

22.7/8/1

11 May 2005

Mr Stig Enevoldsen
EFRAG
Avenue des Arts, 41
1040 Bruxelles

RE: IFRIC D12, D13, D14: SERVICE CONCESSIONS ARRANGEMENTS

UNICE welcomes the opportunity to comment on the draft interpretations issued by IFRIC on service concession arrangements.

Entities involved in the concession industry in Europe welcome the work achieved by IFRIC in order to define an accounting guidance that would be applicable to most of the service concession contracts and bring a solution to years of research and so far unsuccessful efforts.

However, as our more detailed comments suggest, the draft interpretations still need to be improved before they are considered as bringing the long awaited relevant accounting guidance. Even if IFRIC succeeded in issuing the final interpretations before the end of 2005, entities would not be able to devote the time necessary for an appropriate conversion from their existing systems and accounting practices to IFRS.

As it has already been proposed to the Board and IFRIC by EFRAG and the European Commission, we urge IASB to authorize IFRIC to include in their final interpretations a provision whereby service concession contracts included in the scope of the interpretations would be accounted for in 2005 in accordance with their previous accounting practices. We indeed believe that forcing entities, because of the lack of time available, into the impracticable exemption from retrospective application is not the solution that will ensure high quality financial reporting to the user. The alternative route, ie adjusting present practices to have them comply with IFRS, would result in an entity changing accounting policies twice in two years. In the concession industry, where the activity derives from numerous and very diverse rather complex contracts, this would undoubtedly involve a very high expense, for no benefit for the user. It is in our view easier for the user to analyse financial reporting on well known bases for one more year instead of trying to understand and interpret financial information established on the basis of changing accounting policies.

Please find at annex to this letter our more detailed comments, in view of improving the present draft interpretations.

Should you wish to comment on our views, please do not hesitate to contact us.

Yours sincerely,



Jérôme P. Chauvin
Director, Company Affairs Department

Appendix

1- *We agree with the scope of the project*

We support the scope definition in paragraph 5 and believe that the criteria set up by IFRIC will help to encompass most of the service concession contracts, in conformity with IFRIC's objective.

We believe that the interpretations have put a lot of emphasis on contracts involving the building of the infrastructure as a first phase, leaving the impression that no guidance is given to account for other service concession contracts. We somewhat regret that the accounting guidance for other contracts is principally to be derived from the basis for conclusions and believe that the interpretations would benefit from a rewording of the consensus to better fit the actual scope of the interpretations.

2- *We believe that the segmentation into a financial asset model and an intangible asset model is relevant. However we believe that who bears the demand risk, not who pays the operator, is a relevant criterion for selecting the relevant accounting treatment*

We believe that IFRIC has correctly identified that there are differences of economic substance within service concession contracts. In some cases, the operator is guaranteed a level of revenue by contract; in other cases, the operator bears all the demand risk; there are also cases where the operator and the grantor share the risks, the operator being guaranteed a level of revenue, but not up to the costs incurred before the operating phase.

In our view, who bears the demand risk is the relevant criterion for identifying differences in economic substance and therefore for selecting the relevant accounting treatment. We believe that whenever the operator is guaranteed a level of revenue, the operator receives a financial asset in return for the construction services (or for whatever asset being transferred in order to become the operator of the infrastructure).

We also believe that mix solutions must be properly reflected for what they are, and that, in those cases, a financial asset and an intangible asset should be reported.

3- *We believe that who bears the demand risk is the criterion to apply to the choice of accounting model, not to determine the scope of the interpretation*

As indicated in paragraph 1, we support the definition of the scope proposed. We do not believe that who bears the demand risk should have an influence over the scope of the interpretations. Too many service concession contracts would be left without any guidance. Furthermore we do not believe that the infrastructure qualifies as a tangible asset of the operator when the operator bears demand risk and criteria in paragraph 5 are met.

4- *We believe that the financial asset model can apply without undermining or stretching too far the definition of a financial asset*

Whether the user or the grantor pays the operator, the right to the revenue derived from operating the infrastructure stems from one single contractual right that has been granted to the operator as part of the service concession contract. We therefore see no analogy whatsoever with circumstances in

which the operator would benefit by a financial guarantee in case the operations would not yield a specified level of revenue.

Moreover, we believe the faithful representation of economic substance should be the first goal set for IFRIC (and for IASB). Interpretations should not be overly constrained by detailed consistency purposes.

- 5- *We feel comfortable that revenue for rendering building services is recognised in exchange for an intangible asset, whenever the building services can be reliably measured*

We are surprised that IFRIC members would feel uncomfortable at recognising revenue without any corresponding cash inflow. Exchanges of assets where no asset is cash take place in the real economical life and should be reported as such. We believe that service concession contracts in which building services are provided are genuinely dealt with in two phases, the building phase and the operating phase, as if the two phases had been contractually agreed in separate contracts. We are however concerned by the need for reliable measurement. We therefore believe that the exchange should be accounted for at fair value only when and if market derived data are available to justify the level of revenue accounted for. We believe that this is strictly in conformity with IAS 18 requirements.

- 6- *We have an additional concern and question regarding the application of the percentage of completion method under IAS18 in this context (operating the service when the hardware has been delivered, and the capitalisation of expenses)*

The concern is about the recognition of a right to revenues in a service concession agreement. This aspect of the issues around concession accounting has not been fully explored under IAS18 rulings. It is not a matter of as IFRIC states: the percentage of completion method provides no basis for deferring or capitalising costs. The costs (i.e also financing costs) included in the "value" of the related hardware are the costs to be recovered over the lifetime of the concession. Indeed tariffs are negotiated (and re-negotiated at regular intervals) with the grantor (or the regulator) in order to ensure that the full "value" (as stated above) is recovered.

Of course one might question whether the upfront financial expenses need also to be included in this hardware value. The answer might be yes because it is also the case in the Financial Asset Model. Under IAS18 and the service contract accounting this might be defended based on the conditions prescribed under IAS18.

Based on the above and to be absolutely certain that IFRIC has not overlooked a possible solution for the service concession arrangements we invite IFRIC to re-examine the intangible asset model in the light of IAS18 and the above concerns.

- 7- *We believe that an intangible arises:*

- a. Either at the time of the exchange, ie when the building phase is complete, when the building services are reliably measurable
- b. Or, as the building phase progresses, when building services are not reliably measurable

We believe that this should be adequately defined in the final interpretations.

- 8- *We believe that IAS 38.98 should apply to service concession arrangements without any restriction*

This is the only way, in our view, to allow for the most relevant accounting treatment, in the circumstances in which amortisation would increase over time to reflect the increasing use of the infrastructure.