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International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting:	**July 2007, London**
Project:	**Customer Contributions – Is using an IAS 20 model to account for customer contributions appropriate? (Agenda Paper 2C)**

Introduction

1. This paper considers whether it is appropriate to account for the receipt of a customer contribution by analogising to IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

2. The paper does not consider the consequences of accounting for such contributions using IAS 20 or the consequences of accounting for such contributions using another standard. If the IFRIC decides that IAS 20 is an appropriate accounting standard, the staff will present a separate paper considering the consequences of that decision.

3. The staff notes that no current Standard or Interpretation specifically addresses the question of how to account for a contributed asset. In the absence of a Standard or an Interpretation that specifically applies to a transaction, paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Policies and Errors* requires that '*management shall use its judgement in developing and applying an accounting policy that results in information that is:*

(a) relevant to the economic decision-making needs of users; and

(b) reliable, in that the financial statements:

(i) represent faithfully the financial position, financial performance and cash flows of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects.'

4. IAS 8.11 states that, in making its judgement in developing and applying an accounting policy, '*management shall refer to, and consider the applicability of, the following sources in descending order:*

(a) the requirements and guidance in Standards and Interpretations dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.'

5. The staff is aware of two differing views as to whether IAS 20 deals with a similar or related issue to customer contributions. There are therefore two differing views as to whether IAS 8.11(a) requires the use of IAS 20 to account for customer contributions by analogy.

View 1 – IAS 20 is an appropriate model to account for customer contributions

6. IAS 20.3 defines government grants as '*assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity*.'

7. Supporters of the view that it is appropriate to account for customer contributions using IAS 20 by analogy note that customer contributions are 'transfers of resources to an entity in return for future compliance with certain

conditions relating to the operating activities of the entity.' Those future conditions are the future delivery of services.

8. Supporters of this view note that, if a government gives a grant to an industry or business, it does not benefit from the receipt of goods or services produced by that industry or business. Instead, it benefits from having achieved a policy objective. Similarly, a property developer that contributes an electricity substation to an electricity company does not benefit from the receipt of electricity. Instead, it benefits from its property being connected to the network which is reflected in the increased sale price of the property.

9. Supporters of the view that IAS 20 should be used to account for customer contributions believe that such contributions are therefore very similar to government grants. As such, under IAS 8.11, it is appropriate for entities to account for the receipt of customer contributions using IAS 20 by analogy.

View 2 – IAS 20 is not an appropriate model to account for customer contributions

10. Supporters of this view note that IAS 20.3 defines government grants as follows:

> '*Government grants* are *assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and <u>transactions with government which cannot be distinguished from the normal trading transactions of the entity.</u>*' [Emphasis added]

11. Supporters of the view that it is not appropriate to account for customer contributions using IAS 20 by analogy note that the receipt, maintenance and use of assets to deliver a service to a customer are normal trading activities of entities that provide services or utilities.

12. Supporters of this view note that, even if the contributions were made by government, they would be specifically excluded from IAS 20 because they form part of the trading transactions of the receiving entity. It would therefore be inconsistent to account for the receipt of customer contributions from entities that are not governments using IAS 20.

13. Supporters of this view also note that customer contributions differ from government grants in a number of significant ways. In particular:

- A customer contribution is an asset which is given to receive access to an ongoing service (either by the contributor of the asset or its successors). The asset is integral to the receipt of the ongoing service. A government grant may be given for a range of reasons, but typically does not involve the receipt of an ongoing service by the government.
- Government grants are distinguishable from the trade of the entity.
- Government grants are typically made to benefit a range of parties, including local populations, regions, or countries. Customer contributions are typically given as a means to secure an ongoing service for one or more identifiable parties (which is paid for).

14. Supporters of this view therefore consider that IAS 20 should not be used by analogy as it specifically excludes trading transactions. Furthermore, customer contributions are fundamentally different from government grants. As the economic substance of the transactions is different, and the parties involved are different, it is not possible use IAS 20 by analogy as it does not deal with 'similar' or 'related issues'.

Staff analysis and conclusion

15. The staff considers that there are some similarities between customer contributions and government grants. In particular, they both are provided to entities that are then required to perform some ongoing activity.

16. However, the staff considers that the differences between government grants and customer contributions out-weigh the similarities. In particular, the staff notes that:

- Government grants, by definition, exclude the receiving entity's trading transactions. Customer contributions arise as part of trading transactions with the receiving entity.
- Customer contributions give rise to an ongoing trading relationship. Government grants may give rise to an ongoing relationship, but it is not a trading relationship.

- In most cases, whilst a government grant requires some action on the part of the recipient, it does not give rise to an asset in the hands of the government. Customer contributions give rise to an access right asset in the hands of the contributor.

17. In the light of the above, the staff does not believe that it is appropriate to consider customer contributions as being similar or related to government grants. The staff does not therefore consider that it is appropriate to account for customer contributions using IAS 20 by analogy.