

## STAFF PAPER

March 2016

## IFRS Interpretations Committee Meeting

Project	IFRIC 12 <i>Service Concession Arrangements</i>		
Paper topic	Service concession arrangements with leased infrastructure		
CONTACT(S)	Jawaid Dossani	<a href="mailto:jdossani@ifrs.org">jdossani@ifrs.org</a>	+44 (0)20 7332 2742

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 Standard do not purport to be acceptable or unacceptable application of that IFRS Standard—only the IFRS Interpretations Committee or the International Accounting Standards Board (the ‘Board’) 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 clarify how an operator accounts for a service concession arrangement in which the infrastructure is leased and the operator is not required to provide any construction or upgrade services in relation to the infrastructure. The submitter asked the Interpretations Committee to clarify whether:
  - (a) the arrangement is within the scope of IFRIC 12 *Service Concession Arrangements* (hereafter referred to as the ‘scope issue’);
  - (b) the operator recognises assets and liabilities arising from the lease arrangement (hereafter referred to as the ‘recognition issue’)<sup>1</sup>; and
  - (c) the operator can present the assets and liabilities arising from the lease arrangement on a net basis (hereafter referred to as the ‘presentation issue’).<sup>2</sup>

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<sup>1</sup> The recognition issue is relevant if the arrangement is within the scope of IFRIC 12.

<sup>2</sup> The presentation issue is relevant only if the operator is required to recognise assets and liabilities arising from the lease arrangement.

2. The Interpretations Committee discussed this issue at its meeting in November 2015. With respect to the scope issue, the Interpretations Committee observed that:<sup>3</sup>
  - (a) assessing whether a particular arrangement is within the scope of IFRIC 12 requires careful consideration of all facts and circumstances. In particular, the operator assesses whether the control conditions in paragraph 5 of IFRIC 12 and the condition relating to the infrastructure in paragraph 7 of IFRIC 12 apply; and
  - (b) the operator is not required to provide construction or upgrade services with respect to the infrastructure to conclude that the arrangement is within the scope of IFRIC 12.
3. With respect to the recognition and presentation issues, the Interpretations Committee noted that an agenda decision is likely to be appropriate for these issues, but directed the staff to perform further analysis of the issues.
4. The purpose of this paper is:
  - (a) to provide an analysis of the recognition and presentation issues;
  - (b) to ask the Interpretations Committee whether it agrees with the staff recommendation not to add this issue to its agenda; and
  - (c) to propose wording for a tentative agenda decision.
5. We have not included any discussion and analysis of the scope issue, because the Interpretations Committee concluded upon this issue at its meeting in November 2015 (see paragraph 2 of this paper). For the purposes of our analysis of the recognition and presentation issues, we have assumed that the arrangement is within the scope of IFRIC 12 (because these issues are relevant only if that is the case).

### **Structure of the paper**

6. This paper is organised as follows:
  - (a) background information;

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<sup>3</sup> [Agenda Paper 13](#) from the Interpretations Committee's meeting in November 2015 provides further details on the staff analysis of this issue.

- (b) staff analysis;
- (c) assessment against the Interpretations Committee’s agenda criteria;
- (d) staff recommendation and questions for the Interpretations Committee;
- (e) Appendix A—Proposed wording for tentative agenda decision; and
- (f) Appendix B—Submission.

**Background information**

- 7. The submitter describes an arrangement that involves three parties: a grantor (governmental body), an operator and a lessor. The operator enters into an arrangement with the grantor to provide a public service (such as the provision of rail services). The infrastructure used in the arrangement is leased from the lessor. The lessor may be related to the grantor (because they are both controlled by the same governmental body). The arrangements are collectively referred to as the ‘service concession arrangement’.
- 8. The submission is reproduced in Appendix B for ease of reference. We describe below some key terms and conditions relating to the concession arrangement between the grantor and the operator, and the arrangement with the lessor.

***Key terms and conditions relating to the service concession arrangement***

*Concession arrangement*

- 9. The grantor determines the major aspects of the service that the operator must provide (ie type of service, pricing of the service, frequency of service, quality level, etc).
- 10. The operator has the right to receive a fee for providing the public service. This fee also covers the costs incurred by the operator for the lease arrangement, which is an integral part of the service concession arrangement initiated by the grantor.
- 11. The operator does not provide any construction or upgrade services with respect to the infrastructure that is used in the arrangement.

*Arrangement with the lessor*

12. The operator makes lease payments to the lessor (hereafter referred to as ‘lease-related payments’) and is responsible for proper maintenance of the infrastructure during the term of the arrangement.
13. The lease does not transfer substantially all the risks and rewards incidental to ownership of the infrastructure to the operator. In particular, the lease term is not for the major part of the economic life of the infrastructure. The operator does not have any residual value risk associated with the infrastructure.
15. If the lessor is not related to the grantor, the grantor provides a guarantee of the lease payments during the lease term, and also of the residual value at the end of the lease term. The grantor has an option to renew the lease at the end of the initial non-cancellable period of the contract (ie at the option of the grantor, either the grantor itself, or the next operator, can continue the lease).

*Other key terms and conditions*

16. We understand from the submission that:
  - (a) the operator may receive a right to charge users of the public service or it may receive an unconditional contractual right to receive cash from the grantor in exchange for operating the public service. Regardless of the nature of its rights arising from operating the public service, the operator receives an unconditional contractual right to receive cash from the grantor in relation to the provision of the lease-related services (ie entering into the lease and making lease payments); and
  - (b) in general, the contracts do not provide the operator with a right to offset the lease payments to be made to the lessor with the right to receive cash from the grantor, even if the lessor is related to the grantor.

***Issues identified***

17. The submitter identifies two issues with respect to this arrangement (excluding the scope issue—see paragraphs 2 and 5 of this paper).

*Recognition issue*

18. The submitter notes that, if the service concession arrangement is within the scope of IFRIC 12, paragraph 11 of IFRIC 12 specifies that the operator does not have the right to control the use of the infrastructure. Consequently, the arrangement with the lessor is outside the scope of IFRS 16 *Leases* (IAS 17 *Leases*) for the operator.
19. The submitter identifies two differing views on how the operator accounts for the lease-related payments:
  - (a) recognise the lease-related payments as expenses when incurred over the term of the arrangement, because the lease-related payments are deemed to be executory in nature; or
  - (b) at the start of the concession arrangement, recognise a financial liability for the present value of the lease-related payments and a corresponding asset.

*Presentation issue*

20. The submitter notes that some may argue that the operator is acting as an agent in setting up and managing the arrangement with the lessor. In that case, some think that the operator would either net or not recognise any financial asset and financial liability arising as a consequence of the arrangement with the lessor at the start of the service concession arrangement. This is because:
  - (a) in arrangements in which the lessor and the grantor are controlled by the same governmental body, the lease-related payments are, in essence, a movement of cash between two related parties that has no economic substance.
  - (b) in arrangements in which the lessor is not related to the grantor, the grantor provides the lessor with guarantees for the lease-related payments and any residual value, and controls the arrangement with the lessor following the initial non-cancellable lease term. In addition, those who view the operator as an agent claim that, economically, it is the grantor that is the lessee in the lease arrangement. Therefore, the operator merely acts as a conduit that receives payments from the grantor and then passes those payments to the lessor on the grantor's behalf.

## Staff analysis

21. We have separately analysed the accounting for the lease-related payments for arrangements in which the lessor is related to the grantor and for arrangements in which it is not.

### ***The lessor is related to the grantor***

22. 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.
23. The grantor and the lessor are both controlled by the same governmental body and are related parties. Accordingly, and consistently with our analysis presented in [Agenda Paper 13](#) of the Interpretations Committee's meeting in November 2015, we think that the lease payments made by the operator to the lessor are, in substance, payments made by an operator to a grantor in a service concession arrangement.
24. The operator is providing two services: (a) the operation of the public service, and (b) the provision of lease-related services in respect of the infrastructure (ie entering into the lease contract and making lease-related payments). We understand from the fact pattern in the submission that the operator receives an unconditional contractual right to receive cash from the grantor in relation to the provision of the lease-related services. The operator will therefore apply the financial asset model in IFRIC 12 to the lease-related services portion of the service concession arrangement.
25. The Interpretations Committee recently considered the accounting for payments made by an operator to a grantor in a service concession arrangement. The Interpretations Committee could not reach a consensus on how an operator accounts for variable payments to be made to a grantor in a service concession arrangement when the intangible asset model in IFRIC 12 applies. Consequently, the Interpretations Committee tentatively decided not to add that issue to its agenda, and issued a

tentative agenda decision in the January 2016 [IFRIC Update](#). In the tentative agenda decision, the Interpretations Committee observed that:

if the service concession arrangement results in the operator having only a contractual right to receive cash from the grantor (ie the financial asset model in IFRIC 12 applies), the Interpretations Committee observed that the grantor is no different from a customer in a revenue arrangement. Consequently, the contractual payments would be accounted for in accordance with the guidance on consideration payable to a customer in paragraphs 70-72 of IFRS 15 *Revenue from Contracts with Customers*.

26. Accordingly, in arrangements in which the lessor is related to the grantor, we think that the operator accounts for the lease-related payments to be made to the lessor applying the requirements for consideration payable to a customer in paragraphs 70-72 of IFRS 15. In these arrangements, the operator accounts for the lease-related payments as a reduction of the transaction price and, therefore, of revenue.

***The lessor is not related to the grantor***

*Recognition issue*

27. To assess whether the operator recognises a liability to make lease-related payments to the lessor, the operator first assesses which party (ie the operator or the grantor) is obliged to make those lease-related payments.
28. On the basis of the facts presented in the submission, we understand that:
- (a) the operator is contractually required to make the lease-related payments;
  - (b) the contracts do not provide the operator with a right to offset the lease-related payments against its right to receive cash from the grantor; and
  - (c) the grantor provides a guarantee to the lessor of the lease-related payments over the term of the lease.
29. Those facts indicate that the operator is obliged to make the lease-related payments to the lessor. We do not think that the guarantee provided by the grantor to the lessor is,

in itself, relevant to this assessment. The guarantee is secondary and does not extinguish the operator's obligation to make the lease-related payments.

30. Nonetheless, an analysis of which party (ie the operator or the grantor) is obliged to make lease-related payments requires careful consideration of all facts and circumstances.
31. If the operator determines that it is obliged to make the lease-related payments to the lessor, it must then assess when it should recognise the liability associated with this obligation.
32. The obligation to make lease-related payments arises from a contract, and thus meets the definition of a financial liability<sup>4</sup>.
33. Paragraph 3.1.1 of IFRS 9 *Financial Instruments* states:

An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs B3.1.1 and B3.1.2) ...
34. Paragraph B3.1.2(b) states (emphasis added):

Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised *until at least one of the parties has performed under the agreement*. For example, an entity that receives a firm order does not generally recognise an asset (and the entity that places the order does not recognise a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered...
35. Consequently, in assessing when it recognises the financial liability to make lease-related payments, the operator assesses whether the counterparty (ie the lessor) has performed under the contract.

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<sup>4</sup> Paragraph 11 of IAS 32 further specifies that a financial liability is a contractual obligation to deliver cash or another financial asset to another entity.

36. Because this arrangement is a service concession arrangement, the operator does not have the right to control the use of the infrastructure<sup>5</sup>. As mentioned earlier in the paper, this means that the arrangement with the lessor is not within the scope of IFRS 16 (IAS 17) for the operator. Nonetheless, because the counterparty is a lessor in this arrangement, we think that it is useful to consider the Board's explanation in the Basis for Conclusions on IFRS 16 to assess whether the lessor has performed under the contract.

37. Paragraph BC25 of IFRS 16 states (emphasis added):

The Conceptual Framework defines a liability as 'a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'. The IASB concluded that the lessee's obligation to make lease payments meets the definition of a liability for the following reasons:

(a) the lessee has a present obligation to make lease payments once the *underlying asset has been made available to the lessee*. That obligation arises from past events—not only the *commitment to the lease contract* but also the *underlying asset being made available for use by the lessee*. Unless the lessee renegotiates the lease, the lessee has no right to cancel the lease and avoid the contractual lease payments (or termination penalties) before the end of the lease term.

(b) the obligation results in a future outflow of economic benefits from the lessee—typically contractual cash payments in accordance with the terms and conditions of the lease.

38. Similarly, we think that the operator's obligation to make lease-related payments meets the definition of a liability at the start of the service concession arrangement (once the underlying asset is made available by the lessor). This is because:

(a) the operator has a present obligation to make lease-related payments once the underlying asset is made available by the lessor. That obligation arises from past events—not only the commitment to the service concession

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<sup>5</sup> Paragraph 11 of IFRIC 12.

arrangement, but also the underlying asset being made available by the lessor. Unless the operator renegotiates the service concession arrangement, the operator has no right to cancel the arrangement with the lessor and avoid the contractual lease-related payments before the end of the term of the service concession arrangement; and

- (b) the obligation results in a future outflow of economic benefits from the operator—typically, contractual cash payments in accordance with the terms and conditions of the lease arrangement.

39. Consequently, at the start of the concession arrangement when the infrastructure is made available by the lessor, we think that the operator recognises a financial liability and a corresponding concession asset. The submitter notes that the operator receives an unconditional contractual right to receive cash from the grantor in relation to the provision of the lease-related services. We therefore think that the corresponding concession asset recognised by the operator is a financial asset.

*Presentation issue*

40. Paragraph 42 of IAS 32 states that (emphasis added):

A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position *when, and only when*, an entity:

- (a) currently has a legally enforceable right to set off the recognised amounts; and
- (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

41. The submitter notes that the contracts that form part of the service concession arrangement do not grant the operator a right to offset the obligation to make lease-related payments against the right to receive cash from the grantor. Applying the requirements in IAS 32, the operator is therefore unable to offset its liability to make lease-related payments to the lessor and its right to receive cash from the grantor.
42. The submitter asks whether the role of the operator as an agent or a principal in the arrangement with the lessor affects the presentation of the asset and liability. The

operator's obligation to make lease-related payments is a financial liability. Accordingly, this financial liability can be offset against the concession asset only when the criteria to offset a financial asset and a financial liability in paragraph 42 of IAS 32 are met. We think the role of the operator as an agent or a principal in the arrangement with the lessor does not affect the presentation of the asset and liability on its statement of financial position.

43. However, we think the role of the operator as an agent or a principal might affect the operator's recognition of revenue in respect of the lease-related services. The operator assesses whether it is an agent or a principal in the arrangement with the lessor by applying the requirements of paragraphs B34-B38 of IFRS 15. The outcome of this assessment requires careful consideration of all facts and circumstances.

### Staff conclusion

44. We think that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for the arrangement. In particular, for the recognition and presentation issues, we think that:
- (a) for arrangements in which the lessor is related to the operator:
    - (i) the grantor and the lessor are considered together (applying the requirements in paragraph AG2 of IFRIC 12). The lease-related payments are, in substance, payments that the operator is making to the grantor as part of the service concession arrangement; and
    - (ii) because the operator generally has a contractual right to receive cash from the grantor in respect of the lease-related services (ie the financial asset model in IFRIC 12 applies), the grantor is no different from a customer in a revenue contract. The operator accounts for the contractual payments to be made to the lessor applying the requirements for consideration payable to a customer in paragraphs 70-72 of IFRS 15.
  - (b) for arrangements in which the lessor is not related to the grantor:
    - (i) if the operator has an obligation to make lease-related payments to the lessor, it recognises the liability for this obligation at the

start of the service concession arrangement once it is committed to the arrangement and the infrastructure is made available by the lessor.

- (ii) the operator offsets the liability to make lease-related payments against the corresponding receivable from the grantor only when the criteria for offsetting a financial asset and a financial liability in IAS 32 are met.

### Assessment against the Interpretations Committee’s agenda criteria

45. We have assessed this issue against the agenda criteria of the current *Due Process Handbook* as follows:

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	<b>Yes.</b> On the basis of the feedback received on the outreach <sup>6</sup> , the issue is common in some jurisdictions and can have a material effect on those affected.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	<b>No.</b> We think that the requirements in IFRS Standards are sufficient to determine how to account for the cash payment described in the submission. In addition, on the basis of the feedback received from our outreach activities, we think that diversity in practice is limited.

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<sup>6</sup> See [Agenda Paper 13](#) of the Interpretations Committee’s meeting in November 2015 for a summary of the responses received to the outreach request on this issue.

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that can be resolved efficiently within the confines of existing IFRS Standards and the <i>Conceptual Framework for Financial Reporting</i> .	Not applicable.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	Not applicable.
The solution developed should be effective for a reasonable time period. (paragraph 5.21)	Not applicable.

### Staff recommendation

46. On the basis of our analysis and our assessment of the Interpretations Committee’s agenda criteria, we recommend that the Interpretations Committee should not add the issue to its agenda.
47. We have set out the proposed wording for a tentative agenda decision in **Appendix A** to this paper.

#### Questions for the Interpretations Committee

1. Does the Interpretations Committee agree with the staff recommendation not to add this issue to its agenda?
2. Does the Interpretations Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

## Appendix A Proposed wording for the tentative agenda decision

### **IFRIC 12 *Service Concession Arrangements*—Accounting for service concession arrangements for which the infrastructure is leased**

The IFRS Interpretations Committee (‘the Interpretations Committee’) received a request to clarify how an operator accounts for a service concession arrangement for which the infrastructure is leased. In this arrangement, the operator is not required to provide any construction or upgrade services with respect to the infrastructure.

The submitter describes an arrangement that involves three parties: a grantor, an operator and a lessor. The operator enters into an arrangement with the grantor to operate a public service. The infrastructure in the arrangement is leased from the lessor who may be related to the grantor (because they are both controlled by the same governmental body). The operator is contractually required to make the payments to the lessor for the lease of the infrastructure. In arrangements in which the lessor is not related to the grantor, the grantor provides a guarantee of the lease payments to be made during the lease term, and of any residual value at the end of the lease term.

The submitter asked the Interpretations Committee to clarify whether the arrangement is within the scope of IFRIC 12 *Service Concession Arrangements* (the ‘scope issue’). If the arrangement is within the scope of IFRIC 12, the submitter notes that the lease of the infrastructure is not within the scope of IFRS 16 *Leases* for the operator. Consequently, the submitter also asked the Interpretations Committee to clarify how the operator accounts for any assets and liabilities arising from the arrangement with the lessor (‘recognition and presentation issues’).

With respect to the scope issue, the Interpretations Committee observed that:

- (a) assessing whether a particular arrangement is within the scope of IFRIC 12 requires careful consideration of all facts and circumstances. In particular, the operator assesses whether the control conditions in paragraph 5 of IFRIC 12 and the condition relating to the infrastructure in paragraph 7 of IFRIC 12 apply; and
- (b) the operator is not required to provide construction or upgrade services with respect to the infrastructure to conclude that the arrangement is within the scope of IFRIC 12.

With respect to the recognition and presentation issues, if the arrangement is within the scope of IFRIC 12, the Interpretations Committee observed that:

(a) for arrangements in which the lessor is related to the grantor, the grantor and the lessor are considered together (applying the requirements of paragraph AG2 of IFRIC 12). The Interpretations Committee concluded that the payments to the lessor are, in substance, payments that the operator makes to the grantor as part of the service concession arrangement. The operator has a contractual right to receive cash from the grantor for the lease-related services (ie entering into the lease contract and making lease payments to the lessor). Consequently, the grantor is no different from a customer in a revenue arrangement. In such arrangements, the operator accounts for the contractual payments to be made to the lessor applying the requirements for consideration payable to a customer in paragraphs 70-72 of IFRS 15 *Revenue from Contracts with Customers*.

(b) for arrangements in which the lessor is not related to the grantor:

(i) the operator first assesses whether it is obliged to make payments to the lessor for the lease. This assessment requires careful consideration of all facts and circumstances.

(ii) if the operator is obliged to make the payments to the lessor, then the operator recognises a liability for this obligation and a corresponding asset when it is committed to the service concession arrangement and the infrastructure is made available by the lessor. Because the operator has a contractual right to receive cash from the grantor for the lease-related services, the corresponding asset that the operator recognises is a financial asset.

(iii) the operator's liability is a financial liability. Accordingly, the operator offsets the liability to make payments to the lessor against the corresponding receivable from the grantor only when the criteria for offsetting a financial asset and a financial liability in IAS 32 *Financial Instruments: Presentation* are met.

The Interpretations Committee noted that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for the arrangement.

In the light of the existing requirements in IFRS Standards, the Interpretations Committee determined 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.

**Appendix B  
Submission**



Berlin, 7 August 2015

## IFRS IC – POTENTIAL AGENDA ITEM REQUEST

### IFRIC 12

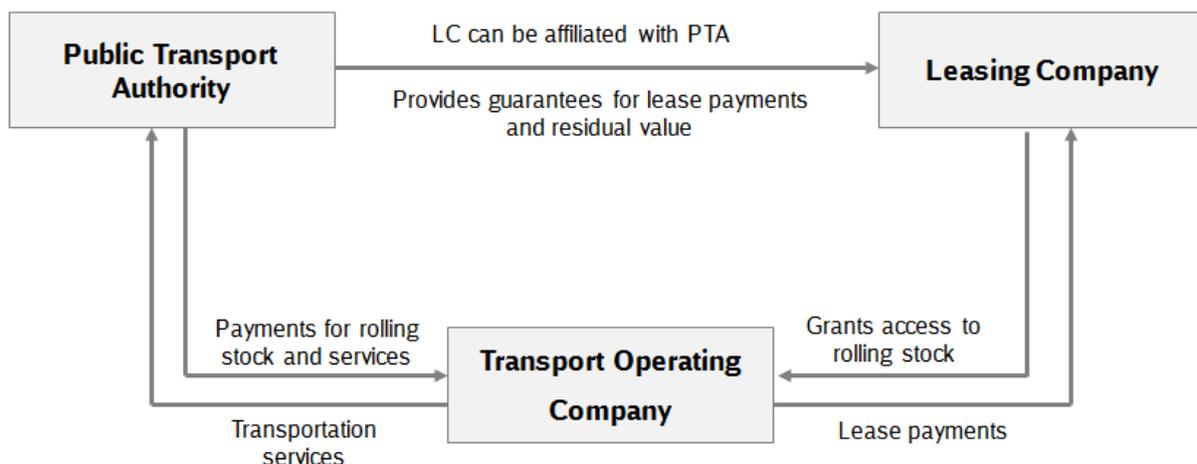
#### Combined service concession and lease arrangements

(Also referring to your outreach request as of 17 July 2015, Issue #2

‘Payments made by an operator to a grantor in a service concession arrangement’)

#### 1. The issue and fact pattern

The European public transport market, as evidenced in the UK, the Netherlands, Sweden, Denmark, and Germany, is characterized by tendering/franchising procedures whenever public funds are needed to make the business economically attractive. Many public transport authorities (“PTA”) have chosen to initiate service concession arrangements in conjunction with guaranteed lease contracts. One model, which is often initiated by the PTA, offers financing support such as lease payment guarantees, residual value guarantees, etc. The relationship between the PTA, the transport operating company (“TOC”) and the leasing companies (“LC”) can be depicted as follows:



[The railway tracks may be owned by the TOC or not. They are not subject to this analysis.]



The characteristics of these agreements can be described as follows:

#### *Service concession granted by the PTA*

- The public passenger transport contracts specify the kind of service the TOC must provide to the public. The price that can be charged for rendering the transport service is also determined or at least authorised by the PTA or the governmental body to which it belongs. Hence, the PTA determines all major aspects of the service the TOC must provide (type, price, frequency of service, quality level etc.)
- The TOC has the right to charge the PTA a fee for rendering the transport service. This fee will also cover any expenditure incurred by the TOC for entering into the lease arrangement, which is an integral part of the service concession arrangement initiated by the PTA (see below). However, the TOC will not be reimbursed if it is responsible for an interruption of the service.
- The passenger transport contract does not contain any construction services to be rendered as regards the tracks or any other equipment.

#### *Lease of infrastructure from the LC*

- The TOC leases the rolling stock from a LC under an arrangement with the following characteristics:
  - There is no residual value risk from the leased assets for the TOC.
  - The lease does not transfer substantially all the risks and rewards incidental to ownership so that the leasing contract qualifies for operating lease classification per IAS 17 on the part of the TOC. In particular, the lease term is not for the major part of the economic life of the assets and the lease payments usually do not cover all of the investment and financing costs.
  - The TOC is responsible for proper maintenance of the rolling stock so that the TOC hereby bears all technical risk – as well as the operational risk – during the lease term.
- The lease arrangement is economically linked to the PTA. Two types of arrangements can be distinguished in this respect:
  - Case 1: The LC is affiliated with the PTA and is, hence, controlled by the same governmental body.
  - Case 2: The LC is an unaffiliated third party. It is then provided with guarantees from the PTA regarding lease payments over and the residual value at the end of the lease term (= for the duration of the passenger transport contract). At the end of the passenger transport contract and at the option of the PTA, the PTA itself or the next TOC will continue the lease of the rolling stock.



## 2. The Questions

Three questions arise in practice with regard to the accounting under IFRS on the level of the PTA as operator:

1. Do the arrangements in the fact pattern fall under the scope of IFRIC 12?
2. If so, what accounting consequences do arise from the lease arrangement?
3. How does an agency role of the TOC with regard to the lease affect the accounting?

## 3. The Views

### ***Sub-Issue 1: Scoping of the fact pattern in the light of IFRIC 12***

There is diversity in practice as to whether the fact pattern falls within the scope of IFRIC 12:

#### *View A: In scope of IFRIC 12*

IFRIC 12 applies to the fact pattern of a public-to-private service concession arrangement above as the rolling stock leased is regarded as infrastructure and the grantor (PTA) regulates what services the operator (TOC) must provide with this infrastructure, to whom it must provide it, and at what price. Furthermore, the PTA controls any significant residual interest in the infrastructure at the end of the term of the arrangement: [IFRIC 12.5]

- In situations described in Case 1 in the fact pattern, the PTA controls the residual interest as the rolling stock is owned by the LC, which is controlled by the same governmental body. According to IFRIC 12.7(b) the regulation of IFRIC 12 also applies for contracts, where the PTA through the affiliated LC grants access to the rolling stock to the TOC.
- In situations described in Case 2 in the fact pattern, which would fall under IFRIC 12.7(a), the PTA controls the residual interest through the right and responsibility to step into the lease contract at the end of the transport contract (or at any other breakage point), or by naming a replacement TOC to step in, or through direct legal ownership.

Proponents of this view argue that the fact pattern is in the scope of IFRIC 12 regardless of how the leased infrastructure shall be categorised pursuant to IFRIC 12.7 and regardless of the type of services that are provided by the TOC according to IFRIC 12.12. Especially, construction or upgrade services for the infrastructure are not necessary as per IFRIC 12.7(b) also existing infrastructure to which the grantor gives access falls within the scope of IFRIC 12.

#### *View B: Out of scope of IFRIC 12*

From an economic perspective, an operating lease arrangement is not treated as an additional construction and upgrade service under the service concession. Following this view, the operator only provides a public service and operates and maintains the infrastructure (operation services) for a specified period of time.



Opponents of view A argue that IFRIC 12 shall only apply to service concession arrangements that cover (inter alia) a construction and upgrade service (which is not the case in the operating lease scenario of the fact pattern<sup>1</sup>).

This is because

- IFRIC 12.12 states that “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.”
- IFRIC 12 does not provide specific accounting guidance for operation services. Under either view the operator shall recognise and measure revenue in accordance with IFRS 15 for the operation services it performs [IFRIC 12.20].

They conclude that such arrangements are not in scope of IFRIC 12 as they do not include any construction or upgrade services performed by the TOC. The specifications of the rolling stock are determined by the PTA and there is no value added by the TOC in relation to the rolling stock. They argue that, as only operation services are provided, the arrangement is not within the scope of IFRIC 12.

Proponents of view B would therefore account for the lease arrangement under IAS 17. Consequently, no leased asset and financial liability would be recognised, if the leasing contract qualifies for an operate lease under IAS 17.

Only applicable if the resulting view on Sub-Issue 1 is View A:

### ***Sub-Issue 2: Accounting consequences from the lease arrangement under IFRIC 12***

Under View A on Sub-Issue 1, the fact pattern described represents a service concession arrangement in the scope of IFRIC 12. As the operator does not have the right to control the use of the assets that are subject to the service concession arrangement, property, plant and equipment cannot be recognised [IFRIC 12.11]. Consequently, IAS 17 or the new leasing standard, respectively, are not applicable when accounting for the lease arrangement.

Instead, the following accounting treatments are seen in practice for the lease payments from the operator to the grantor:

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<sup>1</sup> Excursus finance lease: In this case the leased infrastructure can be seen as infrastructure that the operator acquires for the purpose of the service arrangement [IFRIC 12.7(a)]. From an economic perspective, the lease arrangement implies a capital investment of the TOC for the benefit of the service concession. This implies a construction or upgrade service in the meaning of IFRIC 12.12 as the operator constructs or upgrades the infrastructure of the grantor.



*View A: Accounting for assets and liabilities from the lease at the start of the concession (On-balance)*

The consideration given by the grantor to the operator covers both, operation and lease-related services. The portion of the fee received from the PTA for providing/leasing the infrastructure is a consideration that may be rights to a financial asset or an intangible asset (a concession asset similar to IFRIC 12.15).<sup>2</sup> As the fees for the lease-related services made by the PTA form an unconditional contractual right to receive cash, those passenger transport contracts fall most likely under the financial asset model per IFRIC 12.16.

The present value of the minimum lease payments to the LC is used as a cost basis for this asset. These payments are an integral part of the service concession arrangement. Hence, these payments are one prerequisite for the TOC to acquire the right to receive the fees for the transportation services. Accordingly, proponents of this view recognise a financial liability for the lease payments and a concession asset.

This approach is supported by decisions made by the Interpretations Committee in March 2013, when it proposed additional guidance to be added to IFRIC 12 for payments made from the operator to the grantor. In 2011, the IFRS Interpretations Committee (IFRS IC) received a request how payments of the operator to the grantor for the access to infrastructure should be accounted for. In March 2013, the IFRS IC decided to propose amendments to IFRIC 12. In applying these amendments the net present value of the lease payments is recognised as a financial liability. The payments are necessary to get the service concession granted. Accordingly, a concession asset is recognised at the same amount as that of the liability.

*View B: Deem the lease payments executory in nature (Off-balance)*

Contractual lease payments to be made by an operator under a service concession arrangement within the scope of IFRIC 12 are deemed executory in nature and are accounted for accordingly (i.e. they are recognised as expenses as they are incurred over the term of the concession arrangement).

Only applicable if the resulting view on Sub-Issue 2 is Treatment A:

***Sub-Issue 3: Role of the operator: Principal vs. Agent***

Proponents of View A of Sub-Issue 2 request that IFRIC 12 should also clarify in which circumstances the payments from the operator to the LC should not be included in the measurement of the liability and the corresponding asset at the start of the concession. Usually, the contracts do not grant the TOC with a right to offset the obligation to pay lease rates with the right to receive cash from the PTA, even if the LC is affiliated with the PTA.

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<sup>2</sup> The nature of the consideration given by the grantor to the operator shall be determined by reference to the contract terms and, when it exists, relevant contract law (IFRIC 12.19 by analogy).



Therefore, in both Cases of the fact pattern, offsetting under the principles of IAS 32 is not possible.

However, the question arises under which criteria the TOC would be classified as an agent with regard to the lease arrangement with the PTA.

#### *TOC as agent*

Some argue that the TOC is acting as an agent in the lease arrangement. Proponents of this view make reference to IFRIC 12.AG2 which says “*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.*” Following this argument one would conclude that in a situation, in which the legal entity acting as lessor and the PTA are controlled by the same governmental body, the payments from the PTA to the TOC and from the TOC to the leasing company of the PTA are, in essence, a seesaw of cash flows without economic substance. Consequently, the TOC can be regarded as an agent, such that no financial asset and financial liability would be recognised. This could particularly be the case, if the risk that the TOC has to provide the lease payments but will not receive the fees from the PTA upon an interruption of services is remote.

Some would even argue for Case 2 of the fact pattern that the TOC is not necessarily acting as a principal. In Case 2, where the LC is not affiliated with the PTA, the PTA provides the LC with substantial guarantees for the lease payments and the residual value and controls the lease arrangement following the first lease term. Another argument for the TOC not considering payments from the lease contract in the measurement basis of a concession asset would be that, economically, the PTA (and not the TOC) is the lessee.



#### **4. Reasons for the Interpretations Committee to address the issue**

##### ***Is the issue widespread and has a material effect on those affected?***

The issues concern major parts of the European passenger transport market. In Germany, a large number of PTAs has chosen to initiate service concession arrangements linked with guaranteed lease contracts. Similar models are also common in France (e.g. passenger rail transport in region Ile-de-France) or the Netherlands (e.g. line Arnhem-Nijmegen, fast ferry Breskens Vlissingen). In the UK, there are currently considerations of moving towards comparable service concession arrangements.

The identified diversities in the accounting practice have a significant impact on the balance sheet. While some TOCs gross up liabilities and receivables, other TOCs don't recognize them or claim the existence of an agency relationship. The different practices lead to limited comparability of the financial statements of TOCs.

##### ***Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?***

The objective of this letter is the presentation of the diversity of accounting practices in relation to passenger transport contracts linked with lease contracts of the underlying rolling stock. A clarification would assist TOCs in accounting for such public concession arrangements on a comparable basis.

##### ***Can the issue be resolved efficiently within the confines of IFRSs and the Conceptual Framework for Financial Reporting?***

We have raised two major questions:

1. Sub-Issues 1 and 2 raise the question whether a passenger transport contract comprising operating services and a lease contract to finance the rolling stock (which is controlled by the PTA) without any construction services falls under the scope of IFRIC 12.
2. Sub-Issue 3 questions whether and how an agency relationship between the PTA and TOC should affect the recognition of the concession asset and financial liability in relation to the lease rates of the rolling stock.

In our opinion the questions could be answered efficiently within the existing IFRSs.

As mentioned above, the IFRIC already addressed some of the accounting issues that we raise in our submission. The amendments were postponed because the IASB decided in May 2013 to wait for the outcome of the discussions on the accounting for variable payments within the Leases project. As the Leases project has almost been finished, the proposed amendments could be brought back to the agenda.



***Is the issue sufficiently narrow in scope?***

We think that we have outlined three issues that are sufficiently narrow in scope. We are convinced that the IFRS IC can undertake the due process in an effective and efficient way.

***Will the solution developed by the Interpretations Committee be effective for a reasonable time period?***

IFRIC 12 remains effective even when the new leasing standard becomes effective. The changes to IFRIC 12 proposed in March 2013 do not fully cover the issues described in this letter. The upcoming improvements and changes of existing IFRSs do not eliminate the diverse accounting practices. The solution to be developed would therefore be effective for a reasonable period of time.

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Please don't hesitate to contact us in case of any question. We would also be pleased to discuss in person.

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**Submitted by:**

**Name:** Prof. Dr. Andreas Barckow  
**Organisation:** ASCG (Accounting Standards Committee of Germany)  
**Address:** Zimmerstrasse 30 - 10969 Berlin - Germany  
**Telephone:** +49 (0)30 206412-12  
**Email:** info@drsc.de / barckow@drsc.de