Date

20 June 2005

Le Président

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Mr. Robert Garnett
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Dear Mr. Garnett,

Re: IFRIC draft interpretations D12, D13 and D14 on Service Concession Arrangements

FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) is pleased to submit its views on the IFRIC Draft interpretations D12 Service Concessions Arrangements – *Determining the Accounting Model*, D13 Service Concessions Arrangements – *The Financial Asset Model* and D14 – Service concessions Arrangements – *The Intangible Asset Model*.

FEE as a founding organisation of EFRAG has also contributed to the EFRAG commenting process by submitting our views on their preliminary comments. This response should be read in conjunction with the response submitted by EFRAG. Where we are in agreement with the EFRAG comments we refer to their comments. Where we are in disagreement, our own views are put forward.

We welcome the work achieved by IFRIC to develop accounting guidance applicable to service concession contracts.

We support EFRAG's general comments in their letter to IFRIC of 24 May 2005.

We share EFRAG's concern on the scope of the interpretation. It is too narrow and too rules-based. The scope is so specific on which parties are involved and which circumstances have to be met, that it could lead to circumvention. We are concerned that contracts could be built in a way to avoid being within the scope of the interpretation. The scope would not be so limited if it was more a principle-based approach. It is important that the interpretations deal with borderline cases in a clear manner.

We are also unsatisfied with the outcome of the two accounting models. Transactions that are economically identical will be accounted for differently. The models are too much based on the form rather than on the substance of transactions. The determination of the accounting should rather be based on the substance (risks and rewards) than on the form (source of payment). We support EFRAG's suggestion to reintegrate the demand risk feature into the interpretation.

We share EFRAG's concerns that a final interpretation is needed before the year end of 2005 to give clarity to companies reporting under IFRS for 2005. As suggested by EFRAG, we believe the best solution is a temporary relief from the IAS 8 hierarchy for 2005, similar to what has been established in IFRS 6, to allow companies to continue applying their existing practices.

We have the following comments on the answers to the questions raised in the draft interpretations.

Draft interpretation D12 – Determining the accounting model

Question 1

The proposal in paragraph 5 of the draft Interpretation reflects the IFRIC's decision that whether an operator recognises service concession infrastructure as its property, plant and equipment should depend on whether it controls the use of that infrastructure. The IFRIC selected this approach instead of one based on the extent to which the risks and rewards of ownership lie with the operator. The rationale for selecting this approach is explained in paragraphs BC9-BC11 of the Basis for Conclusions. Do you support the approach selected?

We support EFRAG's concerns on the control approach set out in paragraph 5. The control approach and the risk and rewards approach are both relevant and should both be considered. The risk and rewards approach should not be left out of the analysis of service concessions arrangements. The Basis for Conclusions of IFRIC D12 does not elaborate on the conflict between the two approaches and does not give convincing arguments to explain why the risk and rewards approach was rejected. Applying the control approach could result in different consequences than if the risks and rewards approach was applied consistently in the standards. For example, under IAS 17, it is possible to classify a lease as an operating lease even if the lessee gets ownership of the asset at the end of a lease. We believe that the risks and rewards approach is not just relevant for the recognition criteria but also for the determination of the accounting model. We would also like to point out that the demand risk is not the only element to consider in a risk and rewards approach. Other risks have to be taken into consideration when operating a concession, for example, the cost variation risk or the residual value risk.

We agree with EFRAG that the difference between BC12 and BC21 might create a conflict between the control concept and the derecognition rules of IAS 18. IFRIC should adjust the interpretation to be consistent with the rules of IAS 18.

We agree with EFRAG that D12 is unclear about which assets are to be used in a concession arrangement, compared to IFRIC 4 which requires the use of a specific asset. IFRIC creates a conflict between IFRIC 4 and D12. However, we are of the opinion that in practice, it will often be clear which assets are to be used and there is no difficulty to identify them.

We are surprised by the statement of BC 21 that it is unusual for the operator to use its existing infrastructure assets in a new concession arrangement. We see multiple situations where existing assets of the operator are used. As an example, a bus operator would usually own the buses before entering into a contract for public transport. IFRIC should elaborate within the interpretation on how to deal with situations where the operator uses existing assets.

It is unclear to us what IFRIC means when stating that the grantor has the control of the pricing policy. Partial control of the pricing will often exist and it will be difficult to determine the scope of such a mechanism. We feel that this criterion will be difficult to apply in practice.

We suggest to IFRIC that the criterion of a public service obligation should be better defined to clarify the scope of D12. In our view, the notion of public service obligation is interpreted in different ways across jurisdictions. IFRIC states that a public service obligation is to provide a service to be available to the public. However, the meaning of a public service obligation could be different from the meaning of providing a service to the public. For example, the construction and operation of a prison is not a service to the public but could be considered a public service obligation.

D12 - Question 2

Paragraph 11 of the draft Interpretation proposes that the operator should apply the financial asset model only if the grantor has primary responsibility to pay for the concession services. The rationale is explained in paragraphs BC24-BC43 of the Basis for Conclusions. Do you agree with this proposal? If not, what criteria would you use to determine whether the financial asset model should apply? How would you reconcile those criteria to the definition of a financial asset set out in IAS 32 Financial Instruments: Disclosure and Presentation?

We support the EFRAG response that not only the primary responsibility to pay but also the risks and reward approach should be applied in determining whether there is a financial asset. The criteria to select the accounting model should not only be based on who is responsible to pay but also on the demand risk feature. The determination of the accounting should rather be based on the substance (risks) than on the form (source of payment). Also the related Standards IAS 17 and IAS 18 are based on a risk and reward approach. The proposal of IFRIC will result in dissimilar results for very similar contracts. Such significant consequences raise concerns for us about the comparability of financial information.

The primary responsibility to pay the operator for the services will sometimes be difficult to establish when the operator receives payment by users and significant other financing from the grantor.

IFRIC should refine the determination of the accounting model proposed in D12.

D12 - Question 3

As explained in paragraph BC44 of the Basis for Conclusions, paragraph 13 of the draft Interpretation proposes that the identity of the party or parties with primary responsibility to pay for the concession services should be determined by reference to the substance of the contractual arrangements (which would not be affected by, for example, changing the parties through whom payment is routed). Do you agree with this proposal?

We agree with EFRAG about the difficulty to interpret BC 44. The substance over form concept should have been used to determine the criteria to select the accounting model.

We share EFRAG's suggested solution on bifurcating a contract. The draft interpretation should give additional guidance on the possibility to unbundle a contract into components. Such a situation would be allowed when meeting proper criteria to be determined by IFRIC.

D12 - Question 4

The IFRIC aims to issue this and the two other proposed Interpretations on service concessions (D13 and D14) in final form before the end of 2005. It proposes that, subject to it achieving this aim, the three Interpretations should be applied for annual periods beginning on or after 1 January 2006. Do you agree with this proposal?

We share EFRAG's concerns that a final interpretation is needed before the year end of 2005 to give clarity to companies reporting under IFRS for 2005. A delay in issuance of the interpretations would create practical problems for 2005. However, we fear that under the timing pressure, the solution adopted may have flaws.

As suggested by EFRAG, we believe the best solution is a temporary relief from the IAS 8 hierarchy for 2005, similar to what has been established in IFRS 6, to allow companies to continue applying their existing practices.

We support the transitional provisions and the retrospective application. We would like to point out the inadequate comment included in the IFRIC press release of 3 March regarding the early adoption. It is mentioned that "operators not wishing to adopt the final Interpretations early and whose existing accounting practices are not inconsistent with IFRSs will be able to continue to apply those practices…". This is not mentioned in the draft interpretations. Companies should be allowed to continue applying their existing practices without referring to their consistency with IFRSs.

Draft interpretation D13 – The Financial Asset Model

Question 1

As discussed in paragraphs BC3-BC5, the proposals in the draft Interpretation are based on a conclusion by the IFRIC that the discharge of each contractual obligation (including obligations to repair and maintain the infrastructure) gives rise to revenue for the operator. Do you agree with this conclusion? (Question 3 in the Invitation to Comment on draft Interpretation D14 Service Concession Arrangements—the Intangible Asset Model poses a similar question in relation to the intangible asset model.)

We disagree with EFRAG and with IFRIC's conclusion that a contractual obligation is to be treated under two different approaches depending on the accounting model. We see no reason to apply a different accounting approach for obligations under the financial asset model and under the intangible asset model. We prefer the application of IAS 37 for the contractual obligation under both accounting models.

D13 - Question 2

As explained in paragraphs BC6 and BC7, the IFRIC has concluded that, applying IAS 11 Construction Contracts, operators might recognise different profit margins on different activities undertaken within a single service concession contract. Do you agree with this conclusion?

We agree with IFRIC's conclusion in BC6 and BC7 to recognize different profit margins.

Draft interpretation D14 – The Intangible Asset Model

Question 1

In the intangible asset model on which this draft Interpretation is based, the service concession operator is regarded as receiving an intangible asset from the grantor in exchange for the construction or other services it provides to the grantor. Paragraph 7 of the draft Interpretation proposes that the operator should recognise revenue and profit or loss on that exchange. The rationale for this proposal and for an alternative view – i.e. that no revenue or profit should be recognised on the exchange - is set out in paragraphs BC7-BC14 of the Basis for Conclusions. Do you agree with the proposal? If not, how would you reconcile non-recognition of revenue and profit to the requirements of existing IFRSs?

The majority within FEE is not convinced that an exchange takes place and has doubts that the recognition criteria under IAS 18 are met. IAS 16.24-26 and IAS 38.45-47 are relevant to conclude against the idea that an exchange of assets occurs. It states that there should be (among other things) a change in configuration of the cash flow (i.e. risk, timing and amount) related to the assets exchanged in order to have economic substance, which is relevant for the recognition of profit. In the case of concession agreements there will not be a change in the configuration of expected cash flows related to the assets exchanged as these cash flows are related to the same service revenues. For the operator, the inflow of economic benefits arises from the operation of services and not from the exchange of construction or services against an intangible asset. Therefore the majority is not convinced that the recognition criteria under IAS 18 are met and views the construction cost as payments to acquire an intangible asset and not as a revenue earning activity.

A minority within FEE supports the proposal in the draft interpretations and believes that the exchange that takes place at the end of the construction phase is properly justified in D14 and in line with IAS 18.

Furthermore, we question the basis of the intangible asset model. If the condition of D12 paragraph 5 (a) is fulfilled, the grantor has control over the cash flow from the asset. If there is no sufficient control to recognize a physical asset, how can one justify that there is sufficient control to recognize an intangible asset? D14 lacks justification of the basis for recognizing an intangible asset. The model appears to be not realistic.

The accounting under the intangible asset model should reflect the economic substance of the transaction. The revenue recognized should not be more than the economic revenue from the transaction, being the cash flow received by the operator. There is double counting if revenue is recognized at the moment of the exchange and during the operation of the service. We would prefer a method under which the revenues are limited to the cash flows received.

D14 - Question 2

As explained in paragraph BC6 of the Basis for Conclusions, the draft Interpretation does not specify the timing of recognition of the intangible asset. The IFRIC identified three possible approaches. Do you agree that the proposed Interpretation should remain silent on this matter? If not, which of the three approaches do you think should be specified and in what circumstances?

The approach b) is supported by a majority because it is more appropriate for when the construction costs are built up as a receivable for the intangible asset. Otherwise, the alternative c) is the most appropriate approach if there is an exchange. We agree with the EFRAG that the interpretation should be more specific with respect to the timing of recognition of the intangible asset.

D14 - Question 3

As explained in paragraph BC16 of the Basis for Conclusions, the proposed requirements for maintenance and repair obligations in this draft Interpretation are different from those in D13 Service Concession Arrangements—The *Financial Asset Model. Do you agree that the IFRIC has interpreted existing IFRSs correctly in respect of these proposals?*

We agree that the obligations should be provided according to IAS 37 under the intangible asset model, as long as the operator operates the asset. We suggest to IFRIC to be more explicit on the way to apply IAS 37 to concession obligations.

Other comments

1. In general, we note that the basis for conclusions of the draft interpretations include more useful and relevant guidance than the text of the interpretations themselves. We are concerned that this may undermine the usefulness and comprehension of the interpretations, as the basis for conclusions will not always be translated.

2. IAS 38.97 requires that the intangible asset be amortised on a systematic basis over its useful life. IAS 38.98 leaves the possibility, in rare case, to use other methods than the straight line basis for an intangible asset with a finite useful life. We believe that IFRIC D14 should also permit the possibility to amortise according to another pattern than the straight-line method to allow for the most relevant accounting treatment.

3. D14 paragraph 9 states that the liability to provide for an obligation shall be included in the cost of the intangible asset. The draft interpretation does not give guidance on how to treat such a liability. We suggest it should refer to IFRIC 1 on Changes in Decommissioning, Restoration and Similar Liabilities.

We would be pleased to discuss any aspect of this letter with you.

Yours sincerely,

David Devlin
President