IFRIC

International Accounting Standards Board®

International Financial Reporting Interpretations Committee

IFRIC DRAFT INTERPRETATION D14

Service Concession Arrangements—
The Intangible Asset Model

Comments to be received by 3 May 2005

IFRIC Draft Interpretation D14 *Service Concession Arrangements—The Intangible Asset Model* is published by the International Accounting Standards Board (IASB) for comment only. Comments on the draft Interpretation should be submitted in writing so as to be received by **3 May 2005**.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org** or addressed to:

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This draft Interpretation is available from www.iasb.org

INVITATION TO COMMENT

The International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC) invites comments on any aspect of this draft Interpretation *Service Concession Arrangements—The Intangible Asset Model.* It would particularly welcome answers to the questions below. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **3 May 2005**.

Questions

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—ie 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?

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?

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?

International Accounting Standards Board®

IFRIC *International Financial Reporting Interpretations Committee*

IFRIC DRAFT INTERPRETATION D14

Service Concession Arrangements—The Intangible Asset Model

IFRIC [draft] Interpretation X *Service Concession Arrangements—The Intangible Asset Model* ([draft] IFRIC X) is set out in paragraphs 1-21 and the Appendix. [Draft] IFRIC X is accompanied by an Illustrative Example and a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 1 and 8-10 of the IFRIC *Preface*.

References

- IFRS 1 *First-time Adoption of International Financial Reporting Standards*
- IFRS 4 *Insurance Contracts*
- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 11 *Construction Contracts*
- IAS 18 *Revenue*
- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
- IAS 23 *Borrowing Costs*
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- IAS 38 *Intangible Assets*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- [Draft] Interpretation [D12] *Service Concession Arrangements—Determining the Accounting Model*
- [Draft] Interpretation [D13] *Service Concession Arrangements—The Financial Asset Model*

Background

1 [Draft] Interpretation [D12] and its Basis for Conclusions set out the background to the IFRIC's project on accounting for service concession arrangements and explain that, because of the range of issues to be covered, the IFRIC decided to prepare a series of related Interpretations, rather than a single document.

2 [D12] states that, for service concession arrangements within its scope, the operator should not recognise the infrastructure used to provide the concession services as its property, plant and equipment. Rather, the operator should account for the rights it receives in exchange for constructing the infrastructure using:

(a) the financial asset model—if the grantor has the primary responsibility to pay the operator for the concession services; or

(b) the intangible asset model—if users have the primary responsibility to pay the operator for the concession services.

3 Under the intangible asset model, the right received by the operator in exchange for its cash or non-cash consideration is accounted for as an intangible asset. This [draft] Interpretation describes how the intangible asset model should be applied.

Scope

4 This [draft] Interpretation applies to the accounting by the operator in all service concession arrangements to which [D12] requires the intangible asset model to be applied. This [draft] Interpretation does not address the accounting by grantors.

Issues

5 This [draft] Interpretation addresses the following issues:

(a) when the operator provides construction or other services in exchange for the intangible asset, whether it should recognise revenue and profit or loss on the exchange and, if so, how the amounts should be measured.

(b) which contractual obligations should be treated as consideration given by the operator for the intangible asset, and which should not.

(c) how contractual obligations that are not included in the consideration given for the intangible asset should be accounted for.

(d) whether commitments to transfer or return infrastructure to the grantor at the end of the service concession should be recognised as liabilities.

(e) how borrowing costs incurred by the operator should be accounted for.

(f) how revenue caps, floors and other agreements included in the terms of the service concession, designed to limit the operator's exposure to variations in demand, should be accounted for.

(g) how items provided to the operator by the grantor should be accounted for.

Consensus

Intangible asset

6 The intangible asset shall be accounted for in accordance with IAS 38. It shall be measured initially at cost. Paragraphs 45-47 of IAS 38 provide additional guidance on measuring the cost of intangible assets acquired in exchange for non-monetary assets.

Revenue and profit or loss recognition

7 When the operator provides construction or other services in exchange for the intangible asset, revenue and profit or loss shall be recognised on the exchange.

8 The revenue and costs relating to the construction or other services shall be recognised and measured in accordance with IASs 11 and 18. In particular, revenue shall be measured at the fair value of the intangible asset received, adjusted by the amount of any cash or cash equivalents transferred. If the fair value of the intangible asset received cannot be measured reliably, revenue shall be measured at the fair value of the services provided by the operator, adjusted by the amount of any cash or cash equivalents transferred.

Contractual obligations included in the consideration given for the intangible asset

9 Obligations to construct new infrastructure, or to enhance either new or existing infrastructure to a condition better than at the start of the concession, shall be included in the consideration given for the intangible asset, and therefore in its cost. They shall be measured as specified in paragraph 6.

Contractual obligations excluded from the consideration given for the intangible asset

10 All other contractual obligations of the operator—including obligations to maintain, replace or restore infrastructure, except for any enhancement element—shall be excluded from the consideration given for the intangible asset. They shall be recognised and measured in accordance with IAS 37, ie at the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

Commitments to transfer or return assets to the grantor at the end of the concession

11 Because the infrastructure is not recognised as property, plant and equipment of the operator, the operator shall not recognise any liability in respect of its commitment to transfer or return the infrastructure to the grantor at the end of the service concession.

12 Contractual obligations that the operator must fulfil before the transfer or return—such as obligations to restore the infrastructure to a specified condition—shall be accounted for in accordance with paragraph 10.

Borrowing costs

13 Subject to paragraph 14, if the operator adopts the allowed alternative treatment in IAS 23, it shall capitalise borrowing costs attributable to the acquisition or production of the intangible asset. IAS 23 requires capitalisation to cease when substantially all activities necessary to prepare the intangible asset for its intended use are complete.

14 If the operator has a right to recover its borrowing costs from the grantor (or another party) that is not contingent on other revenues being insufficient to cover those costs, it shall treat the borrowing costs as an expense and recognise revenue in respect of its right of recovery.

15 If the operator's right to recover borrowing costs from the grantor (or another party) is contingent on other revenues being insufficient to cover those costs, it is not a right of recovery but an agreement designed to limit the operator's exposure to variations in demand, and shall be accounted for in accordance with paragraph 16.

Revenue caps, floors and similar agreements

16 The operator shall account for revenue caps, floors and other agreements included in the terms of the service concession to limit the operator's exposure to variations in demand, as follows:

(a) any premium paid or received for the agreements shall be included in the measurement of the intangible asset.

(b) any rights of recovery from the grantor or another party arising from the agreements shall be accounted for in accordance with IAS 37.

(c) any obligations arising from the agreements shall be accounted for in accordance with IAS 37.

Items provided to the operator by the grantor

17 In accordance with [draft] Interpretation [D12], infrastructure items to which the operator is given access by the grantor for the purpose of the service concession are not recognised as property, plant and equipment of the operator.

18 The grantor may also provide other items to the operator that the operator can keep or deal with as it wishes. If such assets form part of the consideration payable by the grantor for the concession services, they are not government grants as defined in IAS 20. They shall be recognised as assets of the operator, measured at fair value on initial recognition. The operator shall recognise a liability in respect of unfulfilled obligations it has assumed in exchange for the assets.

Effective date

19 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [1 January 2006]. Earlier application is encouraged. If an entity applies this [draft] Interpretation for a period beginning before [1 January 2006], it shall disclose that fact.

Transition

20 Subject to paragraph 21, changes in accounting policies shall be accounted for in accordance with IAS 8.

21 If, for any particular service concession arrangement, it is impracticable for an operator to apply this [draft] Interpretation retrospectively at the start of the earliest period presented, it shall:

(a) recognise intangible assets that existed at the start of the earliest period presented;

(b) use the previous carrying amounts of those intangible assets (however previously classified) as their carrying amounts as at that date; and

(c) test recognised intangible assets for impairment as at that date, unless this is not practicable, in which case the amounts shall be tested for impairment as at the start of the current period.

Appendix

Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

The amendments to IFRS 1 effected by this [draft] Interpretation are included with those set out in the appendix to [D13].

The amendments in that appendix shall be applied for annual periods beginning on or after [1 January 2006]. If an entity applies this [draft] Interpretation for an earlier period, the amendments shall be applied for that earlier period.

Illustrative Example—The Intangible Asset Model

This [draft] example accompanies, but is not part of, the [draft] Interpretation.

Concession terms

IE1 The terms of a service concession require an operator to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (ie years 3-10). The terms of the concession also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator forecasts it will have to undertake the resurfacing at the end of the year 8. At the end of year 10, the concession will end. The operator estimates that the costs it will incur to fulfil its obligations will be:

Table 1 *Contract costs*

	Year	Currency units
Construction	1	500
	2	500
Operation and maintenance (per year)	3-10	10
Road resurfacing	8	100

IE2 The terms of the concession allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of 200 currency units (CU200) in each of years 3-10.

IE3 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year.

Intangible asset

IE4 The operator provides construction services to the grantor in exchange for an intangible asset, ie a right to collect tolls from road users in years 3-10. In accordance with IAS 38 *Intangible Assets*, the operator recognises the intangible asset at cost, ie the fair value of the construction services.

IE5 The [draft] interpretation does not specify when the intangible asset should be recognised. It could be recognised (a) at the outset of the contract (with a corresponding amount recognised in respect of the obligation to provide construction services in exchange); (b) as construction services are provided, by reference to the stage of completion; or (c) once construction is complete.

IE6 For the purpose of this illustration, it is assumed that the operator receives the intangible asset only once construction is complete, ie at the end of year 2. Until then, it recognises a receivable for its construction services. It estimates the fair value of its construction services to be equal to the forecast construction costs plus 5 per cent and the prevailing market rate of interest for lending to the grantor to be 6.18 per cent. It measures the cost of the intangible asset recognised at the end of year 2 by reference to the fair value of the receivable given up at that date:

Table 2 ***Initial measurement of intangible asset***

	Currency units
Fair value of construction in year 1 (CU500 + 5%)	525
Effective interest in year 2 on receivable at end of year 1 (6.18% x CU525)	32
Fair value of construction in year 2 (CU500 + 5%)	525
Cost of intangible asset at end of year 2	1,082

IE7 In accordance with IAS 38, the intangible asset is amortised over the period in which it is expected to be available for use by the operator, ie years 3-10. The depreciable amount of the intangible asset (CU1,082) is allocated using a straight-line method. The annual amortisation charge is therefore CU1,082 divided by 8 years, ie CU135 per year.

Construction costs and revenue

IE8 The exchange of construction services for an intangible asset is regarded as a transaction that generates revenue. The operator recognises the revenue and costs in accordance with IAS 11 *Construction Contracts*, ie by reference to the stage of completion of the construction. It measures contract revenue at the fair value of the consideration receivable. Thus in each of years 1 and 2 it recognises in its income statement construction costs of CU500, construction revenue of CU525 (cost plus 5 per cent) and, hence, construction profit of CU25.

Toll revenue

IE9 The road users pay for the concession services at the same time as they receive them, ie when they use the road. The operator therefore recognises toll revenue when it collects the tolls.

Resurfacing obligations

IE10 The operator's obligation to resurface the road is excluded from the consideration given for the intangible asset. It is recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, ie at the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

IE11 For the purpose of this illustration, it is assumed that the terms of the operator's contractual obligation are such that the best estimate of the expenditure required to settle the obligation at any date is proportional to the number of vehicles that have used the road by that date and increases by CU17 each year. The operator discounts the provision to its present value in accordance with IAS 37. The income statement charge each period is:

Table 3 ***Resurfacing obligation*** *(currency units)*

Year	3	4	5	6	7	8	Total
Obligation arising in year (CU17 discounted)	12	13	14	15	16	17	87
Increase in earlier years' provision arising from passage of time	0	1	1	2	4	5	13
Total expense recognised in income statement	12	14	15	17	20	22	100

Overview of cash flows, income statement and balance sheet

IE12 For the purposes of this illustration, it is assumed that the operator finances the concession wholly with debt and retained profits. It pays interest at 6.7 per cent per year on outstanding debt. If the cash flows and fair values remain the same as those forecast, the operator's cash flows, income statement and balance sheet over the duration of the concession will be:

Table 4 ***Cash flows*** *(currency units)*

Year	1	2	3	4	5	6	7	8	9	10
Receipts	-	-	200	200	200	200	200	200	200	200
Contract costs*	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)
Finance costs†	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)
Net inflow/ (outflow)	(500)	(534)	121	129	137	147	157	67	171	183

* Table 1

† Debt at start of year (table 6) x 6.7%

Table 5 ***Income statement*** *(currency units)*

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue	525	525	200	200	200	200	200	200	200	200	2,650
Finance income*	-	32	-	-	-	-	-	-	-	-	32
Amortisation	-	-	(135)	(135)	(136)	(135)	(135)	(136)	(135)	(135)	(1,082)
Resurfacing expense	-	-	(12)	(14)	(15)	(17)	(20)	(22)	-	-	(100)
Other operating costs†	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(1,080)
Finance costs (table 4)	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net profit	25	23	(26)	(20)	(14)	(5)	2	9	36	48	78

* Effective interest on receivable

† Table 1

Table 6 *Balance sheet* *(currency units)*

End of year	1	2	3	4	5	6	7	8	9	10
Receivable	525	-	-	-	-	-	-	-	-	-
Intangible asset	-	1,082	947	812	676	541	406	270	135	-
Cash/(debt)*	(500)	(1,034)	(913)	(784)	(647)	(500)	(343)	(276)	(105)	78
Resurfacing obligation	-	-	(12)	(26)	(41)	(58)	(78)	-	-	-
Net assets	25	48	22	2	(12)	(17)	(15)	(6)	30	78

* Debt at start of year plus net cash flow in year (table 4).

IE13 To make this illustration as clear as possible, it has been assumed that the concession period is only ten years and that the operator's annual receipts are constant over that period. In practice, concession periods may be much longer and annual revenues may increase with time. In such circumstances, the changes in net profit from year to year could be greater.

Basis for Conclusions

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

Introduction

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

Scope

BC2 The IFRIC agreed that the scope of the draft Interpretation should be consistent with that of draft Interpretation D12 *Service Concession Arrangements—Determining the Accounting Model*. Therefore, it applies only to those arrangements for which D12 specifies that the intangible asset model should be applied, and deals only with the accounting by the operator.

Intangible asset

BC3 The draft Interpretation proposes to require the operator to account for its intangible asset in accordance with IAS 38 *Intangible Assets*. Amongst other requirements, IAS 38 requires an intangible asset with a finite useful economic life to be amortised over that life. Paragraph 97 states that 'the amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.'

BC4 The IFRIC considered whether it would be appropriate for service concession intangible assets to be amortised using an 'interest' method of amortisation, ie one that takes account of the time value of money in addition to the consumption of the intangible asset, treating the asset more like a monetary than a non-monetary asset. But the IFRIC concluded that there was nothing unique about service concession intangible assets that would justify use of a method of depreciation different from that used for other intangible assets. The IFRIC noted the observation in paragraph 98 of IAS 38 that, for intangible assets with finite useful economic lives, there is rarely, if ever, persuasive evidence to support an amortisation method that results in less accumulated amortisation than would result from applying the straight-line method.

BC5 Hence, the draft Interpretation does not provide exceptions to permit use of interest methods of amortisation.

BC6 The IFRIC considered whether to address within the Interpretation the timing of recognition of the intangible asset. It noted that an operator could be regarded as receiving its right to charge users at three different points in time: (a) at the outset of the contract (with a corresponding obligation to provide construction services in exchange); (b) as construction services are provided, by reference to the stage of completion; or (c) once construction is complete, in settlement of the amount due by the grantor for the construction services. The IFRIC decided not to specify when the operator should first recognise an intangible asset. The draft Interpretation is therefore silent on this matter.

Revenue and profit or loss recognition

BC7 If service concession arrangements fall within the scope of the draft Interpretation, the operator does not recognise the concession infrastructure as its own property, plant and equipment. Instead, it recognises an intangible asset, ie the right to charge users of the services it provides with the infrastructure.

BC8 Different views have been expressed on the nature of the transactions that give rise to the operator's intangible asset. One view is that the operator's expenditure on construction represents payments to acquire an intangible asset. The other view is that the operator provides construction services to the grantor, for which the grantor makes a non-cash payment by giving the operator an intangible asset in exchange. The operator then uses the intangible asset to generate further revenues from users.

BC9 Those who view the construction costs as payments to acquire an intangible asset would accumulate the costs on the balance sheet in accordance with IAS 38: the construction would not be viewed as a revenue-earning activity. Revenue would be recognised only in respect of the cash received from users for the availability and operation of the infrastructure. In favour of this view, supporters argue that:

(a) to view the concession as two separate revenue-generating activities (ie construction services for which the operator receives an intangible asset, followed by exploitation of the intangible asset) is tantamount to segmenting the concession into two contracts that are accounted for separately. Segmentation of contracts is consistent with IAS 11 *Construction Contracts* only if specified conditions are met. These conditions will rarely be met in a concession arrangement. In particular, the two different parts would not normally be negotiated separately, with the grantor able to reject one or other part: they would be subject to a single tendering process.

(b) the operator enters the concession agreement expecting to receive only one set of cash flows, ie charges for availability and operation of the infrastructure. The exchange of construction services for an intangible asset does not give rise to any change in the substance of the cash flows and so should not be reported as giving rise to additional revenue.

BC10 The majority of IFRIC members did not support this view. They believe that the operator has provided the grantor with construction services and received an intangible asset in exchange. They note that paragraph 12 of IAS 18 *Revenue* states that:

> When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

BC11 Reflecting this view, the draft Interpretation proposes that revenue should be recognised in respect of the construction services provided by the operator, with the revenue measured in accordance with paragraph 12 of IAS 18.

BC12 The IFRIC noted that, if these requirements are applied, total revenue does not equal total cash inflows. For example, suppose that the operator builds a road at a cost of 100 currency units (CU100), the fair value of the intangible asset received (which in a reciprocal transaction will equal the fair value of the construction services provided) is CU105, and total cash inflows over the life of the concession are CU200. The operator recognises construction revenue of CU105, in exchange for an intangible asset of CU105, and a construction profit of CU5. Over the life of the service concession, the intangible asset of CU105 is amortised against revenues of CU200. Total revenues are CU305, compared with cash inflows of CU200.

BC13 The reason for this outcome is that, under the intangible asset model, there are two pairs of inflows and outflows rather than one. In the first pair, the construction services are exchanged for the intangible asset in a barter transaction with the grantor. In the second pair, the intangible asset received from the grantor is used up to generate CU200 of cash flows from users. This result is not unique to service concession arrangements. Any situation in which an entity provides goods or services in exchange for another asset that is subsequently used to generate cash revenues would lead to a similar result.

BC14 Many IFRIC members were uncomfortable with such a result, and would have preferred a method of accounting under which total revenues were limited to the cash inflows of (in the example) CU200. However, the majority accepted that it is an inevitable consequence of recognising revenue on a barter transaction.

Contractual obligations included in and excluded from the consideration given for the intangible asset

BC15 The IFRIC concluded that some obligations arising under a concession arrangement, such as the obligation to build new infrastructure, are clearly consideration given for the intangible asset. Others, such as the requirement to maintain the infrastructure to a satisfactory standard, might be seen either as consideration for the intangible asset, which would be included in its cost, or as conditions of the contract, which would be excluded from the cost of the intangible asset and recognised directly in profit or loss as operating costs. If included in the cost of the intangible asset, the obligations would be regarded as revenue-earning activities. The IFRIC took the view that maintenance, replacement and restoration (without enhancement) all compensate the grantor for the using up of the service potential of its infrastructure and should be excluded from the cost of the intangible asset. However, enhancement expenditure goes beyond this. If the operator agrees to incur enhancement expenditure as well, this suggests that the service concession has an inherent value that should be recognised as an intangible asset, with a corresponding obligation.

BC16 The draft Interpretation proposes that contractual obligations excluded from the cost of the intangible asset, and hence not regarded as revenue-earning activities, should be recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, ie at the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The IFRIC noted that this proposal would lead to such obligations being accounted for differently under the financial and intangible asset models. (D13 *Service Concession Arrangements—The Financial Asset Model* proposes that when the financial asset model applies, all activities that the operator contracts to undertake are revenue-earning activities, the costs of which are recognised as expenses as the work is performed and revenue is recognised.) The IFRIC concluded that the different proposals were a consequence of the differences in the underlying accounting models.

BC17 The IFRIC noted that IAS 37 prohibits an entity from providing for the repairs and maintenance of its own property, plant and equipment. The IFRIC—concluded that this prohibition would not apply to an operator's obligation to repair and maintain infrastructure that is the subject of a service concession. The operator has an unavoidable obligation that it owes to a third party, the grantor, in respect of the grantor's infrastructure, not its own intangible asset. The operator should recognise its obligations in accordance with IAS 37 and not instead depreciate any part of its intangible asset separately.

BC18 The IFRIC considered whether the proposed Interpretation should contain guidance on the timing of recognition of the obligations. It noted that the precise terms and circumstances of the obligations would vary from contract to contract. It concluded that the requirements and guidance in IAS 37 were sufficiently clear to enable an operator to identify the period(s) in which different obligations should be recognised.

Borrowing costs

BC19 IAS 23 *Borrowing Costs* permits borrowing costs to be capitalised as part of the cost of a qualifying asset to the extent that they are directly attributable to its acquisition, construction or production. Capitalisation ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. The IFRIC noted that, for most service concessions, the intangible asset will be ready for use by the time that it has been paid for, either in cash or in the form of construction or other services, if not before.

BC20 The IFRIC believes that, if an entity has a contractual right to recover borrowing costs, it is consistent with the usual principles of contract accounting to recognise revenue in respect of that right. To avoid double-counting the entity's assets, the finance costs should not be capitalised in these circumstances, but should be recognised in profit or loss.

Revenue caps, floors and similar agreements

BC21 The terms of a service concession arrangement may include revenue caps, floors or other agreements designed to limit the operator's exposure to variations in demand. The question arises whether such agreements should be accounted for separately at fair value through profit or loss, or included in the measurement of the intangible asset.

BC22 The IFRIC noted that:

(a) the agreement does not meet the definition of a derivative in IAS 39 *Financial Instruments: Recognition and Measurement*, which requires, among other things, that the underlying variable is not specific to a party to the contract. Accordingly, the requirements in IAS 39 in relation to embedded derivatives do not apply.

(b) an agreement (such as a floor or a shortfall guarantee) that protects the operator from loss will generally meet the definition of an insurance contract in IFRS 4 *Insurance Contracts*, being a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder. Insurance contracts are excluded from the scope of IAS 39, and IFRS 4 does not contain any requirements on accounting for insurance contracts by policyholders.

(c) there is no general requirement to account for rights under insurance contracts at fair value. Nor would this be consistent with present practice by policyholders, which is usually to amortise the insurance premium paid and recognise any right of recovery if and when it arises. There is no practical need to separate out the premium paid in order to amortise it because IAS 38 requires the intangible asset to be amortised.

(d) revenue caps and other agreements designed to limit the operator's upside are not insurance contracts; any obligations in respect of such agreements should be accounted for in accordance with IAS 37.

BC23 The IFRIC therefore concluded that operators should not account for revenue caps, floors and similar agreements separately from the intangible asset. They should recognise any right of recovery only if and when it satisfies the recognition criteria in IAS 37, and should account for any obligations in accordance with IAS 37.

Items provided to the operator by the grantor

BC24 For concession arrangements within the scope of this draft Interpretation, pre-existing infrastructure items made available to the operator for the purpose of the service concession are not recognised as property, plant and equipment of the operator.

BC25 However, different considerations apply to other assets provided to the operator by the grantor if the operator can keep or deal with the assets as it wishes. Such assets become assets of the operator and so should be accounted for in accordance with general recognition and measurement principles, as should the obligations undertaken in exchange for them.

BC26 The IFRIC considered whether such assets would represent government grants, as defined in paragraph 3 of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*:

> Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

The IFRIC concluded that if such assets were part of the overall consideration payable by the grantor on an arms' length basis for the operator's services, they would not constitute 'assistance'. So they would not meet the definition of government grants in IAS 20 and that standard would not apply.

Transition

BC27 The transitional provisions set out in the draft Interpretation are consistent with those set out in D13 *Service Concession Arrangements—The Financial Asset Model.* The Basis for Conclusions in D13 explains the rationale for them.