Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Service Concession Arrangements**	**Meeting:**	21 June 2016 (M152)
Topic:	**Liability Recognition Model**	**Agenda Item:**	4.1
		Date:	6 June 2016
Contact(s):	Daen Soukseun dsoukseun@aasb.gov.au (03) 9617 7633 Nikole Gyles ngyles@aasb.gov.au (03) 9617 7639	**Project Priority:** **Decision-Making:** **Project Status:**	High High Redeliberations

Introduction and objective of this paper

1 The objective of this paper is to obtain Board decision to address the issue raised by constituents on which service concession liability recognition model should be applied to an arrangement where the operator charges the grantor based on the third-party usage of the service concession asset.

2 This paper is structured as follows:

(a) summary of staff recommendations (paragraph 3);

(b) background, including the relevant feedback received on ED 261 *Service Concession Arrangements: Grantor* (ED 261) (paragraphs 4-7); and

(c) Staff analysis (paragraphs 8-60).

Summary of staff recommendations

3 Staff recommend:

(a) the final Standard prescribe the grantor is to account for the arrangement under consideration, by analogy, as a financial liability contingent on settlement provisions under the financial liability model and not the grant of the right to the operator model;

(b) with respect to the recommendation in paragraph 3(a) above, the principles appropriate to the specific Standard are more important than achieving symmetry in accounting by parties to an arrangement, such as IFRIC 12;

(c) refer the issue to IFRIC for consideration in the context of achieving symmetry between the final Standard and IFRIC 12;

(d) include the proposals that the grantor:

(i) initially recognise the financial liability to the same amount as the fair value of the service concession asset as required by ED 261; and

(ii) subsequent to the initial recognition:

- apportion the financial liability over the service concession period similar to paragraph 20 of ED 261; and
- where there is a difference between the apportioned amount and the actual payment by the grantor to the operator based on the third-party usage of the asset, the difference may be accounted for as an expense or revenue in the period in which it is incurred similar to the financial instrument Standards.

(e) Staff continue to monitor the IASB's consideration on the accounting for variable payments on asset purchases for possible inclusion in the final Standard.

Background

4 In May 2015, the AASB issued ED 261[1] that proposed the grantor accounts for the service concession liability using the:

(a) financial liability model where the grantor compensates the operator for the service concession asset by making payments to the operator (ED261.16(a)); and/or

(b) 'grant of a right to the operator model' (GORTO model) where the grantor compensates the operator for the service concession asset by other means, such as granting the operator the right to earn revenue from third-party users of the asset or granting the operator access to another revenue-generating asset for the operator's use (ED 261.16(b));

5 At its September 2015 meeting, the Board approved the project plan[2] for progressing the project. The project plan includes redeliberating the issues raised by constituents in response to feedback received on ED 261 (refer Appendix B to Staff Paper 4.0 Cover Memo).

---

[1] Link to Exposure Draft 261 *Service Concession Arrangements: Grantor* http://www.aasb.gov.au/admin/file/content105/c9/ACCED261_05-15.pdf

[2] Link to Exposure Draft 261 *Service Concession Arrangements: Grantor* – Draft Project Plan September 2015 http://www.aasb.gov.au/admin/file/content102/c3/M147_6.3_Draft_Project_Plan_SCA.pdf

Feedback received on ED 261

6 Constituents, in their feedback to ED 261[3] requested broadening the scope of the GORTO model to include the accounting for arrangements where an operator charges a grantor based on the third-party usage of the asset.

7 Staff also obtained input from the Service Concession Arrangements: Grantor Project Advisory Panel (the Panel) in the analysis of the issues in this Paper.

Staff analysis

8 ED 261 paragraph 16(b) proposed the use of the GORTO model to account for the service concession liability where the grantor compensates the operator for the service concession asset by granting the operator the right to earn revenue from third-party users of the asset.

9 One constituent requested that "… the AASB consider broadening the scope to situations where the operator instead charges the grantor, rather than third-parties, for services provided. For example a public hospital built and operated by the operator where the operator charges the grantor based on the volume of patients treated and a pre-agreed price list. In this case the grantor does not have a contractual obligation to pay cash or another financial asset, nor does it grant a right to charge third party users … and therefore does not appear to fall under either model."[4]

10 The issues to be considered in the accounting for the arrangement referred to in paragraphs 6 and 9 above are:

(a) whether in exchange for the service concession asset, the grantor recognises a corresponding liability[5] under the:

---

[3] AASB Meeting 4 September 2015 Staff Issues Paper – Staff Collation and Analysis of Comment Letters and Outreach ED 261 *Service Concession Arrangements: Grantor*, paragraph 31.

Link to Staff Issues Paper
http://www.aasb.gov.au/admin/file/content102/c3/M147_6.2_Staff_Collation_and_Analysis_of_Comment_Letters_on_ED_261_SCA.pdf

Link to comment letters to ED 261
http://www.aasb.gov.au/Work-In-Progress/Pending.aspx

[4] Link to Heads of Treasuries Accounting and Reporting Advisory Committee submission to ED 261
http://www.aasb.gov.au/admin/file/content106/c2/HoTARAC%20submission%20to%20ED%20261%20service%20concession%2010%20aug%202015_11-08-2015_091729.pdf

[5] For the purpose of analysing the liability recognition model for the arrangement under consideration, Staff are of the view it is necessary to assume the grantor has control of the asset in accordance with the final Standard.

ED 261 proposed that the grantor controls the asset, if the grantor "controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price" (ED 261.8(a)).

Staff think the grantor, in the arrangement under consideration, controls the underlying infrastructure of the service concession arrangement and regulates what the services the operator must provide, to whom it must be provided and at what price as per the proposed control concept of ED 261 for the recognition as a service

(i) GORTO model or financial liability model; and

(ii) implications of adopting the model in paragraph 10(a)(i) above; and

(b) the initial measurement of the service concession liability and subsequent accounting for the liability.

Liability recognition model

11 ED 261 proposed that where the grantor recognises a service concession asset, "the grantor shall also recognise a liability" (ED 261.13). The nature of the liability recognised is dependent on the nature of the consideration given by the grantor to the operator (ED 261.14).

12 The grantor accounts for the service concession liability using either the financial liability model or the GORTO model. Where the grantor compensates the operator by making payments to the operator[6], the financial liability model applies. Where the grantor compensates the grantor by other means, such as the grant of the right to the operator to charge third-party users of the asset, the GORTO model applies.

13 ED 261 proposed that "Where the grantor has a contractual obligation to deliver cash or another financial asset to the operator for the construction, development, acquisition or upgrade of a service concession asset, the grantor shall account for the liability recognised" (ED 261.17).

---

concession asset. Further guidance is provided in ED 261.AG9 that "The control or regulation referred to in paragraph 8(a) could be by a contract, or otherwise … It may include circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users." The difference in the arrangement under consideration is the grantor's payment to the operator is contingent on the "volume of patients treated and a pre-agreed price list".

In Staff's discussion with the Panel, the Panel:

(a) noted that the arrangement under consideration is an increasing service concession arrangement model entered into by the public and private sector entities to develop and deliver major public infrastructure assets for public service. Consequently, the Panel agreed that the Board should provide additional guidance in the final Standard to account for such an arrangement; and

(b) also agreed the grantor controls the asset in the arrangement under consideration for recognition in the service concession arrangements Standard.

[6] ED 261.16 states that:

"In exchange for the service concession asset, the grantor may compensate the operator for the service concession asset by any combination of:

(a) making payments to the operator (the 'financial liability' model); and

(b) compensating the operator by other means (the 'grant of a right to the operator' model) such as:

(i) granting the operator the right to earn revenue from third-party users of the service concession asset; or

(ii) granting the operator access to another revenue-generating asset for the operator's use (eg a private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients or a private parking facility adjacent to a public facility)".

14 Additionally, ED 261 provides guidance that "The grantor has a contractual obligation to pay cash if it has agreed to pay the operator:

(a) specified or determinable amounts; or

(b) the shortfall, if any, between amounts received by the operator from users of the public service and any specified or determinable amounts referred to in paragraph 18(a) even if the payment is contingent on the operator ensuring that the service concession asset meets specified quality or efficiency requirements" (ED 261.18).

View 1 – Applying the GORTO model

15 View 1 proposes that the grantor, does not have a contractual obligation to pay the operator cash or another financial asset in the manner outlined in paragraph 14 above. That is, the arrangement may not stipulate a "specified or determinable amounts" that the grantor pays the operator, instead the operator charges the grantor based on the usage of the asset by third-party users. Consequently the grantor does not have a financial liability under paragraph 14 above. The grantor instead accounts for the arrangement under the GORTO model[7]. This accounting treatment would be consistent with the constituent's view and request to broaden the scope of third-party users under the GORTO model to include the grantor (refer paragraph 9).

16 However, the application of the GORTO model requires the grantor granting a right to the operator to charge third-party users of the asset. The arrangement under consideration does not involve the grantor granting the operator such a right. That is, the operator does not have a right to charge third-party users. Rather, the operator charges the grantor for the third-party usage of the asset. This is supported by IPSAS 32, which noted that under the GORTO model "the cash consideration for the service concession asset is not being met by the grantor but by users of the service concession asset or other revenue-generating asset" (IPSAS 32.BC29). Therefore, it would not be appropriate to broaden the scope of third-party users to include the grantor as requested by constituents.

17 In developing ED 261, the Board noted[8] that under the GORTO model, the right in the service concession arrangement is the 'access' granted to the operator to enable the operator to fulfil its performance obligations of providing construction and operating services to the grantor. The operator in turn generates the future cash flows by providing services to the grantor and those future cash flows are in the form of a right

---

[7] ED 261.23 states that where "the grantor does not have a contractual obligation to pay cash or another financial asset to the operator … and instead grants the operator the right to earn revenue from third-party users or another revenue-generating asset, the grantor shall account for the liability recognised … as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator."

[8] AASB Meeting 23-24 February 2016 – Staff Paper Service Concession Arrangements: Redeliberation of Proposed Asset and Liability Recognition and Measurement, paragraph 66.

Link to Staff Paper
http://www.aasb.gov.au/admin/file/content102/c3/13.1_Redelib_SCA_Asset_and_Liab_Recog_Measurement_M150.pdf

that exposes the operator to the demand risk associated with the use of the public asset by third-parties. In contrast, the arrangement under consideration requires the grantor to pay the operator based on the volume of usage by third-party users. The grantor and the operator are therefore exposed to the demand risk.

18 Additionally, the practical implication of View 1 is that the grantor would initially recognise a liability that is then amortised to revenue over the life of the concession arrangement. When payments are actually made to the operator, an expense would be recognised. Recognition of a revenue and an expense would not appear to reflect the economic substance of the transaction. This would be consistent with the Board's decision to not retain the guidance paragraph AG 49 of IPSAS 32 in ED 261 relating to a shadow toll under the grant of the right to the operator model. IPSAS 32.AG49 states where "The grantor compensates the operator only to the usage of the service concession asset, and accounts for such payments as expenses in accordance with IPSAS 1"[9]. Consequently, the financial liability model may be a more appropriate model to account for the arrangement. View 2 below examines the application of the financial liability model further.

<u>View 2 – Applying the financial liability model</u>

19 View 2 proposes the use of the financial liability model to account for the arrangement.

20 ED 261 proposed that "AASB 132 *Financial Instruments: Presentation*, the derecognition requirements in AASB 9 *Financial Instruments*1 and AASB 7 *Financial Instruments: Disclosures* apply to the financial liability recognised under paragraph 13, except where this [draft] Standard provides requirements and guidance" (ED 261.19).

21 View 2 adopts the notion that the grantor may not have a contractual obligation to pay the operator specified or determinable amounts at the inception of the arrangement in the manner outlined in paragraph 14 above. That is, some may view that the grantor only has a contractual obligation in accordance with the financial liability definition if the grantor has an unconditional obligation to pay the operator. The grantor, in the arrangement under consideration, has an unconditional obligation if the grantor cannot control the third-party usage of the asset by regulating or denying the third-party from using the asset (for example the closure of the road). Given that the grantor has permitted the operator the right to operate the asset, it is unlikely that the grantor is able to regulate or deny the third-party usage without compensating the operator.

---

[9] IPSAS 1 is the IPSASB equivalent to AASB 101 *Presentation of Financial Statements*.

IPSAS 32.AG49 states that:
"In some cases under the grant of the right the operator model, there may be a "shadow toll". Some shadow tolls are paid for the construction, development, acquisition, or upgrade of the service concession asset, and its operation by the operator. In cases where the grantor pays the operator solely for the usage of the service concession asset by third-party users, such payments is compensation in exchange for the usage and not the acquisition of the service concession asset. Accordingly, such payments do not relate to the liability specified in paragraph AG48. The grantor compensates the operator only to the extent of the usage of the service concession asset, and accounts for such payments as expenses in accordance with IPSAS 1."

22 Additionally, the operator would most likely require the grantor to, contractually or otherwise, make payments to the operator in exchange for the service concession asset. In this case, the grantor may be contractually or otherwise obliged to pay the operator based on the volume of the third-party's usage of the service concession asset. This view is:

(a) supported by ED261.AG43 which proposed that "The grantor has a contractual obligation if it has little, if any, discretion to avoid the obligation usually because the contract with the operator is enforceable by law"; and

(b) further reinforced by the 'service concession arrangement' definition, which defines the arrangement as a "contract between a grantor and an operator …" and a 'contract' is defined as an "agreement between two or more parties that creates enforceable rights and obligations" (ED 261.Appendix A).

Accordingly, the grantor would have a contractual obligation in the form of a financial liability under AASB 132[10] with the amounts contingent on the volume of the asset used by the third-party users. This appears similar to a financial instrument that is contingent on settlement provisions.

23 AASB 132 provides guidance on a financial instrument that is contingent on settlement provisions as one that "may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer …"[11] (AASB 132.25).

24 Additionally AASB 132.AG8 states that "The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be

---

[10] A financial liability is defined as:

"(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments…" (AASB 132.11).

[11] AASB 132.15 states that this is unless

"(a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;

(b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or

(c) the instrument has all the features and meets the conditions in paragraphs 16A and 16B" (AASB 132.15).

contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognised in the financial statements."

25 Consequently, the grantor could account for the service concession liability, either directly or by analogy[12], as a financial liability contingent on settlement provisions in accordance with AASB 132 that is consistent with the financial liability model of ED 261. This accounting treatment would more accurately reflect the substance of the arrangement of initially recognising a service concession asset with a corresponding liability, rather than recognising the transaction as a revenue and expense transaction as outlined in paragraph 18 above.

26 Despite that the arrangement meeting the definition of a financial liability, Staff noted that it may be difficult to apply the financial instrument Standards to the arrangement. This difficulty is imposed by the:

(a) guidance in IPSAS 32.AG49 requiring similar arrangements such as a shadow toll be accounted as a profit and loss transaction, rather than a balance sheet transaction (as outlined in paragraph 18 above); and

(b) the IFRS Interpretation Committee decision to link the recognition of a financial asset (by an operator) and by implication the financial liability (by the grantor) to the guarantee of the cash flows arising from the arrangement. The grantor guarantees the cash flows if it agrees to pay the operator a specified or determinable amounts or a shortfall between the amounts received by the operator from users of the asset. However, if the "operator's cash flows are conditional on usage when it has no such guarantee but must obtain its revenue either directly from users of the public service or from the grantor in proportion to public usage of the service (road tolls or shadow tolls for example)" (IFRIC 12.BC40). This contrasts with the financial instrument Standards, which defines the financial liability on a broader basis. However, the restrictions in IFRIC 12 *Service Concession Arrangements* (IFRIC 12) (refer paragraph 31 below) would result in the operator not accounting for the arrangement as a financial asset in the absence of a guarantee by the grantor. The implication of this is that, even if the grantor accounts for the arrangement as a financial liability as defined in AASB 132, the financial liability may not be a financial instrument under the financial instrument Standards of AASB 9 and/or AASB 132. As a financial instrument is defined as "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity" (ASSB 132.11).

[12] Staff in their discussion with the Panel put forth the view that the arrangement could be accounted for as a financial liability contingent on settlement provisions. Some Panel members preferred this accounting treatment be expressed "by analogy" to a financial liability contingent on settlement provisions.

Panel feedback

27 The feedback from the Panel on the discussion of this issue is:

(a) while the arrangement under consideration does not fit perfectly under the financial liability model or the GORTO model, it is important to consider the underlying substance of the service concession arrangement. That is, the operator has entered into the arrangement to expect payments from the grantor in return for the construction and delivery of the service concession asset. As such, the grantor has an obligation to make payments to the operator based on the third-party usage of the asset. Additionally, it would be more likely than not that the operator would require the grantor to guarantee a minimum payment to the operator;

(b) given the increasing use of the arrangement by the grantor, it is important that the Board provide guidance on the accounting for such an arrangement in the final Standard using a pragmatic approach rather than striving for a technically precise approach; and

(c) on balance, the arrangement would be more appropriately accounted for under the financial liability model than the GORTO model.

Staff recommendation

28 Based on the analysis in paragraphs 11-27 above, on balance, staff think View 2 has more merit than View 1 in that the grantor does have contractual obligation to pay cash to the operator, with the amounts contingent on the volume of the asset used by the third-party users. The grantor is unlikely to be able to control the usage of the asset and therefore how much to be paid. Therefore, the arrangement should be accounted for as a financial liability that is contingent on settlement provisions under the financial liability model and not the GORTO model. Accordingly, consistent with paragraph 16, it would not be appropriate to broaden the scope of third-party users to include the grantor, as requested by constituents.

Questions to the Board

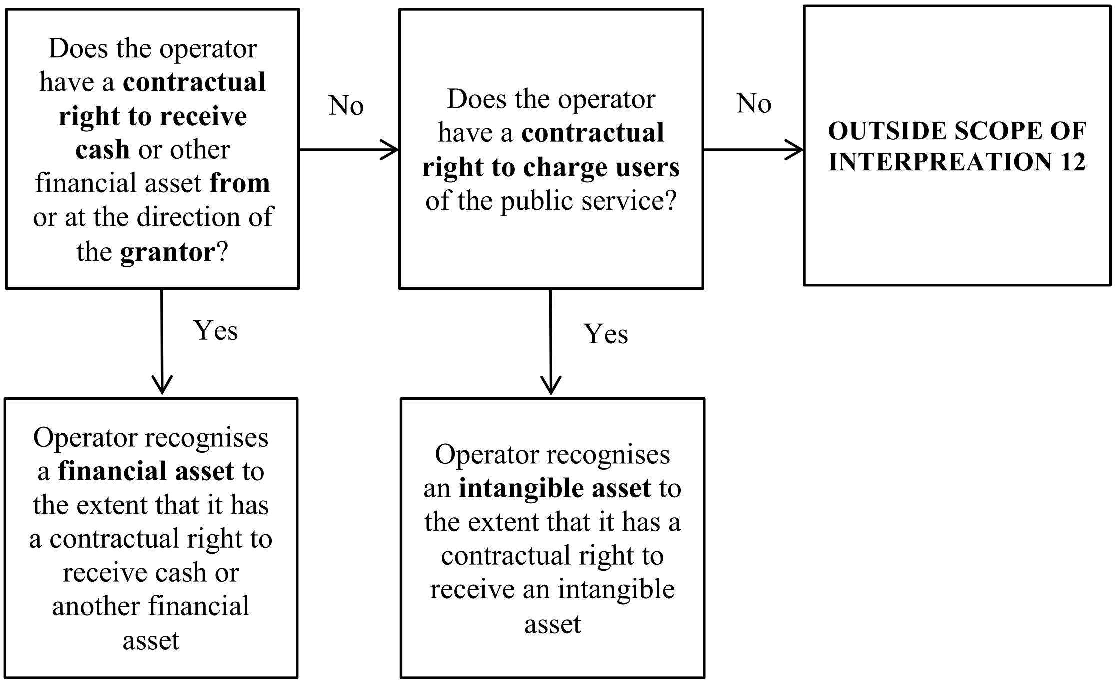
Q1. Does the Board agree with the staff recommendation that the arrangement under consideration should be accounted for, by analogy, as a financial liability contingent on settlement provisions under the financial liability model and not the GORTO model?

Q2. If the Board not does not agree with the Staff recommendation in Q1, which view does the Board support and why?

Implications of applying the financial liability model

29 Staff also examined the IFRIC's considerations in its development of IFRIC 12 from an operator's perspective. This is on the basis that the accounting from a grantor's perspective in ED 261 mirrors the application of IFRIC 12.

30 The diagram below summarises the accounting framework for service concession arrangements contained in AASB Interpretation 12 *Service Concession Arrangements*[13].



31 IFRIC's decisions in the development of IFRIC 12 for the accounting by the operator considered the following:

Issue	**IFRIC Consideration and decisions**
Which party has the primary responsibility to pay the operator for the service	• IFRIC 12 proposed that the nature of the operator's asset is dependent on "who had the primary responsibility to pay the operator for the services. The operator should recognise a financial asset when the grantor had the primary responsibility to pay the operator for the services. The operator should recognise an intangible asset in all other cases" (AASB Interpretation 12.BC37). • Applying the mirror accounting to this proposal would suggest that the grantor, in the arrangement under consideration, could have a financial liability. However, this accounting is dependent on the definition of a 'financial asset' being satisfied for recognition by the operator (refer below).

[13] The diagram is an extract of AASB Interpretation 12 Information Note 1 "Accounting framework for public-private service arrangements" with emphasis (in bold text) by Staff for the purpose of this Paper. AASB Interpretation 12 reflects IFRIC's decisions in the development of IFRIC 12 for the accounting by an operator.

Issue	IFRIC Consideration and decisions
Whether the definition of 'financial asset' is met	• To satisfy the definition of a financial asset (by the operator for recognition), IFRIC decided that the operator should recognise a financial asset to the extent that it has "an unconditional present right to receive cash from or at the direction of the grantor for the construction services; and the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has a contractual right to receive cash for the construction services if the grantor contractually guarantees the operator's cash flows, in the manner described in paragraph 16. The IFRIC noted that the operator has an unconditional right to receive cash to the extent that the grantor bears the risk (demand risk) that the cash flows generated by the users of the public service will not be sufficient to recover the operator's investment." (AASB Interpretation 12.BC42)[14]. • AASB Interpretation 12.16 states that the "operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if the payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements". • Additionally, AASB Interpretation 12, paragraphs: o BC47 states that, "The IFRIC concluded that the right of an operator to charge users of the public service meets the definition of an intangible asset, and therefore should be accounted for in accordance with IAS 38. In these circumstances the operator's revenue is conditional on usage and it bears the risk (demand risk) that the cash flows generated by users of the public service will not be sufficient to recover its investment."; and o BC48 states that, "In the absence of contractual arrangements designed to ensure that the operator receives a minimum amount … the operator has no contractual right to receive cash even if receipt of the cash is highly probable. Rather, the operator has an opportunity to charge those who use the public service in the future. The operator bears the demand risk and hence its commercial return is contingent on users using the public service. The operator's asset is a licence, which would be classified as an intangible asset within the scope of IAS 38."

32 Based on the above IFRIC consideration and decisions, the operator would account for the arrangement under consideration using the financial asset model, where the grantor contractually guarantees to pay the operator specified or determinable amounts as outlined in paragraph 31 above. In the absence of this contractual guarantee to the operator, the operator would not have a financial asset. The arrangement would also not meet the framework for recognition under the GORTO model, as the operator has not been granted the right earn revenue by charging third-party users of the asset. The arrangement instead could potentially be outside the scope of Interpretation 12.

[14] Staff in their analysis noted that this is an example in IFRIC 12 and are not necessarily the only circumstances that meet the financial asset definition in accordance with AASB 132.

33 The accounting for the arrangement under consideration as a financial liability in View 2 above where the grantor does not provide a contractual guarantee may result in asymmetry in the accounting for the same arrangement by the operator.

Staff recommendation

34 Staff are of the view that where possible, there should be symmetry in the accounting for a service concession arrangement by the grantor and the operator[15]. However, staff think the principles that are appropriate to the specific Standard prevail over the want for symmetry in accounting by the parties to the same arrangement. Given that the final Standard will prescribe the accounting for a service concession arrangement from a grantor's perspective, the appropriate principles for accounting for the arrangement under consideration is to recognise the service concession liability in accordance with the financial liability model. This view is on the basis there are different accounting treatments by parties to the same transaction in existing Standards[16].

35 However, staff recommend the accounting by the operator, under IFRIC 12, for the arrangement under consideration should be referred to IFRIC for consideration to align the requirements of IFRIC 12, in particular paragraphs BC47 and BC48 (refer paragraph 31 above) with the proposals in the final Standard.

Questions to the Board

Q3. Does the Board agree with the Staff recommendation in paragraph 34 above, that:

(a) principles appropriate to the specific Standard are more important than achieving symmetry in accounting by parties to an arrangement?

(b) If the Board agrees with Q3(a), does the Board agree that the final Standard should prescribe the financial liability model for the recognition of the arrangement under consideration from a grantor's perspective?

Q4. Does the Board have a view as to whether the issue should be referred to IFRIC for consideration in the context of IFRIC 12?

[15] This is despite ED 261.7 stating that "This [draft] Standard does not specify the accounting by operators".

[16] The Panel agreed with Staff's views and recommendation in paragraph 34. However, some Panel Members were of the view that referring the issue to IFRIC for consideration (in paragraph 35) may not be a good use of Staff resources. This is on the basis, it is likely Staff will need to develop the fact pattern and include extensive analysis in their request to IFRIC.

Initial measurement and subsequent accounting of the service concession liability

36 ED 261.14 proposed that a service concession liability is measured initially at the same amount as the fair value of the service concession asset[17]. This approach can be applied to the initial measurement of the financial liability in the arrangement under consideration where the amount the grantor pays the operator on the agreed periods is based on the volume of usage by the third-party users of the service concession asset.

37 The issue to consider is the grantor's accounting for the financial liability subsequent to its initial recognition. In particular, the consideration of how the grantor accounts for the periodic payments to the operator when the operator charges the grantor for the third-party usage of the asset.

38 Staff are of the view that (as noted in paragraph 28 above) the arrangement under consideration is accounted for as a financial liability that is contingent on settlement provisions[18]. However, the financial instruments Standards[19] do not provide specific guidance on the accounting for a financial liability that has variable settlement provisions with respect to changes in the quantity of the underlying good or service, as in the case of the arrangement under consideration.

39 Staff are aware of four possible approaches that may be considered in the grantor accounting for a financial liability subsequent to its initial recognition:

(a) apply AASB 16/AASB 117 *Leases* by analogy;

(b) await the outcome of the IASB's decision on accounting for variable payments for asset purchases;

(c) apply AAS 15 *Revenue from Contracts with Customers* by analogy; or

(d) include guidance by referencing the proposed requirements and guidance in ED 261 to the financial liability model.

---

[17] ED 261.14 states that:

"The liability recognised in accordance with paragraph 13 shall be initially measured at the same amount as the service concession asset, adjusted by the amount of any other consideration (eg the transfer of an existing asset) from the grantor to the operator, or from the operator to the grantor."

[18] Staff analysis in this section is based on the Board agreeing with staff view that the arrangement should be accounted for as a financial liability that is contingent on settlement provisions.

[19] AASB 9 and AASB 132. Staff also noted if the Board agrees the arrangement should be accounted for as a financial liability, the transaction would need to be accounted for in accordance with AASB 9 and AASB 132. Given the lack of specific guidance in AASB 9 and AASB 132 for the arrangement under consideration, Staff for completeness, have provided alternative approaches for the accounting of the financial liability subsequent to its initial recognition.

Approach 1: Apply AASB 16/AASB 117 by analogy

40 Approach 1 considers whether the leases Standard can be used, by analogy, to account for the financial liability subsequent to its initial recognition of finance leases with contingent rent in AASB 117 or variable lease payments in AASB 16[20].

41 Contingent rent is defined as the "portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (e.g. percentage of future sales, amount of future use, future price indices, future market rates of interest)" (AASB117.4).

42 Variable lease payments are defined as the "portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time" (AASB 16.Appendix A).

43 AASB 117 states that the:

(a) minimum lease payments of a lease are the "payments over the lease term that the lessee is or can be required to make, **excluding contingent rent** …" (emphasis added) (AASB 117.4); and

(b) "contingent rents shall be charged as expenses in the periods in which they are incurred" (AASB 117.25);

44 AASB 16 contains similar accounting for variable lease payments to that of contingent rents in AASB 117 in that subsequent to the commencement date of the lease, the lessee recognises in the profit or loss the "variable payments that are not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs" (AASB17.38(b)) [21].

45 Under Approach 1, the grantor could:

(a) initially recognise the financial liability to the same amount as the fair value of the service concession asset as required by ED 261; and

(b) subsequent to the initial recognition:

---

[20] AASB 117 uses the term 'contingent rent' while AASB 16 replaces this term with 'variable lease payments'.

It should be noted that the effective date of AASB 16 is for annual reporting periods beginning on or after 1 January 2019. ED 261 proposed the effective date for annual reporting periods beginning on or after 1 January 2017 with constituents requesting an extension to 1 January 2018. The effective date of the final Standard is scheduled for redeliberation at the August 2016 Board meeting.

[21] AASB 16 requires variable lease payments that depend on an index or a rate would initially be measured using the index or rate at the commencement date of the lease to be included in the lease payments in the measurement of the lease liability (AASB17.27(b)).

AASB 16.28 states that "Variable lease payments that depend on an index or a rate described in paragraph 27(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates."

(i) apportion the financial liability over the service concession period similar to paragraph 20 of ED 261, which states that "The grantor shall allocate the payments to the operator under the contract and account for them according to their substance as a reduction in the liability recognised in accordance with paragraph 13, a finance charge and charges for services provided by the operator"; and

(ii) where there is a difference between the apportioned amount and the actual payment by the grantor to the operator based on the third-party usage of the asset, the difference may be accounted for as an expense or revenue in the period in which it is incurred.[22]

46 The Panel in their discussion with staff on this issue is supportive of Approach 1 as a pragmatic method in accounting for the financial liability initially and subsequent to its initial recognition. However, the Panel preferred the guidance not to reference the leases Standard in application. This is on the basis that the calculation of minimum lease payments under the leases Standard, exclude contingent rents in AASB 117 while AASB 16 includes certain variable payments (refer footnote 21). These contrasts with the proposal in the service concession Standard which requires the service concession liability to be measured initially at the same amount as the service concession asset.

<u>Approach 2: Await IASB decision on accounting for variable payments</u>

47 Staff in their analysis on this issue also considered the Interpretations Committee's discussions on the accounting for variable payments made to an operator by a grantor in the context of IFRIC 12.

48 The Interpretations Committee, at is meeting in January 2016, "noted that accounting for variable payments to be made by the operator in a service concession arrangement, when the intangible asset model in IFRIC 12 applies, is linked to the broader issue of accounting for variable payments for asset purchases. In its discussions on that broader issue, the Interpretations Committee could not reach a consensus on whether the variable payments that depend on the purchaser's future activity should be recognised as a liability before that activity is performed or on what the initial measurement of this liability should be. In the case of the broader issue on variable payments for asset purchases, the Interpretations Committee concluded that the issue was too broad for it to address… However, on balance, the Interpretations Committee concluded that addressing service concession arrangements that included such variable payments would also be too broad for it to address. The Interpretations Committee [decided] not to take the issue of accounting for payments by an operator to a grantor in a service concession arrangement onto its agenda."[23]

---

[22] This is analogous to the accounting treatment for contingent rents in AASB 117 or variable lease payments in AASB 16.

[23] Link to IFRIC Update January 2016 http://media.ifrs.org/2016/IFRIC/January/IFRIC-Update-January-2016.html#B

49 Additionally, IFRIC Staff in the IFRIC Staff Paper IAS 16 *Property, Plant and Equipment* and IAS 138 *Intangible Assets* (March 2016, Agenda regarding 08)[24] examined the accounting for variable payments to be made for the purchase of an item of property, plant and equipment or an intangible asset that is not part of a business combination. IFRIC Staff noted that the Interpretations Committee considered this issue at its September and November 2015 meetings. The Interpretations Committee:

(a) tentatively agreed that "the purchaser must recognise a financial liability at the date it purchases the asset for variable payments that do not depend on its future activity, and initially measure that liability at fair value in accordance with IFRS 9 *Financial Instruments* (IAS 139 *Financial Instruments: Recognition and Measurement*)" (paragraph 3);

(b) "was unable to reach a consensus on whether the purchaser must recognise a liability at the date it purchases the asset for variable payments that depend on the purchaser's future activity or, instead, recognises such a liability when the related activity occurs. The Interpretations Committee was also unable to reach a consensus on how the purchaser measures such a liability for variable payments" (paragraph 4)" and

(c) "considered the proposed definition of a liability in the May 2015 Exposure Draft The Conceptual Framework for Financial Reporting … The Interpretations Committee observed that, during the Board's deliberations on its project on leases, the Board did not conclude on whether variable payments linked to future performance or use of the underlying asset in a lease meet the definition of a liability at commencement of a lease, or instead, meet the definition at the time that the related performance or use occurs" (paragraph 6).

50 Staff are of the view it is prudent to include the IASB's decisions on the accounting for variable payment on asset purchases, where relevant[25], in the guidance and/or Basis for Conclusions to the final Standard on service concession arrangements. However, staff think that the issuance of the final Standard should not be delayed in the event that the IASB has not made decisions on the accounting for variable payments in time for incorporation into the final Standard. Staff intend to continue monitoring the developments on this issue. The Panel also agreed with the staff view.

<u>Approach 3: Apply AASB 15 by analogy</u>

51 Approach 3 considers whether the AAS 15 can be applied, by analogy, to account for the financial liability subsequent to its initial recognition.

---

[24] Link to IFRIC Staff Paper IAS 16 *Property, Plant and Equipment* and IAS 138 *Intangible Assets* (March 2016, Agenda regarding 08) http://www.ifrs.org/Meetings/Pages/IFRS-Interpretations-Committee-March-2016.aspx

[25] Staff also noted that generally, contingent consideration for the purchase of an asset is recognised at the lower of cost and fair value of the consideration given. Consequently, contingent payments are excluded from the purchase consideration. However, ED 261 proposed the service concession asset (and corresponding liability) is measured at fair value.

52 AASB 15.31 states that "An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset".

53 One view is that the application of Approach 3 to ED 261 may result in a grantor having control of asset at the inception of the arrangement, which could result in an up-front revenue recognition. However, staff noted this approach would contradict the application of the financial liability model to recognise the arrangement under consideration. Additionally, the revenue (or expense) recognition in the arrangement under consideration is for the differences between the periodic amount of financial liability apportioned and actual amount paid by the grantor to the operator. The possible approach in AAS 15 that could be used to account for this difference is the paragraph B63 which states that "Notwithstanding the requirements in paragraphs 56–59, an entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

(a) the subsequent sale or usage occurs; and

(b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied)."

54 The Board noted in its previous meetings that "the Board considered the implications and suitability of a grantor applying IFRS 15, either directly or by analogy, to service concession arrangements ... This involved considering the remaining steps … of the revenue recognition in IFRS 15. The consideration assumed that the service concession arrangement is a contract with a customer. The Board noted that:

(a) significant judgement is required to apply IFRS 15's revenue model to service concession arrangements from the grantor's perspective. This is because service concession arrangements are typically complex in nature and have specific facts and circumstances that could result in different arrangements being accounted for differently;

(b) this suggested that IFRS 15 may not be particularly suitable to be directly applied to service concession arrangements from the grantor's perspective….

(c) if the principles of IFRS 15 were to be applied to service concession arrangements, a separate set of revenue requirements tailored specifically to service concession arrangements (from the grantor's perspective) would need to be developed. The tailored requirements would be based on IFRS 15's core principle of recognising revenue to depict the transfer of goods and services and using control as a basis for that core principle. The requirements would broadly retain the revenue recognition requirements in IFRS 15, but would include modification to those requirements to ensure that the accounting of a grantor's rights and obligations in a service concession arrangement provides relevant information to users of a grantor's financial statements. Any modifications to IFRS 15 would be made in accordance with the *Process for Modifying IFRSs for PBE/NFP*. This would require further research on how many changes to IFRS 15 would be necessary to overcome the concerns and subsequently assessing whether the modified version of IFRS 15 is preferable (from a conceptual and operability perspective) to the corresponding requirements in IPSAS 32 …" (Staff Paper 13.1 Feb 2016, paragraph 68).

55 Consistent with the Board's previous decisions on the difficulties in applying AASB 15, and because the view is not consistent with the application of the financial liability model, staff are of the view that Approach 3 would not be appropriate in accounting for the arrangement under consideration.

Approach 4: Reference to existing requirements and guidance

56 Approach 4 proposes that there are sufficient requirements and guidance in ED 261 and the financial instruments Standards for the initial and subsequent accounting for a service concession liability that is recognised under financial liability model. This is evidenced with the following paragraphs in ED 261:

(a) "AASB 132 *Financial Instruments: Presentation*, the derecognition requirements in AASB 9 *Financial Instruments*[1] and AASB 7 *Financial Instruments: Disclosures* apply to the financial liability recognised under paragraph 13, except where this [draft] Standard provides requirements and guidance" (paragraph 19);

(b) "The grantor shall allocate the payments to the operator under the contract and account for them according to their substance as a reduction in the liability recognised in accordance with paragraph 13, a finance charge and charges for services provided by the operator" (paragraph 20); and

(c) "The finance charge and charges for services provided by the operator in a service concession arrangement determined in accordance with paragraph 20 shall be accounted for in accordance with other relevant Australian Accounting Standards" (paragraph 21).

57 Consequently, Approach 4 would include guidance that the arrangement under consideration is to be accounted for under the financial liability model in accordance with paragraphs 19 to 21 of ED 261.

58 Staff think that while there are existing guidance in Approach 4 that can be applied to account for the arrangement under consideration, Approach 1 would provide useful guidance in accounting for the arrangement as requested by constituents, especially if the guidance clarifies the subsequent accounting for the service concession liability. In essence, the subsequent accounting for the financial liability would be to adjust the difference between the apportioned amount of the actual payment by the grantor to the operator as a revenue or expense transaction in the period it is incurred while maintaining the original interest rate that was used to determine the initial fair value of the service concession asset.

59 The Panel in their discussion with staff on this issue:

(a) reinforced the importance of the Board in its decision on the approach to account for the financial liability, should be pragmatic and applicable to the majority of the service concession arrangements. The approach should also take into account of the costs and benefits of its application in that the approach must be sufficiently robust and easy in application;

(b) requested the Board address the issue of re-measurement of the financial liability subsequent to its initial recognition from the perspective that over the service concession period:

   (i) what conditions would trigger the need to review or assess the value of the financial liability; and

   (ii) where there is a change in the value of the financial liability, how would the change be account for.

Some Panel Members expressed the view that guidance on the re-measurement of the financial liability may require time to be developed. Accordingly, this assessment may form part of a broader project, as guidance on the re-measurement of liabilities in other Australian Accounting Standards are not always provided in the Standard that deals with the specific transaction, such as the re-measurement of finance lease liabilities.

Staff recommendation

60 Based on the above analysis, staff recommend the following:

(a) include the proposals under Approach 1 that the grantor:

   (i) initially recognise the financial liability to the same amount as the fair value of the service concession asset as required by ED 261; and

   (ii) subsequent to the initial recognition:

   - apportion the financial liability over the service concession period similar to paragraph 20 of ED 261, which states that "The grantor shall allocate the payments to the operator under the contract and account for them according to their substance as a reduction in the liability recognised in accordance with paragraph 13, a finance charge and charges for services provided by the operator"; and

   - where there is a difference between the apportioned amount and the actual payment by the grantor to the operator based on the third-party usage of the asset, the difference may be accounted for as an expense or revenue in the period in which it is incurred similar to the financial instruments Standards.

(b) Staff continue to monitor the IASB's consideration on the accounting for variable payments on asset purchases for possible inclusion in the final Standard.

Questions to the Board

Q5. Does the Board agree with the Staff recommendation in paragraph 60 above, that:

(a) under Approach 1, the grantor:

(i) initially recognise the financial liability to the same amount as the fair value of the service concession asset as required by ED 261; and

(ii) subsequent to the initial recognition:

- apportion the financial liability over the service concession period similar to paragraph 20 of ED 261, which states that "The grantor shall allocate the payments to the operator under the contract and account for them according to their substance as a reduction in the liability recognised in accordance with paragraph 13, a finance charge and charges for services provided by the operator"; and

- where there is a difference between the apportioned amount and the actual payment by the grantor to the operator based on the third-party usage of the asset, the difference may be accounted for as an expense or revenue in the period in which it is incurred similar to the financial instrument Standards.

(b) Staff continue to monitor the IASB's consideration on the accounting for variable payments on asset purchases for possible inclusion in the final Standard?

Q6. If the Board does not agree with Staff recommendation in Q5 above, what other approach(es) does the Board suggest and for what reasons?

Q7. If the Board agree with Staff recommendation in Q5 above, would the Board prefer its decisions on the above be included in the Application Guidance section and/or the Basis for Conclusions to the final Standard?

Q8. How would the Board prefer to address constituents' request on the issue of re-measurement of the financial liability subsequent to its initial recognition?