

FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2014-05
January 2014

Service Concession Arrangements (Topic 853)

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The objective of this Update is to specify that an operating entity should not account for a service concession arrangement within the scope of this Update as a lease in accordance with Topic 840, Leases. Service concession arrangements may become more prevalent in the United States as public-sector entities seek alternative ways to provide public services on a more efficient and cost-effective basis.

A service concession arrangement is an arrangement between a public-sector entity¹ grantor and an operating entity under which the operating entity operates the grantor's infrastructure (for example, airports, roads, and bridges). The operating entity also may provide the construction, upgrading, or maintenance services of the grantor's infrastructure.

Who Is Affected by the Amendments in This Update?

The amendments apply to an operating entity of a service concession arrangement entered into with a public-sector entity grantor when the arrangement meets both of the following conditions:

1. The grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them, and at what price.
2. The grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

What Are the Main Provisions?

The amendments specify that an operating entity should not account for a service concession arrangement that is within the scope of this Update as a lease in accordance with Topic 840. An operating entity should refer to other Topics as applicable to account for various aspects of a service concession arrangement. The amendments also specify that the infrastructure used in a service concession arrangement should not be recognized as property, plant, and equipment of the operating entity.

¹A public-sector entity includes a governmental body or an entity to which the responsibility for the public service has been delegated.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Current U.S. GAAP does not contain specific guidance for the accounting for service concession arrangements. Depending on the terms of a service concession arrangement, an operating entity may or may not conclude that a service concession arrangement meets the lease criteria in Topic 840. Consequently, the amendments in this Update will improve financial reporting by clarifying that a service concession arrangement within the scope of this Update should not be accounted for as a lease in accordance with Topic 840 and, thereby, alleviating the confusion that arises for preparers when determining whether a service concession arrangement is a lease.

When Will the Amendments Be Effective?

The amendments in this Update should be applied on a modified retrospective basis to service concession arrangements that exist at the beginning of an entity's fiscal year of adoption. The modified retrospective approach requires the cumulative effect of applying this Update to arrangements existing at the beginning of the period of adoption to be recognized as an adjustment to the opening retained earnings balance for the annual period of adoption. The amendments are effective for a public business entity for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For an entity other than a public business entity, the amendments are effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early adoption is permitted.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

The amendments in this Update are consistent with IFRS in that service concession arrangements under IFRS are not considered leases. However, IFRIC Interpretation 12, *Service Concession Arrangements*, addresses the accounting by operating entities of service concession arrangements and provides additional guidance about how to account for service concession arrangements. IFRIC 12 applies to service concession arrangements if (1) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price and (2) the grantor controls—through ownership, beneficial entitlement, or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement.

IFRIC 12 clarifies how certain aspects of existing IFRS should be applied by an operating entity in accounting for various aspects of service concession arrangements (for example, how to recognize and measure revenue for operating, construction, or upgrade services in accordance with IAS 11, *Construction Contracts*, and IAS 18, *Revenue*, and how to account for borrowing costs).

The amendments in this Update do not provide specific accounting guidance for various aspects of service concession arrangements but, rather, indicate that an operating entity should refer to other Topics as applicable to account for various aspects of a service concession arrangement.

The conclusions reached in IFRIC 12 indicate that service concession arrangements that are within the scope of IFRIC 12 do not meet the definition of a lease and are not included within the scope of IFRIC Interpretation 4, *Determining whether an Arrangement contains a Lease*. IFRIC 12 also specifies that the infrastructure within the scope of IFRIC 12 should not be recognized as property, plant, and equipment of the operating entity. According to IFRIC 12, the consideration to be received by the operating entity in exchange for construction or upgrade services may result in the recognition of a financial asset (as defined under IFRS), an intangible asset, or a combination of both. The operating entity recognizes a financial asset as consideration for an unconditional contractual right to receive a guaranteed amount of cash or another financial asset in return for construction or upgrade services performed. The operating entity recognizes an intangible asset as consideration for construction or upgrade services if it receives from the grantor the right to charge users for the use of the infrastructure. IFRIC 12 allows for the recognition of both types of consideration within a single contract.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–5. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~. **[For ease of readability, the newly added Topic is not underlined.]**

Addition of Topic 853

2. Add Topic 853, with a link to transition paragraph 853-10-65-1, as follows:

Service Concession Arrangements—Overall

Overview and Background

General

853-10-05-1 A service concession arrangement is an arrangement between a grantor and an operating entity for which the terms provide that the operating entity will operate the grantor's infrastructure (for example, airports, roads, bridges, tunnels, prisons, and hospitals) for a specified period of time. The operating entity may also maintain the infrastructure. The infrastructure already may exist or may be constructed by the operating entity during the period of the service concession arrangement. If the infrastructure already exists, the operating entity may be required to provide significant upgrades as part of the arrangement. Service concession arrangements can take many different forms.

853-10-05-2 In a typical service concession arrangement, an operating entity operates and maintains for a period of time the infrastructure of the grantor that will be used to provide a public service. In exchange, the operating entity may receive payments from the grantor to perform those services. Those payments may be paid as the services are performed or over an extended period of time. Additionally, the operating entity may be given a right to charge the public (the third-party users) to use the infrastructure. The arrangement also may contain an unconditional guarantee from the grantor under which the grantor provides a guaranteed minimum payment if the fees collected from the third-party users do not reach a specified minimum threshold. This Topic provides guidance for reporting entities when they enter into a service concession arrangement with a

public sector grantor who controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them, and at what price (which could be set within a specified range). The grantor also controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

Scope and Scope Exceptions

General

> Overall Guidance

853-10-15-1 The Scope Section of the Overall Subtopic establishes the scope for the Service Concession Arrangements Topic.

> Entities

853-10-15-2 The guidance in this Topic applies to the accounting by operating entities of a service concession arrangement under which a public-sector entity grantor enters into a contract with an operating entity to operate the grantor's infrastructure. The operating entity also may provide the construction, upgrading, or maintenance services of the grantor's infrastructure.

853-10-15-3 A public-sector entity includes a governmental body or an entity to which the responsibility to provide public service has been delegated. In a service concession arrangement, both of the following conditions exist:

- a. The grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them, and at what price.
- b. The grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

853-10-15-4 A service concession arrangement that meets the scope criteria in Topic 980 on regulated operations shall apply the guidance in that Topic and not follow the guidance in this Topic.

Recognition

General

853-10-25-1 An operating entity shall refer to other Topics to account for various aspects of a service concession arrangement. For example, an operating entity shall account for revenue and costs relating to construction, upgrade, or operation services in accordance with Topic 605 on revenue recognition.

> The Operating Entity's Rights over the Infrastructure

853-10-25-2 The infrastructure that is the subject of a service concession arrangement within the scope of this Topic shall not be recognized as property, plant, and equipment of the operating entity. Service concession arrangements within the scope of this Topic are not within the scope of Topic 840 on leases, as indicated in paragraph 840-10-15-9A.

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2014-05, *Service Concession Arrangements (Topic 853)*

853-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2014-05, *Service Concession Arrangements (Topic 853)*:

- a. The pending content that links to this paragraph shall be effective for a **public business entity** for annual periods and interim periods within those annual periods, beginning after December 15, 2014. For an entity other than a public business entity, the amendments shall be effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early adoption is permitted.
- b. The pending content that links to this paragraph shall be applied on a modified retrospective basis to service concession arrangements that exist at the beginning of an entity's fiscal year of adoption. The cumulative effect of applying the pending content that links to this paragraph to arrangements existing at the beginning of the fiscal year of adoption shall be recognized as an adjustment to the opening balance of retained earnings in the fiscal year of adoption.
- c. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

Amendments to Subtopic 840-10

3. Add paragraph 840-10-15-9A, with a link to transition paragraph 853-10-65-1, as follows:

Leases—Overall

Scope and Scope Exceptions

> Transactions

> > Arrangements that Do Not Qualify as Leases

840-10-15-9A Service concession arrangements within the scope of Topic 853 on service concession arrangements are not within the scope of the guidance in this Topic.

4. Add paragraph 853-10-00-1 as follows:

853-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
Not-for-Profit Entity	Added	2014-05	01/23/2014
Public Business Entity	Added	2014-05	01/23/2014
853-10-05-1	Added	2014-05	01/23/2014
853-10-05-2	Added	2014-05	01/23/2014
853-10-15-1 through 15-4	Added	2014-05	01/23/2014
853-10-25-1	Added	2014-05	01/23/2014
853-10-25-2	Added	2014-05	01/23/2014
853-10-65-1	Added	2014-05	01/23/2014

5. Amend paragraph 840-10-00-1, by adding the following item to the table, as follows:

840-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
840-10-15-9A	Added	2014-05	01/23/2014

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Current U.S. GAAP does not contain specific guidance for the accounting for service concession arrangements. Depending on the terms of a service concession arrangement, operating entities may or may not conclude that the service concession arrangement meets the lease criteria in Topic 840. The Task Force decided it was necessary to provide clarifying guidance for these types of arrangements that involve a public-sector entity grantor. The amendments in this Update specify that a service concession arrangement within the scope of this Update should not be accounted for as a lease in accordance with Topic 840 and that an operating entity should refer to other Topics, as applicable, to account for various aspects of a service concession arrangement. The Task Force also decided to clarify that the infrastructure that is the subject of a service concession arrangement within the scope of this Update should not be recognized as property, plant, and equipment of the operating entity.

BC3. The Board issued a proposed Accounting Standards Update on July 19, 2013, with a comment period that ended on September 17, 2013, and received three comment letters on the proposed Update.

Scope and Other Considerations

BC4. The Task Force decided to limit the scope of this Update to service concession arrangements in which the grantor is a public-sector entity because those are the types of arrangements for which guidance is primarily being sought. There were mixed views from respondents on the proposed scope. Some respondents agreed that most service concession arrangements involve public-sector grantors and commented that the scope should not be expanded at this time in order to expedite the issuance of the final amendments in this Update. In contrast, one respondent commented that the scope should be expanded to include service concession arrangements under which the grantor is

a private-sector entity because the substance of those arrangements—including their public-service nature—is similar to service concession arrangements for which the grantor is a public-sector entity. The Task Force concluded that the accounting for a service concession arrangement in which the grantor is not a public-sector entity is not a prevalent issue in practice and that expanding the scope may delay the issuance of the amendments. The Task Force noted that if guidance is needed for other types of service concession arrangements, a separate project could be undertaken at a later date.

BC5. The Task Force decided that the amendments should address only arrangements in which (a) the grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them, and at what price and (b) the grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

BC6. A key feature of many service concession arrangements is the public service nature of the obligation undertaken by the operator. The public service is intended to benefit the general public and accomplish a public duty or responsibility. The Task Force concluded that these conditions are intended to preserve the public use objective of the infrastructure both during and after the term of the arrangement and that those conditions generally are met in most of the service concession arrangements for which guidance is being sought. The Task Force considered defining the scope on the basis of the public-service nature of the arrangement instead of the type of grantor but decided that such a scope distinction would be overly subjective and therefore difficult to apply.

BC7. The Task Force considered in its deliberations how this Issue interacts with Topic 980, Regulated Operations. Regulated operations and service concession arrangements share the feature that the price that can be charged for the service is determined by the grantor. However, the Task Force observed that the scope of Topic 980 differs from the scope of this Update. In regulated operations the infrastructure is typically controlled by the operating entity and the residual interest is retained by the operating entity, unlike service concession arrangements. The Task Force concluded that most rate-regulated entities that are within the scope of Topic 980 would not typically be accounted for under Topic 853. If an operating entity is within the scope of Topic 980, that entity should continue to follow that guidance.

BC8. The Task Force discussed whether the scope of the guidance should also include arrangements in which the infrastructure is used for its entire useful life but the grantor does not control the residual interest in the infrastructure. The Task Force concluded that the control over the residual interest in the infrastructure is important in deciding the economic substance of the arrangement. The Task Force decided that when the operating entity controls the residual interest (regardless of the expected value of that interest at the end of the arrangement), it would not be appropriate to conclude whether the

infrastructure should be recognized as a lease or as property, plant, and equipment of the operating entity.

Recognition

BC9. The Task Force concluded that service concession arrangements within the scope of Topic 853 should not be accounted for as leases under Topic 840. Most respondents to the proposed Update agreed that a service concession arrangement within the scope of this Update should not be accounted for as a lease. Some members of the Task Force acknowledged that in many service concession arrangements, the operating entity is receiving substantially all of the economic output from the infrastructure during the term of the arrangement but the price paid is not fixed per unit of output or at current market price per unit of output. As such, service concession arrangements generally do meet one or more of the conditions in paragraph 840-10-15-6 to qualify as a lease. One Task Force member suggested that an operating entity should first look to Topic 840 to determine whether a service concession arrangement is a lease. Other Task Force members stated that requiring an operating entity to assess whether a service concession arrangement is a lease under Topic 840 does not provide clarity to stakeholders because of the difficulty in making such an assessment, which is why this Issue was considered by the Task Force. The Task Force concluded that the accounting for service concession arrangements should be determined on the basis of whether the operating entity controls the infrastructure that is being used to provide the public service.

BC10. The operating entity may have managerial discretion in operating the infrastructure; however, the grantor determines the services the operating entity must provide with the infrastructure, to whom it must provide them, and at what price. Also, the grantor controls any residual interest in the infrastructure at the end of the term of the arrangement. The Task Force concluded that the notion of control as used in the proposed definition of a lease in the FASB and IASB joint project on leases in paragraphs 842-10-15-2 through 15-3 of the proposed Update, *Leases (Topic 842)*, points to a tentative conclusion that service concession arrangements within the scope of this Update generally do not meet the definition of a lease under the leasing proposals.

BC11. The Task Force decided that it also was necessary to clarify that the operating entity's rights over the infrastructure do not result in the infrastructure being recognized as property, plant, and equipment of the operating entity. That is because the operating entity does not control or have title to the infrastructure under the terms of the arrangement. Many service concession arrangements have a very long term. In such cases, the form and/or the substance of the arrangement may convey the responsibilities customary of ownership over the infrastructure to the operating entity during the term of the arrangement. The Task Force decided that because the operating entity does not have control over the infrastructure, the amendments should state that the infrastructure should not

be recognized as the operating entity's property, plant, and equipment. Respondents to the proposed Update generally agreed with this principle.

BC12. The Task Force decided not to include specific guidance on what asset, if any, the operating entity should recognize for the infrastructure that is within the scope of this Topic. An operating entity should look to other Topics, as applicable, to account for various aspects of a service concession arrangement. Some Task Force members indicated a preference to expand the scope of Topic 853 to include specific guidance about how an operating entity should account for various aspects of a service concession arrangement. The Task Force concluded that many of the principles in current U.S. GAAP could direct preparers to the most appropriate guidance for their specific service concession arrangement. In addition, some related issues currently are being addressed in other ongoing FASB projects (for example, the FASB and IASB joint projects on revenue recognition and leasing).

Transition, Effective Date, and Early Adoption

BC13. The Task Force reached a consensus that the amendments in this Update should be applied on a modified retrospective basis to all arrangements existing at the beginning of the fiscal year of adoption and to all arrangements entered into after that date. The cumulative effect of applying the amendments in this Update to arrangements existing at the beginning of the fiscal year of adoption will be recognized as an adjustment to the opening balance of retained earnings. The Task Force considered whether the amendments should be applied on a full retrospective basis or a prospective basis and concluded that a modified retrospective basis provides a better balance between comparability and ease of transition in comparison to a full retrospective application and prospective application.

BC14. The Task Force reached a consensus that the amendments resulting from this Update should be effective for a public business entity for annual periods and interim periods within those annual periods beginning after December 15, 2014. The Task Force considered the feedback on the proposed Update about whether the amendments should have a different effective date for nonpublic entities. The Task Force did not identify a significant need for there to be an annual deferral for entities other than public business entities based on the nature of the amendments. After considering the Private Company Decision-Making Framework, which indicates that private companies generally should not be required to adopt amendments during an interim period within the initial fiscal year of adoption, the Task Force decided that for all entities, other than public business entities, the amendments should be effective for the annual period beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early adoption is permitted for all entities.

Benefits and Costs

BC15. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC16. The Task Force does not anticipate that entities will incur significant costs as a result of the amendments in this Update. The amendments will provide the benefit of improving consistent application of U.S. GAAP by specifying that a service concession arrangement within the scope of the amendments should not be accounted for as a lease in accordance with Topic 840 and should not be accounted for as property, plant, and equipment of the operator.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). Those changes, which will be incorporated into the proposed 2015 UGT, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process starting in September 2014.