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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**December 2008, London**
Project:	**Annual Improvements 2009**
Subject:	**Guidance inconsistency in Appendix to IAS 18 (Agenda paper 11A)**

INTRODUCTION

1. The IASB received a request in October 2008 to improve consistency between the principles set out in IAS 18 *Revenue* and its Appendix. The Appendix gives examples of transactions and explains how revenue should be recognised (see the full text of the submission in Appendix A).

2. The inconsistency the constituent identifies relates specifically to example 17 of Appendix to IAS 18 that deals with "Initiation, entrance and membership fees".

BACKGROUND

3. IAS 18, and more specifically the issue of single transactions that ought to be split into components, is the subject of ongoing discussions. IFRIC 13 *Customer Loyalty Programmes*, published in June 2007, deals with the accounting treatment for incentives to customers to buy goods or services from an entity. Current discussions are being held on the issue of "Transfers of assets from customers" and should lead to an interpretation in the first quarter of 2009.

4. Also a Discussion Paper on Revenue Recognition is currently being drafted by the IASB staff and should be published for comments before the end of this year.

ISSUE

5. The first sentence of paragraph 17 of the Appendix to IAS 18 states that in cases of fees that relate to membership only, revenue is recognised immediately. The constituent claims that such an accounting treatment is not consistent with the general principle of revenue recognition set out in IAS 18 and especially with paragraph 13 that deals with components of a single transaction. According to the constituent, no service is delivered when a customer becomes a member. Thus membership fees should be deferred over the membership period and cannot be recognised immediately.

6. The request is to delete the example in paragraph 17 of the Appendix to IAS 18.

STAFF ANALYSIS

7. IAS 18.13 specifically addresses the case where a single transaction can be split into separately **identifiable** components, for example a subsequent servicing in addition to the sale of a product. Revenue from the ongoing subsequent service is then to be deferred over the period during which the subsequent service is performed.

8. This paragraph fully applies to examples provided in the second part of paragraph 17 of the Appendix to IAS 18, where the upfront fee "entitles the customer to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non-members". More guidance on measurement in such cases can be applied by analogy to IFRIC 13 *Customer Loyalty Programmes*.

9. The staff believe that the first sentence of paragraph 17 of the Appendix to IAS 18 cannot be read by itself. It has to be considered together with the following sentence that gives examples of cases where revenue from identifiable components of a single transaction should be deferred.

10. In the staff's opinion, the example in the first sentence of paragraph 17 of Appendix to IAS 18 clearly shows that facts and circumstances have to be analysed in order to conclude on the revenue recognition accounting treatment. Removing the example might imply that revenue cannot ever be taken immediately. This would be inconsistent with the IFRIC's conclusion in the forthcoming Interpretation on "Transfers of Assets from Customers".

11. In cases where the fee relates only to membership, the situation might be analysed as the sale of a right to access a facility. The analysis then requires being able to determine whether the membership is a standalone sale or whether there is an ongoing service attached to it that would require deferring revenue.

12. Should the analysis of such transactions lead to considering that both a right to access a facility and an ongoing service to benefit from cheaper products or services are provided, the transactions would have to be split between the two components. However, it cannot be concluded upfront that the whole revenue should be deferred.

13. The staff believe that under current discussions on Revenue Recognition the analysis would consist in determining whether the right to access the facility is an asset controlled by the customer in which case the transfer of the asset would be assessed and revenue would be recognised upfront.

STAFF RECOMMENDATION

14. Based on this analysis, the staff recommend that this issue not be included in the 2009 annual improvements.

QUESTIONS FOR THE IASB

15. Does the IASB agree with the staff recommendation?

APPENDIX A: Submission

Annual Improvement suggestion
Appendix to IAS 18 (inconsistent guidance)

Issue

The appendix to IAS 18 contains a number of examples that illustrate the principles in the standard. We are concerned that one of those principles is inconsistent with the principles in the standard.

Background

Example 17 in the Appendix to IAS 18 states that revenue in connection with membership fees can be recognised immediately: 'If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognised as revenue when no significant uncertainty as to its collectability exists'.

The example is inconsistent with the general principle in IAS18.13, which requires that the components of a transaction are separately assessed based on the substance of the arrangement to determine when revenue should be recognised. Revenue from the delivery of a service is not recognised until a service has been delivered (IAS 18.20). Up-front fees should therefore not be recognised as income until the customer has received a service that is separable from any other ongoing contractual arrangement with the supplier.

There is no service delivered when a customer becomes a member. The payment of a membership fee will usually permit the customer to receive goods or services without future payments or for a price less than the market price. A customer would not pay a membership fee that gave entitlement only to purchase goods or services at a market price in the future. There would be no benefit to the customer from paying the fee in those circumstances. No services have therefore been delivered when the customer pays the fee and the revenue should be deferred and recognised as goods and services are delivered in the future.

The IFRIC concluded in January 2007 that:

- “fees may be recognised as revenue only to the extent that services have been provided
- whilst the proportion of costs incurred in delivering services may be used to estimate the stage of completion of the transaction, incurring costs does not by itself imply that a service has been provided
- the receipt of a non refundable initial fee does not, in itself, give evidence that an upfront service has been provided or that the fair value of the consideration paid in respect of any upfront services is equal to the initial fee received
- to the extent that:
    - an initial service can be shown to have been provided to a customer,

- the fair value of the consideration received in respect of that service can be measured reliably and

- the conditions for the recognition of revenue in IAS 18 have been met,

up front and ongoing fees may be recognised as revenue in line with the provision of services to the customer."

Example 17 in the Appendix to IAS 18 is therefore inconsistent with both IAS 18 and with the conclusions reached by the IFRIC

Proposed Amendment

We suggest that Example 17 in the Appendix to IAS 18 is deleted.

Consequential amendments

We do not believe that there are any other consequential amendments required to other standards or implementation guidance.

Appendix – Draft Basis for Conclusions

The Board was notified that the guidance in example 17 in the Appendix to IAS 18 is inconsistent with the principle in IAS 18.20 that revenue is not recognised until a service has been delivered. The Board noted that the IFRIC had concluded in connection with its discussion of up front fees that revenue should not recognised when a fee is received unless a service has been delivered.

The Board agreed that example 17 in the Appendix to IAS 18 suggests that revenue might be recognised in connection with membership fees before any service has been delivered. This is inconsistent with the principle in IAS 18.20, so the Board concluded that example 17 should be deleted.

[Paragraph omitted from observer note].