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**Re : “Comments on Adoption of IFRIC 12 Service Concession Arrangements”**

Dear Sirs,

We are pleased to respond to your request for comments on the “Adoption of IFRIC 12 *Service Concession Arrangements*”.

Due to the tight deadline, the following comments have been submitted without undergoing OIC’s ordinary due process.

In addition, our comments refer mostly to the motorways industry, as this may be considered representative of the most common issues pertaining to “Service Concession Arrangements” in Italy.

We have already commented on the previous Draft Interpretations, D12-14, and expressed our serious concerns on the accounting guidance thereon. The same concerns remain on IFRIC 12, which gives guidance on the accounting by operators for “public-to-private” service concession arrangements, while “private-to-private” service concession arrangements are not within the scope of IFRIC 12.

In Italy, “Service Concession Arrangements” are regulated by fairly specific provisions. As an example, motorway concessions are granted by ANAS Spa, the “grantor” (previously a public entity, now an ordinary joint-stock company), and are based upon government directives issued by the “regulator”, CIPE, an Interministerial Committee. All concessions have to be approved by the Infrastructure Minister and the Treasury Minister.

On 26 January 2007, CIPE issued a new directive which specifically requires, among other provisions, that infrastructure assets should be accounted for as property, plant and equipment and be depreciated as such.

Because of peculiarities of the service concessions in Italy and, last but not least, due to the fact that they refer to “ private-to-private” service concession arrangements (ANAS Spa being an ordinary joint-stock company), such arrangements would fall outside the scope of the interpretation. Accordingly, Italian operators would remain without the necessary accounting guidance.

It should be noted that, due to such specific features of this business sector in Italy, all the service concession infrastructures are treated as tangible assets of the operator (property, plant and equipment) and not of the grantor. As a matter of fact, for the grantor, ANAS Spa, it would be impossible to recognise the infrastructures as its own assets, not having the necessary information for their accounting (i.e. detailed listings of property items, their useful lives, maintenance programmes, etc) . Vice versa, the IFRIC Draft Interpretation provides only two models (the Financial Asset Model and the Intangible Asset Model) and both of them imply that infrastructure be recognised as assets of the grantor.

We firmly believe that, in order to reflect concession infrastructure as tangible assets, the “risk and rewards” control test, aimed at identifying the accounting model to be utilised, should not be excluded. The “risk and 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. In addition, it is a concept already adopted in other IAS/IFRS.

Some of the specific features of the motorways industry in Italy that support the requirement of maintaining the “risk and rewards” approach are as follows:

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.). In addition, at the expiration of the concession, either it is renewed or it is granted to another operator. Accordingly, the grantor will never obtain the use of the motorway infrastructures.

- b) The duration of the concession exceeds the useful life of a not 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 tariff is adjusted according to a formula, generally based on the “price cap” mechanism. As a consequence, the tariff is no longer controlled by the grantor as it is, in substance, influenced either by external parameters (i.e. forecast inflation) or internal parameters (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 tariff agreed in advance of the commencement of a capital investment project generally does not entitle the operator to recuperate losses caused by delays or cost overruns. Failure to complete projects within the planned timeframe and/or budget may have a material adverse effect on the operator’s result of operations or financial condition.
- f) The operator faces competition from alternative forms of transportation, such as high-speed rail, air and sea travel, which could reduce traffic and consequently the operator’s revenues.  
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.
- g) The accounting rules provided in the regulator directives, which are the same utilised by the operator to prepare its financial statement require the recognition of infrastructure as assets of the operator and that they be depreciated, accordingly - not necessarily on a straight-line basis. 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.

We also do not agree on the assumption made in the Intangible Asset Model, which considers the operator as receiving an intangible asset from the grantor in exchange for the construction of the infrastructure it provides to the grantor. Accordingly, the operator should recognise revenue and profit or loss on that exchange. We have already expressed our disagreement about such an assumption.

In substance, the cost incurred by the operator to build the infrastructure is the capital investment to operate the service concession; accordingly, the construction activity does not represent a

“revenue-earning activity “ of the operator. This is consistent with the previous comments of considering the infrastructure under concession as an asset of the operator ( i.e. “tangible asset”).

It is also to be noted that the Intangible Asset Model would require measuring the fair value of the “intangible asset” at the exchange. This would be very difficult because of the lack of a free market where concessions are traded. Concessions are, in fact, unique and are not replaceable assets. The IFRIC Draft Interpretation provides that 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. However, also in this circumstance, such fair value is impossible to measured or is highly arbitrary.

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In summary, taking into account how service concession arrangements are structured in Italy, we do not agree that the “control approach” is the best and the only criterion to determine the accounting model.

On the contrary, looking to the economic substance of the arrangements in Italy, we firmly believe that the “risk and rewards” approach should be maintained for determining who should recognise the service concession infrastructure as property, plant and equipment. It is worth mentioning that the definition of asset discussed at the World Standard Setters Meeting, last September, referred to the following definition: “An asset is a present economic resource to which an entity has a present right or other privileged access”. There is no doubt in Italy that, in addition to the ownership of the economic resource, the operator has a right or other privileged access to such resource (the infrastructure) and that resource is a tangible asset.

In addition, we do not agree with the IFRIC conclusion that the “risk and rewards” approach leads to complexities and that inconsistencies and it is difficult to apply to service concession arrangements.

The “risk and rewards” approach for asset recognition is still being maintained both in IAS 17 Leases and IAS 39 Financial instruments (paragraph 20), both revised as a result of the improvement project. Accordingly, we firmly believe that the “risk and rewards” approach is an essential term of reference to correctly determine who should recognise the infrastructure asset as property, plant and equipment in its balance sheet.

Should you need further clarification on the comments made in this letter, we would be pleased to discuss them further.

Yours sincerely,

Prof. Angelo Provasoli  
(OIC – Chairman)