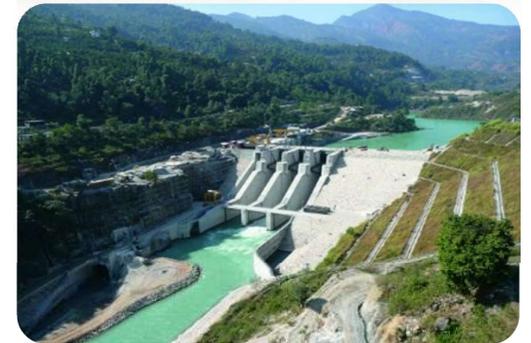


Service Concession Arrangements

IFRIC 12

Part 1



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IFRIC 12: Effective on or after 1 January 2008

Introduction:

Service Concession Arrangements (SCAs) is an arrangement whereby a government or other public sector body (i.e. grantor) contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy projects, prisons or hospitals. The grantor controls or regulates what services the operator must provide with the infrastructure, to whom, and at what price, and controls any significant residual interest in the assets at the end of the term of the arrangement. This type of arrangements are designed to develop infrastructures by reducing capital expense and government's role and also providing job opportunities for locals which are dictated in the project agreements with the private partners. For private sector, this opens a new avenue for investment.

Nepal's Context:

In developing countries like Nepal, this has become a very efficient way of achieving development targets by Public-Private Partnerships (a.k.a. PPP Model). Government's national priority projects like Nijgadh International Airport, Arun 3 Hydropower, Upper Karnali Hydropower, etc. are implemented under a concession arrangement.

Majorly concession arrangement is made in hydropower sector in Nepal. These companies obtained license for a specified period from the grantor, which is Government of Nepal, via Nepal Electricity Authority (NEA). Such license provides operator with the right to generate electricity and sell to Nepal Electricity Authority (NEA), as it is primarily the distributor company in Nepal. NEA signs PPA (Power Purchase Agreement) with the companies where the selling rate and other required terms are agreed.



Ongoing practice is to record the assets from these arrangements is under Property Plant & Equipment, which is not as instructed by the Nepal Financial Reporting Standard.



Three types of SCAs:

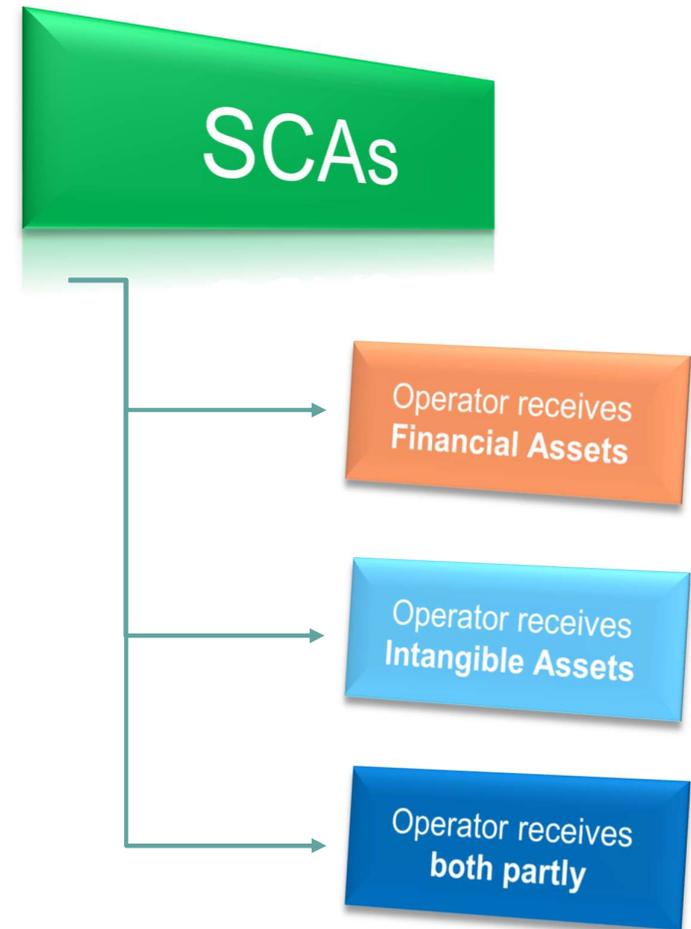
IFRIC 12 draws a distinction between two types of service concession arrangements.

In one, the *operator receives a financial asset*, specifically an unconditional contractual right to receive a specified or determinable amount of cash or another financial asset from the government in return for constructing or upgrading a public sector asset, and then operating and maintaining the asset for a specified period. This category includes guarantees by the government to pay for any shortfall between amounts received from users of the public service and specified or determinable amounts.

In the other, *the operator receives an intangible asset* – a right to charge for use of a public sector asset that it constructs or upgrades and then must operate and maintain for a specified period. A right to charge users is not an “unconditional right” to receive cash because the amounts are contingent on the extent to which the public uses the service.

IFRIC 12 allows for the possibility that both types of arrangement also may exist within a single contract. To the extent that the government has given an unconditional guarantee of payment for the construction of the public sector asset, the operator has a financial asset and to the extent that the operator has to rely on the public using the service in order to obtain payment, the operator has an intangible asset.

The summarized *illustrative examples* are explained hereunder:



IFRIC Application Illustration

Example 1: The grantor gives the operator a financial asset

Terms and Condition

Type	Period	Amount
Cost of Construction Service	1	500
	2	500
Operating Service p.a.	3-10	10
Road resurfacing	8	100
Tolls collected from Drivers	3-10	200 p.a.

Transaction price allocated to each performance obligation

Particulars	Fair Value
Construction services (over two years)(a)	1050
Operation services (over 8 years)(b)	96
Road resurfacing services (in year 8)(c)	110
Total	1256

Implied interest rate(d) **6.18% p.a.**

- > (a) The operator estimates the relative stand-alone selling price by reference to the forecast **cost plus 5 per cent.**
- > (b) The operator estimates the relative stand-alone selling price by reference to the forecast **cost plus 20 per cent.**
- > (c) The operator estimates the relative stand-alone selling price by reference to the forecast **cost plus 10 per cent.**
- > (d) The implied interest rate is assumed to be the rate that would be reflected in a financing transaction between the operator and the grantor.

Points to remember:

- ✓ -Amount due from the grantor is to be booked as contract asset
- ✓ Fairvalue of the construction service is transaction price or consideration paid to acquire the financial asset.

Contract Asset / Receivable **6.18%**

Year	Op Balance	Revenue	Finance Income	Receipt	CI Balance
1	-	525	-	-	525
2	525	525	32	-	1,082
3	1,082	12	67	(200)	961
4	961	12	59	(200)	833
5	833	12	51	(200)	696
6	696	12	43	(200)	551
7	551	12	34	(200)	397
8	397	122	25	(200)	344
9	344	12	21	(200)	177
10	177	12	11	(200)	0
		1,256	344	(1,600)	

Statement of Financial Position

Year	Amount due from Grantor	Cash/(Debt)	Net Assets
1	525	(500)	25
2	1,082	(1,034)	49
3	961	(913)	49
4	833	(784)	49
5	696	(646)	50
6	551	(500)	52
7	397	(343)	54
8	344	(276)	68
9	177	(105)	72
10	0	78	78

IRR **6.18%**

FV of Outflow	Receipt	Total
525	0	525
525	0	525
12	-200	-188
12	-200	-188
12	-200	-188
12	-200	-188
12	-200	-188
12	-200	-188
122	-200	-78
12	-200	-188
12	-200	-188

Cashflows **6.70%**

Year	Receipts	Contract Cost	Burrowing Cost	Net Cash Flows	Cumulative
1	-	(500)	-	(500)	(500)
2	-	(500)	(34)	(534)	(1,034)
3	200	(10)	(69)	121	(913)
4	200	(10)	(61)	129	(784)
5	200	(10)	(53)	137	(646)
6	200	(10)	(43)	147	(500)
7	200	(10)	(33)	157	(343)
8	200	(110)	(23)	67	(276)
9	200	(10)	(19)	171	(105)
10	200	(10)	(7)	183	78
	1,600	(1,180)	(342)	78	

Statement of Comprehensive Income **6.18%** **6.70%**

Year	Revenue	Contract Cost	Finance Income	Burrowing Cost	Net Profit
1	525	(500)	-	-	25
2	525	(500)	32	(34)	24
3	12	(10)	67	(69)	(0)
4	12	(10)	59	(61)	0
5	12	(10)	51	(53)	1
6	12	(10)	43	(43)	2
7	12	(10)	34	(33)	3
8	122	(110)	25	(23)	14
9	12	(10)	21	(19)	5
10	12	(10)	11	(7)	6
					78

IFRIC Application Illustration

Example 2: The grantor gives the operator a Intangible asset

Terms and Condition

Type	Period	Amount
Cost of Construction Service	Year 1	500
	Year 2	500
Operating Service p.a.	Year 3-10	10
Road resurfacing	Year 8	100
Tolls collected from Drivers	Year 3-10	200 p.a.

Amortisation of Intangible Assets

Cost	Calculation	Amount
Construction Service year 1		525
Construction Service year 2		525
Borrowing Cost capitalised till the year of construction	500*6.7%	34
		1084
Amortisation per annum over the year	1084/8	135

Points to remember:

- ✓ License to charge the drivers is Intangible Asset (IA)
- ✓ Construction service is the consideration paid to acquire the IA
- ✓ IA is amortised over the period of license
- ✓ Borrowing Cost during construction is capitalised
- ✓ Toll Collections are treated as revenue

Cashflows

6.70%

Year	Receipts	Contract Cost	Borrowing Cost @6.7%	Net Cash Flows	Cumulative
1	-	(500)	-	(500)	(500)
2	-	(500)	(34)	(534)	(1,034)
3	200	(10)	(69)	121	(913)
4	200	(10)	(61)	129	(784)
5	200	(10)	(53)	137	(646)
6	200	(10)	(43)	147	(500)
7	200	(10)	(33)	157	(343)
8	200	(110)	(23)	67	(276)
9	200	(10)	(19)	171	(105)
10	200	(10)	(7)	183	78
	1,600	(1,180)	(342)	78.27	

Statement of Comprehensive Income

Year	Revenue	Contract Costs	Borrowing Cost	Resurfacing Obligation	FC Relating to Resurfacing Obligation	Amortisation IA	Net Profit
1	525	(500)	-	-	-	-	25
2	525	(500)	-	-	-	-	25
3	200	(10)	(69)	(12)	-	(135)	(27)
4	200	(10)	(61)	(13)	(1)	(135)	(20)
5	200	(10)	(53)	(14)	(2)	(135)	(13)
6	200	(10)	(43)	(15)	(3)	(135)	(6)
7	200	(10)	(33)	(16)	(4)	(135)	2
8	200	(10)	(23)	(17)	(5)	(135)	10
9	200	(10)	(19)	-	-	(135)	36
10	200	(10)	(7)	-	-	(135)	48
	2,650	(1,080)	(308)	(86)	(14.44)	(1,084)	78

Resurfacing Obligation

6.70%

Obligation A/c

Year	Obligation	Years left	Present Value @6.7%	Year	Opening Balance	Finance Cost unwinding	CY Cost	Closing Balance
1	-	-	-	1	-	-	-	-
2	-	-	-	2	-	-	-	-
3	17	5	12	3	-	-	12	12
4	17	4	13	4	12	1	13	26
5	17	3	14	5	26	2	14	41
6	17	2	15	6	41	3	15	59
7	17	1	16	7	59	4	16	78
8	17	-	17	8	78	5	17	100
	100.00					14.44	85.56	

Statement of Financial Position

Year	Intangible Asset	Cash/(Debt)	Resurfacing Obligation	Net Assets
1	525	(500)	-	25
2	1,084	(1,034)	-	50
3	948	(913)	(12)	23
4	813	(784)	(26)	3
5	677	(646)	(41)	(10)
6	542	(500)	(59)	(17)
7	406	(343)	(78)	(15)
8	271	(276)	-	(5)
9	135	(105)	-	31
10	-	78	-	78

IFRIC Application Illustration

Example 3: The grantor gives the operator a financial asset as well as intangible asset

Terms and Condition

Type	Period	Amount
Cost of Construction Service	Year 1	500
	Year 2	500
Operating Service p.a.	Year 3-10	10
Road resurfacing	Year 8	100
Tolls collected from Drivers	Year 3-10	200 p.a.

Dividing the operator consideration

Cost	67%		33%	Total
	FA	IA		
Construction Service year 1	350	175		525
Construction Service year 2	350	175		525
	700	350		1050
Burrowing Cost capitalised upto construction @6.7%	22	11		33.5
	722	361		1083.5
IA amortised over 8 years		45.15		

Allocation of toll receipts

Particulars	Amount
Gauranteed Receipt	700
Finance Income	236
Total	936
Cash allocated to FA p.a.	117
Receipts attributable to IA	664
Amount received from IA p.a.	83

Cashflows

Year	6.70%				
	Receipts	Contract Cost	Burrowing Cost	Net Cash Flows	Cumulative
1	0	-500	-	(500)	(500)
2	0	-500	(34)	(534)	(1,034)
3	200	-10	(69)	121	(913)
4	200	-10	(61)	129	(784)
5	200	-10	(53)	137	(646)
6	200	-10	(43)	147	(500)
7	200	-10	(33)	157	(343)
8	200	-110	(23)	67	(276)
9	200	-10	(19)	171	(105)
10	200	-10	(7)	183	78
	1600	-1180	(342)	78	

Contract Asset / Receivable

Year	6.18%				
	Opening Balance	Amount Due	Interest	Receipt	Closing Balance
1	-	350	-	-	350
2	350	350	22	-	722
3	722	-	45	(117)	649
4	649	-	40	(117)	572
5	572	-	35	(117)	491
6	491	-	30	(117)	404
7	404	-	25	(117)	312
8	312	-	19	(117)	214
9	214	-	13	(117)	110
10	110	-	7	(117)	(0)
			236	(936)	

Statement of Financial Position

Year	Receivable	Intangible Asset	Cash/(Debt)	Resurfacing Obligation	Net Assets
1	350	175	(500)	-	25
2	722	361	(1,034)	-	49
3	649	316	(913)	(12)	40
4	572	271	(784)	(26)	34
5	491	226	(646)	(41)	29
6	404	181	(500)	(59)	26
7	312	135	(343)	(78)	26
8	214	90	(276)	-	28
9	110	45	(105)	-	51
10	(0)	-	78	-	78

Resurfacing Obligation

6.70%				Obligation A/c				
Year	Obligation	Years left	PV@6.7%	Year	Opening Balance	Finance Cost	CY Cost	Closing Balance
1	-	-	-	1	-	-	-	-
2	-	-	-	2	-	-	-	-
3	17	5	12	3	-	-	12	12
4	17	4	13	4	12	1	13	26
5	17	3	14	5	26	2	14	41
6	17	2	15	6	41	3	15	59
7	17	1	16	7	59	4	16	78
8	17	-	17	8	78	5	17	100
	100.00				14.44	85.56		

Statement of Comprehensive Income

Year	Revenue from Construction	Revenue from IA	Finance Income	Amortisation	Resurfacing Obligation	FC Relating to Resurfacing Obligation	Contract Costs	Other Contract Cost	Burrowing Cost	Net Profit
1	525	-	-	-	-	-	(500)	-	-	25
2	525	-	22	-	-	-	(500)	-	(22)	24
3	-	83	45	(45)	-	(12)	-	(10)	(69)	(9)
4	-	83	40	(45)	(1)	(13)	-	(10)	(61)	(7)
5	-	83	35	(45)	(2)	(14)	-	(10)	(53)	(5)
6	-	83	30	(45)	(3)	(15)	-	(10)	(43)	(3)
7	-	83	25	(45)	(4)	(16)	-	(10)	(33)	(0)
8	-	83	19	(45)	(5)	(17)	-	(10)	(23)	2
9	-	83	13	(45)	-	-	-	(10)	(19)	23
10	-	83	7	(45)	-	-	-	(10)	(7)	28
	1,050	664	236	(361)	(14)		(1,000)	(80)	(331)	78

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