

STAFF PAPER

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Rate-regulated Activities Consultative Group

Project	Rate Regulation
Paper topic	Scope Issues: Interaction with IFRIC 12 <i>Service Concession Arrangements</i>
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Purpose of the paper

1. Many of the respondents to the Exposure Draft *Rate-regulated Activities*, published in July 2009, (the 2009 ED), and some respondents to the Request for Information *Rate Regulation*, published in March 2013 (the RFI), have raised the point that there appear to be significant interactions between rate regulation and service concession arrangements. They question how, if an accounting model is developed for rate regulation, this would interact with the requirements of IFRIC 12 *Service Concession Arrangements*.
2. The purpose of this paper is to introduce Consultative Group members to what is, in our opinion, a significant cross-cutting issue. The purpose of this meeting is to focus on the scope of the planned Discussion Paper being developed ('the planned Rate Regulation DP' or 'the planned DP') and so we do not intend to spend time discussing the details of IFRIC 12 at this time. However, we want to raise the issue with the Consultative Group to obtain initial views and experiences of this interaction. We will address more detailed issues about this interaction at a later date.

Common features of service concession arrangements

3. The introductory paragraphs of IFRIC 12 highlight that such arrangements usually contain some element of rate regulation. Indeed, the activities within the scope of this Interpretation display many similarities to more general rate-regulated activities, as indicated in the following extract from IFRIC 12 (with emphasis added):

Background

- 1 In many countries, infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.
- 2 In some countries, governments have introduced contractual service arrangements to **attract private sector participation in the development, financing, operation and maintenance of such infrastructure**. The infrastructure may already exist, or may be constructed during the period of the service arrangement. An arrangement within the scope of this Interpretation typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that **sets out performance standards, mechanisms for adjusting prices**, and arrangements for arbitrating disputes. Such an arrangement is often described as a ‘build-operate-transfer’, a ‘rehabilitate-operate-transfer’ or a ‘public-to-private’ service concession arrangement.
- 3 A feature of these service arrangements is the **public service nature of the obligation** undertaken by the operator. Public policy is for the services related to the

infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually **obliges the operator to provide the services to the public** on behalf of the public sector entity. Other common features are:

- (a) the party that grants the service arrangement (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 period of the service arrangement.**
- (d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

Similarities with rate regulation

4. The summary of responses to the RFI (agenda paper 4 for this meeting) notes a global trend in rate regulation to introduce more incentives or penalties relating to performance standards (see paragraph 25 of paper 4). In addition, rate regulation is usually imposed for goods or services that are essential and so are considered to be ‘public service’ type activities¹, which impose significant obligations on the suppliers of those services (see paragraph 30 of paper 4).

¹ SIC Interpretation 29 *Service Concession Arrangements: Disclosures* (SIC 29), sets out disclosure requirements for service concession arrangements. Paragraph 3 of SIC 29 states: “The common characteristic of all service concession arrangements is that the operator both receives a right and incurs an obligation to provide public services.”

5. The main distinguishing features that differentiate service concession arrangements from general rate-regulated activities are:
- (a) the contractual nature of service concession arrangements; and
 - (b) the obligation of the operator [service supplier] to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration.

Interaction between IFRIC 12 and rate regulation

6. The scope of IFRIC 12 (paragraph 5 of IFRIC 12) is restricted to arrangements where:
- “(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—any significant residual interest in the infrastructure at the end of the term of the arrangement.”
7. Although the focus of IFRIC 12 is related to the treatment of the infrastructure, it does establish an accounting model for the recognition and measurement of other items, including revenue, financial assets and intangible assets created by the contractual arrangements. The recognition of a financial asset or an intangible asset is dependent on whether the service operating has a right to a guaranteed financial amount for provided the public services (a financial asset) or whether the ability to recover its costs (and a return on its investment) depends on receiving sufficient revenue from consumers over the period of the arrangement (an intangible asset).
8. The staff think that service concession arrangements are (almost always) rate regulated and so should be specifically considered when developing the planned Rate Regulation DP.

Questions for the Consultative Group

Scope issues: interaction with IFRIC 12

1. Do you agree that service concession arrangements are rate-regulated activities and, consequently, should be specifically included within the scope of the planned Rate Regulation DP?
2. What experience do you have with accounting for service concession arrangements? What are the main interactions with any accounting requirements for such arrangements and any for rate regulation do you consider are most important to address in the planned DP (if any)?
3. If you agree that service concession arrangements are rate-regulated activities within the scope of this project, are there elements of the scope of IFRIC 12 that could be generalised or broadened to encompass the scope of the Rate-regulated Activities project as a whole?