

Nov 10, 2006

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

Dear Sirs,

Comments on the near-final draft of the proposed IFRIC Interoperation “Service Concession Arrangements”

Thank you for the invitation to the public meeting regarding the service concession arrangement. Since the date is not available for us unfortunately, we will not be able to attend the meeting. We wrote comments on the near-final draft of the proposed IFRIC Interpretation “Service Concession Arrangements” (hereinafter referred to as “the proposed Interpretation”) instead. The views expressed in this letter are those of International Issues Standing Committee of the Accounting Standards Board of Japan (ASBJ).

The proposed Interpretation 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. Regarding the intangible asset model, we do not agree that revenue should be recognized when an intangible asset is procured in exchange for the construction service. In our view, the operator should not recognize revenue when the future cash flow expected from the asset is contingent on the subsequent efforts.

The reasons for our objection to the proposed Interpretation are explained below, using the example shown in illustrative example 2, where the operator builds a road at the cost of CU1,034, the fair value of the intangible asset is CU1,084, and the total cash inflows over the term of the concession transaction are CU1,600;

- We believe that total revenue should equal cash inflows. However under the proposal of the proposed Interpretation, the operator would recognize the total revenue of CU2, 650, far exceeding the total cash inflows of CU1, 600. We believe this is an obvious overstatement of revenue. The fair value of the intangible asset (CU1, 084) represents the present value of the future cash flows expected from the asset (CU 1,600 in this example, which is the expected cash inflows from the road-operating activities). Therefore, both the present value of the future cash flows “expected” from the road-operating activities using the intangible asset and the cash flows “realized” through the road-operating activities represent the same cash inflows generated by the road-operating activities. The proposal of the proposed Interpretation is double recognition of revenue at both the “expectation” stage and the “realization” stage of the same cash inflows.

- The reason why the proposed Interpretation allows double recognition of revenues is that it views the road-construction for procuring the intangible asset and the road-operation using it as two distinct investment projects (or two independent accounting units) in paragraph BC34. However, in our view, the objective of investments is to obtain independent asset (cash¹) 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, the proposed Interpretation regards the transaction procuring 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 procured.

First of all, Service Concession is the individual transaction that the grantor assesses the operator as an adequate entity. The intangible asset granted usually does not have the market to buy and sell. It only means that the operator has procured 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, the only way is subsequent operating efforts for years using this asset. The operator can't sell the intangible asset on the open market. 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 (the objective of the investment) should be considered as a single investment project.

- In addition, the fair value of the construction service is calculated by the markup the construction cost in illustrative example 2. This is thought to be similar to recognizing the revenue (CU100) when an entity purchases some electromechanical device for CU1,000 that market price is CU1,100. Are there any existing criteria like this?
- As mentioned above, the proposal of the proposed Interpretation would drastically change the existing criteria for revenue recognition. 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 procuring the intangible asset for the road-construction and the costs are accumulated in accordance with IAS38. In our view, revenue 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 example2, the intangible asset should be initially recognized at the expenditure amount of CU1, 034 and subsequently amortized over the term of the concession. And revenue should be recognized only for CU1, 600, which is equal to the total cash inflows.

¹ "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.

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

Best Regards,

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