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The Theory and Operation of a Modern Economy

Theme: The end of the fixed assets

Author: Francisco de Assis Duarte de Lima

Advisor: Frederick Lindahl

Washington DC

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1. Thanks

I would like to thanks to Eletrobras that gives me the opportunity to make this work.

I would also like to thank my direct to boss (chief of accounts department) to allow my presence in this Minerva course (Accounting in Brazil is in an important moment of change)

And last but not least, I want to thanks to my family: my wife Rita de Cassia and my son Lucas and Matheus who understand this sacrifice: being far from them for so much time. I also remember my father (Antonio Duarte de Lima) who was a person very important in my life.



IFRIC 12 – The end of the Fixed Assets.

2- Introduction

IFRIC12¹ is part of a huge accounting system, that is widely used in Europe. This system is called IFRS². Brazil is converging its accounting system to IFRS in order have comparability with other countries. The objective is to allow an investor to compare results in different countries. Today we have different accounting systems, so the comparability is very complex. IFRS will permit investors and finance institutions to compare the balance sheet because it will be elaborated under the same criteria.

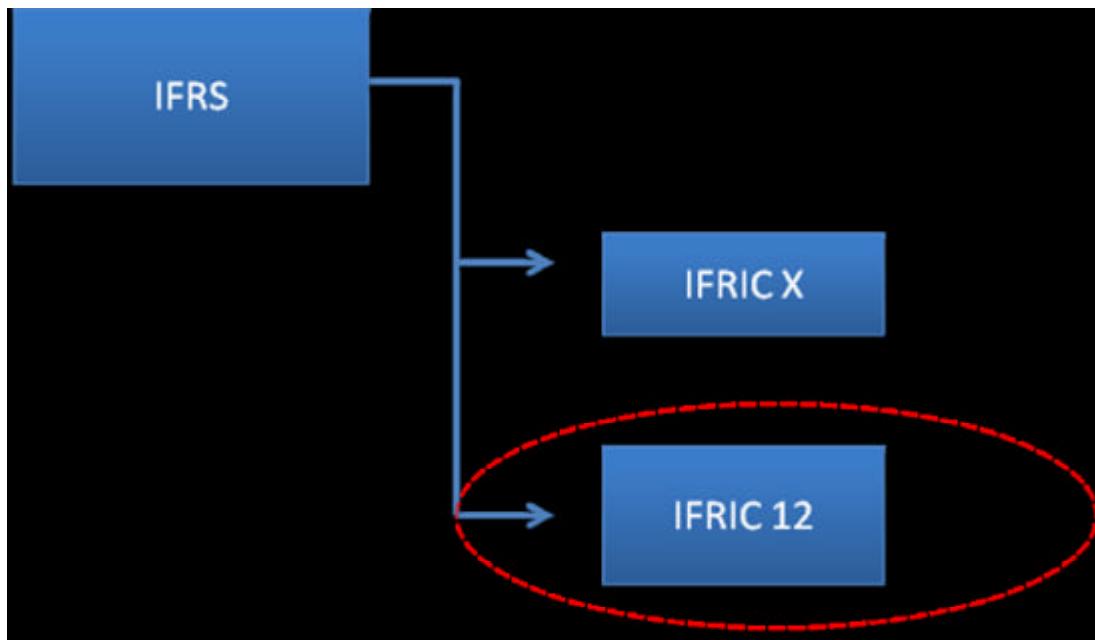
IFRIC 12 (see figure 1) is part of this big change, and is dedicated to “service concession arrangements.”

Service concession arrangements have evolved in recent years as a mechanism for providing public services. Under such arrangements, private capital is used to provide major economic and social facilities for public use, such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks (see figure 2). Today, it is common practice to set up concession arrangements in order to construct, operate and/or service these public service facilities.

¹ International Financial Reporting Interpretations Committee

² International Financial Reporting Standards

Figure 1 – IFRIC 12 as part of IFRS



IFRIC issued an Interpretation on accounting for service concession arrangements. IFRIC 12 was published on 30 November 2006, and while it becomes effective for financial years beginning on or after 1 January 2008, it may be applied earlier.

The Interpretation applies to public-to-private service concession arrangements if: the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; 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.

Figure 2 – Scope of IFRIC 12 (examples of sectors where IFRIC 12 will be applied)



In this paper the focus will be the energy sector.

The main objective of this paper is to discuss the impact of IFRIC 12 in Brazil. How it is going to affect profit? Will this change be good for shareholders? What is being discussed right now in Brazil about IFRIC 12?



3. IFRIC 12

3.1 Brazil Case

Brazil is experiencing huge change. Everything is growing in this country, in many aspects such as financial, political and others. There has also been a money transfer to poor classes that allows to this classes go to the shop and buy things that in the past they are not able to buy. In fact, there is a need to improve in several more areas like education and health. But now, it's clear that Brazil is in the right track. It is important to continue it. It takes some time to correct years of problems, but is important to start.

For many years, the accounting didn't change. The more important Accounting Law was 6.404 in effect since 1976. From that time to now, there has been no more large changes in corporate law in Brazil. The only part that had changed was financial accounting. So, up to now, the accountant that finished university 34 years ago had no problem working without further study, because nothing has changed in corporate law. The concept was the same. There was no difference.

But now, as Brazil is growing up, and wants to be closer to big countries, it needs to be comparable. Things must be clearer. And because of that, Brazilian accounting should converge to international concepts. To be like successful countries we need to be dressed in the same way. In accounting terms it means doing things in the same way.

Up to now, big Brazilian companies, in order to go abroad to obtain money from international banks, have had to convert their financial balance sheet to international accounting, like US GAAP (American accounting). This is because the International banks should be able to read the numbers and compare the indicators in order to decide to lend money or not. An investor, in order to decide to put money in or not, needs to be able to understand the numbers, and it's not easy if the reporting is done by account concepts different from what the investor usually sees.

So the big Brazilian companies need an accounting corporate law that is prepared take into account other accounting rules (international) so it's possible for international banks and investors understand the numbers in order to take decisions. In fact, working with two systems is not effective for all. Two kinds of accounting, leading to different profits, is hard to explain.

Now, the world is mostly moving to a financial standard called IFRS. Europe and a lot of other countries have adopted this kind of accounting. If all countries



did accounting in the same way, it will be easier for all to understand the numbers.

But course it's not easy to change from North to South. And it's not fast. There is a huge amount of work that must be done. There are many rules, many interpretations, many questions, but sometimes without a clear answer. It's necessary to study, to read and the end to do. It's a hard task: it's not like an automatic translation.

In Brazil, big companies are obliged to convert their financial reports to IFRS this year. We have in 2008 a new accounting law called 11.638 that starts the process. But 11.638 Law like others say what companies must do, but not how to do. That is the direction of recent developments.

That is being done by an Agency called CVM – Comissão de Valores Mobiliários (figure 3), responsible for regulation in terms of Public Companies. And most of the time, this agency creates detail for the rules in order to regulate all those changes and the same try to explain how to make the changes.

Figure 3 – CVM and Public Companies





But the deadline is very short. Now in fact CVM³ is discussing many points that should already be in effect this year, so it is a difficult timetable to achieve. The point is that there are more question than answers. Because IFRS – International Financial Reporting Standards -- is an principles-based accounting system, it requires much interpretation. At this moment, a lot of accounting professionals (consultancy, auditors and accountant) are involved in discussions for IFRS implementation in Brazil. For consultancy this is a huge opportunity to make money (if they are prepared), but in fact in order to be hired by a company, the consultancy must have knowledge of IFRS. Most of time it involves the Big Four Audit companies.

At this moment in Brazil most of the companies have big projects under way for IFRS implementation. Accountancy is totally immersed in IFRS. Companies' administrations need to understand what are the new rules for profit measurement, otherwise it will have a problem explaining profit. In same cases, maybe will be necessary to remodel business plans in order to take into account the changes in profit measures. Managers may need to explain why it was not possible to achieve certain goals, and perhaps part of that may be due to changes in accounting. The budget will be affected in several groups of accounts. It's clear that 2010 will be a difficult year for companies, because they will need to clarify many questions from Boards of Directors and investors about these changes. It will also be necessary to restate 2009 in order compare the results.

After all this, the good part: for investors will be easy to compare performance for one company in Brazil or in Europe because it will be with the same rules in finance reports. And in the future, with international standards it will not be necessary make another balance sheet for international presentation.

But now, we are at the middle of a big change, so accountants are working too much, spending many hours in discussions, because the future of accounting will be changed very drastically. Most of the auditors, accountants, and consultants are very involved and work around the clock in order to understand and implement the changes at the right time.

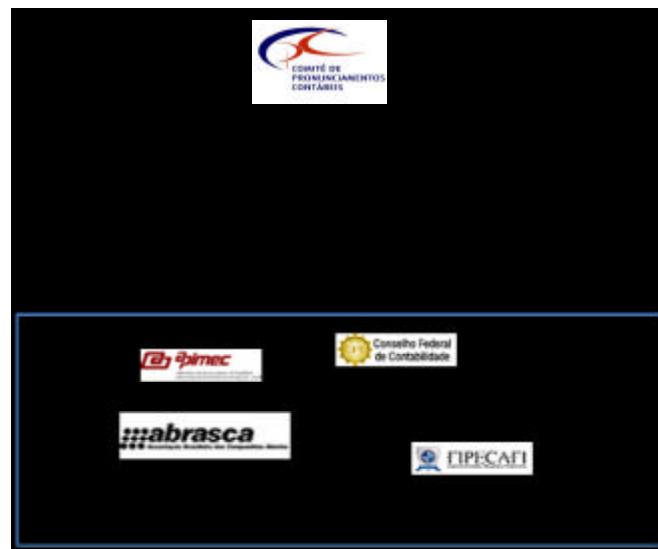
In this scenario of changes, the only thing that is certain is that everything is going to change. And for that, you need a new profile for the accountant in order to understand and explain to investors the new results according to new accountancy.

³ Comissão de Valores Mobiliários (Just like SEC in United States)



In Brazil, we have an institution called CPC⁴ that elaborates accounting pronouncements and interpretations. It is composed by the institutions showed in the figure 4.

Figure 4



This institution invited other institutions to participate in the decisions, like CVM, Receita Federal do Brasil and Banco Central do Brasil (See Figure 5)

Figure 5



⁴ Comite de Pronunciamentos Contábeis



As Brazil is converging to IFRS, this CPC makes pronouncements, but CPC has no power of regulation, so CVM and agencies from government must approve it as a regulation and then the companies are obliged to apply it.

In Brazil for 2010 public companies are obliged to implement IFRS as of the end of the year. In fact, companies produce balance sheet information each three months (that must be audited) and in the middle of 2010, most of the companies are not yet using IFRS, so they give public information not using IFRS, and at the end of the year it will be necessary to restate all the accounts. And it will be also necessary to explain to investors that the Profit and Loss will be changed by effect of IFRS. In Brazil, Petrobras is one of the companies that has already implemented IFRS in the first trimester.

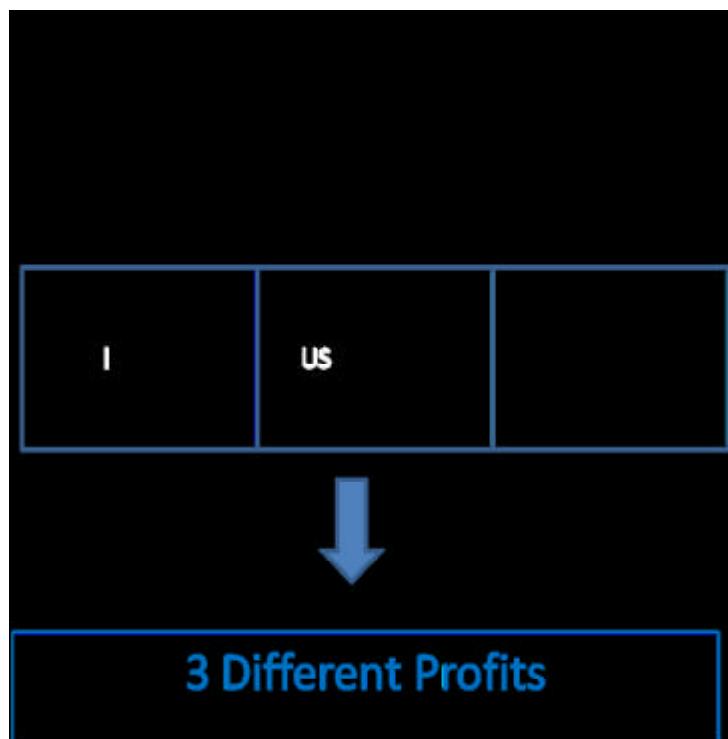
CVM, which regulates public companies, gives them the option of restating the information altogether at the end of the year. The point is that IFRS means in Brazil a huge change in accounting, and for big companies it's not an easy task. To have a good implementation of IFRS you need the right people, to spend money and time. And there are not many professionals that know IFRS deeply.

IFRIC 12 as part of IFRS is very complex rule. Its implementation is sensitive because it involves an important part of the balance sheet: the fixed assets.

If you look to Energy Sector in Brazil that is regulated by ANEEL (Agência Nacional de Energia Elétrica), we had a complete change in terms of calculation, and the main point is: there are no more fixed assets reported in the financial statement for IFRS due to the application of IFRIC. But this agency will not accept IFRIC 12, then it was created the Regulatory Accounting: A third group of Financial Statement (see figure 6)



Figure 6



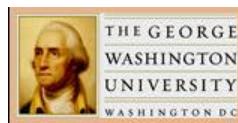
The fixed asset changes to an intangible asset or a finance asset. So the investor, and in fact all the people when look to balance sheet of a Energy Company, normally find a huge fixed asset balance. And from now on they will not find it any more. It could be intangible or finance or both.

ICPC 01⁵ is an interpretation that tries to help companies to understand better how to implement IFRIC 12. It is intended to clarify IFRIC 12. At this moment you have a huge number of consultants, professionals and auditors working on this theme.

IFRIC 12 as part of IFRS is one of the most of challenge rules in terms of IFRS implementation, because is very complex. It is necessary to make a huge number of calculations in order to recalculate the fixed assets, and to have more controls.

In a few months, when you look a balance sheet of an energy company, it will be totally different from today. The profit can be also very different. The asset, the liabilities, everything. It is because the rules of accounting are changing and changing fast.

⁵ Technical Interpretation issued by CPC



And as the rules are changing, the way to measure profit will be affected greatly. It's difficult to show a trend in terms of profitability.

The company goals, the KPI⁶ and the covenants with banks or other finance institution will have to be negotiated again, because the will be affected by these changes.

Investor Relations will need to be prepared in order to explain to investors all these changes. It will not be easy. The investor is accustomed to see the distribution of assets, liabilities and profit and loss in a way that will be completely changed. The first challenge will be internal: to explain to the Board of the companies all these changes; to show them the impacts of IFRS.

But back to IFRIC 12, we can say that it will take some time to implement due to complexity. ICPC 01 tries to help companies at those points:

- ? How to deal with concessionary rights
- ? Recognize and measure
- ? Operation services
- ? Borrowing costs
- ? Account treatment to finance and intangible assets

The operator, instead of recognizing a fixed asset will create a finance asset, an intangible asset or both.

In fact, In the Brazil case, we can say that we don't find everything clear yet. When you are discussing the Energy Sector things remain not so clear.

There is another kind of detailed explanation that is called OCPC. OCPC is used in Brazil in order help companies. The different between ICPC and OCPC is that ICPC is a translation of an explanation given by IASB⁷, and OCPC gives more detailed information with local examples issued by CPC, which is a local organization. In other words, we can say that OCPC intends to make the rule clearer than ICPC.

In terms of Energy Sector, there is a big discussion about the implementation of IFRIC 12. At this moment there is a work group in CPC that is discussing IFRIC 12 in order to issue an OCPC to clarify the remain points.

⁶ Key Performance Indicator

⁷ International Accounting Standard Board



We know how these discussions are conducted. There is an approach for each business segment: Generation, Transmission and Distribution (See figure 7).

In terms of Distribution we can affirm that the implementation of IFRIC 12 is going to create two kinds of assets: financial and intangible. So distribution companies will change from Fixed Asset to Intangible and Financial Asset. The intangible will be the part of the asset that represents the amount that the Distributor will collect from customers, and the finance asset represents the amount that remains at the end of the concession and will not be recovered during this period. This is because at the end of the agreement (as required in the concession agreement) the government will pay for it. In Brazil there is a big discussion about this calculation and the results. There is one or more versions from both parts (distributor and government). Of course these two partners have different interests. The first one wants to receive the highest amount for payment, and the second one wants to pay the least amount possible. There is the same discussion for Transmission and Generation.

In generation there is almost a consensus that IFRIC 12 will not be applied. This consideration is due the fact that the price in Brazil for Generation is not controlled. There is an auction, and the lowest price is chosen as a winner. The only point that will change is that it will be permitted at the initial date (in Brazil: 1, January, 2009) to establish dummy costs, that means: revalue the fixed asset. The result of this evaluation could higher than the amount that is accounted or not. For example:

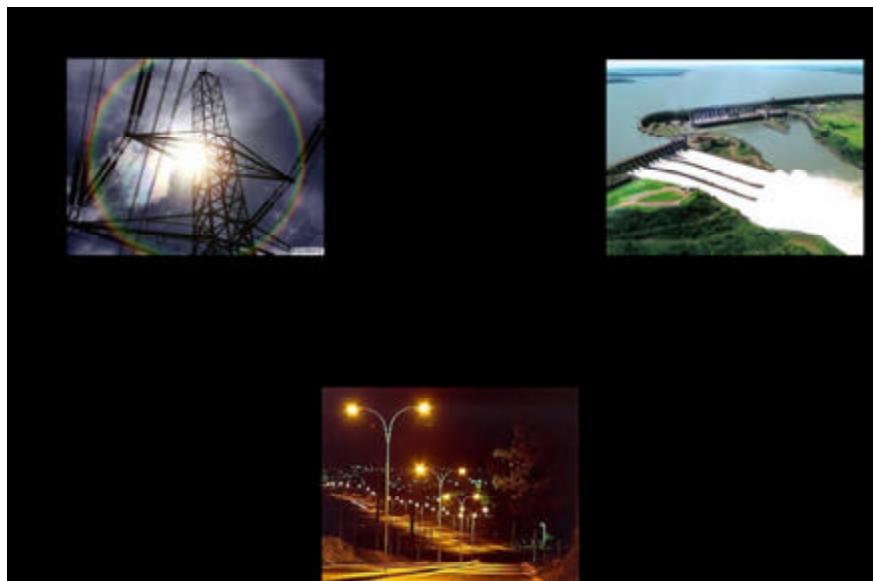
There is a power plant that is accounted on the books by the amount of 2 Billion Reais. So in order to make the revaluation, a specialist who was engaged concluded that market value was 4 billion. So the company will book in 1, January, 2009 the amount of 2 Billion Reais as evaluate in Shareholders' Equity as Other Comprehensive Income. But the company is not obliged to do that, as it is optional.

For generation the only case where it could possibly apply IFRIC 12 is wind power. But is a special situation, since in Brazil there is a program that has price control in this case, most of the useful life is in the duration of the contract.

In the Transmission Segment the discussion come to a Finance Asset.



Figure 7

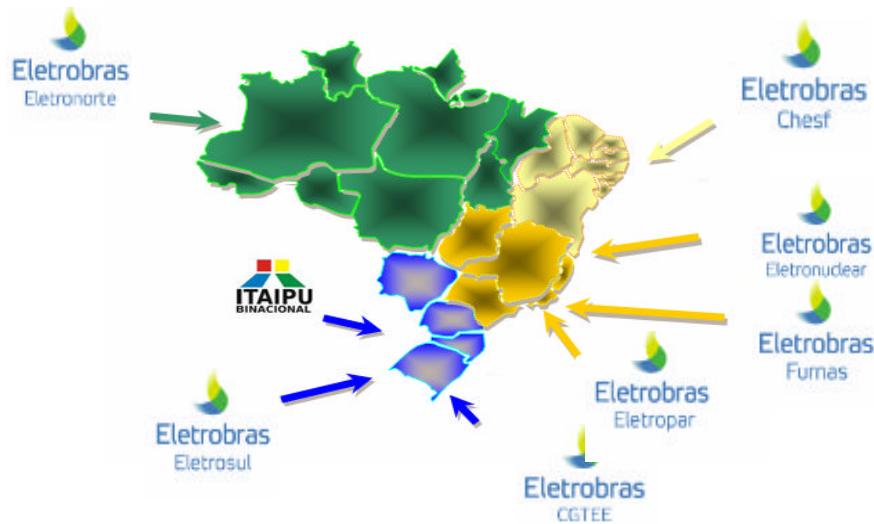


Below you are going to talk about a real case of IFRS Implementation with a closer discussion of IFRIC 12 impacts.

Before starts discussing about IFRIC 12 Implementation we need to explain the Eletrobras context.

Eletrobras is a group formed by 15 controlled companies (see figure 8) that are present in Energy Sector in Generation, Transmission and Distribution. It has 30,000 employees in Brazil and Brazilian Government has the control, but there also other private shareholder's. It's a company that is listed in Brazil, Spain and United States. It's responsible for 60% of all generation in Brazil. Eletrobras has also at least 50 partnerships in Brazil and abroad.

Figure 8 – Eletrobras Group in Brazil*



- ? There are also 6 distribution companies that belong to Eletrobras Group, most of them located in North of Brazil.

Today it makes investments abroad in order have an international presence. To achieve this objective it is looking for partners in order share business around the world.

In Brazil it is responsible together with other partners for two big projects: UHE Santo Antonio and UHE Jirau (See figure 9). These both plants are very important for Brazil. It's a huge investment, around 24 Billion of reais (see figure 9)

Figure 9



Now it's possible imagine how difficult is to implement IFRIC 12 and IFRS in a group like Eletrobras.

As we discussed before, in Brazil public companies like Eletrobras are obliged to implement IFRS at the end of 2010. But during the year public companies present intermediate reports, and they have the option to present them without IFRS implementation. At the end of the year it will be necessary to republish all reports (intermediate) together with final Financial Demonstrations. In fact, it's not a good option, because imagine that you present the first quarter w/o IFRS with a Profit of 500 million of Reais, and when will implement IFRS this result might change to a loss of 100 million of Reais. It will be a hard task to explain this. But in fact, it can happen (see figure 10).

The best choice is to start the year 2010 with IFRS implementation already done.

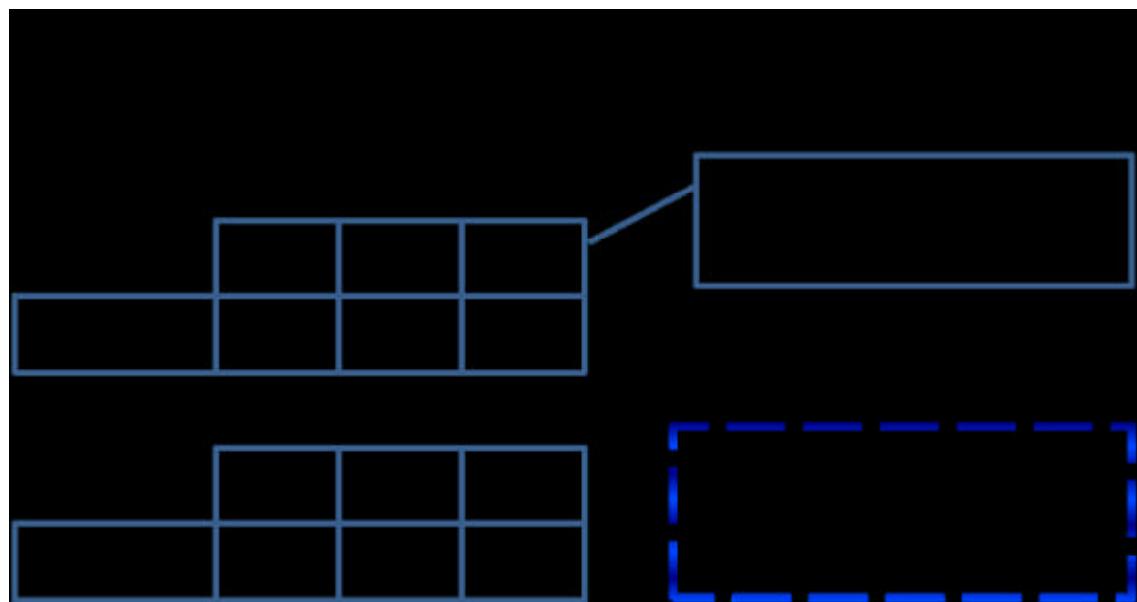
Looking to Eletrobras it was necessary to hire a consultancy company in order to allow a correct implementation.

The first step it was make a Diagnostic of the state of art of Eletrobras. After trying to understand which impacts you will have, the next step is to make an implement schedule. And more difficult is implementation. IT requirements change, and it is necessary to talk to all the people involved in this process.



IFRS is not in the agenda of United States. SEC⁸ is accepting the financial statements in IFRS.

Figure 10



The main point of describing these changes is to show what are the impacts in the financial statements of all this companies and how the investors will understand and be impacted by it. To explain to investors will be a challenge to Investor Relations areas and will take some time. Of course that will want to know how your money will be affected by this changes. United States is not up to now involved in change from USGAAP to IFRS.

United States is not involved in IFRS implementation. There is no agenda for implementing IFRS. USA has US GAAP. SEC is accepting Financial

⁸ Security Exchange Comission



Statements in IFRS, not only in US GAAP anymore. But there are differences between them.

US GAAP and IFRS. US GAAP has many rules where there is no room for interpretation. IFRS has general rules, with room for interpretations.

As it's possible to see, there is a hard work to do, and the impacts and procedures are well detailed on the Appendix at the end of this paper. The Appendix shows detailed information about how IFRIC 12 is applied, and it was extracted from a document produced by a Big Four auditor called Ernst & Young from a document the name of Service Concession Agreement Guidance (2007).

4. Conclusion

IFRIC 12 is part of a big change called IFRS, that is a group of accounting rules up to now used extensively in Europe.

IFRIC 12 is about how to account for service concession agreements. And in order to do that is important to understand the contract and how it works, in order to know if IFRIC 12 applies or not.

In Brazil this rule involves a huge discussion between all account authorities. And up to know it is not completely clear of what are all the calculations and how and who must do them. The discussion are continuing. And all this must be solved by the end of this year, because this affects financial statement of 2010.

Impacts in results are not clear yet relative to implement IFRIC 12, but we expect a little improvement of result due to more financial revenue. In fact as the companies are implementing IFRS and not only IFRIC 12, the impact is a little bit difficult to forecast.

In Brazil the account end of 2010 will be hard, due to all this changes and all this not defined. Investors are afraid of all this impacts. Certainly questions will arise like, "If you did not implement IFRS what would be our results?" And Accounting must be able to give answers. Because IFRS is not just a report: It will impact shareholder's gains.



And this moment in Brazil many accounting issues are the subject of huge discussions and training in order to be prepared for IFRS.

Auditing Companies are discussing many points with Accounts Department and are also afraid of these changes, and depending on the company, they must ask permission from their National Offices, that are located abroad, to give an independent opinion.

And all this process takes time. It involves many people and costs resources (time, people, money).

We are in a moment of change and for things to be clear we must work together: Accounts Department, Auditors, Regulators, Investors and Investor Relations. It's the only way to successfully conclude all this.



5. APPENDIX

Not all service concession arrangements are within the scope of IFRIC 12. However, the Interpretation provides some guidance on which standards to apply to service concession arrangements that are scope out of IFRIC 12. Additionally, the IFRIC has clarified that IFRIC 12 applies by analogy to other contracts with similar characteristics in accordance with the IAS 8 hierarchy.

Infrastructure within the scope of the Interpretation should not be recognized as property, plant and equipment of the operator, irrespective of the extent to which the operator bears the risks and rewards incidental to ownership and regardless of which party has legal title to it during the term of the arrangement, since the asset is 'controlled' by the grantor. This applies equally to infrastructure items constructed or acquired by the operator or to which it is given access for the purpose of the arrangement. Instead, the operator recognizes a financial asset to the extent that it has an unconditional right to receive consideration from the grantor, and/or an intangible asset to the extent it has a right to charge users of the public service.

The 'control approach' requires consideration of the infrastructure as a whole, thereby avoiding the piecemeal accounting for the different components of the infrastructure as required by IAS 16 Property, Plant and Equipment (e.g., when part of an item of infrastructure, such as the roof of a building or the top layer of a road needs replacing during the life of the concession).

However:

- ? assets given to the operator that it can keep or deal with as it wishes are recognized as the operator's property, plant and equipment at fair value together with a liability for any unfulfilled obligations the operator has assumed in exchange for the asset
- ? existing assets of the operator (ie, assets that the operator held and recognized as its property, plant and equipment before entering into the concession arrangement) remain subject to the de-recognition requirements of existing standards and are not within the scope of IFRIC 12.

A financial asset is recognized to the extent that the operator has an unconditional contractual right to receive cash or another financial asset from the grantor for construction or upgrade services. An unconditional right also exists when the grantor guarantees the operator's cash flows by agreeing to pay (1) specified or determinable amounts or (2) the shortfall, if any, between user payments and specified or determinable amounts.



An intangible asset is recognized to the extent that the operator receives a right to charge users of the public service and, in fact, is a residual category. When the operator is paid for its services partly by a financial asset and partly by a license to charge users, the two components of the consideration must be recognized separately.

The extent to which demand risk is borne by the operator does not determine whether the operator should recognize a financial asset or an intangible asset. This is because IAS 32 Financial Instruments: Presentation does not define financial assets by reference to the likelihood of future cash flows and, therefore, the extent of risk. It defines them solely by reference to the existence or absence of an unconditional right to receive cash. While it is true that to the extent the financial asset model is used demand risk is borne by the grantor, there are instances where the intangible asset model must be applied, even though the demand risk borne by the operator is substantially eliminated.

Under both the financial asset and the intangible asset models, the operator must account for revenue and costs relating to construction (or upgrade) services in accordance with IAS 11 Construction contracts.

If it is the policy of the operator to capitalize borrowing costs attributable to the construction of assets, it will capitalize those costs during the period of construction of the infrastructure only if the consideration received or receivable is an intangible asset. In all other cases, borrowing costs are expensed as incurred; however, if a financial asset is recognized in respect in the construction services, that receivable will accrue interest during its life.

Most service concession arrangements contain contractual obligations to maintain the infrastructure to a specified level of serviceability or to restore the infrastructure to a specified condition before it is handed back to the grantor at the end of the service arrangement. To the extent that the grantor specifically pays or guarantees payments for these services, they are considered a revenue-generating activity. Otherwise, a provision is accrued for the obligation to maintain or restore the infrastructure, in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

IFRIC 12 is effective for annual periods beginning on or after 1 January 2008, with earlier application permitted. The resulting changes in accounting policies are accounted for retrospectively, except when this is impracticable. This Interpretation is highly complex, interprets many standards, requires judgment



and is not uncontroversial. Implementation will not be easy and will significantly affect the way operators present their financial position and performance. Careful analysis of each service concession and timely preparation for the implementation of IFRIC 12 is highly recommended.

It can take time an implementation process. Depend on the size of the company. If we have just one company can be easy, but if you have a group can be a hard task.

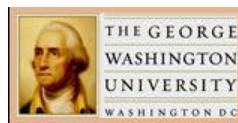
Service concession arrangements have gained popularity in recent years as a mechanism for providing public services. Under such arrangements, private capital is used to provide major economic and social facilities for public use, such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks.

Today, it is common practice to set up concession arrangements in order to construct -and/or upgrade and operate and/or service these public service facilities. Such arrangements are popular because they enable the public sector to attract private sector participation and funding in the development, financing and operation of such facilities – which may already exist, or may be constructed during the concession period.

The characteristics of these arrangements and the terms used to identify them vary greatly, but the IFRIC identifies them as ‘Service Concession Arrangements’. In the light of the growing importance of these types of arrangements and the lack of guidance in IFRS on how to account for them, the IFRIC issued IFRIC 12 addressing the accounting from the perspective of the operator of the service concession.

The issues raised by service concessions range across a number of existing accounting standards, which explains why it was a challenging task for the IFRIC to develop a coherent accounting model for these arrangements

A common example of a service concession arrangement is a transmission line. In this infrastructure concession, the operator is required to construct a transmission line within a specific time frame , and then maintain and operate the line to a specified standard for, say, 28 years thereafter (i.e., years 3-30). Usually, the terms of the concession also require the operator to incur hand-over costs at the end of the concession period. At the end of year 30, the concession will come to an end and the asset (e.g., the road) will transfer to the grantor. During the operating phase of the concession, the grantor controls what services the operator should provide, to whom and at what price (for example, by means of a mechanism that caps the operator’s return).



A feature of service concession arrangements is the public service nature of the obligation taken on by the operator. The infrastructure, or its output, must be made available to the public because of the nature of the services involved, regardless of who operates it. Further common characteristics of a service concession arrangement mentioned by the Interpretation include:

- ? the grantor is a public sector entity or a private sector entity to which the responsibility for the service has been delegated
- ? the operator does not act merely as an agent of the grantor and has responsibility for at least some of the management of the facility concerned
- ? the pricing and the regulation of possible subsequent price changes are set by the contract
- ? there is an obligation to return the infrastructure asset to the grantor in a specified condition at the end of the contract.

The accounting challenge is to reflect the substance of these arrangements fairly in the operator's accounts.

5.1. Scope of IFRIC 12

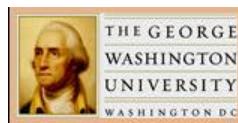
5.1.1 Operator and grantor

IFRIC 12 addresses the accounting by the operator of the service concession only, and not the accounting by the grantor. The main reason is that because the scope of the Interpretation is confined to public-to-private service concessions, the grantor is very likely to be a public sector body and IFRSs are not designed to apply to the public sector.

This is different from the scope of SIC 29 Service Concession Arrangements – Disclosures, which applies to both the operator and the grantor. Additionally, SIC 29 encompasses more arrangements than IFRIC 12 (which addresses only arrangements where the control criteria are met) and requires disclosures of aspects of service concession arrangements that are not covered by IFRIC 12 (e.g., significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows).

5.1.2 Concession arrangements are within the scope of IFRIC 12

The Interpretation applies to public-to-private service concession arrangements if the infrastructure is constructed or acquired by the operator or is given for use by the grantor as part of the arrangement.



Instead, the IFRIC considered many of the existing types of arrangements and included references to the relevant existing standards that would apply to arrangements outside the scope of IFRIC 12.

While the IFRIC did not provide any guidance on the application of these standards, it pointed out that if experience were to show that such guidance would be required, this would be the subject of another project.

The scope of IFRIC 12 is, therefore, limited to cases, where:

- ? the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price
- ? 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.

If there is no expected significant residual interest at the end of the term of the arrangement (that is, the arrangement is for the entire useful life of the asset), the grantor is considered to ‘control’ the asset if condition (a) is met.

5.1.3 The ‘control of use’ approach

Infrastructure within the scope of the Interpretation should not be recognized as property, plant and equipment of the operator as the grantor is considered to “control” the assets. This is because, the IFRIC argues, it remains under the control of the grantor and the operator merely has “access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.”

In the IFRIC’s view, the grantor’s ability to control the use of the infrastructure throughout the term of the concession and its control of the residual infrastructure at the end is such an overpowering indicator of control that the infrastructure should not be recognized by the operator either as its property, plant and equipment or as an asset leased to the grantor. To make this clear, the IFRIC has amended the scope of IFRIC 4 Determining whether an Arrangement contains a Lease, to exclude service concession arrangements from the scope of IFRIC 4.

The control or regulation does not have to result solely from the contractual terms of the concession arrangement. In the Interpretation requires the grantor and any related parties to be considered together. This means that when the grantor is a public sector entity, the public sector as a whole, together with any regulator acting in the public interest, must be regarded as related to the grantor



for the purposes of IFRIC 12. This is often the case in the utility sector (eg, electricity or water supply).

Condition (a) is also met when the grantor buys all the output of the infrastructure, as this indicates that the grantor controls the service, the customer and the price.

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 mechanism to cap the operator's return. The control condition, however, must relate to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, must be ignored. Conversely if, for example, a contract purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.

When the grantor retains both the degree of control described in condition (a) and any significant residual interest in the infrastructure, the operator is only managing the infrastructure on the grantor's behalf even though, in many cases, it may have wide managerial discretion.

For the purpose of condition (2), 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 continuing control throughout the period of the arrangement.⁷

The control approach requires consideration of the infrastructure as a whole (what the IFRIC refers to as a 'holistic' approach), thereby avoiding piecemeal accounting for the different components of the infrastructure as required by IAS 16 Property, Plant and Equipment (eg, when part of an item of infrastructure, such as the roof of a building or the top layer of a road, needs replacing during the life of the concession).

As a result, any concession infrastructure, whether acquired from a third party or constructed by the operator or to which the grantor gives the operator access for the purpose of the service concession arrangement, should not be recognized as property, plant and equipment of the operator, regardless of whether it is used for its entire useful life during the concession period or of which party has legal title to it during the arrangement.



By contrast:

- ? assets given to the operator that it can keep or deal with as it wishes are treated differently. Such assets become assets of the operator and must be accounted for in accordance with the applicable general recognition and measurement principles
- ? existing assets of the operator (i.e., assets that the operator held and recognized as its property, plant and equipment before entering into the concession arrangement) are outside the scope of IFRIC 12 and remain subject to the de-recognition requirements of existing standards (e.g., IAS 16 and IAS 17 as interpreted by IFRIC 4).

There may also be situations where the use of infrastructure is partly regulated and partly unregulated.

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 accounted for separately if it is used wholly for purposes that are not controlled or regulated by the grantor. For example, this might be the case for a private wing of a hospital where the remainder of the hospital is used to treat public patients.

When purely ancillary activities (such as a hospital shop) are unregulated, the control tests must be applied as if those activities did not exist, because in cases in which the grantor controls the services, “the existence of ancillary activities does not detract from the grantor’s control of the relevant infrastructure.”

In either case, there may in substance be a lease from the grantor to the operator for the separable infrastructure or the facilities used to provide ancillary unregulated services. If so, this is to be accounted for in accordance with IAS 17 Leases. It is likely that this would involve applying the guidance in IFRIC 4 to distinguish the lease payments from other parts of the arrangement.

5.1.4 Public service obligation

Initially, as described in the exposure draft D12, the Interpretation was intended to apply only to arrangements that involved a ‘public service obligation’, ie, a contractual obligation for the operator to “keep available to the public the services related to the infrastructure.”



Having agreed that “the concept of a public service obligation was not in itself robust enough to form the basis for the scope”, the IFRIC did not retain this condition. As a result, the reference to “the public service nature of the obligation undertaken by the operator “as a feature of these service arrangements” in the background section of IFRIC 12 is somewhat unclear.

Other circumstances might, however, be less clear, in particular when the infrastructure is not to be used by members of the public directly. Assume, for example, that a private entity enters into an arrangement with a government administration to construct and subsequently maintain for 20 years a building that will be used for administrative purposes by the government. Such a building may or may not be open to members of the public. There is no requirement to ‘provide a public service’ so that it may be unclear whether this arrangement falls within the scope of IFRIC 12.

Hand-back commitments at fair value

It is not uncommon for service concession arrangements to provide for the grantor to make a payment to the operator when the concession infrastructure is handed back to the grantor at the end of the contract. Some have queried whether arrangements providing for a payment that is based on the fair value of the concession assets when they are handed back (ie, when the operator bears the residual value risk) are within the scope of IFRIC 12, given the reference to hand-over commitments at the end of the period of the arrangement ‘for little or no incremental consideration’ in the background section of the Interpretation.

In the IFRIC’s view, whether the concession assets are handed back at fair value or for a nominal amount does not influence whether the control test is met. Even when concession assets are handed back at fair value, this does not preclude an arrangement from being within the scope of IFRIC 12.

In Brazil the concession, regarding to Energy Sector, concessions agreement have a prevision to pay to the operator the amount that was recovered during the concession. But it's not clear how this payment is calculated: if it is by the market value or the book value . The only sure is that the amount is due by the government. The main point is that most of the cases this book value is far from the market value, there is a huge gap between this two criteria.



5.1.5 Regulated Industries

In many countries, the provision of utilities (eg, water, natural gas or electricity) to consumers is regulated by the national government. Regulations differ between countries but often regulators operate a system under which the operator is allowed to make a fixed return on regulatory capital.

The IFRIC pointed out that one reason for including the ‘residual interest’ requirement was to differentiate between regulated industries and service concession arrangements. Indeed, in most regulated industries, operators have no obligation to transfer their infrastructure assets at the end of the arrangement. These assets revert to the grantor only in the event of a major breach of the conditions of the concession by the operator. In these cases, the grantor does not control the assets in the sense intended by IFRIC 12.

In the course of developing IFRIC 12, the IFRIC also discussed the circumstances under which a concession operator could recognize an asset for the right to recover finance or other costs in a price-regulated environment.

The IFRIC concluded that expenses incurred in performing price-regulated activities must be recognized in accordance with existing applicable IFRSs. It specifically noted that the requirements of SFAS 71 Accounting for the Effects of Certain Types of Regulation were not indicative of the requirements of IFRSs.

The IFRIC’s intention was mainly to put out a warning that an operator could not avail itself of the IAS 8 hierarchy to apply the SFAS 71 accounting treatment under IFRS without due consideration of the requirements in IFRSs.

It is, however, difficult to see how costs that a regulator permits an entity to recover through increased charges would meet the general definition of assets in the Framework, which requires a present right to exist at the balance sheet date before an asset can be recognized. This is because, in the absence of an unconditional contractual right to receive cash or other financial assets, the recovery of regulatory assets depends on future events including: the future rendering of services future volumes of output (generally consisting of utilities such as water or electricity consumed by users) the continuation of regulation.

In this regard, the IFRIC emphasized that the fact that there may be little risk that the operator will not recover the costs concerned, as may well be the case under such regulation, has no bearing on the question of whether an asset should be recognized.?



5.2 Does the operator have a financial or an intangible asset?

5.2.1 Classification criteria

As explained on, for arrangements within the scope of IFRIC 12 the operator should not recognize the concession assets as its own property, plant and equipment, regardless of the extent to which the operator bears the risks and rewards incidental to ownership of the assets.

Instead, the operator recognizes the consideration received or receivable in exchange for its infrastructure construction services (or its acquisition of infrastructure to be used in the arrangement) as either a financial asset (ie, a receivable) or an intangible asset (i.e., a right to charge the users of the public service) or both.

A financial asset is recognized to the extent that the operator has an unconditional contractual right to receive cash or other financial asset for its construction services from or at the direction of the grantor.

The IFRIC clarified that the grantor does not need to pay the cash to the operator directly: to the extent that the operator is remunerated for its construction services by obtaining a contractual right to receive cash “from, or at the direction of, the grantor”, the operator would recognize a financial asset.

This includes circumstances under which the grantor guarantees the operator’s cash flows by agreeing to pay (i) specified or determinable amounts or (ii) the shortfall, if any, between user payments and specified or determinable amounts. For example, when the operator has a right to receive payments based on usage and the grantor has guaranteed a minimum return or a topping-up of collections from users if the usage payments fall short of a specified amount, fees or tolls received directly from users are viewed as essentially no more than collections ‘on behalf of the grantor.’

The IFRIC further clarified that the definition of a financial asset is met “even if payment is contingent on the operator ensuring that the infrastructure meets quality or efficiency requirements.” The rationale for this view is that, when payments are conditional on availability or service performance criteria being met during the operating phase, variations in payments for these reasons relate to the quality of subsequent services rather than to the operator’s right with respect to the infrastructure.



Accordingly, such potential variations are not relevant in determining which model should be applied to reflect the operator's right to recover the infrastructure construction or upgrade costs it has incurred. Rather, they should be analyzed in substance as liquidated damages for failure to satisfy contractual requirements in providing subsequent services.

Finally, IFRIC 12 emphasizes that the nature of the consideration given by the grantor to the operator is determined by reference to the contract terms and, when it exists, relevant contract law. It notes that the terms of the contractual agreement may depend on the specific features of the overall legal framework of the particular country and that, where they exist, public-to-private service contract laws may contain terms that do not have to be repeated in individual contracts.

An intangible asset is recognized as the difference between the fair value of the infrastructure acquired or constructed and the financial asset, if any, recognized by the operator. This intangible asset represents the operator's right (a license) to charge the users or the grantor for the public service it provides.

If the operator is paid for its services partly by a financial asset and partly by an intangible asset, it is necessary to account separately for each component of the operator's consideration.

Under both the financial asset and the intangible asset models, the operator must account for revenue and costs relating to construction (or upgrade) services in accordance with IAS 11 Construction Contracts.

During the construction phase of the arrangement, the operator's asset (representing its right to recover the accumulating cost of providing construction services) should be classified: as a financial asset when it represents cash or another financial asset due from or at the direction of the grantor, or an intangible asset to the extent that it represents a right to receive a license to charge users of the public service, or combination of both.

5.3.1 Accounting with Finance Asset or Intangible Asset

5.3.1.1 Revenue and expense recognition

When the operator provides more than one service under a service concession arrangement (eg, construction or upgrade services and operating services), the total consideration received or receivable must be allocated "by reference to the relative fair values of the services provided, when the amounts are separately



identifiable.” The IFRIC noted that the amount of each service would usually be identifiable because such services are often provided as a separate service. This is required even if the service concession arrangement was negotiated as a single package between the grantor and the operator.

Therefore, under both the financial asset and the intangible asset models, the operator must account for revenue and costs relating to construction (or upgrade) services in accordance with IAS 11.

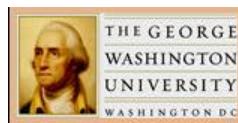
This requirement has proved to be contentious as under the intangible asset model it results in the total amount of revenue recognized by the operator exceeding the total amount of cash flows during the life of the contract.

According to the IFRIC, the reason for the ‘double’ recognition of revenue is that, when the operator receives an intangible asset in exchange for its construction services, there are two sets of inflows and outflows rather than one. In the first set, the construction services are exchanged for the intangible asset in a barter transaction with the grantor. In the second set, the intangible asset received from the grantor is used up to generate cash flows from users of the public service. The IFRIC noted that this result is not unique to service arrangements within the scope of IFRIC 12—any situation in which an entity provides goods or services in exchange for another dissimilar asset that is subsequently used to generate cash revenues would lead to a similar result.

It is common for the concession operator to be a special purpose entity that subcontracts the physical construction of the asset. In these circumstances the operator will not earn the construction profit as this will be earned by the subcontractor. This does not affect the operator’s recognition and measurement of revenue on its construction services, which would still be on a percentage of completion basis.

5.3.1.2 Replacement and maintenance expenditures

In order for the grantor to be able to control the quality of the public service and/or the condition of the infrastructure when it is handed back at the end of the service concession period, service concession arrangements often contain a contractual obligation: (i) to perform certain maintenance or replacement services at certain intervals, or (ii) to maintain the infrastructure to a specified level of serviceability and/or (iii) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the concession period. The way in which these contractual obligations are accounted for will depend upon their nature and is independent of the accounting model used for the infrastructure.



To the extent that the obligation requires the operator to perform certain services at a particular point in time and the operator is entitled to be paid for the services specified, IAS 18 Revenue would apply. Such an arrangement is an executor contract until the service is rendered. If the obligation constitutes a present obligation because the operator is required to maintain the infrastructure in a certain condition during the concession period, however, the obligation is recognized and measured in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets, ie, at the best estimate of the expenditure that would be required to settle the present obligation at the balance sheet date.

When the operator is separately remunerated for its replacement and maintenance activities, a practical issue is how to separate normal maintenance, to be expensed as incurred, from replacement obligations, to be accounted for separately under IAS 18. If the service concession arrangement specifies the activities and the timing of these activities, this may not be a major issue, but if they do not, judgment is required to distinguish the one from the other.

When the operator is not separately remunerated for its replacement and maintenance activities and IAS 37 applies, this may also require judgment.

At one end of the spectrum of possible contractual commitments, a concession arrangement may provide for a specified total amount of expenditure to be incurred by the operator throughout the contract. Sometimes, the contract provides for mechanisms whereby at the end of the contract, any shortfall in the agreed amount is paid in cash to the grantor by the operator.

At the other end of the spectrum, particularly in the case of older contracts, it is common for the maintenance and repair obligation to be expressed in very general terms such as keeping the infrastructure in 'good working condition' or 'state of the art' working condition.

The obligation to maintain the infrastructure in a particular condition, to replace certain components, or to restore it to a certain condition, may be settled by the operator carrying out the required work or by the operator paying the grantor for any shortfall at the end of the life of the service concession.

Either way, the accounting should be the same.

The amounts expected to be incurred to settle the replacement obligation or to provide maintenance and replacement services may change over time. There



may also be changes in discount rate. When the replacement obligation is accounted for as an IAS 37 provision, any changes in estimates are accounted for by revising the net present value of the amount expected to be paid, to the extent that it represents a current obligation, and recognizing these changes in estimate in profit or loss (except in the limited circumstances when the liability for the replacement obligations is included in the cost of the intangible asset, see below). When the maintenance or replacement services are revenue generating activities, such changes in expectations would be recognized only if the contractual obligation to provide these maintenance or replacement services became onerous, thereby triggering the need to make a provision.

Judgment may sometimes be needed in assessing whether contractually required replacement expenditures can be included in the cost of the intangible asset when that model is applied. Some concession contracts require the operator to replace certain items at the operator's cost, whether or not the items concerned become unserviceable.

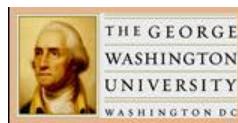
IFRIC 12 states that "contractual obligations to maintain or restore infrastructure, except for any upgrade element shall be recognized and measured in accordance with IAS 37" while explaining that "the operator shall account for revenue and costs relating to construction or upgrade services in accordance with IAS 11."

5.3.1.3 Initial classification of the financial asset

The amount due from or at the direction of the grantor will normally be accounted for on initial recognition and thereafter as a 'loan or receivable' in accordance with IAS 39 and measured at fair value on initial recognition and thereafter at amortized cost using the effective interest rate method.

If a financial asset contains a derivative, it may not be classified as a loan or receivable. In this regard, IFRIC concluded that when the amount to be received by the operator could vary with the quality of services it provided or based on performance or efficiency targets, the contract does not include an embedded derivative. This conclusion is not entirely convincing, especially as the IASB intends to delete from IAS 39 the principal justification for the conclusion cited in IFRIC 12.

It is unlikely to be possible to designate a financial asset as at fair value through profit or loss on initial recognition (not that companies are likely to wish to do this) as, in most circumstances,(based on the conclusion reached by the IFRIC discussed above) the financial asset does not contain an embedded derivative.



5.3.1.4 Date of recognition of intangible asset

The IFRIC concluded that the intangible asset received in exchange for construction services should be recognized in accordance with the general principles applicable to contracts for exchange of assets or services. Therefore, service concession contracts should not be recognized to the extent that they remain executory , which is generally the case when they are signed.

During the construction phase of the arrangement, the operator effectively provides construction services to the grantor in exchange for an intangible asset, i.e., the right to charge users of the public service infrastructure that it has constructed or upgraded. In accordance with IAS 38 Intangible Assets, the operator recognizes the intangible asset at cost.

An intangible asset is built up over the period of construction of the infrastructure asset, measured at the fair value of the construction services that have been provided. This intangible asset is, according to the IFRIC, the right to receive the license on completion of the underlying infrastructure so that the accumulated asset at completion will represent the cost to the operator of the actual license. At the same time, revenue and costs relating to construction or upgrade services will be accounted for in accordance with IAS 11. As a result, there will be a double recognition of revenue.

In our view, one possible interpretation is to recognize the intangible asset at the earlier of the date when the expenditure to acquire it is incurred and the date when the operator starts earning revenues from its right to charge. When the intangible is recognized ahead of incurring the expenditure, its cost of acquisition should be the present value of the expenditures to be incurred.

An operator may agree to make extensions to the infrastructure that are expected to generate additional revenues in the future. For example, the operator may extend a distribution network and under its right to charge for the services, it will obtain revenues from newly connected users. These revenues will be collected under the terms of the original license granted to the operator on completion of the infrastructure; however, the cost of the extension work will only be recognized when the expenditure is made, with a corresponding increase in the value of the intangible asset. That cost would be deemed not to



be an additional cost of the intangible asset existing from the outset but to be the acquisition cost of an additional intangible (the right to charge newly connected users).

Upon signing the contract, the concession arrangement is an executory contract, i.e., one under which neither party has performed any of its obligations.

The contract is no longer executor:

- ? if the operator has started to fulfill its contractual obligations by constructing the

infrastructure concerned or enhancing an existing infrastructure before being entitled to derive benefits from its right to charge for the public service, or

- ? if the operator starts deriving benefits from its right to charge for the public service

before fulfilling its obligations (e.g., when the contract provides for a new item to be constructed some time ahead in the concession period).

This means that an intangible asset will often be recognized before it is 'ready for use', typically during the construction phase of the arrangement. In this case, in accordance with IAS 36 Impairment of Assets, it must be tested for impairment annually, irrespective of whether there is any indication of impairment.

5.3.1.5 Measurement of the intangible asset upon initial recognition

Under the intangible asset model, the grantor gives the operator a right, which is in the nature of a license, to charge users of the public service, in exchange for the provision of construction services by the operator. This is a transaction for non-cash consideration or barter transaction.

IAS 38 requires intangible assets that are acquired in exchange for non-monetary assets to be measured at fair value unless either the exchange lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable. If the fair value of either the asset received or the asset given up can be determined reliably, then "the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident." When an operator receives rights to an intangible asset in consideration for providing construction or upgrade services



to a grantor, in most cases the fair value of the construction or upgrade services will be more evident than the fair value of the intangible asset received. This is because whereas the fair value of the construction or upgrade services is likely to be equal to the forecast construction or upgrade costs plus a reasonable margin, measurement of the consideration attributable to the construction or upgrade services (i.e., the intangible asset) would generally be far more subjective and uncertain. Measurement of the consideration would have to be based on an estimate of the total sum receivable on the contract as a whole and an apportionment of that amount between the construction or upgrade services and operation services.

Amortization of the intangible asset

IAS 38 requires an intangible asset to be amortized over its expected useful life. IAS 38 provides for a number of amortization methods for intangible assets with finite useful lives, including the straight-line method, the diminishing balance method and the unit of production method. The method used should be selected on the basis of the expected pattern of consumption. For example, in a toll road concession, some argue that the number of cars that use the road might be regarded as reflecting the pattern of consumption of the economic benefits derived from the intangible asset.

The unit-of-production method may result in lower amortization in the early years of the asset's operation. However, IAS 38 states that "there is rarely, if ever, persuasive evidence to support an amortization method for intangible assets with finite useful lives that results in a lower amount of accumulated amortization than under the straight-line method." This might be regarded as discouraging, if not prohibiting, the use of the unit of production method in the case of many service concessions. The IASB has indicated that it will consider amending this statement in IAS 38 as part of its 2007 annual improvements process.

The IFRIC also concluded that annuity depreciation is not permitted for intangible concession assets as it is not permitted for any kind of intangible asset under IAS 38.

Borrowing costs

An intangible asset meets the definition of a 'qualifying asset' under IAS 23. This is because generally the license will not be ready for use until the infrastructure has been constructed or upgraded. Consequently, borrowing costs attributable to the arrangement may be capitalized during the construction phase of the arrangement, in accordance with the allowed alternative treatment



under IAS 23, if this is the accounting policy of the operator. Under the revised IAS 23 Standard, effective from 2009, capitalization of borrowing costs will be required. A financial asset, which is defined as “a contractual right to receive cash or another financial asset from another entity” (in this case the grantor) does not meet the definition of a qualifying asset of the operator. Therefore, borrowing costs attributable to the arrangement are not capitalized. Instead, interest is accreted on the carrying value of the financial asset.

5.4 Disclosures

Disclosure requirements applicable to service concession arrangements are all included in SIC 29 Service Concession Arrangements: Disclosures, except for the requirement in IFRIC 12 to disclose any early adoption of the Interpretation before its effective date.

SIC 29 applies to both grantors and operators in all arrangements whereby the operator both receives a right and incurs an obligation to provide services that give the public access to major economic and social facilities. This scope includes, but is not limited to, service concession arrangements within the scope of IFRIC 12.

SIC 29 requires all aspects of a service concession arrangement to be considered in determining the appropriate disclosures. It requires the following minimum disclosures in each period:

- a) description of the arrangement
- b) 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)
- c) the nature and extent (e.g., quantity, time period or amount as appropriate) of:
 - i) rights to use specified assets
 - ii) obligations to provide or rights to expect provision of services
 - iii) obligations to acquire or build items of property, plant and equipment
 - iv) obligations to deliver or rights to receive specified assets at the end of the concession period
 - v) renewal and termination options



- vi) other rights and obligations (e.g., major overhauls)
- d) changes in the arrangement occurring during the period
- e) how the service arrangement has been classified.

Additionally, an operator must disclose the amount of revenue and profits or losses recognized in the period on exchanging construction services for a financial or an intangible asset.

These disclosures should be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (e.g., roads, telecommunications and water treatment services)

Effective date and transition

IFRIC 12 becomes effective for annual periods beginning on or after 1 January 2008, with earlier application permitted. Any resulting change in accounting policy must be accounted for in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. The general requirement in IAS 8 is that the changes should be accounted for retrospectively, except to the extent that retrospective application is impracticable.

There are two aspects to retrospective restatement: reclassification and re-measurement. Usually, operators can determine the appropriate classification in retrospect, but the retrospective remeasurement of service arrangement assets might not always be practicable.

If it is impracticable for an operator to apply IFRIC 12 retrospectively at the start of the earliest period presented to a particular service concession arrangement, it must:

- a) use the carrying amounts of the assets previously recognized in respect of the arrangements concerned and classify them as financial and/or intangible assets at the start of the earliest period presented
- b) test those financial and intangible assets recognized at the start of the earliest period presented for impairment, unless this is not practicable, in which case the amounts must be tested for impairment as at the start of the current period.



These transitional provisions offer relief from the full retrospective application of the change in accounting methods required on first application, on a contract-by-contract basis.

However, they are likely to lead to some practical difficulties. For example:

- ? When a service concession financial asset is initially measured upon transition at the carrying amount of the asset recognized previously, this is unlikely to produce the same carrying amount as if the operator had recognized a financial asset throughout. In these circumstances how should the operator subsequently account for that financial asset and compute interest income thereon?
- ? If bifurcation of the arrangement is required under IFRIC 12, how should the carrying amount of each component be derived from the carrying amount of the assets recognized previously?

In order to allow a first-time adopter to apply the transitional provisions of IFRIC 12, this interpretation amends IFRS 1 First-time Adoption of International Financial Reporting standards.



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