

Issues paper

Assessing whether service concession arrangements are within the scope of IFRS 15 from the grantor's perspective

- 1 This paper considers whether, from a grantor's perspective, a service concession arrangement would be a contract with a customer that is within the scope of IFRS 15 *Revenue from Contracts with Customers*.
- 2 This paper does not include a staff recommendation in relation to whether a grantor should account for a service concession arrangements in accordance with IFRS 15. Instead, the staff recommendation in this regard is included in agenda paper 15.3, which considers the application of IFRS 15 to account for a grantor's rights and obligations in a service concession arrangement. Based on the conclusions in both agenda papers 15.2 and 15.3, the Board will be asked to decide whether a grantor should account for a service concession arrangement in accordance with IFRS 15.

Structure of this paper

- 3 This paper is organised as follows:
 - (a) Background
 - (b) Overview of the IFRS 15 requirements on scope
 - (c) Applying the definition of contract
 - (d) Applying the definition of customer
 - (i) Identifying goods or services
 - (ii) An output of the entity's ordinary activities
 - (e) Considering whether a grantor and operator could be collaborators or partners
 - (f) Preliminary staff views.

Background

- 4 A conventional role of government is to provide infrastructure for public services. There are many ways in which a government can provide public infrastructure and related services (as outlined in agenda paper 8.2 from the July 2014 AASB meeting¹). One of those ways is via service concession arrangements, which (depending on the nature and scope of the arrangements) are also known as Build-Own-Transfer or Build-Own-Operate-Transfer arrangements. A service concession arrangement generally involves an operator (a private sector entity) constructing a public infrastructure asset (service concession asset) and providing public services, such as operating and maintaining the infrastructure on behalf of the grantor (public sector entity), for an agreed period. In exchange for the asset and services, the grantor

¹ http://www.aasb.gov.au/admin/file/content102/c3/M139_8.2_Info_Paper_PPP_SCA.pdf
(accessed 19 August 2014)

promises consideration in the form of cash (or another financial asset) or grants a ‘right to charge users’ to the operator. Accordingly, the operator usually finances the construction of the public infrastructure.

- 5 The features, terms and conditions, and risk allocation of service concession arrangements are determined on a project-by-project basis. In addition, the legal and economic structure of these arrangements can be complex involving a network of individual contractual agreements and multiple parties. Service concession arrangements typically include the following key characteristics.
- (a) the grantor (public sector entity) determines the operating features of the public infrastructure (the service concession asset) and related services—in particular, it sets the use, users and the usage price of the service concession asset;
 - (b) the operator (private sector entity) finances the construction or upgrade of a service concession asset;
 - (c) the operator provides public services involving the service concession asset to the public (third party users) for a defined period of time;
 - (d) the grantor makes regular payments (also known as ‘availability payments’) or provides a licence for the ‘right to charge users’ (or a combination of both) to the operator in exchange for the delivery of the service concession asset and related services over the term of the arrangement;
 - (e) the grantor may also guarantee a minimum return to the operator and share in the operator’s revenue; and
 - (f) the operator agrees to transfer the related infrastructure to the grantor at the end of the agreed term.

Overview of the IFRS 15 requirements on scope

- 6 IFRS 15 applies to contracts with customers. Accordingly, the definitions of a ‘contract’ and a ‘customer’ establish the scope of IFRS 15. However, not all contracts with customers are within the scope of IFRS 15. IFRS 15 applies to only those contracts (or parts of contracts) with customers that are not within the scope of another standard. Consequently, if—and to the extent that—a contract includes, for example, a lease within the scope of AASB 117 *Leases* or a financial instrument within the scope of AASB 9 *Financial Instruments*, those standards apply rather than IFRS 15.
- 7 The remainder of the paper considers whether a grantor’s rights and obligations from a service concession arrangement would be within the scope of IFRS 15.

Applying the definition of a contract

- 8 IFRS 15 defines a contract as “an agreement between two or more parties that creates enforceable rights and obligations” (see Appendix A).
- 9 Staff understand that service concession arrangements in Australia are typically established by a contract between the grantor and the operator. These contracts are considered to create enforceable rights and obligations for both parties to the contract.

Consequently, it is anticipated that service concession arrangements in Australia would meet the definition of a contract in IFRS 15.

- 10 IPSAS 32 contemplates that a service concession arrangement could be established other than by a contract because it requires that a service concession arrangement must be a ‘binding arrangement’. Paragraph 8 of IPSAS 32 defines a binding arrangement as “describing contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract”. Because IFRSs are developed to apply to ‘profit orientated entities’, IFRS 15 did not need to consider whether other legal mechanisms available to the public sector (such as Acts of Parliament) might create enforceable rights and obligations of the parties to a service concession arrangement. In those cases, consideration would need to be given to whether that other mechanism could still be regarded as a contract if it constitutes an agreement between the grantor and the operator that creates enforceable rights and obligations.

Applying the definition of a customer

- 11 IFRS 15 defines a customer as “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration” (see Appendix A). Beyond that definition, IFRS 15 contains limited guidance on identifying a customer by acknowledging the following points:
- (a) both parties to a contract involving a non-monetary exchange can be simultaneously acting as a supplier and as a customer (see paragraph 5(d) of IFRS 15, which states that contracts with customers involving a non-monetary exchange are outside scope if the non-monetary exchange is between entities in the same line of business to facilitate sales to customers or potential customers); and
 - (b) entities that are working together as collaborators or partners to share in risks and benefits that result from an activity or process may not be acting in a supplier-customer relationship (IFRS 15 paragraph 6).
- 12 Assessing whether an operator is a customer of the grantor requires determining:
- (a) the goods or services that the operator will obtain from the grantor; and
 - (b) whether those goods or services are an output of the grantor’s ordinary activities.

Identifying goods or services

- 13 Identifying the goods or services promised in a service concession arrangement will depend on the facts and circumstances of each arrangement, and in particular on how the construction and operation of the public infrastructure is being financed. However, both the grantor and the operator should be able to identify their respective rights and obligations in the arrangement and, therefore, the goods or services promised by the parties. With that in mind, the types of goods or services (i.e. assets) that the grantor may promise to transfer to the operator should be the same as the assets that AASB Interpretation 12 identifies as forming the consideration received by the operator. AASB Interpretation 12 identifies that those assets may be:

- (a) a financial asset, being the unconditional contractual right to receive cash or another financial asset from the grantor (this right to cash is described as ‘availability payments’ in paragraph 5(d) of this paper);
 - (b) an intangible asset, being a right to charge users of the public service; or
 - (c) both a financial asset and an intangible asset.
- 14 AASB Interpretation 12 distinguishes between the financial asset and the intangible asset based on which party bears demand risk associated with the use of the service concession asset. Consequently, even though the operator may have the risk to collect and retain cash directly from users, the asset promised by the grantor would be a financial asset “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” (see IFRIC 12 paragraph BC42).
- 15 Agenda Paper 15.3 also identifies other goods or services that the grantor may promise to the operator in some service concession arrangements. However, because not every service concession arrangement will include additional promised goods or services, this analysis assumes that the grantor does not transfer any other goods or services to the operator.

An output of the entity’s ordinary activities

- 16 The definition of a customer refers to ‘ordinary activities’, but IFRS 15 does not define that term. Paragraph BC53 explains that additional clarification was not provided because the notion of ordinary activities is derived from the existing definitions of revenue in the IASB’s and the FASB’s respective conceptual frameworks.
- 17 The following paragraphs analyse whether the promised financial or intangible assets identified in paragraph 13 above could be an output of the grantor’s ordinary activities. This paper does not specifically address the accounting that should apply if the grantor promises to transfer both a financial asset and an intangible asset to the operator.

Is a financial asset an output of the grantor’s ordinary activities?

- 18 If the asset transferred to the operator is a financial asset (e.g. cash), staff think that the operator will not be a customer of the grantor. Instead, staff think that, in these circumstances, the grantor’s role in the arrangement will be only as the customer of the operator.
- 19 Staff consider that the cash or a right to cash (or another financial asset) that will be transferred to the operator should not be regarded as an output of the grantor’s ordinary activities. Although the grantor in its capacity as a government can obtain cash by exercising its taxation rights, taxation is considered to be an activity that finances the government’s ordinary activities (such as the provision of public services) rather than being an ordinary activity of the government. Staff note that, if obtaining cash was considered to be an ordinary activity of the government, the consequence would be that the grantor conceivably would be simultaneously an entity and a customer for every procurement contract it enters into. Staff think that such an outcome would not faithfully represent all of the grantor’s contracts.

Is the intangible asset an output of the grantor's ordinary activities?

- 20 Staff understand that there are differing views about whether the intangible asset—being the right to charge users—granted to the operator represents an output of the grantor's ordinary activities. Each view is considered in the paragraphs below.

View A—The intangible asset is unrelated to the entity's ordinary activities

- 21 View A adopts a relatively narrow view of the scope of a grantor's ordinary activities and considers that charging users of a public asset (including a service concession asset) is typically a financing activity rather than an ordinary activity of the grantor. The act of assigning that right to charge users to another party (i.e. an operator) does not change the character of that right or the nature of the grantor's activities. In that regard, the right to charge users could be considered to be akin to a securitisation of the future cash flows that the grantor could otherwise generate from the asset.

View B—The intangible asset is an output of the entity's ordinary activities

- 22 View B adopts a relatively broad view of the scope of a grantor's ordinary activities. It is based on the view that a government's ordinary activities include regulating access to, and the usage of, public assets. In that regard, a right to charge users for access to public assets that is transferred to an operator could represent an output of the grantor's ordinary activities, especially if the grantor charges for the use of other public assets. Furthermore, the competitive tendering environment that is associated with many service concession arrangements could be viewed as operators offering construction and operations services as consideration in order to acquire an asset—being the right to charge users.

Analysis of Views A and B

- 23 View A and View B consider the intangible asset from different perspectives.
- 24 View A considers that the intangible asset and the financial asset are alternative means available to the grantor for financing the construction and operation of public assets. Aside from the non-cash form of the intangible asset, the main feature that distinguishes consideration in the form of a financial asset from consideration in the form of an intangible asset is whether 'demand risk' associated with the use of the public infrastructure has been accepted by the grantor or the operator. On the assumption that a financial asset is not an output of the grantor's ordinary activities (see paragraph 19 above), it is unclear why the presence or absence of 'demand risk' would change a conclusion as to whether an asset represents an output of an entity's ordinary activities.
- 25 More generally, there are arrangements in the for-profit sector whereby an entity assigns rights to future cash flows in order to obtain finance. This includes the sale of royalty interests in an asset that constitutes intellectual property (for example, in the pharmaceutical industry). Although the accounting for each sale of a royalty interest will depend on the specific facts and circumstances of each arrangement, staff understands that those arrangements will more typically be regarded as involving the disposal of a non-financial asset rather than the sale of an output of the entity's ordinary activities.

- 26 In contrast, View B focuses on the similarities between the intangible asset and both of the following types of arrangements:
- (a) a grantor charging users for access to other public assets (e.g. fishing licences); and
 - (b) in the for-profit sector, a franchisor transferring franchise rights (and access to underlying intellectual property).
- 27 However, staff think that a key distinguishing factor between the arrangements listed above and the rights in a service concession arrangement is that the ‘access’ granted to the operator is to enable the operator to fulfil its performance obligations of providing construction and operation services to the grantor. This is acknowledged by paragraph BC25 of IFRIC 12, which states “Under the terms of the contract the operator has access to operate the infrastructure to provide the public service on the grantor’s behalf”. Furthermore, the ‘access’ granted to the operator is the same regardless of whether the consideration transferred from the grantor is in the form of a financial asset or an intangible asset. In both cases, the operator needs to have the right to access the public asset in order to provide the contracted services to the grantor.
- 28 As a result, staff think that the intangible asset is not transferring a benefit of access to the grantor’s assets in the same way as a holder of a fishing licence or a franchisee benefits from access to the assets identified in their contracts. This is because the holder of a fishing licence or a franchisee pays to access the asset in order to generate future cash flows. In contrast, the operator generates future cash flows by providing services to the grantor and those future cash flows are in the form of an intangible asset that exposes the operator to demand risk associated with the use of the public asset by third parties.
- 29 The above analysis illustrates the difficulty associated with determining conclusively whether a right to charge users in a service concession arrangement can represent an output of the grantor’s ordinary activity. Although there is merit to both views, staff think that View B is more persuasive for the reasons noted in paragraphs 27 and 28.

Considering whether a grantor and operator could be collaborators or partners

- 30 As noted earlier in the paper, paragraph 6 of IFRS 15 acknowledges that entities working together as collaborators or partners to share in risks and benefits that result from an activity or process may not be acting in a supplier-customer relationship. Staff think it is possible that, at least in some cases, the parties to a service concession arrangement might negotiate their respective rights and obligations in the arrangement to reflect a pooling of resources (e.g. public land and construction services) in order to jointly share in the risks and benefits of a public asset. Although such a conclusion would depend on the specific facts and circumstances of the arrangement, staff think that relevant factors to consider may include whether the duration of the arrangement corresponds to the economic life of the public asset and whether the grantor and the operator share the revenue received from users of the public asset.

Preliminary staff views

- 31 Based on the above analysis, the preliminary staff views are as follows:

- (a) Service concession arrangements in which the grantor promises to transfer a financial asset to the operator would not be within the scope of IFRS 15. This is because, in those circumstances, the operator would not be a customer of the grantor.
 - (b) Service concession arrangements in which the grantor promises to transfer an intangible asset to the operator could be within the scope of IFRS 15, but only if View B (as outlined in paragraph 22) applies. If View A applies (as outlined in paragraph 21), the operator would not be a customer of the grantor and, consequently, the grantor would not (directly) account for the service concession arrangement in accordance with IFRS 15. Staff's preliminary view is that the operator would not be a customer of the grantor (i.e. View A).
- 32 The analysis also queries whether non-contractual service concession arrangements would be within the scope of IFRS 15 and acknowledges it is possible that, at least in some arrangements, the grantor and operator may be acting as collaborators rather than in a supplier-customer relationship. In either of those circumstances, those service concession arrangements would not be within the scope of IFRS 15.
- 33 Staff views in the paper are preliminary because staff have only performed a limited amount of targeted outreach on the issue of scope and further targeted outreach is planned prior to the AASB meeting. Staff will advise AASB members of the outcomes of that outreach during the AASB meeting.

Question to Board members

Does the Board agree with the staff's views in paragraphs 31 and 32?