IFRIC

International Accounting Standards Board®

International Financial Reporting Interpretations Committee

IFRIC DRAFT INTERPRETATION D24

Customer Contributions

Comments to be received by 25 April 2008

IFRIC Draft Interpretation D24 *Customer Contributions* is published by the International Accounting Standards Board (IASB) for comment only. Comments on the draft Interpretation should be sent in writing so as to be received by **25 April 2008**. Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org) using the 'Open to Comments' page with a copy emailed to ifric@iasb.org.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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INVITATION TO COMMENT

The International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC) invites comments on any aspect of this draft Interpretation *Customer Contributions*. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **25 April 2008**.

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IFRIC DRAFT INTERPRETATION D24

Customer Contributions

IFRIC [draft] Interpretation X *Customer Contributions* ([draft] IFRIC X) is set out in paragraphs 1–24. [Draft] IFRIC X is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 2 and 7–17 of the *Preface to International Financial Reporting Standards.*

References

- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 11 *Construction Contracts*
- IAS 16 *Property, Plant and Equipment*
- IAS 17 *Leases*
- IAS 18 *Revenue*
- IFRIC 4 *Determining whether an Arrangement contains a Lease*
- IFRIC 12 *Service Concession Arrangements*

Background

1 In some industries, entities receive contributions of property, plant and equipment that must be used to provide access to a supply of goods or services to customers. Sometimes, the entities receive cash contributions that must be used to acquire or construct such items of property, plant and equipment. The contributions may be received from the customers who will purchase the goods and services or from other parties. In some cases, the entity that provides access may not be the supplier of the related goods or services. Customers are typically required to pay additional amounts for the goods or services based on usage.

2 In such situations, it is not clear:

(a) whether the contribution gives rise to an asset of the entity receiving the contribution;

(b) if an asset is recognised, at what amount the items of property, plant and equipment should be recorded on initial recognition by the entity receiving the contribution;

(c) if the item of property, plant and equipment is recorded at an amount other than its cost to the entity receiving the contribution, how the resulting credit should be accounted for.

3 This [draft] Interpretation gives guidance on the accounting for the receipt of such contributions in the financial statements of an access provider.

Scope

4 This [draft] Interpretation applies to all situations in which an entity receives an item of property, plant and equipment or cash it is required to use to construct or acquire an item of property, plant and equipment that must be used to provide access to a supply of goods or services. The customer that receives access to a supply of goods or services may contribute the asset or it may be contributed by another party.

Definitions

5 The following terms are used in this [draft] Interpretation with the meanings specified:

A *customer contribution* is an item of property, plant and equipment that is contributed to an access provider. The access provider is required to use the item of property, plant and equipment to provide access to a supply of goods or services to a customer or customers.

A *cash contribution* is a payment of cash to an access provider. As a result of receiving the cash, the access provider is required to acquire or construct an item of property, plant and equipment that it must use to provide access to a supply of goods or services to a customer or customers.

6 A customer contribution or a cash contribution may be received from a customer or prospective customer or from another entity. The access provider may supply the related goods or services to the customers itself or may operate a network that provides customers with access to a supply of goods or services from other suppliers.

Issues

7 The [draft] Interpretation addresses the following issues:

(a) How should an entity determine whether it should recognise an asset as a result of receiving a customer contribution?

(b) If an entity recognises an asset as a result of receiving a customer contribution, at what amount should the contributed property, plant and equipment be initially recognised?

(c) If a customer contribution is recorded at fair value on initial recognition, how should the resulting credit be accounted for?

(d) How should an entity account for the receipt of a cash contribution?

Consensus

Recognition of a customer contribution as an asset

8 An entity that has received a customer contribution shall assess whether the contributed resource qualifies for recognition as an asset. If so, that resource shall be recognised as property, plant and equipment and measured on initial recognition at its fair value.

9 The entity shall determine whether the resource received meets the definition of an asset as well as the recognition criteria set out in the *Framework*. In particular, in determining whether the resource qualifies for recognition as an asset, the entity shall assess whether it controls the resource and whether future economic benefits are expected to flow to it from that resource.

10 In order to demonstrate that it controls the resource, the entity shall consider the terms and conditions of the arrangement to assess whether it has the ability to access the benefits arising from the resource and whether it has the power to restrict others' access to those benefits. In some circumstances, the entity may be using the contributor's asset to provide access to a supply of goods or services. In such cases, the resource is not an asset of the entity.

Obligation to provide access to a supply of goods or services

11 An entity that receives an asset that meets the definition of a customer contribution has an obligation to provide access to a supply of goods or services. That obligation shall be recognised in the statement of financial position and measured on initial recognition at the fair value of the contribution received. The obligation shall be reduced and revenue recognised as access to a supply of goods or services is provided.

Determining whether the ongoing arrangement contains a lease

12 An entity that has received an asset as a result of a customer contribution shall assess whether the ongoing arrangement to provide access to a supply of goods or services using that asset contains a lease. Determining whether an arrangement is or contains a lease shall be based on the substance of the arrangement. This assessment shall be made in accordance with IAS 17 and IFRIC 4.

13 An entity that determines that the ongoing arrangement contains a lease shall assess whether that lease is an operating or finance lease in accordance with IAS 17.

14 An entity may determine that it has received an asset as a result of a customer contribution and that an ongoing service arrangement entered into at the same time contains a finance lease. In these situations, when the arrangement is considered as a whole, the entity does not have an asset that it may recognise. 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. Because the asset is recognised and the liability is settled immediately afterwards, the entity does not recognise either the contribution or the obligation to provide access.

15 An entity that determines that the ongoing service arrangement contains an operating lease shall account for that lease in accordance with IAS 17.

Provision of access to a supply of goods or services

16 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.

17 The obligation to provide access to a supply of goods or services may be to the contributor of the asset or to another party or parties. Those parties may or may not be identified at the time the contribution is made.

18 The obligation to provide access may arise as a result of a contract. It may also arise as a result of law or regulation. For example, a law that requires a utility provider to continue to provide occupants of residential properties with access to goods or services creates an obligation to provide access.

19 Alternatively, the obligation may be a constructive obligation that arises as a result of the entity's past actions in situations in which:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other existing or future customers that it will provide access to a supply of goods or services using the contributed asset; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will do so.

20 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.

Accounting for a cash contribution

21 An entity that receives a cash contribution shall first consider whether the asset that must be acquired or constructed as a result of receiving the cash contribution will meet the criteria for recognition as an item of property, plant and equipment of the entity. If not, the entity shall account for the cash contribution as proceeds for providing the asset to the customer, using IAS 11 or IAS 18 as applicable.

22 If the asset that is acquired or constructed will meet the criteria to be recognised as an item of the entity's property, plant and equipment, it shall be recognised and measured as it is constructed or acquired in accordance with IAS 16. In this case, the entity that receives the cash contribution has an obligation to use that asset to provide access to a supply of goods or services. That obligation shall be measured with reference to the cash contribution received and accounted for as described in paragraphs 11 and 16–20 above.

Effective date

23 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [date to be set at three months after the Interpretation is finalised]. If an entity applies this [draft] Interpretation for a period beginning before [date to be set at three months after the Interpretation is finalised], it shall disclose that fact.

Transition

24 An entity shall apply this [draft] Interpretation prospectively to contributions received in periods beginning on or after [date to be set at three months after the Interpretation is finalised].

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.

Consensus

BC2 The IFRIC received a request for it to issue guidance on the accounting for customer contributions received by an access provider. Divergence had arisen in practice with some entities recognising the contributed asset at fair value and others recognising it at a cost of nil. Amongst those that recorded the asset at fair value, some recognised the resulting credit as revenue immediately while others recognised it over the period of the ongoing service.

BC3 The IFRIC has prepared this draft Interpretation in response to that divergence in practice. In developing the Interpretation, the IFRIC decided that it would not address the accounting for the contribution by the contributor because it did not believe that similar issues arose to the same extent for the contributor.

Determining whether an asset has transferred

BC4 The IFRIC considered that, in many cases, a customer contribution will not give rise to an asset that meets the recognition criteria. For example, there may be requirements or contractual terms attached to the transfer of the asset that result in control of the asset or the benefits associated with it remaining with the contributor. In this case the access provider uses the contributor's asset to provide access to a supply of goods or services.

BC5 In developing the draft Interpretation, the IFRIC decided to include guidance making it clear that an entity that receives a customer contribution must first assess whether it has received an asset that meets the recognition criteria. Without the receipt of an asset it may recognise, no customer contribution has taken place.

BC6 In developing this guidance, the IFRIC decided to stress the elements of the definition of an asset that are likely to be relevant to an entity receiving a customer contribution, ie the ability to control the asset and the ability to receive benefits from that asset.

BC7 The IFRIC considered whether to develop detailed indicators that an entity could use to determine whether a contributed resource qualifies for recognition as an asset. The IFRIC noted that determining whether a contributed resource qualifies for recognition is no different from determining whether any item of property, plant and equipment should be recognised. Therefore, any guidance developed in this area would be applicable to a far wider range of circumstances than customer contributions. Beyond emphasising the need to consider all the terms and conditions of the arrangement, the IFRIC concluded it was not appropriate to include such indicators in its proposed Interpretation.

Recording the contributed asset

BC8 The IFRIC considered whether the contributed asset should be initially recorded at cost or at fair value. Paragraph 24 of IAS 16 *Property, Plant and Equipment* requires an item of property, plant and equipment acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, to be measured at fair value on initial recognition.

BC9 The IFRIC concluded that the customer providing the property, plant and equipment to the supplier received a non-monetary asset in return—an ability to access a supply of goods or services. That ability may exist over a specified period of time, for example a contract period. Alternatively, it may be a right to enter into negotiations for a future agreement to receive services. In either case, it is a non-monetary asset.

BC10 Because the IFRIC concluded that the property, plant and equipment was received in exchange for a non-monetary asset, it decided that IAS 16 required the property, plant and equipment to be recorded on initial recognition at its fair value.

Determining whether the ongoing arrangement contains a lease

BC11 The IFRIC noted that an entity receiving a customer contribution must use that asset to provide access to an ongoing service to a customer. The question therefore arises whether the ongoing service arrangement contains a lease of the asset back to the customer.

BC12 IFRIC 4 *Determining whether an Arrangement contains a Lease* provides guidance on how an entity should assess whether an ongoing service contract contains a lease. IAS 17 *Leases* contains detailed guidance on how an entity should account for a lease.

BC13 The IFRIC decided that the proposed Interpretation should require entities receiving a customer contribution to apply IFRIC 4 to assess whether a leaseback has taken place. If an entity concludes that a leaseback has occurred, it should apply IAS 17 to account for the lease. The IFRIC decided that IAS 17 and IFRIC 4 provided sufficient guidance on how to determine whether the ongoing arrangement contains a lease and on how to account for an operating lease.

BC14 The IFRIC then considered a situation in which an entity received a customer contribution and concluded that the ongoing service arrangement contained a finance lease. The IFRIC noted that, by returning the asset to the customer by way of a finance lease, the entity had settled its obligation to provide the contributor with access to a supply of goods or services. As a result, the customer would be provided with access using its own asset. The IFRIC therefore concluded that an entity that returned the property, plant and equipment to its customer by way of a finance leaseback had settled its obligation.

BC15 Similarly, the IFRIC noted that the access provider did not have an asset to recognise because the asset was returned to the customer by way of the finance lease. When all that the customer needs to obtain access is the asset, the customer has no obligation to make any future payments to the access provider in return for access to a supply of goods or services. The IFRIC therefore concluded that, if an entity received a customer contribution and determined that its ongoing service arrangement contained a finance leaseback to the customer, it should not recognise an asset or obligation.

Obligation to provide access to a supply of goods or services

BC16 In determining how a customer contribution should be measured on initial recognition, the IFRIC concluded that the item of property, plant and equipment is received in exchange for a non-monetary asset. The customer's asset is its ability to access a supply of goods or services. The customer's ability to access a supply of goods or services from the access provider gives rise to an obligation of the access provider.

BC17 In considering what the obligation relates to, the IFRIC considered three possible alternatives:

(a) The obligation arises as a result of the supplier agreeing to provide goods or service to the customer at a reduced price in the future.

(b) The obligation is to provide a connection to a network supplying goods and services. Once that connection has been made, the obligation is settled.

(c) The obligation is to provide an ongoing access to a supply of goods or services.

BC18 The IFRIC noted that, in many cases, customers that make a contribution pay the same price for ongoing services as those that do not. The IFRIC therefore rejected the first option. The IFRIC also rejected the second option because, in many cases, once the supplier receives the asset it has a continuing obligation to use the asset to provide customers with access to a supply of goods or services.

BC19 The IFRIC therefore concluded that the obligation was to provide ongoing access to a supply of goods or services. In reaching this conclusion, the IFRIC noted that, while the obligation is an ongoing obligation, it may exist for only a very short period of time. In particular, the supplier may be obliged to provide access for a shorter period than the useful economic life of the asset.

BC20 In contrast, because the obligation is to provide access to a supply of goods or services *using the contributed asset*, the IFRIC considered that the obligation could not exist for a longer period than the useful economic life of the asset.

BC21 In the IFRIC's view, the provision of access to a supply of goods or services is likely to be part of the ordinary activities of an access provider that has received a customer contribution. Furthermore, the settling of the obligation will give rise to increases in equity that do not relate to contributions from owners. The IFRIC therefore concluded that settling the obligation would give rise to revenue.

BC22 In reaching this conclusion, the IFRIC noted that many of the arrangements that arise as a result of a customer contribution last for a significant period. The time value of money should be taken into account in measuring the revenue that is recognised.

Accounting for a cash contribution

BC23 The IFRIC noted that, if it restricted the scope of its proposed Interpretation to the contribution of items of property, plant and equipment, the Interpretation would not be applicable to a significant number of transactions in which a cash contribution is made. In particular, it would not be applicable to situations in which the entity receiving the cash contribution must acquire or construct an item of property, plant and equipment that is then used to provide the customer with access to a supply of goods or services. 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.

BC24 The IFRIC considered five different views as to how cash contributions should be accounted for:

(a) The acquisition or construction of an item of property, plant and equipment that remains the property of the access provider is not a service to a customer. Instead, it is a necessary activity in providing access to a supply of goods or services to a customer. The cash contribution should therefore be accounted for as an advance payment for the provision of access to a supply of goods or services. The construction or acquisition of the property, plant and equipment should be accounted for as the construction or acquisition of an item of property, plant and equipment for use in delivering a service to a customer.

(b) A customer making a cash contribution does so in order to receive access to a supply of goods or services. Without that access, the contribution is worthless. While the acquisition or construction of an item of property, plant and equipment is a service to the customer, no consideration should be allocated to it. Instead, the cash contribution should be treated as an advance payment for access to a supply of goods or services. An entity receiving a cash contribution should recognise an obligation to provide access when the cash is received. This obligation should be reduced and revenue recognised as the access is provided. The acquisition or construction of the property, plant and equipment should be accounted for in the same way as the acquisition or construction of any item of property, plant and equipment by the service provider for its own use.

(c) The access provider provides two services. One is the construction or acquisition of the property, plant and equipment. The other is the provision of access to a supply of goods or services. The total revenue for these services (including both the cash contribution and any ongoing payments) should be apportioned between these services on the basis of their fair values and recognised as revenue as the services are provided.

(d) The access provider provides two services. One is the construction or acquisition of the property, plant and equipment. The other is the provision of access to a supply of goods or services. The revenue for the construction or acquisition is the cash contribution. The revenue for the access is the ongoing charge. The cash contribution should be recognised as revenue in accordance with IAS 11 *Construction Contracts* or IAS 18 *Revenue* (as appropriate) as the construction or acquisition takes place.

(e) The acquisition or construction of the asset is a service to the customer that is paid for by the cash contribution. Revenue, being the amount of the cash contribution received, should be recognised in profit or loss as the asset is constructed or acquired. The cost of acquiring or constructing the asset should be recognised as the cost of sales. Once construction is complete, the contributed asset should be recognised at fair value as a customer contribution. An obligation to provide access to a supply of goods or services should be recognised and included in profit or loss as revenue as the access is provided.

BC25 Because the IFRIC concluded that the receipt of a cash contribution has a similar economic effect to the receipt of an item of property, plant and equipment, it also concluded that either form of contribution should result in a similar accounting outcome.

BC26 The IFRIC noted that it had previously concluded that an entity receiving a contribution of property, plant and equipment had an obligation to provide access to a supply of goods or services. It concluded that an entity receiving a cash contribution had the same obligation. It therefore rejected views (c) and (d) on the basis that these approaches record a different obligation depending upon whether property, plant and equipment or cash to acquire or construct property, plant and equipment is contributed.

BC27 The IFRIC considered whether the construction of the property, plant and equipment constituted the provision of a service to the customer. It concluded that the access provider was obliged to provide the customer with access to a supply of goods or services. Constructing an asset for its own use in providing that access may be an activity that is necessary to provide that service but is not, in itself, a service to a customer that generates revenue. The IFRIC therefore rejected views (b) and (e), which treat the acquisition or construction of the asset as a service to the customer.

BC28 The IFRIC therefore concluded that its Interpretation should reflect view (a).

BC29 In reaching this conclusion, the IFRIC noted that its conclusion in respect of recognising revenue for construction services differed from its conclusions when it had developed the Intangible Asset model in IFRIC 12 *Service Concession Arrangements*. The IFRIC concluded that, in the case of a service concession, the constructor of the property, plant and equipment was obliged to construct the asset for another party, the grantor. The recipient of a cash contribution constructs its own asset for its own use. Furthermore, a service concession operator receives a right to charge users of the infrastructure, which it recognises as an intangible asset, in return for providing the property, plant and equipment to the grantor. In contrast, the recipient of a customer contribution has an obligation to provide access to a supply of goods or services.

BC30 The IFRIC therefore concluded that the construction of an item of property, plant and equipment as a result of a cash contribution was fundamentally different from the construction of an asset by a service concession operator.

Transition

BC31 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that a change in accounting policy that is required by an IFRS shall be applied retrospectively 'except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.'

BC32 Paragraph 52 of IAS 8 states that applying a new accounting policy retrospectively requires an entity to distinguish two types of information. It concludes that 'For some types of estimates (eg an estimate of fair value not based on an observable price or observable inputs), it is impracticable to distinguish these types of information ... [therefore] it is impracticable to apply the new accounting policy ... retrospectively.'

BC33 The IFRIC noted that applying its Interpretation retrospectively would require entities to establish a carrying value for assets that had been contributed 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.