

## Accounting Standards Board of Japan (ASBJ)

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International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sirs,

### **Comments on IFRIC D12-14 “Service Concession Arrangements”**

Accounting Standards Board of Japan (ASBJ) is pleased to make comments on IFRIC D12-14 “Service Concession Arrangements”. The views expressed in this letter are those of International Issues Standing Committee of ASBJ.

D12 treats the selection of accounting models from the viewpoint of whether the right obtained by the operator is a financial asset or an intangible asset. And it requires that revenue should be recognized at the same time as the right obtained by the operator is recognized, irrespective of which accounting model is adopted. However, we believe, in determining the accounting models to be applied, the greater focus should be put on the adequate timing of revenue recognition than on the type of the obtained assets. In our view, whether the asset obtained by the operator is a financial asset or an intangible asset, revenue should not be recognized when the future cash flow expected from the asset is contingent on the subsequent efforts by the operator. In other words, revenue should not be recognized until the result of the investment has been released from the risks of investment.

Regarding the intangible asset model in D14, we do not agree that revenue should be recognized when an intangible asset is obtained in exchange for the construction service. And regarding the financial asset model in D13, we believe that revenue should be recognized only when the operator’s contractual right to receive cash from the grantor is not contingent on the future operating activities (that is, the operator’s right is a receivable).

### **D14“Service Concession Arrangements-The Intangible Asset Model”**

We do not agree with the proposal of D14 that revenue and profit or loss shall be recognized when the operator provides the construction service or other services in exchange for the intangible asset. The reasons for our objection to D14 are explained below, using the example shown in BC12, where the operator builds a road at the cost of CU100, the fair value of the intangible asset obtained by the operator is CU105, and the total cash inflows over the term of the concession are CU200;

- Under the proposal of D14, the operator would recognize the total revenue of CU305, exceeding the total cash inflows of CU200. We believe this is an obvious overstatement of revenue. The fair value of the intangible asset (CU105) represents the present value of the future cash flows expected from the asset<sup>1</sup> (CU 200 in this example, which is the

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<sup>1</sup> In IE6 of D14, the fair value of the construction service is calculated by the markup on the construction cost. Even if such a method is to be accepted, its use should be limited to the cases where the amount calculated by

expected cash inflows from the road-operating activities). Therefore, both construction revenue (the present value of the future cash flows “expected” from the road-operating activities using the intangible asset) and service revenue (the cash flows “realized” through the road-operating activities) represent the same cash inflows generated by the road-operating activities. The proposal of D14 is double recognition of revenue at both the “expectation” stage and the “realization” stage of the same cash inflows.

- We suppose that the reason why D14 allows double recognition of revenues is that it views the road-construction for obtaining the intangible asset and the road-operation using it as two distinct investment projects (or two independent accounting units). However, in our view, the objective of investments is to obtain cash<sup>2</sup> that are not constrained by the business purpose. Therefore, the whole process from the investment of cash, in expectation of the future cash inflows, to the recovery of cash as the result of the investment should be viewed as a single investment project.

On this point, D14 regards the transaction obtaining an intangible asset as consideration for the road-construction as equivalent to the transaction obtaining cash not constrained by the business purpose. It consequently requires that revenue should be recognized when the intangible asset is obtained.

However, we believe those transactions have to be differently treated, even though the road is constructed in the same way. When cash is obtained as the result of the investment, the road-construction could be regarded as a separate investment project for which revenue should be recognized. On the contrary, when an intangible asset is obtained, it only means that the operator has obtained an asset necessary for road-operation for the purpose of obtaining cash that is the objective of the investment. In order to obtain cash that is the objective of the investment, subsequent operating efforts using this asset is necessary. Therefore, it is inappropriate to recognize revenue at this timing and revenue should not be recognized until cash is obtained through the road-operating activities. Such belief is based on the view that the whole process from the time when cash is invested (in the form of road-construction) in expectation of the future cash inflows to the time when cash is recovered through the road-operating activities should be considered as a single investment project.

- In addition, the future cash inflow that is the basis for measurement of the intangible asset is a mere expectation by the operator, at the time of its acquisition. Recognition of revenue based on such expectation might lead to recognition of internally generated goodwill, which is prohibited under IAS 38.
- As mentioned above, the proposal of D14 would drastically change the existing criteria for revenue recognition by introducing the asset-liability approach. However, the principles for revenue recognition are under consideration in the joint project of the IASB and the FASB. We do not believe that this kind of drastic change should be made without waiting for the conclusion of the revenue recognition project.

We believe that the operator’s expenditure on the construction is aimed at obtaining the intangible asset for the road-construction and the costs are accumulated in accordance with IAS38, like the views shown in paragraphs BC8 and BC9 of D14. In our view, revenue

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this method could be a surrogate of the present value of the future cash flows generated by the intangible asset. We consider it difficult to reliably estimate the fair value of the intangible assets obtained in service concession arrangements and therefore we believe that revenue recognition based on the fair value of such intangible assets would inevitably involve arbitrariness

<sup>2</sup> “Cash” in this context contains not only cash in a strict sense but also financial assets readily convertible to cash in the market without additional operating efforts.

should be recognized only when cash not constrained by the business purposes is obtained through the operating activities using the intangible asset. We believe that, in the example of BC12, the intangible asset should be initially recognized at the expenditure amount of CU100 and subsequently amortized over the term of the concession. And revenue should be recognized only for CU200, which is equal to the total cash inflows.

**D13“Service Concession Arrangements-The Financial Asset Model”**

We believe that, even under the financial asset model, revenue should not be recognized when the operator’s contractual right to receive cash from the grantor is contingent on the future operating activities, for the same reason we have explained in the abovementioned comments on D14.

**D12“Service Concession Arrangements-Determining the Accounting Model”**

D12 proposes that the operator shall apply the financial asset model when the grantor has the primary responsibility to pay the operator for the concession service the operator provides for, and that the operator shall apply the intangible asset model when the user has the primary responsibility to pay. However, we do not agree with the proposal because of the following reasons:

- As shown in the illustrative examples in D13 and D14, allocation of profit or loss on each period would significantly differ depending on which accounting model is applied. However, the meaning of “primary responsibility to pay”, which is the criterion for determining which accounting model is to be applied, does not seem to be always clear. There can be a case where both the grantor and the users take responsibilities for payment. Moreover, there are some ambiguities, including whether the case where the users directly pay to the operator would be treated differently from the case where the users pay to the grantor and the grantor pays a part of the toll to the operator.
- Under the criteria in D12, accounting consequence would differ between the two cases where the patterns of cash inflows are similar but the primary payers are different, for example, the cases where the payment to the operator (by the grantor or the users) is determined according to the actual traffic volume. It would go against the “substance over form” principle in the IASB Framework and undermine faithful representation that different accounting models would be applied and different profit or loss would be determined for the transactions which have similar economic substance.

We hope our comments will contribute to the discussion in both IFRIC and IASB.

Best Regards,

Ikuo Nishikawa  
Chairman, International Issues Standing Committee  
Vice-Chairman, Accounting Standards Board of Japan