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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IFRIC meeting: **September 2007, London**

Project: **Customer Contributions (Agenda Paper 4A)**

INTRODUCTION

1. At its July meeting, the IFRIC commenced its discussions about the accounting for customer contributions. Such contributions arise in situations in which a customer contributes an asset to a service provider that the service provider then uses to provide an ongoing service to the customer.

2. This paper primarily considers the situation in which an entity contributes an asset and, at the same time enters into a contract to receive services from the service provider. Situations in which an entity contributes an asset and then another entity receives access to the ongoing service and situations in which the entity contributes an asset but does not enter into a contract to receive an ongoing service are considered in section III of this paper.

3. At its July meeting the IFRIC agreed with the staff analysis that, in some situations, an asset will have transferred from a customer to the service provider whilst in others, it will not. The IFRIC also agreed that, in some situations, the ongoing service arrangement may include a leaseback of the asset to the customer whilst in others, it will not. The IFRIC therefore asked the staff to

prepare a paper including a flowchart showing the implications of concluding that an asset has or has not transferred and the implications of concluding that there has or has not been a leaseback.

4. The IFRIC asked the staff to illustrate this flowchart with examples showing the journal entries that would be required in each of these situations.

5. The IFRIC concluded that it was not appropriate to use IAS 20 to account for contributed assets. In cases in which assets had transferred, it decided that they should be recognised initially at fair value.

6. The IFRIC tentatively concluded that the credit that arises from the recognition of a contributed asset at fair value represents an obligation to provide access to an ongoing service that should be recognised in the balance sheet and included in income as access to the service is provided. In reaching this conclusion, the IFRIC noted that the period of the service may be very small (effectively nil) and so asked the staff to develop indicators that could be used to estimate the duration over which access to the ongoing service is given.

7. This paper includes:

- a flowchart showing how an entity should determine how to account for the receipt of customer contributions;
- illustrative journal entries showing the implications of the different accounting models arising from the flowchart; and
- a proposed approach to developing indicators to estimate the duration over which access to the ongoing service is given.

8. It should be noted that, in common with the paper presented at the July IFRIC meeting, this paper considers only contributions of existing property, plant and equipment. As agreed at that meeting, the staff will present a separate paper considering how that scope may be extended (including how it may be extended to the contribution of cash for the construction or acquisition of an asset).

Flowchart

9. The flowchart below summarises the proposed approach and how it fits together. Following the flowchart are further details as to how entities will apply

- step 1, assessing whether an asset has transferred; and
- step 2, assessing whether the ongoing service arrangement contains a leaseback to the customer.

Also after the flowchart is a summary of the accounting implications of each of the three accounting models: contribution with no leaseback, contribution with an operating leaseback, and contribution with a finance leaseback.

Step 1: Has an asset transferred?

No

No accounting consequences to record

Yes

Initially record the asset at fair value with a corresponding credit recorded as an obligation to perform ongoing services.

Step 2: Does the ongoing service arrangement include a leaseback of the asset to the customer?

Yes

Is the lease an operating lease or a finance lease in accordance with IAS 17?

No

Finance

Operating

Identify the service the contribution relates to and recognise the revenue from satisfying the obligation in profit or loss over the period that access to that service is provided.

Depreciate the asset over the useful economic life of that asset.

(Appendix 1.1)

Identify the service the contribution relates to and recognise the revenue from satisfying the obligation in profit or loss over the period that access to that service is provided.

Derecognise the PPE recognised in Step 1 and replace it with a finance lease receivable. Compute the lease payments in accordance with IFRIC 4. Set off future lease payments against the finance lease receivable and recognise interest income.

(Appendix 1.3 and 1.4)

Identify the service the contribution relates to and recognise the revenue from satisfying the obligation in profit or loss over the period that access to that service is provided.

Compute the lease payments in accordance with IFRIC 4 and recognise them in profit or loss as rental income over the life of the lease.

Depreciate the asset over the useful economic life of that asset.

(Appendix 1.2)

Step 1: Has an asset transferred?

10. Paragraph 49(a) of the Framework defines an asset as:

    'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.'

11. The staff considers that, in the case of a customer contribution, the contribution is the past event. In most situations, the ongoing service contract will not be expected to be onerous at the outset (if it is the entity should refer to IAS 37). The staff considers it likely that future economic benefits will be expected to flow to the entity receiving the asset.

12. The staff therefore considers that the key question in assessing whether the asset has transferred is whether the service provider has control of that asset.

13. The Framework discusses control of a resource in terms of control of benefits that are expected to flow from it. Paragraph 57 states:

    'Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.'

14. In assessing whether control has passed, the staff believes that an entity should consider whether it has the capacity to control the benefits of that asset. Indicators that it has gained control may include that:

    - it has legal rights to the asset;
    - it can sell or pledge the asset; or
    - it can restrict other parties' access to the asset (for example, other parties cannot access the asset without the entity's permission or are required to pay the entity for use of the asset).

15. In contrast, indicators that it may not have control may include that:

    - its customer can require the entity to return the asset to the customer on demand at no cost;
    - the customer can change suppliers without any need to pay compensation; or

- the entity cannot restrict its competitors from using the asset.

16. The staff considers that an entity will make assessments on a day to day basis as to whether it has control of assets and whether they should be recognised in the balance sheet. In most cases, entities will make this assessment of control based upon factors such as ownership rights and access to benefits. Assessing whether the recipient of a customer contribution has control of the contributed asset is, in principle, no different to assessing whether the recipient had control of any other asset.

17. The staff also notes that giving detailed guidance on the notion of control of an asset could be seen as a separate project to a project on Customer Contributions. Any guidance published on whether an asset has transferred may have implications for transfers of a wide range of other assets.

18. The staff therefore concludes that any guidance in the Interpretation should be limited to:

    - Stating that an entity should assess whether a transfer of an asset has occurred.
    - Noting that assets are resources that arise as a result of past events from which future economic benefits are expected to flow to an entity and that that entity must control those resources.
    - Noting that control requires an entity to have the ability to access the benefits of the asset and the power to control access to those benefits (for example by restricting access to those benefits by another party.

19. The staff considers that this could be achieved by using wording similar to:

    In order for an entity to assess whether it has received an asset as a result of a customer contribution, it must assess whether it has gained control over a resource and whether future economic benefits are expected to flow to it from that resource.

    In order to demonstrate that it has control over the resource, the entity shall assess whether it has the ability to access the benefits arising from that resource and whether it has the power to restrict others' access to those benefits.

20. The staff does not believe that it is appropriate to develop further detailed guidance as to whether an asset has or hasn't transferred as part of the customer contributions project.

Step 2 – does the ongoing service arrangement contain a leaseback to the customer?

21. Having concluded that an entity has received an asset, it is next necessary to consider whether the asset has been leased back to the customer as a part of the ongoing service agreement. IFRIC 4 *Determining whether an Arrangement contains a lease* gives guidance on how an entity assesses whether an agreement includes a lease and states that (paragraph 6):

    Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

    (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and

    (b) the arrangement conveys a right to use the asset.

22. The staff notes that IFRIC 4 answers the exact question of whether an ongoing service arrangement contains a lease. Consequently, the staff believes that it is unnecessary to recreate this guidance in a new interpretation on customer contributions.

23. The staff therefore considers that any interpretation on customer contributions should go no further than to refer to IFRIC 4 and state that entities should refer to that Interpretation for guidance on assessing whether the ongoing arrangement contains a lease.

24. The staff considers that, in addition to stating that an entity should assess whether the ongoing service arrangement contains a lease (with reference to IFRIC 4) the interpretation should include guidance noting that when the entity applies IFRIC 4 if:

    - the contributed asset can be used only to service one customer and not for any other purpose, and
    - the customer controls the output of that asset,

the entity would be likely to conclude that the ongoing arrangement contains a lease.

25. Similarly, if the service provider were able to use the asset to service a number of customers and potential customers, the entity would be unlikely to conclude that the arrangement contains a lease.

ILLUSTRATIVE EXAMPLES

26. Appendix 1 to this paper includes four examples. These describe the accounting (including journal entries) that would result if:

    1.1 an asset had transferred without a leaseback.

    1.2 an asset had transferred with an operating leaseback.

    1.3 an asset had transferred with a finance leaseback.

    1.4 an asset had transferred with a finance leaseback and there was a right of set off between the finance lease receivable and the obligation to provide future services.

27. Appendix 1.1 provides illustrative journal entries that may arise in situations in which an entity determines that an asset has transferred and there is no leaseback.

28. Using this approach, the asset is initially recognised on the balance sheet at fair value with a corresponding liability recognised as an 'obligation to provide access to future services'. The asset is depreciated over its useful economic life. The obligation is recognised in income on a basis that reflects the provision of access to the ongoing services provided.

29. In this example, the service period is equal to the useful economic life of the asset. The staff notes that it is unlikely that an entity will conclude that an asset has been contributed in return for a period of service that extends beyond the useful economic life of the contributed asset. Similarly, the staff notes that it would be unlikely that an entity would conclude that a leaseback was a finance lease (under IAS 17) if the useful economic life of the asset was significantly longer than the service period. The staff therefore considers that, in the case of a finance leaseback, the service period and the asset's useful economic life are likely to be approximately the same.

30. Whilst all the examples assume that the service period and the asset's useful economic life are both 10 years, the staff does not consider that this will always be the case. In particular, in situations in which there is no leaseback or the leaseback is an operating lease, the service period and the asset's useful economic life may differ, perhaps significantly. The Interpretation should emphasise this point.

31. Appendix 1.2 illustrates the accounting that arises if the ongoing service arrangement contains an operating lease. This results in an identical balance sheet and recognition of profit as in appendix 1.1. The only difference in appendix 1.2 is that part of the revenue arises from rental income rather than from the supply of goods or the provision of a service.

32. Appendix 1.3 considers the situation in which an entity determines that there has been a leaseback to the customer and the leaseback is a finance lease. The key differences between this example and those in appendices 1.1 and 1.2 are that:

- In example 1.3, the entity no longer has an item of property, plant and equipment on the balance sheet. This is replaced by a finance lease receivable.
- In example 1.3, revenue is reduced since some of the cash inflows are treated as the receipt of principal payments on the finance lease receivable.
- In example 1.3, there is no depreciation charge as the entity no longer has PPE on its balance sheet.
- In example 1.3, the entity earns interest income on its finance lease receivable.

33. It should be noted that the existence of the finance lease receivable and associated interest income means that example 1.3 results in the recognition of more income in the earlier years (when the finance lease receivable is largest) than in later years.

34. In developing example 1.3, the staff also considered an alternative method an entity may wish to use to account for an arrangement in which the asset is leased back to the customer under a finance lease. The staff noted that, using the approach in appendix 1.3, the customer would have a prepayment because of

contributing an asset. It would also have a liability in respect of the finance lease.

35. The staff considered whether it may be appropriate to set off the obligation to perform future services against the finance lease receivable on the basis that the only way that the obligation could be settled would be by giving access to the leased asset.

36. The staff noted that the credit on the service provider's balance sheet arises because the customer has paid the supplier in advance. If this payment were considered to be a pre-payment of the lease rentals rather than of the ongoing service, it would be appropriate to set off the pre-payment of the lease rentals against the lease payable.

37. The staff notes that the setting off of assets and liabilities is not generally permitted under IFRS. However, the staff also notes that IAS 32 includes guidance that allows the setting off of financial assets and liabilities provided that certain conditions are met. Whilst the staff accepts that pre-payments and obligations to provide future services are not financial assets or financial liabilities, the staff considers that, as the guidance in IAS 32 applies to analogous situations in which assets and liabilities are net settled and no other guidance exists, it may be appropriate to analogise to this guidance.

38. IAS 32.42 states:

'A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, an entity:

(a) currently has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

39. In the case of the obligation to provide services, the staff considers that the service provider does have a right to set off the liability against the finance lease receivable. The finance lease receivable will be settled by the entity performing its ongoing obligations. The staff also notes that the obligation and the finance lease receivable will only ever be settled simultaneously.

40. The staff therefore considers that in most cases in which there is a finance leaseback, the service provider will have the right and intention to offset the receivable and the obligation. The staff has illustrated the accounting that results if this is the case in appendix 1.4 to this paper.

41. The staff considers that the approach in appendix 1.4 represents a simpler model for the accounting for finance leasebacks than the approach in appendix 1.3. The staff also considers that, in most cases in which there is a finance leaseback, there will be a right and an intention to offset the receivable and the obligation.

42. Furthermore, the setting off of these assets and liabilities could be seen as applying the guidance in IAS 18.13 which requires transactions to be considered together for the purposes of recognising revenue if the commercial effect of those transactions cannot be understood separately. In this case, the receipt of an asset from the customer and the return of that asset via a finance lease to the customer are so closely linked that they could not be understood separately. Considering the two together and reflecting the fact that, after the combined transaction has taken place, the service provider does not have an asset and has not therefore earned revenue is consistent with IAS 18.13.

43. When the conditions in IAS 32.42 are met, the staff therefore considers that the alternative approach in appendix 1.4 should be required by the final interpretation.

44. If the model described in appendix 1.4 is applied then, in this simple example, profit recognition would be the same whether or not there was a leaseback.

45. If this approach were adopted, the key differences arising in terms of income statement presentation would be that:

- If there is no leaseback, revenue would be increased by the fair value of the contributed asset over the period that access to the ongoing service is provided. This is matched by an increased depreciation charge over the useful economic life of the asset.
- If there is an operating leaseback, revenue will be split between revenue from providing access to the ongoing service and ‘rental income’.

- If there is a finance leaseback, revenue over the period of the ongoing service will be reduced and as will depreciation over the asset's useful economic life.

46. If the useful economic life of the asset and the period of the ongoing service are different, it is likely that the above differences will result in the recognition of profit in different periods. However, as discussed above, the staff does not consider that it is likely that an entity will ever conclude that a finance leaseback has occurred if the service period and the useful economic life of the asset are significantly different.

47. The key difference in terms of the balance sheet would be that, if there is a leaseback under a finance lease and assuming that the conditions for set off are met, there would be no asset and no corresponding liability recognised.

PART II ESTIMATING THE DURATION OF THE ONGOING SERVICE

48. At its July 2007 meeting, the IFRIC asked the staff to consider what indicators an entity could use to estimate the duration of the ongoing service to which the contributed asset relates. This section sets out the staff's conclusions.

49. So far in this paper, the staff has assumed that the contribution of an item of property, plant and equipment gives rise to a right to access an ongoing service, and that the customer that contributes the asset is the same as the customer that receives the ongoing service.

50. The staff considers that, in reality, this will not always be the case. For example, a builder constructing a house may connect a telephone wire from the house to the telephone exchange and contribute that wire to the telephone company. The contribution of this wire gives the builder the *ability* to obtain access to a telephone service. It does not give the *right* to obtain a telephone service. In order to obtain that right, the builder may be required to pay an additional connection charge.

51. Suppose that the builder finishes building the house and decides to rent it to a tenant. The tenant will then be required to pay the connection fee in order to obtain the right to receive the telephone service. In this example, the contribution of the wire by the builder gives the builder the ability to obtain the service. However, it is not until the tenant pays the connection charge that the tenant receives a right to receive the telephone service.

52. In considering the period over which the ongoing service is provided, the staff has initially analysed situations in which the contribution of the asset gives rise to a contract that gives an access right to an ongoing service. This is covered in Part II. In Part III the staff considers situations in which:

    i. the contribution of the asset gives rise to an ability to obtain access to a service but an access right is not granted until some further event takes place (for example the payment of a connection charge); and

    ii. the asset is contributed by one party but access to the ongoing service is received by another.

Finance leasebacks

53. As discussed above, the staff considers that it will normally be appropriate to set off the obligation to perform future services and the finance lease receivable in situations in which there is a finance leaseback.

54. When this is the case, there will be no obligation recorded on the service provider's balance sheet and so the duration of the ongoing service will not be relevant. That is, the service provider does not recognise revenue or expense for the use of the customer's asset.

55. The staff analysis therefore only considers situations in which there is either no leaseback or an operating leaseback.

Operating leaseback or no leaseback

56. In cases in which there is no leaseback or an operating leaseback, the physical PPE remains on the balance sheet of the service provider. Following the receipt of the contributed asset, the service provider will also have a liability representing its obligation to provide access to a service using that asset.

57. As discussed above, the staff's initial analysis considers only the situation in which the contribution of the asset gives rise to a right to receive access to an ongoing service in the hands of the customer.

58. In this section, the staff has considered over what period the revenue arising from providing that ongoing access to a customer should be recognised by the service provider.

59. The staff first considered what principle should be applied in determining the duration of the ongoing access. Two views exist:

    - The duration of the access should be the period for which the customer has a right to receive access to ongoing services (for example under a contract or under statute).

    - The duration of the access should be the period over which the customer is expected to receive access to the ongoing services.

60. In most cases the staff considered that the period over which the customer was expected to receive access to the ongoing service would be longer than the period in which it had a right to receive access to the service (as this was likely

to take into account contract renewals). However, the staff noted that this may not always be the case. For example, in the case of a prepaid mobile phone, the service provider may have an obligation to provide ongoing access to the network for as long as the customer continues to spend a fixed amount per month. In this case, the obligation may be theoretically limitless but past experience may show that most customers switch networks after a specific period of time.

61. The staff notes that IAS 18 includes little guidance as to the period over which revenue should be deferred. For example, IAS 18.20 states that revenue should be '*recognised by reference to the stage of completion of the transaction at the balance sheet date'* but does not give guidance on how to determine what the transaction is.

62. IAS 18.13 includes guidance on how to identify a transaction. This states that '*the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole*'

63. The staff considers that the commercial effect of a contract renewal can be understood without reference to a contribution made in anticipation of the initial contract. At the point at which a renewal is made, for both the contributor and the service provider, the initial contribution will be a sunk cost. The renewal will be considered based upon whether access to a future service is required and whether the price for access to that future service is reasonable in relation to alternatives (with no reference to the contributed asset unless changing service providers also requires a new contribution).

64. The staff therefore believes that IAS 18.13 could be read to imply that it is correct to recognise the revenue over the initial period that the entity is obligated to provide access to a service without taking into account future renewals.

65. The staff also considered the liability that is recorded on the balance sheet during the period that access to the service is being provided. Paragraph 60 of the Framework states '*An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or*

perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement.'

66. The staff considers that it would be consistent with paragraph 60 of the Framework to expect to recognise a liability for as long as the entity continues to have a liability. At the outset of an arrangement, an entity will have an obligation in respect of that arrangement only during the period in which the customer has a right. It could be argued that it would be inconsistent with this to recognise revenue in such a way that would result in the recognition of a liability beyond the point at which the supplier has an obligation to a customer.

67. The staff therefore considers that the principle for recognising revenue should be that revenue is recognised over the periods in which the customer has a right to receive access to the service.

68. An Interpretation developed in this way could read as follows:

    The obligation to provide access to a service exists for the period that the customer has a right to receive access to the service from the service provider. In many cases, this period will be determined by contract or by statute.

69. The staff considers that, if the period of the ongoing service cannot be estimated, the outcome of the transaction cannot be estimated reliably. In accordance with IAS 18.26, revenue shall be recognised only to the extent of 'the expenses recognised that are recoverable.'

PART III CONTRIBUTIONS THAT DO NOT RESULT IN A RIGHT TO RECEIVE ACCESS TO A SERVICE

70. As discussed above, the staff's initial analysis has considered only situations in which customers obtain a right to access a service as a result of contributions.

71. The staff notes that this will not always be the case. In particular, the staff considers that an entity will often contribute an asset in return for an *ability* to access a service rather than a *right* to access the service.

72. Examples of this may include situations in which an asset (for example a phone line) must be contributed in order to access a service, but no contract giving the right to receive the service is granted until a separate connection charge is paid.

73. Other examples may include situations in which a house builder is required to build and contribute a sub-station as part of the planning regulations for a particular development of houses. In this case, the contribution will give the future house-owners the ability to receive electricity. They will not have a right to demand the receipt of electricity and the electricity company will not have an obligation to provide electricity to a particular house until its owner enters into a separate contract with the electricity supplier.

74. In these situations, the contribution of the asset does not give rise to a right to receive a service but instead gives rise to an ability to access a service. Since no contract or other obligation arises on contribution of the asset, it is not possible to recognise revenue over the period of the ongoing arrangement.

75. In this section, the staff has considered how revenue should be recognised in respect of the contribution of PPE in these situations.

76. The staff has considered 2 views. Supporters of view 1 consider that the contributor of the asset would only have contributed the asset in order to receive the ongoing service. The 'service' that they expect to receive in return is ongoing access to a service that is provided by the service provider. Supporters of this view consider that, despite the lack of a formal contract, revenue should be recognised over the period that the asset is expected to be used to provide ongoing access to the service.

77. Supporters of view 2 consider that the same principle should be applied as in situations in which the contribution gives rise to a contract under which the

customer has a right to receive access to an ongoing service. They believe that, in this case an asset has been contributed which gives the customer the ability to receive access to an ongoing service but that the customer has no right to receive the ongoing service at this point. Supporters of this view consider that revenue arising from the receipt of an asset which does not give rise to an obligation to give access to an ongoing service should be recognised as revenue immediately.

78. The staff notes that, if revenue is not recognised on receipt of the contributed asset, the service provider must recognise a liability representing an obligation to provide access to a service in the future. If the entity has no obligation to provide access to services in the future, then it should not recognise a liability. The staff therefore considered whether an obligation will exist that meets the definition of a liability after the asset has been contributed but before any connection charge has been paid.

79. IAS 37.10 defines a liability as *'a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'*.

80. Supporters of view 1 note the definition of a constructive obligation in IAS 37.10:

'A constructive obligation is an obligation that derives from an entity's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.'

81. Supporters of this view consider that, in most cases, the contributor of a contributed asset will expect that future access to an ongoing service will either be given to them, or to another party. If the contributor did not have that belief it would not have contributed the asset. Supporters of this view believe that the service provider will have created an expectation that the contribution of the asset will lead to access to services in the future. This expectation may have

been created by past practice, or published policies or a specific statement about a specific set of circumstances.

82. Supporters of this view therefore believe that the contribution of an asset gives rise to a constructive obligation on the service provider to give future access to services.

83. Supporters of this view also believe that the obligation arises from a past event (the contribution of the asset) and that it will give rise to an outflow, being the provision of access to an ongoing service. They therefore conclude that an entity that has received a customer contribution has a liability which is embodied in an obligation to provide access to services in the future.

84. Opponents of this view do not believe that the contribution of an asset gives rise to an obligation to provide access to services in the future. They consider that the contribution of the asset merely allows the contributor to access a service in the future if it or another party enters into a contract in the future to receive that service.

85. Supporters of this view consider that any obligation of the service provider to give access to services in the future arises when the service provider enters into an agreement or contract to provide access to those services.

86. Supporters of this view do not therefore consider that the contribution of the asset gives rise to any obligation. Furthermore, they consider that any obligation will only arise when the service provider enters into a contract at some point in the future. The obligation therefore arises because of a future event rather than a past event.

87. Supporters of this view also note that a rational entity will only enter into a contract in the future if it believes that it will generate profit by entering into that contract. They do not therefore believe that the contribution of the asset or the entering into a contract will result in a net outflow of resources.

88. Supporters of this view do not therefore consider that the receipt of a contributed asset in these circumstances gives rise to a liability.

89. The staff considers that an entity that has received a customer contribution is unlikely to have an obligation to provide future services in the absence of a contract or agreement to provide those services.

90. The staff therefore does not believe that a liability exists before a contract or other agreement is entered into. As such, it would not be correct to recognise a liability on the balance sheet representing an obligation to give a customer access to services in the future before such a contract or other agreement exists. The staff considers that revenue arising from the receipt of the asset should therefore be recognised immediately.

91. The staff considers that this treatment is consistent with the treatment proposed in section II in situations in which entities contribute an asset as part of a contract to supply ongoing services. In that example, the revenue was recognised over the period of the contract to provide ongoing access to a service. In this example, there is no ongoing contract, so the revenue is recognised immediately.

OTHER ISSUES

Connection fees

92. In the example discussed above, the staff considered a situation in which a customer contributed an asset which gave it the ability to access an ongoing service. The customer did not receive a right to access the ongoing service until such time as a connection fee was paid and a contract entered into between the customer and the service provider.

93. Having concluded above that the contribution of the asset results in the service provider recognising revenue immediately, the staff then considered the accounting for the receipt of the connection fee.

94. The staff notes that the connection fee results in a contract which gives the customer the right to receive ongoing access to the service. This is similar to the situation in which a contributed item of PPE gives rise to a contract to receive ongoing access to a service.

95. The staff considers that, if a connection fee is paid, it is paid for access to a service. That access is granted using existing infrastructure. The facts around that payment are therefore that a customer pays an upfront sum followed by regular payments in respect of a service which takes place over a period of time.

96. The staff considers that it is clear that such a connection fee is an advance payment for access to ongoing services and should be recognised as a liability in the balance sheet to be recorded in income over the expected or contractual period of the ongoing service.

Contributions in which the contributor is different from the recipient of the ongoing service

97. The staff considered the situation in which a contributor of an asset (for example a house builder) was not the same as the recipient of the ongoing service (for example a house owner).

98. The staff considers that this situation typically arises when the contributor sells or leases the asset or assets that will provide ongoing access to a service to a third party.

99. For example, a house builder may construct houses on a new development. Planning permission may require the builder to construct a sub-station which has to be contributed to the electricity company. When the contribution takes place, the houses the house builder constructs will gain the ability to access the electricity service but not the right to access the electricity service.

100. Suppose that the house builder then sells a house. The house will be sold with the ability to access the ongoing service. The new owner of the house will be required to enter into a contract with the electricity company in order to gain the *right* to receive access to the electricity supply.

101. Two questions may arise in this situation:

    1. How should the service provider account for the receipt of the contributed asset?

    2. How should the service provider account for any connection fee paid by the recipient of the ongoing service?

102. The staff considers that the fact that the contributor and the recipient of the ability to access the ongoing service are different should not affect the accounting treatment in this case.

103. The initial contribution of the asset is a contribution which gives rise to an ability to receive access to a service but does not give rise to a contract to receive an ongoing service. As discussed above, in this situation, the service provider should recognise revenue immediately.

104. The connection fee gives rise to a contract. It is paid along with an ongoing fee for access to an ongoing service. As discussed above, the connection should be recognised as revenue as that ongoing service is provided.