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**Status:** Final**Effective date:**

Periods beginning on or after 1 January 2008 – early application is permitted. But IFRIC 12 has not yet received EU endorsement

**Accounting impact:**

This will impact the accounting for operators for public to private service concession arrangements (PFI type contracts).



# International Financial Reporting Bulletin

## IFRIC Interpretation 12: Service Concession Arrangements

### Background

IFRIC 12 was developed in response to widespread concern over the lack of accounting guidance for public to private service arrangements (such as Private Finance Initiative ('PFI') contracts) where typically a private sector entity (operator) constructs or upgrades the public sector infrastructure to be used and then operates and maintains that infrastructure for a specified period of time. Such an arrangement might cover roads, airports, prisons, hospitals or energy/water supply and distribution facilities.

IFRIC 12 gives guidance on the accounting by the operator. It does not address the accounting by the public sector entity (grantor). Requirements for disclosing information about service concession arrangements are in SIC-29 *Service Concession Arrangements: Disclosures*.

### Requirements

#### Scope

IFRIC 12 applies to public-to-private service concession arrangements in which:

- a. The grantor controls or regulates the services to be provided by the operator with the infrastructure, their prices and customers
- b. The grantor controls any significant residual interest in the infrastructure at the end of the arrangement or the infrastructure is used for its entire useful life in the service concession arrangement.

The application guidance to the IFRIC notes that in considering whether the grantor controls or regulates the services to be provided, control could be by contract or otherwise (e.g. through a regulator) and the grantor and any related parties must be considered together. In addition, it is not necessary for the grantor to have complete control over the price; regulation through a capping mechanism (which has substance) would be sufficient.

IFRIC 12 does not seek to address all forms of infrastructure service arrangements, and does not address accounting by grantors. Neither does it address the accounting for infrastructure that was recognised by the operator as property, plant and equipment (PPE) before entering the service arrangement. The derecognition requirements of IAS 16 *Property, Plant and Equipment* would apply to such PPE.

IFRIC 12 amends IFRIC 4 *Determining whether an Arrangement Contains a Lease* such that any service concession arrangements within the scope of IFRIC 12 are excluded from the scope of IFRIC 4.

*Accounting* For service concession arrangements within the scope of IFRIC 12 the consideration receivable from the construction or upgrade of infrastructure may give rise to a financial asset or an intangible asset depending on whether the operator has an unconditional contractual right to receive cash or another financial asset.

IFRIC 12 contains three illustrative examples covering:

- Example 1: The grantor gives the operator a financial asset
- Example 2: The grantor gives the operator an intangible asset (a licence to charge users)
- Example 3: The grantor gives the operator a financial asset and an intangible asset

The intangible asset approach can lead to a “grossing up” of revenue. The operator recognises construction revenue in accordance with IAS 11 *Construction Contracts* as it constructs the infrastructure – the consideration being the right to charge for use of the infrastructure in the operation stage which is recognised as an intangible asset. The operator then recognises operational revenue in accordance with IAS 18 *Revenue* as it charges users and amortises the intangible. This is illustrated in example 2 of the IFRIC where the operator records total revenue of CU2,650 but only receives cash of CU1,600 over the term of the contract.

IFRIC 12 sets out general principles on recognising and measuring the obligations and related rights in service concession arrangements as noted in the following table.

<i>Treatment of the operator's rights over the infrastructure</i>	The infrastructure assets are not recognised as the property, plant or equipment (PPE) of the operator. Infrastructure that was recognised by the operator as PPE before entering the service arrangement is outside of the scope of the IFRIC.
<i>Recognition and measurement of arrangement consideration</i>	Revenue is recognised and measured in accordance with IAS 11 (for construction or upgrade services) or IAS 18 (for operation services, where the operator operates and maintains the infrastructure).
<i>Construction or upgrade services</i>	The revenue is recognised at fair value. Consideration may be a financial asset or an intangible asset. <ul style="list-style-type: none"> <li>• The operator recognises a <b>financial asset</b>, where it has an unconditional contractual right to receive cash or another financial asset from the grantor in return for constructing or upgrading the public sector asset</li> </ul>

	<ul style="list-style-type: none"> <li>The operator recognises an <b>intangible asset</b>, where it has no more than a right to charge for use of the public sector asset that it constructs or upgrades.</li> </ul> <p>IFRIC 12 allows for the possibility that both types of arrangement may exist within a single contract: to the extent that the grantor has given an unconditional guarantee of payment for the construction of the public sector asset regardless of the extent to which the asset is used, the operator has a financial asset; to the extent that the operator has to rely on the public using the service in order to obtain payment, the operator has an intangible asset</p>
<i>Operator's contractual obligations to maintain/ restore the infrastructure to a specified level of serviceability</i>	Contractual obligations to maintain or restore infrastructure, except for any upgrade element (see above), shall be recognised and measured in accordance with IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> , i.e. at the best estimate of the expenditure that would be required to settle the present obligation at the balance sheet date.
<i>Borrowing costs incurred by the operator</i>	Borrowing costs attributable to the arrangement are recognised as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (i.e. a right to charge users of the public service). In this case borrowing costs attributable to the arrangement may be capitalised during the construction phase of the arrangement in accordance with IAS 23 <i>Borrowing Costs</i> .
<i>Subsequent accounting treatment of a financial asset and an intangible</i>	IAS 32 <i>Financial Instruments: Presentation</i> , IAS 39 <i>Financial Instruments: Recognition and Measurement</i> and IFRS 7 <i>Financial Instruments: Disclosures</i> apply to the financial asset recognised under the IFRIC. If the financial asset is classified as a loan or receivable or as an available-for-sale financial asset interest is calculated using the effective interest method and recognised in profit or loss.  IAS 38 <i>Intangible Assets</i> applies to the intangible asset recognised under the IFRIC.

**Effect** IFRIC 12 is effective for annual periods beginning on or after 1 January 2008. Earlier adoption is permitted and the fact must be disclosed. Changes in accounting policies should be accounted for retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

IFRIC 12 provides special transitional relief when retrospective application is impracticable. This relief is available to both existing users of IFRSs and to first-time adopters of IFRSs.

If retrospective application at the start of the earliest period presented is impracticable, then an operator should:

- reclassify assets recognised previously under the service concession arrangement as intangible and / or financial assets at the start of the earliest period presented, measured at the previous carrying amount of the assets recognised previously ie without remeasurement, at that date, and
- test the financial and intangible assets recognised for impairment at that date, or if this is impracticable, at the start of the current period.

#### **Action required**

IFRIC 12 is not mandatory until annual financial periods commencing on or after 1st January 2008. However, for companies which report in accordance with EU-endorsed IFRS, IFRIC 12 has not yet received EU endorsement meaning that although it might be adopted early (as it is an interpretation of endorsed IFRS), the transitional relief outlined above would not be available. Entities will need to consider whether IFRIC 12 is applicable to their activities and start collecting the information required to quantify the appropriate financial assets or intangible assets required to be recognised.