



23 JAN. 2007

Mr. Stig Enevoldsen
EFRAG Chairman & CEO
Avenue des Arts/Kunstlaan 13-14
1210 Brussels
Belgium

Madrid, 22th January 2007

Dear Mr. Enevoldsen,

I take the liberty of addressing to you, on behalf of our associated member companies, our comments on the Interpretation-IFRIC-12 *Service Concessions Arrangements* that has been approved by IASB and is now in the Agenda of the incoming EFRAG Board Meeting.

SEOPAN is the Federation of the main construction and infrastructure companies in Spain. The members of SEOPAN own total or substantial equity participation in 158 contracts of transport concessions in 26 countries. These concessions total an investment value of 120 billion Euros. It is not exaggerated to state that these companies represent a major share of this industry in the world.

We wish to inform you on the reasons why, in our opinion, the present IASB interpretation should not be approved by EFRAG. These reasons may be divided in two groups: those related to accounting principles and those directly linked to the eventual difficulties that this approval will represent for the future investment in European infrastructure and for the role of the European companies in this growing industry through the world.

Reasons related to the accounting principles applied:

- The division of concession contracts between financial assets and intangible assets is artificial.
- The intangible asset model shows big losses in the first years of operation and huge profits in final years that are both not realistic.



- Therefore, the accounting results do not reflect the true image of the underlying business and then, the interpretation is contrary to the “true and fair principle” set out in Article 16 (3) of Council Directive 83/349/EEC and Article 2 (3) of Council Directive 78/660/EEC; and does not meet the criteria of understanding, relevance, reliability and comparability assessing the stewardship of management
- Concessions that show huge losses due to the accounting model are nevertheless increasing their value year by year, as proven by the prices of exchange of shares in said business. To verify the above statement it is enough to compare the accounting results shown by a financial participant -an investment fund- in one of those businesses, and an industrial participant in the same business. The first acknowledges a substantial profit where the second is obliged to present losses to the markets and to its own shareholders in the same accounting period.
- There is no consideration of the important legal provisions linked frequently with concessions contracts. The economic balance of the contract, an acknowledged principle in countries with a secular experience in this type of activities is not taken into account, though it represents a substantial change in the share of risks between grantor and concessionaire.

Other reasons linked to the negative effects that this regulation will have in Europe or for European Groups worldwide are:

- The interest of the industry and especially of the construction groups for the type of concessions where the user pays will decrease. Nobody likes to assign substantial investments to a business that is to show ineluctably huge losses in the near future.
- This interpretation opposes or does not facilitate the clear intention of the EU to promote this type of contracts that do not represent an increase of the public expense, as a way of accelerating the development of European infrastructure, especially in the New Accession Countries.

We enclose a document (Annex 1) explaining alternative accounting treatments to solve the problem, also according to IASB framework. One group of these alternatives would suppose to change the revenue recognition criteria in the case of the intangible asset model (i.e. percentage of completion) and a second group will suppose a more extensive application of the financial asset model.



We trust that the high qualification and high concern of EFRAG members on this matter will drive them to recommend to the European Union the **non endorsement** of the present IFRIC proposal.

We will be very pleased to provide all our collaboration to ensure that the European Union has a fair and reliable accounting system without hindering the competitiveness of its own systems and of the European groups.

Sincerely Yours,

Enrique de Aldama y Miñón
President of SEOPAN

(*) Document 1 is enclosed.



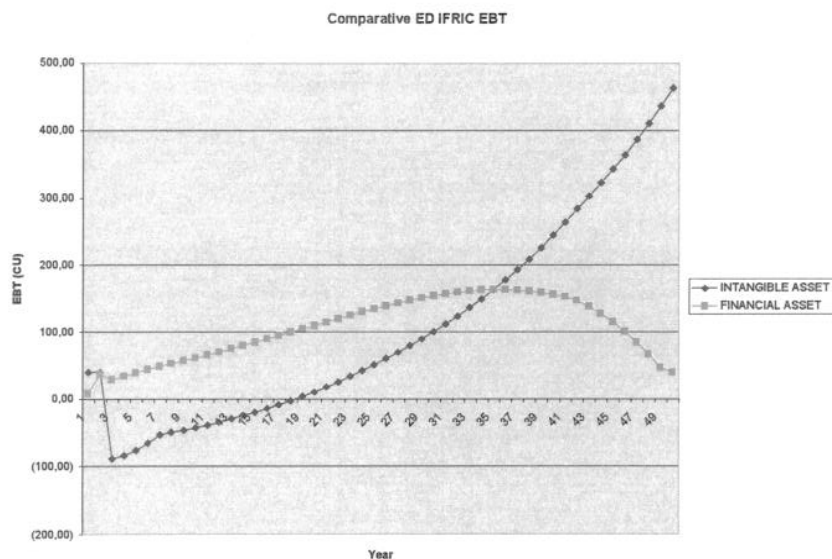
APPENDIX 1 ALTERNATIVE ACCOUNTING TREATMENTS FOR CONCESSIONS

Background

IFRIC's draft interpretation on concessions "IFRIC 12" fundamentally establishes two distinct accounting models: The "Financial Asset" model (the concession holder records the cost of the infrastructure as a financial asset) and the Intangible Asset Model (the concession holder records the cost of the infrastructure as an intangible asset that amortises over the concession period). Whether the Intangible Asset model or the Financial Asset model should be applied (or the extent to which each should be applied) is to be determined by, in summary, asking whether the operator is exposed to demand risk. If (and to the extent that) it is exposed to demand risk, it has an Intangible Asset and if (and to the extent that) it is not, it has a financial asset.

The IFRIC interpretation does not contemplate, except in the concessions accounted for under the Financial Asset Model, any solution to prevent significant book losses being recorded during the first operating years, in generally profitable agreements, primarily due to the impact of financial expenses arising from the high level of debt which is normal in these types of projects, and the application of an amortisation criteria that differs from the consumption/use of the asset. The practical application of this interpretation for a typical concession would establish the following income statement profile:

- Concession type: Toll road
- Concession duration: 50 years
- Expected investment (2 years of construction): 800 mu. For simplification, replacement investment is not considered necessary.
- Initial financial structure: 20% shareholders' equity and 80% debt over 40 years with a 5% fixed interest rate.
- Traffic growth: 3% annually
- Inflation: 2.5% annually
- Straight line amortisation of the intangible asset





The fact that the IFRIC interpretation propose two completely different accounting models exclusively based on demand risk analysis can create situations in which two concessions with the same economic basis and similar risks should make highly disparate accounting entries depending solely on a subjective and sometimes a borderline conclusion on the sharing of risk between the operator and the grantor. Also, it will favour the extension of models based on payments for availability with in fact are mixed models (payments for availability subject to the fulfilment of certain conditions that, not formally but in fact, depend on demand), given rise to subjectivity and abuse on the application of the accounting rules.

Also, we believe that, for concessions to be accounted for under the intangible asset model, to record significant operational losses in a concession's first years which, when considered as whole, is profitable and whose economic and financial plan contemplates the recovery of the financial expenses and the remaining operational costs in the long term, is not, for the majority of infrastructure concessions, representative of the true and fair view of the concession's results or contributes to increasing the reliability and value of the financial statements for users. Moreover, neither is it representative of the true and fair view to record highly significant results in the last years of the concession that may cause social concerns and subsequent political complications.

Moreover, it should be considered that a new type of investor has become established in the sector for the development and private financing of infrastructure projects, who have been competing with the traditional investors in this type of business. These investors are the infrastructure investment funds, the most important of which originated in Australia, although they have also appeared in the USA.

These investors take up major holdings in contracts in which the intention to maintain a long-term holding influences their management, even though they do not take a majority holding. Now, with the existing IFRS standards, a paradox occurs, in that this type of investor, to whom the IFRS standards apply (for example, the IFRS standards are already of mandatory application in Australia), is nevertheless exempt from being required to apply the standards mentioned above because they are investment funds; such standards should require them to recognise major losses, but in their financial statements they are posting the vast majority of their holdings in DBFO companies as financial assets valued at fair value instead, thus recognising major capital gains for the year in their profit and loss accounts.

In practice, what is happening is that for one and the same contract, one and the same standard, and one and the same financial year, one investor, with a holding of 55%, is recognising considerable losses, and another investor with 45% of the same contract is posting significant profits, simply because it is an investment fund.

This situation, apart from generating a situation where the financial statements of different investors cannot be compared, is further proof that the general accounting regime presented for the DBFO contract business by IFRIC does not reflect a true and fair image because if the investment is analysed from the point of view of the existing IFRS standards applicable to investment funds, one reaches the conclusion that the projects are capable of generating profits from the very beginning if the project is profitable as a whole (which is coherent with the proposal to analyse the contract as a whole), while by applying the general standards proposed by IFRIC significant losses are produced during the initial financial years of the operation.

Based on the above, the practical application of this interpretation could have highly negative consequences on the development of this type of business, since:



- It will worsen the perception of the business in the capital markets since companies operating in these markets will have to recognise significant losses in the first operating months.
- It will substantially reduce the interest of potential investors and promoters, because:
 - they will have to post significant book losses even in projects which are profitable and which create significant value for their shareholders;
 - they will find that their capacity to receive dividends from the DBFO companies is restricted;
 - there may occur situations in which the DBFO companies are in technical bankruptcy during the first few years of their operations, when these are financial years in which the costs of finance are at their highest while operating revenues are at their lowest. This will make it necessary for the shareholders, or sponsors, to inject additional capital as a result of a legal requirement to balance the equity situation of a company when the company's own funds are significantly reduced as a consequence of the accumulated losses.

All of these factors have the consequence of a negative impact on their rates of return, and this will mean that this type of project is not attractive to private initiative.

The factors mentioned have been decisive in the economic success of transport infrastructure contracts, because they have had a significant impact upon decision making by private infrastructure promoters, even to the point of determining the positions taken by companies in this sector of business activity. Last but not least, the application of the interpretation will favour the entering in the market of financial type investors, the majority of them based out of the European Union, versus industrial promoters, mainly based in EU countries.

Proposed Actions

Based on the above, a series of actions must be implemented aimed at providing a satisfactory accounting solution for the concession industry within the European Union framework. The specific actions proposed are:

- That the IFRIC 12 interpretation is not recommended for endorsement by the EFRAG and that the Accounting Regulatory Committee (ARC) of the European Union decided not to approve IFRIC 12.
- That the IASB approves the development of a specific standard for the concession sector.
- That, as a provisional measure, while the above IFRS standard is being developed, the accounting standards of each country continue to apply, under certain conditions.

As a second best alternative, the industry would not oppose to the approval of IFRIC 12 by EFRAG and UE if the interpretation is amended permitting a widening of the application of the financial asset model as explained below.



Alternative accounting treatments under a new IFRS standard

The first step to consider should be the development by the IASB, under the auspices of the European Union, of a new specific IFRS applicable to infrastructure concession agreements, which contemplates the characteristics of this type of enterprise and that, free from the restrictions that are intrinsic in any IFRIC interpretation, provides a solution that reflects a true and fair view of the financial status of concession companies, taking into account the project as a whole. Therefore, the development of a specific IFRS for the concession sector could take some of the following alternatives taken into consideration:

- Percentage of completion accounting (preferred alternative)
- Regulatory asset accounting
- Fair value accounting

Percentage of completion accounting

We believe that it is consistent with IASs 11 and IAS 18 for percentage of completion accounting to be adopted in accounting for the operating phase of Transport Infrastructure Concessions that currently fall within the scope of the intangible asset model, as long as relevant criteria are met.

IFRS provide the following basis for conclusions:

- IAS 18 (Revenue) and IAS 11 (Construction Contracts) require the percentage of completion method when the outcome of a transaction involving the rendering of services can be estimated reliably (IAS18, paragraph 20 and IAS 11, paragraph 22). The objective of the percentage of completion method is to reflect appropriately over time the revenues and expenses generated by long-term contracts for the rendering of services or construction contracts, respectively.
- It should be noted that generally Transport Infrastructure Concession contracts (especially Public-Private contracts) meet the criteria established under the existing IFRS to qualify for a percentage of completion type accounting, as the outcome of the contract can generally be estimated reliably (IAS 11.23, IAS 18.20), it is probable that the economic benefits associated to the contract will flow to the enterprise (IAS 11.28, IAS 18.20), the stage of the completion of the transaction at each balance sheet date can be measured reliably (IAS 11.23, IAS 18.20), the costs incurred for the transaction and the costs to complete the transaction can be measured reliably (IAS 18.20) and the contract costs attributable to the contract can be clearly identified and measured reliably so that the actual contract costs incurred can be compared with prior estimates (IAS 11.23).
- IAS 11.27 establishes that when a contractor has incurred contract costs that relate to future activity under the contract, such costs are recognised as an asset provided it is probable that they will be recovered. Finance costs could be considered as a contract cost in Public-Private concession arrangements, as they meet two of the requirements set forth in IAS 11.16 (costs that relate directly to the project or are attributable to the project activity) and may even be deemed to meet the requirement of being specifically chargeable (recovered) by the customer (grantor/users) under the terms of the contract.



Therefore, considering the economic and financial substance of certain Transport Infrastructure Concession contracts, IAS 11 and IAS 18 could provide sufficient basis for applying the percentage of completion method to service concessions, as paragraphs 22 and 23 of IAS 11 and paragraph IAS 18.20 require percentage of completion accounting when the same criteria are broadly met.

In this connection, the standard-setters of some jurisdictions currently permit or require the deferral of finance costs and other initial costs in some service concessions arrangements. The capitalization rules in these jurisdictions give results, in terms of revenue recognition over the concession periods, similar to the application of percentage of completion accounting to service concession arrangements, and are subject solely to the requirement to provide “reasonable evidence” that future revenues will permit the recovery of previously incurred costs. For these purposes, there is deemed to be “reasonable evidence” if all of the following conditions are met:

- It is likely that future revenues will be generated for an amount at least equal to the sum of the capitalised costs, through the inclusion of such expenses as a part of permitted costs for the purposes of establishing tariffs.
- There is sufficient evidence that future revenues will permit the recovery of the prior costs incurred. This point requires that it should be the clear intention of the regulator that at least the amounts capitalised be recovered against future revenues. In this regard, there is deemed to be such an intention whenever the costs are included in the concession’s Business Plan (BP) and the latter has been formally approved by the grantor.
- In view of the demand for the services or products and the level of competition, both direct and indirect, it is reasonable to assume that rates are set at levels that will enable the company's costs to be recovered and that they can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalised costs.

The extent to which the costs can be recovered is subject to approval by the regulator (i.e. meaning the approval of the rate adjustment rather than approval of its detailed calculation). In some cases, the principle of systematic recoverability is referred to in the service concession arrangement but the detailed process for achieving such recoverability is not described and applied in full, whereas in other cases such reasonable assurance as to the recoverability of costs cannot be directly inferred from the contractual terms and conditions.

Also, in most Transport Infrastructure Concession contracts Government guarantees co-exist with the principle that the risks and the business venture pertain to the concession operator. Therefore, the core issue is to assess whether the prevailing economic logic is one where the concession operator retains substantially all the risks and rewards related to the activity or one where the concession provider is mitigating the risks to a level at which percentage of completion accounting is reasonable.

Finally, the application of percentage of completion in the recognition of income and expenses in long term contracts is also contemplated in UK accounting rules. In this sense, paragraph 7 of SSAP 9 "Stocks and long term contracts" establishes that “Owing to the length of time taken to complete such contracts, to defer recording turnover and taking profit into account until completion may result in the profit and loss account reflecting not so much a fair view of the results of the activity of the company during the year but rather the result relating to contracts



that have been completed in the year. It is therefore appropriate to take credit for ascertainable turnover and profit while contracts are in progress in accordance with paragraphs 8 to 11 below". These paragraphs establish that the requirement for the application of percentage of completion will be "that the outcome of a long term contract can be assessed with reasonable certainty before the conclusion of the contract"

The percentage of completion method – a method recommended to the IASB by the international "Concessions Group" provided certain conditions are fulfilled – was discarded by the IFRIC because this method "does not permit the deferral or the capitalisation of costs, unless they are costs which are related to future activities and their recovery is probable". However, we understand that there are solid arguments in the IFRS literature for allowing the application of the percentage of completion method in the accounting of concession contracts.

The argument of the IFRIC that concession contracts cannot be recorded in accordance with the percentage of completion method because the deferral of costs or their transformation into assets is not permitted, unless they are costs related to future activities whose recovery is likely, can be refuted. In this respect, if we centre on the costs related to future activities, we conclude that the initial costs (including finance costs) can be considered as costs of future activities, due to the fact that they are related to the raising of funds which are necessary for the global execution of the project (financial, construction and commercial operation), which would allow them to be considered as costs which are "used" during the whole of the period of the concession. If there is sufficient evidence that the future income will enable the initial costs incurred to be recovered, there will be sufficient arguments for recognizing these costs as an asset.

The arguments that the percentage of completion method should not be applied in concession contracts that refer to very long periods, on the basis that the revenue and expenses of these projects can rarely be reliably measured, and that any potential solution that allows revenue and expenses to be correlated should be based on the concept that there is a certainty of recovering the costs incurred, implies more burdensome requirements for Transport Infrastructure Concession contracts than those established for other issues, such as accounting of goodwill and business mergers, provisions for deterioration, development costs and fair value accounting of investment properties. In this aspect, the IFRS accept the use of long-term estimates for the accounting recognition of some transactions (goodwill and acquisitions) and for the recognition of assets (as in the case of development costs) based on the fact that revenues will "probably" (instead of "certainly") be able to be obtained in the future.

In any event, we believe that it is possible to estimate, on a reasonable basis, the key variables relative to the economic and financial performance of the concession (for example traffic, changes in tariffs, costs of operation and maintenance, etc.). It should be emphasised that the greater part of the costs of these projects (initial investment and related finance costs) have a significant degree of certainty when the asset becomes operative and that many countries have decades of experience in infrastructure projects with independent experts carrying out estimates of revenue and demand with a high degree of precision. Other characteristics of this type of contract should also be considered in evaluating the applicability of percentage of completion accounting for service concessions:

- Investors consider this type of transport infrastructure investments (for example toll highways) as projects with a low level of risk, due to the fact that it is possible to make reliable estimates of future revenue, investments and costs. These estimates are normally made by independent experts.



- The low level of risk is the reason why this type of project is habitually financed with bank debt without any type of recourse to the sponsors/shareholders of the project. Banks use the estimates of the independent experts for taking decisions in relation to the financing of these projects.
- The estimates made by the concession holder are normally presented and approved by the Government, in the form of a Project Economic and Financial Plan. This means that there is formal or implicit approval from the Government, at inception, of the economics of the Project. It should be noted that this is a regulated industry, since concession companies cannot set prices, which are fixed by the administrative authority based on considerations that take the character of the infrastructure's public service into account. European regulations on agreements with public authorities and specific regulations on administrative concessions regulate the general aspects affecting concession activities.
- In certain countries concession arrangements include certain guarantees from the administrative authority (equilibrium of the financial plan, regulated prices, maximum and minimum returns that can be obtained by the concession holder, restriction of competition to the benefit of the concessionaire, etc). The execution of these guarantees, which can occasionally cause significant changes in the project's structure and time frames, in order to maintain and ensure the appropriate economic and financial equilibrium of the project, is always evaluated by comparison with the initial Project Economic and Financial Plan.

In summary, we believe that the application of the percentage of completion method to concession contracts is consistent with IAS 11 and IAS 18. Determining whether a specific project complies with the necessary conditions for applying the percentage of completion method should always be a subject in which companies and their auditors should apply their professional judgment – but while taking into account that it cannot be concluded that in the majority of these types of contracts there is “reasonable evidence” that the necessary conditions for applying the percentage of completion method are present.

Regulatory asset accounting

The staff of the IASB proposed to IFRIC in their meeting in March 2004 that if the concession holder had the right to recover the costs incurred, a method that eliminated the timing disparities between a concession's revenues and expenses could be acceptable in the IFRS. This solution was not accepted by IFRIC.

The IASB staff analysed the accounting treatment of the rights to recover the costs incurred in two jurisdictions: the generally accepted accounting practices of the USA (US GAAP) and Spain's accounting standards. The IASB staff concluded that an accounting treatment similar to that established in both jurisdictions for financial expenses and other costs incurred could also be appropriate under IFRS. The provisional recommendations of the IASB staff determined that a “regulatory” asset for to the right to recover the costs incurred should be recognised when:

- It is fair to assume that prices may be set at levels that allow the company's capitalised costs to be recovered.
- It is likely that they are set at these levels



- There is sufficient evidence that future revenues will allow previously incurred costs to be recovered
- The following conditions are fulfilled:
 - a) The prices of the products or services provided are (i) set by, or subject to approval by an independent regulator and/or (ii) established by a contractual mechanism. The IASB staff indicated that US GAAP legislation would not allow the capitalisation of costs in case (ii). Nevertheless, it is considered that in order to achieve comparability between jurisdictions, and to ensure that the contracts with a similar commercial impact are accounted for in a similar way, case (ii) should be allowed; which also includes the perspective of the IASB staff that the bases for recognising a regulatory asset are implicit in the agreement and,
 - b) (i) prices are designed to recover the specific costs which the company incurs through providing its services, or (ii) if there is sufficient evidence that the prices will allow the company to recover the costs incurred. The IASB staff also indicated that case (ii) is not permitted under US GAAP, but is consistent with the previously mentioned point of view that the bases for recognising this type of asset are implicit in the agreement.

The fundamental reason to finally dismiss the creation of a regulatory asset comes from the fact that IFRIC is an entity that merely interprets the IFRS and the creation of this asset was outside of its scope. This restriction would not apply in the event of developing an IFRS standard for concessions.

Fair value accounting

The International Accounting Standards (IAS 40) allow valuation of real estate investment properties at fair value. IAS 40 itself indicates that this rule is the first in which the IASB has introduced an accounting model based on fair value for non-financial assets. In the rule itself it is mentioned that many of the comments received on the IAS project support this step, although a similar number have significant reservations, both from the theoretical and from the practical point of view, about extending the fair value model to non-financial assets.

Also, some gave the opinion that certain real estate investment markets are not sufficiently mature for this fair value model to function satisfactorily.

Finally, the IASB took the view that it was appropriate to apply the fair value model to investment in real estate. This development is a step that will permit those who prepare and use financial statements to obtain more experience working with this fair value model, and will give time for certain real estate markets to attain greater maturity.

We believe that a model similar to that proposed for real estate properties could be authorized for those sectors of the concession industry that comply with certain characteristics (among others, cash flows that are predictable as from a given moment, and regulatory stability).

In this respect, as explained before, it should be pointed out that this criterion is the one that the IFRS are applying when the partners who play a part in DBFO contract are investment funds and have no majority shareholding, a situation which, if the IFRIC interpretation was approved, places traditional investors in the DBFO business in the European Union in an unfavourable position *vis-à-vis* their competitors, basically investment funds from Australia and the United States of America, in respect of the accounting treatment which they apply to their projects.



We understand therefore that a model similar to that applied by the IFRS for investment funds in infrastructure or for property investment funds should be perfectly acceptable for all other investors in this type of business activity. The fact that the fair value model for concession accounting is, in fact, currently being accepted for investment funds in the concession industry is a probing argument that the fair value model for this industry has sufficient maturity to be applied.

It is important to note that, in any alternative being considered, including the percentage of completion method, an annual impairment test must be carried out comparing the global revenue and expense forecasts for the business with the actual figures. Companies must recognise an impairment loss when the book value of the asset exceeds its recoverable value, taken as the greater of the net realisation value or the present value of the future cash flows. This obligation is an additional guarantee to be incorporated in the proposed new IFRS standard.

Widening of the application of the Financial Asset Model

We understand that the dividing line between the Financial and the Intangible Model should be drawn considering whether the effect of the contractual arrangements provides the concession operator with sufficient evidence that the cost of the infrastructure will be recovered.

The basis for this proposal is that, because of the nature of infrastructure concession companies, the sector is highly regulated, and presents a series of distinguishing features, some of which are highly relevant to the specific accounting treatments applicable to their activities. These are briefly described below:

1. Concessions are provided for in the legislation as a special kind of public works contract (public works concession agreement). Pursuant to such contracts, a government agency charges a private individual or legal entity with the performance of specified construction, refurbishment, repair, maintenance or demolition work in connection with real assets (e.g. roads, railways, ports, canals, dams, buildings or airports). The consideration obtained by the entity awarded the concession consists of the right to operate the asset or the right to operate coupled with the right to charge users a price. Operation is undertaken at the risk and for the profit of the concession holder.
2. European legislation governing contracts with government agencies and specifically referring to government concessions regulates general aspects of the concession's activities, such as the nature of tender processes, the maximum term of projects, general obligations assumed by the contractor, the possibility of government imposed modifications to the service contracted, grounds for rescission, the remuneration system under which the concession holder earns a return, the tariff regime (tariff review system, applicable schedules, bonuses and discounts), applicable financing systems, the financial regime of the concession, the extension of the statutory object of concession companies to include other activities (e.g. operation of service areas, service stations, integrated transportation centers or parking lots) and numerous other issues.
3. Since the applicable regulations (included in legislation related to Government contracting and specific regulations applicable to the transport infrastructure concessions sector) are of a general nature, the definition of a large part of the variables affecting the economic management of the project (applicable tariffs, other financial compensation for the entrepreneur, maximum and minimum returns for the concession holder, the volume of own



funds, minimum guaranteed traffic volumes, specific conditions and mechanisms to redress the financial balance of the contract, distribution of risks, etc.) is left to the terms and conditions of the award (i.e. the concession agreement).

4. Tariffs, which are regulated by government, are applied to guarantee the recovery of all costs inherent in the concession project, including financial expenses.
5. The projects are for a limited period with a long time horizon. The term of the project is a determining factor for its economic and viability and the conditions of financing, as well as for the rates of return obtained by the concession holder.
6. Tenders for concessions must include an Economic and Financial Plan (hereinafter EFP) containing forecasts for all relevant figures connected with the economic and financial management of the project (e.g. forecast traffic, evolution of tariffs, depreciation charges, financial expenses and cash flow generation), as well as detailing the assumptions and hypotheses employed in the calculation thereof (inflation forecasts, interest rates, traffic growth, operating revenues and expenses, resurfacing work, etc.).
7. The risk and expectation of profit assumed by the concession holder coexist with guarantees on the part of Government in order to underpin the financial balance of the concession.

Although differences exist between the legislation prevailing from country to country, it is in general the case that the features enumerated above (i.e. Government regulation, limited term of projects and the link between business risk and State guarantees) are applicable to the majority of the infrastructure concessions tendered in recent years, as well as concessions in process of award and invitations to tender.

In most countries, service concessions arrangements contemplate the right of the concession operator to the economic and financial balance of the concession. This right consists of a warranty of the Administration as to compensate the concession operator in case of a breakage of the economics of the concession in specific cases. In the majority of the concessions the operator is compensated if the breakage of the economics of the concession is due to an act of the Administration, but also in the specific cases listed in the contract and, in certain concessions, even if this breakage is due to unforeseen events.

Also, the legal framework of some jurisdictions clearly establishes the responsibility of the Administration for the infrastructure built. As an example, in Spain both the old and the new law applicable to concession contracts specifically contemplate the “Equity responsibility of the administration” (Responsabilidad Patrimonial de la Administración-RPA). This responsibility regime usually provides that, in the event of the termination of a motorway concession because of the concessionary’s breach or bankruptcy, or the extinguishment of its legal status, the Administration will deliver to the concessionary the value of all the investments made by the concessionary in the motorway in respect of compulsory purchase of land, performance of construction works and inclusion of assets necessary for the operation.

The concept of “Equity responsibility of the administration” is not a specific feature of the Spanish Law, but is also contemplated in the legal framework of other jurisdictions in both Europe and Latin America.

We propose that the Financial Asset Model be applied to concessions where the effect of the contractual arrangements, considering the legal framework and the concession specific agreements, provides the concession operator sufficient evidence that the cost of the



infrastructure will be recovered. As regards the recognition of this Financial Asset, we propose that a Financial Asset for the right of recovery of the infrastructure shall be recognized if:

- (i) The rates for the services or products are established by, or are subject to approval by, an independent regulator, and/or established by a contractual mechanism that is designed to recover the specific enterprise's costs of providing its services or products or there is sufficient evidence that future revenue will be provided to permit recovery of the infrastructure costs.
- (ii) The legal framework or the concession arrangements provide mechanisms for considering that the cost of the infrastructure will be recovered from the regulator in specific cases.

Judgement is to be made by companies and auditors on the applicability of the Financial Asset Model on a project by project basis, but as a rule it can be concluded that in most of this type of contracts a "sufficient evidence" type of condition is usually met.

In any case, the application of the Financial Asset Model should be linked to an annual impairment test that should be performed in order to evaluate the recoverability of the financial asset recognized.

Transitional situation

Considering the period that has passed since IFRIC began to analyse accounting treatment of the concession sector (October 2003) and the wide debate that this has generated, without any definitive interpretation having been issued until November 2006, we believe that the development of a specific IFRS for the sector would require a long period of time. It therefore seems essential to contemplate a transitional solution to be applied during this period in Europe. This transitional solution should clearly be provided by the European Union, the accounting and securities markets authorities of member countries, independently of the IASB, as in the case of IAS 39 and should clearly be based on the possibility of continuing to apply local regulations, considering other existing precedents.

For example, IFRS 4 (insurance contracts) establishes a temporary exemption that allows an insurance entity to continue to apply the accounting policies that it applied prior to the publication of this standard, with some exceptions, and could also improve these accounting policies if they fulfil certain specific criteria. Additionally, at its meeting of September 2003, the IASB agreed to allow previous accounting principles to continue to be applied for the recognition of certain assets related to the exploration and evaluation of mineral resources. IFRS 6 therefore allows entities that incur exploration and evaluation expenses, exemptions from the IFRS requirements and, in specific circumstances, allows these entities to continue with their current accounting treatment of exploration and evaluation expenses.

A solution to the question asked in relation to the accounting of concession agreements could therefore be a proposal in line with the IASB's decisions for the insurance sectors (IFRS 4) and extraction industries (IFRS 6). It is worth noting that some countries have developed a set of accounting standards which deal with certain types of concession agreements for public-private services. These standards are normally designed and focused to ensure that the financial statements reflect the image closest to the economic and financial reality of the business. The basic principle is the recognition of income progressively over the life of the project subject to an annual impairment test of the company's assets based on the evolution in the business compared to the financial plan.



To conclude, it appears that there is a basis for arguing that a provisional extension should be applied to concession agreements as a means to an ordered transition and the preparation of a specific IFRS for concession agreements, enabling those responsible for preparing the financial statements to continue applying local accounting principles, whenever these have been specifically developed for the treatment of concession agreements.