TA ALERT 2010-52
NOVEMBER 2010

Grant Thornton

Technical Accounting Alert

IFRIC 18 Transfers of Assets from Customers

Relevant standards

References are made to standards issued by the International Accounting Standards Board. The Australian equivalent to each standard included in this alert is shown below:

International Standard reference	Australian equivalent standard
IFRIC 18 Transfers of Assets from Customers	Interpretation 18 Transfers of Assets from Customers
IFRIC 12 Service Concession Arrangements	Interpretation 12 Service Concession Arrangements
IAS 16 Property, Plant and Equipment	AASB 116 Property, Plant and Equipment
IAS 18 Revenue	AASB 118 Revenue
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance	AASB 120 Accounting for Government Grants and Disclosure of Government Assistance

Introduction

On 29 January 2009, the International Financial Reporting Interpretations Committee (IFRIC) published IFRIC 18 *Transfers of Assets from Customers*. IFRIC 18 applies to the recipient of a transfer of property, plant and equipment from a customer where the item received must be used to connect the customer to a network and/or provide ongoing access to a supply of goods or services. In practice the recipients of such transfers tend to be companies in the utilities industry.

IFRIC 18 was developed in response to divergent views on how to account for such transfers. The main issues to be addressed include:

- whether an asset should be recognised by the recipient (and, if so, the amount to be recognised)
- whether these transactions result in revenue for the recipient and, if so, the period over which revenue is recorded.

IFRIC 18 addresses situations such as those where a property developer constructs a water supply system for a new housing development and 'donates' the resulting asset to the water supply company (or pays the water supplier to undertake the construction) which in turn connects the houses to its network. In some jurisdictions the rights and obligations of the developer and the water supplier are set out in local law or regulation. In other cases such matters are negotiated by the two parties.

Overview

IFRIC 18

Scope of IFRIC 18

IFRIC 18 applies to agreements in which an entity receives an item of property, plant and equipment from a customer* that the entity must then use to connect the customer to a network, or to provide the customer with ongoing access to a supply of goods or services, or both. It also applies to agreements in which an entity receives cash that must be used only to construct or acquire property, plant and equipment that must be used for those purposes.

IFRIC 18 does not apply to transfers that fall within the scope of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* or IFRIC 12 *Service Concession Arrangements.*

* IFRIC 18 refers for convenience to the entity transferring the asset as the 'customer'. It notes however that the transferor of the asset will not always be the entity that will eventually have access to the supply. For example, in the example above, the donor is the property developer but services will be provided to the occupants of the houses.

Should an asset be recognised by the recipient?

IFRIC 18 requires that the recipient recognises an asset in respect of the transferred item if that item meets the definition of an asset as set out in the Framework. The key consideration in applying that definition is whether the recipient controls the item in question.

Assessing control

IFRIC 18 provides very limited guidance on determining whether the recipient has obtained control over the transferred item. The IFRIC notes that in most circumstances the entity obtains the right of ownership of the transferred item although it adds that obtaining ownership is not necessarily conclusive in making the assessment. It does note however that "although the entity must use the transferred item of property, plant and equipment to provide one or more services to the customer, it may have the ability to decide how the transferred item of property, plant and equipment is operated and maintained and when it is replaced. In this case, the entity would normally conclude that it controls the transferred item…".

Our preliminary assessment is that the control criterion will usually be met. However, in some arrangements the customer might retain substantial rights of access and decision-making powers to the extent that the customer, rather than the recipient, is regarded as having control.

At what amount?

If an asset is recognised, it is recorded at fair value on initial recognition.

Revenue recognition

IFRIC 18 considers that transfers within its scope that give rise to a recognised asset for the recipient are revenue generating transactions. This is on the grounds that 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.' The issue is then the period over which the revenue is recorded. Paragraphs 14 to 20 of IFRIC 18 provide guidance on this matter. In summary, the appropriate pattern of revenue recognition depends on the service or services that the recipient has agreed to provide to the customer. These might be:

- *a connection service* - recognise revenue when the connection is delivered;
- *ongoing access to a supply of goods and services* - recognise revenue over the term specified in the agreement (or the useful life of the transferred asset if the agreement does not specify a term);
- *both services* - allocate revenue between the two service components then apply the revenue recognition criteria to each component.

Assessing the services being provided by the recipient

The timing of revenue recognition will be greatly affected by the assessment of which separately identifiable services the recipient has agreed to provide. Revenue would be recognised much sooner if, for example, the assessment concludes that the only service is connection. IFRIC 18 provides brief but useful guidance in making this determination:

- if the **customer receives value from the service connection** and its fair value can be measured reliably this indicates that the connection is a separately identifiable service
- the **pricing of the subsequent good or services** is also an important factor:
  - if the customer pays a lower price for the ongoing goods or services than would otherwise be charged, this indicates that the identifiable service is the ongoing access to goods and services

conversely, if the recipient is obliged to provide the connection under the terms of its licence and the customer pays the same price as other customers that have not transferred assets, this indicates that the recipient is not providing the customer with ongoing access to a supply of goods and services.

Cash contributions

Cash contributions that are within the scope of IFRIC 18 are accounted for as follows:

- the asset constructed by the developer is recoded at cost in accordance with IAS 16;
- the cash received is recognised as revenue in a manner consistent with the above guidance and IAS 18.

Effective date and transition

IFRIC 18 must be applied **prospectively** to transfers of assets received on or after 1 July 2009. Earlier application is permitted provided the valuations and other information needed to apply the Interpretation to past transfers were obtained at the time those transfers occurred.

Grant Thornton comment
We welcome the publication of this guidance. We are also pleased to note that the final Interpretation addresses the concerns we expressed in our comment letter of April 2008 on the exposure draft which preceded it.

Applying the IFRIC 18 approach will require judgement, in particular in assessing whether an asset should be recognised and, if so, the period over which the associated revenue should be recorded. It is also likely to result in a number of companies in the utility sector changing their accounting policies. Nonetheless IFRIC 18 should result in more consistent application in an area where practice has been diverse and is therefore to be welcomed.

Example

A property developer is constructing a retail park and, as part of that development, will install a network of underground water supply pipes. Under local law, those pipes will be donated free of charge to the local water supply company ("W"). Under the terms of its licence agreement, W is obliged to:

- connect the new water pipes to its existing network
- supply water to the developer or the subsequent owners/occupant of the retail park at a 10% discount for a 5 year period.

After the transfer, W is obliged to maintain supply to the retail park but has unrestricted access to the supply system, full maintenance responsibilities and discretion over how and when to maintain or replace the new pipelines.

W determines that the fair value of the new pipelines it receives is $10m. It considers that the connection has value to the developer because it will enhance the value of the development. It assesses the fair value of the connection it provides as $2m on the basis of other arrangements in which a connection fee is negotiated. It estimates the fair value of the discount on the water it will supply as $6m based on the present value of estimated future cash flows.

On the basis of the above facts, it seems appropriate for W to:

- record the asset at its fair value of $10m (entity W appears to have control of the transferred pipelines)
- recognise revenue of $2.5m on connection (25% of the total, determined on a relative fair value basis)
- defer the remaining revenue of $7.5m and recognise it as water is supplied over the 5 year discount period.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia contact member or a member of the National Audit Support team at NAS@grantthornton.com.au.