

Accounting for customer contributions has until recently been an area that has been subject to varying accounting treatments. The term 'customer contribution' generally refers to a situation where an entity receives contributions, in the form of cash or other assets, from a customer or prospective customer or another third party entity, for example:

"A property developer may be required to install an electricity substation to service a new housing development and the developer must then contribute the substation to the utility that operates the electricity network. The utility must use the substation to provide access to electricity to the future homeowners. The homeowners may choose to purchase their electricity from suppliers other than the utility, but the utility always provides the distribution." (IASB, 2008)

To encourage standardised practice in respect of accounting for the receipt of these 'customer contributions' in the annual financial statements of an access provider, the International Financial Reporting Interpretations Committee (IFRIC) has issued IFRIC Draft Interpretation D24, Customer Contributions. It is important at this stage to note that the IFRIC concluded that the accounting treatment is not the same as was suggested in IFRIC 12, Service Concession Arrangements as the transactions are fundamentally different (refer IFRIC D24.BC 29 and BC 30).

The IFRIC has sought to make a distinction between those customer contributions of assets, such as property, plant and equipment and those in the form of cash. Customer and cash contributions have, therefore, been defined in IFRIC D24, Customer Contributions, as follows:

A customer contribution is:

- an item of property, plant and equipment

- that is contributed
- to an access provider.

A cash contribution is:

- a payment of cash
- to an access provider
- who is then required to acquire or construct an item of property, plant and equipment.

The property, plant and equipment

- must be used
- to provide access
- to a supply of goods or services
- to a customer or customers (in some cases by operating a network)

Customers are generally required to pay additional amounts at market rate for the goods and services supplied.

(IFRIC D24.5 and .6)

Accounting for customer contributions

The first issue that is considered by IFRIC D24 is whether an asset should be recognised by the access provider in respect of the customer contribution. In order to answer this question, one has to go back to the definition of an asset and the recognition criteria as contained in the IASB Framework. If the customer contribution meets the definition and recognition criteria, the next question is how to measure the asset and what the credit entry has to be. In terms of IAS 16.24 (AC 123), Property, Plant and Equipment, where an item of property, plant and equipment is received in exchange for non-monetary assets, fair value should be used on initial recognition.

The entity that receives a customer contribution has an obligation to provide ongoing access to a supply of goods and services, by using the contributed access. This obligation will need to be recognised in the annual financial statements of the

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access provider. It is suggested that the obligation should be measured at the fair value of the contribution received.

In terms of IFRIC D24.11, the obligation must then be reduced and revenue recognised as access to a supply of goods or services is provided. By concluding that revenue needs to be recognised, the following was taken into account by the IFRIC:

- That the provision of access will most likely be part of the ordinary activities of the access provider.
- By settling the obligation to provide access, equity will increase (not related to owner contributions), therefore the definition of income as stated in the *Framework* is met.

If the arrangement lasts for a significant period, the time value of money should be taken into account. The period over which the revenue will be recognised shall be the period over which the obligation to provide the access exists. This period may be shorter than the useful life of the assets, but cannot be longer.

Example 1: An entity concludes that it has received an asset that it may recognise

Entity A contributes asset X to Entity B. Asset X has a fair value of R400 and useful economic life of 10 years. Entity B is responsible for maintaining asset X. Entity A will pay entity B R250 pa for 10 years for an ongoing service that is provided using asset X. The cost to entity B of providing

these services is R150 pa. If Entity A had not provided the asset, entity B would have charged entity A an additional R50 pa.

Has an asset transferred to B?

Yes, entity B will receive the future economic benefits of the asset by way of cash inflows and profits. It can restrict access to the asset (no other parties are allowed to use it without B's permission) *see table 1*.

Implications of a possible lease arrangement

Before the asset can be recognised, it has to be determined whether this arrangement to provide access contains a lease of the asset back to the customer. For this purpose reference must be made to IAS 17 (AC 105), Leases and IFRIC 4, Determining whether an Arrangement contains a Lease.

If the arrangement does contain a lease, the lease has to be classified as either an operating or a finance lease. When a finance lease is applicable, the entity does not have an asset that it may recognise (and as a result the obligation is also not recognised). This is because 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 a finance lease. The access provider has a right to set off the liability against the finance lease receivable, because the finance lease receivable will be settled by the entity performing the ongoing obligations.

Example 2: An entity concludes that it has received an asset that it may recognise and the ongoing service contains an operating lease


Exactly the same information applies as in example 1. However, in this example, entity B assesses whether the ongoing service arrangement contains a lease using IFRIC 4 and concludes that it does. Because the 

Table 1: What are the journal entries to record the transaction in the records of entity B (the access provider)?

	Dr R	Cr R
<i>20X0, when the asset is contributed</i> <i>At 20X0, the asset is recognised by entity B (at fair value):</i>		
Property, plant and equipment	400	
Obligation to provide service		400
Years 1 – 10 <i>During years 20X1 – 20X10, entity B incurs costs of R150, and makes sales of R250. The following journal entries are required:</i>		
Obligation to provide service	40	
Revenue		40
<i>To recognise service performed and settlement of the obligation.</i>		
Cost of sales	150	
Cash		150
<i>To record cash payments made by B to provide the ongoing services.</i>		
Cash	250	
Revenue		250
<i>To record cash receipts from A for ongoing services.</i>		
Depreciation	40	
Property, plant and equipment		40
<i>To record depreciation of the contributed asset.</i>		

(IASB, 2007^a)

asset may only be used to provide a service to customer A, the service cannot be provided without the use of asset X, and customer A dictates the output from the asset, the arrangement contains a lease of asset X.

Is the lease a finance or an operating lease?

In this example, entity B assesses the lease arrangement in accordance with IAS 17. It

determines that substantially all of the risks and rewards of ownership have remained with entity B and therefore concludes that the ongoing service contract contains an operating lease.

What is the lease rental?

Entity B has leased an asset with a fair value of R400 to entity A. It computes a lease rental of R40 pa. see table 2.

Example 3: An entity concludes that it has received an asset that it may recognise and the ongoing service contains a finance lease

Example 3 contains exactly the same information as example 1, except that in example 3 entity B assesses the lease arrangement in accordance with IAS 17. It determines that substantially all of the risks and rewards of ownership have transferred back to entity A and therefore concludes that the ongoing service contract contains a finance lease.

Entity B has leased an asset with a fair value of R400 to entity A. The lease rental is R50 pa and the interest rate implicit in the lease is 4.25%.

Entity B determines that:

- it has a right to set off the finance lease receivable and the obligation to perform future services; and
- it intends to settle the finance lease receivable and the obligation to perform future services on a net basis.

Entity B therefore sets off the finance lease receivable and the obligation to perform future services in the balance sheet.

See table 3.

Accounting for cash contributions

When accounting for cash contributions, the first consideration is whether the property, plant and equipment that must be acquired or constructed will meet the definition and recognition criteria of an asset. If not, the cash contribution will be recognised as proceeds for providing the asset to the customer, by either using IAS 11 (AC 109), Construction Contracts or IAS 19 (AC 111), Revenue.

If the definition and recognition criteria are met, the property, plant and equipment will be recognised and measured as it is constructed or acquired in accordance with IAS 16 (AC 123), Property, Plant and Equipment. In this case the obligation to provide the access has to be recognised and it will be measured with reference to the cash contribution received.

An entity receiving the cash contribution has the same obligation as an entity receiving a customer contribution. The acquisition/constructing of the item of property, plant and equipment (in case of a cash contribution) is a necessary activity and an integral part in providing the access to a customer. The cash contribution is therefore an advance payment for the provision of the access.

Example 4: Cash contribution

Entity B receives a cash contribution of R100 in 20X0. As a result, it is required to construct

Table 2: What are the journal entries to record the transaction in the records of entity B?

All the journals are the same as in example 1, except the following:

Years 1 – 10	Dr	Cr
	R	R
Obligation to provide service	40	
Rental income (instead of revenue in example 1)		40
<i>To recognise service performed and settlement of the obligation.</i>		

(IASB, 2007^a)

Table 3: What are the journal entries to record the transaction in the records of entity B?

20X0, when the asset is contributed

At 20X0, the asset is recognised by entity B (at fair value):	Dr	Cr
	R	R
Property, plant and equipment	400	
Obligation to provide service		400
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The asset is then leased back to entity A:		
Finance lease receivable	400	
Property, plant and equipment		400
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The obligation is considered to be a prepayment of the lease and so the finance lease receivable is reduced by the prepayment received:		
Obligation to provide service	400	
Finance lease receivable		400

(IASB, 2007^a)

Table 4: What are the journal entries to record the transaction in the records of entity B (the access provider)?

20X0, when the asset is constructed	Dr	Cr
	R	R
Cash	100	
Obligation to provide service		100
<i>To account for the receipt of the cash contribution</i>		
Property, plant and equipment	90	
Cash		90
<i>To account for the construction of the property, plant and equipment</i>		
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Years 1 – 5		
<i>During years 20X1 – 20X5, the following journal entries are required:</i>		
Obligation to provide service	20	
Revenue		20
<i>To recognise service performed and settlement of the obligation.</i>		
Depreciation	18	
Property, plant and equipment		18
<i>To record depreciation of the asset.</i>		

(IASB, 2007^b)

an item of property, plant and equipment. Construction occurs in 20X0. The cost of construction is R90. The property, plant and equipment has a useful economic life of five years and entity B will use the asset to provide access to a supply of goods or services to the customer for a period of five years. See table 4 opposite.

Conclusion

A reporting entity will not be required to apply this draft retrospectively, as it is deemed impracticable to establish a fair value for assets that had been contributed in the past. It will therefore apply the draft prospectively to contributions received in

periods beginning on or after the effective date of the Interpretation.

In conclusion the following decision tree may assist preparers of financial reports in applying the information as contained in the draft interpretation:

References

International Accounting Standards Board (2007^a). Information for observers. September 2007. Appendix 1 to Agenda Paper 4A Customer contributions. London: IASCF.
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