

IFRIC



International Financial Reporting Interpretations Committee

IFRIC DRAFT INTERPRETATION D12

Service Concession Arrangements— Determining the Accounting Model

Comments to be received by 3 May 2005

IFRIC Draft Interpretation D12 *Service Concession Arrangements—Determining the Accounting Model* is published by the International Accounting Standards Board (IASB) for comment only. Comments on the draft Interpretation should be submitted in writing so as to be received by **3 May 2005**.

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INVITATION TO COMMENT

The International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC) invites comments on any aspect of this draft Interpretation *Service Concession Arrangements—Determining the Accounting Model*. It would particularly welcome answers to the questions below. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **3 May 2005**.

Questions

- 1 The proposal in paragraph 5 of the draft Interpretation reflects the IFRIC's decision that whether an operator recognises service concession infrastructure as its property, plant and equipment should depend on whether it controls the use of that infrastructure. The IFRIC selected this approach instead of one based on the extent to which the risks and rewards of ownership lie with the operator. The rationale for selecting this approach is explained in paragraphs BC9-BC11 of the Basis for Conclusions. Do you support the approach selected?
- 2 Paragraph 11 of the draft Interpretation proposes that the operator should apply the financial asset model only if the grantor has primary responsibility to pay for the concession services. The rationale is explained in paragraphs BC24-BC43 of the Basis for Conclusions. Do you agree with this proposal? If not, what criteria would you use to determine whether the financial asset model should apply? How would you reconcile those criteria to the definition of a financial asset set out in IAS 32 *Financial Instruments: Disclosure and Presentation*.
- 3 As explained in paragraph BC44 of the Basis for Conclusions, paragraph 13 of the draft Interpretation proposes that the identity of the party or parties with primary responsibility to pay for the concession services should be determined by reference to the substance of the contractual arrangements (which would not be affected by, for example, changing the parties through whom payment is routed). Do you agree with this proposal?

- 4 The IFRIC aims to issue this and the two other proposed Interpretations on service concessions (D13 and D14) in final form before the end of 2005. It proposes that, subject to it achieving this aim, the three Interpretations should be applied for annual periods beginning on or after 1 January 2006. Do you agree with this proposal?



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IFRIC DRAFT INTERPRETATION D12

Service Concession Arrangements— Determining the Accounting Model

IFRIC [draft] Interpretation X *Service Concession Arrangements—Determining the Accounting Model* ([draft] IFRIC X) is set out in paragraphs 1-16 and Appendices A-C. [Draft] IFRIC X is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 1 and 8-10 of the IFRIC *Preface*.

References

- *Framework for the Preparation and Presentation of Financial Statements*
- *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors*
- *IAS 11 Construction Contracts*
- *IAS 16 Property, Plant and Equipment*
- *IAS 17 Leases*
- *IAS 18 Revenue*
- *IAS 32 Financial Instruments: Disclosure and Presentation*
- *IAS 38 Intangible Assets*
- *IFRIC 4 Determining whether an Arrangement contains a Lease*
- *SIC-29 Disclosure—Service Concession Arrangements*
- [Draft] Interpretation [D13] *Service Concession Arrangements—The Financial Asset Model*
- [Draft] Interpretation [D14] *Service Concession Arrangements—The Intangible Asset Model*

Background

- 1 In many countries, infrastructure used to provide public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed and maintained by the public sector and financed through public budget appropriation.
- 2 In some countries, governments have introduced contractual arrangements (service concession arrangements) to attract private participation in the development, financing and operation of such infrastructure. The infrastructure may already exist, or may be constructed during the concession period. An important feature of these service concession arrangements is that public policy is for the services related to the infrastructure to be kept available to the public, irrespective of the identity of the party that operates the services (the operator). The service

concession arrangement contractually obliges the operator to provide these services to the public (the public service obligation). Other common features are:

- (a) the party that grants the concession (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
 - (b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.
 - (c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the concession period.
 - (d) the operator is obliged to return the infrastructure to the grantor in a specified condition at the end of the concession period, irrespective of which party initially financed it.
- 3 This [draft] Interpretation is one of a series dealing with accounting for service concession arrangements. Appendix B summarises the accounting framework for service concession arrangements established by this [draft] Interpretation, and shows how it relates to other relevant [draft] Interpretations.

Scope

- 4 The primary purpose of this [draft] Interpretation is to give guidance on the accounting by operators for public-to-private infrastructure service concessions. However, the [draft] Interpretation also applies to other arrangements that meet the conditions set out in paragraph 5. Conversely, it does not apply to public-to-private concessions that do not meet these conditions.
- 5 This [draft] Interpretation applies to service concession arrangements involving public service obligations, as described in paragraph 2. It applies to infrastructure used in such arrangements if:
- (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
 - (b) the grantor controls—through ownership, beneficial entitlement or otherwise—the residual interest in the infrastructure at the end of the concession, and the residual interest is significant.

Paragraphs C1-C6 of Appendix C provide guidance on determining whether, and to what extent, service concession arrangements are within the scope of this [draft] Interpretation.

- 6 This [draft] Interpretation applies to both:
- (a) infrastructure that the operator constructs or acquires from a third party for the purpose of the concession; and
 - (b) existing infrastructure to which the grantor gives the operator access for the purpose of the concession.

It does not specify the accounting for infrastructure that the operator held and recognised as its property, plant and equipment before entering the concession arrangement. The derecognition requirements of IAS 18 apply to such infrastructure.

- 7 This [draft] Interpretation does not specify the accounting by grantors.

Issues

- 8 For service concession infrastructure within its scope, this [draft] Interpretation specifies:
- (a) whether the infrastructure is to be recognised as property, plant and equipment of the operator; and
 - (b) the accounting model that applies to the rights received by the operator in different circumstances.

Consensus

Recognition of infrastructure as property, plant and equipment

- 9 To the extent that service concession infrastructure is within the scope of this [draft] Interpretation, it shall not be recognised as property, plant and equipment of the operator.

Determining the accounting model

- 10 If the operator provides infrastructure or other consideration in exchange for the right to the service concession, one of two accounting models applies to the rights received by the operator:
- (a) the financial asset model—the operator recognises a financial asset; or
 - (b) the intangible asset model—the operator recognises an intangible asset.
- 11 The financial asset model, which is described in [draft] Interpretation [D13], applies if the grantor (rather than users) has the primary responsibility to pay the operator for the concession services.
- 12 The intangible asset model, which is described in [draft] Interpretation [D14], applies in all other cases.
- 13 Whether the grantor (rather than users) has the primary responsibility to pay the operator for the concession services shall be determined by reference to the substance of the contractual arrangements.
- 14 Paragraphs C7 and C8 of Appendix C give further guidance on when to apply the financial asset model.

Effective date

- 15 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [1 January 2006]. Earlier application is encouraged. If an entity applies this [draft] Interpretation for a period beginning before [1 January 2006], it shall disclose that fact.

Transition

- 16 Changes in accounting policies shall be accounted for in accordance with IAS 8.

Appendix A

Amendments to SIC-29 *Disclosure—Service Concession Arrangements*

The amendments in this appendix shall be applied for annual periods beginning on or after [1 January 2006]. If an entity applies this [draft] Interpretation for an earlier period, these amendments shall be applied for that earlier period.

A1 SIC-29 *Disclosure—Service Concession Arrangements* is amended as described below.

Its title is amended to *Service Concession Arrangements—Disclosure*.

All references to ‘Concession Operator’ are changed to ‘operator’, and all references to ‘Concession Provider’ are changed to ‘grantor’.

In paragraph 6, subparagraph (d) is amended, and subparagraph (e) is inserted, to read as follows:

- (d) changes in the arrangement occurring during the period; and
- (e) how the arrangement has been accounted for.

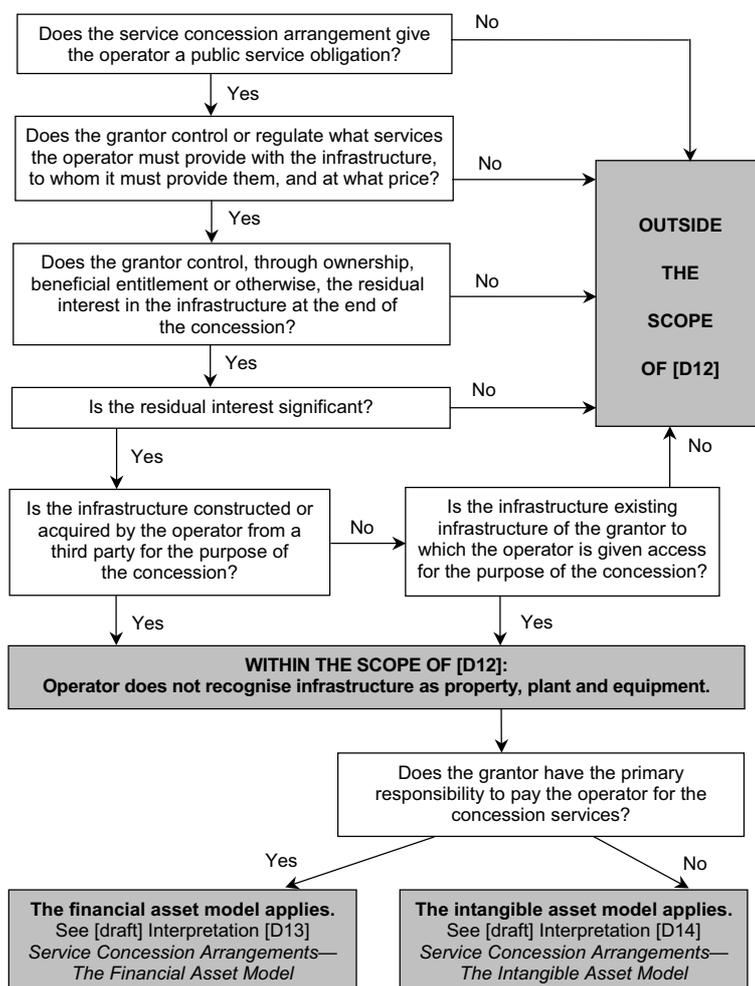
A new paragraph 6A is inserted, as follows:

6A An operator shall disclose the amount of revenue and profits or losses recognised in the period on exchanging construction or other services for an intangible asset.

Appendix B

Accounting framework for service concession arrangements

The diagram below summarises the accounting framework for service concession arrangements established by this [draft] Interpretation, and shows how it relates to other relevant [draft] Interpretations.



Appendix C

Application Guidance

This Application Guidance is an integral part of the [draft] Interpretation.

Scope

- C1 Paragraph 5 of the Consensus specifies that service concession infrastructure is within the scope of the [draft] Interpretation when:
- (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
 - (b) the grantor controls—through ownership, beneficial entitlement or otherwise—the residual interest in the infrastructure at the end of the concession, and the residual interest is significant.
- C2 The control or regulation referred to in condition (a) 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 it is bought by other users. When this test is applied, the grantor and any related parties shall be considered together. If the grantor is a public sector entity, the public sector as a whole, together with any independent regulators acting in the public interest, shall be regarded as related to the grantor.
- C3 For the purpose of condition (a), the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, for example by a capping mechanism. However, the condition shall be applied to the substance of the agreements. Non-substantive features, such as a cap that will apply only in remote circumstances, shall be ignored. Conversely, for example, if a contract purports to give the operator freedom to set its prices, but any excess is clawed back by the grantor, the operator's return is capped and the price element of the control test is substantively met.
- C4 Conditions (a) and (b) together identify when the infrastructure is controlled by the grantor for the whole of its economic life. If the operator has to replace part of an item of infrastructure during the life of the concession (for example, the top layer of a road or the roof of a building), the item of infrastructure shall be considered as a whole, so that condition (b) will be met for the whole of the infrastructure, including the part that is replaced, if the grantor has the residual interest in the final replacement of that part.

- C5 Sometimes, the use of infrastructure is partly regulated in the manner described in condition (a) of paragraph 5 and partly unregulated. There are too many variables to give guidance on all possible situations. However:
- (a) any infrastructure that is physically separable and capable of being operated independently shall 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) where purely ancillary activities (such as a hospital shop) are unregulated, the control tests shall be applied as if those services did not exist, because their existence does not detract from the grantor's control of the relevant infrastructure (in cases in which it has such control).
- C6 The operator may have a right to use the separable infrastructure in (a), or the facilities used to provide ancillary unregulated services in (b). In either case, there may be a lease from the grantor to the operator; if so, it shall be accounted for in accordance with IAS 17.

Determining the accounting model

- C7 The financial asset model applies when the grantor has the primary responsibility to pay the operator for the concession services.
- C8 The grantor has the primary responsibility to pay the operator for the concession services if the operator looks first to the grantor for payment. The grantor does not have the primary responsibility to pay the operator if users pay for the services, even if the grantor guarantees the payments, making up any shortfall below a specified amount itself. However, guarantees from the grantor may constitute financial assets in their own right. The treatment of such assets is discussed in [draft] Interpretation [D14].

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the draft Interpretation.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

Background

BC2 SIC-29 *Disclosure—Service Concession Arrangements* contains disclosure requirements in respect of service concession arrangements, but does not otherwise specify how they should be accounted for.

BC3 There was widespread concern about the lack of such guidance. In particular, operators wished to know how to account for infrastructure that they either constructed or acquired for the purpose of a service concession, or were given access to for the purpose of the concession. They also wanted to know how to account for other rights and obligations arising.

BC4 In response to this concern, the International Accounting Standards Board asked a working group comprising representatives of the standard-setters of Australia, France, Spain and the United Kingdom (four of the countries that had expressed such concern) to carry out some initial research on the subject. The working group recommended that the IFRIC should seek to clarify how certain aspects of existing accounting standards were to be applied. Because of the range of issues to be covered, the IFRIC decided to do this in a series of related Interpretations, rather than in a single document.

Terminology

BC5 SIC-29 uses the terms 'Concession Provider' and 'Concession Operator' to describe, respectively, the grantor and operator of the concession. Some commentators, and some members of the IFRIC, found these terms confusingly similar. The IFRIC decided to adopt the terminology 'grantor' and 'operator', and proposes to amend SIC-29 accordingly.

Scope

- BC6 The working group recommended that the scope of the IFRIC's project should be restricted to public-to-private infrastructure service concession arrangements. The IFRIC was concerned that the scope recommended by the working group was arbitrary. It therefore decided to define the scope in terms of the nature of the arrangements themselves rather than the status of the parties to the arrangements.
- BC7 The IFRIC decided to restrict the scope of the draft Interpretation to arrangements in which the grantor (a) controlled or regulated the services provided by the operator, and (b) controlled the significant residual interest in the infrastructure at the end of the concession. It also decided to specify the accounting treatment only for infrastructure that the operator constructed or acquired from a third party, or to which it was given access by the grantor, for the purpose of the concession. The IFRIC concluded that these conditions were likely to be met in most of the public-to-private arrangements for which guidance had been sought. It decided to include them in the scope of the draft Interpretation because, as explained in the next section, their practical effect is that, for all arrangements within its scope, the infrastructure is not property, plant and equipment of the operator. Their inclusion was a pragmatic decision in order to limit the set of draft Interpretations to a reasonable size.
- BC8 The draft Interpretation does not specify the accounting by grantors, because the IFRIC's objective and priority were to establish guidance for operators.

Recognition of infrastructure as property, plant and equipment

Recognition on basis of control

- BC9 IAS 16 *Property, Plant and Equipment* defines property, plant and equipment as tangible items that 'are held for use in the production or supply of goods or services, for rental to others or for administrative purposes...'. It requires items within this definition to be recognised as property, plant and equipment unless another Standard requires or permits a different approach. As an example of a different approach, it highlights the requirement in IAS 17 *Leases* for recognition of leased property, plant and equipment to be evaluated on the basis of the transfer of risks and rewards.

- BC10 The IFRIC thus identified two possible approaches for determining whether an operator should recognise service concession infrastructure as its property, plant and equipment that would be consistent with existing IFRSs. The first approach—an interpretation of the IAS 16 requirement to recognise items that are ‘held for use’, supported by the definition of an asset in the *Framework*—would be to assess whether the operator controlled the use of the infrastructure. The alternative approach would be to follow by analogy the precedent set for leased assets in IAS 17, ie to assess whether substantially all the risks and rewards of ownership of the infrastructure were held by the operator.
- BC11 The IFRIC chose to adopt the first approach, which it believes is consistent with the *Framework* and likely to be more durable. It noted that the risks and rewards approach as applied in IAS 17 leads to complexities and inconsistencies in lease classification and could be difficult to apply to service concession arrangements, especially those in which users pay for the concession services or large elements of the payments are contingent on usage.

Identifying whether the operator has control

- BC12 As explained above, the draft Interpretation is based on a conclusion that service concession infrastructure should be recognised as property, plant and equipment of the party that controls its use. The reference to control stems from the *Framework*:
- (a) an asset is defined by the *Framework* as ‘a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.’
 - (b) the *Framework* notes that many assets are associated with legal rights, including the right of ownership. It goes on to clarify that the right of ownership is not essential.
 - (c) rights are often unbundled. For example, they may be divided proportionately (undivided interests in land) or by specified cash flows (principal and interest on a bond) or over time (a lease).
- BC13 In a service concession, rights are usually divided over time, which is similar to a lease. However, for arrangements within the scope of the draft Interpretation, the operator’s right is different from that of a lessee: the grantor retains control over the use to which the infrastructure is put, by controlling or regulating what services the operator must provide, to whom it must provide them, and at what price, as described in paragraph 5(a).

Unlike a lessee, the operator does not have a right of use: it has only access to the infrastructure to provide the specified services on the specified terms.

- BC14 Another indicator of possible control by the grantor is that, if the infrastructure reverts to the grantor at the end of the concession, as described in paragraph 5(b), this both restricts the operator's practical ability to sell or pledge the infrastructure and gives the grantor a continuing right of use.
- BC15 The IFRIC also noted that control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 5(a) and the residual interest (which is significant) in the infrastructure, the operator is only managing the infrastructure on the grantor's behalf—even though, in many cases, it may have wide discretion.
- BC16 The IFRIC therefore concluded that the grantor of a service concession controls the use of the infrastructure items that are the subject of the concession, even if they are owned by the operator, if the scope conditions (a) and (b) of paragraph 5 are both met. The operator has access to, but not a right to use, the infrastructure. In principle, the operator should recognise neither the infrastructure nor a lease of the infrastructure.

Consistency with existing IFRSs

- BC17 The control principles discussed above can be applied only to the extent that they are consistent with existing IFRSs. The IFRIC discussed the following types of infrastructure:
- (a) existing infrastructure of the grantor, to which the operator is given access for the purpose of the concession;
 - (b) existing assets of the operator that are used exclusively in the concession; and
 - (c) infrastructure that is constructed or acquired by the operator specifically for the purpose of the concession.

Existing infrastructure of the grantor to which the operator is given access

- BC18 The IFRIC believes that IAS 18 *Revenue* should be applied to determine whether a sale should be recognised when the grantor gives the operator access to existing infrastructure for the purpose of the concession. If the conditions for recognising a sale from the grantor to the operator are not met, the operator should not recognise the infrastructure as its property, plant and equipment.

BC19 Paragraph 14 of IAS 18 states that revenue from the sale of goods is recognised only when five conditions are satisfied:

- (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
- (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- (c) the amount of revenue can be measured reliably;
- (d) it is probable that the economic benefits associated with the transaction will flow to the entity; and
- (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

BC20 The IFRIC believes that, for arrangements within the scope of the draft Interpretation, the second of these conditions is not satisfied. Hence, no sale can be recognised by the grantor. The IFRIC further believes that, without the IAS 18 conditions for a sale having been met, there cannot be a sale and leaseback. Therefore, existing infrastructure that has been transferred by the grantor to the operator for the duration of the concession is not recognised as the property, plant and equipment of the operator.

Existing assets of the operator

BC21 IAS 18 is also relevant to determining whether the operator should recognise a sale of any of its existing assets that are used exclusively in the concession. The IFRIC noted that there will be circumstances when the conditions of IAS 18 are not met, and therefore the assets should continue to be recognised by the operator (with no sale), even if the grantor controls the assets. The draft Interpretation does not specify the treatment of such assets, because the IFRIC agreed that it would be (a) difficult to add to the requirements of IAS 18, and (b) unusual for such assets to be significant in the context of a service concession arrangement as a whole.

Infrastructure constructed or acquired by the operator for the purpose of the service concession

BC22 The IFRIC believes that the treatment of items that are constructed or acquired by the operator for the purpose of the service concession should be determined solely by whether they are controlled by the grantor. If they are so controlled (as will be the case for all arrangements within the scope of the draft Interpretation), then, regardless of which party has legal title to

them during the concession, they should not be recognised as property, plant and equipment of the operator. The IFRIC believes that there is no conflict with IAS 18 because the commercial effect of the arrangements is that the infrastructure is constructed or acquired by the operator on the grantor's behalf, rather than sold by the operator to the grantor. If construction is involved, the operator is not selling the infrastructure that it builds, but supplying construction services to the grantor.

BC23 For the same reason, there will not be a lease of the infrastructure from the operator to the grantor. IFRIC 4 *Determining whether an Arrangement contains a Lease* applies when (before taking any leases into account), the infrastructure items that are the subject of the concession are property, plant and equipment of the operator. In these circumstances, IFRIC 4 is relevant to the determination of whether there is a lease from the operator to the grantor, and IAS 17 applies to any lease that is identified. IFRIC 4 will not apply to infrastructure within the scope of draft Interpretation D12, because it is not property, plant and equipment of the operator.

Determining the accounting model

BC24 The IFRIC identified two accounting models that, in different circumstances, would apply to the asset received by an operator when it provides infrastructure or other consideration in exchange for the right to the service concession and the infrastructure items are not recognised as its property, plant and equipment:

- (a) the financial asset model—the operator recognises a financial asset;
or
- (b) the intangible asset model—the operator recognises an intangible asset.

BC25 The IFRIC also considered whether the operator's right could be a prepayment under an operating lease. For this to be so, IAS 17 would require the operator to have the right to use the infrastructure. The IFRIC concluded that if the grantor controls the use of the infrastructure in the manner described in conditions (a) and (b) of paragraph 5, the operator does not have the right to use the infrastructure, but only access to the infrastructure to provide the specified services on the specified terms. Therefore, the operating lease model does not apply to arrangements within the scope of the draft Interpretation.

The financial asset model

- BC26 Paragraph 11 of IAS 32 *Financial Instruments: Disclosure and Presentation* defines a financial asset to include ‘a contractual right to receive cash or another financial asset from another entity’. Paragraph 13 of that Standard clarifies that ‘contractual’ refers to ‘an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law.’
- BC27 The contractual rights that the operator receives in return for its investment in a service concession can take a variety of forms. They are not necessarily rights to receive cash or another financial asset.

I Fixed payments by the grantor

- BC 28 In some service concessions, the operator has a contractual right to receive fixed payments from the grantor. The IFRIC believes that such rights clearly meet the IAS 32 definition of a financial asset.

II Payments by the grantor are contingent on availability or usage

- BC29 The IFRIC concluded that the definition of a financial asset is met even if payment by the grantor is conditional on availability and performance conditions being achieved.
- BC30 The operator may have further activities to perform before the grantor is required to pay it for its services. But in this respect the operator’s position is the same as that of any other entity that recognises contract revenue on a stage of completion basis in accordance with IAS 11 *Construction Contracts*. The IFRIC believes that, if a customer will pay cash or another financial asset for contract services, the ‘amounts due from customers’ asset that arises from the application of the stage of completion method of revenue recognition is a financial asset as defined in IAS 32.
- BC31 The analysis is less straightforward if the operator’s investment is recovered via payments from the grantor that are contingent on usage levels. For example, an operator may build a hospital and be paid an amount that depends on the rate of bed occupation. Similarly, an operator may construct a road and be paid an amount that depends on the volume of traffic using the road.

BC32 The IFRIC noted that the operator does not have an absolute right to receive usage-based payments until the services have been used. But it also noted that:

- (a) the operator has performance obligations under the contract, in consideration for which the grantor has an obligation to pay the operator, with only the amount being uncertain. The grantor has no discretion to avoid making the payments to which it has become contractually bound.
- (b) the extent of the operator's contractual rights is contingent on future events. IAS 32 provides evidence that such contingent rights meet the definition of a financial asset. Paragraph AG8 of the application guidance in IAS 32 states that:

The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower.

BC33 The draft Interpretation therefore treats the construction services provided to the grantor as giving rise to a financial asset irrespective of whether the amounts receivable are fixed or contingent on levels of usage.

III Payment by users

- (i) *No contractual arrangements to reduce variability in the operator's return*

BC34 In some service concession arrangements, users pay for the services provided by the operator and the operator recovers its investment from the payments made by the users. In the absence of any contractual arrangements designed to ensure that the operator receives a specified minimum return, the operator has no contractual right to receive cash from any other party. Rather, the operator has an opportunity to charge those who choose to use the asset in future. In that respect, the operator's asset is akin to a licence, which would be classified as an intangible asset within the scope of IAS 38 *Intangible Assets*. And, as clarified in paragraph AG10 of the application guidance in IAS 32:

Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial

assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

BC35 The IFRIC considered an argument that the operator's rights are different from those arising under other licence agreements. An entity that holds a typical licence has to perform additional activities in order to convert that intangible asset into a right to receive cash. In contrast, the operator has no further activities to perform in order to collect payments from users. Commercially, it is in the same position as it would be if it had a right to receive usage-based payments from the grantor: it has a right to receive cash contingent only on events outside the control of either itself or the grantor. Classification of the operator's right as a financial asset would reflect this similarity. Any alternative classification could lead to two entirely different accounting treatments for two economically very similar service concessions. The identity of the payer should not affect the classification: the grantor has given the operator a contractual right to be paid, whether directly by the grantor or indirectly by charges levied on users.

BC36 The IFRIC therefore considered whether a right to be paid by users could be regarded as an indirect right to receive cash arising from the contract with the grantor. It concluded, however, that, whilst the operator's asset might have characteristics that are very similar to those of a financial asset, it would not meet the definition of a financial asset in IAS 32: the operator would not at the balance sheet date have a contractual right to receive cash from another entity. That other entity (ie the user) would still have the ability to avoid any obligation. The grantor would be passing to the operator an opportunity to charge users in future, not a present right to receive cash. Within the definitions in existing IFRSs, an operator's right to receive payments from users could not be classified as a financial asset.

(ii) *Users pay but contractual arrangements eliminate substantially all variability in the operator's return*

BC37 The IFRIC considered whether the analysis would be different if the concession agreement incorporated contractual arrangements designed to ensure that the operator received a specified return. It first considered arrangements that did not involve the grantor guaranteeing the operator's return. Instead, for example:

(a) the price charged by the operator would be varied by regulation designed to ensure that the operator received a substantially fixed return; or

- (b) the operator would be permitted to collect revenues from users until it achieved a specified return on its investment, at which point the concession would come to an end and the infrastructure would revert to the grantor.

BC38 The IFRIC noted that, as a result of such contractual arrangements, the operator's return would be very low risk. Only if usage were extremely low would the contractual mechanisms fail to give the operator a fixed return. The likelihood of usage being that low could be remote. Commercially, the operator's return would be regarded as fixed, giving its asset many of the characteristics of a financial asset.

BC39 However, the IFRIC concluded that the fact that the operator's asset was very low risk did not influence its classification. IAS 32 does not define financial assets by reference to the amount of risk in the return—it defines them solely by reference to the existence or absence of a contractual right to receive cash. There are other examples of licences that offer the holders of the rights very predictable, low risk returns, but such licences are not regarded as giving the holder a contractual right to cash. And there are other industries in which price regulation is designed to provide the operators with substantially fixed returns—but the rights of operators in these other industries are not classified as financial assets as a result.

(iii) Users pay but the grantor guarantees payments

BC40 The IFRIC considered whether the analysis would be different if the grantor guaranteed the operator a minimum return, making up any shortfall in user payments itself.

BC41 In this situation, it could be argued that the operator has a contractual right to receive, and hence a financial asset for, the full amount of cash guaranteed by the grantor:

- (a) the grantor has no discretion to avoid making payments to the operator. The grantor's liability might be reduced by amounts received by the operator directly from users. But the nature of the operator's asset is not altered solely because the amount receivable from the grantor may be paid by users.
- (b) the right to collect payments from one party and a guarantee from another party normally would be regarded as two separate assets with two different parties. However, for the purpose of service concessions, grantors and users could be regarded in substance as one and the same party. The grantor is not acting on its own behalf when it enters a service concession arrangement. It is acting on behalf of the public. One way or another, the grantor will raise the funds to pay for the concession from the public. It may use its

general tax revenues or it may require users to pay for the services. If users pay for the services, the grantor may allow the operator to collect payment directly from the users. But the method of payment is a matter of form only. In each case, the operator has, in substance, a contract with the public on whose behalf the grantor is acting.

BC42 Against these arguments, the IFRIC noted that:

- (a) IAS 32 seeks to recognise separately each of the rights that an entity has to receive cash. As discussed in paragraph BC32(b) above, IAS 32 acknowledges that a guarantee gives rise to a financial asset in its own right, the fair value of which depends on the likelihood of the guarantee being called upon. But IAS 32 recognises guarantees as separate assets from the assets they guarantee. The operator should recognise its right to collect payments from users and the guarantee from the grantor as two separate assets.
- (b) treating the grantor and users as a single counterparty makes fundamental assumptions about the nature of transactions involving the public sector. It views the public sector as indistinguishable from, rather than a supplier to, the public. It may set a precedent that has wider, perhaps inappropriate, ramifications.
- (c) allowing the operator to treat the right to collect user payments as a financial asset if they are guaranteed by the grantor does not eliminate the need for two different accounting models being applied to similar commercial arrangements—it merely changes the position of the dividing line.

BC43 In the light of the above concerns, the draft Interpretation restricts the financial asset model to concession arrangements where the grantor is primarily responsible for paying the operator.

BC44 Whether the financial asset model applies therefore depends on the operator's contractual rights. However, the IFRIC did not wish to overemphasise the importance of legal form. Paragraph 13 of the draft Interpretation therefore notes that the identity of the party with primary responsibility for paying for the concession services should be determined by reference to the substance of the contractual arrangements.

The intangible asset model

- BC45 IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It mentions licences as examples of intangible assets. It describes an asset as being identifiable when it arises from contractual rights.
- BC46 The IFRIC concluded that the right of an operator to charge users of the concession services meets the definition of an intangible asset, and therefore should be accounted for in accordance with IAS 38.
- BC47 Paragraph 3(a) of IAS 38 states that the requirements of that Standard do not apply to financial instruments as defined in IAS 32. Hence, concession assets that are regarded as financial assets, ie those arising when the grantor pays for the concession services, must be accounted for using the financial asset model rather than the intangible asset model.

Transition

- BC48 The draft Interpretation contains no specific transitional arrangements, because the IFRIC decided that the appropriate accounting model should be applied in all cases. However, if a different accounting model has previously been used, it may be difficult to determine retrospectively the amounts to be included in the financial statements. Transitional arrangements for the financial asset model and the intangible asset model are set out in draft Interpretations D13 *Service Concession Arrangements—The Financial Asset Model* and D14 *Service Concession Arrangements—The Intangible Asset Model*.