



**INTERNATIONAL
FEDERATION
OF ACCOUNTANTS**

545 Fifth Avenue, 14th Floor Tel: (212) 286-9344
New York, New York 10017 Fax: (212) 286-9570
Internet: <http://www.ifac.org>

DATE: 15 FEBRUARY 2005
MEMO TO: MEMBERS OF IFAC IPSASB
FROM: LI LI LIAN
SUBJECT: **SERVICE CONCESSION ARRANGEMENTS**

ACTION REQUIRED

The Board is asked to:

- **appoint** a sub-committee to prepare a response to IFRIC on its Draft Interpretations on service concession arrangements.

AGENDA MATERIAL:

Pages

11.8 Summary Report on Service Concessions 11.132 - 11.134

The IPSASB/PSC has been monitoring the IASB's International Financial Reporting Interpretations Committee's (IFRIC's) progress in preparing Draft Interpretations on service concession arrangements (public private sector arrangements). The IPSASB/PSC has also agreed to respond to those Draft Interpretations.

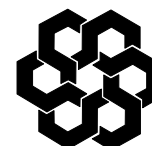
At the November 2004 meeting, the PSC noted that, if possible, IFRIC's Draft Interpretations and a draft IPSASB response thereto should be tabled at the March 2005 meeting. IFRIC approved three Draft Interpretations on service concession arrangements subject to final amendment and then clearance by the IASB at its February 2005 meeting. The Draft Interpretations are to have a comment period of about 60 days. However, the Draft Interpretations have not yet been issued. Consequently, staff have not been able to prepare a draft response for the IPSASB to review. Staff anticipate that these Draft Interpretations will be issued before the Oslo meeting and they will be forwarded to the IPSASB once they become available. If this occurs, it may be possible to draw out key issues that will form the basis of the response at this meeting. (An extract from IASB's Standards Advisory Council's (SAC's) Observer Notes from the February 2005 meeting is attached. That extract outlines key features of the Draft Interpretations at that time.)

At this meeting, staff propose that the IPSASB appoint a sub-committee to prepare a response to the IFRIC on the Draft Interpretations. The draft response will then be circulated to IPSASB members for comment out-of-session before its submission to IFRIC.

Agenda item 11.9 is a summary report of authoritative guidance and current practice on service concession arrangements in members' jurisdictions. This report was prepared from input provided by members in response to a request from staff in late August 2004 and was included in agenda materials for the November 2004 meeting. If there are any updates to this report, please inform me and an updated report will be tabled during the meeting.

Attachment:

This is an extract from the IASB's Observer Notes from the IASB's SAC meeting in February 2005 on IFRIC's service concession arrangements project.



**International
Accounting Standards
Board**

30 Cannon Street, London EC4M 6XH, England
Phone: +44 (20) 7246 6410, Fax: +44 (20) 7246 6411
Email: iasb@iasb.org.uk Website: <http://www.iasb.org>

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff paper prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

SAC Meeting: 10-11 February 2005, London
Project: Service Concession Arrangements (Paper 5)

Introduction

- 1 The IFRIC will soon publish three draft interpretations on service concession arrangements. The draft interpretations address arrangements whereby public services—such as the construction and operation of roads, hospitals, prisons, waste disposal plants or energy distribution facilities—are contracted to private ‘operators’. The draft interpretations address only the accounting by the operators. They do not specify the accounting by the ‘grantors’ of the contracts, typically governments or their agencies.
- 2 These arrangements typically involve significant capital expenditure on infrastructure. The infrastructure may already exist and need only be maintained (and perhaps enhanced) by the operator. Or the concession may require the operator to construct the infrastructure before operating it.
- 3 The draft interpretations apply only to concessions in which the grantor retains control over the use to which the infrastructure is put: it decides what services the operator must provide, to whom it must provide them and at what price; and it retains control of the residual interest in the infrastructure at the end of the concession.
- 4 The way in which operators at present account for such infrastructure under their local GAAPs varies. In some countries, the accounting has been characterised by smoothing adjustments designed to report constant margins over the duration of a concession. There has been uncertainty about the requirements of IFRS. One question is about the nature of the operator's expenditure on construction of infrastructure—should the operator recognise property, plant and equipment or some other type of asset? Another question is about the treatment of borrowing costs incurred by the operator to finance the

infrastructure. These borrowing costs tend to be higher in early years—can they be capitalised and allocated evenly over the contract?

- 5 The IFRIC has sought to address these questions and provide guidance on other aspects of service concession accounting. Because of the range of matters to be covered, the IFRIC has split the interpretations into three separate documents.

D12 Determining the Accounting Model

- 6 D12, the first draft interpretation, specifies how an operator should classify its expenditure on construction of infrastructure. D12 proposes that, because the operator does not control the use of the infrastructure, it should not recognise the infrastructure as its own property plant and equipment. Instead, it should account for the rights it receives in return for providing construction services to the grantor.
- 7 D12 proposes that the classification of the operator's rights should depend on who is required to pay the operator for the concession services:
- a) if the grantor will pay for the concession services itself, the operator has a contractual right to receive cash in exchange for the construction services. D12 proposes that such a right to receive cash meets the definition of a financial asset and should be accounted for as such.
 - b) if instead, the contract gives the operator a right to charge users for the concession services—for example, to charge tolls for operating a road—D12 proposes that the operator does not have a contractual right to receive cash. Instead, the operator has a right to charge users if and when they used the concession services—a right that meets the definition of an intangible asset. The operator should therefore recognise the right it receives in exchange for providing construction services as an intangible asset.
- 9 The two different models have different accounting consequences and are dealt with separately in the second and third of the interpretations.

D13 The Financial Asset Model

- 10 D13 sets out the accounting proposed when the financial asset model applies. The operator would apply standard construction contract accounting, recognising revenue and a receivable on a percentage of completion basis as construction progressed. The receivable would meet the definition of a financial asset and be accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The amounts received from the grantor for the concession services would be allocated between three components:
- repayment of the receivable
 - finance income — the effective interest on the outstanding receivable
 - operating revenue — for provision of ongoing services such as maintenance and staffing.

- 11 Often an operator's borrowings will be similar to the receivable from the grantor, both tending to reduce over the duration of the contract. Applying the financial asset model, the impact on profit of higher borrowing costs in earlier years and lower borrowing costs in later years would tend to be offset by a similar pattern of finance income.

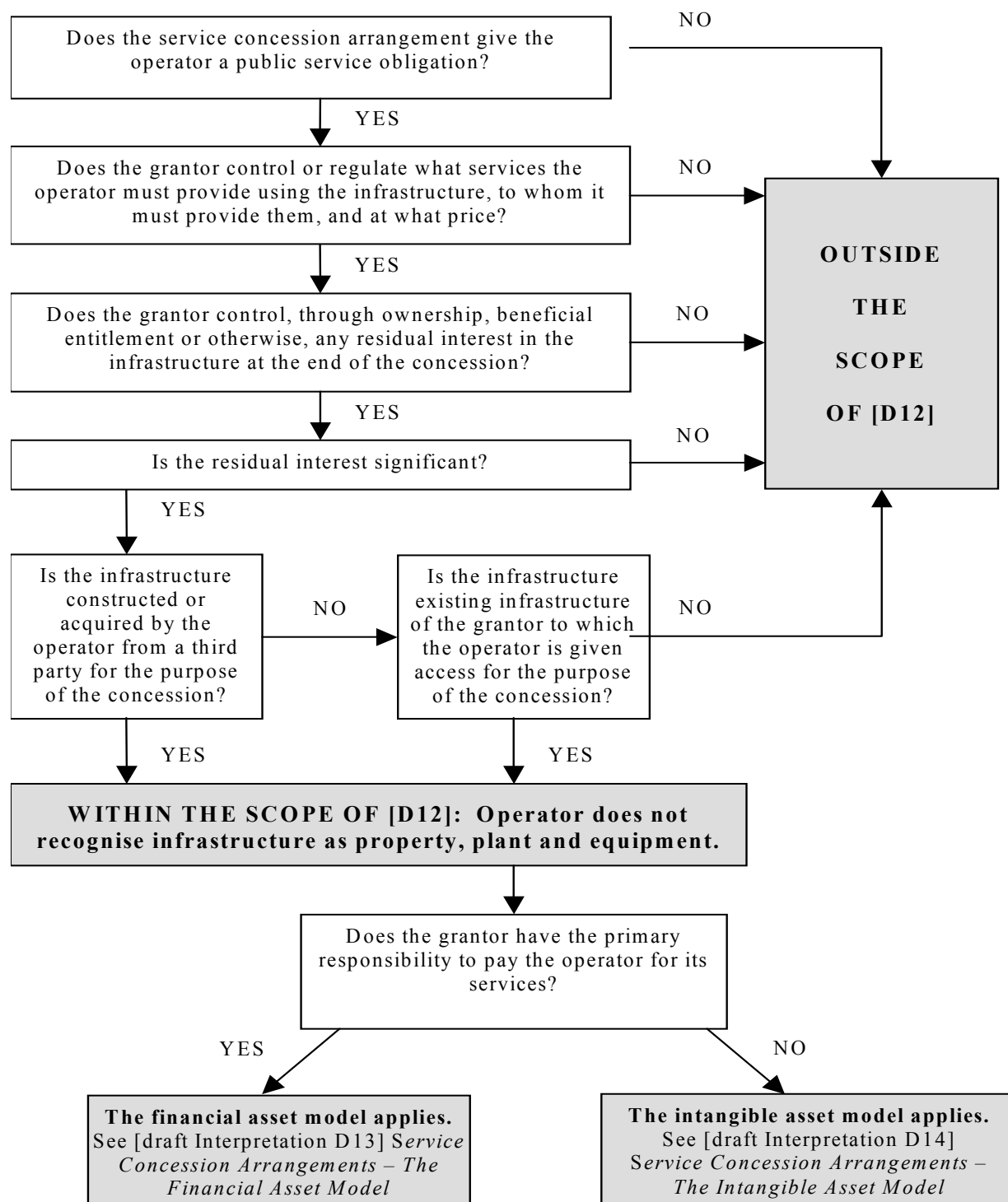
D14 The Intangible Asset Model

- 12 D14 sets out the accounting proposed when the intangible asset model applies. The operator would again apply construction contract accounting, recognising construction revenue on a percentage of completion basis as construction progressed. But it would not be receiving cash for its services. So instead of giving rise to a receivable, the revenue-earning activity would give rise to an intangible asset. This intangible asset would be accounted for in accordance with IAS 38.
- 13 The amounts reported in the income statement would be different from those reported under the financial asset model. Overall, the net profit or loss reported on over the duration of the contract would be the same. But both revenues and operating expenses would be higher: all receipts from users—not just those attributable to operating the facilities after construction—would be recognised as revenues, matched by additional operating expenses from the amortisation of the intangible asset. And the pattern of profit recognition could be different: higher borrowing costs in earlier than later years would contribute to lower profits (or losses) being recognised in earlier years and higher profits in later years (because there would be no corresponding finance income). The IFRIC concluded that it would be inconsistent with IFRS, and the IASB's conceptual framework, to defer borrowing costs in order to smooth profits over the duration of the contract.

Appendix

Proposed accounting framework for service concession arrangements

The diagram below summarises the proposals of draft Interpretation D12



Overview of Response from the IPSASB - public-private sector arrangements

Question / Country	ARG	AUS	CND	FRA	FRA	GER	ISR	JPN	MAL	MEX	NETH	NZ	NOR	SA	UK	USA
				MOF	Cs-Exprts											
General Questions																
1 Do the examples in the survey arise in your jurisdiction? If yes, all of them?		Yes Yes	Yes Yes	Yes Yes	Yes* Yes			Yes Yes				Yes Yes	Yes Yes	Yes Yes	Yes Yes	
* In the French context, the notion of concession arrangements only applies for the operator delivering services to the public and not to another public sector entity Eg: cleaning the building of a judicial court is not a concession arrangement.																
2a Do you have any specific accounting guidance that deals with service concession arrangements?		No	No	Yes only for operator	Yes			No				Yes	No	No	Yes	
b If yes in 2a, are they found in: Accounting standards? Legislation? Other?		N/A N/A N/A	N/A N/A N/A	Yes Yes No	Yes Yes No			N/A N/A N/A				Yes No No	N/A N/A N/A	N/A N/A N/A	Yes No Yes	
c If no in 2a, do you have any general guidance on how to account for or deal with service concession arrangements?		Yes #	Yes #	N/A	N/A			No				+	Yes #	No	N/A	
# The relevant accounting guidance that members noted include: general accounting framework/accounting acts, leases, provisions standards + NZ has an Interpretation based on IASB's SIC-29 requiring entities to disclose certain service concession arrangements. However, entities rely on general guidance to recognize and measure service concession arrangements. General guidance includes general accounting framework and accounting standards on leases, revenue property plant and equipment and joint ventures																
3a If answered "no" to question 2(a), does your jurisdiction have in its work program a project on accounting for service concession arrangements?		Yes	No	N/A	N/A ^			No				N/A	N/A	Yes	N/A	
3b If yes, have you commenced on that project?		Yes	N/A	N/A	N/A ^			No				N/A	N/A	Yes	N/A	
^ The present accounting regulation is currently under review																
4 If answered "yes" in questions (2) or (3)																
a Is the guidance/project only applicable to the public sector?		No	N/A	No	No			N/A				No	N/A	Yes	No	

Question / Country	ARG	AUS	CND	FRA	FRA Cs-Expts	GER	ISR	JPN	MAL	MEX	NETH	NZ	NOR	SA	UK	USA
				MOF												
b Is the guidance/project only applicable to the private sector?		No	N/A	No	No			N/A				No	N/A	No	No	
c Is the guidance/project applicable to both the public and private sector?		Yes	N/A	Yes	Yes			N/A				Yes	N/A	No	Yes	
5 The IFRIC proposes to issue 3 Interpretations on service concession arrangements.																
a Is the IFRIC's approach consistent or contrary with existing guidance/practice in your jurisdiction?		Yes consist ent		No contrary (i)	No contrary			Yes consist ent				Yes consist ent	Yes consist ent	Yes consist ent	No contrary (ii)	
b Do you think that the IFRIC's approach should be supported and is worth pursuing?		No (iii)	Yes	Yes	Yes			Yes				Yes	Yes	Yes	No (ii)	
(i) The notion of control in the MOF of France is different from the IFRIC's. However, the MOF is currently reviewing the IFRIC's approach. (ii) Because the IFRIC's approach, which is from a "control" perspective, contrasts with the UK's "risks and rewards" approach in FRS 5 and Application Note F. Moreover, UK believes that the IFRIC's approach is tantamount to standard-setting rather than an interpretation (iii) Australia noted that the IFRIC's focus on the operator might not give rise to a truly robust set of principles, and therefore, may not represent the best starting point for work undertaken by the PSC.																
Specific Questions related to Accounting Treatment																
6 Is the IASB's description similar to the description in your jurisdiction?		Yes	N/A	Yes	Yes			N/A				Yes	N/A	N/A	Yes	
7 Does your jurisdiction's guidance include recognition criteria for the assets and liabilities arising from the different types of service concession arrangements?		Yes broadly **	N/A	No	No in part only			N/A				Yes	N/A	N/A	Yes	
** The entities rely on the broad guidance in existing accounting framework and other accouting standards eg leases																
8 Does your jurisdiction's guidance have any measurement criteria for the assets and liabilities arising from the different types of service concession arrangements?		Yes broadly	N/A	No	No			N/A				Yes	N/A	N/A	Yes	

Legend:
DNA: Did not provide an answer
N/A: Not applicable to the question

Question / Country	ARG	AUS	CND	FRA	FRA	GER	ISR	JPN	MAL	MEX	NETH	NZ	NOR	SA	UK	USA
				MOF	Cs- Exptrs											
9 Does your jurisdiction include any disclosure requirements for service concession arrangements?		Yes broadly	N/A	Yes	Yes			N/A				Yes	N/A	N/A	Yes	
10 Since the accounting guidance has been issued, have any significant issues arisen in relation to the definition, recognition, measurement or disclosure of service concession arrangements transactions?		Yes	N/A	Yes	Yes			N/A				No	N/A	N/A	Yes	
Legend: N/A Not Applicable to the Question																