

STAFF PAPER

September 2015

IFRS Interpretations Committee Meeting

Project	IAS 16 <i>Property, Plant and Equipment</i>, IAS 38 <i>Intangible Assets</i> and IFRIC 12 <i>Service Concession Arrangements</i>		
Paper topic	Variable payments for asset purchases and payments made by an operator to a grantor in a service concession arrangement—Cover memo and possible alternatives		
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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Background

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request to address the accounting for contractual payments that are to be made by an operator under a service concession arrangement within the scope of IFRIC 12 *Service Concession Arrangements*. Specifically, the submitter asked the Interpretations Committee to clarify in what circumstances (if any) those payments should:
 - (a) be included in the measurement of an asset and liability at the start of the concession; or
 - (b) be accounted for as executory in nature (ie be recognised as expenses as they are incurred over the term of the concession arrangement).
2. The Interpretations Committee noted that the issue of variable concession fees payable by an operator under a service concession arrangement is linked to the broader issue of accounting for variable payments for the purchase of property, plant and equipment and intangible assets outside of a business combination (hereafter referred to as 'variable payments for asset purchases').

3. The Interpretations Committee discussed this issue over several meetings in the past, with its most recent discussion being in March 2013. The Interpretations Committee had reached a conclusion on several issues including the subsequent accounting for variable payments for asset purchases and payments by an operator to a grantor. The Interpretations Committee could not reach a consensus on whether variable payments that are dependent on the purchaser's future activity should be excluded from the initial measurement of the liability until that activity is performed.

4. The Interpretations Committee decided to recommend certain proposed amendments to the IASB to reflect its tentative decisions on subsequent accounting for such payments and on accounting for payments made by an operator to a grantor. These proposals did not include any amendments related to the initial accounting for variable payments in an asset purchase. The IASB noted that the initial accounting for variable payments affects subsequent accounting and should be addressed together. As accounting for variable payments is a topic that was discussed as part of the Leases and *Conceptual Framework* projects, the IASB decided that it would reconsider this project after the proposals in the Exposure Draft *Leases* (the 'Leases ED') had been redeliberated. Accordingly, the discussion on both these issues (ie variable payments in asset acquisitions and payments by an operator to a grantor in a service concession arrangement) was put on hold. Further details on the project, together with all relevant staff papers and summaries of discussions to date can be found [here](#).

Objective of the papers

5. The IASB has substantially completed its redeliberations on the proposals in the Leases ED. Informal discussions with some IASB members have indicated a preference to first bring the issue back to the Interpretations Committee with the aim of determining the appropriate way forward for this project.

6. We have also updated our outreach on these issues, which is summarised as part of these papers. The objective of this paper, together with Agenda Papers 06A, 06B and 06C, is to provide the Interpretations Committee with the background on these issues together with a summary of previous discussions and tentative decisions and to obtain

its feedback on the appropriate way forward for this project. Agenda Paper 6C includes simplified illustrative examples.

Structure of the papers

7. Agenda Paper 06A discusses the issue on variable payments for asset purchases. In particular, it provides:
 - (a) a summary of previous discussions and tentative decisions of the Interpretations Committee;
 - (b) a summary of the outreach activities;
 - (c) a summary of tentative decisions reached in the Leases project and implications for variable payments in asset purchases;
 - (d) proposals in the *Conceptual Framework* Exposure Draft for liabilities; and
 - (e) update for potential implications of IFRS 9 *Financial Instruments*.
8. Agenda Paper 06B discusses the issue on payments made by an operator to a grantor on service concession arrangements. In particular, it provides:
 - (a) a summary of previous discussions and tentative decisions of the Interpretations Committee;
 - (b) update for potential implications of IFRS 15 *Revenue from Contracts with Customers*;
 - (c) a summary of the outreach activities; and
 - (d) proposed amendments to IFRIC 12 that had previously been discussed by the Interpretations Committee.
9. Agenda Paper 06C provides examples illustrating the impact of applying the principles of the Leases project to variable payments for asset purchases. It also illustrates the impact of applying the Interpretation Committee's previous tentative decisions on subsequent accounting for variable payments for asset purchases and payments made by an operator to a grantor in a service concession arrangement.

10. Because variable payments for asset purchases and payments made by an operator to a grantor are interlinked, and the decision on how to proceed on one of the issues could have an impact on the decision on the other, this paper outlines some possible alternatives available to the Interpretations Committee together with a staff recommendation on the appropriate way forward for this project.

Possible alternatives

11. Our outreach has confirmed that the types of arrangements being considered (ie variable payments in separate purchases of assets and payments by an operator to a grantor in a service concession arrangement) continue to be widespread. There continues to be significant diversity of practice in accounting for these types of transactions.

12. We think the IFRS Interpretations Committee has the following possible alternative approaches that it can adopt when deciding how to take the project forward:

- (a) *revisit the accounting for variable payments in asset purchases in the light of recent decisions made during the redeliberations of the Leases ED and confirm its previous tentative decisions on accounting for payments made by an operator to a grantor in a service concession arrangement.*

Previously, the Interpretations Committee could not reach a consensus on whether variable payments for asset purchases that are dependent on the purchaser's future activity should be excluded from the initial measurement of the liability until that activity is performed. The Interpretations Committee had reached a tentative decision on subsequent accounting for these variable payments.

Under this approach, we will revisit the accounting for variable payments for asset purchases. We will base the analysis on the principles developed in the Leases project for variable payments in lease arrangements.

As explained in more detail in Agenda Paper 06A, if the principles developed in the Leases project were to be applied to the *initial accounting* for variable payments for asset purchases, we think:

- (i) variable payments that are dependent on an index or a rate, or are in substance fixed payments (but structured as variable payments), will be included in the initial measurement of the liability on the date of purchase of the asset; and
- (ii) other variable payments (such as those dependent on a future activity of the purchaser) would not be included in the initial measurement of the liability on the date of purchase of the asset.

For variable payments that are dependent on an index or a rate, the Interpretations Committee will have to decide whether such liabilities should be measured at fair value or if they should be measured using the index or rate at the date of purchase of the asset. We think that, consistent with the principles in the Leases project, the index or rate at the date of purchase should be used to measure the liability.

If the principles developed in the Leases project were to be applied to the *subsequent accounting* for variable payments for asset purchases, we think:

- (i) for variable payments that are based on an index or a rate, the amount of the remeasurement of the lease liability resulting from a change in the index or rate should be recognised with a corresponding adjustment to the asset; and
- (ii) for variable payments that have not been included in the initial measurement of the liability, the amounts should be recognised in profit or loss in the period in which the obligation for those payments is incurred (unless the costs are included in the carrying amount of another asset in accordance with other applicable standards).

The Interpretations Committee will have to decide whether it should reconfirm its previous decisions on subsequent accounting for variable payments in an asset purchase or whether it should revisit its decisions based on the principles developed in the Leases project.

For subsequent accounting for variable payments based on an index or a rate, we think that the Interpretations Committee should recommend the application of the principles developed in the Leases project (ie adjustments should be recorded against the cost of the asset). For subsequent accounting for variable

payments that are not dependent on an index or a rate (such as purchaser's future activity), we think that the Interpretations Committee should retain its previous decision to recommend that those payments are recognised as corresponding adjustments to the cost of the asset to the extent that those payments are associated with future economic benefits to be derived from the asset.

Obligations under lease agreements are generally scoped out of IFRS 9 and are accounted for under the Standard applicable to lease contracts.

Consequently, if the principles developed in the Leases project are applied to variable payments for asset purchases, we think that the recognition and measurement for variable payments for asset purchases will have to be scoped out of IFRS 9 and additional guidance will need to be included in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

We think that the Interpretations Committee should confirm its previous tentative decisions on payments made by an operator to a grantor in a service concession arrangement. Some of the Interpretation Committee's previous tentative decisions were based on Standards such as IAS 18 *Revenue* and IAS 39 *Financial Instruments: Recognition and Measurement* for which new guidance has been issued, namely IFRS 15 and IFRS 9. We have examined potential implications of the revised guidance in Agenda Papers 06A and 06B and do not think that the new guidance has any implications on the tentative decisions previously reached by the Interpretations Committee.

- (b) *recommend that the IASB should consider a project on variable payments for asset purchases while the Interpretations Committee addresses separately the accounting for payments made by an operator to a grantor in a service concession arrangement.*

If the Interpretations Committee thinks that the issue on variable payments for asset purchases is not sufficiently narrow in scope in order for it to be able to address the issue in an efficient manner, it could consider recommending the project to the IASB. The IASB can then consider whether or not to add the project to its work plan based on the feedback

from the Interpretations Committee and the feedback it will receive from constituents as part of its Agenda Consultation.

The Interpretations Committee can continue its work on the related issue of payments made by an operator to a grantor under a service concession arrangement. Because IFRIC 12 is effectively a specific accounting regime similar to leases, we think that it may be possible to effectively develop a solution for this issue within the confines of IFRIC 12 without the need to address the broader issue of variable payments for asset purchases.

- (c) *defer the discussions on this project until the redeliberations of the Exposure Draft Conceptual Framework for Financial Reporting (the 'CF ED') have been finalised.*

As discussed in Agenda Paper 06A, the CF ED can provide the Interpretations Committee with a basis for determining whether or not a 'present obligation' exists for certain types of variable payments. Based on this, the Interpretations Committee may want to consider deferring the discussions on both these issues until the redeliberations on the CF ED have been completed.

Other considerations regarding scope of the project

13. Previously, the discussion on variable payments for asset purchases has focussed on the purchases of intangible assets and property, plant and equipment. Respondents to the outreach indicated that variable payment arrangements for inventory purchases were not as common as arrangements for the purchases of intangible assets and property, plant and equipment, but there have been some examples of such payment arrangements (see Agenda Paper 6A). We do not propose to explicitly address inventories as part of the project, however, we think that we should be mindful of the potential consequences that the decisions made in the project may have on the accounting for variable payments for inventories.
14. A respondent to the outreach noted that there is a risk of diversity in the presentation of payments to grantors in profit or loss, particularly with regards to whether amounts

paid should be treated as an expense or a deduction from revenue. We will consider related presentation issues as part of the project.

15. A couple of respondents to the outreach commented that the Interpretations Committee should consider the guidance in IFRS 15 when developing its proposals in this project. We will be mindful of potential implications of this guidance when relevant.
16. Two respondents noted that it may be worth considering the accounting for the acquisition of a subsidiary in a transaction that involves contingent consideration in the separate financial statements of the acquirer within the scope of this project. The respondents noted that there is specific guidance on subsequent changes to the carrying amount of contingent consideration in a business combination for consolidated financial statements. However, the respondent noted a diversity of views, with some applying the guidance for consolidated financial statements by analogy (ie recording subsequent changes through profit or loss) and others recording the subsequent changes as an adjustment to the cost of the investment. One respondent commented that any guidance developed by the Interpretations Committee on this project may be applied by analogy to this transaction. We do not think that this issue is related to the project and thus we do not recommend that the Interpretations Committee address the issue as part of this project.

Staff recommendation

17. We recommend the approach described in paragraph 12(a), which is that the Interpretations Committee should:
 - (a) analyse the accounting for variable payments in asset purchases based on the proposals for variable consideration in the Leases ED. This would mean that:
 - (i) variable payments that are dependent on an index or a rate, or are in substance fixed payments (but structured as variable payments), will be included in the initial measurement of the liability on the date of purchase of the asset; and

- (ii) other variable payments (such as those dependent on a future activity of the purchaser) would not be included in the initial measurement of the liability on the date of purchase of the asset.

We think that the liability related to variable payments that are dependent on an index or a rate should be measured using the index or rate at the date of purchase of the asset. This is consistent with the principles developed in the Leases project.

For subsequent accounting for variable payments based on an index or a rate, we think that the Interpretations Committee should recommend the application of the principles developed in the Leases project (ie adjustments should be recorded against the cost of the asset). For subsequent accounting for variable payments that are not dependent on an index or a rate (such as purchaser's future activity), we think that the Interpretations Committee should retain its previous decision to recommend recognition of those payments as corresponding adjustments to the cost of the asset to the extent that those payments are associated with future economic benefits to be derived from the asset.

- (b) confirm its previous tentative decisions on accounting for payments made by an operator to a grantor in a service concession arrangement.
18. We do not think that there are significant benefits in waiting for the redeliberations on the CF ED to be completed and accordingly do not recommend the approach noted in paragraph 12(c).
 19. Because the Interpretations Committee had previously been able to reach a conclusion on several aspects of the project, except for the initial accounting for certain types of variable payments, we do not think it should recommend referring the issue on variable payments for asset purchases to the IASB without first attempting to resolve the issue itself. Accordingly, we do not recommend the approach described in paragraph 12(b).

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree that the project should be revisited now that the redeliberations in the Leases project have been completed?
2. Does the Interpretations Committee agree with the staff recommendation and the proposed approach for the project? In particular, does the Interpretations Committee:
 - (a) agree that the analysis of the initial accounting for variable payments should be based on the principles developed in the Leases project?
 - (b) agree that the initial measurement of the liability for variable payments based on an index or a rate should be based on the index or rate at the date of purchase of the asset?
 - (c) agree that the subsequent accounting for variable payments based on an index or a rate should be based on the principles developed in the Leases project?
 - (d) agree that variable payments that are not based on an index or a rate should be recognised as corresponding adjustments to the cost of the asset to the extent that those payments are associated with future economic benefits to be derived from the asset when incurred?
 - (d) confirm its previous tentative decisions on accounting for payments made by an operator to a grantor and agree with the proposed amendments to IFRIC 12 as described in Agenda Paper 6B?
3. Does the Interpretations Committee agree that the accounting for the acquisition of a subsidiary in a transaction that involves contingent consideration in the separate financial statements of the acquirer should not be included within the scope of this project?