

FASB Emerging Issues Task Force

Issue No. 12-H

Title: Accounting for Service Concession Arrangements

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Background

1. U.S. GAAP does not have accounting guidance that specifically addresses accounting for service concession arrangements. Depending on the terms of a service concession arrangement, operating entities may conclude that an arrangement does or does not meet the lease criteria in Topic 840, Leases. This Issue addresses whether an operating entity should account for certain service concession arrangements as a lease under Topic 840.
2. The Task Force previously reached a consensus-for-exposure that this Issue would apply to an operating entity that enters into a service concession arrangement with a public-sector entity grantor when the arrangement contains both of the following conditions:

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

- a. The grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them, and at what price.
 - b. The grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.
3. The Task Force decided to limited the scope of this Issue to service concession arrangements for which the grantor is a public-sector entity and concluded that those arrangements are the types of arrangements for which guidance is primarily being sought by stakeholders.
4. The Task Force considered whether a service concession arrangement should be accounted for as a lease in accordance with Topic 840 and acknowledged that some service concession arrangements may qualify under the current definition of a lease because the operating entity receives substantially all of the economic output from the infrastructure during the term of the arrangement (and price paid is not fixed per unit of output or at current market price per unit of output), which is one of the conditions in paragraph 840-10-15-6 to qualify as a lease. However, the Task Force concluded that the accounting for service concession arrangements should be determined based on whether the operating entity controls the infrastructure that is being used to provide the public service. Therefore, service concession arrangements within the scope of this Issue (that is, arrangements in which the grantor controls the services provided through the infrastructure and controls residual interest in the infrastructure) should not be accounted for as leases under Topic 840 because the operating entity, in those cases, does not have the right to control the use of the grantor's infrastructure. The operating entity may have wide managerial discretion in operating the infrastructure; however, it does not control the infrastructure because the grantor determines the services the operating entity must provide with the infrastructure, to whom it must provide them, and at what price. Also, the grantor controls any residual interest in the infrastructure at the end of the term of the arrangement.
5. Additionally, the Task Force noted that the notion of control as used in the proposed definition of a lease in the FASB and IASB joint project on leases in paragraphs 842-10-15-2

through 15-3 of the FASB proposed Accounting Standards Update, *Leases (Topic 842)*, points to a tentative conclusion that service concession arrangements within the scope of this Issue would generally not meet the definition of a lease under the leasing proposal. In the joint leases project, service concession arrangements would generally not pass the right-to-control test because the operating entity does not direct how, when, and in what manner the infrastructure will be used and does not direct the use of the infrastructure. The operating entity also does not have the ability to determine what construction and or upgrade services are to be performed.

6. The Task Force decided that it was necessary to clarify that the operating entity's rights over the infrastructure also do not result in the infrastructure being recognized as property, plant, and equipment of the operating entity. That is because the operating entity does not control the use of the infrastructure under the terms of the arrangement.

7. The Task Force also discussed whether guidance may be needed for other aspects of service concession arrangements but decided to limit the guidance in this Issue to initial recognition of an operating entity's rights under a service concession arrangement within the scope of this Issue. The Task Force concluded that some aspects of service concession arrangements were currently being addressed in other ongoing FASB projects (for example, the FASB and IASB joint project on revenue and leases) and were not the primary issue for which authoritative guidance was being sought. The Task Force stated that if guidance is needed for any other aspects of a service concession arrangement, then those aspects could be considered under separate issues.

8. The Task Force reached a consensus-for-exposure that a service concession arrangement within the scope of this Issue should not be accounted for as a lease under Topic 840 and issued a proposed Update on July 19, 2013. The Task Force will have the opportunity to consider the comment letters received and the staff's analysis as it redeliberates the consensus-for-exposure. The Task Force will then be asked whether it would like to affirm its consensus-for-exposure on this Issue as a final consensus.

Summary of Comment Letters Received and FASB Staff Analysis and Recommendations

9. Only three comment letters were received on the proposed Update. Respondents included:

Preparers (CL#1, CL#2)	2
Professional accounting association (CL#3)	1
Total	3

10. Respondents were asked to comment on the following questions in the proposed Update:

Question 1: Do you agree that the scope of this proposed Update should include only service concession arrangements for which the grantor is a public sector entity? If not, what other types of arrangements should be included within the scope of this proposed Update? Please explain why.

Question 2: Do you agree that a service concession arrangement within the scope of this proposed Update should not be accounted for as a lease under Topic 840? If not, please explain why.

Question 3: Do you agree that the infrastructure that is the subject of a service concession arrangement within the scope of this proposed Update should not be recognized as property, plant, and equipment of the operating entity? If not, please explain why.

Question 4: Do you agree that the amendments in this proposed Update should be applied using a modified retrospective approach to all arrangements existing at the beginning of the reporting entity's fiscal year of adoption? If not, please explain why.

Question 5: Would the transition requirements in this proposed Update be difficult to apply? If yes, please explain why.

Question 6: The proposed amendments would apply to public and nonpublic entities. Should the proposed amendments be different for nonpublic entities? If so, please describe how and why you think they should be different.

Question 7: For preparers, how much time would be needed to implement the proposed amendments?

11. The FASB staff has analyzed the comment letters received and included the significant comments, as well as the FASB staff's recommendations on how the Task Force should proceed, in the following sections:

- Scope

- Recognition
- Transition
- Effective Date and Early Adoption

Scope

12. In question 1, respondents were asked whether they agreed that the scope of the proposed Update should include only service concession arrangements for which the grantor is a public-sector entity. The proposed Update indicates that a public-sector entity includes governmental bodies or entities to which the responsibility to provide the public service has been delegated.

13. One respondent agreed because most service concession arrangements involve public-sector grantors and stated that the scope should not be expanded at this time in order to expedite the issuance of the final standard. Another respondent noted that the scope should be extended to service concession arrangements for which the grantor is a private-sector entity because the substance of those arrangements—including their public-service nature—could be similar to service concession arrangements for which the grantor is a public-sector entity.

14. The FASB staff notes that the types of arrangements for which guidance is primarily being sought are service concession arrangements for which the arrangement has a public-service nature intended to benefit the general public and accomplish a public duty or responsibility. The staff considered defining the scope based on the public-service nature of the arrangement instead of the type of the grantor. However, the staff noted that such a distinction would be overly subjective. Accordingly, the staff believes that defining the scope based on the type of grantor (that is, public-sector entities) is more operable. Moreover, the public-sector specific scope is consistent with the scope of the guidance in IFRS for service concession arrangements (IFRIC 12) which also emphasizes the public-service nature of those arrangements in its scope. The staff further notes that the accounting for private-to-private service concession arrangements has not been brought to the staff's attention as being a prevalent issue in practice. Expanding the scope of this Issue may delay the issuance of the final Update because entities that would be affected by the enlarged scope may need to be given the opportunity to comment. The staff believes that if guidance is needed for other types of service concession arrangements, a separate

project could be undertaken at a later date. In summary, the staff believes that the scope of this Issue should be limited to service concession arrangements for which the grantor is a public-sector entity.

15. The amendments in the proposed Update require (as one of the two conditions to be scoped into the guidance) that the grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement. One respondent requested that the scope of this Issue also include arrangements in which the grantor does not control any residual interest but the infrastructure is used for its entire useful life similar to IFRIC 12. The staff believes that the economic substance of such arrangements in which control of the infrastructure is retained by the grantor is different from the substance of arrangements in which control of the infrastructure's residual rests with the operating entity at the end of the arrangement. In the latter case, it may not be appropriate in all arrangements to conclude that the arrangement is not a lease or property, plant and equipment because the operating entity may have control of the infrastructure. Therefore, the staff believes that the scope of this Issue should exclude those arrangements in which control of the infrastructure is not retained by the grantor.

Question 1 for the Task Force: Does the Task Force wish to affirm its consensus-for-exposure that the scope of this Issue should include only service concession arrangements for which the grantor is a public-sector entity?

Recognition

16. In question 2, respondents were asked whether they agreed that a service concession arrangement within the scope of the proposed Update should not be accounted for as a lease under Topic 840. Two respondents agreed. Those respondents indicated that the proposed Update would reduce diversity in practice hence improve comparability between entities. Respondents also noted that the proposed Update would reduce complexity by eliminating the analysis of these intricate arrangements under the leasing guidance.

17. One respondent indicated that they were unable to come up with an example of an arrangement that resembles a lease. That respondent views the arrangement as a service agreement between the operating entity and grantor. That respondent also indicated that if the grantor controls the infrastructure that the operator uses to perform the public service, the operator has, in effect, simply gained the right to access, and not gained control of, the grantor's infrastructure to provide services.

18. The staff believes that the accounting for service concession arrangements should be determined on the basis of whether the operating entity controls the infrastructure that is being used to provide the public service. Therefore, service concession arrangements within the scope of this Issue should not be accounted for as leases under Topic 840 because the operating entity does not have the right to control the use of the grantor's infrastructure. The operating entity may have wide managerial discretion in operating the infrastructure; however, it does not control the infrastructure because the grantor determines the services the operating entity must provide with the infrastructure, to whom it must provide them, and at what price. Also, the grantor controls any residual interest in the infrastructure at the end of the term of the arrangement. The notion of control as used in the proposed definition of a lease in the FASB and IASB joint project on leases in paragraphs 842-10-15-2 through 15-3 of the proposed leases Update, points to a tentative conclusion that service concession arrangements within the scope of this proposed Update generally would not meet the definition of a lease under the leasing proposals. The staff recommends that the Task Force reaffirm its consensus-for-exposure that service concession arrangements within the scope of this Issue should not be accounted for as leases under Topic 840.

Question 2 for the Task Force: Does the Task Force wish to affirm its consensus-for-exposure that service concession arrangements within the scope of this Issue should not be accounted for as leases under Topic 840?

19. Question 3 asked respondents whether they agreed that the infrastructure that is the subject of a service concession arrangement within the scope of this Issue should not be recognized as property, plant, and equipment of the operating entity. The three respondents generally agreed

with the proposed amendment. However, one respondent indicated concerns about potential ramifications of that decision. For example, if an operating entity makes significant improvements to the infrastructure, and those improvements will not benefit the grantor at the end of the arrangement, such as leasehold improvements, then, the respondent argued, those costs should be capitalized by the operator. The staff believes that an operating entity should not recognize leasehold improvements if they do not control and therefore do not record the property, plant and equipment for infrastructure assets that are within the scope of this Issue. An entity would need to evaluate the individual terms of an arrangement to determine how to account for various aspects of the arrangement including what asset, if any, the operating entity should recognize for the costs to build or improve the infrastructure that is within the scope of this Issue.

20. Another respondent commented that the proposed Update appears to be creating a new definition of "control," while other common definitions of control in U.S. GAAP rely more on a risk/benefit analysis, and expressed concern about the potential conflict. For example, some aspects of Topic 605 focus on the risk and rewards approach for recognizing revenue. In addition, Topic 810 requires the evaluation of an entity's decision-making ability to determine when to consolidate another entity.

21. The staff notes that under U.S. GAAP, different principles apply to determining whether an entity has control of an asset versus control of another entity. If an infrastructure used in the service concession arrangement is held within an entity and controlled by that entity, the staff believes that a reporting entity should first determine whether it should consolidate the infrastructure entity under Topic 810 before applying the guidance in the proposed Update. If consolidation is not required, an operating entity should assess whether the arrangement qualifies for the scope of this Issue by evaluating the conditions in the proposed Update. If the arrangement is within the scope of this Issue, the reporting entity should not recognize the arrangement as a lease or the infrastructure asset as property, plant, and equipment.

22. The staff believes that when the operating entity does not control the use of the infrastructure under the terms of the arrangement and when the arrangement does not qualify as a

lease, the operating entity's rights over the infrastructure should not result in the infrastructure being recognized as property, plant, and equipment of the operating entity. An operating entity would look to other relevant Codification Topics, as applicable, to account for various aspects of a service concession arrangement.

Question 3 for the Task Force: Does the Task Force wish to affirm its consensus-for-exposure that the infrastructure that is the subject of a service concession arrangement within the scope of this Issue should not be recognized as property, plant, and equipment of the operating entity?

Transition

23. In question 4, respondents were asked whether they agreed that the amendments in the proposed Update should be applied using a modified retrospective approach to all arrangements existing at the beginning of the reporting entity's fiscal year of adoption. The modified retrospective approach would require the cumulative effect of applying the proposal to arrangements existing at the beginning of the period of adoption to be recognized as an adjustment to the opening retained earnings in the period of adoption. Of the two respondents who answered the question, both agreed.

24. In question 5, respondents were asked whether the transition requirements in the proposed Update would be difficult to apply. Of the two respondents who answered the question, one respondent indicated they do not anticipate any obvious challenges in applying the proposed transition requirements. The other respondent suggested that detailed transition guidance would be helpful in implementing the amendments quickly and accurately (for example, how to account for asset retirement obligations that were capitalized to the infrastructure asset). The staff does not believe that additional transition guidance should be provided because, to be useful, any such guidance would have to contemplate the multiple different accounting methods previously applied by preparers and related accounting issues for those arrangements. Rather, the staff believes that practice can determine the most appropriate way to transition to this guidance.

Question 4 for the Task Force: Does the Task Force wish to affirm its consensus-for-exposure that the final Update would be applied on a modified retrospective basis to service concession arrangements that exist at the beginning of an entity's fiscal year of adoption?

Effective Date and Early Adoption

25. In question 7, respondents were asked about the effort that would be necessary to implement the amendments in the proposed Update. Of the two respondents who answered the question, both noted that significant efforts would not be needed. Respondents were not asked whether early adoption should be permitted. However, one respondent indicated support for early adoption. The staff agrees that early adoption should be permitted.

26. In question 6, respondents were asked whether the amendments in the proposed Update should be different for nonpublic entities. Of the two respondents who answered that question, both indicated that they do not see a need for there to be a difference between the amendments for public and nonpublic entities. The staff agrees that there should not be a difference between the amendments for public and nonpublic entities.

27. The FASB staff has considered the feedback and recommends that the amendments in the final Update be effective for annual reporting periods beginning after December 15, 2014, including interim reporting periods within those years, with early adoption permitted.

28. The staff believes that this effective date would provide sufficient time for entities, including nonpublic entities, to adopt the final Update. Entities would refer to other Topics to account for various aspects of a service concession arrangement. For example, an operating entity shall account for revenue and costs relating to construction, upgrade, or operation services in accordance with Topic 605 on revenue recognition.

29. Because revenue recognition is relevant in service concession arrangements, the staff considered providing an alternative that would align the effective date of the final Update with the timing of the effective date of the final revenue recognition standard. However, the staff believes that the guidance should become effective as soon as possible, because the guidance

provided in this proposed Update should generally not change how an entity would account for revenue recognition. In addition, the staff believes that the final Update would improve financial reporting through increased consistency in the accounting for service concession arrangements within the scope of this Issue.

Question 5 for the Task Force: Does the Task Force agree with the FASB staff recommendation that the amendments that result from this Issue should be effective for fiscal years (and interim reporting periods within those fiscal years) beginning after December 15, 2014, with early adoption permitted?