Exposure Draft

Guidance Note on Accounting for Service Concession Arrangements by Concessionaires

(Last date for Comments: August 29, 2014)

Issued by

Accounting Standards Board

The Institute of Chartered Accountants of India

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CONTENTS

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The following is the Exposure Draft of the Guidance Note on Accounting for Service Concession Arrangements by Concessionaire issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comments. The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than ***August 29, 2014****. Comments can also be sent by e-mail at commentsasb@icai.in.*

INTRODUCTION

1 Infrastructural facilities for public services such as roads, bridges, tunnels, prisons, hospitals, airports, railways, dams, water distribution facilities, energy supply and telecommunication networks have traditionally been owned, constructed, operated and maintained by the Government and Government Agencies and generally financed through budget appropriations.

2 Governments have introduced contractual service arrangements to attract private sector participation in the design, development, financing, operation and maintenance of such infrastructural facilities. The infrastructural facilities may already exist, or may be constructed / upgraded during the period of the service arrangement. An arrangement within the scope of this Guidance Note typically involves a private sector entity (a concessionaire) constructing the infrastructural facilities used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining[1] those infrastructural facilities for a specified period of time. The concessionaire is compensated for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards,

[1] Hereinafter the term ‘operate’, ‘ operation’ and ‘operating’ includes ‘maintenance’ unless the context requires otherwise

payments/compensation arrangements, mechanisms for adjusting prices, and arrangements for arbitrating disputes and, where it exists, the relevant law. The specific terms of the contract may vary in each situation, based on the nature of infrastructural facility covered (for e.g, roads, railways, hospitals, airports etc.). The guidance is intended to lay down the principles and has taken into consideration practices currently in vogue. However, in all such service concession arrangements, the principles set out in this Guidance Note are to be followed by applying them to the specific facts and circumstances and the terms of the contract between the parties. Such an arrangement is often described as a '*Build-Operate-Transfer'*, a '*Rehabilitate-Operate-Transfer'* etc.

3 A feature of these service arrangements is the public service nature of the obligation undertaken by the concessionaire. The `Government policy is for the services related to the infrastructural facilities to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the concessionaire to provide the services to the public on behalf of the Government/Government Agencies. Other common features usually are:

(a) the party that grants the service arrangement (the grantor) is a Government/Government Agency or a private sector entity to which the responsibility for the service has been devolved.

(b) the concessionaire is responsible for at least part of the management of the infrastructural facilities and related services and does not merely act as an agent on behalf of the grantor.

(c) the contract sets payment/compensation mechanisms if any,and/ or the initial prices to be levied by the concessionaire for utilisation of infrastructural facilities and regulates price revisions over the period of the service arrangement.

(d) the concessionaire is obliged to hand over the infrastructural facilities to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

4 In certain cases, the concessionaire exchanges its services for an intangible asset such as a toll collection right. This Guidance Note is based on the premise that when under a service concession arrangement, the grantor makes non-cash payment for the construction and/or other services, i.e., it gives the concessionaire an intangible asset (a right to charge users of the public service) in exchange for the concessionaire providing the services in a barter

transaction. The concessionaire uses the intangible asset to generate revenues in future from users of the public service.

SCOPE

5 This Guidance Note gives guidance on the accounting by concessionaires for service concession arrangements.

6 This Guidance Note applies to service concession arrangements if:

(a) the grantor controls or regulates what services the concessionaire must provide with the infrastructural facilities, to whom it must provide them, and at what price; and

(b) the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructural facilities if remaining at the end of the term of the arrangement.

7 Infrastructural facilities used in a service concession arrangement for its entire useful life (whole of life assets) are within the scope of this Guidance Note if the conditions in paragraph 6(a) are met. Paragraphs A1–A8 of Appendix I provide guidance on determining whether, and to what extent, service concession arrangements are also within the scope of this Guidance Note.

8 This Guidance Note applies to both:

(a) infrastructural facilities that the concessionaire constructs or acquires from a third party for the purpose of the service arrangement; and

(b) existing infrastructural facilities to which the grantor gives the concessionaire access for the purpose of the service arrangement.

9 Certain service concession arrangements may convey to the grantor a right to use the fixed assets recognised by the concessionaire in its financial statements before entering the service concession arrangement. Such assets when utilized in the service concession arrangements should be derecognized for the purpose of applying the relevant requirements of AS 10, "*Accounting for Fixed Assets".*

10 This Guidance Note does not specify the accounting by grantors.

ACCOUNTING

11 This Guidance Note sets out general principles for recognising and measuring the obligations and related rights in service concession arrangements. The issues addressed in this Guidance Note accordingly are:

(a) treatment of the concessionaire's rights over the infrastructural facilities;

(b) recognition and measurement of arrangement consideration;

(c) construction or upgrade services;

(d) operation services;

(e) borrowing costs;

(f) subsequent accounting treatment of a receivable and an intangible asset;

(g) cash support/equity support/viability gap funding receivable by the concessionaire from the grantor;

(h) concession fees and/or premium payable by the concessionaire to the grantor; and

(g) other items provided to the concessionaire by the grantor.

Treatment of the concessionaire's rights over the infrastructural facilities

12 Infrastructural facilities within the scope of this Guidance Note should not be recognised as fixed assets of the concessionaire because the contractual service arrangement does not convey the right to control the use of the public service infrastructural facilities to the concessionaire. The concessionaire has access to operate the infrastructural facilities to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

Recognition and measurement of arrangement consideration

13 Under the terms of contractual arrangements within the scope of this Guidance Note, the concessionaire acts as a service provider. The concessionaire constructs or upgrades infrastructural facilities (construction or upgrade

services) used to provide a public service and operates and maintains those infrastructural facilities (operation services) for a specified period of time.

14 The concessionaire should recognise and measure revenue in accordance with Accounting Standard (AS) 7, *Construction Contracts,* and Accounting Standard (AS) 9, *Revenue Recognition,* for the construction or upgrade and operating the services it performs, respectively. If the concessionaire performs more than one service under a single contract or arrangement, consideration received or receivable should be allocated by reference to the relative fair values of the services delivered. The nature of the consideration determines its subsequent accounting treatment. The subsequent accounting for consideration received as a receivable and as an intangible asset is detailed in paragraphs 25–29 below.

Construction or upgrade services

15 The concessionaire should account for revenue and costs relating to construction or upgrade services in accordance with AS 7.

Consideration given by the grantor to the concessionaire

16 If the concessionaire provides construction or upgrade services the consideration received or receivable by the concessionaire should be recognised at its fair value. The consideration may be rights to:

(a) a receivable , or

(b) an intangible asset.

17 The concessionaire should recognise a receivable to the extent that it has an unconditional contractual right to receive cash from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The concessionaire has an unconditional right to receive cash if the grantor contractually guarantees to pay the concessionaire (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the concessionaire to ensure that the infrastructural facilities meet specified quality or efficiency requirements.

18 AS 10, *Accounting for Fixed Assets,* requires that “when a fixed asset is acquired in exchange for another asset, its cost is usually determined by

reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident”. Thus, in accordance with AS 10, service concessions arrangement which is compensated by grant of a right to collect fees from users of the public service would require the acquired “intangible asset” to be recorded at a value which represents the fair value of the construction services rendered. The accounting treatment of considering the market value of the intangible asset acquired is not appropriate as the same may not be clearly evident.

19 The concessionaire should recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.`

20 If the concessionaire is paid for the construction services partly as a receivable and partly by an intangible asset it is necessary to account separately for each component of the concessionaire’s consideration. The consideration received or receivable for both components should be recognised initially at the fair value of the consideration received or receivable.

21 The nature of the consideration given by the grantor to the concessionaire should be determined by reference to the contract terms.

Operation services

22 The concessionaire should account for revenue and costs relating to operation services in accordance with AS 9.

Contractual obligations to restore the infrastructural facilities to a specified level of serviceability

23 The concessionaire may have contractual obligations it must fulfill as a condition of its licence such as, (a) to maintain the infrastructural facilities to a specified level of serviceability and/or (b) to restore the infrastructural facilities to a specified condition before these are handed over to the grantor at the end of the service arrangement. These contractual obligations to maintain or restore infrastructural facilities, except for any upgrade element (see paragraph 14), should be recognised and measured in accordance with Accounting Standard) (AS) 29, *Provisions, Contingent Liabilities and Contingent Assets* i.e.

at the best estimate of the expenditure that would be required to settle the present obligation at the balance sheet date.

Borrowing costs incurred by the concessionaire

24 In accordance with AS 16, *Borrowing Costs*, the borrowing costs attributable to the arrangement should be recognised as an expense in the period in which they are incurred unless the concessionaire has a contractual right to receive an intangible asset (a right to charge users of the public service). In this case borrowing costs attributable to the arrangement should be capitalised during the construction phase of the arrangement in accordance with AS 16. However, in case consideration is recognised as receivable, the borrowing costs should be added to the cost of constructing the infrastructure, if such infrastructure is a qualifying asset in accordance with AS 16.

Receivable

25 The amount due from or at the direction of the grantor is accounted for as a receivable

26 In case of an annuity, interest element should be segregated and should be recognised in the statement of profit and loss at the rate implicit in the annuity contract.

Intangible asset

27 Accounting Standard (AS) 26, *Intangible Assets,* applies to the intangible asset (s) recognised in accordance with paragraphs 19 and 20 of this Guidance Note.

28 The depreciable amount of the intangible asset recognised according to paragraph 27 should be allocated on a systematic basis over the best estimate of its useful life.

29 The amortisation method used should be in accordance with the principles laid down in AS 26.

Cash Support/Equity Support/Viability Gap Funding receivable by the concessionaire from the grantor

30 In many cases, the concession agreements allow cash support to the concessionaire in the form of grant (also referred to as ‘viability gap funding’ and ‘equity support’) by the grantor. These grants are payable as per the

agreements and are generally paid over a period of time in proportion to the amount incurred by the concessionaire on the project during construction. As per the agreement, these grants are given to help the concessionaire meet the cost of the project.

31 The cash support / equity support / viability gap funding as allowed to the concessionaire by the grantor, in substance, is a consideration under a service concession arrangement and, accordingly, it should be accounted for as a receivable as per the accounting principles prescribed in this regard in paragraph 17 of this Guidance Note. In case of contracts with cash support / equity support / viability gap funding, the initial measurement of intangible asset is arrived at after deducting the amount of cash support / equity support / viability gap funding, receivable unconditionally from the grantor, from the fair value of the consideration related to the construction services rendered.

Consideration paid to Grantor

32 Consideration paid to the grantor in return of the right to collect toll (sometimes termed as ' Negative Grants' in the service concession agreements) should be accounted for as a liability with the corresponding debit by way of increase in the cost of the intangible asset.

33 In those service concession arrangements, where the concession fees or periodic premium payable to the grantor is of the nature of revenue sharing arrangement, i.e., the concessionaire acts as the agent of the grantor as a collector of fees from the users of the public service, the amount of fees collected is adjusted for the concession fees or premium paid to the grantor.

Items provided to the concessionaire by the grantor

34 In accordance with paragraph 12, infrastructural facilities to which the concessionaire is given access by the grantor for the purposes of the service arrangement are not recognised as fixed assets of the concessionaire.

35 The grantor may also provide other items to the concessionaire that the concessionaire can keep or deal with as it wishes. If such assets form part of the consideration payable by the grantor for the services, they are not government grants as defined in AS 12. They are recognised as assets of the concessionaire, measured at fair value on initial recognition. The concessionaire should recognise a liability in respect of unfulfilled obligations it has assumed in exchange of the said assets.

EFFECTIVE DATE

36 An entity should apply this Guidance Note for annual periods beginning on or after----------. Earlier application is permitted. If an entity applies this Guidance Note for a period beginning before, it should disclose that fact.

TRANSITIONAL PROVISIONS

37 Subject to paragraph 38, changes in accounting policies on application of this Guidance Note should be accounted for retrospectively and the effect thereof should be adjusted in the opening balance of revenue reserves and/or the balance of the profit and loss.

38 If, for any particular service arrangement, it is impracticable for a concessionaire to apply this Guidance Note retrospectively, it should:

(a) recognise receivables and intangible assets that existed at the start of the accounting period in which this Guidance Note is applied;

(b) use the previous carrying amount of those receivables and intangible assets (however previously classified) as their carrying amounts as at that date; and

(c) test intangible assets recognised at that date for impairment, unless this is not practicable, in which case the amounts should be tested for impairment as at the start of the current period.

DISCLOSURE REQUIREMENTS

39 All aspects of a service concession arrangement should be considered in determining the appropriate disclosures in the notes to the financial statements. A concessionaire should disclose as a minimum the following in each reporting period:

(a) a description of the arrangement;

(b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);

(c) the nature and extent (eg quantity, time period or amount as appropriate) of:

(i) rights to use specified assets;

(ii) obligations to provide or rights to expect provision of services;

(iii) obligations to acquire or build items of fixed assets;

(iv) obligations to deliver or rights to receive specified assets at the end of the concession period;

(v) renewal and termination options; and

(vi) other rights and obligations (eg major overhauls); and

(d) changes in the arrangement occurring during the period; and

(e) how the service arrangement has been classified, either as receivable or intangible asset or both.

40 A concessionaire should disclose the amount of revenue recognised in the period on exchanging construction services for a receivable and/or an intangible asset.

41 The disclosures required in accordance with paragraph 39 of this Guidance Note should be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (eg road infrastructure, telecommunications and water treatment services).

42 The following disclosures should also be made:

(1) The carrying amounts of receivables, should be disclosed either on the face of the balance sheet or in the notes.

(2) An entity should disclose total interest income and total interest expense for receivable either on the face of the financial statements or in the notes.

(3) Amortisation method used explaining how it reflects the pattern in which the assets economic benefits are consumed by the enterprise.

(4) Accounting policy for negative grants and concession fees or premium paid to the grantor.

(5) Amount of negative grant and concession fees or premium paid to the grantor

Appendix I

APPLICATION GUIDANCE

This appendix forms an integral part of the Guidance Note.

Scope (paragraph 6)

A1 Paragraph 6 of this Guidance Note specifies that infrastructural facilities are within the scope of the Guidance Note when the following conditions apply:

(a) the grantor controls or regulates what services the concessionaire must provide with the infrastructural facilities, to whom it must provide them, and at what price; and

(b) the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructural facilities if remaining at the end of the term of the arrangement.

A2 The control or regulation referred to in condition (a) above, could be by contract or otherwise (such as through a regulator), and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. In applying this condition, the grantor and any related parties should be considered together. If the grantor is a Government/Government Agency, as a whole, together with any regulators acting in the public interest, should be regarded as related to the grantor for the purposes of this Guidance Note.

A3 For the purpose of condition (a), above, the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, or under a contract or by a regulator, for example by a capping mechanism. However, the condition should be applied to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, should be ignored. Conversely, if for example, a contract purports to give the concessionaire freedom to set prices, but any excess profit is returned to the grantor, the concessionaire's return is capped and the price element of the control test is met.

A4 For the purpose of condition (b), the grantor's control over any significant residual interest should both restrict the concessionaire's practical ability to sell or pledge the infrastructural facilities and give the grantor a continuing right of use throughout the period of the arrangement. The residual interest in the infrastructural facilities is the estimated current value of the infrastructural facilities as if these were already of the age and in the condition expected at the end of the period of the arrangement.

A5 Control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 6(a) and any significant residual interest in the infrastructural facilities, the concessionaire is only managing the infrastructural facilities on the grantor's behalf—even though, in many cases, it may have wide managerial discretion.

A6 Conditions (a) and (b) together identify when the infrastructural facilities, including any replacements required (see paragraph 23), are controlled by the grantor for the whole of its economic life. For example, if the concessionaire has to replace part of an item of infrastructural facility during the period of the arrangement (eg the top layer of a road or the roof of a building), the item of infrastructural facility should be considered as a whole. Thus condition (b) is met for the whole of the infrastructural facility, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part.

A7 Sometimes the use of infrastructural facilities is partly regulated in the manner described in paragraph 6(a) and partly unregulated. However, these arrangements take a variety of forms:

(a) any infrastructural facility that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in AS 28 should be analysed separately if it is used wholly for unregulated purposes. For example, this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients.

(b) when purely ancillary activities (such as a hospital shop) are unregulated, the control tests should be applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in paragraph 6, the existence of ancillary activities does not detract from the grantor's control of the infrastructural facilities.

A8 The concessionaire may have a right to use the separable infrastructural facilities described in paragraph A7(a), or the facilities used to provide ancillary unregulated services described in paragraph A7(b). In either case, there may in substance be a lease from the grantor to the concessionaire; if so, it should be accounted for in accordance with AS 19.

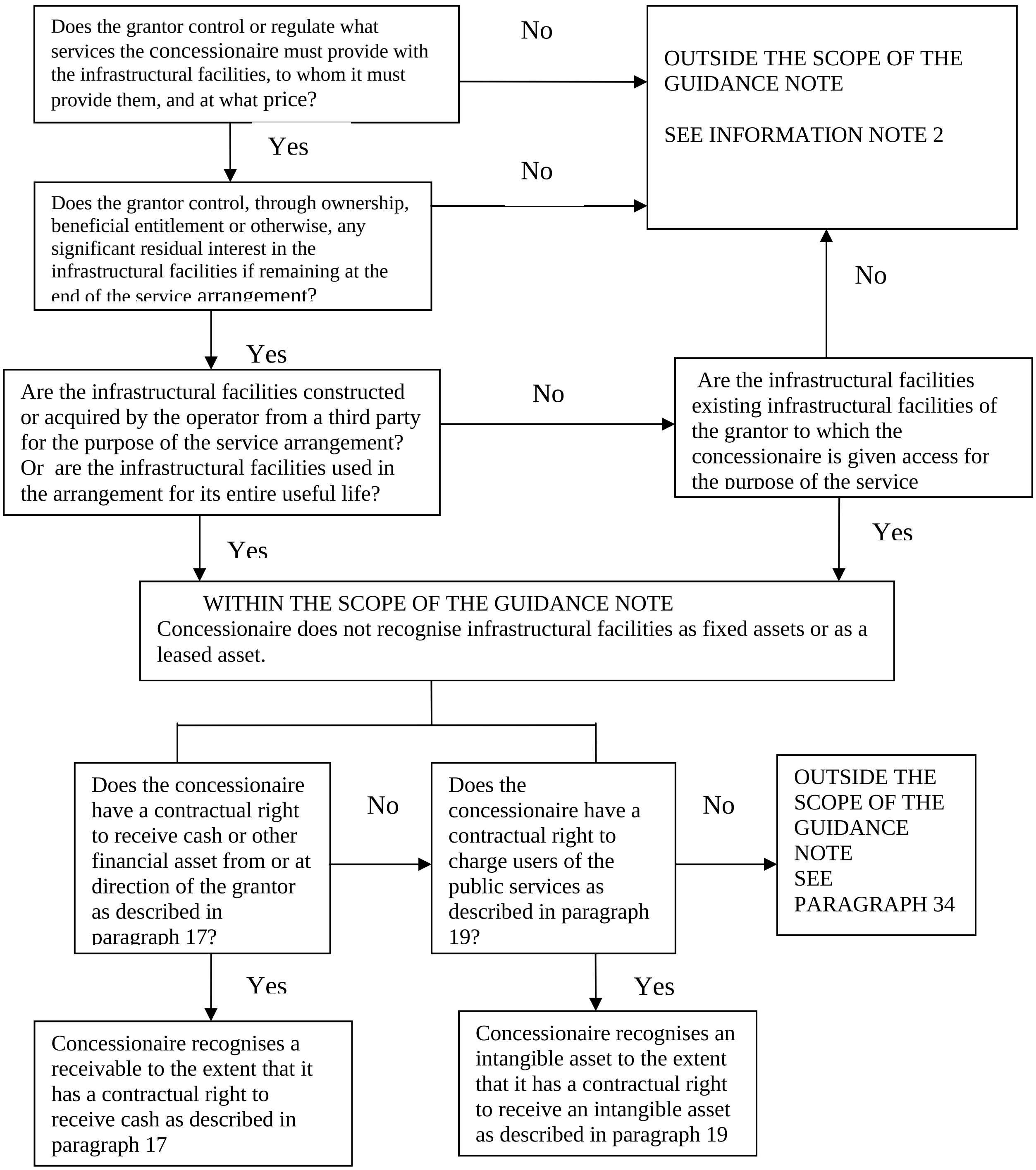
Appendix II

Information Notes

1. Accounting framework for service concession arrangements

This note accompanies, but is not part of, this Guidance Note.

The diagram below summarises the accounting for service arrangements established by this Guidance Note.



2. References to Accounting Standards that apply to typical types of service concession arrangements

This note accompanies, but is not part of this Guidance Note.

The table sets out the typical types of arrangements for private sector participation in the provision of public sector services and provides references to accounting standards that apply to those arrangements. The list of arrangements types is not exhaustive. The purpose of the table is to highlight the continuum of arrangements. It is not the Guidance Note's intention to convey the impression that rules have been prescribed between the accounting requirements for service concession arrangements.

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (eg Concessionaire leases asset from grantor)	Service and/or maintenance contract (specific tasks eg debt collection)	Rehabilitate – operate - transfer	Build - operate - transfer	Build - own - operate	100% Divestment/ Privatisation/ Corporation
Asset ownership	Grantor				Concessionaire	
Capital investment	Grantor		Concessionaire			
Demand risk	Shared	Grantor	Concessionaire and/or Grantor		Concessionaire	
Typical duration	8–20 years	1–5 years	25–30 years			Indefinite (or may be limited by licence)
Residual interest	Grantor				Concessionaire	
Relevant AS	AS 19	AS 9	This Guidance Note		AS 10	

Illustrative Examples

These examples accompany but are not part of this Guidance Note.

Example 1: The grantor gives the concessionaire a receivable

Arrangement terms

1 The terms of the arrangement require an concessionaire to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (ie years 3–10). The terms of the arrangement also require the concessionaire to resurface the road at the end of year 8—the resurfacing activity is revenue-generating. At the end of year 10, the arrangement will end. The concessionaire estimates that the costs it will incur to fulfill its obligations will be:

Table 1.1 Contract costs

	Year	Rs.*
Construction services	1	500
	2	500
Operation services (per year)	3–10	10
Road resurfacing	8	100

2 The terms of the arrangement require the grantor to pay the concessionaire Rs. 200 per year in years 3–10 for making the road available to the public.

3 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

Contract revenue

4 The concessionaire recognises contract revenue and costs in accordance with AS 7, *Construction Contracts* and AS 9, *Revenue Recognition*. The costs of each activity—construction, operation and resurfacing—are recognised as expenses by reference to the stage of completion of that activity. Contract revenue—the fair value of the amount due from the grantor for the activity undertaken—is recognised at the same time. Under the terms of the arrangement the concessionaire is obliged to resurface the road at the end of year 8. In year 8 the concessionaire will be reimbursed by the grantor for resurfacing the road. The obligation to resurface the road is measured at zero

in the balance sheet and the revenue and expense are not recognised in the statement of profit and loss until the resurfacing work is performed.

5 The total consideration (Rs. 200 in each of years 3–10) reflects the fair values for each of the services, which are:

Table 1.2 Fair values of the consideration received or receivable

	Fair value		
Construction services	Forecast cost	+	5%
Operation services	’’ ’’	+	20%
Road resurfacing	’’ ’’	+	10%
Effective interest rate	6.18% per year		

6 In year 1, for example, construction costs of Rs. 500, construction revenue of Rs. 525 (cost plus 5 per cent), and hence construction profit of Rs. 25 are recognised in the statement of profit and loss.

Receivable

7 The amounts due from the grantor is recognised as a receivable. The receivable is measured initially at fair value of service rendered. It is subsequently measured at amortised cost, i.e., the amount initially recognised plus the cumulative interest on that amount calculated using the effective interest method minus repayments.

8 If the cash flows and fair values remain the same as those forecast, the effective interest rate is 6.18 per cent per year and the receivable recognised at the end of years 1–3 will be:

Table 1.3 Measurement of receivable

	Rs.
Amount due for construction in year 1	525
Receivable at end of year 1*	525
Effective interest in year 2 on receivable at the end of year 1 (6.18% × Rs.525)	32
Amount due for construction in year 2	525
Receivable at end of year 2	1,082
Effective interest in year 3 on receivable at the end of year 2 (6.18% × Rs.1,082)	67
Amount due for operation in year 3 (Rs.10 x (1 + 20%))	12
Cash receipts in year 3	(200)
Receivable at end of year 3	961

* No effective interest arises in year 1 because the cash flows are assumed to take place at the end of the year.

Overview of cash flows, statement of profit and loss and balance sheet

9 For the purpose of this illustration, it is assumed that the concessionaire finances the arrangement wholly with debt and retained profits. It pays interest at 6.7 per cent per year on outstanding debt. If the cash flows and fair values remain the same as those forecast, the concessionaire's cash flows, statement of profit and loss and balance sheet over the duration of the arrangement will be:

Table 1.4 Calculation of periodic outstanding balances of debt

Year	1	2	3	4	5	6	7	8	9	10
Opening	0	500	1034	913	784	647	500	344	277	106
Interest @ 6.7%	0	34	69	61	53	43	34	23	19	7
Addition /reduction*	500	500	(190)	(190)	(190)	(190)	(190)	(90)	(190)	(113)
Closing	500	1034	913	784	647	500	344	277	106	0

*Table 1.5

Table 1.5 Cash flow Statement (Rupees)

Years	1	2	3	4	5	6	7	8	9	10	Total
Cash flows from operating activities											
Cash received from toll collected	0	0	200	200	200	200	200	200	200	200	1600
Cash paid for construction cost	(500)	(500)	0	0	0	0	0	0	0	0	0
Cash paid for operation & maintenance cost	0	0	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(180)
Net cash from operating activities	(500)	(500)	190	190	190	190	190	90	190	190	1,420
Cash flows from financing activities											
Loan amount received	500	500	0	0	0	0	0	0	0	0	1000
Payment of Interest	-	-	(103)	(61)	(53)	(43)	(34)	(23)	(19)	(7)	(343)
Payment of debt	-	-	(87)	(129)	137	(147)	(156)	(67)	(171)	(106)	(1000)
Net cash from financing activities	500	500	(190)	(190)	(190)	(190)	(190)	(90)	(190)	(113)	(343)
Net increase in cash & cash equivalents	-	-	-	-	-	-	-	-	-	77	77
Cash & cash equivalents at beginning of period	-	-	-	-	-	-	-	-	-	-	-
Cash & cash equivalents at end of period	-	-	-	-	-	-	-	-	-	77	77

* Table 1.4

Table 1.6 Calculation of Finance Income

Year	1	2	3	4	5	6	7	8	9	10
Amount due at the beg.	0	525	1082	961	832	695	550	396	343	177
Finance income@ 6.18%	0	32	67	59	51	43	34	25	22	11
Amount due during the year	525	525	12	12	12	12	12	122	12	12
Amount received	0	0	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)
Amortised cost of receivables	525	1082	961	832	695	550	396	343	177	0

Table 1.7 Statement of Profit and Loss (Rupees)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue											
Revenue from construction services	525	525									1050
Revenue from operation services			12	12	12	12	12	122	12	12	206
Other income*	0	32	67	59	51	43	34	25	22	11	344
Total Revenue(A)	525	557	79	71	63	55	46	147	34	23	1600
Expenses											
Contract Cost	500	534	0	0	0	0	0	0	0	0	1034
O&M Cost			10	10	10	10	10	110	10	10	180
Borrowing Cost#	0	0	69	61	53	43	34	23	19	7	309
Total Expenses(B)	500	534	79	71	63	53	44	133	29	17	1523
Net Profit (A-B)	25	23	0	0	0	2	2	14	5	6	77

* Table 1.6
\# Table 1.4

Table 1.8 Balance sheet (Rupees)

End of Year	1	2	3	4	5	6	7	8	9	10
Equity and Liabilities										
Shareholders' funds										
Reserve & Surplus	25	48	48	48	48	50	52	66	71	77
Non-current liabilities										
Long term borrowings	500	844	723	594	457	310	154	254	0	0
Current liabilities										
Current maturities of long term borrowings	0	190	190	190	190	190	190	90	106	0
Total	525	1082	961	832	695	550	396	410	177	77
Assets										
Non-current assets										
Receivables	525	965	844	715	578	433	279	226	0	0
Current assets										
Current maturities of Receivables	0	117	117	117	117	117	117	117	117	0
Cash and cash equivalents	0	0	0	0	0	0	0	0	0	77
Total	525	1082	961	832	695	550	396	343	117	77

10 This example deals with only one of many possible types of arrangements. Its purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustration as clear as possible, it has been assumed that the arrangement period is only ten years and that the concessionaire’s annual receipts are constant over that period. In practice, arrangement periods may be much longer and annual revenues may increase with time. In such circumstances, the changes in net profit from year to year could be greater.

Example 2: The grantor gives the concessionaire an intangible asset (a licence to charge users)

Arrangement terms

11 The terms of a service arrangement require a concessionaire to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (ie years 3–10). The terms of the arrangement also require the concessionaire to resurface the road when the original surface has deteriorated below a specified condition. The concessionaire estimates that it will have to undertake the resurfacing at the end of the year 8. At the end of year 10, the service arrangement will end. The concessionaire estimates that the costs it will incur to fulfil its obligations will be:

Table 2.1 Contract costs

	Year	Rs.*
Construction services	1	500
	2	500
Operation services (per year)	3–10	10
Road resurfacing	8	100

12 The terms of the arrangement allow the concessionaire to collect tolls from drivers using the road. The concessionaire forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of Rs. 200 in each of years 3–10.

13 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

Intangible asset

14 The concessionaire provides construction services to the grantor in exchange for an intangible asset, ie a right to collect tolls from road users in years 3–10. In accordance with AS 26, *Intangible Assets*, the concessionaire recognises the intangible asset at cost, ie the fair value of consideration transferred to acquire the asset, which is the fair value of the consideration received or receivable for the construction services delivered.

15 During the construction phase of the arrangement the concessionaire's asset (representing its accumulating right to be paid for providing construction services) is classified as an intangible asset (licence to charge users of the infrastructural facilities). The concessionaire estimates the fair value of its

consideration received to be equal to the forecast construction costs plus 5 per cent margin. It is also assumed that the concessionaire, as per AS 16, capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase of the arrangement:

Table 2.2 Initial measurement of intangible asset

	Rs.
Construction services in year 1 (Rs.500 × (1 + 5%))	525
Capitalisation of borrowing costs (table 2.4)	34
Construction services in year 2 (Rs.500 × (1 + 5%))	525
Intangible asset at end of year 2	1,084

16 In accordance with AS 26, the intangible asset is amortised over the period in which it is expected to be available for use by the concessionaire, ie years 3–10. For the purpose of this example, the depreciable amount of the intangible asset (Rs.1,084) is allocated using the straight-line method. The annual amortisation charge is therefore Rs.1,084 divided by 8 years, i.e. Rs.135 per year.

Construction costs and revenue

17 The concessionaire recognises the revenue and costs in accordance with AS 7, *Construction Contracts*, ie by reference to the stage of completion of the construction. It measures contract revenue at the fair value of the consideration received or receivable. Thus, in each of years 1 and 2 it recognises in its statement of profit and loss construction costs of Rs.500, construction revenue of Rs.525 (cost plus 5 per cent) and, hence, construction profit of Rs.25.

Toll revenue

18 The road users pay for the public services at the same time as they receive them, ie when they use the road. The concessionaire therefore recognises toll revenue when it collects the tolls.

Resurfacing obligations

19 The concessionaire's resurfacing obligation arises as a consequence of use of the road during the operating phase. It is recognised and measured in accordance with AS 29, *Provisions, Contingent Liabilities and Contingent Assets*, i.e. at the best estimate of the expenditure required to settle the present obligation at the end of each reporting period.

20 For the purpose of this illustration, it is assumed that the terms of the concessionaire's contractual obligation are such that the best estimate of the expenditure required to settle the obligation at any date is proportional to the number of vehicles that have used the road by that date and increases by Rs.17 each year. The expense recognised in the Statement of Profit and Loss is:

Table 2.3 Resurfacing obligation (Rupees)

Year	3	4	5	6	7	8	Total
Obligation arising in year (100/6)	17	17	17	17	17	15	100
Total expense arising in the profit and loss	17	17	17	17	17	15	100

Overview of cash flows, statement of profit and loss and balance sheet

21 For the purposes of this illustration, it is assumed that the concessionaire finances the arrangement wholly with debt and retained profits. It pays interest at 6.7 per cent per year on outstanding debt. If the cash flows and fair values remain the same as those forecast, the concessionaire's cash flows, statement of profit and loss and balance sheet over the duration of the arrangement will be:

Table 2.4 Calculation of periodic outstanding balances of debt

Year	1	2	3	4	5	6	7	8	9	10
Opening	0	500	1034	913	784	647	500	344	277	106
Interest @ 6.7%	0	34	69	61	53	43	34	23	19	7
Addition/reduction*	500	500	(190)	(190)	(190)	(190)	(190)	(90)	(190)	(113)
Closing	500	1034	913	784	647	500	344	277	106	0

* Table 2.5

Table 2.5 Cash flow Statement (Rupees)

Years	1	2	3	4	5	6	7	8	9	10	Total
Cash flows from operating activities											
Cash received from toll collected	0	0	200	200	200	200	200	200	200	200	1600
Cash paid for construction cost	(500)	(500)	0	0	0	0	0	0	0	0	0
Cash paid for operation & maintenance cost	0	0	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(180)
Net cash from operating activities	(500)	(500)	190	190	190	190	190	90	190	190	1,420
Cash flows from financing activities											
Loan amount received	500	500	0	0	0	0	0	0	0	0	1000
Payment of Interest	-	-	(103)	(61)	(53)	(43)	(34)	(23)	(19)	(7)	(343)
Payment of debt	-	-	(87)	(129)	137	(147)	(156)	(67)	(171)	(106)	(1000)
Net cash from financing activities	500	500	(190)	(190)	(190)	(190)	(190)	(90)	(190)	(113)	(343)
Net increase in cash & cash equivalents	-	-	-	-	-	-	-	-	-	77	77
Cash & cash equivalents at beginning of period	-	-	-	-	-	-	-	-	-	-	-
Cash & cash equivalents at end of period	-	-	-	-	-	-	-	-	-	77	77

* Table 2.4

Table 2.6 Statement of profit and loss (Rupees)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue											
Revenue from construction services	525	525									1050
Revenue from operation services			200	200	200	200	200	200	200	200	1600
Total Revenue(A)	525	525	200	200	200	200	200	200	200	200	2650
Expenses											
Contract Cost	500	500	0	0	0	0	0	0	0	0	1000
O&M Cost	0	0	10	10	10	10	10	10	10	10	80
Resurfacing cost*	0	0	17	17	17	17	17	15			
Borrowing Cost#	0	0	69	61	53	43	34	23	19	7	309
Amortisation expenses(1084/8)	0	0	136	136	136	136	136	136	136	132	1084
Total Expenses(B)	500	500	232	224	216	206	197	184	165	149	2573
Net Profit (A-B)	25	25	(32)	(24)	(16)	(6)	(3)	16	35	51	77

*Table 2.3

Table 2.4

Table 2.7 Balance sheet (Rupees)

End of Year	1	2	3	4	5	6	7	8	9	10
Equity and Liabilities										
Shareholders' funds										
Reserve & Surplus	25	50	18	(6)	(22)	(28)	(25)	(9)	26	77
Non-current liabilities										
Long term borrowings	500	844	723	594	457	310	154	187	0	0
Resurfacing Obligation			17	34	51	68	0	0	0	0
Current liabilities										
Current maturities of long term borrowings	0	190	190	190	190	190	190	90	106	0
Resurfacing Obligation	0	0	0	0	0	0	85	0	0	0
Total	525	1084	948	812	676	540	404	268	132	77
Assets										
Non-current assets										
Intangible Asset	525	1084	948	812	676	540	404	268	132	0
Current assets										
Cash and cash equivalents	0	0	0	0	0	0	0	0	0	77
Total	525	1084	948	812	676	540	404	268	132	77

22 This example deals with only one of many possible types of arrangements. Its purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustration as clear as possible, it has been assumed that the arrangement period is only ten years and that the concessionaire’s annual receipts are constant over that period. In practice, arrangement periods may be much longer and annual revenues may increase with time. In such circumstances, the changes in net profit from year to year could be greater.

Example 3: The grantor gives the concessionaire a receivable and an intangible asset

Arrangement terms

23 The terms of a service arrangement require a concessionaire to construct a road—completing construction within two years—and to operate the road and maintain it to a specified standard for eight years (ie years 3–10). The terms of the arrangement also require the concessionaire to resurface the road when the original surface has deteriorated below a specified condition. The concessionaire estimates that it will have to undertake the resurfacing at the end of year 8. At the end of year 10, the arrangement will end. The concessionaire estimates that the costs it will incur to fulfil its obligations will be:

Table 3.1 Contract costs

	Year	Rs.*
Construction services	1	500
	2	500
Operation services (per year)	3–10	10
Road resurfacing	8	100

* in this example, monetary amounts are denominated in 'Rupees' (Rs.).

24 The concessionaire estimates the consideration in respect of construction services to be cost plus 5 per cent.

25 The terms of the arrangement allow the concessionaire to collect tolls from drivers using the road. In addition, the grantor guarantees the concessionaire a minimum amount of Rs.700 and interest at a specified rate of 6.18 per cent to reflect the timing of cash receipts. The concessionaire forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of Rs.200 in each of years 3–10.

26 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

Dividing the arrangement

27 The contractual right to receive cash from the grantor for the services and the right to charge users for the public services should be regarded as two separate assets under Accounting Standards. Therefore in this arrangement it is necessary to divide the concessionaire's consideration into two

components—a receivable based on the guaranteed amount and an intangible asset for the remainder.

Table 3.2 Dividing the concessionaire's consideration

Year	Total	Receivable	Intangible asset
Construction services in year 1 (Rs.500 × (1 + 5%))	525	350	175
Construction services in year 2 (Rs.500 × (1 + 5%))	525	350	175
Total construction services	1,050	700	350
	100%	67%*	33%
Finance income, at specified rate of 6.18% on receivable (see table 3.3)	22	22	-
Borrowing costs capitalised (interest paid in year 1 and 2 × 33%) see table 3.7	11	-	11
Total fair value of the concessionaire's consideration	1,083	722	361

* Amount guaranteed by the grantor as a proportion of the construction services

Receivable

28 The amount due from or at the direction of the grantor in exchange for the construction services is recognized as a receivable. The receivable is measured initially at fair value. It is subsequently measured at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.

29 On this basis the receivable recognised at the end of years 2 and 3 will be:

Table 3.3 Measurement of receivable

	Rs.
Construction services in year 1 allocated to the receivable	350
Receivable at end of year 1	350
Construction services in year 2 allocated to the receivable	350
Interest in year 2 on receivable at end of year 1 (6.18% × Rs.350)	22
Receivable at end of year 2	722
Interest in year 3 on receivable at end of year 2 (6.18% × Rs.722)	45
Cash receipts in year 3 (see table 3.5)	(117)
Receivable at end of year 3	650

Intangible asset

30 In accordance with AS 26, *Intangible Assets*, the concessionaire recognises the intangible asset at cost, ie the fair value of the consideration received or receivable.

31 During the construction phase of the arrangement the concessionaire's asset (representing its accumulating right to be paid for providing construction services) is classified as a right to receive a licence to charge users of the infrastructural facilities. The concessionaire estimates the fair value of its consideration received or receivable as equal to the forecast construction costs plus 5 per cent. It is also assumed that the concessionaire capitalizes borrowing cost as per AS 16, estimated at 6.7 per cent, during the construction phase:

Table 3.4 Initial measurement of intangible asset

	Rs.
Construction services in year 1 (Rs.500 x (1 + 5%) × 33%)	175
Borrowing costs (interest paid in year 1 and 2 × 33%) see table 3.7	11
Construction services in year 2 (Rs.500 x (1 + 5%) × 33%)	175
Intangible asset at the end of year 2	361

32 In accordance with AS 26, the intangible asset is amortised over the period in which it is expected to be available for use by the concessionaire, ie years 3–10. For the purpose of this example, the depreciable amount of the intangible asset (Rs.361 including borrowing costs) is allocated using the straight-line

method. The annual amortisation charge is therefore Rs.361 divided by 8 years, ie Rs.45 per year.

Contract revenue and costs

33 The concessionaire provides construction services to the grantor in exchange for a financial asset and an intangible asset. Under both the receivable model and intangible asset model, the concessionaire recognises contract revenue and costs in accordance with AS 7, *Construction Contracts*, ie by reference to the stage of completion of the construction. It measures contract revenue at the fair value of the consideration receivable. Thus, in each of years 1 and 2 it recognises in its statement of profit and loss construction costs of Rs.500 and construction revenue of Rs.525 (cost plus 5 per cent).

Toll revenue

34 The road users pay for the public services at the same time as they receive them, ie when they use the road. Under the terms of this arrangement the cash flows are allocated to the receivable and intangible asset in proportion, so the concessionaire allocates the receipts from tolls between repayment of the receivable and revenue earned from the intangible asset:

Table 3.5 calculation of finance income

Year	1	2	3	4	5	6	7	8	9	10	Total
Amount due at the beg.	0	350	722	650	573	491	404	312	215	112	3829
Finance income@ 6.18%	0	22	45	40	35	30	25	20	14	5	236
Amount due during the year	350	350	0	0	0	0	0	0	0	0	700
Amount received(EMI)	0	0	(117)	(117)	(117)	(117)	(117)	(117)	(117)	(117)	(936)
Amortised cost of receivables	350	722	650	573	491	404	312	215	112	0	3829

Table 3.6 Allocation of toll receipts

Year	Rs.
Guaranteed receipt from grantor	700
Finance income (see table 3.5)	236
Total	936
Cash allocated to realisation of the receivable per year (Rs.936 / 8 years)	117
Receipts attributable to intangible asset (Rs.200 x 8 years – Rs.936)	664
Annual receipt from intangible asset (Rs.664 / 8 years)	83

Resurfacing obligations

35 The concessionaire's resurfacing obligation arises as a consequence of use of the road during the operation phase. It is recognised and measured in accordance with AS 29, *Provisions, Contingent Liabilities and Contingent Assets*, ie at the best estimate of the expenditure required to settle the present obligation at the end of each reporting period.

36 For the purpose of this illustration, it is assumed that the terms of the concessionaire's contractual obligation are such that the best estimate of the expenditure required to settle the obligation at any date is proportional to the number of vehicles that have used the road by that date and increases by Rs.17 each year. The expense recognised in the Statement of Profit and Loss is:

Table 3.7 Resurfacing obligation (Rupees)

Year	3	4	5	6	7	8	Total
Obligation arising in year (100/6)	17	17	17	17	17	15	100
Total expense arising in the profit and loss	17	17	17	17	17	15	100

Overview of cash flows, statement of profit and loss and balance sheet

37 For the purposes of this illustration, it is assumed that the concessionaire finances the arrangement wholly with debt and retained profits. It pays interest at 6.7 per cent per year on outstanding debt. If the cash flows and fair values remain the same as those forecast, the concessionaire's cash flows, income statement and balance sheet over the duration of the arrangement will be:

Table 3.8 Calculations of periodic outstanding balances of debt

Year	1	2	3	4	5	6	7	8	9	10
Opening	0	500	1034	913	784	647	500	344	277	106
Interest	0	34	69	61	53	43	34	23	19	7
Addition/reduction	500	500	(190)	(190)	(190)	(190)	(190)	(90)	(190)	(113)
Closing	500	1034	913	784	647	500	344	277	106	0

* Table 3.9

Table 3.7 Cash flow statement (Rupees)

Years	1	2	3	4	5	6	7	8	9	10	Total
Cash flows from operating activities											
Cash received from toll collected	0	0	200	200	200	200	200	200	200	200	1600
Cash paid for construction cost	(500)	(500)	0	0	0	0	0	0	0	0	0
Cash paid for operation & maintenance cost	0	0	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(180)
Net cash from operating activities	(500)	(500)	190	190	190	190	190	90	190	190	1,420
Cash flows from financing activities											

Loan amount received	500	500	0	0	0	0	0	0	0	0	1000
Payment of Interest*	-	-	(103)	(61)	(53)	(43)	(34)	(23)	(19)	(7)	(343)
Payment of debt	-	-	(87)	(129)	137	(147)	(156)	(67)	(171)	(106)	(1000)
Net cash from financing activities	500	500	(190)	(190)	(190)	(190)	(190)	(90)	(190)	(113)	(343)
Net increase in cash & cash equivalents	-	-	-	-	-	-	-	-	-	77	77
Cash & cash equivalents at beginning of period	-	-	-	-	-	-	-	-	-	-	-
Cash & cash equivalents at end of period	-	-	-	-	-	-	-	-	-	77	77

* Table 3.8

Table 3.10 Statement of profit and loss (Rupees)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue											
Revenue from construction services	525	525	0	0	0	0	0	0	0	0	1050
Revenue from* Intangible assets	0	0	83	83	83	83	83	83	83	83	664
Other income$	0	22	45	40	35	30	25	20	14	5	236
Total Revenue(A)	525	547	128	123	118	113	108	103	97	88	1950
Expenses											
Contract Cost	500	523	0	0	0	0	0	0	0	0	1023
O&M Cost	0	0	10	10	10	10	10	10	10	10	80
Resurfacing cost#	0	0	17	17	17	17	17	15	0	0	100
Borrowing Cost@	0	0	69	61	53	43	34	23	19	7	309
Amortisation expenses(361/8)	0	0	45	45	45	45	45	45	45	46	361
Total Expenses(B)	500	523	141	133	125	115	106	93	74	63	1873
Net Profit (A-B)	25	24	(13)	(10)	(7)	(2)	2	10	23	25	77

* Table 3.6
$ Table 3.5
# Table 3.7
@ Table 3.8

Table 3.11 Balance sheet (Rupees)

End of Year	1	2	3	4	5	6	7	8	9	10
Equity and Liabilities										
Shareholders' funds										
Reserve & Surplus	25	49	36	26	19	17	19	29	52	77
Non-current liabilities										
Long term borrowings	500	844	723	594	457	310	154	187	0	0
Resurfacing Obligation	0	0	17	34	51	68	0	0	0	0
Current liabilities										
Current maturities of long term borrowings	0	190	190	190	190	190	190	90	106	0
Resurfacing Obligation	0	0	0	0	0	0	85	0	0	0
Total	525	1083	966	844	717	585	448	306	158	77
Assets										
Non-current assets										
Intangible Asset	175	361	316	271	226	181	136	91	46	0
Current maturities of Receivables	350	605	533	456	374	287	195	98	0	0
Current assets										
Receivables	0	117	117	117	117	117	117	117	112	0
Cash and cash equivalents	0	0	0	0	0	0	0	0	0	77
Total	525	1083	966	844	717	585	448	306	158	77

38 This example deals with only one of many possible types of arrangements. Its purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustration as clear as possible, it has been assumed that the arrangement period is only ten years and that the

concessionaire's annual receipts are constant over that period. In practice, arrangement periods may be much longer and annual revenues may increase with time. In such circumstances, the changes in net profit from year to year could be greater.

Example 4: Arrangements involving consideration paid by the concessionaire for acquiring the intangible asset

A government authority is planning to give rights to build, operate and maintain a toll road passing through a central location in a city. It is willing to provide to the concessionaire, the right to charge the users utilising the facility. As per a government estimate, due to the development projects upcoming in the nearby city, a lot of employment opportunities would be generated and a lot of people would be shifting their base to this city. In the future years, it is estimated that this would generate high revenues.

The government plans to initiate a bidding process with a minimum bid price of Rs.100 Crore for grant of the service concession arrangement. In addition, the bidder would have to incur the cost of construction which would approximate to an amount of Rs.120 Crore.

What should be the treatment accorded to such construction paid for obtaining the right to build, operate, maintain and charge the users for the toll plaza?

In this case, apart from the fair value of the construction services rendered, the amount that would be paid for obtaining the service concession contract should also be considered for valuation of the intangible asset.