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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: **November 2007, London**

Project: **D24 *Customer Contributions* – Draft Interpretation (Agenda Paper 2B)**

Introduction

The staff redrafted the Interpretation in accordance with the decisions taken by the IFRIC during its redeliberations. The main changes from the previous draft (see agenda paper 2B for the September 2008 IFRIC meeting) are the following:

(a) In some jurisdictions, the term 'contribution' has the implication of a donation rather than an exchange transaction. For that reason, the staff suggest using the term 'transfer' and redrafted the Interpretation accordingly, including the title ('transfers of assets from customers')

(b) As discussed by the IFRIC in September, the staff added an indicator of control based on IAS 17 in paragraph 10(c)

(c) The staff deleted the indicator 'customers are charged a fee for ongoing access either as a separate charge or as a minimum periodic charge regardless of usage' set out in paragraph 16(a) of agenda paper 2B for the September IFRIC meeting. The staff agree with the IFRIC view at the September meeting that this indicator is not critical in the identification of a separate component for the ongoing service

(d) In the background section, the staff added an example of the transfer of assets as part of an outsourcing agreement

(e) The issue of transfers of cash is addressed separately from the issue of transfers of PP&E

The staff welcome comments on these redrafting proposals.

IFRIC Interpretation X

Transfers of assets from customers

References

- *Framework for the Preparation and Presentation of Financial Statements*
- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 16 *Property, Plant and Equipment*
- IAS 18 *Revenue*
- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
- IFRIC 12 *Service Concession Arrangement*

Background

1 In the utilities industry, an entity may receive transfers of items of property, plant and equipment from its customers that must be used to connect customers to a network and provide customers with ongoing access to a supply of commodities such as electricity, gas or water. Sometimes, an entity receives a transfer of cash from a customer for the acquisition or construction of an item of property, plant and equipment. In some cases, the entity may connect the customer to a network and then provide ongoing access to a supply of goods or services but may not be the supplier of the related goods or services. Customers are typically required to pay additional amounts for the goods or services they receive based on usage.

2 In some cases, the entity that transfers the asset is not the entity that will eventually have access to the supply and will use those goods or services. For example, an electricity substation may be transferred by a property developer in relation to a number of residential houses it is constructing. In this case, it is the homeowners that will eventually have ongoing access to the supply and will use the electricity. However, for convenience this Interpretation refers to the entity transferring the asset as the customer.

3 Transfers of assets from customers may also occur in industries other than the utilities. One example is the transfer of an entity's existing items of property, plant and equipment to another entity as part of an arrangement involving the outsourcing of its information technology functions.

Scope

4 This Interpretation applies to the accounting for transfers of items of property, plant and equipment by entities that receive such transfers from their customers.

5 Agreements in the scope of this Interpretation are agreements in which an entity receives a transfer of an item of property, plant and equipment from a customer that the entity must use to connect the customer to a network, to provide ongoing access to a supply of goods or services or both.

6 This Interpretation also applies to agreements in which an entity receives a transfer of cash from a customer when that cash must be used only for the construction or acquisition of an item of property, plant and equipment and the entity then must use the item of property, plant and equipment to connect the customer to a network, to provide ongoing access to a supply of goods or services or both.

7 This Interpretation does not apply to agreements in which the transfer is either a government grant as defined in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* or infrastructure used in a service concession arrangement that is in the scope of IFRIC 12 *Service Concession Arrangements*.

Issues

8 The Interpretation addresses the following issues:

(a) Are the criteria to recognise an asset met?

(b) If the recognition criteria are met, how should the transferred item of property, plant and equipment be measured on initial recognition?

(c) If the item of property, plant and equipment is measured at fair value on initial recognition, how should the resulting credit be accounted for?

(d) How should the entity account for a transfer of cash from its customer?

Consensus

Are the criteria to recognise an asset met?

9 When an entity receives a transfer from a customer in the form of an item of property, plant and equipment, it shall assess whether the transferred item meets the criteria to recognise an asset set out in the *Framework*. Paragraph 89 of the *Framework* states that 'an asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably'. In most circumstances, the entity obtains the right of ownership of the transferred item of property, plant and equipment and is responsible for repairs, maintenance, upgrade and replacement of that asset. When assessing whether the recognition criteria are met, the entity shall also consider whether it controls the benefits that are expected to flow from the transferred item.

10 In contrast, if the customer continues to control the use of the transferred item of property, plant and equipment, the recognition criteria would not be met despite the transfer. The customer controls the use of the transferred item if one or more of the following conditions is met:

(a) the customer has the ability or right to operate the transferred item or direct others to operate the item in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the item;

(b) the customer has the ability or right to control physical access to the transferred item while obtaining or controlling more than an insignificant amount of the output or other utility of the item;

(c) the transferred item is used to provide the customer with ongoing access to a supply of goods or services for the major part of its economic life.

How should the transferred item of property, plant and equipment be measured on initial recognition?

11 If the entity concludes that the recognition criteria are met, it shall recognise the transferred asset as item of property, plant and equipment and measure it on initial recognition at its fair value in accordance with paragraph 24 of IAS 16 *Property, Plant and Equipment*.

How should the credit be accounted for?

12 The following discussion assumes that the entity receiving a transfer of an item of property, plant and equipment has concluded that the item should be recognised and measured in accordance with paragraphs 9 and 11.

13 Paragraph 12 of IAS 18 *Revenue* states that 'when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue.' According to the terms of the agreements within the scope of this Interpretation, a transfer of an item of property, plant and equipment would be exchanged for dissimilar goods or services. Consequently, the entity shall recognise revenue in accordance with IAS 18.

Indentifying the components of the transaction

14 An entity that receives an item of property, plant and equipment shall apply the recognition criteria in IAS 18 to the separately identifiable components of a single transaction in accordance with paragraph 13 of that Standard. Services to be provided in exchange for the transfer of an item of property, plant and equipment may include connecting the customer to a network, providing ongoing access to a supply of goods or services or both.

15 Features that indicate that connecting the customer to a network is a separately identifiable component of the transaction include:

(a) a service is provided to the customer and represents value for that customer;

(b) the entity receives consideration for the service and the fair value of that consideration can be measured reliably; and

(c) the service could be sold separately.

16 A feature that indicates that the service to provide ongoing access to a supply of goods or services is a component of the transaction is that the goods or services are delivered to the customer in the future at a price lower than would otherwise be charged.

17 Conversely, features that indicate that the obligation to provide ongoing access arises from the terms of the entity's operating license or other regulation rather than from the arrangement relating to the transfer of an item of property, plant and equipment include:

(a) customers that make a contribution pay the same price for the ongoing service as those that do not; and

(b) customers have the ability to choose to receive goods or services from suppliers other than the entity, although they must use the entity's network to receive them.

In these circumstances, the obligation to provide ongoing access to a supply of goods or services is not a component of the transaction.

Revenue recognition

18 When more than one component is identified, the fair value of the total consideration received or receivable for the agreement shall be allocated to each component and the recognition criteria of IAS 18 shall be applied to each component.

19 If an ongoing service is identified as a component of the transaction, the period over which revenue shall be recognised for that service is generally determined by the terms of the arrangement with the customer. If the arrangement does not specify a term, the revenue shall be recognised over a period no longer than the useful life of the transferred asset used to provide the ongoing service.

How should the entity account for the receipt of a transfer of cash from its customer?

20 When an entity receives a transfer of cash from a customer, it shall assess whether the agreement is in the scope of this Interpretation in accordance with paragraph 6. If the agreement is in the scope of this Interpretation, the entity shall assess whether the constructed or acquired item of property, plant and equipment meets the recognition criteria in accordance with paragraphs 9-11. If the recognition criteria are met for such an item, the requirements of paragraphs 13-19 are applicable to the recognition of revenue.

Effective date and transition

21 An entity shall apply this Interpretation for annual periods beginning on or after [date to be set X months after publication]. If an entity applies this Interpretation for a period beginning before [date to be set], it shall disclose that fact.

22 An entity shall apply this Interpretation prospectively to transfers of assets from customers received in periods beginning on or after [date to be set].