

**INVITATION TO COMMENT ON THE EFRAG'S ASSESSMENTS OF IFRIC 18
'TRANSFERS OF ASSETS FROM CUSTOMERS'**

**Comments should be sent to commentletter@efrag.org or
uploaded via our website by 8 May 2009**

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IFRIC 18 *Transfers of Assets to Customers* (IFRIC 18). In order to do that, EFRAG has been carrying out a technical assessment of IFRIC 18 against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the EU.

A summary of IFRIC 18 is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

1 Please provide the following details about yourself:

- (a) Your name or, if you are responding on behalf of an organisation or company, its name:

- (b) Are you/Is your organisation or company a:

Preparer User Other (please specify)

- (c) Please provide a short description of your activity/ the general activity of your organisation or company:

(d) Country where you/your organisation or company is located:

(e) Contact details including e-mail address:

2 EFRAG’s initial assessment of IFRIC 18 is that it meets the technical criteria for endorsement. In other words, it is not contrary to the true and fair principle and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG’s reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

Yes No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG’s endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of IFRIC 18? If there are, what are those issues and why do you believe they are relevant to the evaluation?

3 EFRAG is also assessing the costs that will arise for preparers and for users to implement IFRIC 18, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment are set out in Appendix 3. To summarise, EFRAG’s initial assessment (see Appendix 3, paragraphs 6 and 7) is that IFRIC 18 is:

(a) likely to involve some preparers in some additional year one and ongoing costs. However, those costs are unlikely to be significant; and

(b) likely to involve users in no year one or ongoing incremental costs.

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

- 4 EFRAG’s initial assessment is that IFRIC 18 is likely to result in improvements in the comparability of the information provided—and in some cases also the relevance. EFRAG’s initial assessment is that overall the benefits to be derived from applying IFRIC 18 will exceed the costs involved (Appendix 3, paragraphs 8 and 10).

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

- 5 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on IFRIC 18.

Do you agree that there are no other factors?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

APPENDIX 1 A SUMMARY OF IFRIC 18

- 1 Sometimes an entity receives one or more non-cash assets from its customers in return for goods or services that the entity agrees to provide to its customers using the asset(s) it received. For example, a real estate developer (in this example, the customer) might construct an electricity substation and transfer that substation to an electricity network provider. The customer does that so that the persons to whom it will eventually sell the houses it is building will have a connection to an electricity network and will therefore be in a position to be supplied with electricity.
- 2 In some other cases, an entity will receive cash from their customers and will be required to use that cash to construct or acquire an asset that it will then use to provide goods or services to its customers. For example, an alternative arrangement to the one described in the real estate developer/electricity network provider example above could be that the real estate developer asks the electricity network provider to build the substation and reimburse it for that work.
- 3 IFRIC 18 provides guidance on three issues: how to account for the transferred item, how to account for the credit side of the transfer transaction, and how to account for a transfer of cash that is used to construct or acquire an item of property, plant or equipment (PPE) in a transfer transaction.¹

How to account for the transferred item of PPE?

- 4 IFRIC 18 explains that, if an entity receives an item of PPE in a transfer that falls within the scope of IFRIC 18, it should recognise that item as an asset if both the item meets the definition of an asset under the IASB's Framework and the recognition criteria for PPE are met.
- 5 IFRIC 18 also explains that when an entity first recognises such an asset, it shall measure it at its fair value.

How to account for the resulting credit side of the transfer transaction?

- 6 When an entity receives an asset in a transfer falling within the scope of IFRIC 18 it will do so in return for accepting some sort of obligation to provide goods or services. As such, IFRIC 18 requires the fair value of the asset received to be credited to the statement of comprehensive income as revenue under IAS 18 *Revenue*. When that revenue is recognised will depend on the exact obligation accepted and when that obligation is fulfilled.
- 7 IFRIC 18 requires the entity that receives the asset to identify which services arise from the transfer transaction.
 - (a) When only one service is identified, the entity recognises revenue when that service is delivered in accordance with IAS 18 *Revenue*.
 - (b) If more than one service is identified, the entity is required to allocate the fair value of the asset it receives to each of the identified services, and apply the recognition criteria of IAS 18 to each of those services.

¹ For ease of reference, an arrangement that involves a transfer of assets from customers is referred to as a 'transfer transaction' through this document.

- (c) When the service or one of those services is an ongoing type of service—such as ongoing access to a supply of goods or services—revenue is recognised based on the terms of the transfer transaction, but not exceeding the useful life of the transferred asset.

How to account for a transfer of cash?

- 8 Sometimes an entity will receive a transfer in the form of cash from its customer, which it must use to construct or acquire an asset that it will use to provide goods or services to its customer using that asset.
- 9 The accounting for a cash transfer that IFRIC 18 requires is similar to the accounting for a non-cash asset transfer as described above. That is, the entity will recognise the item of PPE it constructs or acquires when the item of PPE meets the recognition requirements under IAS 16. The entity also recognises revenue under IAS 18 when it has delivered the goods or services it has agreed to provide under the transfer transaction.

APPENDIX 2 EFRAG'S TECHNICAL ASSESSMENT OF IFRIC 18 AGAINST THE ENDORSEMENT CRITERIA

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?

Is there an issue that needs to be addressed?

- 2 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?

- 3 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 relating to how an entity should account for transfers of assets from customers that are included in the scope of IFRIC 18.

Is IFRIC 18 a correct interpretation of existing IFRS?

- 4 As explained in Appendix 1, 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
- 5 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

- 6 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.
- 7 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

- 10 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.
- 11 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 lack 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.
- 12 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.
- 13 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 as agreed with the customer. If the agreement with the customer does not specify a period, the period over which revenue is recognised cannot exceed the useful life of the transferred asset that is used to provide the ongoing service.

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

Accounting for a transfer in the form of cash

- 15 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.
- 16 The IFRIC concluded that the economic effect of a cash transfer was 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.
- 17 EFRAG agrees that this is an appropriate interpretation of existing IFRS.

Conclusion

- 18 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?

- 19 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

- 20 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.

- 21 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

- 22 EFRAG also considered the reliability of the information that will be provided by applying IFRIC 18. 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.
- 23 EFRAG considered whether the accounting in IFRIC 18 would raise concerns about risk of error. 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 not more significant than those that arise under other IFRS literature and are considered acceptable.

Comparability

- 24 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.
- 25 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, which will enhance the comparability of the information being provided.
- 26 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.
- 27 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.
- 28 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

- 29 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.
- 30 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

- 31 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

- 32 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 initial 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

- 33 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.

APPENDIX 3

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF IFRIC 18

- 1 EFRAG has also considered whether, and if so to what extent, implementing IFRIC 18 in the EU might involve preparers and users incurring incremental costs, and whether those costs are likely to be exceeded by the benefits to be derived from its adoption.

Costs for preparers

- 2 EFRAG's initial assessment is that the requirements in IFRIC 18 concerning the recognition and measurement of any items of PPE deemed to have been transferred as a result of the transaction will involve those preparers either not currently recognising such assets or not measuring them at fair value with some incremental costs in the year of the transfer. If such transfers are a regular part of the entity's business model, this will be an incremental ongoing cost. EFRAG's initial assessment is however that these costs are unlikely to be significant, particularly as it would appear that the fair value measures required should be reasonably straight-forward to estimate. EFRAG also understands that some entities are currently applying the approach required by the Interpretation, and for them there will be no incremental cost.
- 3 EFRAG recognises that the requirements in IFRIC 18 concerning the 'credit side' of the transaction might involve some preparers in making changes to their existing accounting, either to recognise revenue that was not previously being recognised (because an asset transfer for value was not being recognised in the financial statements) or to change the pattern of revenue recognition.
 - (a) EFRAG's initial assessment is that any incremental costs involved in recognising revenue that was not previously recognised will be insignificant.
 - (b) EFRAG believes that the incremental ongoing costs involved in any change in revenue recognition pattern could be more significant because of the additional complexity that might arise in identifying the separately identifiable services involved and accounting for each one separately. There might also be some year one costs involved to set up the necessary procedures and systems. However, EFRAG's initial assessment is that for the vast majority of entities involved these costs are unlikely to be significant.
- 4 EFRAG's initial assessment is that the requirements in IFRIC 18 concerning the accounting treatment of transfers of cash will have very similar cost implications for preparers to those described in paragraphs 2 and 3.
- 5 IFRIC 18 is to be applied prospectively from 1 July 2009, although earlier application is permitted. Thus, there are no costs that entities will be required to incur to transition to IFRIC 18.
- 6 In summary, EFRAG's initial assessment is that IFRIC 18 will result in some year one costs and some incremental ongoing costs for some preparers, but that these costs are unlikely to be significant.

Costs and benefits for users

- 7 EFRAG is not aware of any aspect of IFRIC 18 that will increase the costs users will incur in analysing the financial statements as a result of its adoption.
- 8 EFRAG also notes that IFRIC 18 will reduce to some extent the diversity of accounting in respect to the accounting for transfers of assets entities received from their customers. This will benefit users. In some cases, the effect of IFRIC 18 will also be to enhance the relevance of the information being provided by bringing the accounting treatment of the transfers falling within the scope of IFRIC 18 into line with other revenue-generating transactions. Where that is the case, EFRAG believes that the benefit could be significant.

Conclusion

- 9 Summarising the comments above, EFRAG's initial assessment is as follows.
 - (a) IFRIC 18 is likely to involve some preparers in some additional year one and ongoing costs. Those costs are however unlikely to be significant.
 - (b) IFRIC 18 is likely to involve users in no year one or ongoing incremental costs.
 - (c) IFRIC 18 is likely to result in some improvements in the comparability of the information provided—and in some cases the relevance—and thus bring benefits to users.
- 10 EFRAG has found it difficult to assess the costs of implementing IFRIC 18 in the EU relative to the benefits to be derived, because the costs and benefits will vary so much depending on the accounting currently adopted and the frequency of the transactions involved. However, EFRAG's initial assessment is that the costs are likely to be highest in circumstances in which the benefits are also likely to be the highest and that overall the benefits of implementing IFRIC 18 in the EU are likely to outweigh the costs involved.