

STAFF PAPER

November 2015

IFRS Interpretations Committee Meeting

Project	IFRIC 12 Service Concession Arrangements
Paper topic	Accounting for combined service concession and lease arrangements
CONTACT(S)	Takashi Yamagami tyamagami@ifrs.org +44 (0)20 7246 6410

This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Introduction

1. The IFRS Interpretations Committee (the ‘Interpretations Committee’) received a request to address an issue related to the application of IFRIC 12 *Service Concession Arrangements*. The issue relates to the scope, recognition, presentation and measurement relating to a service concession arrangement, in which the infrastructure that is used in the arrangement is leased.
2. The objective of this Agenda Paper is to provide the Interpretations Committee with a summary of the issue, along with the staff analysis and recommendation.
3. The submission is reproduced in full in Appendix B of this paper.
4. This paper provides:
 - (a) a summary of the issue;
 - (b) staff analysis;
 - (c) summary of the outreach result;
 - (d) agenda criteria assessment;
 - (e) staff recommendation;
 - (f) Appendix A—Proposed wording for tentative agenda decision; and
 - (g) Appendix B—Submission.

Summary of the issue

5. The issue relates to the scope, recognition, presentation and measurement relating to a service concession arrangement, in which the infrastructure that is used in the arrangement is leased. The service concession arrangement in the submission relates to an operation of transport services (for example, a train). The submitter has provided a number of fact patterns, along with the potential issues associated with the arrangements of those fact patterns.

Fact patterns provided in the submission

6. The submitter identified the following fact patterns relating to a service concession arrangement and a lease agreement in question:

Overall

- (a) There are three parties involved in the overall arrangement, consisting of a grantor, an operator and a leasing company. The leasing company:
- (i) may be an affiliated company of the grantor, because the grantor and the leasing company are controlled by the same governmental body (Case 1); or
 - (ii) may be unaffiliated with the grantor.

Fact patterns relating to the service concession arrangement

- (a) The grantor determines all major aspects of the service that the operator must provide (ie type, price, frequency of service, quality level etc.).
- (b) The operator has the right to charge the grantor a fee for rendering the transport services. This fee covers the costs incurred by the operator including the lease arrangement, which is an integral part of the service concession arrangement initiated by the grantor.

- (c) The arrangement does not contain any construction or upgrade services with respect to the tracks or any other equipment that is used in the arrangement.

Fact patterns relating to the lease agreement

- (a) There is no residual value risk from the leased assets (ie the infrastructure) for the operator.
- (b) The lease does not transfer substantially all the risks and rewards incidental to the ownership. In particular, the lease term is not for the major part of the economic life of the assets.
- (c) The lease arrangement is economically linked to the grantor, because either:
 - (i) the leasing company is affiliated with the grantor and is controlled by the same governmental body (Case 1).
 - (ii) the leasing company is unaffiliated with the grantor, but it is provided with guarantees from the grantor regarding lease payments over the lease term and the residual value at the end of the lease term. At the end of the concession arrangement and at the option of the grantor, the grantor itself or the next operator will continue the lease of the infrastructure (rolling stock) (Case 2).

- 7. For the ease of reference, in this Agenda Paper we refer to the arrangement with the fact patterns relating to Case 1 and Case 2 as the ‘Case 1 arrangement’ and the ‘Case 2 arrangement’, respectively.

Issues and views identified

- 8. The submitter identified three issues with respect to the Case 1 and Case 2 arrangements. The issues relate to:
 - (a) scope—whether the arrangement falls within the scope of IFRIC 12 (Issue 1);

- (b) recognition—whether the lease arrangement gives rise to the recognition of assets and liabilities by the operator (Issue 2);¹ and
- (c) presentation and measurement—whether the recognised assets and liabilities should be presented on a gross or net basis and how recognised assets and liabilities should be measured (Issue 3).²

Issue 1—scope

9. The first issue relates to whether the Case 1 and Case 2 arrangements would fall within the scope of IFRIC 12. The submitter identified two views relating to this issue.

View A—within the scope of IFRIC 12

10. Proponents of this view believe that IFRIC 12 applies to both Cases 1 and 2 arrangements because:
- (a) the leased rolling stock is regarded as infrastructure;
 - (b) the grantor regulates what services the operator must provide with the infrastructure, to whom it must provide them and at what price; and
 - (c) the grantor controls any significant interest in the infrastructure at the end of the term of the arrangement.
11. These proponents claim that the condition in paragraph 10(c) would be met for both Cases 1 and 2 arrangements, because:
- (a) in Case 1 the grantor controls the residual interest through the control over the leasing company; and
 - (b) in Case 2 the grantor controls the residual interest through the right and responsibility to step into the lease contract at the end of the concession arrangement.

¹ Issue 2 becomes relevant if considerations of Issue 1 indicate that the arrangement is within the scope of IFRIC 12.

² Issue 3 becomes relevant if considerations of Issue 2 indicate that the operator has to recognise assets and liabilities at the commencement of the arrangement.

12. Proponents of this view believe that IFRIC 12 applies to these arrangements regardless of whether there are any construction or upgrade services with respect to the infrastructure.

View B—out of the scope of IFRIC 12

13. Proponents of this view argue that IFRIC 12 would be applicable to only service concession arrangements that involve, among other things, a construction and/or upgrade service in relation to the infrastructure. This is because paragraph 12 of IFRIC 12 states that (emphasis added) ‘the operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service *and* operates and maintains that infrastructure (operation services) for a specified period of time’.
14. They also point out that IFRIC 12 does not provide specific accounting requirements for operation services, but instead it directs entities to IFRS 15 *Revenue from Contracts with Customers* for accounting for such services.
15. Consequently, proponents of this view believe that because the operator provides only operation services and does not provide construction or upgrade services, these arrangements do not fall within the scope of IFRIC 12. They would account for the lease contract in accordance with IAS 17 *Leases*.

Issue 2—recognition

16. The second issue relates to whether the operator should recognise liabilities arising from the lease of the infrastructure, with corresponding assets at the commencement of the service concession arrangement.

View A—recognise liabilities associated with the lease arrangement, with corresponding assets at the start of the concession

17. Proponents of this view argue that lease payments are an integral part of the service concession arrangement, and they are a prerequisite for the operator to acquire the right to receive the fees for the public services. Consequently, proponents of this view would recognise a financial liability for the lease payments and a corresponding concession asset. In this regard, the present

value of the minimum lease payments to the leasing company would be used as a cost basis for the asset.

View B—deem the lease payments to be executory in nature, and hence no recognition of assets and liabilities at the start of the concession

18. Proponents of this view would see the lease payments by the operator as being executory in nature. Consequently, the operator would not recognise liabilities associated with the lease arrangement at the start of the concession. Instead, the operator would recognise lease expenses as they are incurred over the term of the concession arrangement.

Issue 3—presentation and measurement

19. The third issue relates to whether the operator acts as an agent with respect to the lease arrangement, and if so, whether it affects the presentation and measurement of the recognised assets and liabilities.
20. The submitter has presented that some may argue that the operator is acting as an agent in the lease arrangement and, therefore, no financial asset and financial liability should be recognised to the extent that those amounts relate to the amounts of the lease payments. This is because:
- (a) in Case 1, in a situation in which the legal entity acting as the lessor and the grantor are controlled by the same governmental body, the payments from the grantor to the operator and from the operator to the leasing company are, in essence, a ‘seesaw’ of cash flows without economic substance.
 - (b) in Case 2, the grantor provides the leasing company with substantial guarantees for the lease payments and residual value and controls the lease arrangement following the first lease term. In addition, proponents of this view claim that economically it is the grantor that is the lessee of the lease arrangement.

Staff analysis

21. In the following analyses, we will look at factors that entities should consider when determining the appropriate accounting in relation to each issue, and what impacts particular fact patterns could have on the conclusion of the analyses.

Issue 1—scope

22. We note from the scope requirements of IFRIC 12 that there are two important elements to consider in determining whether an arrangement falls within its scope. These include considerations relating to:
- (a) the grantor’s control over the services associated with the infrastructure, and any residual interest in the infrastructure: and
 - (b) the infrastructure used in the arrangement.
23. Paragraph 5 of IFRIC 12 sets out criteria about the control that the grantor must have in relation to the arrangement:

This Interpretation applies to public-to-private service concession 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—any significant residual interest in the infrastructure at the end of the term of the arrangement.
24. Paragraph 7 of IFRIC 12 specifies the types of infrastructure to which the Standard applies:

This Interpretation applies to both:

- (a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and
- (b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement.

25. Consequently, in assessing whether a particular arrangement falls within the scope of IFRIC 12, entities should analyse whether the arrangement meets the control criteria in paragraph 5 of IFRIC 12 and includes a type of infrastructure specified in paragraph 7 of IFRIC 12.

Control criterion in paragraph 5(a) of IFRIC 12

26. Paragraph 5(a) requires that the grantor must control or regulate:

- (a) what services the operator must provide with the infrastructure;
- (b) to whom the operator must provide those services; and
- (c) the price that the operator charges for those services.

27. Consequently, entities must assess whether the concession arrangement in question meets these conditions. We understand that this assessment requires judgement and, therefore, entities should consider all the facts and circumstances. In particular, in considering whether the arrangement meets the conditions in paragraph 26, they should consider the contractual terms of the arrangement as well as the relevant regulation applicable to the arrangement. In addition, in making this assessment, if there are any parties related to the grantor, those parties should be considered together with the grantor.

Paragraph AG2 of IFRIC 12 states:

... 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 regulators acting in the public interest, shall be regarded as related to the grantor for the purposes of this Interpretation.

28. With respect to the price condition, factors that entities should consider could include whether:
- (a) the grantor has a complete control over the price; and, if not,
 - (b) the price is regulated by the grantor, contract or regulator.
29. Paragraph AG3 of IFRIC 12 provides a guidance in relation to regulation of the price, which states:

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, for example by a capping mechanism. However, the condition shall be applied to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, shall be ignored. Conversely, if for example, a contract purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.

30. The Interpretations Committee also noted in the past with respect to the price condition that:³

... any reviews or approvals by the grantor required by the agreement would generally be sufficient to meet this requirement, and it would be inappropriate to assume that they are perfunctory or 'rubber stamps' that can be disregarded.

31. If, after considering all the facts and circumstances, entities conclude that the grantor has control over those described in paragraph 26, they should consider whether the grantor also has control over any significant residual interest in the infrastructure.

³ [IFRIC Update](#) in July 2009.

32. We think that if entities conclude that the grantor alone controls the conditions relating to the type of services using the infrastructure, then whether the leasing company is affiliated as in the Case 1 arrangement or not as in the Case 2 arrangement would not be relevant in assessing this condition. This is because it is the grantor who controls the conditions relating to the type of services using the infrastructure, and not the leasing company.

Control criterion in paragraph 5(b) of IFRIC 12

33. In order for a concession arrangement to fall within the scope of IFRIC 12, the grantor also has to control any significant residual interest in the infrastructure at the end of the term of the arrangement.
34. In making this assessment, entities have to consider the guidance in paragraph AG4 of IFRIC 12, which states:

For the purpose of condition (b), the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the infrastructure and give the grantor a continuing right of use throughout the period of the arrangement.

35. We note that factors that entities should consider in making an assessment in relation to the condition in paragraph 5(b) of IFRIC 12 could include the following:
- (a) whether the infrastructure comes back to the grantor at the end of the concession arrangement;
 - (b) duration of the concession arrangement in relation to the useful life of the infrastructure, including whether the infrastructure is used for its entire life in the concession arrangement; and
 - (c) whether the grantor has an option to acquire the infrastructure at the end of the concession arrangement.

The entities should consider whether these factors would suggest that the operator does not have a practical ability to sell or pledge the infrastructure

and whether the grantor has a continuing right of use throughout the period of the arrangement.

36. We note that in the Case 1 arrangement the leasing company of the infrastructure is an affiliated company of the grantor and they are controlled by the same governmental body, while in the Case 2 arrangement the leasing company is not affiliated with the grantor.
37. We think that this different fact pattern has impacts on the assessment.
38. In the Case 1 arrangement, because the grantor and the leasing company are controlled by the same governmental body, they should be considered together in making this assessment.
39. In this regard, if the infrastructure will go back to the leasing company, entities could conclude in the Case 1 arrangement that the grantor controls any significant residual interest in the infrastructure at the end of the term of the arrangement because the infrastructure will go back to the grantor (through the leasing company).
40. On the other hand, in the Case 2 arrangement in which the leasing company is not affiliated with the grantor, entities have to consider other factors to assess whether they would suggest that the operator is not able to sell or pledge the infrastructure during the term of the concession period.
41. In the Case 2 arrangement, the grantor has an option to continue to use the infrastructure either by itself or through the next operator under a new concession arrangement. In the light of this option, we think that entities should assess whether the option effectively prevents the operator from selling or pledging the infrastructure and whether such an option enables the grantor to have a continuing right of use of the infrastructure throughout the period of the arrangement. If it is concluded that the grantor's option is sufficient to prevent the operator from selling or pledging the infrastructure, entities would conclude that the arrangement in which such an option exists would meet the condition in paragraph 5(b) of IFRIC 12.
42. On the basis of the analysis, entities should consider all the facts and circumstances relating to the concession arrangement, and determine if any of

them would suggest that the operator is prevented from selling or pledging the infrastructure during the terms of the arrangement.

Infrastructure specified in paragraph 7 of IFRIC 12

43. In addition to the control criteria in paragraph 5 of IFRIC 12, entities should consider whether the infrastructure subject to the concession arrangement meets either of the conditions in paragraph 7 of IFRIC 12. Paragraph 7 states that the Standard applies to the following types of infrastructure:
- (a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and
 - (b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement.

Consequently, entities have to consider whether the infrastructure subject to the concession arrangement meets either of these conditions.

44. With respect to the type of infrastructure in (b) above, we are of the view that ‘existing’ infrastructure does not prevent the grantor from acquiring new infrastructure at the same time as entering into a service concession arrangement and giving access to the operator for the arrangement to be within the scope of IFRIC 12. This is because we think that there is no economic difference from the perspective of the operator, for which IFRIC 12 sets out requirements, if the grantor gives the operator access to the infrastructure that the grantor already owned or acquires for the purpose of the concession arrangement. We think that the condition (b) above merely highlights that the infrastructure in the arrangement does not need to be constructed or acquired by the operator on behalf of the grantor.
45. As is the case with the assessment for control in paragraph 5(b) of IFRIC 12, we think that whether the leasing company is affiliated with the grantor (ie the difference between the Case 1 arrangement and the Case 2 arrangement) could have impacts on this assessment.
46. If the grantor and the leasing company are considered together because they are controlled by the same governmental body (ie the Case 1 arrangement),

entities would conclude that the infrastructure used in the arrangement meets the condition in paragraph 7(b) of IFRIC 12. This is because, in such a case, entities would conclude that the grantor gives the operator access to the infrastructure that the grantor already owns (ie it was owned by the leasing company).

47. In contrast, in the Case 2 arrangement, because the leasing company is not affiliated with the grantor, entities would conclude that the conclusion in the previous paragraph would not apply to the Case 2 arrangement. This would be the case if in the Case 2 arrangement, the grantor is not considered to be the acquirer of the infrastructure with respect to the lease arrangement. This is because in such a case, the grantor does not give the operator access to the infrastructure that the grantor neither owns nor acquires. Consequently, in such a case, entities would have to consider whether the infrastructure in the Case 2 arrangement would meet the condition in paragraph 7(a) of IFRIC 12.
48. If the infrastructure does not meet the condition in paragraph 7(b) of IFRIC 12, and there is no construction or upgrade services in relation to the infrastructure, entities have to consider whether the operator acquires the infrastructure for the purpose of the service concession arrangement.
49. In this regard, we note that paragraph 7(a) of IFRIC 12 uses the term 'acquires', but we think that it should not be limited to purchases of the infrastructure. This is because, in our view, procuring the infrastructure through a lease agreement with a third party would have the same economic effects within the context of the service concession arrangement in following ways:
 - (a) the operator makes an up-front investment (commitment to pay a large sum of consideration to the supplier (purchase) or the lessor (lease)).
 - (b) through the transaction, either by purchase or lease, the operator acquires a right of use of the asset solely for the purpose of the service concession arrangement. In other words, purchases and leases of the infrastructure by the operator are the same in the sense that both of these are an integral part of the service concession arrangement.

Consequently, we think that entities could still conclude that the infrastructure in the Case 2 arrangement would meet the condition included in paragraph 7 of IFRIC 12 even if they concluded that the infrastructure does not meet the condition in paragraph 7(b), if they concluded that the lease arrangement was entered into as an integral part of, and solely for, the purpose of the service concession arrangement.

No construction or upgrade services of the infrastructure

50. We note that the main argument for the view that both Cases 1 and 2 arrangements do not fall within the scope of IFRIC 12 is that there are no construction or upgrade services in relation to the infrastructure used in the concession arrangement. We understand that the statement in paragraph 12 of IFRIC 12 contributes to ambiguity in this respect, because it states (emphasis added):

Under the terms of contractual arrangements within the scope of this Interpretation, the operator acts as a service provider. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service *and* operates and maintains that infrastructure (operation services) for a specified period of time.

51. However, we are of the view that IFRIC 12 envisages its application to a service concession arrangement in which there are neither construction nor upgrade services in relation to the infrastructure used in the arrangement. This is because the infrastructure specified in paragraph 7(b) of IFRIC 12 is a grantor's existing infrastructure to which the grantor gives the operator access. If the grantor gives the operator access to its existing infrastructure, it implies that there are no construction or upgrade services by the operator that are associated with that infrastructure. Consequently, we think that IFRIC 12 also applies to arrangements in which there are no construction or upgrade services, as long as those arrangements meet other scope requirements.

Summary for the scope issue

52. On the basis of the analysis, we believe that the entities should consider all the facts and circumstances in making an assessment on whether the concession arrangement meets the control conditions in paragraph 5 of IFRIC 12 and the condition relating to the infrastructure in paragraph 7 of IFRIC 12. In addition, we are of the view that construction or upgrade services of the infrastructure is not necessary for the arrangement to fall within the scope of IFRIC 12 as long as the scope requirements are met.

Issue 2—recognition

53. As analysed in the previous section, we think that the arrangements in both Cases 1 and 2 could fall within the scope of IFRIC 12, depending on a detailed analysis of the given facts and circumstances. Consequently, we next analyse whether Cases 1 and 2 would result in the operator recognising assets and liabilities at the commencement of the service concession arrangement for circumstances in which it is concluded that the arrangements are in the scope of IFRIC 12.
54. We note that:
- (a) in Case 1 any payments made by the operator to the leasing company constitute the operator's payments to the grantor, because in Case 1 the grantor and the leasing company are controlled by the same governmental body.
 - (b) the Interpretations Committee had considered and resumed considering accounting for payments made by the operator to the grantor within the context of the service concession arrangement. The latest discussion on this issue can be found in [Agenda Paper 6B](#) of the September 2015 Interpretations Committee meeting.
55. We think that the conclusion of our analysis on Issue 2 with respect to the Case 1 arrangement depends on the outcome of the separate issue that the

Interpretations Committee continues to discuss. Consequently, we think that this issue should be considered together with the other project.

56. Consequently, the following analysis considers only the Case 2 arrangement.
57. The second issue relates to whether, and if so, how the operator should recognise liabilities arising from the lease of the infrastructure with a corresponding asset.
58. We think that in making an assessment on whether the operator should recognise a liability with a corresponding asset at the commencement of the service concession arrangement, it is important to consider whether a contract is executory. This is because if the contract is executory, generally no asset or liability is recognised.
59. We are of the view that in making this assessment, entities should not consider requirements in IAS 17 because once the arrangement is within the scope of IFRIC 12, there is no lease for the operator. This is because under the service concession arrangement that falls within the scope of IFRIC 12, the operator does not control the right to use the infrastructure, but instead it merely has access to the infrastructure that is controlled by the grantor.
60. When determining whether a contract is executory or not, factors that entities could consider include :
 - (a) whether the leasing company has already performed its obligation by making the infrastructure available for the use for the public services; and
 - (b) whether the operator has performed part of its obligation in the service concession arrangement, such as procuring and transferring the right of use of the infrastructure to the grantor in order to obtain a financial asset or intangible asset or both.
61. If entities conclude that the contract is no longer executory, we think that the operator would have to recognise a liability for the future payments to the leasing company on the basis of the present value of the future payments.

62. With respect to a corresponding asset, we are of the view that the operator would not recognise a leased asset because, as noted in paragraph 59, it is the grantor and not the operator who controls the infrastructure. Instead, we think that the type of asset that the operator would recognise depends on the contractual terms between the operator and the grantor in terms of the consideration given by the grantor to the operator. In accordance with paragraphs 15–19 of IFRIC 12, the operator recognises:

- (a) a financial asset to the extent that it has an unconditional right to receive cash or another financial asset from, or at the direction of, the grantor;
- (b) an intangible asset to the extent that the operator receives a right (license) to charge users of the public service; or
- (c) both a financial asset and an intangible asset if the operator is compensated partly by a financial asset and partly by an intangible asset.

63. Paragraph 16 of IFRIC 12 goes on to explain a circumstance in which an operator has an unconditional right to receive cash as follows:

The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

64. We understand that these requirements are provided within the context of consideration for construction services, but we think that these requirements are also applicable to arrangements in which there are no construction or upgrade services. This is because, in our view, even in circumstances in which the operator does not perform any revenue-generating activities at the start of

the concession arrangement (ie construction or upgrade services), if they fall within the scope of IFRIC 12, its requirements would be applicable.

65. Consequently, we are of the view that the operator considered in Case 2 would have to recognise a financial asset, an intangible asset or both, depending on the nature of the consideration given by the grantor.
66. We note that in Case 2 the operator has the right to charge the grantor a fee for rendering the transport services and that this fee covers the costs incurred by the operator, including the lease arrangement. It is, however, not clear whether this arrangement creates an enforceable right for the operator to receive:
- (a) fixed or determinable amounts of payments from the grantor;
 - (b) variable amounts of payments from the grantor, depending on the usage of the public services; or
 - (c) fixed or determinable amounts of payments to a certain extent, with the excess being variable, if any.
67. We understand that the terms of any service concession arrangement can be complex and, therefore, entities have to understand the nature of the consideration with reference to the contract terms, in order to determine an appropriate type of asset to recognise.

Summary for the recognition issue

68. On the basis of the analysis, we think that entities should first consider whether there are any parts of the service concession arrangement that are not executory at commencement. If entities conclude that the arrangement is not executory, they would have to recognise a liability with a corresponding asset, which depends on the nature of the consideration that the operator receives from the grantor.

Issue 3—presentation and measurement

69. The third issue included in the submission relates to the role of the operator and if the conclusion of such an assessment affects the presentation and measurement of the recognised assets and liabilities.
70. As is the case with the analysis on Issue 2, the following considers only the Case 2 arrangement.
71. With respect to an assessment of whether the operator acts as an agent with respect to the lease arrangement, entities should consider all the facts and circumstances.
72. In making this assessment, factors to consider could include:
- (a) who controls the benefits arising from the lease arrangement; and
 - (b) whether the operator assumes risks associated with payments to the leasing company.
73. In this regard, we note that the following factors could be an indication that the operator acts as an agent with respect to the lease arrangement:
- (a) the operator appears not to control the right of use over the infrastructure, but it merely has a right to access the infrastructure for the purpose of the service concession arrangement; instead
 - (b) in service concession arrangements that are within the scope of IFRIC 12, it is the grantor that controls the right of use over the infrastructure.
74. In contrast, if the operator is obliged to make payments to the leasing company regardless of whether or not the service operates and revenue is generated, it could be an indication that:
- (a) the operator assumes the risks associated with the lease arrangement; and therefore,
 - (b) the operator is acting as a principal.
75. We think that even if entities conclude that the operator acts as an agent with respect to the lease arrangement, if they concluded that the arrangement is not executory, the operator would have to recognise a liability for its obligation to

make future payments to the leasing company, with a corresponding asset.

This is because we think that being an agent itself does not exempt the operator from a contractual obligation to make future payments to the leasing company, nor does it deprive the operator of a contractual right to receive cash from the grantor or an intangible asset.

76. If, however, the asset that the operator receives represents a financial asset, we think that entities should consider whether there is an agreement and intention to settle on a net basis among the three parties. We think that this assessment should be performed in accordance with IAS 32 *Financial Instruments:*

Presentation:, which would require:

- (a) the parties to the lease arrangement (ie the grantor, the operator and the leasing company) to currently have a legally enforceable right to set off the recognised amounts; and
- (b) that they intend either to settle on a net basis or to realise the asset and settle the liability simultaneously.

77. We are of the view that it is unlikely that the conditions in the previous paragraph would be met for the Case 2 arrangement. This is because the offsetting arrangement does not seem to be consistent with the service concession arrangement, in which the operator separately enters into a lease arrangement with a third party leasing company. Consequently, we think that even if entities conclude that the contract is not executory and the operator has a financial asset to receive cash from the grantor and a liability to make future lease payments, the asset and the liability would be presented on a gross basis.

78. Consequently, we think that as long as it is the operator that has a contractual obligation to make future payments to the leasing company and a contractual right to receive cash from the grantor or an intangible asset, the operator would account for the asset and liability separately. The operator would, therefore, not present these obligations and rights on a net basis.

Summary for the presentation and measurement issue

79. On the basis of the analysis, we think that entities should consider all the facts and circumstances in making an assessment on whether the operator acts as an agent with respect to the lease arrangement. In addition, even if the operator is considered to be an agent with respect to the lease arrangement, we think that as long as it is the operator that has a contractual obligation to make future payments to the leasing company and a contractual right to receive cash from the grantor or an intangible asset, the operator would account for the asset and liability separately and present them on a gross basis.

Summary of the outreach result

80. We have performed outreach with members of the International Forum of Accounting Standard Setters (IFASS), securities regulators and global accounting firms. Specifically, we asked:
- (a) Question 1—Are these issues common or prevalent in your jurisdiction? If yes, please provide us with qualitative or quantitative information about how common they are.
 - (b) Question 2—When faced with these issues, what is the prevalent practice applied in your jurisdiction, in what circumstance and why?
 - (c) Question 3—Did you observe diversity in practice? If so, please explain how and why the accounting is diversified.
81. We received 14 responses from seven IFASS members, five global accounting firms and two groups of securities regulators.
82. By region, responses were received from two securities regulators, five global accounting firms and seven jurisdictions (three jurisdictions from Asia and Oceania, two from Europe and two from Americas). The views received represent informal opinions and do not reflect the formal views of those organisations.

Responses to Question 1

83. Four respondents said that the issue is common. Of these four respondents, one of them said that the issue is common in the UK, while another respondent said that the issue is common in France and in the UK. Other respondents said that the issue is not common in their jurisdictions.

Responses to Question 2

84. Views on the predominant accounting were mixed.
85. The respondent who commented that the issue is common in the UK said that the predominant accounting is not to apply IFRIC 12 to a concession arrangement in which the arrangement includes operation services only (ie View B for Issue 1). The respondent noted that the various parts of IFRIC 12 seemed to support View B, including paragraphs 2, 12 and BC12 of IFRIC 12.
86. In addition, the respondent who said that the issue is common in France and in the UK commented that the predominant accounting in the UK is that the arrangements included in the submission are deemed out of the scope of IFRIC 12. The respondent explained that this was because there are significant levels of unregulated revenue earned by the operator, which would lead to a determination that the condition in paragraph 5(a) of IFRIC 12 is not met. The respondent also commented that if the condition in paragraph 5(a) was met, the arrangement in the submission would fall within the scope of IFRIC 12.
87. In contrast, two other respondents who said that the issue is common commented that the predominant accounting is that the arrangement included in the submission would be within the scope of IFRIC 12 (ie View A for Issue 1). With respect to Issue 2, one of them commented that the predominant accounting observed in the respondent's jurisdiction is that the operator would treat the lease arrangement as executory and, therefore, account for the arrangement under IAS 17 as an operating lease. In contrast, the other respondent said that the predominant accounting treatment with respect to Issue 2 is to recognise a liability for future lease payments with a

corresponding asset. Both of these respondents commented that the operator would be seen as a principal with respect to the service concession arrangement.

Responses to Question 3

88. Only one respondent commented that there was some diversity in practice in a jurisdiction.

Other comment

89. One respondent suggested that this issue should be considered together with the issue relating to the accounting for payments made by the operator to the grantor within the context of the service concession arrangement.

Agenda criteria assessment

Agenda criteria	
We should address issues (see paragraph 5.16 of the <i>IFRS Foundation Due Process Handbook</i>):	
that have widespread effect and have, or are expected to have, a material effect on those affected.	Yes , according to the feedback on the outreach, the issue is common and has widespread effect in a certain jurisdiction.
in which financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	No , we think that diversity in practice is limited. Furthermore, we consider that there is sufficient guidance in existing Standards.
that can be resolved efficiently within the confines of existing IFRS and the <i>Conceptual Framework for Financial Reporting</i> .	N/A
In addition:	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address it in an efficient manner, but not so narrow that it is not cost-effective for it to undertake the due process that would be required when making changes to IFRS (see paragraph 5.17 of the <i>IFRS Foundation Due Process Handbook</i>)?	N/A

Agenda criteria	
<p>Will the solution developed by the Interpretations Committee be effective for a reasonable time period (see paragraph 5.21 of the <i>IFRS Foundation Due Process Handbook</i>)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).</p>	N/A

Summary and staff recommendation

90. A summary of our analysis is that:

Issue 1—scope:

- (a) An assessment of whether a particular arrangement falls within the scope of IFRIC 12 requires judgement and, therefore, entities should consider all the facts and circumstances in making an assessment on whether the concession arrangement meets the control conditions in paragraph 5 of IFRIC 12 and the condition relating to the infrastructure in paragraph 7 of IFRIC 12.
- (b) In making an assessment of whether the grantor has control over the services that the operator must provide, to whom the operator must provide those services and at what price (ie the condition in paragraph 5(a) of IFRIC 12), entities should take into account any parties related to the grantor.
- (c) When assessing whether the grantor has any significant residual interest in the infrastructure (ie the condition in paragraph 5(b) of IFRIC 12), entities should exercise judgement. They should assess whether the facts and circumstances would suggest that the operator does not have a practical ability to sell or pledge the infrastructure and whether the grantor has a continuing right of use throughout the period of the arrangement.
- (d) We think that the construction or upgrade services of the infrastructure are not necessary for the arrangement to fall within the scope of IFRIC 12 as long as the scope requirements are met.

Issue 2—recognition⁴

- (a) Entities should first consider whether there are any parts of the service concession arrangement that are not executory at the commencement. If it is concluded that the arrangement is not executory, entities would have to recognise a liability with a corresponding asset.
- (b) Entities have to assess the type of asset to recognise on the basis of the nature of the consideration that the operator receives from the grantor. The operator should recognise:
 - (i) a financial asset to the extent that it has an unconditional right to receive cash or another financial asset from, or at the direction of, the grantor;
 - (ii) an intangible asset to the extent that the operator receives a right (licence) to charge users of the public service; or
 - (iii) both a financial asset and an intangible asset if the operator is compensated partly by a financial asset and partly by an intangible asset.

Issue 3—presentation and measurement⁴

- (a) As long as it is the operator that has a contractual obligation to make future payments to the leasing company and a contractual right to receive cash from the grantor or an intangible asset, the operator would account for the asset and liability separately. Consequently, the operator would not present these obligations and rights on a net basis.
91. We think that there is sufficient guidance in the Standards to enable us to reach these conclusions. On the basis of our analysis, we recommend that the Interpretations Committee should not add the issue onto its agenda. The proposed wording for the tentative agenda decision is set out in Appendix A of this paper.

⁴ As explained in paragraphs 52–55, for these issues we analysed only the Case 2 arrangement.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree with the staff's recommendation that it should not add this issue to its agenda?
2. If the answer to Question 1 is 'Yes', does the Interpretations Committee agree with the wording of the tentative agenda decision in Appendix A of this paper?

Appendix A

Proposed wording for the tentative agenda decision

A1. We propose the following wording for the tentative agenda decision.

IFRIC 12 *Service Concession Arrangement*—Accounting for combined service concession and lease arrangements

The IFRS Interpretations Committee (the ‘Interpretations Committee’) received a request to clarify an issue relating to application of IFRIC 12 *Service Concession Arrangements*. More specifically, the issue relates to the scope, recognition, presentation and measurement relating to a service concession arrangement, in which the infrastructure used in the arrangement is leased.

The key features of the service concession arrangement and the lease arrangement were:

Overall

There are three parties involved in the overall arrangement, consisting of a grantor, an operator and a leasing company. The leasing company:

- (a) is an affiliated company of the grantor, because the grantor and the leasing company are controlled by the same governmental body (Case 1); or
- (b) is unaffiliated with the grantor.

Fact patterns relating to the service concession arrangement

- (a) The grantor determines all major aspects of the service that the operator must provide (ie type, price, frequency of service, quality level etc).
- (b) The operator has the right to charge the grantor a fee for rendering the transport services. This fee covers the costs incurred by the operator including the lease arrangement, which is an integral part of the service concession arrangement initiated by the grantor.
- (c) The arrangement does not contain any construction or upgrade services

with respect to the tracks or any other equipment that are used in the arrangement.

Fact patterns relating to the lease agreement

- (a) There is no residual value risk from the leased assets (ie the infrastructure) for the operator.
- (b) The lease does not transfer substantially all the risks and rewards incidental to the ownership. In particular, the lease term is not for the major part of the economic life of the assets.
- (c) The lease arrangement may be economically linked to the grantor, because:
 - (i) in Case 1, the leasing company is affiliated with the grantor.
 - (ii) in Case 2, the leasing company is unaffiliated with the grantor, but it is provided with guarantees from the grantor regarding lease payments over the lease term and the residual value at the end of the lease term. At the end of the concession arrangement and at the option of the grantor, the grantor itself or the next operator will continue the lease of the infrastructure (rolling stock).

The Interpretations Committee discussed the three questions relating to the arrangements in Cases 1 and 2.

Issue 1—scope

The first question relates to whether the arrangements with particular fact patterns would fall within the scope of IFRIC 12.

The Interpretations Committee noted that an assessment of whether a particular arrangement falls within the scope of IFRIC 12 requires judgement and, therefore, entities should consider all the facts and circumstances in making an assessment on whether the concession arrangement meets the

control conditions in paragraph 5 of IFRIC 12 and the condition relating to the infrastructure in paragraph 7 of IFRIC 12.

The Interpretations Committee noted that in making an assessment of whether the grantor has control over services that the operator must provide, to whom the operator must provide those services and at what price (ie the condition in paragraph 5(a) of IFRIC 12), entities should take into account any parties related to the grantor.

The Interpretations Committee was also noted that when assessing whether the grantor has any significant residual interest in the infrastructure (ie the condition in paragraph 5(b) of IFRIC 12), entities should exercise judgement to determine whether the facts and circumstances would suggest that the operator does not have a practical ability to sell or pledge the infrastructure and whether the grantor has a continuing right of use throughout the period of the arrangement.

The Interpretations Committee also noted that construction or upgrade services of the infrastructure are not necessary for the arrangement to fall within the scope of IFRIC 12 as long as the scope requirements are met.

Issue 2—recognition

The second issue relates to whether the operator should recognise liabilities arising from the lease of the infrastructure, with corresponding assets at the commencement of the service concession arrangement.

With respect to the arrangement in Case 1, the Interpretations Committee noted that:

- (a) any payments made by the operator to the leasing company constitute the operator's payments to the grantor because, in Case 1, the grantor and the leasing company are controlled by the same governmental body; and
- (b) the Interpretations Committee had been considering accounting for payments made by the operator to the grantor within the context of the service concession arrangement.

Consequently, the Interpretations Committee thought that this issue should be considered in the Interpretations Committee's other project that deals with accounting for payments to the grantor by the operator.

With respect to an arrangement in which the operator does not make payments to the grantor, the Interpretations Committee noted that entities should first consider whether there are any parts of the service concession arrangement that are not executory at the commencement. If entities conclude that the arrangement is not executory, they would have to recognise a liability with a corresponding asset. The Interpretations Committee noted that entities have to assess the type of asset to recognise on the basis of the nature of the consideration that the operator receives from the grantor. It noted that the operator would recognise:

- (a) a financial asset to the extent that it has an unconditional right to receive cash or another financial asset from ,or at the direction of, the grantor;
- (b) an intangible asset to the extent that the operator receives a right (license) to charge users of the public service; or
- (c) both a financial asset and an intangible asset if the operator is compensated partly by a financial asset and partly by an intangible asset.

Issue 3—presentation and measurement

The third issue relates to whether the operator acts as an agent with respect to the lease arrangement, and if so, whether it affects the presentation and measurement of the recognised assets and liabilities.

In assessing whether the operator acts as a principal or agent, the Interpretations Committee noted that entities should consider, among other things:

- (a) who controls the benefits arising from the lease arrangement; and
- (b) whether the operator assumes risks associated with payments to the leasing company.

The Interpretations Committee also noted that as long as it is the operator that has a contractual obligation to make future payments to the leasing company and a contractual right to receive cash from the grantor or an intangible asset, the operator would account for the asset and liability separately.

Consequently, the operator would not present these obligations and rights on a net basis.

On the basis of this analysis, the Interpretations Committee concluded that, in the light of the existing requirements of IFRIC 12, sufficient guidance exists and that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.