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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 Basis for Conclusions (Agenda Paper 2C)**

The staff drafted the following basis for conclusions in accordance with the decisions taken by the IFRIC during its redeliberations. The staff welcome comments on these drafting proposals.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, draft IFRIC X.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 The IFRIC released draft Interpretation D24 *Customer Contributions* for public comment in January 2008 and received 59 comment letters in response.

Background

BC3 The IFRIC received a request to issue guidance on the accounting for transfers of items of property, plant and equipment by service providers that receive such transfers from their customers. Divergence had arisen in practice with some service providers recognising the transferred item at fair value and others recognising it at a cost of nil. Among those that recorded the item at fair value, some recognised the resulting credit as revenue immediately, while others recognised it over the period of the ongoing service. The IFRIC has prepared this Interpretation in response to that divergence in practice.

Scope

BC4 This Interpretation applies to the accounting for transfers of items of property, plant and equipment by entities that receive such transfers from their customers. In developing the Interpretation, the IFRIC decided that it would not address the accounting for transfers by the customers because it did not believe that similar issues arose to the same extent on the transferor's side.

BC5 In response to the request received by the IFRIC, draft Interpretation D24 suggested addressing two types of 'contributions': items of property, plant and equipment and cash. Respondents to D24 questioned whether other types of assets would lead to the same answer, eg intangible assets. In its redeliberations, the IFRIC decided not to expand the scope to assets other than those already considered in D24 but did not prohibit application by analogy in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC6 Therefore, agreements in the scope of this Interpretation are agreements that result in an entity receiving 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. The IFRIC also decided to include transfers of cash in the scope of the Interpretation because many respondents noted that, in practice, customers often transfer cash instead of transferring an item of property, plant and equipment. However, the IFRIC emphasised that, for a transfer of cash to be in the scope of this Interpretation, the agreement must require it to be used only for the construction or acquisition of the item of property, plant and equipment that would otherwise be contributed.

BC7 Many respondents to D24 were concerned that D24 could create unintended overlaps with existing IFRSs such as IFRIC 12 *Service Concession Arrangements* and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. In its redeliberations, the IFRIC agreed with these respondents and clarified that items within the scope of the Interpretation were not within the scope of IFRIC 12 or IAS 20.

BC8 Some respondents to D24 questioned the application by analogy to situations other than utility entities providing connection and access to their networks (eg electricity, gas, water or telecom networks). In its redeliberations, the IFRIC noted that this Interpretation might also be relevant to industries other than utilities. The IFRIC also clarified the background section of the Interpretation adding an example of an outsourcing agreement.

Issues

BC9 When an entity receives a transfer of an item of property, plant and equipment from a customer, the first issue is whether the item has effectively transferred to the entity or remained with the customer.

BC10 If the entity concludes that it should recognise the transferred item as its own asset, the issues are at what amount it should be recognised and how the resulting credit should be accounted for.

BC11 The last issue the IFRIC considered is how the entity should account for the receipt of a transfer of cash instead of a transfer of an item of property, plant and equipment.

Consensus

Are the criteria to recognise an asset met?

BC12 In its redeliberations, the IFRIC discussed the different steps that D24 required an entity to follow to determine whether an asset should be recognised, including the consideration of IFRIC 4 *Determining whether an Arrangement contains a Lease* and IAS 17 *Leases*. Although respondents to D24 generally did not object to the proposals, they believed that D24 was unduly complex and difficult to understand and apply. For this reason, the IFRIC decided to simplify the requirements and to address the issue of which entity controls the asset by giving guidance based on the *Framework* and existing IFRSs:

- Paragraph 9 gives guidance based on the *Framework*;
- Paragraph 10 gives guidance based on the relevant criteria set out in paragraph 9 of IFRIC 4 and paragraph 10(c) of IAS 17. Although the objective of IFRIC 4 is to determine whether an arrangement contains a lease, it does so by determining whether the arrangement effectively gives an entity a right to control the use of a physical asset. In the IFRIC's view, if either the criterion in paragraph 9(a) or that in paragraph 9(b) of IFRIC 4 is met, the entity could not conclude that it controls the asset.

As a result of this redrafting, readers of the Interpretation do not need to refer to other IFRSs or Interpretations.

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

BC13 When developing D24, the IFRIC was of the view that, in a normal trading transaction, the item of property, plant and equipment is received in exchange for something, ie the provision of services such as connection to a network, provision of ongoing access to a supply of goods or services or both.

BC14 The IFRIC noted that both paragraph 24 of IAS 16 *Property, Plant and Equipment* and paragraph 12 of IAS 18 *Revenue* lead to the same measurement attribute for such exchange transactions, ie the item received should be measured at fair value on initial recognition. Therefore, if the entity concludes that the recognition criteria are met, it should recognise the transferred asset as item of property, plant and equipment and measure it on initial recognition at its fair value. The IFRIC also noted that respondents to D24 generally agreed with that conclusion.

How should the credit be accounted for?

BC15 The following discussion assumes that the entity receiving a transfer of an item of property, plant and equipment from a customer has concluded that the item should be recognised as an asset and measured at fair value. The following discussion also assumes that the services to be provided in exchange for the transferred asset are part of the ordinary activities of the entity.

Identifying the components of the transaction

BC16 Many respondents to D24, including utility entities, noted that paragraph BC17 of D24 stated three possible alternatives:

a) The obligation is to provide the customer with goods or services at a reduced price in the future.

b) The obligation is to provide the customer with a connection to a network supplying goods and services. Making that connection settles the obligation.

c) The obligation is to provide the customer with ongoing access to a supply of goods or services.

Respondents concurred with these alternatives but they noted that, after having dismissed alternatives (a) and (b), the IFRIC concluded in paragraph BC19 of D24 that 'the obligation was to provide ongoing access to a supply of goods or services'. They questioned whether an entity receiving a transfer of an asset from a customer *always* has an obligation to provide ongoing access to a supply of goods or services. For example, some of them pointed out that, when a utility company is required by law or regulation to provide access to a supply of a commodity to all customers at the same price, it may have no further obligation once connection to the service has been made. Some of them also argued that an obligation to provide ongoing services to the customer who transferred the asset may exist only if the customer obtains in exchange some exclusive right of access to goods or services, eg at a reduced price. Overall, these respondents asked the IFRIC to reconsider the revenue recognition issue based on an IAS 18 approach.

BC17 In its redeliberations, the IFRIC agreed with these respondents that the timing of revenue recognition depends on facts and circumstances and that judgement is required. The IFRIC also acknowledged that a practical weakness of IAS 18 is that it gives insufficient guidance on contracts that provide more than one good or service to the customer. Therefore, the IFRIC decided to develop guidance based on paragraph 13 of IAS 18 to help identify the services to be provided in exchange for the transferred asset. This decision resulted in the indicators in paragraphs 15-17 of the Interpretation and the examples illustrating its application.

Revenue recognition

BC18 The IFRIC decided that the Interpretation should point out that, when more than one service is identified, the fair value of the total consideration received or receivable for the agreement should be allocated to each component in accordance with IAS 18 and its recognition criteria should be applied to each component. However, in the IFRIC's view, in the types of agreements in the scope of the Interpretation the entity would usually conclude that there is mainly one service to be provided in exchange for the receipt of the transfer, either the connection services or the provision of ongoing access to a supply of goods or services. Therefore, in most cases, no allocation would be required. This conclusion would not necessarily apply to other types of arrangements involving both initial and ongoing fees. The IFRIC acknowledged that this conclusion was different from the approach of always requiring revenue to be recognised over some period after initial recognition of the transferred asset, however short, that was set out in D24. However, the IFRIC concluded that the approach developed in the Interpretation was more consistent with the principles of IAS 18 and was responsive to the issues raised by many respondents.

BC19 If an ongoing service is identified as a component of the transaction, the entity must identify the period over which revenue should be recognised. Paragraph 20 of D24 stated that 'although the period over which an entity has an obligation to provide access to a supply of goods or services using a contributed asset may be shorter than the useful economic life of the asset, it cannot be longer.' Some respondents to D24 asked the IFRIC to clarify whether that period may be determined by the terms of the agreement and why that period cannot be longer than the economic life of the contributed asset.

BC20 The IFRIC agreed with respondents and clarified that the period over which revenue should be recognised for the ongoing service is generally determined by the terms of the agreement with the customer. If the arrangement does not specify a term, the IFRIC reaffirmed its view that the revenue should be recognised over a period no longer than the useful life of the transferred asset used to provide the ongoing service. This is because, the entity can only use the transferred asset to provide access to a supply of goods or services during its useful life and is generally responsible for repairs, maintenance, upgrade and replacement of that asset. Any obligation that exists after the asset is replaced does not arise from the original transfer but from the terms of the entity's operating license or other regulation.

BC21 Almost all respondents disagreed with paragraph BC22 of D24 that the time value of money should be taken into account when measuring revenue. The IFRIC agreed with respondents and noted that paragraph 11 of IAS 18 requires taking the time value of money into account only when payments are deferred.

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

BC22 Respondents to D24 were generally supportive of the IFRIC's proposals related to transfers of cash. However, some respondents asked the IFRIC to clarify the circumstances in which a cash transfer would be in the scope of the Interpretation.

BC23 In its redeliberations, the IFRIC discussed the accounting for agreements in which an entity receives a transfer of cash from a customer that it must use to construct or acquire an item of property, plant and equipment that the entity must then use to connect the customer to a network, to provide ongoing access to a supply of goods or services or both. The IFRIC reaffirmed its view that, in these circumstances, the economic effect of the transfer of cash was similar to that of a transfer of an item of property, plant and equipment. However, the IFRIC emphasised that, for a transfer of cash to be in the scope of this Interpretation, it must be restricted to the construction or the acquisition of the item of property, plant and equipment that would otherwise be transferred.

Transition

BC24 The IFRIC noted that applying the change in accounting policy retrospectively would require entities to establish a carrying value for assets that had been transferred in the past. That carrying value would be based on historical fair values. Those fair values may not be based on an observable price or observable inputs. The IFRIC therefore concluded that it would be impracticable to apply the proposed Interpretation retrospectively and that the Interpretation should require prospective application.

Changes from draft Interpretation D24

BC25 The most significant changes made from D24 in the light of comments received relate to:

(a) *Recognition of transferred assets*. As stated in BC12, the IFRIC decided to simplify the requirements and to address the issue of which entity controls the asset by giving guidance based on the *Framework* and existing IFRSs. As a result, readers of the Interpretation do not need to refer to other IFRSs or Interpretations.

(b) *Revenue recognition*. In the draft Interpretation, the IFRIC took the view of always requiring revenue to be recognised over some period after initial recognition of the transferred asset, however short. In its redeliberations, the IFRIC agreed with respondents to D24 that the timing of revenue recognition depends on facts and circumstances and that judgement is required. Therefore, the IFRIC decided to develop guidance based on paragraph 13 of IAS 18 to help identify the services to be provided in exchange for the transferred asset.

(c) *Title of the Interpretation*. The IFRIC noted that in some jurisdictions, the term ‘contribution’ has the implication of a donation rather than an exchange transaction. For that reason, the IFRIC decided to use the term ‘transfer’ and redrafted the Interpretation accordingly.

(d) *Illustrative examples*. The IFRIC decided that illustrative examples should accompany, but not be part of, the Interpretation to help entities apply the Interpretation.