EFRAG

European Financial Reporting Advisory Group

Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

27 May 2009

Dear Mr Holmquist

Adoption of IFRIC 18 *Transfers of Assets from Customers*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, we are pleased to provide our opinion on the adoption of IFRIC 18 *Transfers of Assets from Customers* (IFRIC 18), which was published in January 2009. The interpretation was proposed in a draft interpretation on which EFRAG commented.

IFRIC 18 provides guidance on the accounting for transfers of items of property, plant and equipment (PPE) from customers (or cash to acquire or construct an item PPE) and addresses three issues: how to account for the transferred item, what the other side of the entry (the credit entry) is when the transferred item is recognised as an asset, and how to account for a transfer of cash that is used to construct or acquire an item PPE in a transfer transaction. Specifically, it states that:

(a) an entity shall recognise a transferred item as an asset if the item meets the definition of an asset under the IASB's Framework and the recognition criteria for PPE are also met. The asset shall be measured at its fair value;

(b) an amount equal to the fair value of the asset received shall be credited to the statement of comprehensive income as revenue in accordance with IAS 18 *Revenue*; and

(c) when that revenue is recognised will depend on the exact obligation accepted and when that obligation is fulfilled.

IFRIC 18 becomes effective on or after 1 July 2009, with earlier application permitted.

EFRAG has carried out an evaluation of IFRIC 18. As part of that process, EFRAG issued for public comment an initial evaluation of IFRIC 18 against the EU endorsement criteria and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports IFRIC 18 and has concluded that it meets the requirements of Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that:

- it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt IFRIC 18 and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix – Basis for Conclusions'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

APPENDIX
BASIS FOR CONCLUSIONS

This appendix sets out the basis for the conclusions reached and for the recommendation made by EFRAG on IFRIC 18 Transfers of Assets from Customers *(IFRIC 18).*

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as adviser to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

1 When evaluating IFRIC 18, EFRAG asked itself four questions:

(a) Is there an issue that needs to be addressed?

(b) If there is an issue that needs to be addressed, is an Interpretation an appropriate way of addressing it?

(c) Is IFRIC 18 a correct interpretation of existing IFRS?

(d) Does the accounting that results from the application of the IFRIC meet the criteria for EU endorsement?

2 Having formed tentative views on the issues and prepared an initial evaluation, EFRAG issued that initial evaluation for comment on 26 March 2009 and asked for comments on it by 8 May 2009. EFRAG has considered all the comments received in response to this invitation, and the main comments received are dealt with in the discussion in this appendix.

Is there an issue that needs to be addressed?

3 EFRAG understands that at present there is significant diversity in practice as to how entities receiving transferred items from their customers account for those transfers. EFRAG agrees that this diversity is undesirable and is an issue that needs to be addressed.

Is an Interpretation an appropriate way of addressing it?

4 An Interpretation is not an appropriate way of addressing diversity in accounting practice if that diversity arises because of inconsistencies between IFRS. Nor in EFRAG's view should Interpretations be used to fill a gap between IFRS if the issues involved are major issues. However, EFRAG's assessment is that the diversity in practice that is the subject of IFRIC 18 falls into neither of these categories. As such, EFRAG has concluded that an Interpretation is an appropriate way of addressing the uncertainties described above that are included in the scope of IFRIC 18.

Is IFRIC 18 a correct interpretation of existing IFRS?

5 IFRIC 18 addresses three main issues involving transfers of assets from customers.

(a) Accounting for the transferred item of PPE

(b) Accounting for the resulting credit side of the transfer transaction

(c) Accounting for a transfer in the form of cash

6 EFRAG has considered whether IFRIC 18 is a correct interpretation of existing IFRS literature on each of those issues.

Accounting for the transferred item of PPE

7 The Interpretation requires that, when an entity receives an item of PPE from its customer, it should recognise that item as an asset if it meets the definition of an asset that is set out in the Framework and if it meets the recognition criteria for PPE set out in IAS 16. EFRAG believes this is uncontroversial.

8 IFRIC 18 also requires the entity to measure the item of PPE recognised initially at its fair value. The Interpretation explains that paragraph 24 of IAS 16 and paragraph 12 of IAS 18 use fair value as the measurement attribute for an exchange transaction. In the IFRIC's view, when an entity receives an item of PPE from its customer, it does so in exchange for something, thus requiring the transferred asset to be measured initially at its fair value would be consistent with the way exchange transactions are accounted for under IFRS. EFRAG believes this is a reasonable interpretation of existing IFRS.

Accounting for the resulting credit side of the transfer transaction

9 IFRIC 18 provides guidance on how an entity should account for the 'credit side' of the transaction. Specifically, paragraph 13 requires the entity to account for it as revenue in accordance with IAS 18 *Revenue*. So, when an entity receives a transferred asset from a customer, it shall determine which goods or services it is obliged to deliver to the customer under the transfer transaction and shall recognise the revenue when those goods or services are delivered.

10 An entity might need to deliver one item of goods or service or more than one item. Paragraph 13 of IAS 18 states that in certain circumstances it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. The IFRIC noted that IFRS lacks specific guidance on how to determine separate services in a transaction, and therefore included in paragraphs 15-17 of IFRIC 18 some indicators to provide guidance on whether separately identifiable components are involved. If more than one service is identified, the entity is required to allocate the fair value of the transferred item to each of the services it is required to deliver under the transfer transaction and account for each of the services separately.

11 A key issue in determining when to recognise the revenue arising from such transfers is whether an obligation that has been taken on in return for the transferred asset is an obligation that is fulfilled at the time of the transfer or is one that involves ongoing responsibilities. (If the obligation is fulfilled at the time of the transfer, the related revenue will be recognised in comprehensive income at the time of the transfer. Otherwise it will not be.) Paragraphs 15-17 of IFRIC 18 provide guidance in this respect.

12 Finally, IFRIC 18 requires that, when an ongoing type of service is involved, the revenue relating to that service shall be recognised in accordance with the terms of the transfer transaction. If the agreement with the customer does not specify a period, the period over which revenue is recognised shall not exceed the useful life of the transferred asset that is used to provide the ongoing service.

13 EFRAG has considered this guidance and believes it is a reasonable interpretation of existing IFRS.

Accounting for a transfer in the form of cash

14 As previously explained, sometimes an entity will receive cash from a customer—rather than an item of PPE—and must use that cash to construct or acquire an asset that it will use to provide goods or services to the customer.

15 The IFRIC concluded that the economic effect of a cash transfer is similar to that of a transfer of PPE and that, consequently, its accounting outcome should be similar. The cash is received in exchange for the entity accepting an obligation to provide the goods or services it will provide using the asset, and will therefore be recognised as revenue as those goods or services are provided in accordance with IAS 18. The asset constructed or acquired with the cash will be accounted for in accordance with the recognition and measurement requirements of IAS 16.

16 EFRAG agrees that this is an appropriate interpretation of existing IFRS.

Conclusion

17 EFRAG concluded that IFRIC 18 is a reasonable interpretation of existing IFRS.

Does the accounting that results from the application of IFRIC 18 meet the criteria for EU endorsement?

18 Having concluded that IFRIC 18 is a reasonable interpretation of existing IFRS, EFRAG asked itself whether it believed that the information resulting from the Interpretation's application would meet the criteria for EU endorsement; in other words, that:

(a) it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered whether it would be in the European interest to adopt the Interpretation.

Relevance

19 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. EFRAG considered whether IFRIC 18 would result in the provision of relevant information; information that has predictive value, confirmatory value or both.

20 EFRAG concluded that the application of IFRIC 18 would result in the provision of relevant information because it requires the revenue arising under the transaction to be identified and recognised in accordance with the pattern of delivery. It also requires assets that have been acquired or constructed as a result of the transaction to be recognised and appropriately measured.

Reliability

21 The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

22 EFRAG considered whether the accounting in IFRIC 18 would raise reliability concerns. In EFRAG's view, the main issue here is whether the requirement that fair value be used to measure the item of PPE that the entity receives under the transfer transaction would lead to difficulties in estimation and, as a consequence, unreliable information being presented in the financial statements. However, EFRAG believes that the reliability issues that arise from that requirement are no more significant than those that arise under other IFRS literature and are considered acceptable.

Comparability

23 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

24 The IFRIC's objective in issuing IFRIC 18 was to address the current diversity in practice in the accounting for transfers of assets from customers. In EFRAG's view IFRIC 18 will do that. That will enhance the comparability of the information being provided.

25 IFRIC 18 is to be applied prospectively to transfers of assets from customers received after 1 July 2009. The IFRIC explains that it decided to require prospective application because retrospective application would have involved entities needing to use historical fair values to measure the assets transferred in past periods, and it considers such a use of hindsight to be undesirable.

26 The Interpretation also permits earlier application provided the valuations and other information needed to apply the Interpretation to past transfers of assets were obtained at the time those transfers occurred. (An entity is required to disclose the date from which the Interpretation was applied.) IFRIC's reasoning here was simply that it should not prohibit earlier application if an entity wishes and is able to implement the Interpretation earlier.

27 EFRAG agrees that it is not always possible to apply the requirements in IFRIC 18 retrospectively to past transfers of assets without the use of hindsight. Therefore, EFRAG concluded that in this case it is acceptable to require the Interpretation to be applied prospectively. EFRAG also agrees that in situations where an entity has the information it needs to apply IFRIC 18 to an earlier date it should be permitted to do so because it will have a positive impact on the comparability of information.

Understandability

28 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

29 EFRAG considered whether the information produced by applying IFRIC 18 is likely to be readily understandable to those that use the information and concluded that it was. It noted in particular that the accounting outcome under IFRIC 18 would better reflect the economic substance of the transactions involved.

True and Fair

30 For the reasons set out above, EFRAG sees no reason to conclude that IFRIC 18 is inconsistent with the true and fair view requirement.

European Interest

31 EFRAG considered whether adoption of the Interpretation might cause those entities that are using a different approach currently to incur costs in excess of the benefits expected from applying the accounting IFRIC 18 requires. Its assessment is that, although the implementation of IFRIC 18 would involve some costs, they are likely to be outweighed by the benefits. EFRAG sees no other reason to believe that endorsement of IFRIC 18 would not be in the European interest.

Conclusion

32 After considering all the above arguments, EFRAG concluded that IFRIC 18 satisfies the criteria for EU endorsement and that therefore EFRAG should recommend its endorsement.