

## Illustrative examples

*These examples accompany, but are not part of, IFRIC 12.*

### Example 1: The grantor gives the operator a financial asset

#### Arrangement terms

IE1 The terms of the arrangement require an operator 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 operator to resurface the road at the end of year 8. At the end of year 10, the arrangement will end. Assume that the operator identifies three performance obligations for construction services, operation services and road resurfacing. The operator estimates that the costs it will incur to fulfil its obligations will be:

**Table 1.1 Contract costs**

	Year	CU <sup>(a)</sup>
Construction services	1	500
	2	500
Operation services (per year)	3–10	10
Road resurfacing	8	100

(a) in this example, monetary amounts are denominated in 'currency units (CU)'.

IE2 The terms of the arrangement require the grantor to pay the operator 200 currency units (CU200) per year in years 3–10 for making the road available to the public.

IE3 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

#### Revenue

IE4 The operator recognises revenue in accordance with IFRS 15 *Revenue from Contracts with Customers*. Revenue—the amount of consideration to which the operator expects to be entitled from the grantor for the services provided—is recognised when (or as) the performance obligations are satisfied. Under the terms of the arrangement the operator is obliged to resurface the road at the end of year 8. In year 8 the operator will be reimbursed by the grantor for resurfacing the road.

IE5 The total expected consideration (CU200 in each of years 3–10) is allocated to the performance obligations based on the relative stand-alone selling prices of the construction services, operation services and road resurfacing, taking into account the significant financing component, as follows:

**Table 1.2 Transaction price allocated to each performance obligation**

	Transaction price allocation (including effect of the significant financing component)
	<b>CU</b>
Construction services (over two years) <sup>(a)</sup>	1,050
Operation services (over 8 years) <sup>(b)</sup>	96
Road resurfacing services (in year 8) <sup>(c)</sup>	110
<b>Total</b>	<b>1,256</b>
Implied interest rate <sup>(d)</sup>	6.18% per year

(a) The operator estimates the relative stand-alone selling price by reference to the forecast cost plus 5 per cent.  
(b) The operator estimates the relative stand-alone selling price by reference to the forecast cost plus 20 per cent.  
(c) The operator estimates the relative stand-alone selling price by reference to the forecast cost plus 10 per cent.  
(d) The implied interest rate is assumed to be the rate that would be reflected in a financing transaction between the operator and the grantor.

IE6 In year 1, for example, construction costs of CU500, construction revenue of CU525, and hence construction profit of CU25 are recognised in profit or loss.

### Financial asset

IE7 During the first two years, the entity recognises a contract asset and accounts for the significant financing component in the arrangement in accordance with IFRS 15. Once the construction is complete, the amounts due from the grantor are accounted for in accordance with IFRS 9 *Financial Instruments* as receivables.

IE8 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 contract asset/receivable**

Amount due for construction in year 1	<b>CU</b> 525
<b>Contract asset at end of year 1<sup>(a)</sup></b>	<b>525</b>
Effective interest in year 2 on contract asset at the end of year 1 (6.18% × CU525)	32
Amount due for construction in year 2	525
<b>Receivable at end of year 2</b>	<b>1,082</b>
Effective interest in year 3 on receivable at the end of year 2 (6.18% × CU1,082)	67
Amount due for operation in year 3 (CU10 × (1 + 20%))	12
Cash receipts in year 3	(200)
<b>Receivable at end of year 3</b>	<b>961</b>
(a) 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 comprehensive income and statement of financial position

IE9

For the purpose of this illustration, it is assumed that the operator 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 operator's cash flows, statement of comprehensive income and statement of financial position over the duration of the arrangement will be:

**Table 1.4 Cash flows (currency units)**

Year	1	2	3	4	5	6	7	8	9	10	Total
Receipts	-	-	200	200	200	200	200	200	200	200	1,600
Contract costs <sup>(a)</sup>	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Borrowing costs <sup>(b)</sup>	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net inflow/(outflow)	(500)	(534)	121	129	137	147	157	67	171	183	78
(a) Table 1.1											
(b) Debt at start of year (table 1.6) × 6.7%											

**Table 1.5 Statement of comprehensive income (currency units)**

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue	525	525	12	12	12	12	12	122	12	12	1,256
Contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Finance income <sup>(a)</sup>	-	32	67	59	51	43	34	25	22	11	344
Borrowing costs <sup>(b)</sup>	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net profit	25	23	-	-	-	2	3	14	5	6	78
(a) Amount due from grantor at start of year (table 1.6) × 6.18%											
(b) Cash/(debt) (table 1.6) × 6.7%											

**Table 1.6 Statement of financial position (currency units)**

End of year	1	2	3	4	5	6	7	8	9	10
Amount due from grantor <sup>(a)</sup>	525	1,082	961	832	695	550	396	343	177	-
Cash/(debt) <sup>(b)</sup>	(500)	(1,034)	(913)	(784)	(647)	(500)	(343)	(276)	(105)	78
Net assets	25	48	48	48	48	50	53	67	72	78

(a) Amount due from grantor at start of year, plus revenue and finance income earned in year (table 1.5), less receipts in year (table 1.4).  
(b) Debt at start of year plus net cash flow in year (table 1.4).

IE10 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 operator'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 operator an intangible asset (a licence to charge users)**

#### **Arrangement terms**

IE11 The terms of a service arrangement require an operator 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 operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8. At the end of year 10, the service arrangement will end. Assume that the operator identifies a single performance obligation for construction services. The operator estimates that the costs it will incur to fulfil its obligations will be:

**Table 2.1 Contract costs**

	Year	CU <sup>(a)</sup>
Construction services	1	500
	2	500
Operating the road (per year)	3–10	10
Road resurfacing	8	100

(a) in this example, monetary amounts are denominated in 'currency units (CU)'.

IE12 The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of 200 currency units (CU200) in each of years 3–10.

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IE13 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

### Intangible asset

IE14 The operator 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 IFRS 15, the operator measures this non-cash consideration at fair value. In this case, the operator determines the fair value indirectly by reference to the stand-alone selling price of the construction services delivered.

IE15 During the construction phase of the arrangement the operator's contract asset (representing its accumulating right to be paid for providing construction services) is presented as an intangible asset (licence to charge users of the infrastructure). The operator estimates the stand-alone selling price of the construction services to be equal to the forecast construction costs plus 5 per cent margin, which the operator concludes is consistent with the rate that a market participant would require as compensation for providing the construction services and for assuming the risk associated with the construction costs. It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator 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**

	<b>CU</b>
Construction services in year 1	525
Capitalisation of borrowing costs (table 2.4)	34
Construction services in year 2	525
<b>Intangible asset at end of year 2</b>	<b>1,084</b>

IE16 In accordance with IAS 38, the intangible asset is amortised over the period in which it is expected to be available for use by the operator, ie years 3–10. The depreciable amount of the intangible asset (CU1,084) is allocated using a straight-line method. The annual amortisation charge is therefore CU1,084 divided by 8 years, ie CU135 per year.

### Construction costs and revenue

IE17 The operator accounts for the construction services in accordance with IFRS 15. It measures revenue at the fair value of the non-cash consideration received or receivable. Thus in each of years 1 and 2 it recognises in its profit or loss construction costs of CU500, construction revenue of CU525 and, hence, construction profit of CU25.

### Toll revenue

IE18 The road users pay for the public services at the same time as they receive them, ie when they use the road. The operator therefore recognises toll revenue when it collects the tolls.

### Resurfacing obligations

IE19 The operator's resurfacing obligation arises as a consequence of use of the road during the operating phase. It is recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, ie at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

IE20 For the purpose of this illustration, it is assumed that the terms of the operator'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 CU17 (discounted to a current value) each year. The operator discounts the provision to its present value in accordance with IAS 37. The charge recognised each period in profit or loss is:

**Table 2.3 Resurfacing obligation (currency units)**

Year	3	4	5	6	7	8	Total
Obligation arising in year (CU17 discounted at 6%)	12	13	14	15	16	17	87
Increase in earlier years' provision arising from passage of time	0	1	1	2	4	5	13
Total expense recognised in profit or loss	12	14	15	17	20	22	100

### Overview of cash flows, statement of comprehensive income and statement of financial position

IE21 For the purposes of this illustration, it is assumed that the operator 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 operator's cash flows, statement of comprehensive income and statement of financial position over the duration of the arrangement will be:

**Table 2.4 Cash flows (currency units)**

Year	1	2	3	4	5	6	7	8	9	10	Total
Receipts	-	-	200	200	200	200	200	200	200	200	1,600
Contract costs <sup>(a)</sup>	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Borrowing costs <sup>(b)</sup>	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net inflow/ (outflow)	(500)	(534)	121	129	137	147	157	67	171	183	78

(a) Table 2.1  
(b) Debt at start of year (table 2.6) × 6.7%

**Table 2.5 Statement of comprehensive income (currency units)**

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue	525	525	200	200	200	200	200	200	200	200	2,650
Amortisation	-	-	(135)	(135)	(136)	(136)	(136)	(136)	(135)	(135)	(1,084)
Resurfacing expense	-	-	(12)	(14)	(15)	(17)	(20)	(22)	-	-	(100)
Other contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(1,080)
Borrowing costs <sup>(a)(b)</sup>	-	-	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(308)
Net profit	25	25	(26)	(20)	(14)	(6)	1	9	36	48	78

(a) Borrowing costs are capitalised during the construction phase.  
(b) Table 2.4

**Table 2.6 Statement of financial position (currency units)**

End of year	1	2	3	4	5	6	7	8	9	10
Intangible asset	525	1,084	949	814	678	542	406	270	135	-
Cash/(debt) <sup>(a)</sup>	(500)	(1,034)	(913)	(784)	(647)	(500)	(343)	(276)	(105)	78
Resurfacing obligation	-	-	(12)	(26)	(41)	(58)	(78)	-	-	-
Net assets	25	50	24	4	(10)	(16)	(15)	(6)	30	78

(a) Debt at start of year plus net cash flow in year (table 2.4)

IE22 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 operator'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 operator a financial asset and an intangible asset

#### Arrangement terms

IE23 The terms of a service arrangement require an operator 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 operator to resurface the road when the original surface has deteriorated below a specified condition. The operator 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. Assume that the operator identifies a single performance obligation for construction services. The operator estimates that the costs it will incur to fulfil its obligations will be:

**Table 3.1 Contract costs**

	<b>Year</b>	<b>CU<sup>(a)</sup></b>
Construction services	1	500
	2	500
Operating the road (per year)	3–10	10
Road resurfacing	8	100

(a) in this example, monetary amounts are denominated in 'currency units (CU)'.

IE24 The operator estimates the consideration in respect of construction services to be CU1,050 by reference to the stand-alone selling price of those services (which it estimates at forecast cost plus 5 per cent.

IE25 The terms of the arrangement allow the operator to collect tolls from drivers using the road. In addition, the grantor guarantees the operator a minimum amount of CU700 and interest at a specified rate of 6.18 per cent to reflect the timing of cash receipts. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of CU200 in each of years 3–10.

IE26 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

### **Dividing the arrangement**

IE27 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 IFRSs. Therefore in this arrangement it is necessary to divide the operator's contract asset during the construction phase into two components—a financial asset component based on the guaranteed amount and an intangible asset for the remainder. When the construction services are completed, the two components of the contract asset would be classified and measured as a financial asset and an intangible asset accordingly.



**Table 3.2 Dividing the operator's consideration**

Year	Total	Financial asset	Intangible asset
Construction services in year 1	525	350	175
Construction services in year 2	525	350	175
Total construction services	1,050	700	350
	100%	67% <sup>(a)</sup>	33%
Finance income, at specified rate of 6.18% on receivable (see table 3.3)	22	22	-
Borrowing costs capitalised (interest paid in years 1 and 2 × 33%) (see table 3.7)	11	-	11
Total fair value of the operator's consideration	1,083	722	361

(a) Amount guaranteed by the grantor as a proportion of the construction services

**Financial asset**

IE28 During the first two years, the entity recognises a contract asset and accounts for the significant financing component in the arrangement in accordance with IFRS 15. Once the construction is complete, the amount due from, or at the direction of, the grantor in exchange for the construction services is accounted for in accordance with IFRS 9 as a receivable.

IE29 On this basis the receivable recognised at the end of years 2 and 3 will be:

**Table 3.3 Measurement of contract asset/receivable**

	CU
Construction services in year 1 allocated to the contract asset	350
<b>Contract asset at end of year 1</b>	350
Construction services in year 2 allocated to the contract asset	350
Interest in year 2 on contract asset at end of year 1 (6.18% × CU350)	22
<b>Receivable at end of year 2</b>	722
Interest in year 3 on receivable at end of year 2 (6.18% × CU722)	45
Cash receipts in year 3 (see table 3.5)	(117)
<b>Receivable at end of year 3</b>	650

**Intangible asset**

IE30 In accordance with IAS 38 *Intangible Assets*, the operator recognises the intangible asset at cost, ie the fair value of the consideration received or receivable.

IE31 During the construction phase of the arrangement the portion of the operator's contract asset that represents its accumulating right to be paid amounts in