

IFRIC 12 Service concession  
arrangements  
*A pocket practical guide*



# Foreword

IFRIC 12 *Service Concession Arrangements* is an Interpretation issued by the IFRS Interpretations Committee (formerly IFRIC) that may have a very significant impact on the financial reporting of any company that enters into a concession arrangement with government. Although it is a relatively short Interpretation, its application to the various types of concession arrangement that exist can be complex. Some would argue that the topic would have justified a full standard.

This Interpretation was extensively debated and was finally published on 30 November 2006 with the objective of decreasing the diversity of existing accounting practice for service concession arrangements. In fact, no specific IFRS recognition and measurement guidance previously existed for these types of arrangement.

The illustrative examples of IFRIC 12 are relatively straightforward and may not address the complex arrangements that are often encountered in practice. Therefore, application of this Interpretation may be challenging and will often require a significant amount of judgement.

In *IFRIC 12 Service Concession Arrangements – A pocket practical guide*, you will find an analysis of the requirements of IFRIC 12 and practical guidance with examples that address some of the more complex issues around service concession arrangements. This Guide provides guidance on scope, the determination of the accounting model, specific characteristics of concessions that are common (take-or-pay arrangements, capacity availability, etc.) and much more. For a full list of the examples provided, refer to the Appendix of this Guide.

This Guide is intended to serve as an illustrative tool for the reader in the application of the Interpretation. However, it does not address all possible fact patterns or industry-specific issues. It is important to remember that as more entities move towards adopting IFRIC 12 (2010 was the first mandatory year of adoption in the EU), additional issues or areas that are problematic in practice may arise and other matters may need to be considered. Readers are encouraged to consult with a professional advisor to discuss specific issues, questions or concerns.

Text in this Guide is highlighted differently to reflect whether it represents official or interpretative material. Accordingly:

- requirements drawn from official IASB material are shown in unshaded text; and
- interpretative material supplementing the IASB guidance is highlighted by blue shading.

We hope that you will find this guide useful in applying IFRIC 12. You can keep up-to-date on future IFRS and IASB developments via our IAS Plus Website at [www.iasplus.com](http://www.iasplus.com). We hope that IAS Plus, this guide, as well as other Deloitte publications will continue to assist you in navigating the ever-changing IFRS landscape.

**Javier Parada**

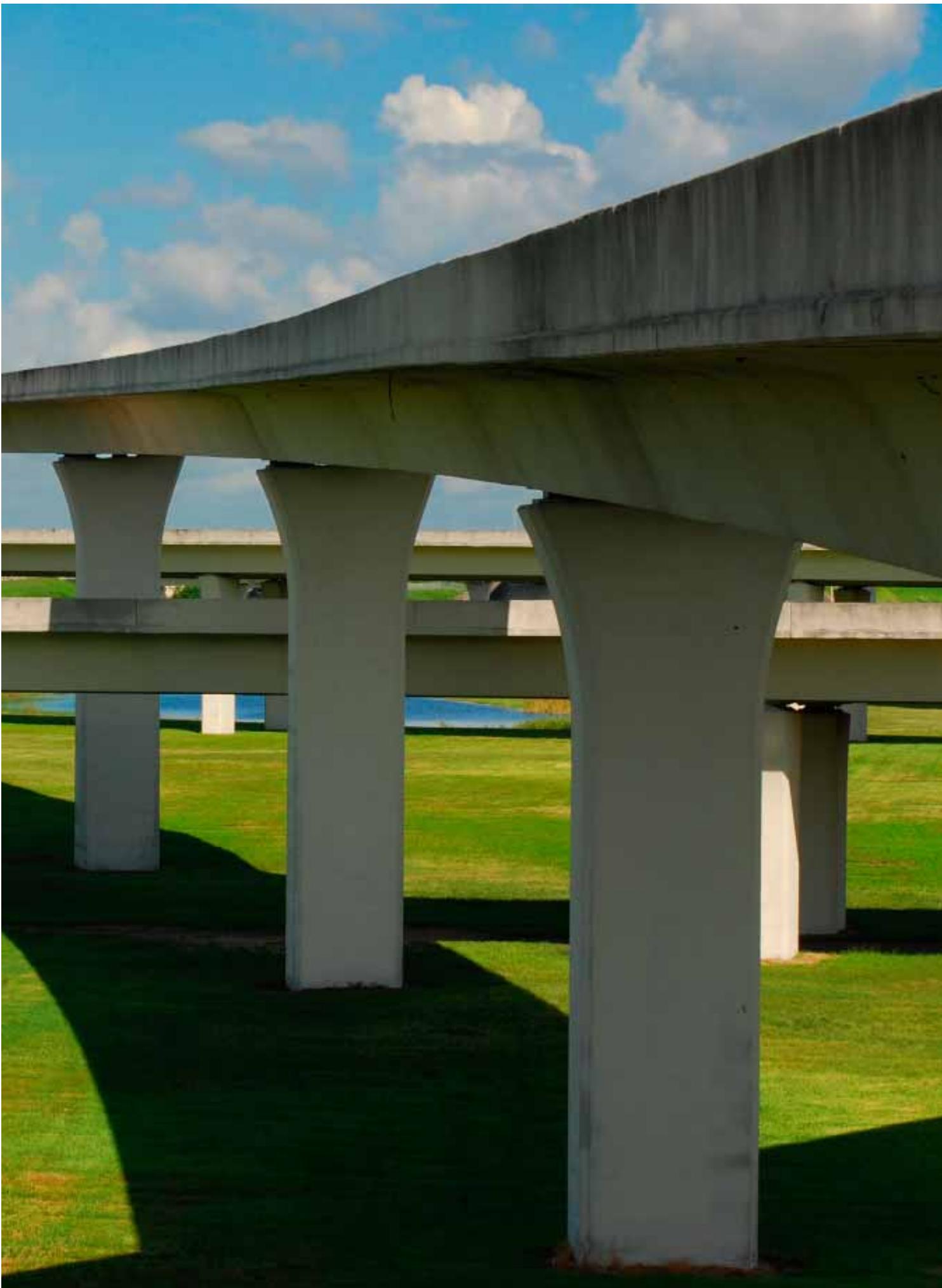
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# 1. Introduction

## 1.1 Background

In November 2006, the IASB published IFRIC 12 *Service Concession Arrangements*. Service concession arrangements are arrangements whereby a government or other body ('the grantor') grants contracts for the supply of public services, such as roads, energy distribution, prisons, or hospitals, to a private sector entity ('the operator'). This is often referred to as a 'public-to-private' arrangement.

A typical type of 'public-to-private' arrangement that would generally fall within the scope of the Interpretation is a 'build-operate-transfer' arrangement. In this type of arrangement, an operator constructs the infrastructure that will be used to provide the public service and operates and maintains that infrastructure for a specified period of time. The operator is paid for the services over the period of the arrangement. A contract sets out performance standards, pricing mechanisms, and arrangements for arbitrating disputes. [IFRIC 12:2] In some cases, the operator may upgrade the existing infrastructure.

Some common features of service concession arrangements are described below.  
[IFRIC 12:3]

- The grantor is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
- The operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.
- The contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.
- The operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration irrespective of which party initially financed it.

For a public service obligation to exist, the services offered do not have to be made available to all members of the public. Rather, the services need to be available to benefit members of the public. For example, prisons only accommodate those individuals required to be incarcerated by law, and cannot be accessed by members of the public seeking accommodation. However, prisons would still be considered to provide services to the public.

There are many different types of concession arrangements that are often specific to each jurisdiction, or even in each municipality. Therefore, each arrangement should be analysed to determine the appropriate accounting based on the individual facts and circumstances.

### 1.2 Summary of key requirements

The following table provides an overview of the key requirements of IFRIC 12.

Issue	Key requirement of IFRIC 12
Operator’s rights over the infrastructure assets	The infrastructure assets are not recognised as the property, plant or equipment (PPE) of the operator.
Revenue recognition	Revenue is recognised and measured in accordance with IAS 11 (for construction or upgrade services) and/or IAS 18 (for operation services, where the operator operates and maintains the infrastructure).
Construction or upgrade services	<p>The consideration received by the operator is recognised at fair value. Consideration may result in the recognition of a financial asset or an intangible asset.</p> <ul style="list-style-type: none"> <li>• The operator recognises a financial asset if it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor in return for constructing or upgrading the public sector asset.</li> <li>• The operator recognises an intangible asset if it receives only a right to charge for the use of the public sector asset that it constructs or upgrades.</li> <li>• IFRIC 12 allows for the possibility that both types of consideration may exist within a single contract. For example, to the extent that the grantor has given to the operator an unconditional guarantee of minimum payments for the construction, the operator recognises a financial asset. The operator may also recognise an intangible asset representing the right to charge users of the public service that is in addition to the minimum guaranteed payments.</li> </ul>

Issue	Key requirement of IFRIC 12
Operator's contractual obligations to maintain/restore the infrastructure to a specified level of serviceability	Contractual obligations to maintain or restore infrastructure, except for any upgrade element, should be recognised and measured in accordance with IAS 37, i.e. at the best estimate of the expenditure that would be required to settle the present obligation at the balance sheet date.
Borrowing costs incurred by the operator	Borrowing costs incurred by the operator that are attributable to the arrangement are recognised as an expense in the period incurred unless the operator has a contractual right to charge users of the public service (intangible asset model). In this case borrowing costs attributable to the arrangement should be capitalised during the construction phase of the arrangement in accordance with IAS 23 <i>Borrowing Costs</i> .
Subsequent accounting treatment of a financial asset	IAS 39 and IFRS 9 (if adopted) apply to the financial asset recognised under IFRIC 12. Under IAS 39, depending on whether the financial asset is classified as a loan or receivable, as an available-for-sale financial asset or designated as at fair value through profit or loss, it is subsequently measured either at amortised cost or fair value, respectively. If IFRS 9 is applied, the financial asset will be measured at amortised cost or at fair value through profit or loss.
Subsequent accounting treatment of an intangible asset	IAS 38 <i>Intangible Assets</i> applies to the intangible asset recognised under IFRIC 12. IAS 38 allows intangible assets to be measured using the cost model or the revaluation model if there is an active market for service concession arrangements.

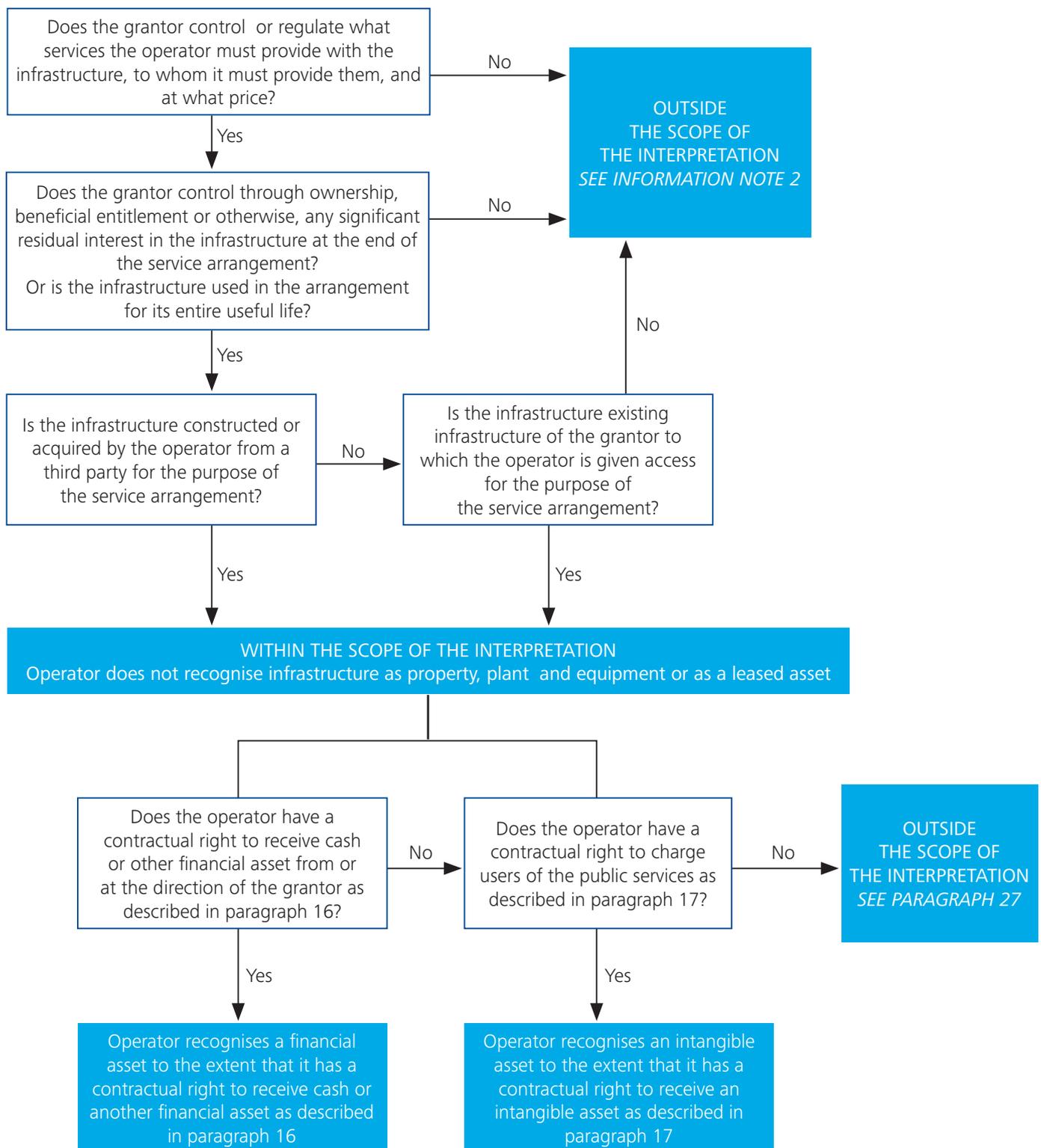
## 2. Scope of IFRIC 12

IFRIC 12 applies to a broad range of concession arrangements. Road and water treatment concession arrangements are two common examples, but other types of arrangements may meet the scope criteria such as contracts for the:

- provision of transport services;
- construction and operation of waste treatment plants;
- provision of public airport services;
- construction and maintenance of hospitals;
- generation of renewable energy;
- production of electricity; and
- construction and operation of public transport systems, schools, prisons, etc.

IFRIC 12 provides specific scope criteria that must be met. These criteria are summarised in the following flowchart:

[Extract from IFRIC 12 (Information Note 1)]



### Control of the services

As noted in the flow chart, the Interpretation applies to public-to-private service concession arrangements if:

[IFRIC 12:5]

- (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.

The determination as to whether the grantor controls the price is important in evaluating whether the criterion in IFRIC 12:5 (a) is satisfied. IFRIC 12:AG3 states that “for the purpose of condition [IFRIC 12:5](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.”

If the agreement requires review or approval of pricing by the grantor that would generally be sufficient for the agreement to meet the IFRIC 12:5(a) requirement. Such reviews or approvals of pricing should not be disregarded unless there is sufficient evidence supporting an assertion that a review or approval of pricing is non-substantive.

If an agreement contained a cap but the cap is set such that it would only ever take effect in very remote circumstances then the grantor would not be considered to have control over the price, e.g. stating in the contract that a road toll must not exceed CU1000, when the anticipated toll is CU2. Such a price capping mechanism would generally be considered non-substantive and the arrangement would be outside the scope of IFRIC 12.

### **Example 2.1**

#### **Concession with unregulated prices and congestion payment**

Company A is granted a concession for the construction and operation of a toll road for 40 years. The price Company A is able to charge users is set by the grantor for years 1-3 of the arrangement. From the fourth year of operation of the toll road, Company A is able to charge users at a price it considers appropriate, based on its own strategy and business perspectives. However, the concession arrangement provides for a mechanism known as a “*Congestion Payment*” whereby Company A will pay certain amounts to the grantor if there is congestion (i.e., traffic jams) in the use of the complementary public infrastructure (i.e., nearby roads).

The grantor exercises absolute control over the pricing for an insignificant period of time in the context of the service concession arrangement as a whole. The congestion payment mechanism would need to be analysed to determine if it is substantive. If this mechanism is included in the contract solely to avoid excessively high prices, it may not be substantive because the operator has the freedom to charge what it wants within a reasonable range. The only limitation is that the operator cannot charge a price the market would not bear and in doing so create congestion on other roads. If the mechanism is considered non-substantive, the arrangement would fall outside the scope of IFRIC 12.

## **Example 2.2**

### **Competitive tender process**

Arrangements in which the public sector seeks to attract private sector participation often involve a tender process under which a number of entities respond to a Request for Proposal (RFP). The RFP may request the respondent to specify the type and level of services that the respondent would provide if its tender is successful, and the amounts that it would charge for those services. When the winning bid has been selected, the services and pricing agreed with the successful respondent are incorporated into a contractual arrangement. IFRIC 12 applies to arrangements in which “the grantor controls or regulates which services the operator must provide with infrastructure, to whom it must provide them, and at what price”. [IFRIC 12:5(a)]

If an arrangement would otherwise fall within the scope of IFRIC 12, does the fact that services and/or prices are determined through a process of competitive tender preclude the arrangement from being accounted for under IFRIC 12?

No. If the arrangement otherwise falls within the scope of IFRIC 12 because all the relevant criteria in IFRIC 12 are met, the fact that services and/or prices are determined through a competitive tender process before the concession begins does not affect the conclusion as to whether the arrangement falls within the scope.

## Significant residual interests

When considering whether a significant residual interest exists for purposes of determining whether the criterion in IFRIC 12:5(b) is satisfied, the residual value should be estimated as the infrastructure's current value as if it was of the age and condition expected as at the end of the contract. An asset which will only be able to be sold for scrap value is unlikely to have a significant residual value at the end of the contract. Conversely, a building with a 50 year useful life that is only used in a service concession arrangement for 20 years is likely to have a significant residual value at the end of the arrangement. If a building with a significant residual value is retained by the operator, the arrangement would be outside the scope of IFRIC 12.

IFRIC 12 does not address the circumstance in which the grantor provides an indemnification to the operator in respect of the residual value of the assets at the end of the arrangement. When such an indemnification is provided, the facts and circumstances relating to the arrangement will need to be analysed to determine whether the arrangement is within the scope of the Interpretation.

Under the terms of a service concession arrangement, an operator may be required to replace parts of an item of infrastructure, for example the top layer of a road or the roof of a building. In these types of arrangements, the item of infrastructure is considered as a whole for the purpose of determining whether the grantor controls any significant residual interest. Thus, condition IFRIC 12:5(b) would be met for the whole of the infrastructure, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part. [IFRIC 12:AG6]

Furthermore, an arrangement where the infrastructure is used for its entire useful life ('whole of life assets') would be within the scope of IFRIC 12 provided condition IFRIC 12:5(a) is met. This is the case irrespective of which party controls any remaining insignificant residual interest. [IFRIC 12:6]

### **Example 2.3**

#### **Infrastructure used in a concession arrangement for its entire useful life**

The term of a concession arrangement for the construction and operation of a solar thermal plant is 30 years, which coincides with the estimated useful life of the plant. The fact that the infrastructure is not controlled by the grantor at the end of the concession arrangement does not automatically lead to a conclusion that the concession arrangement is outside the scope of IFRIC 12. When the term of a concession arrangement is equal to the useful life of the infrastructure, the arrangement is within the scope of IFRIC 12, provided that the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price (IFRIC 12:6).

### **Example 2.4**

#### **Indefinite term of the concession arrangement**

One of two conditions necessary for IFRIC 12 to apply is that the grantor controls any significant residual interest in the infrastructure at the end of the term of the arrangement as indicated in paragraph 5(b).

Certain arrangements allow the operator to renew the license arrangement indefinitely without significant costs. In those cases, a careful analysis of all the facts and circumstances is necessary in order to establish whether, at a point of possible renewal, there will be significant residual interest.

Where there may be significant residual interest in the infrastructure, it is necessary to determine who controls that residual interest. If the terms of the arrangement are such that the grantor controls the residual interest in the infrastructure if the operator chooses not to renew the license, the arrangement would fall within the scope of IFRIC 12. In contrast, if the grantor does not control the significant residual interest in the infrastructure if the operator decides not to renew the arrangement, the arrangement would not meet the criterion in paragraph 5(b) and so would be excluded from the scope of IFRIC 12.

### **Example 2.5**

#### **Application of IFRIC 12 when residual interest is returned to grantor at fair value**

An entity (the operator) has entered into a service concession arrangement in which it will construct a bridge and operate that bridge for 30 years. It cannot sell the bridge to a third party unless the government (the grantor) agrees to the sale. At the end of the arrangement, the grantor is required to repurchase the bridge for its fair value at the end of the term of the arrangement. The bridge has an estimated useful economic life of 50 years.

Does the grantor control the residual interest in the infrastructure at the end of the term of the arrangement in accordance with IFRIC 12:5(b)?

Yes. IFRIC 12:5 states, in part, 'This Interpretation applies to public-to-private service concession arrangements if ... 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.'

IFRIC 12:AG4 states, in part, 'For the purposes of condition (b) [of IFRIC 12:5 outlined above], 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.' In this scenario, the operator would not be able readily to sell or pledge the infrastructure even though it may be able to sell or pledge its economic interest in the residual value of the infrastructure.

IFRIC 12 applies a control approach. Accordingly, the grantor has a continuing right of use of the infrastructure asset at the end of the term of the arrangement and therefore controls the use of the bridge throughout its economic life. This is the case even though the grantor has to pay fair value for the asset at the end of the term of the arrangement.

Would the grantor control the residual interest in the infrastructure at the end of the term of the arrangement if the grantor has the option to purchase the bridge (at an amount equal to its fair value) rather than an obligation to repurchase?

Yes. In the circumstances described, the condition in IFRIC 12:5(b) “together identify when the infrastructure ... is controlled by the grantor for the whole of its economic life” is met due to the existence of the purchase option at the end of the term of the arrangement; the grantor has the power to purchase the bridge or to allow the operator to retain it for its continued use and/or disposal.

Due to the existence of the purchase option held by the grantor, the operator is unable readily to sell or pledge the infrastructure even though it may be able to sell or pledge its economic interest in the residual value of the bridge.

### **Nature of the infrastructure**

The Interpretation applies to both:

[IFRIC 12:7]

- (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.

The requirements may apply to previously recognised property, plant and equipment of the operator where the derecognition criteria of IFRSs are met. If the operator is considered to have disposed of the asset by passing the significant risks and rewards of and control over that asset to the grantor, then the operator should derecognise that asset in accordance with IAS 16:67. The operator would need to determine whether the arrangement was within the scope of IFRIC 12.

Sometimes the use of infrastructure is only partly regulated by the grantor. These arrangements take a variety of forms:

- (a) any infrastructure that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in IAS 36 is analysed separately if it is used wholly for unregulated purposes. For example, this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients; and
- (b) when purely ancillary activities (such as a hospital shop) are unregulated, the control tests are applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in IFRIC 12:5 above, the existence of ancillary activities does not detract from the grantor's control of the infrastructure. [IFRIC 12:AG7]

In either of the circumstances described above, there may in substance be a lease from the grantor to the operator for that part of the infrastructure that is not regulated. If so, the lease should be accounted for in accordance with IAS 17. [IFRIC 12:AG8]

### **Example 2.6**

#### **Infrastructure with different activities**

An operator is granted by the government the concession for a railway infrastructure. The operator will manage the infrastructure for 75 years, at which point the infrastructure will revert to the government. The terms of the agreement split the concession between the railway terminal itself and the shopping area. All activities are provided under the terms of the service concession arrangement and are controlled by the grantor, who regularly monitors the services provided. The railway activity is regulated as the government controls the services to be provided, the train companies to which the operator must provide them and the price charged by the operator. As a consequence, the railway activity falls within the scope of IFRIC 12:5. Regarding the retail activity, the operator can lease the shops to third parties for the purpose of running commercial outlets. Nevertheless, the agreement states that the operator needs to obtain formal permission before the shops are granted in sub-concession and prices must be communicated to the grantor, although they are not subject to explicit formal authorisation.

The operator pays fees to the government for both sections of the concession. The agreement establishes that the operator has an obligation to return a significant percentage of the profits generated from the retail activity (shopping area) through a reduction in the tariffs charged to the train companies for the regulated activity (the terminal itself). As a result, the revenue stream from the railway activity is affected by the profits generated from the retail activity.

At the end of the concession, all assets (from both activities) are returned to the grantor for no consideration.

The grantor controls the nature of the retail activity by setting the guidelines as to the services to be provided, by approving the service providers and by monitoring that these guidelines are, in fact, applied by the operator. In addition, the pricing mechanism is such that part of the profits generated by the shop area must be returned to the grantor via a reduction in the tariffs charged for the railway activity. Therefore indirectly the grantor controls the level of profits generated from the retail services.

As a result of the interdependency of the revenue streams of these two activities and the level of control by the grantor of the shopping area, the entire operation of the railway infrastructure (terminal activity and retail activity) may be subject to IFRIC 12.

In contrast, if the activities were separable and not interdependent, they would be analysed separately. IFRIC 12:AG7(a) states that any infrastructure that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in IAS 36 Impairment of Assets must be analysed separately if it is used wholly for unregulated purposes.

Ultimately, judgement based on all the facts and circumstances will be necessary to determine whether infrastructure assets with different activities are interdependent and should be assessed together for the purposes of IFRIC 12.

IFRIC 12 does not scope in private-to-private arrangements but it could be applied to such arrangements by analogy under the hierarchy set out in paragraphs 7-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. [IFRIC 12:BC14]

The Interpretation specifically excludes the accounting by grantors, i.e. public sector accounting. [IFRIC 12:9]

Where an arrangement does not fall within the scope of IFRIC 12 it may fall within the scope of other IFRS pronouncements. The following table, extracted from Information Note 2 to IFRIC 12, indicates which Standards may be applicable:

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (e.g. Operator leases asset from grantor)	Service and/or maintenance contract (specific tasks e.g. debt collection)	Rehabilitate -operate-transfer	Build-operate-transfer	Build-Own-Operate	100% Divestment / 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 licence)
Residual interest	Grantor			Operator		
Relevant IFRSs	IAS 17	IAS 18	IFRIC 12		IAS 16	

When assessing the contractual terms of some arrangements, it is possible that they could fall within the scope of both IFRIC 4 *Determining whether an Arrangement contains a Lease* and IFRIC 12. To eliminate any inconsistencies between the accounting treatment for contracts which have similar economic effects, with the issuance of IFRIC 12, the IFRIC also amended IFRIC 4 to specify that if a contract appears to fall within the scope of both Interpretations then the requirements of IFRIC 12 prevail [IFRIC 4:4(b)].

# 3. The accounting models

## 3.1 Revenue

An operator provides services under the terms of the contractual arrangement and receives payment for its services over the period of the arrangement. This typically involves the operator constructing or upgrading infrastructure which is used to provide a public service and then being responsible for operating and maintaining that infrastructure for a specified period of time. [IFRIC 12:12]

Revenues and costs of the operator relating to the construction or upgrade services phase of the contract are accounted for in accordance with IAS 11 Construction Contracts [IFRIC 12:14] and the revenue and costs relating to the operating phase are accounted for in accordance with IAS 18 Revenue. Where the operator performs more than one service under a single contract or arrangement, the consideration received or receivable is allocated by reference to the relative fair value of services delivered, when the amounts are separately identifiable. [IFRIC 12:13]

The nature of the consideration determines its subsequent accounting treatment (see 3.2 below).

### **Example 3.1.1**

#### **Recognition of a profit margin on construction work – Infrastructure constructed by the operator**

Company A has been granted a concession arrangement for the construction and operation of an airport. Company A will be responsible for the construction of the infrastructure. IFRIC 12:14 states that an operator must account for revenue and costs relating to the construction phase of a concession arrangement in accordance with IAS 11. Consequently, if this is a construction contract as specified in IAS 11, a profit margin on the construction work will be included in A's financial statements by reference to the stage of completion. This margin arises because Company A has received an intangible asset or a financial asset as consideration for the construction of the airport, which constitutes consideration in the form of an asset that differs in nature from the asset delivered and, in accordance with IFRIC 12:15, the consideration received or receivable is recognised at its fair value.

### **Example 3.1.2**

#### **Recognition of a profit margin on construction work – Infrastructure acquired**

The facts are as described in Example 3.1.1 above, except that Company A (the operator) outsources the construction of the airport to Company B (the sub-contractor), an unrelated company. The grantor is informed of, and approves, the outsourcing of the construction, although it does not enter into a specific and direct agreement with the subcontractor.

The operator will recognise revenue and costs associated with the construction work depending on whether it is acting as an agent or a principal, based on the substance of the agreements with both the concession grantor and the sub-contractor. The fact that the grantor is informed of, and approves, the agreement between Company A and its sub-contractor is not in and of itself evidence that the operator is acting as an agent. The analysis requires a careful consideration of all other relevant facts and circumstances and the application of judgement.

IAS 18:IE 21 provides guidance on how to determine when an entity is acting as a principal or as an agent. An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that indicate that an entity is acting as a principal include:

- (a) the entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;
- (b) the entity has inventory risk before or after the customer order, during shipping or on return;
- (c) the entity has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and
- (d) the entity bears the customer's credit risk for the amount receivable from the customer.

In the above example if the analysis of all relevant facts and circumstances leads to the conclusion that, in substance, Company A is acting as an agent, then revenue and profit margin shall not be recognised on a gross basis. Instead, Company A should recognise the fees associated with the service provided as an agent as net revenue. If, however, based on all relevant facts and circumstances it is concluded that Company A is acting as a principal in relation to the construction services, then Company A should recognise on a gross basis revenue and the profit margin arising from the construction services in accordance with IAS 11.

### 3.2 Determining the nature of the operator's asset

The infrastructure within the scope of IFRIC 12 is not recognised as property, plant and equipment of the operator because the operator does not have the right to control the asset, but merely has access to the infrastructure in order to provide the public service in accordance with the terms specified in the contract. [IFRIC 12:11] It is also not treated as a lease as the operator does not have the right to control the use of the asset. [IFRIC 12:BC 23] Instead, the operator's right to consideration is recorded as a financial asset, an intangible asset or a combination of the two.

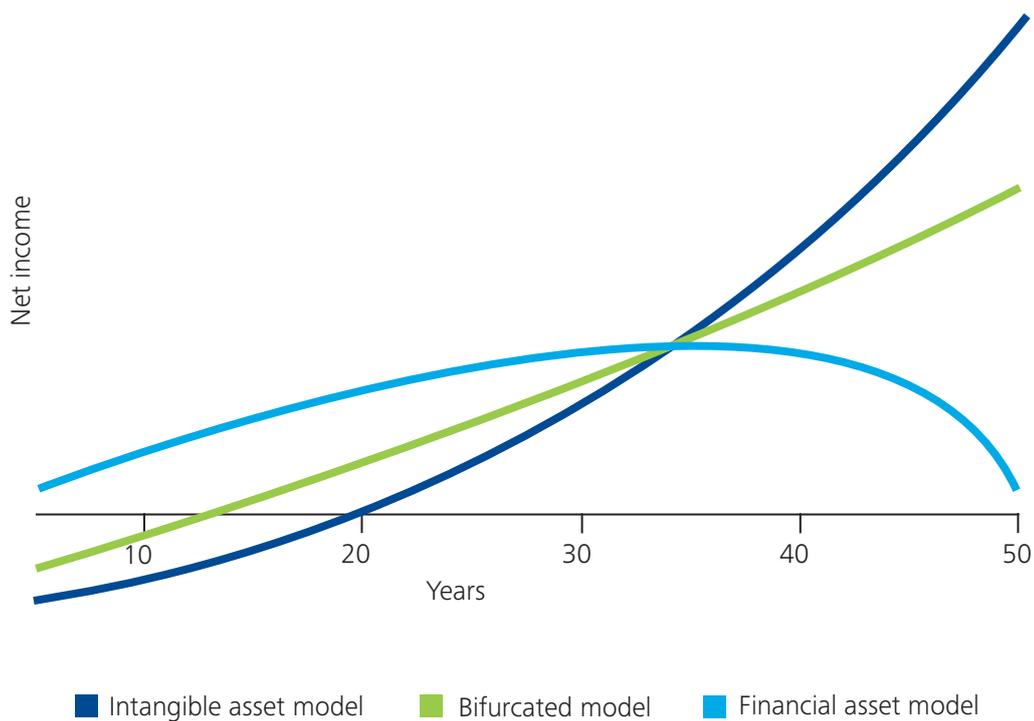
The requirements of IFRIC 12 regarding the nature of the asset to be recognised can be summarised as follows.

Operator's rights	Classification	Examples
Unconditional, contractual right to receive cash or other financial asset from or at the direction of the grantor.	Financial asset [IFRIC 12:16]	<ul style="list-style-type: none"> <li>Operator receives a fixed amount from the grantor over term of arrangement.</li> </ul>
Amounts to be received are contingent on the extent that the public uses the service.	Intangible asset [IFRIC 12:17]	<ul style="list-style-type: none"> <li>Operator has a right to charge users over the term of the arrangement.</li> <li>Operator has a right to charge the grantor in proportion to usage of the services over the term of the arrangement.</li> </ul>
Consideration received partly in the form of a financial asset and partly in the form of an intangible asset	Bifurcated model [IFRIC 12:18]	<ul style="list-style-type: none"> <li>Operator receives a fixed amount from the grantor and a right to charge users over the term of the arrangement</li> <li>Operator has a right to charge users over term of arrangement, but any shortfall between amounts received from users and a specified or determinable amount will be reimbursed by the grantor.</li> </ul>

In some service concession arrangements, the operator may have a contingent right to collect cash or another financial asset from the grantor instead of charging users, if usage of the asset exceeds a specified threshold. Where the threshold has economic substance (i.e. there remains a genuine possibility that it might not be met), the operator does not have an unconditional contractual right to cash and accordingly would recognise an intangible asset. If the threshold lacks economic substance because the possibility of the threshold not being met is remote, the conditionality should be ignored and the operator should recognise a financial asset.

The accounting for a concession arrangement will be determined by the specific terms of the contract and therefore it is difficult to provide specific guidance about the differences between and the impacts on the income statement of the three models within IFRIC 12. However, the graph below illustrates in general terms the likely impact on net income of each model over the term of the arrangement. In the case of a transport concession arrangement with a significant upfront investment in the infrastructure that is financed with bank borrowings, the financial asset model will generally give rise to higher net income in the first few years of the concession term and lower income in the last few years. The intangible asset model will likely have the opposite consequences and will give rise to lower income in the first few years of the concession term compared to the financial asset model and higher income in later years. This difference between the two models normally arises because under the financial asset model the income is front-loaded in the early years due to the use of the effective interest rate method and no amortisation of the asset. The net income under the bifurcated model is likely to be between those of the two “pure” models (the financial asset model and the intangible asset model).

## Distribution of net income over concession period



Basic data of the illustrative example shown in the graph:

- standard toll road;
- 50-year concession term;
- 80%-financed with bank borrowings;
- initial ramp up and subsequent 3% annual growth in traffic;
- operating costs rising in line with the increase in the CPI; and
- for the bifurcated model, there is a guarantee of collection of 40% of the investment.

### Example 3.2.1

#### Examples of some typical concession mechanisms

Characteristics	Type of asset recognised by the operator	Reason
Hospital – the operator receives a fixed amount of revenue, subject to deductions for lack of availability.	Financial asset	<ul style="list-style-type: none"> <li>• Revenue not dependent on usage.</li> <li>• Deductions reflect failure to meet specified quality requirements.</li> </ul>
Toll road – the amounts receivable by the operator are subject to little variation in practice because the road is an established route with highly predictable level of tolls.	Intangible asset	<ul style="list-style-type: none"> <li>• Right to charge users.</li> <li>• Amounts depend on usage of the infrastructure, regardless of whether variation in usage is expected in practice.</li> </ul>
Toll road – the operator has a guarantee by the grantor of minimum revenue that will not fall below a specified level. The guarantee is achieved through an increase in the concession period.	Intangible asset	<ul style="list-style-type: none"> <li>• Right to charge users.</li> <li>• Amounts depend on usage of the infrastructure.</li> <li>• Shortfall guaranteed by the grantor via a concession extension and not via a right to receive cash.</li> </ul>
Water supply concession – the grantor regulates prices that the operator may charge to users or adjusts the duration of the concession based on a targeted rate of return.	Intangible asset	<ul style="list-style-type: none"> <li>• Right to charge users.</li> <li>• Amounts depend on usage of the infrastructure.</li> </ul>
Rail concession - the grantor pays the operator any shortfall between the actual benefit before interest and tax obtained through charging users, and a fixed minimum.	Intangible asset and financial asset - Bifurcated model	<ul style="list-style-type: none"> <li>• Right to charge users.</li> <li>• Amounts depend on usage of the infrastructure.</li> <li>• Shortfall guaranteed by the grantor.</li> <li>• Financial asset arises from the right to receive a minimum determinable amount of cash from users/grantor and intangible asset from the right to earn additional amounts above the fixed guaranteed payments.</li> </ul>
Toll bridge - the grantor pays a fixed payment based on availability during the first half of the concession period and then switches to usage payment.	Intangible asset and financial asset - Bifurcated model	<ul style="list-style-type: none"> <li>• Grantor pays operator.</li> <li>• Amounts do not depend on usage of the infrastructure during the first half of the concession and are usage dependent during the second half.</li> <li>• Financial asset arises from the right to receive cash from grantor during the first part of the concession irrespective of usage; the intangible asset arises from the right to charge the grantor in the second half based on usage.</li> </ul>

### **Example 3.2.2**

#### **Take-or-pay arrangements**

A public sector entity enters into an arrangement for the construction and operation of a desalination plant whereby the concession operator receives the following two items of consideration over the term of the concession:

- a specified annual amount as consideration for the investment undertaken; and
- a specified amount per cubic metre of desalinated water produced by the plant where the grantor guarantees the purchase of all the water output that the plant can produce (take-or-pay arrangement). This specified amount per m<sup>3</sup> is sufficient to cover the concession operator's production costs based on the technical capacity of the plant of 24 million m<sup>3</sup> of water per year.

As the grantor has guaranteed to purchase all of the water output from the plant, the operator is only exposed to availability risk during the operating period, but not demand risk. The concession arrangement should therefore be accounted for using the financial asset model.

If, under the terms of the arrangement, the grantor had only guaranteed to purchase a proportion of the desalinated water output (e.g., up to 15 million m<sup>3</sup> per year) and the operator has a right to charge users for the remaining output (provided that the grantor controls to whom it must be sold and at what price) the concession operator should apply the bifurcated model (i.e., a financial asset and an intangible asset).

### **Example 3.2.3**

#### **Payments for capacity availability**

Company A is granted a concession arrangement for the construction and operation of a hospital for 30 years. This arrangement stipulates that A will be paid a specified amount that will enable it to recover the investment made provided that it has a pre-determined minimum number of hospital beds operating and available.

IFRIC 12:16 states that the operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements (availability payments). Therefore, in this example, Company A should apply the financial asset model.

### **Example 3.2.4**

#### **Guaranteed minimum revenue – Guarantee of NPV of revenue with extension of concession term**

Company A is granted a concession arrangement for a waste treatment plant in which the concession term ends automatically when the concession operator has received a previously stipulated net present value of net revenue (sales less operating costs) from users of the plant. If this minimum guaranteed revenue is not achieved in the normal term of the concession, the term will be extended for successive five-year periods until the guaranteed minimum revenue is achieved.

Since Company A does not have an unconditional contractual right to receive cash or another financial asset, the concession term could be extended indefinitely and the guaranteed minimum revenue might never be achieved, the concession arrangement should be accounted for using the intangible asset model.

### **Example 3.2.5**

#### **Guaranteed minimum revenue – Guarantee of NPV of revenue with limited extension of concession term and final cash**

Assume the same facts as described in Example 3.2.4 above, except that there is a clause limiting the maximum concession term that can be reached with the successive extensions to 50 years. The grantor has guaranteed to pay any shortfall, adjusted for the time value of money, if the minimum guaranteed revenue has not been achieved by the end of the 50-year limit. Since Company A has an unconditional contractual right to receive cash, the financial asset model should be applied in this case.

# 4. Financial asset model

As outlined above, the financial asset model applies if the operator has a contractual right to receive cash from or at the direction of the grantor and the grantor has little, if any, discretion to avoid payment. This will be the case if the grantor contractually guarantees to pay the operator:

- specified or determinable amounts; or
- the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts.

A financial asset exists in these circumstances even if the payments are contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements. [IFRIC 12:16]

The financial asset model cannot apply if the grantor only pays when users use the service or if the grantor only grants a right to charge users for the service.

The financial asset is accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments* (available for early adoption and mandatory for financial reporting periods commencing on or after 1 January 2013\*). The requirements of IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Financial Instruments: Disclosures* also apply.

Under IAS 39 *Financial Instruments: Recognition and Measurement*, the financial asset will, depending on the circumstances, be required to be classified [IFRIC 12:24]:

- as at fair value through profit or loss, if so designated upon initial recognition (provided that the conditions for this classification are met); or
- as a loan or receivable; or
- as 'available-for-sale'.

The asset can only be classified as a loan or receivable if payments are fixed or determinable and the only substantial risk of non-recovery of the initial investment is credit deterioration of the counterparty. IFRIC 12 assumes that the financial asset will not be classified as held to maturity. [IFRIC 12:BC61]

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\* IFRS 9 has not been endorsed by the European Union and, at the time of writing, no expected endorsement date appears on the endorsement status report produced by the European Financial Reporting Advisory Group (EFRAG). It appears unlikely that EFRAG will recommend endorsement until all elements of the IASB's project to replace IAS 39 have been completed. Therefore, for the foreseeable future, early adoption of IFRS 9 will not be an option for companies incorporated in a European Union member state.

If the amount due from the grantor is accounted for either as a loan or receivable or as an available-for-sale financial asset, IAS 39 requires interest calculated using the effective interest method to be recognised in profit or loss [IFRIC 12:25].

If IFRS 9 *Financial Instruments* is applied, the amount due from, or at the direction of, the grantor is accounted for as follows [IFRIC 12:24]:

- at amortised cost; or
- measured at fair value through profit or loss.

IFRS 9 requires interest calculated using the effective interest method to be recognised in profit or loss when the asset is accounted for at amortised cost [IFRIC 12:25].

Revenues and costs relating to the construction or upgrade phase of the contract are accounted for in accordance with IAS 11. A financial asset is recognised during the construction or upgrade activity and finance income is recognised using the effective interest rate method on the financial asset as well as revenue relating to the construction or subsequent upgrade phase. Moreover, the financial asset is reduced when amounts are received. Revenues from the operational phase are recognised in accordance with IAS 18.

Some practical issues may arise as the contracts usually establish a single payment mechanism but the amounts are not split between the construction services consideration (which will reduce the financial asset) and the operating services consideration (which will be revenue). It will be necessary to identify the underlying revenue streams that relate to both activities. This allocation will require a significant amount of judgement.

For the purposes of determining the construction and operation service revenue over the concession term, Example 1 of IFRIC 12 illustrates that an appropriate approach is for an entity to establish appropriate margins for determining the revenue streams first. The example shows how the fair value of the consideration from both activities is calculated as the projected costs plus a reasonable market margin. The discount rate to be used is calculated once the revenue and costs from both activities have been allocated. This discount rate would be one that causes the aggregate present value of all sums receivable from the grantor to be equal to the fair value of the services to be provided over the concession term. This rate would be similar to an internal rate of return of the project.

In practice, some companies establish first an appropriate discount rate in order to determine the appropriate profit margins on the construction and operational services. Significant judgement is required in the selection of the appropriate discount rate and the allocation of the total consideration received or receivable to the relative fair value of the construction and operational services delivered as this will affect the future revenue recognition pattern. Care should be taken to ensure the overall reasonableness of any model chosen.

### Example 4.1

#### Financial asset model

An operator enters into a contract to provide construction services costing CU100. It has been determined that the fair value of the construction services provided is CU110. The total cash inflows over the entire life of the contract are fixed by the grantor at CU200. The finance revenue to be recognised that is calculated by using the effective interest rate method in accordance with IAS 39 is CU10 over the entire life of the service concession arrangement, and the balance of CU80 (CU200 - CU110 - CU10) relates to services provided during the operational phase. The following journal entries are made in this scenario.

#### During construction

	CU	CU
Dr Financial asset	110	
Cr Construction revenue		110
<i>To recognise revenue relating to construction services, to be settled in cash.</i>		
	CU	CU
Dr Cost of construction	100	
Cr Cash		100
<i>To recognise costs relating to construction services</i>		

## During the operational phase

	CU	CU
Dr Financial asset	10	
Cr Finance Revenue		10
<i>To recognise interest income under the financial asset model.</i>		
	CU	CU
Dr Financial asset	80	
Cr Revenue		80
<i>To recognise revenues relating to the operational phase.</i>		
	CU	CU
Dr Cash	200	
Cr Financial asset		200
<i>To recognise cash received from the grantor.</i>		
Total revenue over the life of the contract	CU200	
Total cash inflows over the life of the contract	CU200	

A more detailed example of the financial asset model is included as Example 1 in the Illustrative Examples to IFRIC 12.

## **Example 4.2**

### **Classification of income and expense**

Concession operator A has a contractual right to receive cash from the grantor. It applies the financial asset model and recognises interest income resulting from the unwinding of the discount on the financial asset.

IFRIC 12 does not address the presentation of such interest income in the statement of comprehensive income; this matter is subject to the general requirements of IAS 1 *Presentation of financial statements*.

As explained in more detail in Chapter 3 of *iGAAP 2011 A guide to IFRS Reporting*, presentation of income and expenses shall consider the nature and function of such items and also their relevance to the understanding of an entity's financial performance in the context of the specific entity's business. This analysis also requires an overall consistency of the presentation of items in the statement of comprehensive income so that information is not misleading.

IAS 18:7 defines revenue as the gross inflow of economic resources during the period arising from ordinary activities, excluding inflows from equity participants. Judgement is required in determining an entity's ordinary activities. Accordingly, whether interest income generated by Company A above shall be recognised as finance income or as revenue will depend on the specific facts and circumstances of the company's business.

### **Changes in the estimated cash flows**

Although under the financial asset model the concession operator has a contractual right to receive cash or another financial asset in accordance with IAS 32 and IAS 39 or IFRS 9, changes in expected cash flows could arise for example as a result of a change in the remuneration scheme due to additional works or services demanded and approved by the grantor, payments related to availability or quality levels, etc.

When the entity revises its estimates of receipts, it shall adjust the carrying amount of the financial asset to reflect the revised cash flows. Under IAS 39:AG8, the entity recalculates the carrying amount of the receivable by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate and this adjustment is recognised in profit or loss as income or expense.

# 5. Intangible asset model

The intangible asset model applies if the operator receives a right (a licence) to charge users, or the grantor, based on usage of the public service. There is no unconditional right to receive cash as the amounts are contingent on the extent that the public uses the service. [IFRIC 12:17]

## **“Shadow tolls”**

Arrangements in which the grantor, rather than the users, pay the operator amounts based on usage are often described as 'shadow tolls'. If the amounts received by the operator are contingent on usage rather than being an unconditional right to receive cash or another financial instrument, the operator recognises an intangible asset.

During the construction phase the operator recognises revenue in respect of construction activities with the corresponding entry increasing the amount recognised for the intangible asset (see discussion in 3.1.2 on whether the operator acts as principal or agent with regards to construction services). This is because the operator exchanges construction services in return for a licence. The grantor makes a non-cash payment for the construction services by giving the operator an intangible asset in exchange for the construction services. As this is an exchange of dissimilar goods and services, in accordance with IAS 18:12, revenue must be recognised on the transaction.

The intangible asset generates a second stream of revenue when the operator receives cash from users or from the grantor based on usage. This is in contrast with the financial asset model in which monies received are treated as partial repayment of the financial asset. In the intangible asset model, the intangible asset is reduced by amortisation rather than repayment.

This results in revenue being recognised twice — once on the provision of construction services (in exchange for the intangible asset) and a second time on the receipt of payments for usage.

The intangible asset must be accounted for in accordance with IAS 38 *Intangible Assets*. The intangible asset should be amortised over the period of the concession. The annuity method of amortisation is specifically prohibited. [IFRIC 12:BC65] The most appropriate method of amortisation of the intangible asset is usually the straight-line method, unless another method better reflects the pattern of consumption of the asset's future economic benefits. However, in some circumstances, where the expected pattern of consumption of the expected economic benefits is based on usage, it may be appropriate to use an alternative method of amortisation.

### Example 5.1

#### Amortisation under the intangible asset model

Company B enters into an arrangement under which it will build and operate a toll bridge. Company B is entitled to charge users for driving over the toll bridge for the period from the completion of construction until 1 million cars have driven across the bridge, at which point the concession arrangement will end. It would be appropriate for Company B to amortise its intangible asset based on usage, as Company B's licence to operate the bridge expires on the basis of usage rather than with the passage of time.

### Example 5.2

#### Intangible asset model

As in example 4.1, an operator enters into a contract to provide construction services costing CU100. It has been determined that the fair value of the construction services provided is CU110. The total cash inflows over the entire life of the contract are expected to be CU200, however this amount is not guaranteed by the grantor. The following entries are made in this scenario:

#### During construction

	CU	CU
Dr Cost of construction	100	
Cr Cash		100

*To recognise costs relating to construction services.*

	CU	CU
Dr Intangible asset	110	
Cr Revenue		110

*To recognise revenue relating to construction services provided for non-cash consideration.*

### During the operational phase

	CU	CU
Dr Amortisation expense	110	
Cr Intangible asset (Accumulated depreciation)		110
<i>To recognise amortisation expense relating to the operational phase.</i>		
	CU	CU
Dr Cash	200	
Cr Revenue		200
<i>To recognise revenues received from users in the operational phase.</i>		
Total revenue over the life of the contract	CU310	
Total cash inflows over the life of the contract	CU200	

A more detailed example of the intangible asset model is included as Example 2 in the Illustrative Examples to IFRIC 12.

### Changes in estimated cash flows

Concessions are generally granted for long periods of time. Therefore, there are often changes in the initial estimates of future cash flows relating to the arrangement, for example:

- due to changes in the usage of the infrastructure by the users (increase in traffic on the road, increase in the number of passengers, etc.); or
- due to changes in the estimated costs or other assumptions relating to the arrangement.

Such changes might be an indicator of impairment of the intangible or suggest that the amortisation method for the intangible should be reviewed.

# 6. Bifurcated model

Where an operator receives a financial asset and an intangible asset as consideration, it is necessary to account separately for the component parts. At initial recognition, both components are recognised at the fair value of the consideration received or receivable in respect of work carried out until that date. [IFRIC 12:18] A 'residual approach' is taken in arriving at a value for both components. To the extent that the operator receives a contractual right to receive cash from or at the direction of the grantor, a financial asset is recognised. Any excess of the fair value of the construction services provided over the fair value of the financial asset recognised will be recognised as an intangible asset.

## Example 6.1 Bifurcated model

As in example 4.1, an operator enters into a contract to provide construction services costing CU100. It has been determined that the fair value of the construction services provided is CU110. The total cash inflows over the entire life of the contract are expected to be CU200. Of these, CU60 are guaranteed by the grantor. The appropriate finance revenue to be recognised derived from applying the effective interest rate method in accordance with IAS 39 is in total CU6 over the entire life of the service concession arrangement. The following entries are made in this scenario:

### During construction

	CU	CU
Dr Financial asset	60	
Cr Revenue		60
<i>To recognise revenue relating to construction services, to be settled in cash.</i>		
	CU	CU
Dr Cost of construction	100	
Cr Cash		100
<i>To recognise costs relating to construction services.</i>		
	CU	CU
Dr Intangible asset	50	
Cr Revenue		50
<i>To recognise revenue relating to construction services provided for non-cash consideration.</i>		

## During the operational phase

	CU	CU
Dr Financial asset	6	
Cr Finance revenue		6
<i>To recognise finance revenues.</i>		
	CU	CU
Dr Amortisation expense	50	
Cr Intangible asset (Accumulated depreciation)		50
<i>To recognise amortisation expense relating to the operational phase.</i>		
	CU	Cu
Dr Cash	200	
Cr Revenue		134
Cr Financial asset		66
<i>To recognise revenues relating to the operational phase and cash received from the grantor and users.</i>		
Total revenue over the life of the contract	CU250	
Total cash inflows over the life of the contract	CU200	

A more detailed example of the bifurcated model is included as Example 3 in the Illustrative Examples to IFRIC 12.

# 7. Maintenance obligations

A service concession arrangement may require an operator to:

1. Maintain the infrastructure to a specified level of serviceability; and/or
2. Restore the infrastructure to a specified condition at the end of the arrangement before it is handed over to the grantor.

For example, an operator of a toll road may be required to resurface a road to ensure that it does not deteriorate below a specified condition. IFRIC 12:21 states that such contractual obligations to maintain or restore the infrastructure should be recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Therefore, an estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period needs to be made and recognised as a provision.

The Interpretation does not include guidance on the timing of recognition of the obligations because the terms and conditions of the obligation will vary from contract to contract and the requirements and guidance in IAS 37 should be followed to identify the period(s) in which different obligations should be recognised.

In the case of resurfacing a road, it may be that the amount required to settle the obligation at any point in time is linked to the number of vehicles that have travelled over the road. Thus usage of the road may determine the obligating event. This is illustrated by Example 2 of IFRIC 12 which builds up the provision for the resurfacing obligation over time.

In contrast, when the entity is obligated to restore the infrastructure to a specified condition at the end of the arrangement irrespective of the usage, it represents in substance an obligation analogous to dismantling or removing the asset and restoring the site on which the asset stands under IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*; therefore, the obligation arises on contract signing. Under the intangible asset model, such an obligation is included in the cost of the asset and is subsequently amortised.

IFRIC 12 envisages that maintenance obligations could alternatively be a revenue earning activity, in particular under the financial asset model as illustrated in IFRIC 12 (Example 1). If the grantor reimburses the operator for maintenance, such as resurfacing the road, then the operator would not record the obligation in the statement of financial position but recognise the revenue and expense in profit or loss when the resurfacing work is performed. The accounting result is similar to that of an upgrade (see section 8).

Ultimately, the accounting treatment for maintenance obligations will depend on the precise terms and circumstances of the obligations which will vary from contract to contract and should not be affected by the nature of the infrastructure asset recognised (i.e., a financial asset or an intangible asset).

IAS 37 requires that when the effect of the time value of money is material, the amount of a provision should be the present value of the expenditures expected to be required to settle the obligation. IAS 37 indicates that where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time and that this increase is recognised as a borrowing cost (note that these borrowing costs are not capitalised since they are incurred once the asset is ready for use). This is the only guidance that the standard gives on the unwinding of the discount. In addition, IFRIC 1 *Changes in existing decommissioning, restoration and similar liabilities* addresses some of the issues relating to the use of discounting in the context of provisions for obligations to dismantle, remove or restore items of property, plant and equipment and concludes that the periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs [IFRIC 1:8].

After initial recognition, provisions should be reviewed at the end of each reporting period and adjusted to reflect current best estimates.

Adjustments to provisions arise from three sources:

- revisions to estimated cash flows (both amount and timing);
- changes to present value due to the passage of time; and
- revisions of discount rates to reflect prevailing current market conditions.

In the years following the initial recognition and measurement of a provision at its present value, the provision should be revised to reflect estimated cash flows being closer to the measurement date. Whilst the unwinding of the discount relating to the passage of time should be recognised as a finance cost, the revision of estimates of the amount and timing of cash flows is a reassessment of the provision and should be charged or credited as an operating item rather than as a finance cost. This is consistent with IFRIC 1 *Changes in existing decommissioning, restoration and similar liabilities* which treats changes in the estimated timing or amount of the obligation and changes in the discount rate as operating items with periodic unwinding of the discount recognised as a borrowing cost.

## Example 7.1

### Resurfacing obligations and changes in the estimates of the provision

The operator's resurfacing obligation arises as a consequence of use of the road during the operating phase. It is recognised and measured in accordance with IAS 37, i.e. at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

At any date, the best estimate of the expenditure required to settle the obligation in the future is likely to be proportional to the number of vehicles that have used the road. For illustrative purposes, a continuous traffic flow is assumed allowing for the use of a straight-line method that increases the provision by a fixed amount (discounted to a current value) each year.

The operator discounts the provision to its present value in accordance with IAS 37.

### Illustration 1 No changes in estimates

The best estimate of the expenditure required amounts to CU100 at the end of year 6. The obligation increases by CU16.67 (i.e. CU100 divided by 6 years), discounted to a current value each year and the initial discount rate is 6%. There are no subsequent changes in estimates.

The charge recognised each period in profit or loss will be as follows:

Year	1	2	3	4	5	6	Total
Estimated cost of resurfacing	100	100	100	100	100	100	
Estimated discount rate	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	
<b>Opening provision</b>		12.45	26.40	41.98	59.33	78.62	
Obligation arising in year (operating cost)	12.45	13.20	13.99	14.83	15.72	16.67	86.87
Increase in prior year provision arising from passage of time (finance cost)	0.00	0.75	1.58	2.52	3.56	4.72	13.13
	12.45	26.40	41.98	59.33	78.62	<b>100.00</b>	100.00
Used in year						(100.00)	
<b>Closing provision</b>	12.45	26.40	41.98	59.33	78.62	0.00	

## Illustration 2 Subsequent change in discount rate

The best estimate of the expenditure required is CU100 at the end of year 6. The obligation increases by CU16.67 (i.e. CU100 divided by 6 years), discounted to a current value each year and the initial discount rate is 6%. Subsequently, as a result of a reassessment of prevailing market rates at the beginning of year 4 the discount rate changes to 4%.

The expense recognised each period in profit or loss will be as follows:

Year	1	2	3	4	5	6	Total
Estimated cost of resurfacing	100	100	100	100	100	100	
Estimated discount rate	6.0%	6.0%	6.0%	<b>4.0%</b>	4.0%	4.0%	
<b>Opening provision</b>		12.45	26.40	41.98	61.64	80.13	
Obligation arising in year (operating cost)	12.45	13.20	13.99	17.98	16.03	16.67	90.32
Increase in prior year provision arising from passage of time (finance cost)	0.00	0.75	1.58	1.68	2.47	3.21	9.68
	12.45	26.40	41.98	61.64	80.13	<b>100.00</b>	100.00
Used in year						(100.00)	
<b>Closing provision</b>	12.45	26.40	41.98	61.64	80.13	0.00	

At the beginning of year 4, the discount rate has changed to 4%. The obligation at the end of year 3 was CU41.98. The unwinding of the discount would be the increase in the prior year obligation arising from the passage of time, so an amount of CU1.68 (CU41.98 x 4%) would be charged as a finance cost and the additional amount of CU17.98 (being the net present value of the additional 1/6 of the CU100 provision for the year plus the increase in the provision resulting from the fall in discount rate from 6% to 4%) would increase the provision as an operating item.

### Illustration 3 Subsequent revision to the estimated cash flows

The best estimate of the expenditure required is CU100 at the end of year 6. The obligation initially increases by CU16.67 (i.e. CU100 divided by 6 years), discounted to a current value each year and the discount rate is 6%. Subsequently, at the beginning of year 4, the best estimate changes to CU 106. The charge recognised each period in profit or loss will be as follows:

Year	1	2	3	4	5	6	Total
Estimated cost of resurfacing	100	100	100	<b>106</b>	106	106	
Estimated discount rate	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	
<b>Opening provision</b>		12.45	26.40	41.98	62.89	83.33	
Obligation arising in year (operating cost)	12.45	13.20	13.99	18.39	16.67	17.67	92.38
Increase in prior year provision arising from passage of time (finance cost)	0,00	0.75	1.58	2.52	3.77	5.00	13.62
	12.45	26.40	41.98	62.89	83.33	<b>106.00</b>	106.00
Used in year						(106.00)	
<b>Closing provision</b>	12.45	26.40	41.98	62.89	83.33	0.00	

Based on the revised estimate of CU106 at the end of year 6, the obligation at the end of year 4 should be CU62.89 (CU106 / 6 \* 4 years, discounted by 2 years at 6%). The finance cost in the year of revision is the increase in the prior year obligation arising from the passage of time using the discount rate of 6% (CU41.98 \* 6% = CU2.52). Any other adjustment to the carrying value of the provision (i.e., an additional year's worth of the obligation plus the adjustment arising from the increase in the best estimate of the cash flow at the end of year 6 to CU106) is charged as an operating expense.

# 8. Upgrade of existing infrastructure or new infrastructure

A service concession arrangement contract may require an operator to perform additional construction works during the operation phase. It will be a matter of judgement whether this subsequent expenditure represents maintenance or an upgrade of an existing infrastructure. Construction work would usually be considered an upgrade of existing infrastructure if it extends the life or capacity of the asset even though the additional revenues provided may not be identifiable on a standalone basis. For example, construction of an extra lane of a motorway will allow an increase in the traffic flow and it will represent an upgrade even though it is unclear how much traffic it produces by itself. On the other hand, construction work that does not extend the life or the capacity of the asset is usually considered to represent maintenance.

As explained in section 7, contractual obligations to maintain or restore infrastructure that are maintenance work shall be recognised and measured in accordance with IAS 37 *Provisions, Contingent Assets and Contingent Liabilities*.

IFRIC 12:14 states that revenues and costs of the operator relating to the construction or upgrade services phase of a contract are accounted for in accordance with IAS 11 *Construction Contracts*. If the operator has an unconditional contractual right to receive cash in order to recover the additional upgrade investment, the fair value of the upgrade investment will be treated as a receivable under the financial asset model. If the operator has the right to charge users to recover the upgrade expenditure, the fair value of the upgrade elements will be treated as an intangible asset under the intangible asset model. To the extent that the revenues expected to be generated from the upgrade cannot be readily linked to the upgrade itself, it will generally be appropriate to recognise a single intangible asset for the initial construction work and the subsequent upgrade. In such a case, to the extent that the operator has an unavoidable obligation to upgrade the infrastructure, it would generally be appropriate to recognise, at the outset of the arrangement, the full intangible asset including the upgrade service with a performance obligation for the construction work to be undertaken in the future.

# 9. Borrowing costs

Borrowing costs attributable to a concession arrangement should be capitalised during the construction phase, in accordance with IAS 23, if the operator has a contractual right to receive an intangible asset. A financial asset is not a qualifying asset and so borrowing costs are recognised as an expense in the period in which they are incurred. [IFRIC 12:22] Under the financial asset model interest is imputed on the financial asset using the effective interest method (see Section 4). The financial asset generates interest income since it is accounted for in accordance with IAS 39 (or IFRS 9 if early applied) although the construction phase is still in process [IFRIC 12:IE8].

# 10. Arrangements that do not give rise to construction or upgrade services

IFRIC 12 envisages that under certain service concession arrangements, the operator does not undertake construction or upgrade activities, but instead the grantor gives the operator access to existing infrastructure for the purpose of the service arrangement. [IFRIC 12:7b] However, IFRIC 12 does not deal specifically with situations where a service concession arrangement consists only of an operation phase, so it is necessary to apply the requirements of other relevant IFRSs as discussed below.

In such arrangements, the grantor may pay the operator directly for providing the service or give the operator a right to charge users at a regulated price. If the operator is paid a fixed sum by, or at the direction of, the grantor, revenue relating to the operating phase is accounted for in accordance with IAS 18 Revenue and costs are expensed as incurred. There is no financial asset relating to construction services to be recognised at inception.

Where the operator is given a right to charge users, it would be inappropriate to recognise an intangible asset with a corresponding credit to income at inception of the contract. This is because, in contrast to an arrangement where the operator has constructed the infrastructure, there has been no exchange of dissimilar goods and services in return for the licence at inception in accordance with IAS 18:12. In such arrangements, the operator should recognise revenue from users as earned, charge costs as incurred and recognise a provision for any contractual obligations to maintain and restore the infrastructure in accordance with IAS 37.

Where the operator pays the grantor to acquire a licence so it can charge users for a public service, the operator should recognise an intangible asset at cost, including the present value of all future fixed payments, in accordance with IAS 38. If future amounts payable are contingent on usage, those amounts payable should be recognised as an expense as usage occurs, rather than being accrued at the outset.

# 11. Items provided to the operator by the grantor

The grantor may also provide the operator access to other items (for example, land or other infrastructure assets). Following the basic principles underlying the accounting model proposed in IFRIC 12:11, infrastructure items to which the operator is given access by the grantor for the purposes of the service arrangement are not recognised as property, plant and equipment of the operator because they remain under the control of the grantor.

Where an operator is given infrastructure items by the grantor as part of the consideration payable by the grantor for the services, to keep or deal with as the operator wishes (i.e., they are not for the purposes of the service arrangement), then these assets are recognised as assets of the operator and are measured at fair value on initial recognition. The operator recognises a liability in respect of unfulfilled obligations it has assumed in exchange for the assets. The assets would not be viewed as government grants as defined in IAS 20. [IFRIC 12:27]

## **Example 11.1** **Items provided to the operator by the grantor**

Company A enters into a service concession arrangement in which it will build and operate a new hospital for a period of 30 years. In exchange, the government provides Company A with a fixed annual cash payment, and title to a substantial plot of land surrounding the hospital. Company A is free to use the land as it wishes. Company A should recognise the land as its own property at fair value at the date of initial recognition together with a corresponding obligation for any unfulfilled obligations.

# 12. Disclosures about service concession arrangements

SIC-29 *Service Concession Arrangements: Disclosures* specifies certain disclosures that are required for such service concession arrangements to meet the requirements of paragraph 112(c) of IAS 1(2007). This paragraph requires disclosures to provide additional information that is not presented in the primary financial statements but is relevant to an understanding of them. The disclosure requirements apply to all service concession arrangements, not just those within the scope of IFRIC 12.

IFRIC 12 made the following consequential amendments to SIC-29:

- an additional requirement was added to disclose 'how the service arrangement has been classified'; and
- an additional requirement was added to require an operator to disclose the amount of revenue and profits or losses recognised in the period on exchanging construction services for a financial asset or an intangible asset.

Examples of service concession arrangements given in SIC-29 are water treatment and supply facilities, motorways, car parks, tunnels, bridges, airports and telecommunications networks. SIC-29 also explains that outsourcing the operation of an entity's internal services (e.g. employee restaurant, building maintenance, accounting or IT functions) are not service concession arrangements. [SIC-29:1]

Certain aspects and disclosures relating to some service concession arrangements are addressed in other Standards. For example, IAS 16 would apply to property, plant and equipment used in a service concession arrangement. However, SIC-29 points out that service concession arrangements may involve executory contracts that are not addressed in IFRSs, unless the contracts are onerous, in which case IAS 37 applies. SIC-29, therefore, addresses additional disclosures that are relevant to service concession arrangements. [SIC-29:5]

All aspects of service concession arrangements should be considered in determining the appropriate disclosure in the notes. An operator and a grantor should disclose the following in each period:

[SIC-29:6]

- a description of the arrangement
- significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (e.g. the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);
- the nature and extent (e.g. quantity, time period or amount as appropriate) of:
  - rights to use specified assets;
  - obligations to provide or rights to expect provision of services;
  - obligations to acquire or build items of property, plant and equipment;
  - obligations to deliver or rights to receive specified assets at the end of the concession period;
  - renewal and termination options; and
  - other rights and obligations (e.g. major overhauls);
- changes in the arrangement occurring during the period; and
- how the service arrangement has been classified.

In addition, an operator discloses the amount of revenue and profits or losses recognised in the period of exchanging construction services for a financial asset or an intangible asset. [SIC-29:6A]

These disclosures are required to be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. For this purpose, a class is a grouping of service concession arrangements involving services of a similar nature. For example, arrangements for water treatment services could be treated as a class. [SIC-29:7]. However, where terms are significantly different (e.g. water treatment arrangements may have significantly different terms in different jurisdictions) the entity should consider the quality of the information being provided to users prior to grouping arrangements with dissimilar terms.

# 13. Effective date and transition

IFRIC 12 applies for annual periods beginning on or after 1 January 2008, with earlier application permitted. If an entity applies the Interpretation for a period beginning before 1 January 2008 that fact must be disclosed.

The Interpretation should be applied retrospectively, in accordance with IAS 8. However, if it is not practicable for an operator to apply the Interpretation retrospectively at the start of the earliest period presented it should:

[IFRIC 12:30]

- a) recognise financial assets and intangible assets that existed at the start of the earliest period presented;
- b) use the previous carrying amounts of those financial and intangible assets (however previously classified) as their carrying amounts as at that date; and
- c) test financial and intangible assets recognised at that date for impairment, unless this is not practicable, in which case the amounts should be tested for impairment as at the start of the current period.

IFRS 1 *First-time Adoption of International Financial Reporting Standards* (Appendix D.22) states that first-time adopters may apply the transitional provisions in IFRIC 12. If retrospective application of service concession agreements prior to the date of transition to IFRS is impractical, an entity should use the previous carrying amounts, however previously classified, as the carrying amounts as at the transition date and classify the concession assets as financial or intangible assets in accordance with IFRIC 12. [IFRIC 12:30 (b)]

It is generally accepted that the reference to “previous carrying amounts” in IFRIC 12:30(b) should be interpreted to mean “previous GAAP carrying amounts”, however classified under previous GAAP.

# Appendix – List of the examples included

This guide provides preparers with an overview of IFRIC 12 as well as with guidance through examples as to how apply the requirements of the Interpretation and to answer the most frequently asked questions by preparers.

The following examples are included:

## Scope of IFRIC 12

Example 2.1 Concession with unregulated prices and congestion payment

Example 2.2 Competitive tender process

Example 2.3 Infrastructure used in a concession arrangement for its entire useful life

Example 2.4 Indefinite term of the concession arrangement

Example 2.5 Application of IFRIC 12 when residual interest is returned to grantor at fair value

Example 2.6 Infrastructure with different activities

## The accounting models

Example 3.1.1 Recognition of a profit margin on construction work – Infrastructure constructed by the operator

Example 3.1.2 Recognition of a profit margin on construction work – Infrastructure acquired

Example 3.2.1 Examples of some typical concession mechanisms

Example 3.2.2 Take-or-pay arrangements

Example 3.2.3 Payments for capacity availability

Example 3.2.4 Guaranteed minimum revenue – Guarantee of NPV of revenue with extension of concession term

Example 3.2.5 Guaranteed minimum revenue – Guarantee of NPV of revenue with limited extension of concession term and final cash

## Financial asset model

Example 4.1 Financial asset model

Example 4.2 Classification of income and expense

## Intangible asset model

Example 5.1 Amortisation under intangible asset model

Example 5.2 Intangible asset model

## Bifurcated model

Example 6.1 Bifurcated model

## Maintenance obligations

Example 7.1 Resurfacing obligations and changes in the estimates of the provision

## Items provided to the operator by the grantor

Example 11.1 Items provided to the operator by the grantor

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iGAAP 2011: A guide to IFRS reporting

4th edition (November 2010). A comprehensive guide to the requirements of IFRSs.

IFRSs in your pocket

Published in several languages, this pocket-sized Guide includes summaries of all IASB Standards and interpretations, updates on agenda projects, and other IASB-related information.

IFRSs and US GAAP: A pocket comparison

A summary of the principal differences in pocket-sized format, including a status report as to what is being done about each difference.

Presentation and disclosure checklist

Checklist incorporating all of the presentation and disclosure requirements of IFRSs

iGAAP 2010

Financial instruments: IAS 32, IAS 39, IFRS 7 and IFRS 9 explained

6 th edition (June 2010). Guidance on how to apply these complex Standards, including illustrative examples and interpretations.

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