable payments and tentatively decided that:

(a) if the concession payment gives the operator a right to a good or service that is distinct from the service concession arrangement, the operator should account for that distinct good or service in accordance with the applicable Standard.

(b) when the concession payment is linked to the right of use of a tangible asset, the operator should use judgement to determine whether the operator obtains control of the right of use of the asset. If the operator controls the right of use, then that element of the concession arrangement would be considered to be an embedded lease within the scope of IAS 17 *Leases*.

(c) when the concession payment is linked to the right of use of a tangible asset, but the arrangement does not represent an embedded lease, then the right-of-access payment should be analysed in the same way as a concession fee (discussed further in (d)).

(d) if the concession payment does not give the operator a right to a distinct good or service or a right of use that meets the definition of a lease, then the type of service concession arrangement should be considered to help an operator determine the accounting for the concession payment:

(i) if the service concession results in the operator having a contractual right to receive cash from only the grantor (ie the financial asset model in IFRIC 12 applies), then the concession payment is an adjustment to the overall revenue consideration;

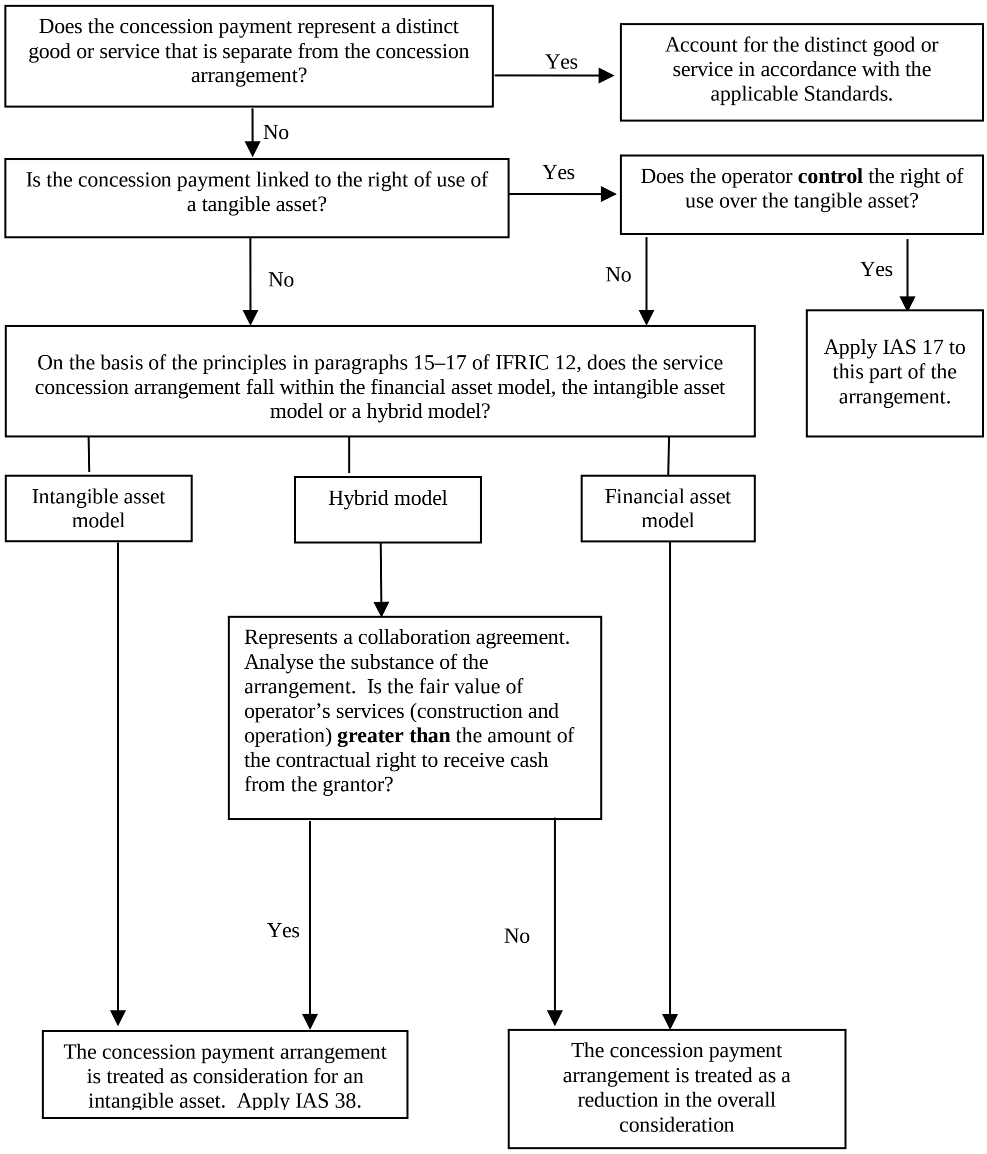
[1] Excerpts of Agenda Paper 06B of Interpretations Committee meeting in September 2015

(ii) if the service concession arrangement results in the operator having only a right to charge users of the public service (ie the intangible asset model in IFRIC 12 applies), then the concession payment represents consideration for the concession right (ie part of the cost of the intangible asset recognised); and

(iii) if the operator has both a right to charge users of the public service and a contractual right to receive cash from the grantor (ie the in-substance guarantee from the grantor for the operator's services), then the amount of the contractual right to receive cash from the grantor needs to be compared with the fair value of the operator's services to help the operator in making the judgement of whether the concession payment represents an adjustment to the overall revenue consideration or whether it represents consideration for the concession right intangible asset.

A2. The following flowchart summarises the discussions and decisions of the Interpretations Committee to date. Further detailed discussions on these issues can be found in the staff papers for the Interpretations Committee meetings in March and May 2012. A brief summary of the rationale behind the conclusions is also discussed in the following paragraphs.

Summary of previous tentative decisions of the Interpretations Committee on the accounting for payments made by an operator to a grantor (March and May 2012)



A3. The Interpretations Committee noted that a service concession arrangement may be a multiple-element arrangement. The analysis noted that judgement is required to identify the elements of the arrangement and determine whether they should be accounted for separately. In particular, judgement is required to assess whether, by making the concession payments, the operator is acquiring distinct goods or services that are separate from the concession arrangement, in which case they should be separated from the service concession arrangement and accounted for in accordance with the relevant Standards.

A4. The Interpretations Committee noted that when the concession payment is linked to the right of use of a tangible asset, the operator should use judgement to determine whether the operator obtains control of the right of use of the asset. If the operator controls the right of use, then that element of the concession arrangement would be considered to be an embedded lease within the scope of IAS 17.

A5. When concession payments cannot be associated with an element of the arrangement that is distinct and that can be accounted for separately, the Interpretations Committee noted that the payments should be analysed together with the other elements of the service concession arrangement. When this is the case, the type of service concession arrangement impacts the accounting for the concession payments as follows:

(a) when the operator has only a right to charge the grantor, the concession fee should be treated as an adjustment to the overall consideration, ie it will reduce the revenue that is recognised from the operator's services when that revenue is recognised. The rationale for this approach is based on the assumption that, in the financial asset model, the grantor is no different from a customer in a revenue arrangement. In other words, an operator would treat a variable concession fee payable to the grantor in the same way that an entity would treat a variable payment to a customer.

(b) when the operator has only a right to charge users of the public service, the Interpretations Committee noted that the concession fee should be treated as follows:

(i) when 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

(ii) when construction and operation services are provided, the payment will represent an incremental payment for the intangible asset.

A6. The rationale for this approach is based on the assumption that, in the intangible asset model, the revenue arrangement is between the operator and the public, and the payment arrangement represents a barter transaction of non-cash consideration in which a service (the operator's construction and/or operation services) is exchanged for an intangible asset (the grantor's concession right). However, as part of the barter transaction, the operator may also be required to pay the grantor a concession payment in order to make up the difference in the relative fair values of the items that are exchanged. 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 CU1,700, then the grantor would require something more than the construction services in exchange for the right to charge the public, ie a concession payment of CU200.[2]

A7. The Interpretations Committee noted that when the payment that the operator is required to make to the grantor is variable, the transaction is analogous to a transaction in which a variable payment is made by the purchaser to acquire an intangible asset from a seller (which has been discussed in Agenda Paper 06A).

A8. In developing this framework, the Interpretations Committee considered situations in which the payments to be made are variable in nature.

(a) when the financial asset model is used, the Interpretations Committee agreed that the principles in IAS 18 *Revenue* should be drawn on for accounting for such payments; and

(b) when the intangible asset model is applicable, the Interpretations Committee noted that the issue of variable concession fees is linked to the broader issue of variable payments for the separate purchase of property, plant and equipment and intangible assets outside of a business combination.

[2] In this Agenda Paper, monetary amounts are denominated in ‘currency units’ (CU).