



To:	AASB Members	Date:	17 August 2010
From:	Jessica Lion	Agenda Item:	5.1
Subject:	Revenue from Contracts with Customers	File:	

Action

Consider the issues presented in the attached documents and in this memorandum and:

- (a) decide whether those issues or any other issues should be included in the AASB's submission on the proposals in the IASB's Exposure Draft ED/2010/6 *Revenue from Contracts from Customers*; and
- (b) form a subcommittee to finalise the AASB's submission out of session.

Background

At the July joint meeting the AASB and FRSB asked staff to prepare a joint issues memo for presentation to each Board at their next respective meetings. This was prepared by FRSB staff and is attached (item 5.3). Given that the FRSB papers were due in advance of the AASB papers, this memorandum includes further issues that have arisen since the FRSB staff issues paper was prepared.

Measuring performance obligations at the transaction price v cost of extinguishing

The current proposals require entities to measure performance obligations at the transaction price. We think a case should be made to the IASB for measuring performance obligations by reference to the cost of relieving or extinguishing those obligations, which would be consistent with IAS 37 on provisions. The draft FRSB submission (pages 4 – 5) notes that the proposal to measure these obligations at the transaction price increases the diversity of measurement bases for liabilities. (However, that draft does not advocate measuring performance obligations by reference to the cost of relieving or extinguishing those obligations.)

Other reasons for measuring performance obligations in this manner are:

- (a) since a liability is an obligation to make an outflow of economic benefits, it is appropriate to measure liabilities at an estimate of that outflow;
- (b) more useful information would be provided about performance obligations with highly uncertain settlement amounts, such as warranties, which to date have been measured under IAS 37. Measuring warranty obligations under the ED at the transaction price is inconsistent with the proposed measurement basis for long-duration stand-ready obligations under the Insurance Contracts ED (namely, at an amount that reflects the estimated outflow of economic benefits); and
- (c) it would often result in revenue recognition upon entry into contracts, which would be representationally faithful because entities often provide various services to customers at the point of contract entry.

Concerns regarding distinct profit margin

Background

The IASB ED says if an entity promises to transfer more than one good or service, it accounts for each promised good or service as a separate performance obligation only if it is distinct. A good or service, or a bundle of goods or services, is distinct if either:

- (a) the entity, or another entity, sells an identical or similar good or service separately; or
- (b) the entity could sell the good or service separately because it both has a distinct function and a distinct profit margin (paragraphs 22 – 23).

Paragraph BC53 says “Even if a good or service has a distinct function, the boards decided that it should be accounted for as [a] separate performance obligation only if it also has a distinct profit margin.” Paragraph BC55 says “When a good or service is not sold separately, its selling price is not observable, which can make it more difficult for an entity to determine whether it has a distinct profit margin. In the absence of an observable selling price, the boards’ view is that an entity would have [a] sufficient basis for estimating a selling price only if the good or service is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service.”

This implies a distinct profit margin can only occur when the good or service is subject to distinct risks. However, an entity may possess intellectual property or operating synergies that cause providing some goods or services to be more profitable than providing others, without necessarily having distinct risks.

Other issue potentially affecting NFPs

Assuming question 18 in the IASB-FASB ED (‘should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations’) could relate to non-exchange transactions, staff have two concerns.

Distinct profit margin

The criteria in (a) and (b) above for identifying a good or service as distinct seem inappropriate and/or unworkable for not-for-profit entities (NFPs). This is because:

- (a) NFPs often provide goods or services to beneficiaries on behalf of ‘customers’ (grantors and other transferors) without selling those goods or services in commercial transactions; and
- (b) profit margins are not a consideration for NFPs.

Price interdependency

Staff are concerned about the principle of combining or segmenting contracts based on price interdependency for not-for-profit entities, because non-exchange transactions might not involve a bargained exchange, or might occur at prices that do not reflect the economics of the transaction. This IASB-FASB proposal would seem inappropriate for revenue from non-exchange transactions. (These proposals are of concern for similar reasons to the proposals regarding identifying a good or service as distinct.)

Attachments

- 5.2 – FRSB B3.0 Cover Page
- 5.3 – FRSB B3.1 Memo from Clive Brodie: Key comments to be raised in FRSB’s comment letter on the IASB Exposure Draft ED/2010/6 *Revenue from Contracts with Customers*
- 5.4 – FRSB B3.2 Draft comment letter on the IASB’s Exposure Draft ED/2010/6 *Revenue from Contracts with Customers*
- 5.5 - FRSB B3.3 New Zealand request for Comment on IASB Exposure Draft ED/2010/6 *Revenue from Contracts with Customers*
- 5.6 – FRSB B3.4 email from AOSSG Revenue Working Group including: (a) minutes of the recent working group meeting in Toyko and (b) a proposed working group timeline for the second working group meeting.