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Re : Comment on the IFRIC Draft Interpretations D12 – Service Concessions Arrangements “*Determining the Accounting Model*”, D13 - Service Concessions Arrangements “*The Financial Asset Model*” and D14 - Service Concessions Arrangements “*The Intangible Asset Model*” .

Dear Mr. De Leeuw,

We are pleased to provide our comment on the IFRIC Draft Interpretations D12 – Service Concessions Arrangements “*Determining the Accounting Model*”, D13 - Service Concessions Arrangements “*The Financial Asset Model*” and D14 - Service Concessions Arrangements “*The Intangible Asset Model*” .

- 1) In Italy, “Service Concession Arrangements” are regulated by fairly specific provisions, in particular for the grant and subsequent review of the concession arrangements between the grantor and the operator (hereinafter also referred to as “concessions”).

The following considerations refer mostly to the motorways industry, as this may be considered representative of the most common issues pertaining to “Service Concession Arrangements” in Italy.

As an example, motorways concessions are granted by the Government and are based upon specific Government guidelines, which stipulate, inter alia, that operators are requested to prepare a financial plan, using standard formats; all concessions are to be approved by the Public Works Minister and the Treasury Minister. The financial plan is to be updated every five years and, in the case of extraordinary events, it may be updated at an earlier date.

The financial plan is clearly the most important document of a concession arrangement signed by the operator; this document preliminarily sets, inter alia, the following:

- the economic and financial performance / balance of the operator (on the basis of a defined performance based on a specific IRR/WACC);
- the planned/expected capital expenditures;

- the formula on which the tariff regime is determined for the entire life of the concession, including the parameters that trigger future variations of the tariff;
- the accounting rules on which the financial plan is based, which are the same utilised by the operator to prepare its financial statements (i.e. depreciation - not necessarily on a straight line basis in view of the above economic and financial performance / balance of the operator, accruals / costs for maintenance, etc...).

The concession agreement also regulates the rights to supervise belonging to the grantor, but substantially all risks deriving from the management of the motorway are transferred to the operator.

- 2) Given the peculiarities of the concessions as represented above under paragraph 1, we fully agree with EFRAG conclusion (refer to the letter dated 18 November 2004) that in practice it would generally be correct for the service concession infrastructure to be treated as an asset of the operator.
- 3) The following are our comments to the draft comment letter prepared by EFRAG in response to the questions proposed by IFRIC:

D12-1 We agree with EFRAG considerations, as in our opinion the “Risks & rewards” approach should not be excluded because there is an interplay between this and the “control” approach; in addition, the “Risks & rewards” approach is in line with concepts already adopted in other IAS/IFRS. We believe that the “Risks & rewards” approach clarifies certain aspects of “control” and therefore it helps to correctly determine the accounting model to be utilised and to identify who will recognise the asset on its balance sheet.

We highlight a number of specific features of this industry that, in our opinion, should be carefully evaluated and that currently are not, on the basis of the “control” approach introduced by the IFRIC Draft Interpretation D12:

- a) The operator substantially bears all risks from the management of the infrastructure, for a long period of time which may cover up to 40 years, which is therefore out of the grantor’s operative control (business risks, infrastructure repair and maintenance risks - also in extreme cases such as natural or accidental events, etc.).
- b) The duration of the concession exceeds the useful life of a non insignificant portion of the infrastructure. As a consequence, the nature of the asset is equivalent to an asset owned by the operator.
- c) The nature of the infrastructure assets is so peculiar that such assets can be utilised by the operator for the purposes of the concession arrangements only.
- d) The grantor does not control the tariff. Once agreed at the inception of the contractual arrangement between the grantor and the operator the formula on which the tariff is based, the tariff is no longer controlled by the grantor as it is, in substance, influenced either by external metrics (i.e. forecasted inflation) or internal metrics (i.e. operator’s efficiency, quality of the services provided, etc.), the latter being under the exclusive control of the operator and impacting any changes in the tariff.
- e) The infrastructure can be utilised by the operator to generate revenues from ancillary activities. For example, in the motorways industry ancillary activities

such as petrol and food stations, telephone networks, optical fibres, etc. are substantially under the sole control of the operator.

In our view it is therefore necessary, as recommended by EFRAG, to insert a specific “Risks & rewards” step, within the existing “control” test aimed at identifying the accounting model to be utilised, which should take into consideration all of the above considerations. To answer the specific questions raised by EFRAG, we believe that this step should be inserted at the point of the “existing control test” (i.e. paragraph D12-5). Such step should therefore state that, should the above indicated situations occur, IFRIC Draft Interpretation D12 is not applicable.

It is our view that the above considerations also apply to contractual obligation to construct new infrastructure or to enhance either new or existing infrastructure to a condition better than at the start of the concession, occurring after the inception of the contractual arrangement between the grantor and the operator (for example the realisation of a third lane).

D12-2 Nothing to add to EFRAG considerations.

D12-3 We agree with EFRAG considerations.

D12-4 We agree with EFRAG considerations. We also share EFRAG transitional concerns on the lack of a clear and stable guidance on “Service Concession Arrangements”, when preparing interim and annual accounts for 2005.

D13-1 Nothing to add to EFRAG considerations.

D13-2 Nothing to add to EFRAG considerations.

D14-1 We do not agree with EFRAG comments. Our conclusion is based, for example, on the fact that “Service Concession Arrangements” in Italy for motorways as well as for other industries do not present the characteristics indicated in IAS 18, paragraph 12 (goods or services rendered in exchange for dissimilar goods or services), as in substance the agreement is solely finalised to obtain the concession; therefore, the cost incurred by the operator to build the infrastructure, if any, represents a form of payment (or one of the payment means) in order to obtain the concession. The contractual agreement is only one and as such can not be segmented; as a consequence, the construction activity managed by the operator, if any, does not represent a “revenue-earning activity”.

In our view, the construction activity managed by the operator, if any, does not imply any revenue recognition, so solving the issue raised by EFRAG on the inconsistency of proposed accounting models for transactions whose substance is very similar (the Financial Asset Model does not imply any revenue recognition for the construction phase) as well as to the revenue recognition higher than the effective cash inflows. We believe that these considerations are fully in line with the above mentioned comments on the non applicability of the IFRIC Draft Interpretation D12, as the infrastructure under concession is to be considered - for all purposes - as an asset of the operator (“tangible asset”).

However, should the above mentioned considerations not be accepted and therefore the proposed model approved, we emphasise the objective difficulty in measuring the “fair value” of the intangible asset to be recognised, because of the lack of a free market where concessions are traded. Concessions are, in fact, unique and not replaceable assets.

As stated in IAS 38 (paragraph 47), IAS 18 (paragraph 12) and also in the IFRIC Draft Interpretation D14 (paragraph 8), 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. We note that also in this circumstance such fair value is impossible to be measured or highly arbitrary.

On the basis of the above considerations and as stated by IAS 18, paragraph 26, when the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue should be recognised to the extent of the expenses incurred to build the infrastructure.

D14-2 Within the accounting models currently proposed by IFRIC, we agree with EFRAG comments and support alternative c).

D14-3 Nothing to add to EFRAG considerations.

Yours sincerely

Prof. Angelo Provasoli
(OIC – Chairman)