GMR

IFRS Workshop – IFRIC 12 Service Concession Arrangements

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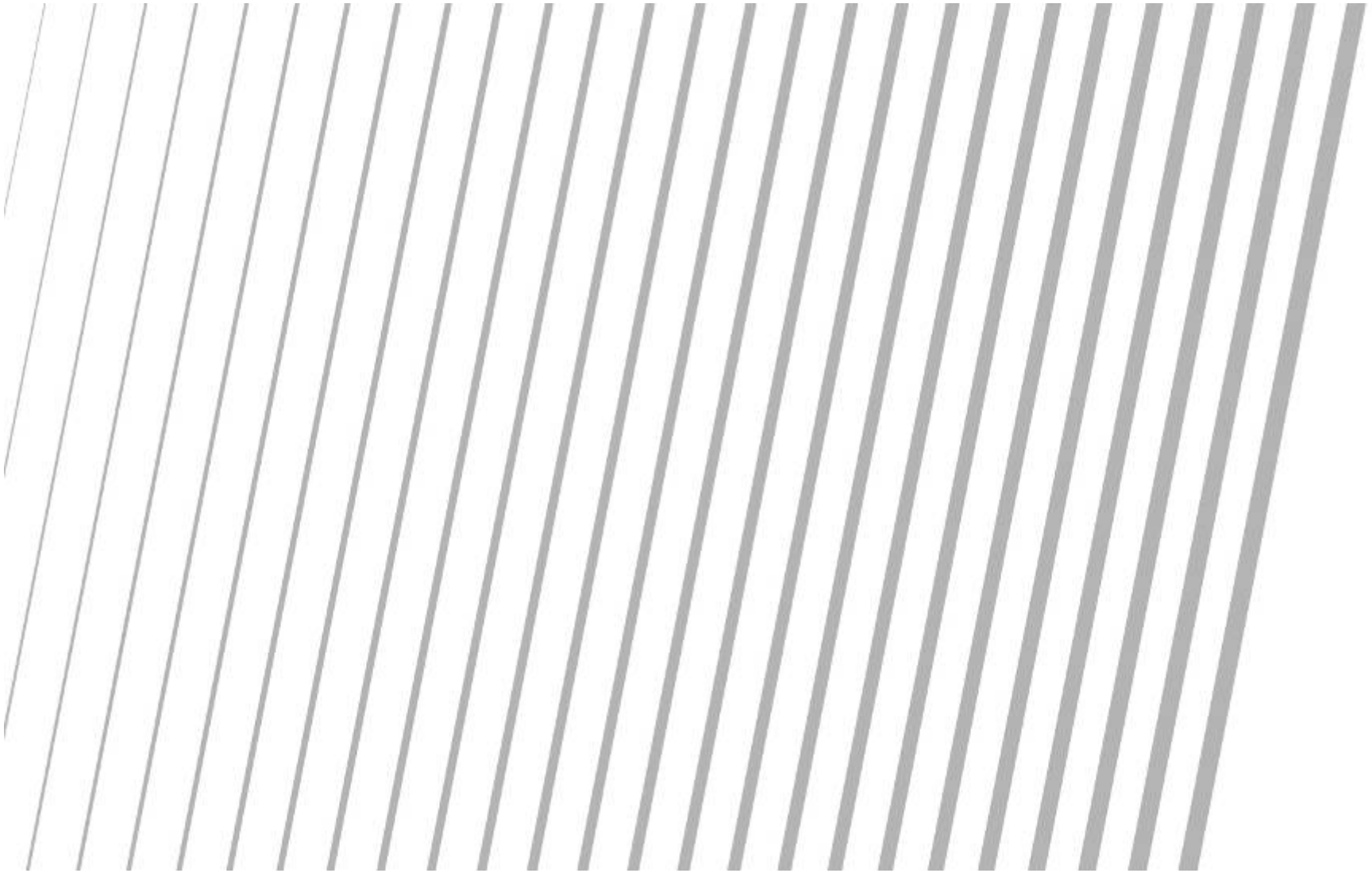
Overview

- Scope of IFRIC 12
  - IFRIC 12 or IFRIC 4 *Arrangements containing a lease*
- Recognition criteria
  - Assets recognized under IFRIC 12
  - Revenue recognition under IFRIC 12
- Measurement criteria
- Other considerations:
  - Amortization of intangible assets
  - Replacement and maintenance expenditure
- Worked example

Background and scope



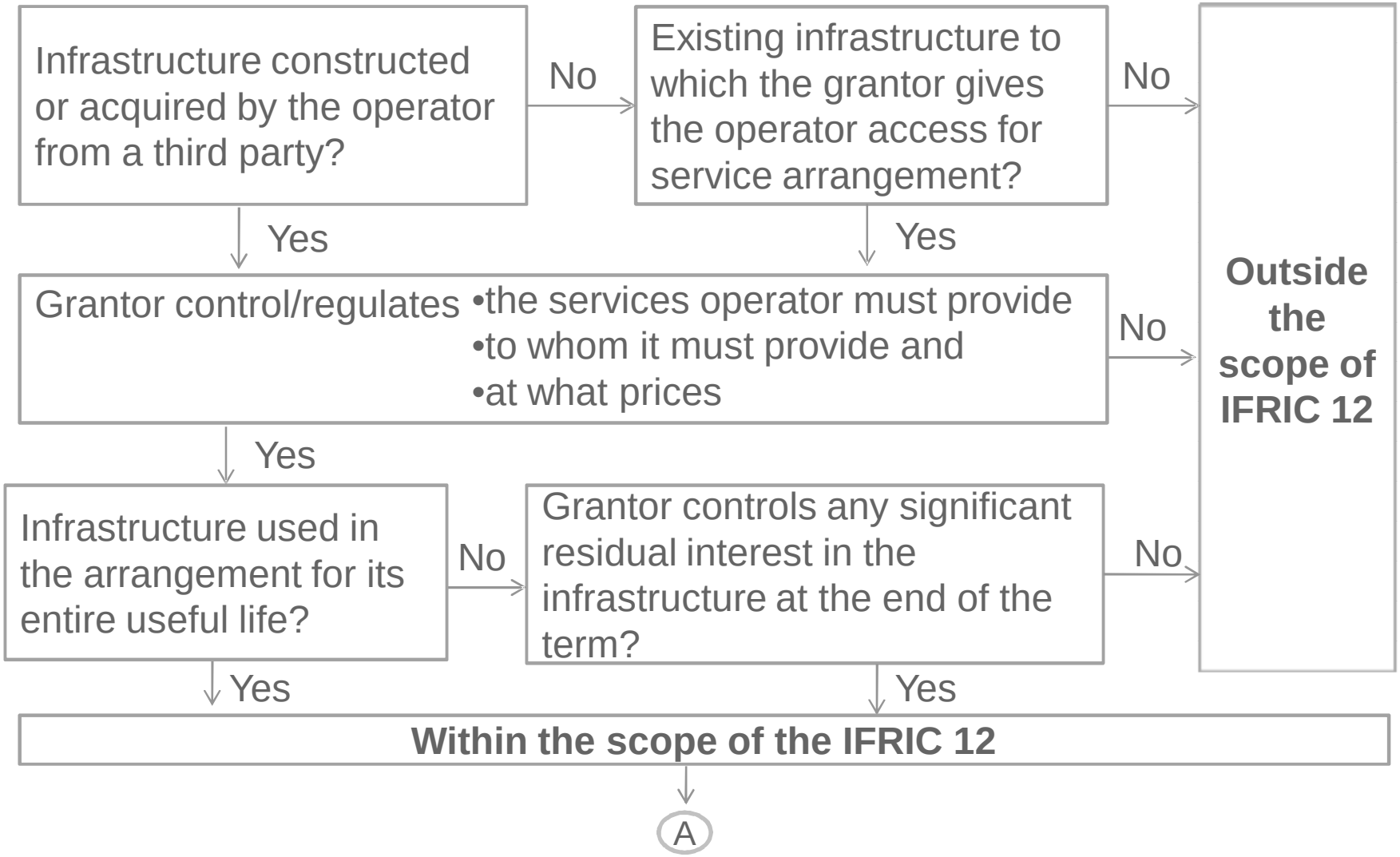
Background to IFRIC 12

- IFRIC 12 deals with contracts where a private sector entity participates in infrastructure for public sector services, such as development, maintenance or operation of the infrastructure.
- Infrastructure within the scope of the Interpretation should not be recognized as property, plant and equipment of the operator. Instead, the operator recognizes a financial asset and/or intangible asset.
- No specific guidance is available under Indian GAAP on such arrangements. The ICAI has issued an Exposure Draft on Accounting for Service Concession Arrangements which is based on IFRIC 12.
- Different treatment by different entities
  - In absence of any guidance, many companies recognise expenditure incurred on construction/ upgradation of public infrastructure as tangible fixed assets.
  - There are companies who recognise such payments as intangible assets.
  - Generally, no revenue is recognised while construction/ upgradation is in progress.
- Under IFRS, treatment for the above arrangements would be governed under IFRIC 12

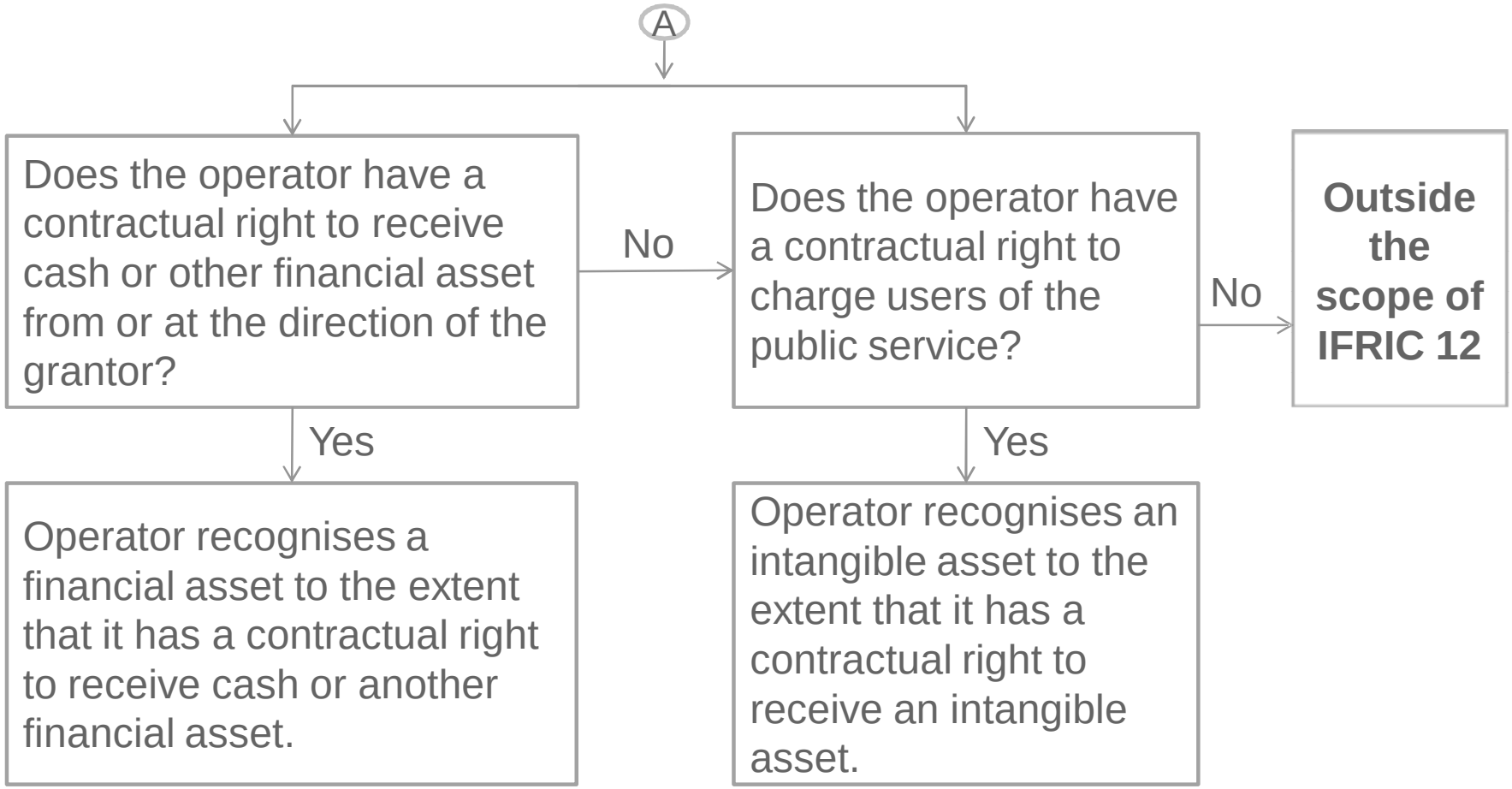
Scope of IFRIC 12

- IFRIC 12 applies to a public-to-private service concession arrangement 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; and
  - 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.

Scope of IFRIC 12 (cont)



Scope of IFRIC 12 (cont)



Public service obligation

- Toll Limited constructs and maintains a toll road. The government operates the road and collects revenue from operations of the road from users. It pays fixed annual amount to Toll Limited.

- Electricity Limited constructs a gas fired power plant. The entity has a power purchase agreement with the State Electricity Board (SEB) for covering the entire life of the power plant under which it supplies the SEB with 100% of the output.

  IFRIC 12 does not require provision of services directly to the public. Both the arrangements are with in scope of IFRIC 12.

Control over pricing

- Scoped in
  - Fixed price
  - Pricing formula
  - Fixed price/ pricing formula subject to revisions subsequently upon approval from grantor
  - Maximum cap on total revenue/ total profit
  - Operator has freedom to set prices, but any excess profit is returned to the grantor
  - Initially fixed price which is subsequently revised based on an index not within the control of grantor, e.g., consumer price index (CPI)

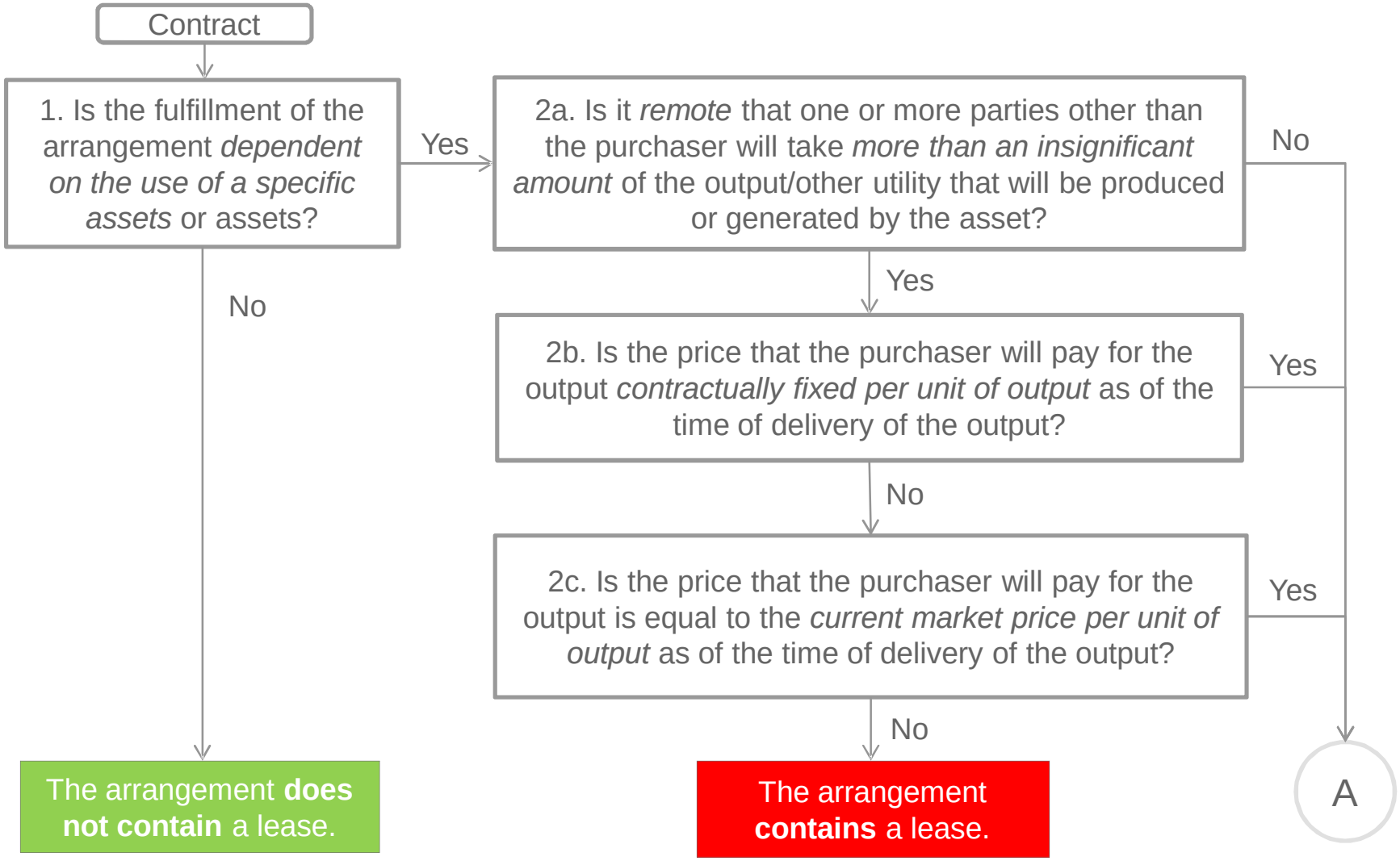
- Scoped out
  - Prices determined by market factors
  - After day 1, price revisions are not subject to grantor's approval
  - Recommendatory prices
  - Non-substantive features, such as a cap that shall apply only in remote circumstances

Control over residual interest

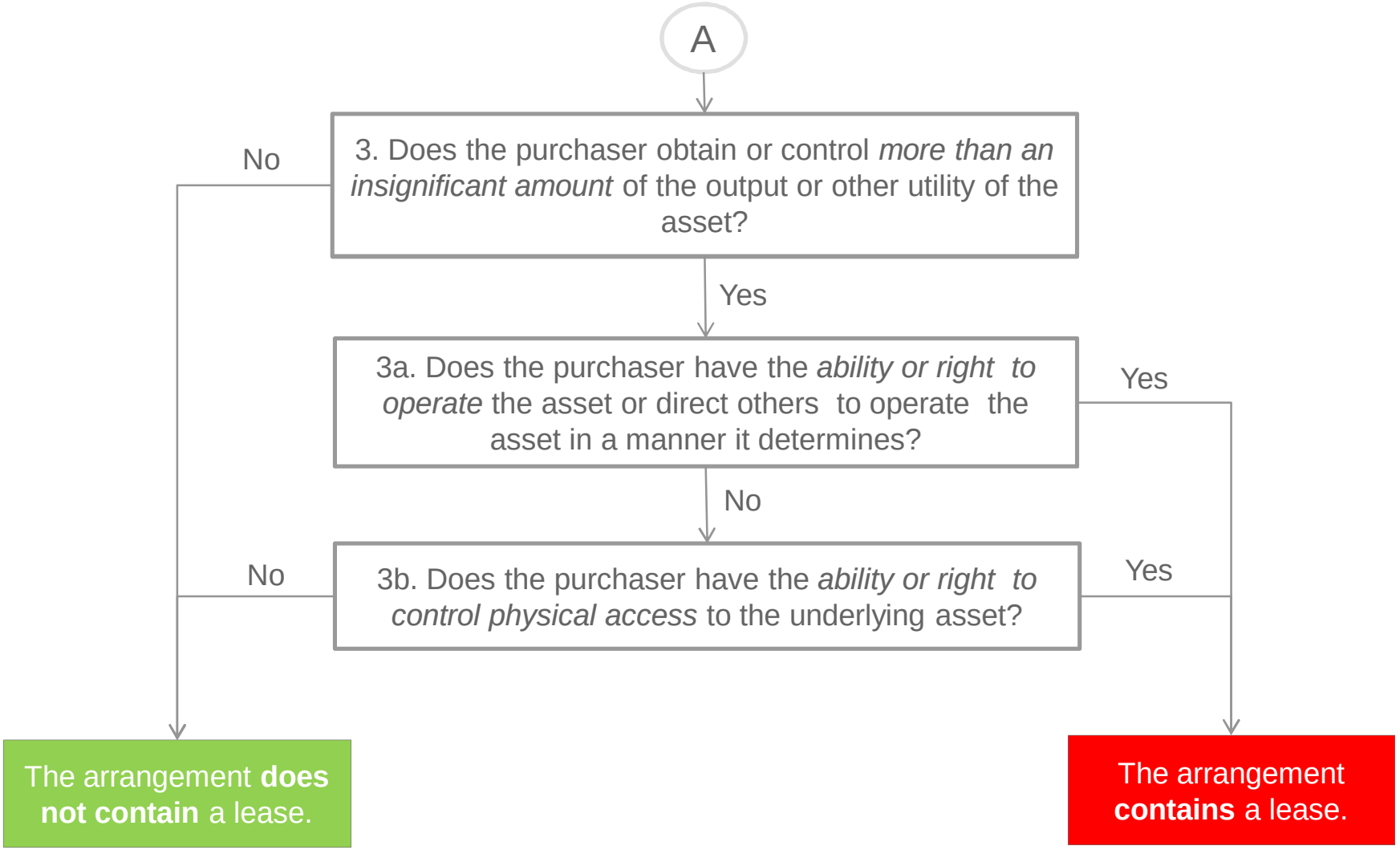
- Scoped in
  - Grantor's right to take over infrastructure at the end of contract period
  - Grantor's option to buy infrastructure at fair value
  - Grantor's option to buy infrastructure at fixed price even if the option is not bargain purchase option
  - "Whole of life arrangements," i.e., arrangements where residual interest is not significant

- Scoped out
  - Operator's option to put the infrastructure back to grantor
  - In "whole of life arrangements," the operator makes significant replacements resulting in substantial increase in life which is not controlled by the grantor, i.e., replacement is an asset of the operator to be governed by applicable IFRS

IFRIC 4 – Decision tree



IFRIC 4 – Decision tree



IFRIC 4 vs. IFRIC 12 – Example

- Company X has entered into power purchase agreement (PPA) with state electricity board for a period of 15 years (SEB).
- As per the agreement, the company has set up a new power plant and it shall sell the entire power generated from the plant to the SEB.
- Amount payable for sale is determined as below:
  - Reimbursement of variable cost, e.g., material and labor
  - Actual interest cost
  - Depreciation on power plant at stated rate
  - Fixed return on initial equity investment
- At the end of PPA, asset shall be transferred to SEB.
- The asset's remaining useful life at the end of the transfer is approximately 10 years.

Issue

- Whether the agreement is within the scope of IFRIC 4 or IFRIC 12?

Response – Example 1

- Apparently, the arrangement meets all criteria for accounting under IFRIC 4.
- IFRIC 12 trumps IFRIC 4.
- Thus, the Company needs to evaluate IFRIC 12 applicability first.
- First condition is also met when the grantor purchases entire output.
- Second condition also seems to be met since the grantor controls residual interest in the infrastructure at the end of the term of the arrangement
- May fall within scope of IFRIC 12 .
- Most probably financial asset model.

IFRIC 4 vs. IFRIC 12 – Example 2

- Company X has entered into power purchase agreement (PPA) with state electricity board (SEB) for a period of 15 years.
- As per the agreement, the company has set up a new power plant and it shall sell the entire power generated from the plant to the SEB.
- Amount payable for sale is determined as below:
  - Reimbursement of variable cost, e.g., material and labor
  - Actual interest cost
  - Depreciation on power plant at stated rate
  - Fixed return on initial equity investment
- **The asset is not transferred to the SEB at the end of the contract, but will be transferred to the SEB if the contract is terminated.**

Issue

- Whether the agreement is within the scope of IFRIC 4 or IFRIC 12?

Response – Example 2

- Apparently, the arrangement meets all criteria for accounting under IFRIC 4.
- IFRIC 12 trumps IFRIC 4.
- Thus, the Company needs to evaluate IFRIC 12 applicability first.
- First condition is not met
- Second condition doesn't appear to be met as the grantor does not control the residual interest in the infrastructure at the end of the term of the arrangement
- As the arrangement is outside the scope of IFRIC 12, the arrangement will need to be assessed under IAS 17 *Leases* as it falls within the scope of IFRIC 4

IFRIC 4 vs. IFRIC 12 – Example 3

- Company X has entered into an memorandum of understanding with the state government to building and operate a power plant
- Under the agreement the State government has transferred land to Company X on which to build and operate the power plant.
- Under the agreement, the state government or its affiliates are entitled to 25% of the output of the power plant for the life of the plant
- The remaining output of 75% is sold to **a third party**. Again this supply agreement is for the life of the plant
- The price at which the remaining output of 75% is sold is determined by the electricity regulator.
- **The asset is not transferred to the SEB or the other party at the end of the contract.**

Issue

- Whether the agreement is within the scope of IFRIC 4 or IFRIC 12?

Response – Example 3

- Apparently, the arrangement meets all criteria for accounting under IFRIC 4 in relation to the agreement with the 3rd party purchaser.
- IFRIC 12 trumps IFRIC 4.
- Thus, the Company needs to evaluate IFRIC 12 applicability first.
- First condition is also met as the grantor is controlling who the output is sold to and at what price
- Second condition doesn't appear to be met as the grantor does not control the residual interest in the infrastructure at the end of the term of the arrangement.
- As the arrangement is outside the scope of IFRIC 12, the arrangement will need to be assessed under IAS 17 *Leases* as it falls within the scope of IFRIC 4

IFRIC 4 vs. IFRIC 12 – Example 4

- Company X has entered into an agreement with the state electricity board (SEB) to building and operate a power plant
- As per the agreement, the company is permitted to sell directly to third party companies (purchasers) at a price agreed by the regulator.
- The agreements with the purchasers has no minimum volume requirements.
- The asset is not transferred to either the SEB or any of the customers at the end of the contract.

Issue

- Whether the agreement is within the scope of IFRIC 4 or IFRIC 12?

Response – Example 4

- The arrangement does not meet the criteria of IFRIC 4 as the purchasers (3rd party companies) do not have the ability or the right to operate the asset or direct others to operate the asset. Nor do the purchaser have the ability or the right to control physical access to the assets.
- The arrangement is also not in the scope of IFRIC 12 as there is no transfer of control of the asset by the operator at the end of the agreement.

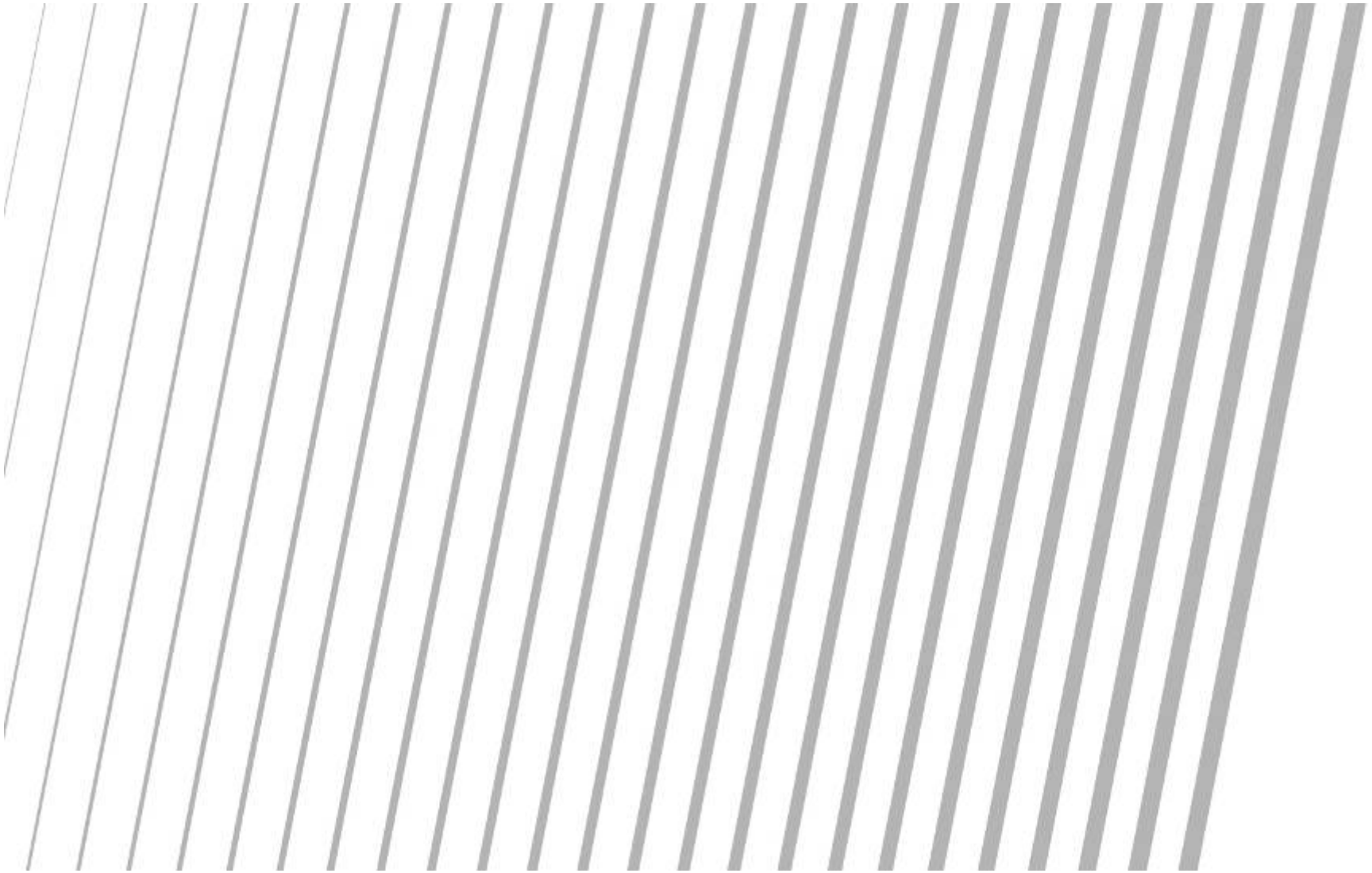
IFRIC 12 – Operator's rights over infrastructure

Operator cannot recognise infrastructure within scope of IFRIC 12 as PPE.

- It does not have right to control the use of the infrastructure.
- Infrastructure continues to be under the control of the grantor.
- Operator merely has access to operate the infrastructure to provide the public services on behalf of the grantor.
- The arrangement is also not a lease since it does not convey the right to control the use of the underlying asset.
- Amount to be recognized as intangible asset/ financial asset, depending upon arrangement with the grantor.

IFRIC 12 focuses on "control approach" as against "risk and rewards" approach in other IFRS/ Indian GAAP!!!

Recognition criteria



Intangible asset and financial asset model – dividing line

- A financial asset is recognised to the extent that the operator has an unconditional contractual right to receive cash or another financial asset from the grantor. An unconditional right also exists when grantor guarantees the operator's cash flows by agreeing to pay
  - Specified or determinable amounts or
  - The shortfall, if any, between user payments and specified or determinable amounts.

- An intangible is recognised to the extent that the operator receives a right to charge users of public service. When the operator is paid for its services partly by financial asset and partly by a licence to charge users, the two components of the consideration must be recognised separately.

Intangible asset and financial asset model – dividing line

Arrangement	Pricing mechanism	Asset(s) recognized by operator
A	Grantor pays a fixed amount per annum	Financial asset
B	Grantor pays a variable amount depending upon usage	Intangible asset
C	Grantor pays fixed sum plus variable charge depending upon usage	Financial asset and intangible asset
D	Operator collects revenue from users at the rates fixed by operator	Intangible asset
E	Operator collects revenue from users and grantor has given guarantee for minimum revenue	Financial asset and intangible asset
F	Operator collects revenue from users. Grantor fixes revenue in a manner that it is highly probable operator shall get minimum return. However, there is no guarantee.	Intangible asset

Operator right to receive revenue is considered unconditional even if it is dependent upon meeting future quality or performance requirements.!!!

Example - The Sun will shine!

- Service concession arrangement with the government electricity company (EC) for supply of solar energy
- EC to buy 100% output @ specified per unit price. The price is subject to change due to CPI adjustments.
- The operator has no demand risk since EC to buy 100% output.
- One view: Income is secured and unconditional because of low credit risk and because sun shines everyday. Therefore financial asset model applies.
- Counter view: The operator does not have an unconditional right to receive cash, hence intangible asset model should be used.
- Risk is not the basis for determining which model applies.

Intangible Asset Example – Toll Limited

- Toll Limited enters a service concession arrangement to construct, operate and maintain a new highway.
- Toll Limited is permitted to collect revenues from users of the grantor until it achieves a 6% return on its agreed infrastructure spend
- Once the operator has achieved the stated return of 6%, the arrangement comes to an end.

Financial Asset Example – Expressway Limited

- Expressway Limited enters a service concession arrangement to construct, operate and maintain a new highway for a period of 15 years
- The construction of the new highway should be completed by the end of 3 years.
- From years 4 to 15 the grantor will pay the operator CU 200 per year.

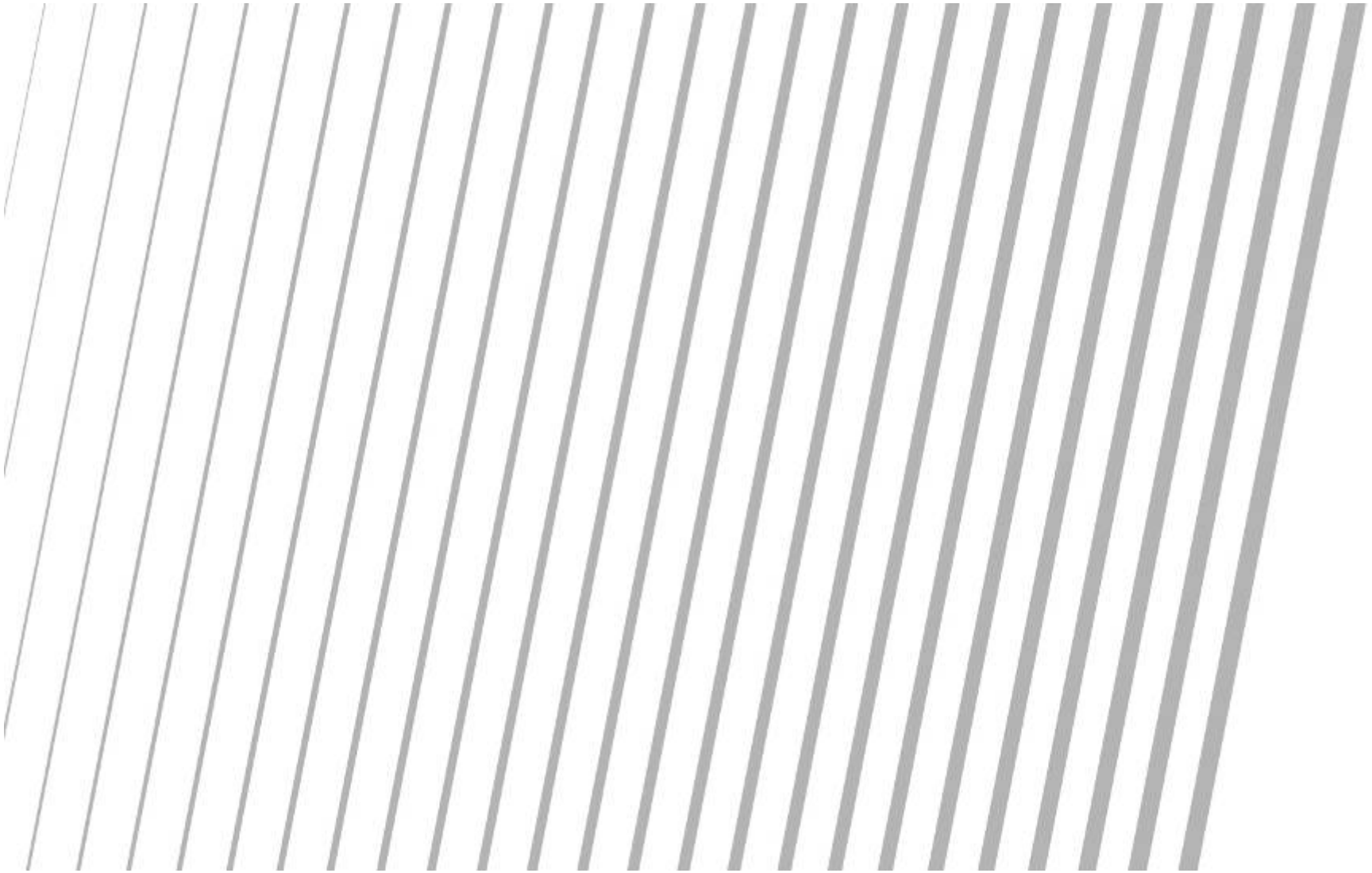
Timing of recognition

- Expressway Limited enters into a contract to construct road.
- As per the contract, it will have right to collect charges from users once construction is complete.
- Can the operator recognize an intangible asset while construction is in progress? Or the same arises only upon completion?

Response

- IFRIC had considered similar issue and concluded that intangible asset arises as soon as operator provides construction/ upgrade services.

Measurement criteria



Initial measurement of construction and other revenue

- The operator acts as a service provider. Typical services include:
  - Construction
  - Upgrade
  - Operation
- Need to recognize and measure revenue in accordance with IAS 11/ IAS 18
- Consideration received or receivable to be allocated by reference to the relative fair values of services
- In case of intangible assets, generally fair value of construction services may be most appropriate method to measure fair value
- IAS 39 requires a financial asset to be measured at fair value which is present value of all future cash receipts discounted using the prevailing market rate. In the case of receivable relating to service concession arrangement, the rate would be the grantor's incremental borrowing rate.

Measurement of construction revenue

- No specific guidance
- Some of the aspects that may be considered
  - Detailed workings done at the time submitting tender
  - Experience with other projects of similar nature
  - Published annual reports and other competitive information
  - Reference to cost plus contracts prevalent in the industry
  - Outsourcing contracts in the industry
- Matter of estimate which need to be disclosed

Measurement of construction revenue – practices followed by certain companies

- A company engaged in construction of power plants

  The financial asset recognized by the company in exchange for the construction services provided is recognized at the fair value of the consideration receivable for the construction services delivered. The fair value of the consideration receivable for the construction services delivered is calculated by including a mark-up, estimated to reflect a margin consistent with other similar construction work, on the actual costs incurred. Mark-up rate used in calculating the fair value of the consideration receivable is estimated by the Group as 10%.

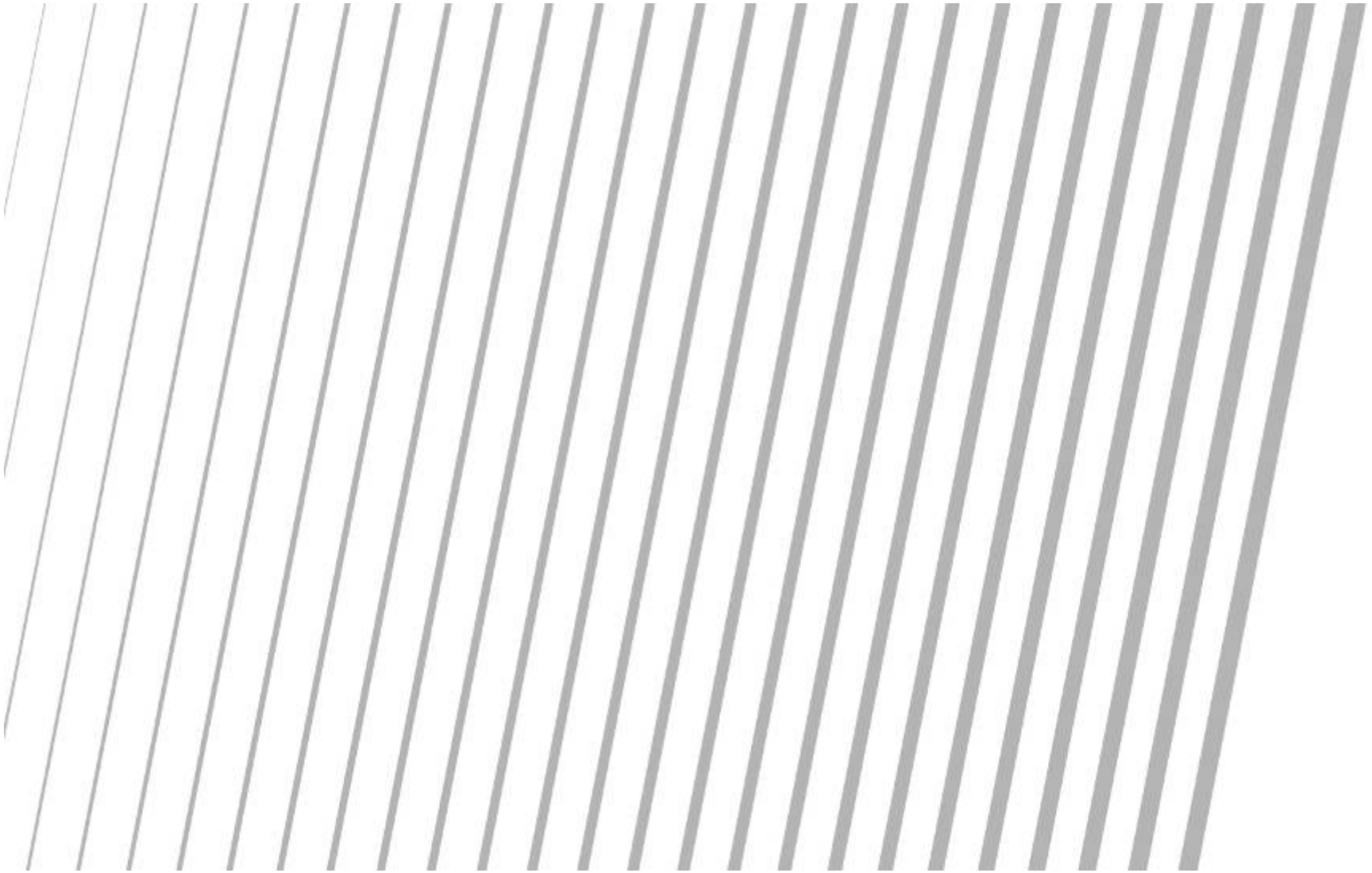
- A company engaged in construction of highways

  The fair value of construction services have been estimated to be equal to the construction costs plus margin of 17.5% and the effective interest rate of 13.5% for lending by the grantor. The construction industry margins range between 15-20% and management has determined that a margin of 17.5% is both conservative and appropriate. The effective interest rate used on the receivable during construction is the normal interest rate which grantor would have paid on delayed payments.

Measurement of revenue – subcontracting

- Often, a new SPE is set-up to undertake service concession arrangement
- SPE subcontracts the physical construction of asset to its parent
- If entire construction is subcontracted, SPE will not earn the construction profit as it will be earned by the subcontractor/ parent.
- At CFS level, profit margin may need to be determined at group level
- Differing results possible at CFS and SFS level if sub-contract is not at arms' length.

Other considerations



Amortisation of intangible assets

- IAS 38 – paragraphs 97 and 98 (extracts)
  - Amortization method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used.
  - A variety of methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method.

- IFRIC 12
  - Refers to IAS 38 for intangible assets accounting
  - As per BC, not appropriate to use an “interest” method of amortization which takes account of the time value of money in addition to the consumption of the intangible asset

Amortisation of intangible assets

- IFRIC staff note – November 2009 meeting
  - Revenue stream is derived from the interaction between quantity and price, hence may not primarily represent the usage of the asset.
  - The staff believes that the units of production should be primarily based on the units that are directly obtained from the use of the asset rather than on derived computation, such as revenue.
- Other key consideration
  - Distinguishing feature of intangible asset is that it represents right to use physical asset. Thus, it is important to consider life of physical asset as well.

Amortisation of intangible assets – commencement

- Amortization of intangible assets begins only when the concession right is available for use.
- For the operator, asset is collection right.
- If right begins at a later date, there may be no amortization in the period.
- Example
  - Company A constructs a road.
  - For first three years, there is no collection right.
  - The Company to starts amortizing intangible asset from fourth year.

Replacement and maintenance expenditure

- Judgment is needed to differentiate maintenance obligations from provision of services
  - Need to understand the exact nature of activities prescribed
  - Operator is required to perform specified activities at specified time – Nature is performance of service covered under IAS 18
  - Operator needs to restore the physical asset to specified performance level whenever loss occurs or at specified times – Nature is maintenance obligation covered under IAS 37

Provision of service – Electricity Supply

- The operator under an electricity supply service concession is required perform major overhaul works after 5 years.
- Expected cost of the overhaul is INR1,000 and operator negotiated a margin of 10%.
- In this case, the operator considers overhaul works to be a separate revenue-generating activity.
- Contract is executory until replacement actually occurs
- On replacement, it will recognize revenue of INR1,100 and costs of 1,000.

Response

- Such service will result in recognition of an addition to the financial asset recorded which will be recorded at fair value
- Finance income will then be accrued over the term of financial asset

Maintenance obligation – Operation of road

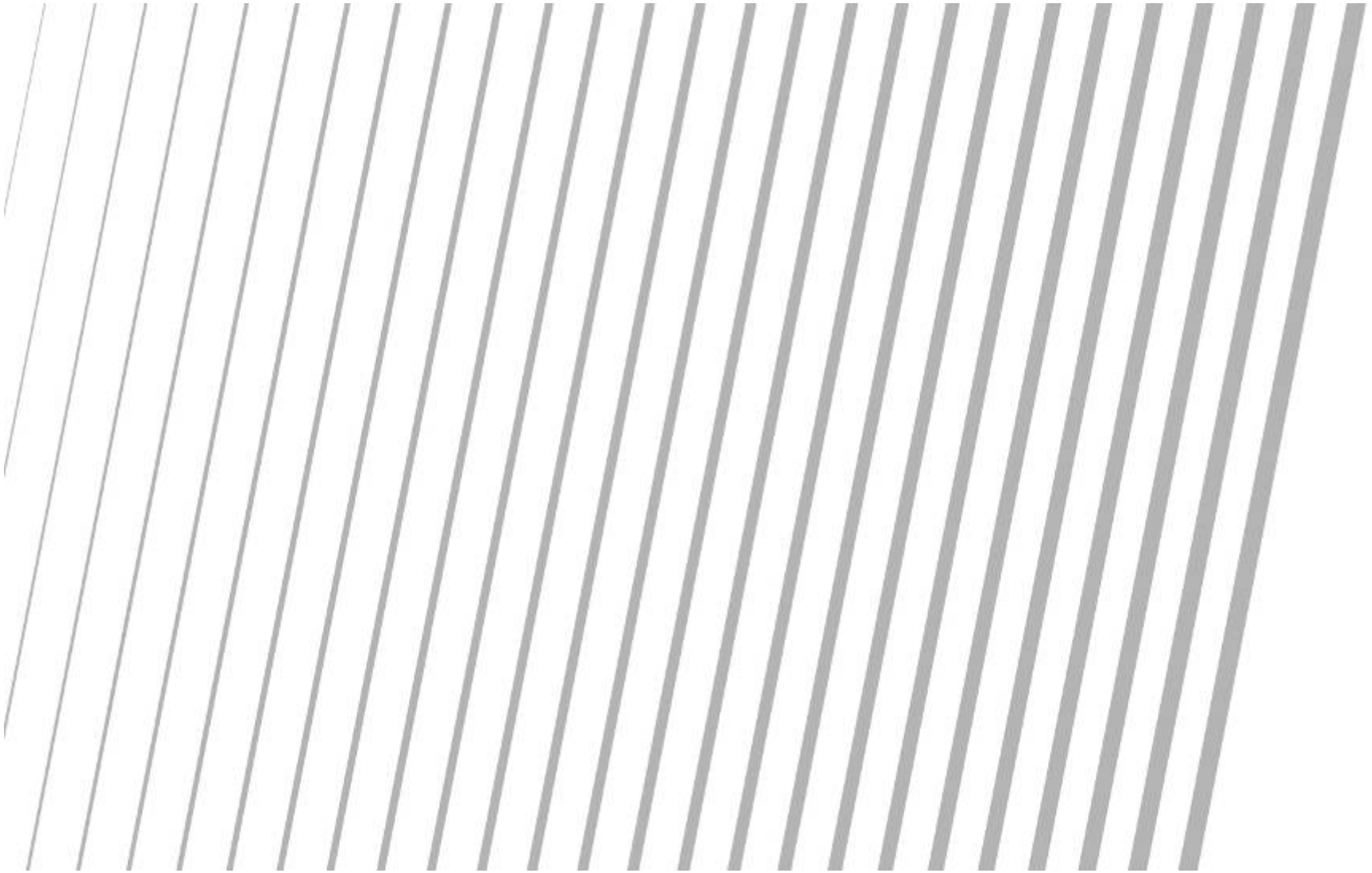
- The company under road service concession arrangement is required to carry out major maintenance:
  - At the end of every four years, or
  - When the quality of infrastructure falls below minimum specified level

  whichever occurs earlier.
- In addition, the operator is also required to carry out such maintenance at the end of concession period.
- Such maintenance is aimed at restoring road to the original level of performance.
- The operator expects that infrastructure shall not fall below minimum specified level before 4 years.
- The expected cost of maintenance is CU10 million.

Response

- Maintenance of infrastructure is not a separate revenue-generating activity.
- Rather, a provision is accrued for the same over the period from inception of the arrangement until the expected date of maintenance.
- The measurement of the provision is at net present value of the amounts expected to be paid.

Intangible asset model – example



Contract costs and revenue – assumptions

	Year	Rs.
Construction services	1	500
	2	500
Operation services (per year)	3 – 8	10
Road resurfacing	8	100

- Operator to collect tolls from drivers using the road.
- Fair value of construction services is cost plus 5%.
- The operator forecasts that vehicle numbers will remain constant over the duration of the contract and that it will receive tolls of Rs 200 in each of years 3 – 10.
- Cash flows take place at the end of the year

Initial measurement of intangible asset

	Rs.
Construction services in year 1 (Rs 500 x (1+5%))	525
Capitalization of borrowing cost	34
Construction services in year 2 (Rs 500 x (1+5%))	525
Intangible asset at end of year 2	**1,084**

Subsequent expenditure

- The operator's resurfacing obligation arises as a consequence of use of the road during the operating phase. It is recognized and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, i.e., at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.
- 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

Resurfacing obligation (Rs)

Year	3	4	5	6	7	8	Total
Obligation arising in year (Rs 17 discounted at 6%)	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**

Cash flows

(Rs.)

Year	1	2	3	4	5	6	7	8	9	10	Total
Receipts	-	-	200	200	200	200	200	200	200	200	1,600
Contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Borrowing costs	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net inflow/(outflow)	(500)	(534)	121	129	137	147	157	67	171	183	78

- It is assumed that the operator finances the arrangement wholly with debt and retained profits. It pays interest at 6.7 per cent year on outstanding debt.

Income statement & balance sheet – Intangible approach

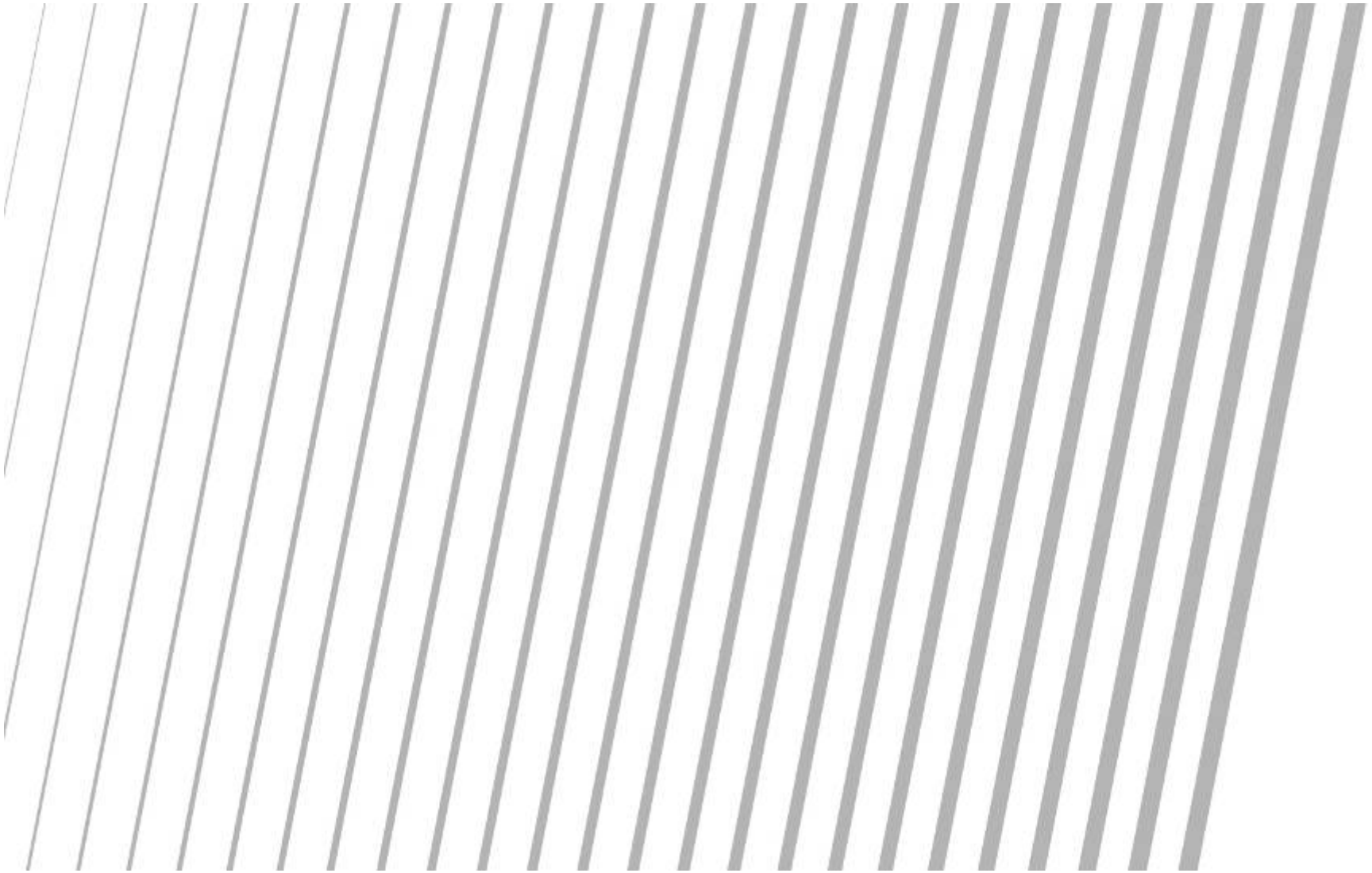
Income Statement (Rs)

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
Amortisation	-	-	(135)	(136)	(136)	(136)	(136)	(136)	(135)	(135)	(1,084)
Resurfacing exp	-	-	(12)	(14)	(15)	(17)	(20)	(22)	-	-	(100)
Other contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(1,080)
Borrowing costs	-	-	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(308)
Net profit	**25**	**25**	**(26)**	**(20)**	**(14)**	**(6)**	**1**	**9**	**36**	**48**	**78**

Balance Sheet

Intangible asset	525	1,084	949	814	678	542	406	270	135	-
Cash/(debt)	(500)	(1,034)	(913)	(784)	(647)	(500)	(343)	(276)	(105)	78
Resurface obligation	-	-	(12)	(26)	(41)	(58)	(78)	-	-	-
Net assets	**25**	**50**	**24**	**4**	**(10)**	**(16)**	**(15)**	**(6)**	**30**	**78**

Financial asset model – example



Contract costs and revenue – assumptions

	Year	Rs.
Construction services	1	500
	2	500
Operation services (per year)	3 – 8	10
Road resurfacing	8	100

- Grantor to pay the operator Rs 200 per year in years 3 – 10 for making the road available to the public
- Cash flows take place at the end of the year

Fair values of the consideration received or receivable

	Fair value		
Construction services	Forecast cost	+	5%
Operation services	” “	+	20%
Road resurfacing	” “	+	10%
Effective interest rate	6.18% per year		

- In year 1, for example, construction costs of Rs. 500, construction revenue of Rs. 525 (cost plus 5 per cent), and hence construction profit of Rs. 25 are recognised in the income statement.

Measurement of receivable

	Rs.
Amount due for construction in year 1	525
Receivable at end of year 1 *	**525**
Effective interest in year 2 on receivable at the end of the year 1 (6.18% x Rs 525)	32
Amount due for construction in year 2	525
Receivable at end of year 2	**1,082**
Effective interest in year 3 on receivable at the end of year 2 (6.18% x Rs 1,082)	67
Amount due for operation in year 3 (Rs 10 x (1+ 20%))	12
Cash receipts in year 3	(200)
Receivable at end of year 3	**961**

*No effect interest arises in year 1 because the cash flows are assumed to take place at the end of the year

Cash flows

(Rs.)

Year	1	2	3	4	5	6	7	8	9	10	Total
Receipts	-	-	200	200	200	200	200	200	200	200	1,600
Contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Borrowing costs	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net inflow/(outflow)	(500)	(534)	121	129	137	147	157	67	171	183	78

- It is assumed that the operator finances the arrangement wholly with debt and retained profits. It pays interest at 6.7 per cent year on outstanding debt.

Income statement & Balance sheet

Income Statement (Rs)

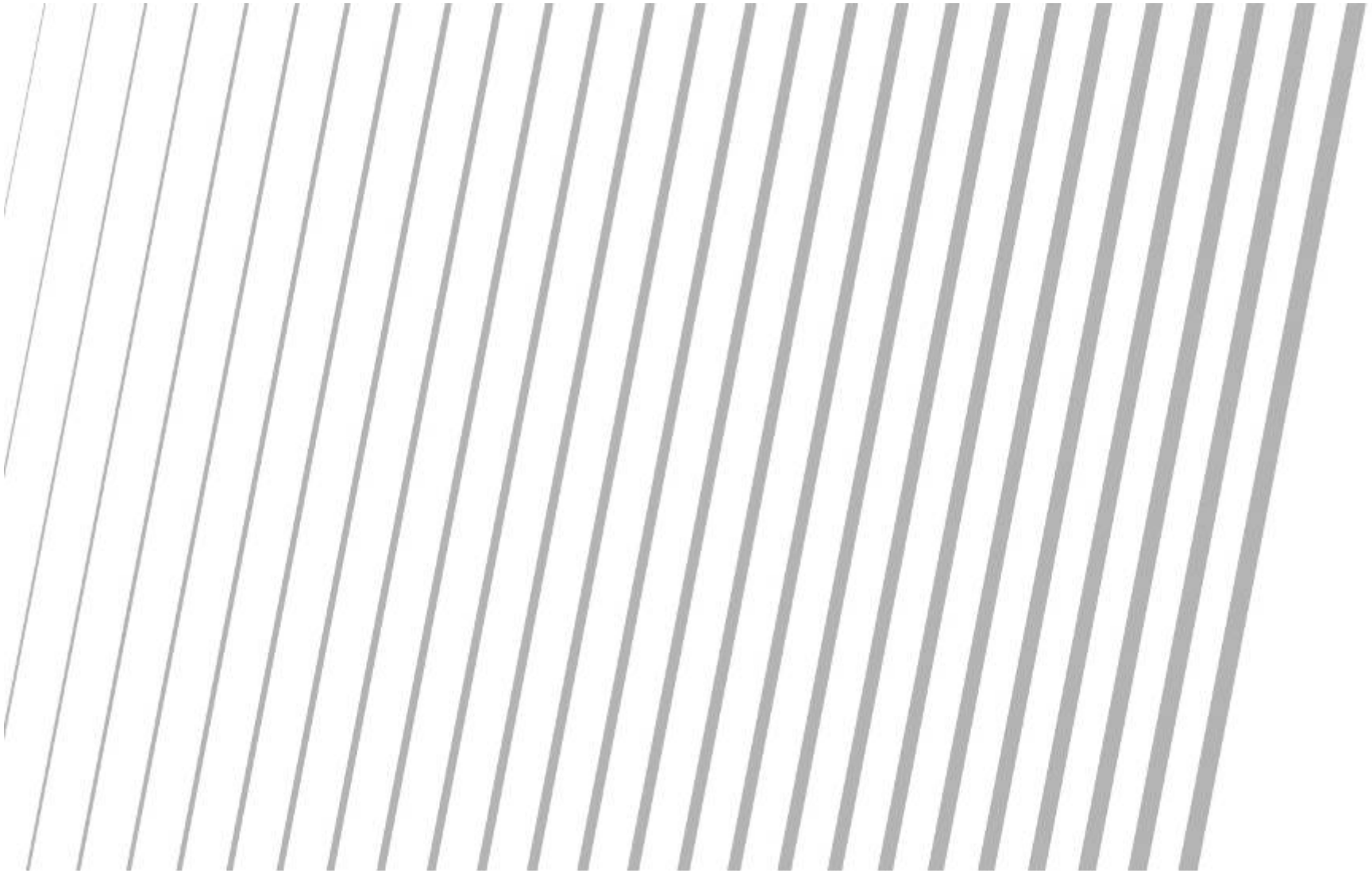
Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue	525	525	12	12	12	12	12	122	12	12	1,256
Contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(110)	(10)	(10)	(1,180)
Finance income *	-	32	67	59	51	43	34	25	22	11	344
Borrowing costs	-	(34)	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(342)
Net profit	**25**	**23**	**-**	**-**	**-**	**2**	**3**	**14**	**5**	**6**	**78**

* Amount due from grantor at start of the year @6.18%

Balance Sheet

Amount due from grantor	525	1,082	961	832	695	550	396	343	177	-
Cash/(debt)	(500)	(1,034)	(913)	(784)	(647)	(500)	(343)	(276)	(105)	78
Net assets	**25**	**48**	**48**	**48**	**48**	**50**	**53**	**67**	**72**	**78**

Comparison



Income statement
Comparison of financial assets model & Intangible assets model

(Rs)

Year	1	2	3	4	5	6	7	8	9	10	Total
Financial asset model											
Total Revenue	525	525	12	12	12	12	12	12	122	12	1,256
Total Costs (net of finance income)	(500)	(502)	(12)	(12)	(12)	(10)	(9)	(108)	(7)	(6)	(1,178)
Net profit	**25**	**23**	**-**	**-**	**-**	**2**	**3**	**14**	**5**	**6**	**78**
Intangible asset model											
Total Revenue	525	525	200	200	200	200	200	200	200	200	2,650
Total Costs	500	500	226	220	214	206	199	191	164	152	2,572
Net profit	**25**	**25**	**(26)**	**(20)**	**(14)**	**(6)**	**1**	**9**	**36**	**48**	**78**

Revenue under intangible model is double than financial asset model. !!!

Income statement
Comparison of P&L Impact – IGAAP and IFRS

Income Statement – As per IFRIC 12 (Intangible assets model) (Rs)

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
Amortisation	-	-	(135)	(136)	(136)	(136)	(136)	(136)	(135)	(135)	(1,084)
Resurfacing exp	-	-	(12)	(14)	(15)	(17)	(20)	(22)	-	-	(100)
Other contract costs	(500)	(500)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(1,080)
Borrowing costs	-	-	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(308)
Net profit	**25**	**25**	**(26)**	**(20)**	**(14)**	**(6)**	**1**	**9**	**36**	**48**	**78**

Income Statement – As per IGAAP

Revenue	-	-	200	200	200	200	200	200	200	200	1,600
Amortisation	-	-	(129)	(129)	(129)	(129)	(129)	(129)	(130)	(130)	(1,034)
Resurfacing exp	-	-	(16)	(16)	(16)	(17)	(17)	(18)	-	-	(100)
Other contract costs	-	-	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(80)
Borrowing costs	-	-	(69)	(61)	(53)	(43)	(33)	(23)	(19)	(7)	(308)
Net profit	**-**	**-**	**(24)**	**(16)**	**(8)**	**1**	**11**	**20**	**41**	**53**	**78**

SIC 29 Service Concession Arrangements: Disclosures

- 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 major economic and social facilities.

- SIC 29 requires all aspects of a service concession arrangement to be considered in determining the appropriate disclosures.

- It requires the following minimum disclosures
  - A description of the arrangement
  - Significant terms of the arrangement that may affect the amount, timing and uncertainty of future cash flows

SIC 29 Service Concession Arrangements: Disclosures

- The nature and extent (e.g. quantity, time period or amount as appropriate) of:
  - Rights to use specified assets
  - Obligations to provide or rights to expect provision of services
  - Obligations to acquire or build items of property, plant and equipment
  - Obligations to deliver or rights to receive specified assets at the end of concession period
  - Renewal and termination options
  - Other rights and obligations (e.g. major overhauls)
- Changes in the arrangement occurring during the period
- How the service arrangement has been classified
- Amount of revenue and profits or losses recognised in the period on exchanging construction services for a financial or an intangible asset.

First time adoption – exemption

- FTA may apply transitional provisions of IFRIC 12

- Transitional provision of IFRIC 12 requires:
  - Apply provisions of IFRIC 12 retrospectively
  - If, for any particular service arrangement, it is impracticable for an operator to apply this Interpretation retrospectively at the date of transition, it shall
    - recognise financial assets and intangible assets that existed at the date of transition;
    - use the previous carrying amounts of those financial and intangible assets (however previously classified) as their carrying amounts as at that date; and
    - test financial and intangible assets recognised at that date for impairment.

Practical issues in applying first time adoption relief

- Toll Limited has previously recognized toll bridge as its PPE and was amortizing the same on straight line basis
- The Company is entitled to collect fixed annuity amount from the grantor for construction and operation services
- Upon transition to IFRS, the company shall treat the carrying amount of PPE as value of financial asset.

Issue

- How should the Company allocate future receivable between recovery of receivable and service income?

Practical issues in applying first time adoption relief - Response

- Based on practical experience, various approaches seem possible:
  - Calculate the fair value of future services using reasonable margin. Allocate remaining amount to recovery of financial asset – EIR may be significantly higher or lower than market rate.
  - Use reasonable EIR to calculate recovery of financial asset and allocate residual amount to service income
  - Use reasonable EIR and reasonable margin for service income and allocate future receivable between two portions (relative fair value approach)

- IFRIC 12 does not provide any specific guidance on the issue. Application of each approach may give significantly different results.

- Further complications to arise when asset to be recognized is part financial asset and part intangible asset.

Key consequences

- Implementation will significantly affect the way operators present their financial position and performance
  - PPE reclassified as receivables or intangibles as applicable – Measurement as fair value
  - Revenue numbers and earnings to change dramatically
- Key aspects to be considered
  - Intangible asset model results in recognition of double revenue – Impact on revenue sharing arrangements
  - MAT and other direct tax calculation as the Company starts recognizing revenue and profit during construction phase
  - Direct tax code implications – As value of assets may be higher due to recognition of profits
  - Debt covenants, particularly, if financial asset model applies
  - IPO plans
  - Whether recognition of construction/ operating revenue may have any indirect tax implications

Thank You