COMMENT LETTER

By electronic submission to IASB website- iasb.org

April 17, 2008

Re: ***IFRIC Draft Interpretation D24 Customer Contributions***

Dear Sirs,

National Accounting Standards Board of Russia (NASB) appreciates the opportunity to submit comments on the ***IFRIC Draft Interpretation D24 Customer Contributions*** (hereinafter "the Draft"). NASB supports the development of the proposed IFRIC as we recognise the existing divergence in practice of accounting for customer contributions. NASB members agree with consensus reached by IFRIC members in principle, however, have some issues to note.

Issue 1: Advance payment or full obligation: what should be recognized by access provider?

Paragraph 11 of the Draft states: '*an entity that receives an asset that meets the definition of a customer contribution has an obligation to provide access to a supply of goods or services. That obligation shall be recognised in the statement of financial position and measured on initial recognition at the fair value of the contribution received*'. NASB members believe that there is a difference between *an obligation to provide access to a supply of goods or services* and *advance payment received for future provision of access to a supply of goods or services*. Notwithstanding the fact that both items may be recognised as liability in the balance sheet, it should be noted that the carrying amount of initially recognized obligation to provide access to a supply of goods or services not in any cases is equal to the fair value of cash or non-cash assets received as a customer contribution.

Such obligation may be regarded as non-financial liability that is within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. In accordance with IAS 37 an entity shall measure that liability at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. In addition to that IAS 37 states that the best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.

On the basis of the approach proposed by IFRIC it may be concluded that expenditure required to provide access to a supply of goods or services is equal to the fair value of assets that are used by the entity receiving customer contribution for providing that access. It is not a case. In the view of NASB, approach proposed by IFRIC ignores operating costs related to maintenance of the contributed asset during its operation. NASB members believe that the fair value of asset contributed by the customer represents only advance payment for future execution of obligation to provide access to a supply of goods or services and therefore may not be considered as measure of whole obligation assumed.

Agreement to provide access to supply of goods or services in future for which the consumer has made cash or non-cash contribution is an executory contract, in which customer has partially performed its obligation. In the case of non-onerous executory contract access provider shall recognise liability to the extent of advance payment received. Therefore accounting outcome will be the same as proposed by IFRIC. However, in the case of onerous contract IAS 37 requires the entity to recognise the present obligation under the contract as provision in amount of unavoidable costs under it that may increase the value of liability recognized. Particularly, it may be the case when an entity that received the asset as a customer contribution provides customer with access to supply of goods or services on free of charge basis but provision of access requires expenditures in excess of the fair value of contribution received.

Having said that, NASB members believe that paragraph 11 should be amended in order to state that only ***advance payment*** is recognised as a liability by the access provider when it receives customer contribution rather than its obligation as a whole. In addition to that they believe that it is appropriate to state in the interpretation that in some cases obligation to provide customer with access to supply of goods or services assumed by the contribution receiver may be classified as obligation under onerous contract and therefore should be accounted for under IAS 37. Noting that we propose to amend paragraph 11 of the Draft as follows (new text <u>is underlined</u>, deleted is ~~struck through~~):

> '11. An entity that receives an asset that meets the definition of a customer contribution has an obligation to provide access to a supply of goods or services. <u>The asset received represents non-cash advance payment for the future provision of access to supply of</u>

> goods or services under this obligation. That ~~obligation~~ non-cash advance payment shall be recognised as liability in the statement of financial position and measured on initial recognition at the fair value of the contribution received. The ~~obligation~~ liability shall be reduced and revenue recognised as access to a supply of goods or services is provided. In some cases obligation assumed by the access provider may meet the definition of onerous contract in IAS 37. In these cases such obligation shall be accounted for in accordance with IAS 37.'

Issue 2: Does an entity settle 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 the finance lease?

NASB members noted that wording in paragraph 14 of the Draft seems to be misleading.

Paragraph 14 of the Draft says '*[an] entity may determine that it has received an asset as a result of a customer contribution and that an ongoing service arrangement entered into at the same time contains a finance lease. In these situations …* ***[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 the finance lease'* (emphasis added). We are of the view that it is inappropriate to conclude in these cases that obligation to provide access is settled in full, because the entity that has transferred contributed asset back to customer by way of the finance lease may still be obliged to provide customer with access to a supply of goods or services using that asset even if it is recognised in the balance sheet of the customer rather than in the balance sheet of the entity itself.

The accounting treatment proposed in the Draft is absolutely correct only in case when asset received is considered as advance payment and related liability is considered as deferred income. Indeed, by returning the asset to the customer by way of the finance lease an entity has actually 'repaid' advance received and therefore no longer has deferred income to be recognized as liability. However, at the same time the entity may still be a party of executory contract and if that contract is onerous the entity shall recognise provision under it as a separate liability.

Our proposals are consistent with conclusions reached by IFRIC in relation to cash customer contributions. In paragraph BC 24 (a) of the Draft IFRIC particularly notes that when access provider recognises the asset acquired or constructed as result of cash contribution from customer '*the cash contribution should … be accounted for as an advance payment for the provision of access to a supply of goods or services*'. We believe that accounting treatment should be similar irrespective whether advance payment has been made in cash or in non-cash assets. Therefore we recommend amending paragraph 14 of the Draft as follows (new text is underlined, deleted is ~~struck through~~):

> ’14. An entity may determine that it has received an asset as a result of a customer contribution and that an ongoing service arrangement entered into at the same time contains a finance lease. In these situations, when the arrangement is considered as a whole, the entity does not have an asset that it may recognise. At the same time the~~The~~ entity has settled its ~~obligation to provide the customer with access to a supply of goods or services~~ liability arisen from advance received by returning the asset to the customer by way of the finance lease. Because the asset is recognized and the liability is settled immediately afterwards, the entity does not recognise either the contribution or ~~the~~ deferred income arisen from advance received ~~obligation to provide access~~.’

Issue 3: Is customer contribution transaction an exchange of the item of property, plant and equipment for a non-monetary asset?

In paragraph BC 16 IRFIC states: ‘*In determining how a customer contribution should be measured on initial recognition, the IFRIC concluded that the item of property, plant and equipment is received in exchange for a non-monetary asset*’. We do not agree with this conclusion.

Firstly, because, as we have mentioned above, we believe that in the case of customer contribution the economic substance of transaction is that the access provider receives an advance payment in non-cash asset for the future provision of access to a supply of goods or services to customer.

Secondly, because we do not believe that it is appropriate to apply provisions on exchange of non-monetary assets in IAS 16 to situations where an entity receives tangible asset to be recognized in its balance sheet in exchange for intangible asset that had not been recognized in its balance sheet.

And at last thirdly, we do not think that initial measurement proposed in the Draft may be justified by IFRIC’s conclusion even if it would be appropriate. Indeed, in accordance with IAS 16 if in the case when one non-monetary asset is swapped for another in exchange transaction that has commercial substance and the entity is able to determine reliably the fair value of either the asset received or the asset given up, the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident. IFRIC’s conclusion indirectly implies either that the fair value of non-tangible asset given up can not be determined reliably or that the fair value of the asset received as customer contribution is more clearly evident. In reality both markets (one for the right to access (intangible asset received by customer) and second for the tangible asset (customer contribution received by access provider)) may exist simultaneously and fair values of both assets may be readily available. Hence conclusion that fair value of received rather than given up asset should be used in all circumstances is not absolutely correct.

Therefore we believe that current wording in paragraph BC 16 does not provide proper rationale for measurement approach selected and recommend to remove it from the Draft.

Thank you for the opportunity to present our views.

Yours sincerely,

Mikhail Kiselev
Chairman
National Accounting Standards Board