Issues paper

Application of IFRS 15 on the Right to Charge Users of a Service Concession Asset

Objective of this paper

1 This issues paper considers the implications and suitability of a grantor applying IFRS 15 *Revenue from Contracts with Customers*, either directly or by analogy, to service concession arrangements in which the grantor promises to transfer to the operator an intangible asset (representing a 'right to charge users') in exchange for the construction of a service concession asset and the provision of related future services.

2 This paper does not address the accounting by grantors for those service concession arrangements in which the grantor promises to transfer a financial asset in exchange for the services promised by the operator. This is because, as agenda paper 15.2 indicates, the operator would not be a customer of the grantor in those circumstances.

3 The Board is requested to provide direction on whether a grantor should account for its rights and obligations in a service concession arrangement in accordance with IFRS 15.

Background

4 At its July 2012 meeting, the AASB considered the requirement in IPSAS 32 *Service Concession Arrangements: Grantor* for a grantor to recognise a liability representing the 'unearned portion of the revenue'[1] arising from the exchange of assets between the grantor and the operator. The AASB noted that the requirements of IPSAS 32 are inconsistent with the proposals in the IASB/FASB Revenue project for an entity to recognise revenue from the granting of a licence at the point in time at which the customer obtains control of the licence[2]. The AASB directed staff to consider the implications and suitability of applying the application guidance on licences being developed in the IASB/FASB Revenue project to service concession arrangements.

5 In May 2014 the IASB issued IFRS 15. Subsequently, at its July 2014 meeting, the AASB considered the implications and suitability of applying, by analogy, the licence application guidance in IFRS 15 to service concession arrangements that involve a grantor providing to an operator an intangible asset in the form of a licence to charge users in exchange for a service concession asset and related future services. The Board

1 IPSAS 32.AG47 rationalises the unearned portion of the revenue from the exchange as follows: "When the grantor compensates the operator for the service concession asset and service provision by granting the operator the right to earn revenue from third-party users of the service concession asset, the operator is granted the right to earn revenue over the period of the service concession arrangement. Likewise, the grantor earns the benefit associated with the asset received in the service concession arrangement in exchange for the right granted to the operator over the period of the arrangement. Accordingly, the revenue is not recognized immediately. Instead, a liability is recognized for any portion of the revenue that is not yet earned."

2 At that meeting, the AASB noted that the IASB/FASB's revised Exposure Draft ED/2011/6 *Revenue from Contracts with Customers* proposed that an entity granting a distinct licence to a customer would recognise revenue at the point in time, in full, when the licence is granted, as "those promised rights give rise to a performance obligation that the entity satisfies at the point in time when the customer obtains control of the rights" [paragraph B34 of ED/2011/6].

did not make any decisions at the meeting and directed staff to undertake further analysis, in particular, to consider:

(a) whether a service concession arrangement from the grantor's perspective could be within the scope of IFRS 15 (Agenda paper 15.2 considers this issue); and

(b) the implications of applying the main requirements in IFRS 15, either directly or by analogy, to service concession arrangements, including considering whether the asset promised to the operator should be accounted for as some other form of good or service (which is the subject of this issues paper).

6 For the purpose of this issues paper, staff have assumed that IFRS 15 applies to service concession arrangements, either directly or by analogy.

Structure of this paper

7 The remainder of this paper discusses the application of the five steps of the revenue recognition model in IFRS 15 to a grantor's rights and obligations in a service concession arrangement. This paper is structured as follows:

(a) Step 1: Identify the contract with a customer

(b) Step 2: Identify the performance obligations in the contract:

  (i) Identifying the promised goods or services in a service concession arrangement

  (ii) What is the nature of the intangible asset for the 'right to charge users'

  (iii) Identifying the distinct goods or services in service concession arrangements

(c) Step 3: Determine the transaction price

(d) Step 4: Allocate the transaction price to each performance obligation

(e) Step 5: Recognise revenue when (or as) the entity satisfies its performance obligations

(f) Preliminary staff views and recommendation

(g) Appendix – Relevant extracts from IFRS 15.

Step 1: Identify the contract with the customer

8 The service concession arrangement is presumed to be the contract to which IFRS 15 applies. Because this paper is considering the application of IFRS 15 either directly or by analogy, it is not necessary to conclude whether a grantor's service concession arrangement would be a contract with a customer in accordance with IFRS 15. That issue is addressed in Agenda paper 15.2.

Step 2: Identifying the performance obligations in the contract

9 Generally speaking, a 'performance obligation' is a promise in a contract with a customer to transfer to the customer a good or service (or bundle of goods or services) that is distinct (see paragraph 22(a) of IFRS 15). Before identifying the performance obligations in the contract, an entity has to identify the goods or services that it has promised to transfer to the customer.

10 Paragraph 24 of IFRS 15 states that promised goods or services "may be explicitly identified in a contract, or implied by an entity's customary business practices, published policies or specific statements that create a valid expectation of the customer that the entity will transfer a good or service". Although 'goods' and 'services' are not defined, IFRS 15 clarifies that a performance obligation does not include "activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to a customer". Paragraph 26 of IFRS 15 lists examples of types of promised goods or services, including:

(a) performing a contractually agreed-upon task (or tasks) for a customer; and

(b) granting licences.

Identifying the promised goods or services in a service concession arrangement

11 The goods or services promised by the grantor to the operator in a service concession arrangement may include:

(a) an intangible asset, being a 'right to charge users' of the public service; and

(b) other goods or services such as performing traffic infringement and enforcement services for the operator (see paragraph 26 below).

12 As noted above, a distinction also needs to be made between the goods and services that transfer to an operator, and any other activities that a grantor might undertake that do not directly transfer goods or services to the operator. The July 2014 Agenda paper 8.3 identified the following activities that grantors commonly undertake relating to toll roads, tunnels and bridges:

(a) to make any improvements to the public transport services or future road projects that may include, for example, extending the operator's toll road or motorway that could be promised or otherwise in the service concession contract or implied;

(b) to cooperate with the operator and coordinate the daily traffic flows with the operator's traffic controller by identifying potential bottlenecks or addressing traffic issues between connecting road networks and the toll road; and

(c) to manage relationships and resolve disputes involving any public sector entity involved or affected by the service concession arrangement, the operator and the public during the course of the arrangement, for example, dealing with a local council on the impact of construction or traffic on its precinct or suburbs.

13 Judgement will be required to determine whether any of these activities identified in service concession arrangements are separate goods or services that the grantor has promised to transfer to the operator. Although that determination will depend on a detailed assessment on the specific facts and circumstances relating to each activity, staff consider that these types of activities would generally be undertaken by the grantor to manage or enhance its own infrastructure assets rather than transfer a separate good or service to the operator.

What is the nature of the intangible asset for the 'right to charge users'?

14 Paragraph 17 of Interpretation 12 *Service Concession Arrangements* describes the intangible asset that is transferred to the operator as a 'right to charge users'. The 'right to charge users' may also incorporate a number of other attributes, such as:

(a) rights to access the grantor's land for construction of the service concession asset; and

(b) rights to access the service concession asset to operate and/or maintain the service concession asset.

15 To be able to apply the rest of IFRS 15, the nature of this intangible asset also must be identified. This is because the nature of the asset will, among other things, influence whether the promised intangible asset represents a performance obligation satisfied over time or a performance obligation satisfied at a point in time (as per Step 5 of the revenue model). The nature of the intangible asset promised to the operator could be described as either:

(a) View 1—a right to a future income stream;

(b) View 2—a right to access the grantor's service concession assets; or

(c) View 3—a licence.

View 1—a right to a future income stream

16 View 1 considers the 'right to charge users' to represent consideration in the form of an intangible asset that is provided by the grantor to the operator for the construction and operations services related to the service concession asset. Under this view, the 'right to charge users' is considered to be akin to a securitisation of the future cash flows that the grantor could otherwise generate from the asset.

View 2—a right of access to the grantor's service concession assets

17 The nature of the grantor's performance obligation relating to the intangible asset could be considered a service of making its service concession asset available for a period of time. In that regard, the access rights granted to the operator may be similar to the rights of access provided in other contracts, including in the for-profit sector. Given that the right of access is an attribute of the 'right to charge users' as identified in paragraph 14 above, some commentators view the intangible asset as a right of access to the grantor's assets.

View 3—a licence

18 Paragraph 17 of Interpretation 12 refers to the 'right to charge users' as a licence to charge users and, as a consequence, some commentators consider that the right should be accounted for as a licence under IFRS 15's licences application guidance.

Analysis of each view

19 View 1 is consistent with staff's view as outlined in Agenda paper 15.2, which is considering whether the intangible asset is an output of the grantor's ordinary activities. Under that view, the intangible asset promised to the operator is a right to a future income stream. Once the right has transferred to the operator, the grantor's performance is complete.

20 In relation to View 2, staff considers that the right to access the grantor's assets does not provide a service to the operator. Instead, staff consider that these attributes together define the intangible asset that transfers to the operator. In other words, the rights of access are granted to the operator to ensure that the operator has legal access to perform the construction and operations services that it has promised to the grantor. The operator obtains no benefits from those access rights which would not already be reflected in its 'right to charge users'. In that regard, the right of access granted to the operator would seem to be similar to the rights of access provided to a cleaner that has been contracted to clean an office premises on a daily basis.

21 The conclusions in Interpretation 12 also provide support for the view that access rights do not provide a separate service to the operator. Interpretation 12 states that a grantor has promised a financial asset as consideration in a service concession arrangement if the operator is not subject to 'demand risk' even though the operator collects tolls from road users. Consequently, the promise of a right of access to collect tolls may be an attribute of a service concession arrangement regardless of whether the grantor transfers (and the operator receives consideration in the form of) a financial asset or an intangible asset. Staff consider that it would be difficult to explain why an equivalent right of access to collect tolls could represent a service to the operator in some arrangements but not in others. This is discussed further in paragraphs 27-28 of Agenda paper 15.2.

22 In relation to View 3, the licence granted to the operator would not be accounted for as a licence under IFRS 15. This is because, within the context of IFRS 15, the licence application guidance applies only to a licence of intellectual property. Intellectual property is not defined but it commonly refers to assets such as an entity's brand or operational know-how. Paragraph B52 of IFRS 15 provides examples of licences of intellectual property, including software and technology, franchises, patents and copyrights. Although a grantor's 'right to charge users' could represent an intangible asset, it is unlikely to be regarded as a form of intellectual property. Accordingly, staff consider the IFRS 15 licences guidance cannot be applied directly to the 'right to charge users'. Instead, a grantor would be required to apply the general revenue model in IFRS 15 to account for the promised transfer of the licence to the operator.

23 The above analysis illustrates the difficulty associated with determining the nature of the intangible asset (being the 'right to charge users') that is promised in a service concession arrangement.

24 Staff do not think that the 'right to charge users' represents a right of access to the grantor's service concession asset (View 2). Staff consider that View 1 is more persuasive, that is, the 'right to charge users' is more likely to be in the nature of a grantor's consideration to the operator.

Identifying the distinct goods or services in service concession arrangements

25 For the types of goods and services identified above, a good or service is distinct if the customer can benefit from the good or service on its own or together with other readily available resources. The intangible asset, being the 'right to charge users', is distinct because the operator will be able to benefit from the right on its own or together with other readily available resources. This is evidenced by the fact that, in some service concession arrangements, the 'right to charge users' may be the only good or service promised by the grantor, and accordingly, the right must be distinct.

26 The July 2014 Agenda paper 8.3 identified other goods or services that a grantor may promise to an operator, for example, the grantor may provide a service of identifying non-paying vehicles or issuing toll evasion notices. Those goods or services could have a use in conjunction with a resource that the operator has already obtained from the grantor (that is, the 'right to charge users'). Consequently, those other goods or services promised in a service concession arrangement also could be distinct.

Staff preliminary views

27 Staff consider that the promise to transfer an intangible asset (being the 'right to charge users') is a performance obligation. Staff hold the view that the 'right to charge users' most likely represents consideration to the operator in the form of the grantor's future income stream (View 1). Implicit in the 'right to charge users' are the rights to access the grantor's physical assets (for example, the land and service concession asset) that is conveyed to the operator but these are not separate goods or services.

28 In addition, staff consider the activities outlined in paragraph 12 above would most likely be undertaken by the grantor to facilitate the successful transfer of the promised goods or services in service concession arrangements, and are not separate goods or services.

Question for the Board
Does the Board support the staff preliminary views above?

Step 3: Determine the transaction price

29 The third step of the revenue model is to determine the transaction price. In a service concession arrangement, the operator promises the grantor non-cash consideration in the form of construction and operations services in exchange for the intangible asset. Paragraph 66 of IFRS 15 requires non-cash consideration (or the promise of non-cash consideration) to be measured at fair value. Staff expect that estimating the fair value of construction services and the fair value of the operation services to be provided over the life of the arrangement could be challenging and the fair value estimate could be highly subjective. Paragraph 67 of IFRS 15 states that if an entity cannot reasonably

estimate the fair value of the non-cash consideration, the consideration should be measured indirectly by reference to the standalone selling price of the goods or services promised to the customer in exchange for the consideration. However, this requirement would not be expected to alleviate the measurement challenge associated with a service concession arrangement because determining the standalone selling price of the intangible asset would be expected to be similarly challenging to estimate.

30 IFRS 15 requires that estimates of variable consideration are included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised would not occur when the uncertainty associated with the variable consideration is subsequently resolved. However, the constraint would only apply to an estimate of non-cash consideration if that consideration varies for reasons other than the form of the consideration. Staff understands that a grantor generally has a fixed entitlement to the consideration (in the form of construction and operations services) and, therefore, the constraint would not apply.

31 In determining the transaction price, paragraph 60 of IFRS 15 also requires the promised amount of consideration to be adjusted for the effects of the time value of money if the timing of payments agreed to by the parties to the contract provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In many cases, one of the main reasons for entering into a service concession arrangement is for a grantor to obtain the benefit of financing the construction and operation of a service concession asset. From the perspective of applying IFRS 15, the objective is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when they transferred to the customer. Consistent with that objective, the existence of a significant financing component in a service concession arrangement would depend, in part, on the expected length of time between when the grantor transfers the intangible asset to the operator and when the operator pays for that asset. Whether a significant financing component exists may also depend on whether the nature of the intangible asset that transfers to the operator is a right (for example, View 1) or access (for example, View 2). Further analysis about the timing of transfer discussed in Step 5 below.

32 If the intangible asset is a right (View 1), the right would be expected to transfer to the operator at a point in time, possibly at contract inception. In that case, there is likely to be a substantial timing difference between performance by the grantor (that is, transferring the right) and performance by the operator (that is, providing the construction and operations services), which would indicate that a significant financing component exists. However, given that the grantor performs before the operator, IFRS 15 would consider the grantor to be providing a significant benefit of financing the operator. In addition to adjusting the transaction price to exclude the financing component implicit in the promised non-cash consideration, the grantor would be required to recognise interest revenue over the life of the service concession arrangement.

33 If the intangible asset provides access (View 2), there is a degree of contemporaneous performance by both parties in the sense that the grantor may be providing access to the operator and, at the same time, the operator is paying for that access by providing construction and operations services. Although an assessment of whether a significant

financing component exists will depend on the specific facts and circumstances, it would be expected that the operator will typically transfer more consideration to the grantor earlier in the contract (via the construction services) while the access provided to the operator is provided over the life of the arrangement. Consequently, it would be expected that a significant financing component would exist but, in this case, the operator would be providing a significant benefit of financing to the grantor. In addition to adjusting the transaction price for the financing component implicit in the promised non-cash consideration, the grantor would be required to recognise interest expense over the life of the service concession arrangement.

34 In summary, staff consider that the transaction price in a service concession arrangement will reflect the fair value of non-cash consideration promised by the operator and to be subject to adjustment if the service concession arrangement includes a significant financing component. If a significant financing component exists, the grantor would also be required to separately recognise either interest revenue or interest expense (depending on whether IFRS 15 considers the grantor to be providing or receiving the benefit of financing).

Step 4: Allocate the transaction price to each performance obligation

35 The fourth step in the revenue model is to allocate the transaction price to each performance obligation. In some service concession arrangements, there will be only one performance obligation—the promise to transfer the intangible asset. In those cases, there would be no need to allocate the transaction price.

36 In other service concession arrangements, there may be more than one performance obligation and, accordingly, an allocation of the transaction price will be required. Earlier in the paper, the promise of infringement and enforcement services was identified as being included in some arrangements. Based on the conclusion in paragraph 26 above, this promised service would most likely be a separate performance obligation.

37 IFRS 15 requires the transaction price to be allocated to each performance obligation on a relative standalone selling price basis. Because the standalone selling prices of the intangible asset and the infringement and enforcement services would not be observable, IFRS 15 would require those standalone selling prices to be estimated using a method such as an adjusted market assessment approach or an expected cost plus a margin approach. Because of the nature of these goods or services, staff expects that it would be challenging to estimate those standalone selling prices.

38 Despite the complexity associated with allocating the transaction price between an intangible asset and another good or service, staff acknowledges that from a practical perspective a grantor might not be required to perform this allocation step if the separate service (for example, the infringement and enforcement service) is immaterial compared to the intangible asset. However, that outcome would depend on the specific facts and circumstances of each arrangement.

Step 5: Recognise revenue when (or as) the entity transfers a good or service

39 Under IFRS 15, revenue is recognised when a performance obligation is satisfied. The timing of revenue recognition depends on whether the grantor's corresponding

performance obligation is a performance obligation satisfied over time or a performance obligation satisfied at a point in time.

(a) A performance obligation is satisfied over time if the criteria in paragraph 35 of IFRS 15 are met. If those criteria are met, an entity selects a method to measure its progress towards complete satisfaction of that performance obligation.

(b) A performance obligation is satisfied at a point in time if the criteria in paragraph 35 of IFRS 15 are not met. In those circumstances, the performance obligation is satisfied at the point when the customer obtains control of the promised good or service. Control refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset. Control also includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, the asset.

40 Although the staff's view is that View 1 (a right to a grantor's future income stream) in paragraph 16 above describes the nature of the intangible asset, the analysis in this section also considers the timing of revenue recognition that would apply if the intangible asset was as described in either View 2 (as a right of access to the grantor's service concession assets) or View 3 (as a licence).

View 1—a right to a grantor's future income stream

41 Under this view, the nature of the intangible asset promised by the grantor is a right to a future income stream (as mentioned in paragraph 16 above), which represents the consideration payable to the operator in exchange for the construction and operations services.

42 Under View 1, there is no ongoing performance by the grantor after the right has transferred to the operator. For that reason, staff consider that the grantor's performance obligation would not represent a performance obligation satisfied over time in accordance with the criteria in paragraph 35 of IFRS 15. Instead, it is likely that a grantor would satisfy its performance obligation at the time when the 'right to charge users' is transferred to the operator, which could be at contract inception. Staff consider that the operator obtains control of the 'right to charge users' at contract inception (or whenever the right is transferred to the operator) because the right is exclusive to the operator, and therefore, entitles the operator to deny other entities from accessing the future income stream relating to the specified service concession asset. The fact that the operator has not yet constructed the service concession asset and, therefore, would not receive payments from users of the asset for some time does not mean that control of the 'right to charge users' has not transferred to the operator.

43 In summary, under View 1, staff consider that the grantor would recognise revenue at the point in time when the 'right to charge users' is transferred to the operator. The amount of revenue recognised would be the transaction price that is allocated to the performance obligation (see discussion of Steps 3 and 4 above).

View 2—a right of access to the grantor's service concession assets

44 Under this view, the nature of the grantor's performance obligation would be considered to be a service of making its service concession asset available for a period of time (as mentioned in paragraph 17 above). In this case, the grantor's performance obligation would be a performance obligation satisfied over time if the operator simultaneously receives and consumes the benefits from accessing the grantor's service concession assets as the grantor provides that access.

45 On the assumption that the promised right of access represents a performance obligation satisfied over time, the grantor would recognise revenue over time by measuring its progress towards complete satisfaction of that performance obligation. Paragraph 40 of IFRS 15 states that "the objective when measuring progress is to depict an entity's performance in transferring control of the goods or services promised to the customer". Staff consider that because grantor's performance would involve providing a service of access to the service concession asset over the life of the arrangement, a time-based method for measuring progress would be appropriate. Judgement may be required to determine the period in which the service of access is provided. For instance, would the grantor be providing access to its service concession asset from contract inception or from when the operator commences toll operations of the service concession asset, or from some other point in time? Under View 2, the amount of revenue recognised by the grantor at the end of a reporting period would be based on the transaction price allocated to the performance obligation and the extent of the grantor's progress towards complete satisfaction of that performance obligation

View 3—a licence

46 Paragraph 22 above notes that the 'right to charge users' would not be a licence of intellectual property and therefore the application guidance on licences in IFRS 15 would not apply directly to a service concession arrangement. However, for the purposes of the analysis in the paper, this section considers the application, by analogy, of the licences application guidance to the 'right to charge users' (on the assumption that the grantor is also applying IFRS 15 by analogy to account for its rights and obligations in a service concession arrangement because the service concession arrangement is not directly within the scope of IFRS 15).

47 Under View 3, the nature of the grantor's performance obligation is considered to be a licence to charge users. The application of IFRS 15's licences guidance by analogy to the grantor's licence to charge users was previously considered in July 2014 at Agenda paper 8.3. That paper analysed five fact patterns common to service concession arrangements. That paper concluded that, depending on the specific facts and circumstances, a grantor would recognise revenue at a point in time for some arrangements, and recognise revenue over time for other arrangements. The difference in revenue recognition outcomes arose because staff considered that only some, but not all, licences granted to the operator would be analogous to a 'right to access the entity's intellectual property as it exists throughout the licence period'. This is because only some service concession arrangements were considered to meet the criteria in paragraph B58 of IFRS 15 for determining whether the nature of a promise in granting a licence is a promise to provide a 'right of access'.

48 That agenda paper also highlighted the following:

(a) Significant judgement would be required in determining whether common types of activities that a grantor may undertake in relation to a service concession arrangement would meet the criteria in paragraph B58 of IFRS 15.

(b) Because of the wide range of possible activities that a grantor might be expected to undertake in respect of its underlying asset and because of the judgement involved in determining whether those activities might directly affect the operator's licence, staff consider that grantors may find it difficult to apply the criterion in paragraph B58 of IFRS 15 consistently to their service concession arrangements.

(c) Some commentators might find it difficult to understand the different revenue recognition patterns that might arise in accounting for different service concession arrangements.

Staff preliminary views

49 Staff consider the revenue model in IFRS 15 could be applied directly to the grantor's 'right to charge users'. However, the outcome of applying the revenue model, including the corresponding revenue recognition pattern, depends on the nature of the intangible asset promised by the grantor.

Question for the Board
Does the Board support the staff preliminary views above?

Preliminary staff views and recommendation

50 The following are three possible ways forward. Each of these approaches is available regardless of the conclusion reached in agenda paper 15.2 as to whether, from the grantor's perspective, the service concession arrangement would be within the scope of IFRS 15. However, if the service concession arrangement is within scope of IFRS 15, staff consider that Approaches 1 or 2 would be more consistent with its policies on transaction neutrality and the *Process for Modifying IFRSs for PBE/NFP.*

Approach 1—proceed with IFRS 15 and supplement with guidance

The Board could consider proceeding with applying the revenue model in IFRS 15 to service concession arrangements (from the grantor's perspective). In addition, the Board could consider developing guidance to IFRS 15 for public sector entities in the same format as the *Australian Implementation Guidance for NFP Entities – Control and Structured Entities*. The guidance would articulate IFRS 15 requirements in a context that is more suited to the public sector environment.

Approach 2—modify IFRS 15

The Board could consider developing a separate set of revenue requirements tailored specifically to service concession arrangements (from the grantor's perspective). 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*.

Approach 3—apply IPSAS 32

The Board could consider applying the IPSAS 32 approach, which is to initially recognise a liability representing the 'unearned portion of the revenue' arising from the exchange of assets between the grantor and the operator, and subsequently recognise revenue and reduce the liability initially recognised according to the economic substance of the service concession arrangement. Staff consider the AASB's *Process for Modifying IFRSs for PBE/NFP* provides sufficient basis for the Board to pursue the IPSAS 32 approach.

Concluding comments

51 Staff consider 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.

52 This suggests that IFRS 15 may not be particularly suitable to be directly applied to service concession arrangements from the grantor's perspective. Of the approaches identified, staff consider that Approach 2 (in paragraph 50) is the preferred approach for progressing the project. Under this approach, staff recommend performing further research on how many changes to IFRS 15 would be necessary to overcome the concerns identified in this paper, 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.

53 Staff views in this issues paper are preliminary because staff have only performed a limited amount of targeted outreach on the application of IFRS 15's revenue model and aim to perform further targeted outreach prior to the AASB meeting. Staff will advise the Board of the outcomes of that outreach during the AASB meeting.

Question for the Board

How would the Board like to proceed?

Appendix – Relevant extracts from IFRS 15

24 A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the performance obligations identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer.

25 Performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.

26 Depending on the contract, promised goods or services may include, but are not limited to, the following:

(a) sale of goods produced by an entity (for example, inventory of a manufacturer);
(b) resale of goods purchased by an entity (for example, merchandise of a retailer);
(c) resale of rights to goods or services purchased by an entity (for example, a ticket resold by an entity acting as a principal, as described in paragraphs B34–B38);
(d) performing a contractually agreed-upon task (or tasks) for a customer;
(e) providing a service of standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides;
(f) providing a service of arranging for another party to transfer goods or services to a customer (for example, acting as an agent of another party, as described in paragraphs B34–B38);
(g) granting rights to goods or services to be provided in the future that a customer can resell or provide to its customer (for example, an entity selling a product to a retailer promises to transfer an additional good or service to an individual who purchases the product from the retailer);
(h) constructing, manufacturing or developing an asset on behalf of a customer;
(i) granting licences (see paragraphs B52–B63); and
(j) granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs B39–B43).

27 A good or service that is promised to a customer is distinct if both of the following criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the good or service is distinct within the context of the contract).

28 A customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

29 Factors that indicate that an entity's promise to transfer a good or service to a customer is separately identifiable (in accordance with paragraph 27(b)) include, but are not limited to, the following:

(a) the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.

(b) the good or service does not significantly modify or customise another good or service promised in the contract.

(c) the good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services.

30 If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

31 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

32 For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 35–37) or satisfies the performance obligation at a point in time (in accordance with paragraph 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

33 Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

(a) using the asset to produce goods or provide services (including public services);

(b) using the asset to enhance the value of other assets;

(c) using the asset to settle liabilities or reduce expenses;

(d) selling or exchanging the asset;

(e) pledging the asset to secure a loan; and

(f) holding the asset.

…

35 An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);

(b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or

(c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

…

38 If a performance obligation is not satisfied over time in accordance with paragraphs 35–37, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the requirements for control in paragraphs 31–34. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

(a) The entity has a present right to payment for the asset—if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.

(b) The customer has legal title to the asset—legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.

(c) The entity has transferred physical possession of the asset—the customer's physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. Paragraphs B64–B76, B77–B78 and B79–B82 provide guidance on accounting for repurchase agreements, consignment arrangements and bill-and-hold arrangements, respectively.

(d) The customer has the significant risks and rewards of ownership of the asset—the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.

(e) The customer has accepted the asset—the customer's acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity shall consider the guidance in paragraphs B83–B86.

39 For each performance obligation satisfied over time in accordance with paragraphs 35–37, an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity's performance in transferring control of goods or services promised to a customer (ie the satisfaction of an entity's performance obligation).

40 An entity shall apply a single method of measuring progress for each performance obligation satisfied over time and the entity shall apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time.

41 Appropriate methods of measuring progress include output methods and input methods. Paragraphs B14–B19 provide guidance for using output methods and input methods to measure an entity's progress towards complete satisfaction of a performance obligation. In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.

…

46 When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with paragraphs 56–58) that is allocated to that performance obligation.

47 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

…

50 If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

…

53 An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

(a) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

(b) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

…

56 An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

…

66 To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

…

73 The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

…

85 An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 22(b) if both of the following criteria are met:

(a) the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and

(b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 73 when considering all of the performance obligations and payment terms in the contract.

…

87 After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

…

B3 For some types of performance obligations, the assessment of whether a customer receives the benefits of an entity's performance as the entity performs and simultaneously consumes those benefits as they are received will be straightforward. Examples include routine or recurring services (such as a cleaning service) in which the receipt and simultaneous consumption by the customer of the benefits of the entity's performance can be readily identified.

B4 For other types of performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer. In determining whether another entity would not need to substantially re-perform the work the entity has completed to date, an entity shall make both of the following assumptions:

(a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and

(b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were to transfer to another entity.

…

B14 Methods that can be used to measure an entity's progress towards complete satisfaction of a performance obligation satisfied over time in accordance with paragraphs 35–37 include the following:

(a) output methods (see paragraphs B15–B17); and

(b) input methods (see paragraphs B18–B19).

B15 Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity shall consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation. An output method would not provide a faithful depiction of the entity's performance if the output selected would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in progress or finished goods controlled by the customer that are not included in the measurement of the output.

…

B18 Input methods recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.