30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

IFRIC meeting: **November 2007, London**

Project: **D24 *Customer Contributions* – Illustrative examples (Agenda Paper 2D)**

Introduction

1. At the September 2008 IFRIC meeting, the IFRIC generally supported the two examples presented by the staff (see below examples 1 and 2). However, the IFRIC directed the staff to link more clearly these examples to the revised draft and to develop an example of an outsourcing agreement.

Staff analysis

2. For discussion at this meeting, the staff present three examples:

   - **Example 1** is a transfer of an electricity substation in exchange for the connection to a price-regulated network. This example focuses on revenue recognition and illustrates the view held by some respondents that an entity receiving a transfer of an asset from a customer does not *always* have an obligation to provide ongoing access to a supply of goods or services. At its meeting in July 2008, the IFRIC agreed that it may not be always the case, depending on facts and circumstances.

- **Example 2** illustrates the issue of who controls the asset. Many respondents asked for clarification and more guidance on this issue. The IFRIC agreed to develop guidance based on existing IFRSs to help users apply the requirements of the Interpretation.
- **Example 3** is an example of a transfer of an item of property, plant and equipment as part of an outsourcing agreement. This example illustrates that the Interpretation would not apply only to utilities.

Example 1— Transfer of an electricity substation in exchange for connection to a price-regulated network

A real estate company is building a residential real estate development in an area that is not connected to the electricity network. In order to have access to the electricity network, the real estate company is required to construct an electricity substation that is then transferred to the utility company operating the electricity network. The transferred electricity substation becomes an asset of the utility company that it must maintain or replace at its cost. The utility company uses the transferred asset to connect each house of the residential real estate development to its electricity network. By regulation, the utility company has an obligation to provide on-going access to the electricity network to all connected customers at the same price, regardless of whether the customers transferred an asset. Customers can choose to purchase their electricity from suppliers other than the utility company but must use the utility's network to receive it.

Alternatively, the utility company could have constructed the substation and received a transfer of cash from the developer that had to be used only for the construction of the substation. The substation remains however an asset of the utility company.

In this example, the ongoing obligation to provide access to a supply of electricity arises from the terms of the entity's operating licence, not from the transfer of the substation or cash (see paragraph 17 of the Interpretation). In these circumstances, the obligation to provide on-going access to a supply of goods or services is not a component of the transaction. Rather, connecting the house to the electricity network is the only service to be provided in exchange for the substation (see paragraph 15 of the Interpretation). Therefore, the utility company should recognise revenue from the exchange transaction at the fair value of the transferred substation when the connection to the network is performed.

Example 2— Who controls the asset?

A house builder constructs a house on a brownfield site in a major city. As part of constructing the house, the house builder installs a pipe from the house to the water main in front of the house. The house builder transfers the pipe to the water company that the latter must use to provide an on-going supply of water to the house. The house receives all of the output from that pipe. The house owner has the ability to dictate how much water flows through the pipe, and can restrict the water company from using the pipe for any purpose other than supplying the house. Furthermore, no other user can use that pipe.

In this example, the facts indicate that the houseowner controls the use of the pipe. The recognition criteria would not be met for the water company that receives the transferred pipe (see paragraph 10 of the Interpretation).

Alternatively, the house is built on a greenfield site some distance from the nearest house. Again, a pipe is built that connects the house to the nearest water main (some distance away in a local town) and is transferred to the water company. The house is in an area which is being rapidly developed, and future houses will also be connected to the water pipe.

In this case, it is likely that other customers will have access to a significant part of the water pipe's output, so the owner of the first house will not control the use of the pipe. The recognition criteria are likely to be met for the water company that receives the transferred pipe.

Example 3— Transfer of assets in an outsourcing agreement

An entity enters into an agreement with a customer involving the outsourcing of the customer's information technology (IT) functions. As part of the agreement, the customer transfers ownership of its existing IT equipment to the entity. The entity is responsible for its maintenance and replacement. The entity must use the equipment to provide the service required by the outsourcing agreement. The useful life of thee equipment is estimated to be 3 years. The outsourcing agreement requires service to be provided for 10 years for a fixed price lower than the entity would have charged if the IT equipment had not been transferred.

In this example, the facts indicate that the recognition criteria are met for the IT equipment (see paragraph 9 of the Interpretation). Therefore, the entity should recognise and measure the equipment on initial recognition at its fair value in accordance with paragraph 24 of IAS 16 *Property, Plant and Equipment*. The fact that the price of the service to be provided under the outsourcing agreement is lower than the entity would charge without the transfer of the IT equipment indicates that this service is a component of the transaction. The facts also indicate that it is the only service to be provided in exchange for the transfer of the IT equipment. Therefore, the entity should recognise revenue arising from the exchange transaction when the service is provided, ie over the 10 year term of the outsourcing agreement.

Alternatively, assume that after the first three years, the price the entity charges under the outsourcing agreement increases to reflect the fact that it will then be replacing the equipment the customer transferred.

In this case, the reduced price for the services provided under the outsourcing agreement reflects the useful life of the transferred equipment. For this reason, the entity should recognise revenue from the exchange transaction over the first 3 years of the agreement.

Questions for the IFRIC

3. Do you have any comments on these examples? Do you think these examples should accompany, but not be part of, the Interpretation?