



Department of Treasury and Finance

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Mr David Boymal
Chairman
Australian Accounting Standards Board
PO Box 204
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Dear Mr Boymal

IFRIC DRAFT INTERPRETATION D24 CUSTOMER CONTRIBUTIONS

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the Australian Accounting Standards Board on the International Financial Reporting Interpretations Committee's draft Interpretation D24 *Customer Contributions*.

Overall, HoTARAC agrees with the asset recognition and measurement proposals. However, HoTARAC does not agree with the accounting for the credit side of the transaction. The nature of a customer contribution can differ from that proposed in D24. In some cases, a customer contribution only obligates the access provider to provide initial, rather than continuing, access to a supply of goods or services. In other cases, it is more in the nature of a levy to fund community infrastructure in general.

In HoTARAC's view, customer contributions are often non-reciprocal transactions imposing no further obligations on the service provider. Subsequent access to the goods or services is covered by commercial arrangements that apply to any of the access provider's customers. Therefore, the mandatory deferral of revenue recognition is not supported. HoTARAC considers that the timing of revenue recognition should depend on the nature and substance of the customer contribution. Detailed comments by HoTARAC in response to the D24 proposals are attached.

If you have any queries regarding HoTARAC's comments, please contact Robert Williams from the NSW Treasury on 02 9228 3019.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D W Challen', written in a cursive style.

D W Challen

CHAIR

**HEADS OF TREASURIES ACCOUNTING AND
REPORTING ADVISORY COMMITTEE**

4 April 2008

Encl

Contact: Suzi Ransom
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Specific comments on IFRIC D24 *Customer Contributions*

HoTARAC offers comments on the following matters in relation to customer contributions:

- (a) Nature of a customer contribution;
- (b) Revenue recognition;
- (c) Potential impact;
- (d) Scope of definition; and
- (e) Terminology.

(a) *Nature of a customer contribution*

HoTARAC does not agree that acceptance of a customer contribution necessarily obligates an access provider to give ongoing access to a supply of goods or services, as asserted in the Basis for Conclusions accompanying D24 (paragraph BC19). HoTARAC considers that the nature of customer contributions can vary and that the accounting should therefore be based on sound principles that distinguish between contributions that are different in nature, for example, whether the transaction is reciprocal or not.

In some instances, a customer contribution only obligates a service provider to arrange initial, rather than continuing, access to a supply of goods or services, as in the case of a network connection fee where no further obligation arises. In other cases, a customer contribution represents a statutory levy that does not of itself obligate the service provider to give any access to a supply of goods or services. In both cases, subsequent access to the supply is covered by commercial arrangements that apply to any of the access provider's customers.

For example, property developers may be required to contribute infrastructure or cash to a public utility. If the infrastructure meets the prescribed standard or the cash is of the prescribed amount, the utility will issue a compliance certificate. Without the certificate, the developer is unable to get local government approval for the development to proceed. The contribution does not obligate the utility to provide any access to a supply of goods or services and it is non-refundable. Such contributions are in the nature of a levy to acquire, or fund the acquisition of, infrastructure generally. They are non-reciprocal transfers and do not have to be used for the benefit of the developer or the developer's customers.

IFRIC considers that the acceptance of a customer contribution may obligate an access provider to:

- (a) supply at a reduced price in future;
- (b) provide initial connection to a supply; or
- (c) provide continuing access to a supply (paragraph BC17).

IFRIC rejected alternatives (a) and (b) in favour of alternative (c). It rejected alternative (a) because in many cases, customers that make a customer contribution pay the same price for ongoing services as those that do not (paragraph BC18). HoTARAC agrees with IFRIC's reason for rejecting alternative (a), but HoTARAC rejects alternative (c) for the same reason. Instead, HoTARAC contends that the rejection of alternative (a) supports alternative (b).

HoTARAC notes that alternative (b) is presently used in AASB Interpretation 1017 *Developer and Customer Contributions for Connection to a Price Regulated Network* which reflects the nature of many such contributions in Australia.

IFRIC's reason for rejecting alternative (b) is not clear. It merely asserts that once a supplier receives an asset it has a continuing obligation to use it to provide customers with access to a supply of goods or services (paragraph BC18). No robust argument is proposed to support this assertion.

D24 effectively asserts that a customer contribution is a prepayment for continuing access to a supply of goods or services. However, where customers pay the same rates for access and/or supply, regardless of whether they have made a customer contribution, it is illogical to assert that the customer contribution is for continuing access.

HoTARAC considers that an access provider's continuing obligation to provide customers with access to a supply of goods or services usually arises explicitly under a standard contract or statute. It applies equally to all customers regardless of whether they were requested to make a customer contribution. In cases where it is asserted that a contribution gives a continuing legal obligation to supply, this often has no economic effect because a separate standard contract imposes equivalent supply obligations.

Similarly, in commercial arrangements for the supply of goods or services, it is in the supplier's interest to provide the customer access to the supply for the term of the contract. Where access was not provided, a customer would logically be entitled to a refund. However, most customer contributions are non refundable.

In summary, if customers have the same ability to access a continuing supply of goods or services, regardless of any customer contribution made to the access provider, it would seem that a customer contribution is irrelevant to the continuing access and that the provider has no further obligation after providing initial access. The customer contribution has no substantive effect on the supplier's continuing obligation.

Moreover, a supplier will not necessarily use a contributed asset to provide any access to anyone. The asset may be altered or substituted or used to give access to other customers. Also, the initial customer may cease to exist or cease to require the supply.

HoTARAC therefore requests that the IFRIC reconsiders the nature of a customer contribution and acknowledges that it may vary and that it may not obligate the recipient to provide continuing access to a supply of goods or services.

HoTARAC considers it inappropriate to assert the existence of a single fact pattern. Instead, the accounting should be based on principles that distinguish between different types of customer contributions, based on their nature or substance.

(b) Revenue recognition

HoTARAC considers that the accounting for customer contribution revenue should be principles-based and that the timing of revenue recognition should reflect the nature of the transaction. This is likely to vary among different types of contribution. Immediate, rather than deferred, recognition of the revenue would be justified where:

- the access provider has no continuing obligation in relation to the customer contribution;
- that obligation has no economic effect; or
- if there is no obligation to return the contribution if access is not provided.

HoTARAC considers it important to avoid false attempts to match revenues with costs where a continuing obligation does not arise.

(c) Potential impact of D24

Adoption of the proposals in D24 would have a major financial impact on some entities. In one utility alone, it would necessitate deferring annual contributions of \$100 million and amortising them over periods of up to 150 years, despite the utility having no additional obligation to provide access to a supply of goods or services as a result of receiving the contributions. Thus, accounting as proposed under D24, would have a material impact on income and profitability, lower the entity's dividend payments and give rise to long term taxation timing differences, due to a mismatch between cash receipt and revenue recognition dates.

(d) Scope of definition

HoTARAC considers that the term "customer contribution" as defined in D24 (paragraph 5) has too broad a scope. The proposed definition in D24 could capture the following transactions:

- (i) A building is bequeathed to a cultural entity on condition that it is used as a concert venue for the next 10 years. The cultural entity is an access provider in relation to performances.
- (ii) A corporation sponsors and pays for the purchase of a block of seats in a new theatre. The seats are to be used by the public at large. The theatre operator is an access provider in relation to performances.

- (iii) A painting is donated to an art gallery to permit the work to be accessed by the public at large. The gallery is an access provider in relation to exhibitions.
- (iv) A substantial infrastructure levy is paid by a property developer to a water authority. The water authority has a statutory obligation to use such levies to fund new or existing infrastructure for the benefit of its customers generally. The water authority does not use the levy to fund any infrastructure on the property developer's estate.
- (v) A statutory contribution is paid by a property developer to a local government. The contribution is used to fund the provision of community amenities (eg parks, child care facilities) generally. The new amenities may not be on the property developer's estate.

To avoid this, HoTARAC suggests that non-reciprocal transactions, within the scope of AASB 1004 *Contributions*, be excluded from the D24 Interpretation.

(e) Terminology

HoTARAC considers that the term "customer contribution" as used in D24 may not truly reflect the nature of the transaction as the definition intends, as it does not necessarily relate to a customer, nor is it a contribution.

According to Paragraph 6, a customer contribution may be received from an entity that is neither an actual or potential customer, thus a property developer could fall into this category.

An inconsistency in defining Contributions is apparent between those stated in D24 and AASB 1004. Paragraph BC16, states that customer contributions would normally be exchange transactions, where the contributor and access provider exchange approximately equal value. A Contribution according to AASB 1004 is that they are non-reciprocal transfers to the entity. This different use of terminology could be misleading. IFRIC might consider using a different term to reflect the economic substance or reality of the transaction and may consider the use of different terms for substantively different transactions.