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INFORMATION FOR OBSERVERS

IFRIC meeting: **September 2008, London**

Project: **D24 *Customer Contributions:* Introduction to the revised draft (Agenda Paper 2B)**

Introduction

1. The purpose of this agenda paper is to summarise the principles on which the revised draft proposed by the staff in agenda paper 2C is based. This agenda paper:

   (a) clarifies the scope;

   (b) simplifies the requirements to recognise customer contributions as items of property, plant and equipment; and

   (c) clarifies when revenue should be recognised.

Staff analysis

Section A – Clarification of the scope

2. Some respondents to D24 were confused about the role of each party to the transaction and which party the Interpretation would apply to:

   (a) Some questioned what 'access provider' means and asked the IFRIC to define such a term. *The meaning of "provide access" and "access provider" is critical to understanding the scope of the Interpretation.* (CL9)

   (b) *although much of the wording of the consensus focuses on the accounting treatment of the access provider, the scope paragraph seems to be saying that the draft interpretation is applicable to all the parties involved* (CL54)

   (c) What *another party* means in the last sentence of paragraph 4 of D24 that states that 'the customer that receives access to a supply of goods or services may contribute the asset or it may be contributed by another party'?

   (d) *Would the Interpretation apply if the access provider already holds the asset in inventory, that is, if the access provider is also the constructor of the asset?* (CL51)

3. Many respondents were also concerned that D24 could create unintended overlaps with existing IFRSs such as IFRIC 12 and IAS 20. They recommend excluding such IFRSs.

4. The staff agree with respondents that the scope of D24 should be clarified. The revised draft deals only with two parties: the entity that receives the contribution and the entity that makes the contribution. The staff note that some respondents were confused by the definitions set out in paragraph 5 of D24. In the revised draft set out in Agenda Paper 2C, the staff redrafted the background and the scope of the Interpretation and removed the definitions on the basis that a clarified scope should be sufficient on its own.

5. The staff did not expand the scope to other types of assets such as intangible assets. The staff suggest discussing whether the scope should be expanded once the IFRIC has reached a consensus with the current scope.

6. Question for IFRIC members: Do you agree with the drafting of the scope suggested by the staff in paragraphs 2-5 of Agenda Paper 2C?

Section B - Recognition and measurement of a contributed item of property, plant and equipment

7. The staff remind the IFRIC of the logic that was the basis for the conclusions in D24:
   - Are the recognition criteria met? If so, recognise the contributed asset at fair value;
   - Does the arrangement contain a lease in accordance with IAS 17 or IFRIC 4?
   - If the arrangement contains a lease, assess whether that lease is an operating or finance lease in accordance with IAS 17.
     - If it is a finance lease, the entity has settled its obligation to provide the customer with access to a supply of goods or services by returning the asset to the customer by way of the finance lease. In that case, the entity does not recognise either the contribution or the obligation to provide access.
     - If it is an operating lease, account for that lease in accordance with IAS 17.
   - If there is no lease, revenue is recognised over the period over which the entity has an obligation to provide access to a supply of goods or services, but no longer than the useful economic life of the contributed asset.

8. Respondents generally agreed with the IFRIC's proposal in paragraphs 8-10 of D24 that deal with recognition of the contributed item of property, plant and equipment (PP&E), including measurement at fair value. However, they pointed out that D24 was overly complex. For example EFRAG said 'we think the draft approaches the transaction in an overly complex way, and the result is an

Interpretation that is difficult to follow and understand.' Some respondents asked the IFRIC to refer specifically to the *Framework* in order to avoid any confusion around the notion of control.

9. The staff think that a simple way to clarify D24 on this aspect would be to require the entity that receives an item of PP&E from a customer to assess whether it controls that item or whether the customer retains control of that item. Paragraph 7 of the revised draft in Agenda Paper 2C quotes paragraph 89 of the Framework and gives guidance on whether the recognition criteria are met. Paragraph 8 of that draft uses the relevant criteria in paragraph 9 of IFRIC 4 as part of the determination of whether the entity has anything to recognise in the first place. It seems to the staff that if either criterion 9(a) or 9(b) of IFRIC 4 is met, the entity could not conclude that it controls the asset. By adopting this approach, the Interpretation would not require readers to think about the lease literature and would avoid the question of whether all sales with finance leasebacks should not result in derecognition of the original asset (see the implications of an approach using IFRIC 4 in agenda paper 4A and its appendix presented at the September 2007 IFRIC meeting[1]).

10. Questions for the IFRIC: Do you agree with the staff's approach to simplifying the analysis the Interpretation requires to determine whether the contributed asset should be recognised? If not, what approach do you suggest?

Section C - How should the credit be accounted for?

11. The following discussion assumes that, if the entity received a customer contribution in the form of an item of PP&E, the entity concluded that it should recognise the item and measure it at fair value on initial recognition. Therefore the question is how should the resulting credit be accounted for?

12. Paragraph BC23 of D24 states that 'the IFRIC noted that the economic effect of a cash contribution was similar to the effect of a contribution of property, plant and equipment. The IFRIC therefore decided to include cash contributions in the scope of its Interpretation.'

[1] http://www.iasb.org/Current+Projects/IFRIC+Projects/D24+Customer+Contributions/Meeting+Summaries+and+Observer+Notes/IASB+September+2007.htm

13. In the revised draft, the staff carried over this view but explicitly refer to IAS 18 in support of this view. Paragraph 12 of IAS 18 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.' Therefore, the staff think that the consideration received or receivable for providing goods or services can be either cash or an item of PP&E, or a mix of both. In any event, this consideration needs to be measured at fair value.

14. For these reasons, the staff think that, provided that cash contributions are explicitly within the scope of the Interpretation, it is not necessary to specify the nature of the consideration for revenue recognition purposes.

Indentifying the components of the transaction

15. At the July 2008 IFRIC meeting, the IFRIC discussed an example of a customer contribution for connection to a price-regulated network. The IFRIC generally supported the staff's conclusion that, in the specific facts of the example (see example 1 in Agenda Paper 2D), the ongoing obligation to provide access arises from the terms of the operating licence not from the contribution. The IFRIC concluded that in these circumstances the ongoing performance obligation is an executory contract and should not be accounted for, unless it is onerous. However, some IFRIC members questioned whether, in accordance with paragraph 13 of IAS 18, connection services would be identified as a separate component from the ongoing service of providing access to the network. The IFRIC directed the staff to develop indicators based on IAS 18 to help identify components.

16. In paragraphs 13 and 14 of the revised draft, the staff provide features that indicate that:

    - connecting the customer to the network is a separately identifiable component;
    - the service to provide on-going access to a supply of goods or services is a component of the transaction;

Whether connecting the customer to the network is a separately identifiable component

17. The staff note that the indicator ‘a service is provided to the customer and represents value for that customer’ set in paragraph 13(a) of the revised draft is consistent with example 10 *Installation Fees* in the Appendix to IAS 18 (Installation fees are recognised as revenue by reference to the stage of completion of the installation, unless they are *incidental* to the sale of a product, in which case they are recognised when the goods are sold). For example, connecting a house to an electricity network is a service that is essential to the provision of ongoing access to the supply of electricity and will increase the value of that house. No revenue from the provision of ongoing access will flow to the utility company without connecting the house to the network. Therefore connection services are not *incidental* to the provision of ongoing access.

18. The staff also note that connection services could be sold separately and for that reason introduced such a feature in the revised draft (see paragraph 13(c)).

Whether the service to provide on-going access to a supply of goods or services is a component of the transaction

19. In developing the guidance set out in paragraph 14 of the revised draft, the staff reflected the view reached at the last IFRIC meeting.

20. Questions for the IFRIC: Do you think that the guidance suggested by the staff in paragraphs 12 to 14 of the revised draft would be useful and should be included in the final Interpretation? Do you think other indicators should be provided?

Revenue recognition

21. Paragraph 16 of D24 states that ‘The period over which revenue is recognised shall be the period over which the entity has an obligation to continue to provide access to a supply of goods or services using the contributed asset.’ Further, paragraph 20 of D24 states 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.’

22. When the service to provide on-going access to a supply of goods or services is identified as a separate component of the transaction, paragraph 16 of the revised draft interpretation is consistent with D24 in terms of revenue recognition.

23. Question for the IFRIC: Do you agree with this view?

Disclosures

24. Customer contributions may be significant when for example the customer is located far from the network or when the volume of the goods or service that will be purchased requires substantial equipment.

25. Question for the IFRIC: should the disclosures already required by IAS 1, IAS 16 and IAS 18 be considered sufficient or should additional specific disclosures be required?

Question for the IFRIC

26. Do you support the draft revised by the staff set out in agenda paper 2C?