Service Concession Arrangements: Paradigm Shift for PPP Infrastructure Entities

Service Concession Arrangements (SCAs) have substantially altered the way of accounting and reporting for entities working as private sector operators of public infrastructure. Such entities operate in the development, financing, operation and maintenance of the infrastructure for public services. Water projects, public airports, toll roads, schools and hospital sectors will have continued thrust of Public-Private Partnership (PPP) models and schemes in India in the coming years. This article deals with the concept of Service Concession Arrangements (SCAs) as enshrined under the IND ASs, as well as the accounting and disclosure norms to be followed by the Operators, and also outlines the transitory provisions for the first time adoption as set out in the Standard(s). Read on…

The Institute of Chartered Accountants of India (ICAI) has deferred the implementation of IFRIC-12 *'Service Concession Arrangements'* due to its significant impact envisaged earlier in the year 2011. Service concession agreement accounting is now a part of the Appendix C-IND AS 115 *'Revenue from Contract with Customers'*.

IND ASs (Indian Accounting Standards) have been made effective from 1st April 2015 when the Ministry of Corporate Affairs (MCA) recently notified The Companies (Indian Accounting Standards) Rules, 2015. With the notification of these Rules, a new era of accounting has begun for Indian companies. Appendix C of IND AS 115 is majorly a replica of IFRIC 12. This appendix deals with the accounting aspects by the Operators and not by the Grantors. IFRIC 12 implements a control based approach to assess arrangements as SCAs.

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What are Service Concession Arrangements (SCAs)?

Under the service concession arrangements (SCAs), the private Operator constructs the infrastructural asset/facility or may upgrade it and/or maintains and operates it for a specified term.

The salient features of SCAs are:

1. There is a performance contract between the Grantor and the Operator of service.
2. Grantor is a government body or public body or private sector body vesting responsibility of service.

3. Operator does the management of the infrastructure fully or partially.
4. The contract sets the initial prices to be charged by the Operator, and
5. The contract regulates the price revisions during the period of service arrangement.
6. The Operator will hand over the infrastructure to the Grantor at the end of the contract.
7. The consideration for transfer of infrastructure is either nil or immaterial.

For an arrangement to categorise as SCA under IND AS 115, below conditions have been laid out:

1. *Controls criteria:* The Grantor controls what services are to be provided, at what prices and to whom, and
2. *Significant Residual Interest criteria:* The Grantor has control in significant residual interest in the infrastructure at the end of the arrangement. It means the Operator hands over the infrastructure at the end of the arrangement in a specified condition.
   Or,
3. Public infrastructure has been used for its entire useful life by the Operator.

Comprehensive review of the terms and conditions, clauses in concession agreement and the contractual document is done to determine whether the agreement meets the conditions referred to for the SCAs. Contractual agreements contain performance standards, price adjusting mechanism and arbitration clause.

Grantors can use clauses of model concession agreement for finalising concession agreement. This step can create uniformity and lesser judgement disparity. However, the use of model concession agreement for awarding PPP projects in India is still new and evolving.

Review of clauses will enable to judge:

- If any substantive review or approval of prices is being done by the Grantor.
- If any substantial capping mechanism of prices (when prices are directly not regulated) is being done adopted by Grantor.
- If determination of prices through bidding process provided other SCAs requirements being met.
- If there is restriction on the Operator to sell or pledge the infrastructure, etc. by the Operator.

Further, significant residual interest vests with the Grantor if the Operator is liable to maintain service level at the end of agreement or in case of termination even if the SCA is for whole of the economic life. A clause indicating presence of significant residual interest could be mentioned as *"After the expiry of the agreement period referred to in clause xx, the project including its all assets and works shall be transferred to the Government free of cost and in good operating conditions."*

Private sector Operators under SCAs will record consideration receivable from the users/Grantors either as intangible asset or financial asset instead of property, plant and equipment.

Accounting Principles

(A)Recognition and Measurement of SCAs for Construction or Upgrade Services:

Earlier practice: Infrastructure companies had accounted for their project related expenses and incomes as a part of capital work-in-progress (fixed assets) during the construction period and recognised only non-project costs and non-project revenues in the profit and loss account during the construction period.

IND AS Norms: Revenue during construction phase will now be recognised and measured by the Operator as per IND AS 115. According to IND AS 115, revenue shall be recognised when (or as) the entity satisfies a performance obligation, over time or at a point in time, by transferring a promised good or service (i.e. an asset) to a customer. Construction work in SCAs would happen normally over a longer period of time, which means that the criterion of 'over time' has to be met.

To recognise revenue, the operator will have to review contracts/concession agreements and determine that when the control is transferred to the Grantor.

An Operator would transfer controls and satisfy performance obligations, if any one of the below three criteria is met:

Sl. No.	Criterion	Example
1.	Grantor (as consumer) simultaneously consumes and receives the benefits.	e.g., cleaning, transportation.

Sl. No.	Criterion	Example
2.	Grantor (as customer) controls the asset as it is created or enhanced.	e.g., work-in-progress/process when any work is owned by the Grantor/customer if the contract is terminated.
3.	Asset created has no alternative use by the seller *and* seller has enforceable payment rights for work completed till now. This right includes costs incurred plus a reasonable profit margin. Check at the inception of contract, whether there is contractually caveat or practical limitation or restriction for alternative use of asset.	

Contract progress is measured using Input and Output methods:

- Exclude from the measured value-any goods or services that are not involved in transferring the control to a customer.

Measurement Method	Example
Output method recognises revenue based on results achieved and value transferred to customer.	Survey or appraisals of work completed to date, milestones reached, time elapsed, units produced or units delivered.

Measurement Method	Example
Input method recognises revenue on the basis of the entity's efforts or inputs to satisfy the performance obligation. • Cost of wastages, uninstalled materials is excluded.	Contract cost incurred till date as a % of total forecast costs, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used.

Operators will classify their contractual rights either as Financial Asset or Intangible Assets:

- In case the Operator has unconditional contractual rights to receive cash or other financial asset as consideration, then it is a *financial asset*. For example, when the contract provides determinable amount or fixed amount or meeting shortfall between the usage and determinable amount. The contract may specify minimum amount for construction.
- If the Operator consideration is dependent upon usage of public service, then Operator has conditional rights since it bears demand risk. In that case, the Operator recognises such conditional rights as *intangible assets*.
- *Hybrid Model:* Consideration received is partly financial assets and partly intangible assets.

The Operator cannot recognise infrastructure as its own asset now, as the Operator does not control the public service infrastructure but is merely a service provider.

(B) Recognition and Measurement of SCAs for Operations Services:

The Operator shall account for operation services in accordance with IND AS 115.

FINANCIAL ASSET MODEL Recognise revenue as per IFRS 15 if performance obligation is met. **Borrowing costs:-** Expensed in Profit and Loss A/c **Initially measured at** • At Cost (Note1) **Subsequently measured at** • Amortised Cost • Fair Value through Other comprehensive Income (FVOCI)(1) , or • Fair Value through P/L **Accounting Entries** **CONSTRUCTION PHASE**	
Construction Expenses A/cs (Material/Labour/Consultancy/Services) To Cash/Bank/Vendor A/cs	Dr Cr
Being cost of construction incurred	

Bank A/c To Loan Payable A/c	Dr Cr
Being loan taken to meet project expenses	
Interest on Loan A/c To Bank A/c	Dr Cr
Being payment of interest on loan for project	
Financial Asset A/c To Revenue A/c	Dr Cr
Being revenue recognised (if IND AS 115 criteria of performance obligation is met; Revenue measurement is done with Input /Output Method)	
OPERATION PHASE Financial Asset A/c To Financial Revenue A/c	 Dr Cr
Being interest revenue recognised over arrangement life; Calculation based on EIR method as per IND AS 109	
Interest on Loan A/c To Bank A/c	Dr Cr
Being payment of interest on loan for project	
Financial Asset A/c To Revenue A/c	Dr Cr
Being revenue recognised (if IND AS 115 criteria of performance obligation is met; Revenue measurement is done with Input /Output Method)	
Cash/Bank A/c To Financial Asset A/c	Dr Cr
Being amount received from Grantor for construction services Note 1. Assuming amount due from Grantor can be classified as trade receivable initial recognition will be at transaction price as per IND AS 115. If financial asset cannot be treated as trade receivable, even in that case, consideration receivable (cost) will be initially representative of fair value in most of cases.	

INTANGIBLE ASSET MODEL

In case of intangible asset (IA) model, non-cash consideration is given by the Grantor to the Operator during construction phase and the Operator generates revenue in operation phase from users.

- **Initial measurement** at cost.
- **Subsequently measured** using either cost model or revaluation model.
- Amortisation of intangible asset over the period of concession during operation phase.
  - o using straight line method, or
  - o using economic usage of asset, if SCA life is dependent on its usage.
- **Borrowing costs:** If operator has contractual right to charge from users then borrowing cost can be capitalised.

Accounting Entries

CONSTRUCTION PHASE

Construction Expenses A/cs (Material/Labour/Consultancy/Services) To Cash/Bank/Vendor A/cs	Dr Cr

Being cost of construction incurred	
Bank A/c	Dr
To Loan Payable A/c	Cr
Being loan taken to meet project expenses	
Intangible Asset A/c	Dr
To Bank A/c	Cr
Being payment of interest on loan for project capitalised to intangible asset if interest is recoverable from public usage of infrastructure	
Intangible Asset A/c	Dr
To Revenue A/c	Cr
Being revenue recognised (if IND AS 115 criteria of performance obligation is met; Revenue measurement is done with Input /Output Method).	
OPERATION PHASE	
Interest on Loan A/c	Dr
To Bank A/c	Cr
Being payment of interest on loan for project	
Cash/Bank A/c	Dr
To Revenue A/c	Cr
Being amount received from user of public service infrastructure services. Revenue is recognised based on usage fee like user –fee, toll collected.	
Amortisation of Intangible Asset Exp A/c	Dr
To Intangible Asset A/c	Cr
Being amortisation of IA over arrangement life	

Contractual obligations to restore the infrastructure or to maintain it to a specified level of serviceability shall be recognised and measured by calculating present value of obligation based on the best estimate at the end of reporting period and shall be recognised as provision in accordance with IND AS 37.

Carrying amount of provision is increased in each reporting period by increasing interest expenses every year.

If the government pays or guarantees payments, partially or fully, for restoration or serviceability then it will be accounted for as revenue to the extent recoverable when the service is rendered.

Borrowing Costs

Borrowing costs during construction phase will be capitalised under intangible asset model if the Operator has the right to charge to the users contractually. For financial assets, it is expensed as incurred.

Items provided to the Operator by the Grantor

The Grantor often shares land or other infrastructure assets so that the Operator can start construction or operating activities. These assets are not the part of property, plant and equipment of the Operator. When the items are provided by the Grantor to the Operator to keep or deal with as it wishes, then these transfers, if part of consideration payable, will be accounted for as part of the transaction price as defined in the IND AS 115.

Lease

Concession agreement has to be examined to see whether an arrangement contains a lease.

If leasing is not present as per IND AS 17 and conditions referred to in Appendix C are satisfied, then it is a case of SCAs.

Further in case, both the lease and SCAs conditions overlap, then IFRIC 12 will prevail.

Transition Provision for First Time Adoption

A carve out to IFRS has been provided in IND AS 101 for the first time adoption for entities covered by Appendix C of IND AS 115. Amortisation policy for toll roads under IGAAP

can be continued for intangible assets recognised in respect of toll roads. Transitional requirements, as provided in IND AS 101, for first time adoption of SCAs are as follows:

1. Changes in accounting policies are accounted retrospectively in accordance with IND AS 8, except for amortisation policy of toll assets recognised as intangible assets.
2. Classification and measurement are, retrospectively, done. If it is not possible then fact should be disclosed.
3. If it is impractical to apply Appendix C retrospectively, then entity shall:
   a. Recognise financial assets and intangible assets that existed at the date of transition to IND ASs,
   b. Use the previous carrying amount,
   c. Test financial asset (FA) and intangible asset (IA) for impairment.

Disclosure Requirements

Disclosure for each SCA or in aggregate for each class of SCAs is required. Major disclosures are:

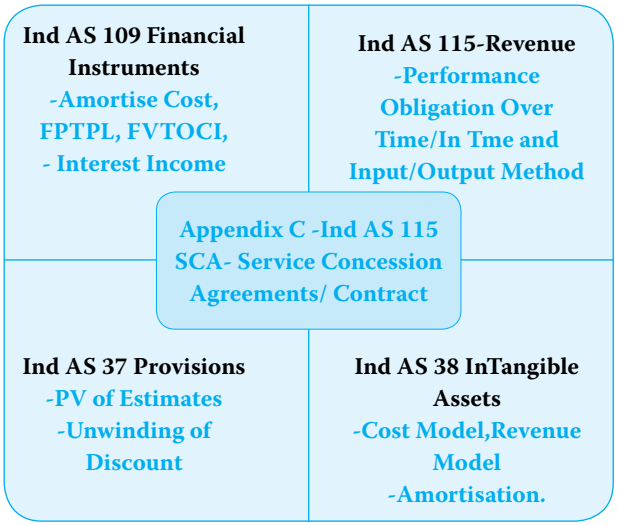
1. Description of the arrangement and significant terms of the arrangement.
2. Description of rights and obligations involved in SCAs.
3. Any changes in the arrangements during the year.
4. Classification of arrangement.
5. Disclose amount of revenue and profit or loss recognised in the period on exchanging construction services for a financial or intangible asset.

Conclusion

Applying service concession agreements (SCAs) to operators will involve exhaustive study, interpretation challenges and analysis of concession agreement and other relevant contracts and agreements between the Grantor and the Operator.

- Evaluate whether below conditions are present:
  - The Grantor controls about services, pricing, users contained in concession agreement, and
  - Significant residual interest of the Grantor Or,
  - Entire useful life usage by the Operator.
- Evaluate whether the arrangement contains a lease or not. If not, then SCAs' provisions of Appendix C of IND AS 115 will apply.
- Expenses in construction phase will not be treated as property, plant and equipment (PPE) further.
- Depreciation on PPE, hence, cannot be claimed as expenses in profit and loss account.
- Consideration received will be recognised as either financial asset or intangible asset. In case of hybrid model it will be recognised as financial asset and intangible asset.
- Apply interest income for financial asset during operation phase. Apply amortisation of intangible asset during operation phase.
- Apply provisions of present value of estimates and unwinding of discount in subsequent year.
- Revenue recognition during construction phase can be done if conditions of performance obligations 'over time' are met. Otherwise, revenue recognition would happen when construction is completed fully and control is transferred.

Hence, accounting standards for financial instruments, intangible assets, provisions and revenue recognition will apply during construction and operation phase for service concession agreements.



Major Requirements –SCAs Summary

Service concession agreements are quite complex. It requires extensive professional judgment for practical application. This will significantly impact the way an Operator does accounting and present its results. ■