



Project **Tentative agenda decisions**

Topic **Scope of IFRIC 12**

Background

1. In March and April 2009 the IFRIC received two requests for guidance on the application of IFRIC 12 *Service Concession Arrangements*. One focuses on one of the criteria for determining whether an arrangement is the scope of the Interpretation. The other also requests guidance on the application of the Interpretation to other features of the arrangement.
2. Portions of the original submissions are included as Appendix A.

Summary of issues outlined in the submissions

First submission

3. The first submission describes two arrangements in which all the conditions of paragraph 5 of IFRIC 12 are clearly satisfied other than whether the grantor controls or regulates the price at which the operator must provide the services.
4. In the first case, the operator has discretion both to set the initial price and to revise it subsequently. The submission asserts that the price is non-regulated but includes the following comments:

Nevertheless, the grantor should be informed regarding revision to price structure by the operator. ... Further such non-regulation of price is also justifiable since the grantor is not providing any guarantee on return to their investment so in order to compensate it, the grantor provide discretion to set price *but retain their discretion by imposing certain grounds on which to revise their pricing structure.* [emphasis added]

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRIC.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRIC or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

Decisions made by the IFRIC are reported in *IFRIC Update*.

Interpretations are published only after the IFRIC and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in *IASB Update*.

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The submission includes no details on what restrictions are imposed on price revisions.

5. In the second case, the submission notes that the grantor does not control the prices to be charged to users of the service – ‘allow operator to set and maintain price to be levied on the user and revise such price as deem necessary’.

However, in this case the submission goes on to state:

The revision must be notified/justified to the grantor and approval of the grantor in practice deem to be rubber stamping exercise as grantor will not object on the price if it is reasonable and enable the operator to have quick pay off on investment and earn decent return on its investment.

6. The submission notes that in practice both arrangements are considered to be outside the scope of IFRIC 12 because the grantor does not explicitly dictate the prices. It asks the IFRIC to consider whether the existence of grantor notification/justification or approval of the price lists can be construed as control over price by the grantor.

Second submission

7. The second submission describes a concession agreement that requires the operator to maintain and replace the infrastructure that is to be returned to the grantor at the end of the concession period. In addition, the terms of the concession agreement also include an obligation for the operator to share revenue from the services with the grantor in addition to a fixed minimum amount that is payable annually.
8. The submission asks the IFRIC for guidance on applying IFRIC 12 to the minimum payment, the revenue sharing requirements and the replacement and maintenance costs. It states that the Interpretation does not provide guidance on accounting for costs other than the infrastructure.

Staff analysis

First submission

9. The staff notes that paragraph 5(a) states that the Interpretation applies to service concession arrangements if:

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The grantor *controls or regulates* what services the operator must provide with the infrastructure, to whom it must provide them, and *at what price* [emphasis added]

10. Paragraphs AG1-AG6 provide guidance on the application of paragraph 5. AG2 and AG3 state:

The control or regulation referred to in condition (a) could be by contract or otherwise (such as through a regulator) ... AG2

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, contract, or regulator ... AG3

11. In the staff's view, the discussion in these paragraphs makes it clear that it is not necessary for the grantor to have the ability to dictate the prices that the operator may charge. In both cases described in the submission it appears that the grantor has retained the right to approve any price changes proposed by the operator and in the first case that there seem to be conditions that the operator must meet to justify changes. The staff believes both situations are specifically covered by paragraph AG3. In addition, in the staff's view it is inappropriate for a contractual requirement for grantor approval to be dismissed as 'rubber stamping'.

Second submission

12. The staff notes that in the Basis for Conclusions on IFRIC 12, the IFRIC states that:

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 arrangement. ... BC11

... Nonetheless, during its redeliberation the IFRIC considered the range of typical arrangements for private sector participation in the provision of public services, including some that were outside the scope of the proposed Interpretation. The IFRIC decided that the Interpretation could provide references to relevant standards that apply to arrangements outside the scope of the Interpretation without giving guidance on their application. ... Information Note 2 contains a table of references to relevant standards for the types of arrangements considered by the IFRIC. BC13

13. Consequently, the focus on accounting for the infrastructure the submission notes is the result of the IFRIC's considered decision in finalizing the

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Interpretation after redeliberation. The staff does not believe that the submission should cause the IFRIC to reconsider that decision.

14. In addition, the staff notes that at least two of the questions raised in the submission are in fact explicitly addressed in the Interpretation:
 - (a) Revenue recognition is discussed in paragraphs 13 and 14-20 and illustrated in Illustrative Examples 1-3.
 - (b) Contractual obligations to maintain and restore the infrastructure are discussed in paragraph 21 and illustrated in Illustrative Examples 2-3.
15. The minimum annual amount the operator has agreed to pay to the grantor under the revenue sharing arrangement appears to be part of the total consideration the operator pays the grantor in return for the service concession asset.

Conclusion

16. In the staff's view, the issues raised in the submissions are already sufficiently addressed in the Interpretation to prevent divergence from emerging in practice. In addition, the staff is of the opinion that the issues raised call for implementation guidance rather interpretation.

IFRIC agenda criteria

17. The staff has analysed the issues against IFRIC's agenda criteria:
 - (a) Is the issue widespread and practical?
The issues are practical but they do not appear to be widespread. IFRIC 12 has already been applied in practice by many entities and these are the first requests the IFRIC has received.
 - (b) Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?
The staff is unaware of divergent interpretations. Given the guidance identified in the staff analysis, we would not expect any to develop.
 - (c) Would financial reporting be improved through elimination of the diversity?
No diversity identified.
 - (d) Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and the Framework for the Preparation and Presentation of Financial Statements, but not so narrow that it is inefficient to apply the interpretation process?

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If the issues were added to the agenda, they are sufficiently narrow to be dealt with in a timely fashion by the IFRIC.

- (e) (e) If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period).
There is no planned IASB project.

Recommendation and question for the IFRIC

Based on the analysis in paragraphs 9-17, the staff recommends that the IFRIC not add either issue to its agenda. Wording for the proposed tentative agenda decision is set out in Appendix B. Does the IFRIC agree that the issue should not be added to the agenda? Does the IFRIC have any comments on the proposed wording for the tentative agenda decision?

Appendix A – IFRIC Potential Agenda Item Request

Excerpts from Submission 1

- B1. There are certain arrangements exist in practice which the said IFRIC failed to capture even though the control approach rightly fit the case.
- B2. The scope paragraph state that service concession arrangement is within the scope if the grantor controls what services to be provided, to whom it must be provided and at what price and grantor controls the significant residual interest in the infrastructure through beneficial entitlement, ownership or otherwise.
- B3. Among others, there are two typical concession arrangements exist in practice which requires IFRIC considerations whether such arrangements are in the scope or not.

Arrangement No.1:

- B4. The grantor enter in to service concession arrangement with operator whereby grantor controls the provision of the service and customers to whom the service should be provided through infrastructure which is to be built and operated by the operator and also retain residual interest through transfer of underlying assets at fair value and book value at end of concession arrangement. The arrangement is typically has BOT (Build, Operate and Transfer) feature.
- B5. However, as far as price to be levied to the user is concerned, the operator provide discretion to set price initially and subsequently revise the price on the ground to offer competitive price structure through aligning the price structure to internationally available price structure and also revise price structure in order to earn decent return on investments. Nevertheless, the grantor should be informed regarding revision to price structure by the operator. The non-regulation of price is justifiable as grantor want to delegate the responsibility, of offering competitive price structure and monitoring the decent return on investment, to the operator. Further such non-regulation of price is also justifiable since the grantor is not providing any guarantee on return to their investment so in order to compensate it, the grantor provide discretion to set price but restrain their discretion by imposing certain grounds on which to revise their pricing structure.

B6. Though the above mentioned arrangement fit the control notion over the use of infrastructure through broadly regulating the service to be provided, the parties to whom it must be provided and retention of significant interest by grantor which reflects that operator is managing the infrastructure on behalf of grantor. Non-existence of price regulation is enough to scope out the arrangement where the broad governance of infrastructure is controlled by the grantor. If assume that price control is something could be ignored then the above arrangement would be treated under intangible asset model.

Arrangement No.2:

B7. Another typical arrangement exist where the grantor control what service to be provided to whom it must be provided. The grantor not controls the prices to be levied to the users of the service. The arrangement is for the whole life of the infrastructure so as per the requirement of paragraph 6, the arrangement is within the scope of IFRIC and paragraph 5 (b) conditions is not necessary to be met.

B8. The non-existence of control over price is justifiable as grantor is not providing any guarantee over the investment pay off and return to the operator and allow operator to set and maintain the price to be levied to the user and revise such price as deem necessary to earn decent return on investment, recoup the principal amount of investment and have competitive price structure. The revision must be notified / justified to the grantor and approval of the grantor in practice deem to be rubber stamping exercise as grantor will not object on the price if it is reasonable and enable the operator to have quick pay off on investment and earn decent return on its investment. Is arrangement is out of scope of IFRIC on account of non-existence of control over price. The operator in such case bear the demand risk, however, the grantor control the usage of infrastructure which rightly fit the control notion approach as used in the said IFRIC.

Current practice:

B9. Since the control over price is not regulated by the grantor, currently such arrangements are considered to be out of the scope of arrangement even though the framework control notion reflects that the asset / infrastructure should not be

recorded by the operator as operator appears to be managing infrastructure on behalf of the grantor. The arrangement in substance does not differ substantially from arrangements which are in the scope where the grantor explicitly dictate the prices and meet all the required conditions.

- B10. It is very rare to see in practice where the grantor completely control the prices to be levied by the operator, rather it delegate the power to the operator but retain the right to be notified and justify the revision to price structure initially determined. Such delegation is very common as grantor considers it to be a part of day to day running of operation but should take in to confidence whenever want to revise the price structure by the operator.

Excerpts from Submission 2

B11. For a period of time, [Jurisdiction] has had concession agreements so called “public to private service concession arrangements”; however, the government (as a grantor) and the private company (as an operator) have used their own accounting treatments by inferring from existing accounting standards. The substance of the concession agreements that we would like to refer to are as follows:

- (a) The grantor gave concession rights to the operator to operate in the telecommunication industry for roughly 15-30 years.
- (b) A type of the concession agreements is a Build-Transfer-Operate (BTO) category which the operator has to build telecommunication networks (infrastructure) and transfer legal ownership of this infrastructure to the grantor, and then the operator can use this infrastructure to render services to the public over the concession period.
- (c) The concession agreement contains the term that the operator has to provide maintenance and replacement of the infrastructure in order that this infrastructure can be operated at the end of the concession period while the operator transfers the physical infrastructure to the grantor.
- (d) The term of the concession agreement also includes the operator’s obligation to provide revenue sharing from the services fees to the grantor. This revenue sharing scheme consists of the minimum amount of revenue sharing per annum (minimum payment) that the operator is committed to disburse to the grantor.

B12. As we are in the process of deliberation of the appropriate accounting treatments for the operator, IFRIC 12: Service Concession Arrangements is the interpretation that we would like to implement. However, IFRIC 12 scopes the explanations mostly on the accounting treatments for infrastructure and leave out the accounting methods for other costs that the operator has to pay to the grantor such as revenue sharing, minimum payment, replacement and maintenance cost, etc. Therefore, we would like to query about the accounting treatments for these transactions as follows:

- (a) How should the revenue sharing be recorded? Should it be recorded as a consideration given for the cost of the concession right at the commencement date (by discounted present value of the future projected revenue sharing) or should it be recorded as a period cost matching with the recognised revenue?
- (b) As the minimum payment has been fixed in the concession contract and the operator is obligated to pay it, should it be recorded as a cost of the concession right and liability at the initiation date?
- (c) For the replacement and maintenance costs which are required by the contract that the operator has to pay for, should the operator records it as a cost of the concession right or records it when these transactions occurs?
- (d) For the above questions, could you please recommend us which IFRSs/IASs are suitable to apply for each transaction (revenue sharing, minimum payment, replacement and maintenance costs) as a reference in our guideline for the operator.

[Appendix B has been omitted from this Observer note]