



FLA RESPONSE TO THE IFRIC DRAFT INTERPRETATION D12: *Service Concession Arrangements—Determining the Accounting Mode*

1. This is the response of the Finance & Leasing Association (FLA) to the IFRIC consultation on Draft Interpretation D12 and the associated control model.
2. The FLA is the major UK industry body for the asset finance, consumer finance and motor finance sectors. Our full members provide asset finance to business, consumer credit, point of sale, credit card and instalment finance. Our associate members provide services or goods to those industries and support the Association's vision.

FLA members provided £25.0 billion of asset finance to the business sector and UK public services, representing over a quarter of all fixed capital investment in the UK in 2004 (excluding real property).

3. Our general comment is that the draft has caused a good deal of debate among our members about the intended scope of this draft and whether or not it has any implications for the project on lease accounting under way at the IASB, with the participation of the UK Accounting Standards Board.

Clarifying the scope

4. In particular, we think it would be helpful if the final version made clearer that, as we believe is the intention, the draft is not generally intended to apply to out-sourcing from the public sector. Although a service is often being supplied in such circumstances, the commercial practices and their financial and accounting implications are quite different from those contracts at which D12 seems to be aimed, such as toll roads and PFI hospitals. We think the key may lie in condition (b) of paragraph 5, but it would be useful to clarify this by including in Appendix C one or two examples of outsourcing arrangements that are outside the scope, with appropriate explanation. We take it that D12 is not aimed at purely private sector out-sourcing arrangements.
5. In that context, it would also be helpful to spell out the definition of 'infrastructure'. The current draft seems to go much wider than its customary meaning in everyday speech, where it refers to roads, railway lines, energy distribution networks and so forth. It seems to cover, for example, hospital laundries, which are not usually referred to as 'infrastructure' and raise quite different accounting and commercial issues. If, as we presume is the case, equipment and facilities in the latter category were not meant to be covered, it would be helpful to clarify this.



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Interpretation and policy on accounting standards

6. Second, we recognise that the draft uses a proposed control model to tackle some very difficult technical issues. But we think that it has gone well beyond interpreting standards, into the policy debate which is more appropriate to the IASB itself. In particular, the discussion of risk and reward seems to us to pre-judge a debate which is yet to be had in the context of lease accounting. We are not saying that it was the intention to pre-judge that debate, but the draft runs the risk of having that effect.
7. For example BC11 of the draft says that IFRIC that “noted that the risks and rewards approach as applied in IAS 17 leads to complexities and inconsistencies in lease classification and could be difficult to apply to service concession arrangements, especially those in which users pay for the concession services or large elements of the payments are contingent on usage.” This is a controversial statement, which must be examined closely as the work on replacing IAS17 progresses, not in this context.
8. In commercial reality, the question of control can often be complex. For example if a lessor is financing an IT investment under conditions stipulated by the manufacturer, it is more realistic often to view the manufacturer as in control, including of the likely residual value of the equipment, rather than the lessor, even though the latter holds legal title to the equipment. What the draft has to say about control is innovative and worth further debate, but it is a contribution to the policy on standard-setting, not an interpretation of existing standards.
9. Similarly, the draft runs the risk of converting many sale and leaseback transactions to financings: again a policy issue that needs close and thorough debate. In particular, BC20 of D12 asserts the primacy of IAS 18 over IAS 17 with the statement that "without the IAS 18 conditions for a sale being met, there cannot be a sale and leaseback". We strongly disagree. Paragraphs 58-65 of IAS 17 set out specific requirements for sale and leasebacks, and specifically contemplate that the leaseback may be either a finance lease or an operating lease. The IFRIC's assertion must be wrong because, if the IAS 18 conditions had to be met, there would be no such thing as a sale and finance leaseback, and the vast majority of sale and operating leasebacks would not qualify either, which would render these paragraphs (which are well established and understood) largely otiose.

Other matters

10. There are two other matters that the FLA wishes to raise.

(1) Financial asset vs intangible asset

11. We do not agree with where the boundary between the financial asset model and the intangible asset model has been drawn. The consultation paper bases it entirely on who has the primary responsibility to pay, but this makes it much too easy to get out of the financial asset model and into the intangible asset model. Two simple examples are:
- (i) Operator is entitled to keep fixed amounts from users. Grantor guarantees these amounts and any surplus income goes to grantor.
 - (ii) Operator keeps all receipts until its specified IRR is met, when the asset reverts to the grantor.
12. The substance in both cases is obviously a financing but they will be intangibles under the proposals. Grantors will like this because (although not specified in D12-14) the implications for their accounting are very favourable.

(2) Loan or receivable vs available-for-sale (AFS) asset

13. Under the financial asset model in D13, the consultation paper says that the financial asset must be accounted for as an AFS asset (marked to market through equity) rather than a loan or receivable (normally at amortised cost) if failure to fulfil an operating condition (service quality, availability) leads to non-payment. This is justified by reference to the definition of loans and receivables in IAS 39 which excludes assets where the holder may not recover substantially all of its initial investment for reasons other than credit deterioration.
14. This seems to the FLA a mistake. Non-payment in this case is in substance liquidated damages for unsatisfactory performance: ie it has to do with the operating phase and should not affect the accounting for the receivable in respect of the supply of the physical asset.

Finance & Leasing Association
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