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**International
Accounting Standards
Board**

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

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

INFORMATION FOR OBSERVERS

IFRIC meeting: May 2006, London

Project: Service Concession Arrangements

Paper: Draft Text IFRIC [X] [Formerly D12] Agenda Paper 5 (ii)

Introduction

At this meeting the IFRIC will consider a draft of the revised text of IFRIC [X] *Service Concession Arrangements – Determining the Accounting Model* [formerly D12] in the light of the IFRIC's post exposure deliberations.

The Consensus, Application Guidance and Appendices A-B have been omitted from the Observer Note. The Observer Note includes Appendix C and the revised draft text of the Basis for Conclusions. A summary of the main changes from the proposals in D12 is set out in BC59. Footnotes to that paragraph reference the main changes to D12.

SERVICE CONCESSION ARRANGEMENTS
EXTRACT FROM REVISED DRAFT TEXT IFRIC [X] [FORMERLY D12] FOR
CONSIDERATION BY THE IFRIC

Appendix C

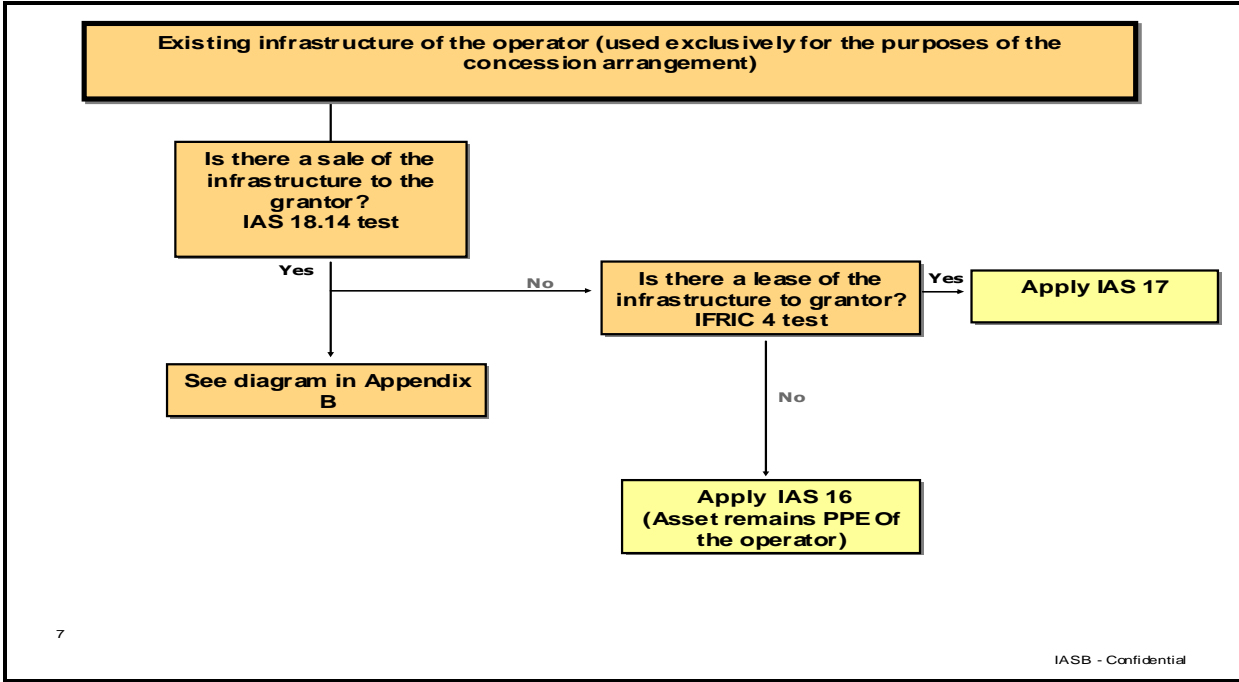
This table and diagram accompany, but are not part of the Interpretation.

Table 1 sets out the typical types of concession arrangements for private sector participation in the provision of public sector services and provides references to IFRSs that may apply to those arrangements. The list of arrangements types is not exhaustive. The purpose of table 1 is to highlight the continuum of service concession arrangements. It is not the IFRIC's intention to convey the impression that bright lines exist between the accounting requirements for service concession arrangements.

Table 1. Typical types of concession arrangements for private sector participation in the provision of public services

Category	Lessee	Service Provider			Owner	
Typical Arrangement Types	Lease (eg Operator leases asset from grantor)	Service and/or maintenance contract (eg specific tasks debt collection)	Concession (eg Operation & Maintenance)	Concession (eg Build-Operate-Transfer)	Concession (eg Build-Own-Operate)	100% Divestiture/ Privatisation/ Corporation
Asset Ownership	Grantor				Operator	
Capital Investment	Grantor		Operator			
Demand Risk	Shared	Grantor	Operator and or Grantor		Operator	
Typical Duration	8-20 years	1-5 years	25-30 years			Indefinite (or may be limited by license)
Residual Interest	Grantor				Operator	
Examples of IFRSs (that may apply)	IAS 17	IAS 18	D12-14		IAS 16	

Diagram 1. Determining whether existing infrastructure of the operator is within the scope of this Interpretation



Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Interpretation.

Introduction

- BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

Background

- BC2 SIC-29 *Disclosure—Service Concession Arrangements* contains disclosure requirements in respect of service concession arrangements, but does not otherwise specify how they should be accounted for.
- BC3 There was widespread concern about the lack of such guidance. In particular, operators wished to know how to account for infrastructure that they either constructed or acquired for the purpose of a service concession, or were given access to for the purpose of providing the concession service. They also wanted to know how to account for other rights and obligations arising.
- BC4 In response to this concern, the International Accounting Standards Board asked a working group comprising representatives of the standard-setters of Australia, France, Spain and the United Kingdom (four of the countries that had expressed such concern) to carry out some initial research on the subject. The working group recommended that the IFRIC should seek to clarify how certain aspects of existing accounting standards were to be applied. Because of the range of issues to be covered, the IFRIC decided to do this in a series of related Interpretations, rather than in a single document.
- BC5 In March 2005 the IFRIC published for public comment three Interpretations D12 *Service Concession Arrangements—Determining the Accounting Model*, D13 *Service Concession Arrangements—The Financial Asset Model* and D14 *Service Concession Arrangements—The Intangible Asset Model* for public comment in March 2005 and received seventy-seven comment letters in response to the proposals. In addition, in order to understand better the practical issues that would have arisen on implementing the proposed Interpretation, IASB staff met a number of preparer, auditor and regulator constituents.
- BC6 Most respondents to exposure draft D12 (ED) supported the IFRIC's proposal to develop an Interpretation. However, nearly all respondents expressed concern with fundamental aspects of the proposals, some urging that the project be passed to the Board to develop a comprehensive standard.
- BC7 In its redeliberation of the ED the IFRIC acknowledged that this project is a large undertaking but the concluded that it should continue its work because given the limited scope of the project it was now better placed than the Board to deal with the issues in a timely way.

Terminology

- BC8 SIC-29 uses the terms 'Concession Provider' and 'Concession Operator' to describe, respectively, the grantor and operator of the concession. Some commentators, and some members of the IFRIC, found these terms confusingly similar. The IFRIC decided to adopt the terminology 'grantor' and 'operator', and has amended SIC-29 accordingly.

Scope

- BC9 The IFRIC observed that service concession arrangements take a variety of forms. The continued involvement of both grantor and operator over the whole of the concession period, accompanied by heavy upfront investment raises questions over what assets and liabilities should be recognised by the operator.
- BC10 The working group recommended that the scope of the IFRIC's project should be restricted to public-to-private infrastructure service concession arrangements.

- BC11 In developing the proposals the IFRIC decided to restrict the scope of the Interpretation to arrangements in which the grantor (a) controlled or regulated the services provided by the operator, and (b) controlled any significant residual interest in the infrastructure at the end of the concession. It also decided to specify the accounting treatment only for infrastructure that the operator constructed or acquired from a third party, or to which it was given access by the grantor, for the purpose of the concession. The IFRIC concluded that these conditions were likely to be met in most of the public-to-private arrangements for which guidance had been sought.
- BC12 Commentators on the ED argued that the proposals ignored many arrangements that were found in practice, in particular, when the operator was a lessee of the infrastructure or, conversely, held the infrastructure as its property, plant and equipment prior to entering into the service concession arrangement.
- BC13 In considering these comments, the IFRIC decided that the scope of the project should not be expanded because the Interpretations deal with arrangements that most need interpretive guidance. Expansion of the scope of the Interpretation at this stage would have significantly delayed its issuance. The scope of the project was considered at length during the initial stage, as indicated in The Background. The IFRIC therefore confirmed its view that the Interpretation should address the issues set out in paragraph 8. Nonetheless, during redeliberation the IFRIC considered the typical types of arrangements for private sector participation in the provision of public services including some that fell outside the scope of this Interpretation. The IFRIC decided that the Interpretation could provide references to relevant Standards that may apply to arrangements falling outside the scope of this Interpretation without giving guidance on their application. If such guidance proved to be required in practice, a separate project would be undertaken at a later date. Appendix C contains a table of references to relevant standards for the types of arrangements considered by the IFRIC.

Private-to-private arrangements

- BC14 Some respondents to the ED suggested the scope of the Interpretation should be extended to include private-to-private service concession arrangements. The IFRIC noted that addressing the accounting for such arrangements was not the primary purpose of the project because the IFRIC had been asked to provide guidance for public-private arrangements that meet the requirements set out in paragraph 5. Nonetheless, in the light of comments received the IFRIC decided to clarify that it would not preclude application of the Interpretation by analogy to private-to-private arrangements. The IFRIC noted that application by analogy may be appropriate under the hierarchy set out in paragraphs 7-12 of IAS 8, resulting in similar accounting for arrangements that are not public-private service concession arrangements but have similar features as those described in paragraph 3 and meeting the conditions set out in paragraph 5.

Grantor accounting

- BC15 The Interpretation does not specify the accounting by grantors, because the IFRIC's objective and priority were to establish guidance for operators. Some commentators on the ED asked the IFRIC to establish guidance for the accounting by grantors. In developing the Interpretations the IFRIC discussed the appropriateness of incorporating the accounting for grantors, and agreed that this was not appropriate. The IFRIC affirmed this view during its redeliberations and therefore rejected the suggestion that it should provide guidance for the accounting by grantors. It noted that in many cases the grantor is a government body, and providing accounting Interpretations for government bodies is not the primary focus of the IFRIC. The Interpretations do not provide guidance on how any other party might account for the infrastructure, in many cases the government will control the physical asset, but the resulting accounting has not been considered explicitly by the IFRIC. For that reason, the Interpretations deal only with the operator's accounting.

Existing assets of the operator

- BC16 The Interpretation does not specify the treatment of existing assets of the operator because the IFRIC agreed that it would be difficult to add to the requirements of existing standards (IAS 16, IAS 17 and IFRIC 4) and (b) unusual for such assets to be significant in the context of a service concession arrangement as a whole.
- BC17 Some respondents asked the IFRIC to provide guidance on the accounting for existing assets of the operator stating the scope exclusion would create uncertainty about the treatment of these assets.
- BC18 In its redeliberations the IFRIC noted that the objective of the Interpretation is to address whether the operator should recognise the infrastructure as its property, plant and equipment. The accounting issue to be addressed for existing assets of the operator is one of derecognition, which

is already addressed in IFRSs (IASs 16, 17 and 18 and IFRIC 4). Nonetheless, in the light of the comments received from respondents, the IFRIC decided to clarify that certain service concession arrangements may convey to the grantor a right to use existing assets of the operator, in which case the operator would apply the derecognition requirements of IFRSs to determine whether it should derecognise its existing assets. The diagram in Appendix C provides references to IFRS that might apply to existing assets of the operator that are used exclusively for the purposes of the service concession arrangement. The IFRIC noted that this Interpretations may apply to arrangements where the derecognition requirements of IFRSs are met.

The significant interest criterion

BC19 Paragraph 5b of the ED proposed that for a concession arrangement to fall within its scope the significant residual interest in the infrastructure reverting to the grantor at the end of the concession must be significant. Respondents to the ED argued, and the IFRIC agreed that the significant residual interest criterion would limit the usefulness of the guidance because a concession for the whole period of the infrastructures physical life would be excluded from the scope of the guidance. That result was not the IFRIC's intention. In its redeliberation of the ED, the IFRIC concluded that it would not retain the proposal that the residual interest in the infrastructure reverting to the grantor at the end of the arrangement must be significant. As consequence 'whole of life' infrastructure, (i.e. where the infrastructure is used in a service concession arrangement for the whole of its useful life) falls within the scope of this Interpretation.

Recognition of infrastructure as property, plant and equipment

Recognition on basis of control

BC20 The Interpretation is based on a conclusion that service concession infrastructure should be recognised as property, plant and equipment of the party that controls its use. The reference to control stems from the *Framework*:

- (a) an asset is defined by the *Framework* as 'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.'
- (b) the *Framework* notes that many assets are associated with legal rights, including the right of ownership. It goes on to clarify that the right of ownership is not essential.
- (c) rights are often unbundled. For example, they may be divided proportionately (undivided interests in land) or by specified cash flows (principal and interest on a bond) or over time (a lease).

BC21 In reaching this conclusion the IFRIC considered IAS 16 *Property, Plant and Equipment*. That standard defines property, plant and equipment as tangible items that 'are held for use in the production or supply of goods or services, for rental to others or for administrative purposes...'. It requires items within this definition to be recognised as property, plant and equipment unless another Standard requires or permits a different approach. As an example of a different approach, it highlights the requirement in IAS 17 *Leases* for recognition of leased property, plant and equipment to be evaluated on the basis of the transfer of risks and rewards. That standard defines a lease as 'an agreement whereby the lessor conveys to the lessee in return for a series of payments the right to use an asset'. IFRIC 4 *Determining Whether an Arrangement Contains a Lease* interprets the meaning of right to use as 'if the arrangement conveys the right to control the use of the underlying asset'.

BC22 The IFRIC thus identified two possible approaches for determining whether an operator should recognise service concession infrastructure as property, plant and equipment. The first approach based on an Interpretation of the requirements of IAS's 16 and 17 to recognise assets that the entity controls the right to use, supported by the definition of an asset in the *Framework*—would be to assess whether the operator controlled the use of the infrastructure. An alternative approach would be to follow by analogy the precedent set for leased assets in IAS 17, ie to assess whether substantially all the risks and rewards of ownership of the infrastructure were held by the operator.

BC23 The IFRIC decided to adopt the first approach, which it believes is consistent with the *Framework* and the requirements of IAS 16 and IAS 17.

BC24 Respondents to the ED disagreed that recognition should be determined solely on the basis of control of use without any assessment of the extent to which the operator or the grantor bears the risks and rewards of ownership. They questioned how the proposed approach could be reconciled

to IAS 17 in which the leased asset is recognised by the party that bears substantially all the risks and rewards incidental to ownership.

- BC25 During redeliberation the IFRIC affirmed its decision that if the service concession arrangement met the control conditions in paragraph 5 of this Interpretation the operator would not have control of use of the underlying asset and should therefore not recognise the infrastructure under IAS 16 or IAS 17. The contractual service arrangement between the grantor and operator would not convey the right to use the infrastructure to the operator. The IFRIC acknowledged that risks and rewards often accompany control; however it is control of the right to use an asset that determines recognition in IASs 16 and 17.
- BC26 In a service concession, rights are usually divided over time, which is similar to a lease. However, for arrangements within the scope of the Interpretation, the operator's right is different from that of a lessee: the grantor retains control over the use to which the infrastructure is put, by controlling or regulating what services the operator must provide, to whom it must provide them, and at what price, as described in paragraph 5(a). Unlike a lessee, the operator does not have a right of use: it has only access to the infrastructure to provide the specified services on the specified terms.
- BC27 The IFRIC considered whether the scope of the Interpretation might overlap with IFRIC 4. In particular it noted the views expressed by some respondents that the contractual terms of certain service concession arrangements would be regarded as leases under IFRIC 4 and would also be regarded as meeting the scope criterion set out in paragraph 5 of this Interpretation. The IFRIC did not regard the choice between accounting treatments as appropriate because it can lead to different accounting treatments for contracts that have similar economic effects. In the light of comments received the IFRIC agreed a consequential amendment to the scope of IFRIC 4 to specify that if a service concession arrangement met the scope requirements of this Interpretation it would not be within the scope of IFRIC 4.

Consistency with existing IFRSs

- BC28 The control principles discussed above can be applied only to the extent that they are consistent with existing IFRSs. The IFRIC discussed the following types of infrastructure:
- (a) existing infrastructure of the grantor, to which the operator is given access to operate the infrastructure for the purpose of the concession;
 - (b) infrastructure that is constructed or acquired by the operator specifically for the purpose of the concession.

Existing infrastructure of the grantor to which the operator is given access

- BC29 The IFRIC believes that IAS 18 *Revenue* should be applied to determine whether a sale should be recognised when the grantor gives the operator access to existing infrastructure for the purpose of the concession. If the conditions for recognising a sale from the grantor to the operator are not met, the operator should not recognise the infrastructure as its property, plant and equipment.
- BC30 Paragraph 14 of IAS 18 states that revenue from the sale of goods is recognised only when five conditions are satisfied:
- (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
 - (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
 - (c) the amount of revenue can be measured reliably;
 - (d) it is probable that the economic benefits associated with the transaction will flow to the entity; and
 - (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.
- BC31 The IFRIC believes that, for arrangements within the scope of the Interpretation, the second of these conditions is not satisfied. Hence, no sale can be recognised by the grantor. The IFRIC further believes that, without the IAS 18 conditions for a sale having been met, there cannot be a sale and leaseback. Therefore, existing infrastructure that has been transferred by the grantor to

the operator for the duration of the concession is not recognised as the property, plant and equipment of the operator.¹

Infrastructure constructed or acquired by the operator for the purpose of the service concession

BC32 The IFRIC believes that the treatment of items that are constructed or acquired by the operator for the purpose of the service concession should be determined solely by whether they are controlled by the grantor in the manner described in paragraph 5. If they are so controlled (as will be the case for all arrangements within the scope of the Interpretation), then, regardless of which party has legal title to them during the concession, they should not be recognised as property, plant and equipment of the operator. The IFRIC believes that there is no conflict with IAS 18 because the commercial effect of the arrangements is that the infrastructure is constructed or acquired by the operator on the grantor's behalf, rather than sold by the operator to the grantor. If construction is involved, the operator is not selling the infrastructure that it builds, but supplying construction services to the grantor.

Determining the accounting model (paragraphs 10-13)

BC33 The IFRIC identified two accounting models that, in different circumstances, would apply to the asset received by an operator when the concession arrangement met the control criterion in paragraph 5:

- (a) the financial asset model—the operator recognises a financial asset; or
- (b) the intangible asset model—the operator recognises an intangible asset.

BC34 The IFRIC observed that the contractual rights that the operator receives in return for its investment in a service concession can take a variety of forms. They are not necessarily rights to receive cash or other financial assets.

BC35 The ED proposed that the nature of the operator's asset depended on who had the primary responsibility to pay the operator for the concession services. The financial asset model applied when the grantor had the primary responsibility to pay the operator for the concession services. The intangible asset model applied in all other cases. The ED proposed that in order to be faithful to the requirements of IAS 32 a contractual right to receive cash did not exist if users pay for the services, even if the grantor guaranteed the payments, making up any shortfall below a specified amount itself. Conversely, a contractual right to receive cash did exist if the grantor pays the operator for the services even if the grantor's payment is contingent on usage.

BC36 Respondents to the ED argued that determining which accounting model to apply by looking at who has the primary responsibility to pay the operator for the concession service, irrespective of who bears demand risk (ie ability and willingness of users to pay for the concession service), would often not result in an accounting treatment that reflected the economic substance of the arrangement. Respondents were concerned that the proposal would require operators with essentially identical cash flow streams to adopt very different accounting models. This would impair users' understanding of entities involved in providing concession services. Several gave the example of a shadow toll road and a toll road, where the economics (demand risk) of the arrangements would be very similar; pointing out that under the draft proposals the two arrangements would be accounted for very differently.

BC37 Responses to the ED provided only limited information about the impact of the proposal. To obtain additional information, the IASB staff arranged for discussions with preparer, auditor and regulator constituents. The consensus of those constituents was that the identity of the payee has no effect on the risks to the operator's cash flow stream. The operator typically relies on the terms of the service concession contract to determine the risks to its cash flow stream.

¹ As explained further in Agenda Paper 5 (i) for this meeting IFRIC members are asked whether they believe that this matter should be the subject of a separate Interpretation

- BC38 As a result of comments received on the ED the IFRIC redeliberated the determination of the dividing line between the financial and the intangible asset models. In particular it reconsidered the circumstances in which the nature of the operator's asset (its investment in the infrastructure) would meet the definition of a financial asset.
- BC39 The IFRIC concluded that the dividing line should reflect the contractual terms of the concession arrangement as a whole.

The financial asset model

- BC40 Paragraph 11 of IAS 32 *Financial Instruments: Presentation* defines a financial asset to include 'a contractual right to receive cash or another financial asset from another entity'. Paragraph 13 of that Standard clarifies that 'contractual' refers to 'an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law.'

Operator's return on investment is guaranteed by the grantor

- BC41 The IFRIC concluded that the definition of a financial asset is met if the grantor gives the operator a contractual right to receive cash for the concession services. This right may take the form of an agreement by the grantor to pay the operator specified amounts or the shortfall, if any, between amounts received from users of the concession service and specified amounts. In either case the operator's return may be contingent on it meeting specified performance targets.
- BC42 The ED proposed that the operator should recognise a right to collect payments from users and the shortfall guarantee from the grantor as two separate assets. It argued that IAS 32 recognises financial guarantees as separate assets from the assets they guarantee, the fair value of which depends on the likelihood of the guarantee being called upon.

Against this argument, the IFRIC noted that:

- (a) The agreement does not meet the definition of a financial guarantee in paragraph 9 of IAS 39. Furthermore, the amendments made to IAS 39, based on exposure draft *Financial Guarantee Contracts and Credit Insurance* published in July 2004 do not address the treatment of financial guarantee contracts by the holder. The objective of the amendments is to ensure that issuers of financial guarantee contracts recognise a liability for the obligations the grantor has undertaken in issuing that guarantee.
 - (b) The contractual amount receivable may be paid directly by users. The method of payment is a matter of form only. The operator has, in substance, a present unconditional contractual right to receive the specified cash flow from the grantor. The nature of the operator's asset is not altered solely because the contractual amount receivable may be paid by users. The IFRIC observed that accounting for these contractual cash flows in accordance with IAS 32 acknowledges their nature. Furthermore, doing so most faithfully reflects the economic substance of the arrangements, which is to provide finance to the grantor.
- BC43 In the light of comments received the IFRIC concluded that the operator should recognise a financial asset if the grantor agrees to pay the operator for the shortfall, if any, between amounts received from users of the concession service and the contractual amount receivable. In these arrangements the operator has an unconditional right to receive a specified amount of cash from the grantor. Hence, the operator has at the balance sheet date a contractual right to receive cash from another entity. The contractual amount is not dependent on usage and the grantor has no discretion to avoid making the payments specified in the contract with the operator, because the contract is legally enforceable.

Operator's guaranteed return is contingent on performance requirements

- BC44 The IFRIC concluded that the definition of a financial asset is met even if the contractual right to receive cash is conditional on availability and performance conditions being achieved.

BC45 The operator may have further activities to perform before the grantor is required to pay it for its services. But in this respect the operator's position is the same as that of any other entity in which payment is contingent on subsequent performance.

BC46 The Interpretation therefore treats the construction services provided to the grantor as giving rise to a financial asset irrespective of whether the contractual amounts receivable are fixed or contingent on levels of availability or performance.

The intangible asset model

BC47 IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It mentions licences as examples of intangible assets. It describes an asset as being identifiable when it arises from contractual rights.

Operator's return on investment is contingent on usage

BC48 The IFRIC concluded that the right of an operator to charge users of the concession services meets the definition of an intangible asset, and therefore should be accounted for in accordance with IAS 38.

BC49 In the absence of contractual arrangements designed to ensure that the operator receives a specified minimum return (see below), the operator has no contractual right to receive cash. Rather, the operator has an opportunity to charge those who choose to use the asset in future. The operator rather than the grantor bears demand risk. The operator's asset is a licence, which would be classified as an intangible asset within the scope of IAS 38 *Intangible Assets*. And, as clarified in paragraph AG10 of the application guidance in IAS 32:

Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

BC50 The IFRIC considered whether a right to be paid by users could be regarded as an indirect right to receive cash arising from the contract with the grantor. It concluded that although, the operator's asset might have characteristics that are very similar to those of a financial asset, it would not meet the definition of a financial asset in IAS 32: the operator would not at the balance sheet date have a contractual right to receive cash from another entity. That other entity (ie the user) would still have the ability to avoid any obligation. The grantor would be passing to the operator an opportunity to charge users in future, not a present right to receive cash.

Contractual arrangements eliminate substantially all variability in the operator's return

BC51 The IFRIC considered whether the analysis would be different if the concession agreement incorporated contractual arrangements designed to eliminate substantially all variability in the operator's return for example:

- (a) the price charged by the operator would be varied by regulation designed to ensure that the operator received a substantially fixed return; or
- (b) the operator would be permitted to collect revenues from users until it achieved a specified return on its investment, at which point the concession would come to an end and the infrastructure would revert to the grantor.

BC52 The IFRIC noted that, as a result of such contractual arrangements, the operator's return would be very low risk. Only if usage were extremely low would the contractual mechanisms fail to give the operator a fixed return. The likelihood of usage being that low could be remote. Commercially, the operator's return would be regarded as fixed, giving its asset many of the characteristics of a financial asset.

BC53 However, the IFRIC concluded that the fact that the operator's asset was very low risk did not influence its classification. IAS 32 does not define financial assets by reference to the amount of risk in the return—it defines them solely by reference to the existence or absence of a contractual right to receive cash. There are other examples of licences that offer the holders of the rights very predictable, low risk returns, but such licences are not regarded as giving the holder a contractual right to cash. And there are other industries in which price regulation is designed to provide the

operators with substantially fixed returns—but the rights of operators in these other industries are not classified as financial assets as a result. They are akin to a variable term licence.

A right to charge users and a contractual right to receive a minimum level of return

- BC54 The IFRIC included the requirement to bifurcate arrangements in response to a concern raised on the ED. This concern was that, in certain arrangements both parties to the contract share the risk (demand risk) that the cash flows generated by the project will not be sufficient to recover the operator's capital investment. In order to achieve the desired sharing of risk, the parties often agree to arrangements under which the grantor pays the operator for concession services partly in cash and partly by granting a right to charge users for the service. The IFRIC concluded that in these circumstances it would be necessary to bifurcate the operator's asset of the infrastructure into a financial asset component for any guaranteed amount of cash and an intangible asset for the remainder.
- BC55 The contractual right to receive cash from the grantor for the concession services and a right to charge users for the concession service would normally be regarded as two separate assets under IFRSs. Paragraph 3(a) of IAS 38 states that the requirements of that Standard do not apply to financial instruments as defined in IAS 32. Hence, concession assets that are regarded as financial assets, ie those arising when the operator has a contractual right to receive cash for the concession services, must be accounted for using the financial asset model rather than the intangible asset model.
- BC56 As a result of its redeliberations, the IFRIC decided that the financial asset model, which is described in Interpretation [D13], applies to the extent that the operator has a contractual right to receive cash from or at the direction of the grantor for the concession services; and the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has a contractual right to receive cash for the concession services if the grantor contractually guarantees the operator's return on investment, and that return may be contingent on performance requirements. This right is provided by the grantor agreeing to pay the operator (1) specified amounts or (2) for the shortfall, if any, between amounts received from users of the concession service and the specified amounts. If the operator is paid for the infrastructure partly by a financial asset it is necessary to bifurcate the operator's asset of the infrastructure. The treatment of such assets is discussed in Interpretation [D13]
- BC57 Whether the financial asset model applies therefore depends on the operator's contractual rights to receive cash. However, the IFRIC did not wish to overemphasise the importance of legal form. Paragraph 13 of the Interpretation therefore notes that whether the operator has a contractual right to receive cash from or at the direction of the grantor should be determined by reference to the substance of the contractual arrangements.

Summary of changes from the Exposure Draft

BC59 The main changes from the ED proposals to the Interpretation are as follows:

- a. Compared with the Interpretation the ED did not explain the reasons for the scope limitations² and the reasons for the control approach adopted by the IFRIC in paragraph 5³. The IFRIC included Appendix C to provide references to standards that might apply to arrangements falling outside the scope of this Interpretation.
- b. The scope of the ED did not include 'whole of life infrastructure' (ie infrastructure used in a service concession arrangement for the whole of its useful life). The Interpretation includes 'whole of life infrastructure' within its scope.⁴

² Staff note: see paragraphs BC9-18 and Appendix C

³ Staff note: see paragraphs BC20-27

⁴ Staff note: see paragraph BC19

- c. Under the approach proposed in the ED, an entity determined the appropriate accounting model by reference to whether the grantor or the user had primary responsibility to pay the operator for the services provided. The Interpretation requires that an entity should recognise a financial asset to the extent that the operator has a contractual right to receive cash from or at the direction of the grantor.⁵ A right other than a contractual right to receive cash does not meet the definition of a financial asset and is within the scope of IAS 38 *Intangible Assets*.
- d. In finalising the Interpretation, the IFRIC identified a necessary consequential amendment to IFRIC 4⁶.

⁵ Staff note: see paragraphs BC33-58

⁶ Staff note: see paragraph BC27