



Australian Government

**Australian Accounting
Standards Board**

Level 7, 600 Bourke Street
MELBOURNE VIC 3000

Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear David

IASB Exposure Draft ED/2010/6
Revenue from Contracts with Customers

The Australian Accounting Standards Board (AASB) is pleased to provide its comments on Exposure Draft ED/2010/6 *Revenue from Contracts with Customers*. In formulating these comments, the AASB sought and considered the views of Australian constituents. The comment letters received are published on the AASB's website.

Overall view

In general the AASB supports the project to review and amend the current standards that deal with revenue recognition and achieve a converged approach to revenue recognition with the Financial Accounting Standards Board (FASB). The AASB supports the conclusion that contracts with customers create rights and obligations, which can be used to develop a revenue recognition model centred on customer contribution amounts and performance obligations. However, given the volume of concerns we have with quite a number of aspects of the proposals, the AASB cannot support the proposals as a whole.

The AASB notes that the proposed model focuses on identifying obligations and how they are measured. However, the AASB considers that this does not obviate the need to also identify rights arising under a contract. In this regard, the AASB does not think that the ED is sufficiently clear as to when rights and obligations should give rise to the recognition of assets and performance obligations, and that the proposals are, at least seemingly, too focused on physical deliverables.

The AASB has further significant concerns with some of the proposals as outlined below and in the attachments.

Notion of control and the four proposed indicators of control

The notion of control in the proposals, whether intentionally or otherwise, still appears to be overly focused on the physical delivery of the final asset. The AASB's suggestions are outlined as follows.

- The control indicator in paragraph 30(a), in relation to the customer being unconditionally obligated to pay the entity, should be given a higher status. The AASB finds it difficult to think of an example in practice where a customer is unconditionally obligated to pay an entity for the work it has performed and is not justified in recognising revenue.
- The proposals need to be clearer that the ‘asset’ that is being transferred to the customer can be the right to work in progress (WIP) construction services, not just the finished product.
- The proposals need to focus more on the provision of services. The AASB would prefer to see more guidance and examples regarding how the concept of control applies to services, which may or may not have a final physical deliverable that is transferred to the customer.

Credit risk in the measurement of revenue

The AASB has concerns with how the impact of credit risk is being recognised in this model and does not agree with the proposal to include credit risk in the measurement of revenue. The AASB would prefer revenue to be recognised gross and to account separately for any impairment of the corresponding receivable (either initially or subsequently) to reflect credit risk. Our reasons are outlined as follows.

- Introducing credit risk into the transaction price takes a ‘valuation-driven’ approach to revenue measurement, rather than a ‘transaction-driven’ (customer contribution) measurement of revenue, which contradicts the exposure draft’s proposals to measure performance obligations at the transaction price.
- Credit loss is a function of financing the customer and not of providing goods or services, and is therefore arguably better, and certainly more practically, measured through impairment of receivables.
- The proposed approach can deny users useful information about expected bad debt expenses, which are now obscured as they are netted against revenue.
- Subsequent changes in credit risk are classified as gains or losses, which is inconsistent with reducing revenue for the effects of credit risk on initial recognition.
- The focus on credit sales ignores the relationship of cash sales to credit sales for many retail and similar businesses that do not discriminate between the prices of goods sold in either fashion. There are interest gains on cash sales and credit losses on credit sales. It is better that both interest and credit losses are measured separately as subsequent transactions/events that can be explicitly analysed and compared.

Lack of consistency with other IFRSs

Presently there is only one measurement basis in IFRS for non-financial liabilities, which is that in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The AASB is concerned that the exposure draft introduces another measurement basis for non-financial liabilities. Consequently there would be inconsistent treatment of similar non-financial liabilities. For example:

- warranty obligations, which are presently measured under IAS 37, would instead be measured on the basis of the customer consideration amount, and would not be

remeasured as estimated fulfilment costs change unless the obligation becomes onerous; and

- insurance liabilities, which will be measured by reference to the present value of fulfilment cash flows (adjusted by the remaining amount of the residual margin) and subsequently remeasured.

The AASB would like to see the proposals include a better justification of why these non-financial liabilities are being measured using a basis different from IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The AASB is concerned that there is a convergence issue with US GAAP going undebated.

The AASB has other concerns about the lack of consistency between these proposals and other IFRSs and current IASB projects. These include:

- the definition of a contract compared with that in IAS 32 *Financial Instruments: Presentation*;
- the inclusion of ‘reasonably estimated’ criteria for uncertainties and rules as to what ‘reasonably estimated’ means, compared with how uncertainty is accounted for in other IFRSs;
- the treatment of contract costs, including the requirement to expense the costs of obtaining a contract (these are to be capitalised for leases under the proposals in ED/2010/9 *Leases*);
- how options to extend a contract are accounted for compared with how options are accounted for under IAS 39 *Financial Instruments: Recognition and Measurement* and the current lease proposals;
- how the notion of control applied to sale and leaseback transactions compares with how the notion of control is applied in other IFRSs;
- the excessive disclosure requirements; and
- the approach to transition requirements compared to the proposed leases approach to transition requirements.

Scope of the proposals

IAS 18 *Revenue* currently applies to other forms of revenue that are not covered by these proposals, for example royalties and dividends. This raises two questions:

- how are these other forms of revenue now to be recognised? If these proposals do not cover all forms of revenue then another Standard will be needed to deal with them; and
- does this mean that only revenue arising from contracts with customers can now be presented as revenue? Some feel that this is an opportunity for the IASB to define revenue as opposed to income.

Further thought should be given to the scope and the title of the proposals ‘revenue from contracts with customers’, because the ED currently deals with a range of issues concerning liabilities, costs, impairment etc.

Drafting of the proposals

A further concern brought to the attention of the AASB, through various constituent meetings, is that the manner in which the proposals are drafted is resulting in widely differing interpretations. We would recommend that the drafting of the proposals is thoroughly reconsidered so that the underlying principles are made clear. At present, the draft seems to reflect the difficulties faced by the Board over the years in coming to consensus.

The AASB's specific comments on the questions in the exposure draft are set out in the attached submission.

If you have any queries regarding any matters in this submission, please contact me or Jessica Lion (jlion@aab.gov.au).

Yours sincerely

A handwritten signature in black ink that reads "K.M. Stevenson". The signature is written in a cursive style with a large, sweeping initial "K".

Kevin M. Stevenson
Chairman and CEO

**AASB's Specific Comments on the IASB Exposure Draft
ED/2010/6 *Revenue from Contracts with Customers***

The AASB's views on the questions in the exposure draft are as follows:

Question 1:

Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether:

- (a) to combine two or more contracts and account for them as a single contract;
- (b) to segment a single contract and account for it as two or more contracts; and
- (c) to account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

The AASB agrees with the principle of aggregating and segmenting contracts and contract modifications based on the principle of price interdependence. However, the AASB thinks that this principle should be broadened to deal with contracts that are negotiated as a single package and where the delivery of goods and services is linked, but the prices are set at market rates and hence there is no price interdependence.

The AASB also agrees with the indicators in paragraph 13 on how to determine whether contracts are price interdependent, but disagrees with how this principle has been applied in Example 2, scenario 2, to contract modifications. The AASB does not think that a contract modification negotiated three years after the original contract, as in Example 2, meets the criterion in paragraph 13(a) of being entered into at or near the same time as the original contract. In this example, applying the indicator in paragraph 13(a) would imply that the contract modification should be accounted for prospectively rather than retrospectively.

Question 2:

The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

The AASB agrees that a performance obligation should be accounted for separately if it is distinct. However, the proposals currently give the impression that 'distinct' implies a very granular level of accounting for performance obligations. The unit of account to which an entity should disaggregate performance obligations is not clear. This is not helped by paragraph 21(g) stating that a performance obligation can be a 'contractually agreed task' and hence the AASB would recommend removing this sentence.

Paragraphs 23(a) and (b)(i) both refer to, ‘the entity or another entity’ selling the good or service separately, when determining distinct goods or services. The AASB would like to see a broader notion considered here. For example, if one entity sells a mobile phone battery separately, should an entity selling a whole telephone conclude that it sells a customer line rental, a handset and a handset battery? As every part of a good that is manufactured (such as a phone handset) could potentially be sold separately by a supplier somewhere in the world, does a manufacturer need to consider every part of the asset they are manufacturing as distinct? The AASB would prefer to see some reference here to an entity’s business model or the market in which the entity and its competitors operates. ‘Customary business practice’ is referred to in the overriding principle in paragraph 20, yet this concept does not flow through into paragraph 23 and the corresponding examples.

The AASB does not agree with the reference to risk in paragraph 23(b)(ii). The proposals could have concluded that ‘distinct’ relates to an identifiable profit margin with no reference to risk. Reference to risk adds confusion and the AASB does not agree that different profits in a contract necessarily equates to different risks in a contract. Two similar products could have the same risk but different margins due to supply and demand or synergies available to particular suppliers that enable them to generate higher margins without a commensurate increase in risk. The AASB recommends that this reference to risk is removed.

Question 3:

Do you think that the proposed guidance in paragraphs 25– 31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

The AASB thinks that the proposed model does not focus on identifying the rights and obligations arising under a contract; it only focuses on how those obligations will be measured. In this regard, the AASB does not think that the ED is sufficiently clear as to when such rights and obligations should give rise to the recognition of assets and performance obligations, and that the proposals are, at least seemingly, too focused on physical deliverables.

The AASB is still concerned that the notion of control implied by the proposals is still a very physical notion. That is, the focus of control seems to be on an underlying physical resource that will ultimately be delivered to the customer. The AASB thinks that the status of the indicator in paragraph 30(a) relating to a customer’s unconditional obligation to pay an entity for work performed should be elevated, as the AASB finds it difficult to envisage a situation in which an entity is entitled to be paid for its work performed to date is not justified in recognising revenue.

The proposals are also not clear as to how the notion of control applies to services. For example, it is unclear when control of a service of supplying an IT help desk is transferred to a customer. What does the customer control? This is further complicated when the entity renders services but also delivers some type of ‘good’ at the end of the term of the contract. An example is the rendering of audit services and the production of an audit report. In this case the subject of control could be interpreted to be the final ‘asset’ (a good). If the

customer broke the contract half way through the service, would the customer have to pay the entity for work to date? If so, the AASB thinks that this indicates revenue should be recognised on the services to date, but it is still not clear what the customer had control of during the period. Another example is providing delivery services. It is clear that the customer controls the item being delivered, but if an entity provides only the shipping service, what does the customer actually control? It would come down to the facts and circumstances of each contract, but the way in which the proposals are worded implies control passes on the physical delivery of a final good, even in a service situation. The AASB would like to see some examples and more guidance on how these proposals apply to services with or without a final deliverable. More detail about how these proposals could be applied to services was included in the discussion paper but this has not been retained in these proposals.

In some contracts control of the good or service never passes to the customer. It passes to the customer's agent or a defined beneficiary. For example, take a private hospital or school where the government or a health fund pays for a particular student or a patient. These proposals would be able to be applied to more situations if the focus was instead on when the entity loses control of assets (which in most cases will be the same point the customer gains control) or an explicit acknowledgement could be included that control may pass to a third party at the request of the customer.

Question 4:

The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

Paragraph 41 states that if the transaction price of the performance obligation cannot be reasonably estimated then no revenue can be recognised. This is inconsistent with how uncertainty is treated in other Standards. For example, regarding level 3 estimates of the fair value of financial assets, IFRS 9 *Financial Instruments* does not consider an inability to make a reliable estimate. The inclusion of reference to 'reasonably estimated' also implies a conservative bias on the recognition of revenue. The concept of 'reliability of measurement' underpins all Standards as it is referred to in the Conceptual Framework. The AASB therefore thinks that reference to 'reasonably estimated' should be removed.

In its response to Question 7, the AASB suggests that an entity should be able to allocate the transaction price to separate performance obligations on a reasonable basis such as its customary business practice. . If an entity can't demonstrate which performance obligation the discount should be applied to, then the AASB would agree that the 'fall back' position should be to allocate the transaction price in proportion to the stand alone selling prices. If this approach is adopted, then the AASB thinks that the unit of account should also be reconsidered in this area of the proposals. Paragraph 38 states that an entity can only

recognise revenue on satisfaction of a performance obligation if the transaction price (which is a whole of contract notion) can be reasonably estimated. The contingent element of the transaction price may only relate to some or one of the performance obligations. Why should uncertain estimates of future performance obligations affect the ability to recognise revenue for performance obligations that have been satisfied and for which the stand-alone selling price is certain? For example, if a fixed progress payment is made for a performance obligation, which is equal to the stand-alone selling price of that performance obligation, why should future uncertainties regarding the next performance obligation, whose stand-alone selling price has some contingencies, affect the entity's ability to recognise revenue for the completed performance obligation? If a contract contains distinct performance obligations, where some of the performance obligations' stand-alone selling prices contain variable consideration and some of which do not, the AASB would prefer that the 'reasonably estimated' criterion for revenue recognition be applied at the performance obligation level, rather than the whole of contract level. The AASB understands that this method could not be applied if a discount has been allocated to the performance obligation, in proportion to the stand-alone selling prices.

The AASB does not think that the 'rules' in paragraph 38 and 39 are necessary in a principles-based standard and does not agree with them. The AASB thinks that an entity that is new to a market may have no experience but could still be able to make a reasonable estimate of its transaction price. It may be able to obtain the knowledge by, for example, hiring a specialist or performing market research. Hence, the AASB thinks that this level of detail as to what constitutes an entity being able to 'reasonably estimate' a selling price is unnecessary and, in some cases, would be incorrect. This is also inconsistent with the treatment of guidance on 'reasonable estimation' elsewhere in IFRSs.

The AASB thinks the factor in paragraph 39(a) is irrelevant to an entity's experience with similar contracts, as market prices are often observable. The factor in paragraph 39(d) may reduce the reliability of the transaction price but not necessarily the relevance of an entity's experience.

The AASB thinks that paragraphs 48 and 49 are also unnecessary in a principles-based Standard.

Changes in estimates

Consistent with our views in the second paragraph of the answer to Question 4, on the unit of account to which variable consideration in a contract should be applied, the AASB thinks changes in estimates should be permitted to be applied to only one performance obligation, if it is clear from which stand-alone selling price and hence performance obligation those changes arose.

Question 5:

Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

The AASB strongly disagrees with this proposal for the following reasons.

- Introducing credit risk into the transaction price takes a ‘valuation-driven’ approach to revenue measurement, rather than a ‘transaction-driven’ (customer contribution) measurement of revenue, which contradicts the exposure draft’s proposals to measure performance obligations at the transaction price.
- Credit loss is a function of financing the customer and not of providing goods or services, and is therefore arguably better, and certainly more practically, measured through impairment of receivables.
- The proposed approach can deny users useful information about expected bad debt expenses, which are now obscured as they are netted against revenue.
- Subsequent changes in credit risk are classified as gains or losses, which is inconsistent with reducing revenue for the effects of credit risk on initial recognition.
- The focus on credit sales ignores the relationship of cash sales to credit sales for many retail and similar businesses that do not discriminate between the prices of goods sold in either fashion. There are interest gains on cash sales and credit losses on credit sales. It is better that both interest and credit losses are measured separately as subsequent transactions/events that can be explicitly analysed and compared.

Whilst the AASB agrees that credit risk should be taken into account in the measurement of the receivable from the customer, the corresponding effect on the statement of comprehensive income should be the recognition of an expense rather than a reduction in revenue.

If the proposals were to proceed the AASB thinks that presenting changes in estimates of credit risk as gains or losses is inconsistent with how other changes in estimates (such as contingent consideration) are presented in the income statement. Paragraph BC86 states that the Boards rejected presenting changes [unrelated to credit risk] in the estimate of the transaction price as a gain or loss separately from revenue, “because the total amount of revenue recognised for the contract would not equal the amount of consideration received from the customer.” This rationale contradicts the approach taken by the Boards to firstly include credit risk in the measurement of revenue and secondly present the effects of changes in estimated credit risk as gains or losses. For example, if the effect of credit risk on the initial recognition of a contract receivable is to reduce a contractual amount of 100,000 currency units (CU) to a carrying amount of 95,000 CU, but the entity collects 100,000 from the customer, it would recognise 95,000 CU as revenue even though (with reference to paragraph BC86) “the total amount of revenue recognised for the contract would not equal the amount of consideration received from the customer”.

The AASB also notes that, in the context of deliberations of comments on ED/2009/12 *Financial Instruments: Amortised Cost and Impairment*, the IASB is considering ‘de-coupling’ the determination of contractual interest revenues from the determination of expected credit loss cash flows. The AASB urges the IASB to also consider de-coupling the determination of the impact of credit risk in the context of revenue recognition in contracts with customers.

Question 6:

Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

The AASB agrees with these proposals.

Question 7:

Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

As raised in the covering letter, the AASB is concerned that measuring non-financial liabilities at an allocation of the transaction price introduces another measurement basis for non-financial liabilities, and the AASB would like to see more justification in the Basis for Conclusions as to why this approach was taken.

The AASB does not agree with the price allocation method imposed in paragraphs 50-52. The AASB thinks that an entity should allocate the transaction price on a reasonable basis. This could be based on customary business practice, or stand-alone selling prices. For example, an entity may always apply a discount to a sub-group of performance obligations whether these are sold in a contract with other goods and services or not. If an entity cannot demonstrate which performance obligation the discount should be applied to, then the AASB agrees that the 'fall back' position should be to apply it in proportion to the stand-alone selling prices.

Example 1 in the ED implicitly acknowledges the AASB's view and contradicts the principle established in paragraph 50. In Example 1 an entity enters into a contract to sell Products A, B and C. As the entity regularly sells A and B together at a discount, the discount on the total contract is allocated to A and B (but not C). Applying the principle in paragraph 50 to this example would have ignored the customary business practice of the entity and allocated the total transaction price of the contract over the three stand-alone selling prices of A, B and C. The AASB agrees with the outcome in Example 1 and the principle implied by this example.

Question 8:

Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

See the response to Question 9.

Question 9:

Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

The AASB does not agree that the Standard replacing IAS 18 *Revenue* should provide guidance on how to account for costs. This guidance should be provided in other Standards such as IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. The AASB does not agree that these proposals should result in the recognition of assets if other Standards or the Framework do not result in those assets being recognised. If the other Standards are inadequate the AASB thinks that those other Standards should be updated. The AASB is also concerned that the proposal to expense the costs of obtaining a contract is not consistent with ED/2010/9 *Leases*, which proposes that these costs be capitalised.

If the proposals proceed

The AASB thinks that costs incurred before the contract is obtained (that meet the criteria) should not be treated any differently from subsequent costs (that meet the criteria) and should be capitalised. Paragraph BC157 acknowledges that pre-contract costs can meet the definition of an asset, but disallows their capitalisation due to the factors in paragraph BC77, which relate to the Boards being concerned about revenue recognition before the transfer of goods or services or at contract inception. The AASB does not think the factors in paragraph BC77 should prohibit capitalisation of pre-contract costs. Capitalisation could occur without revenue recognition at that point. There is also some further confusion regarding this issue, as IASB staff appeared to indicate on a webcast on 13 September 2010, regarding how the exposure draft would impact the construction industry, that pre-contract costs could be capitalised under these proposals.

The proposals also need to be clear as to what this asset is, and how it is measured, depreciated, impaired and presented.

Question 10:

The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Paragraph BC172 states that, "information is obscured if the disclosure of that information is either too aggregated or too granular". The AASB thinks that in the context of this principle the disclosures proposed by the Boards are excessive and will obscure

information. The disclosures should be more focused on the major areas of uncertainty affecting revenue recognition (including risks) and the variability of revenue. The cost to comply with these requirements may be excessive, as many entities will need new systems to capture the information. The AASB's concerns regarding specific disclosures are attached in Appendix 2.

Question 11:

The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

The AASB thinks that the IASB should identify the objective of this disclosure requirement, and provide clearer guidance as to the boundaries of this proposed requirement. The AASB would support such a disclosure if it were confined to the recognised portion of such obligations.

See also the AASB's answers to Question 10. The AASB's concerns regarding specific disclosures are attached in Appendix 2.

Question 12:

Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

The AASB agrees that some disaggregation would be useful to users. However, some constituents have stated that it would be most useful to users if this requirement took a 'through the eyes of management' approach, similar to IFRS 8 *Operating Segments*. Constituents have raised concerns that presenting a granular level of disaggregation would not be useful, would be too onerous and possibly require the disclosure of sensitive information.

Question 13:

Do you agree that an entity should apply the proposed requirements retrospectively (i.e. as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

The AASB agrees with retrospective application, but has concerns regarding the practicalities and cost of doing this for long-term contracts. Some constituents have raised concerns that the same transition proposals should be applied to both leases and revenue, to

aid those entities with contracts containing leases and services, or that have sold a previously leased asset in the transition period. The AASB suggests that the IASB has consistent transitional requirements for these two projects.

The AASB would also strongly support allowing early adoption (the AASB notes that the FASB has made a decision to not allow this).

Question 14:

The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

The AASB has concerns with the volume of proposed application guidance within a principles based standard. The guidance sometimes contradicts the principles (see Example 2 scenario 2) and sometimes infers a principle or rule that is not in the exposure draft (see Example 1), rather than demonstrating how the principle has been applied in a particular situation.

Non-refundable up front fees

The AASB would prefer to see this section portray more of a balanced view. Paragraph B29 states that a non-refundable upfront fee can relate to a separate performance obligation. It would be useful to have an example of when an up-front fee relates to such an obligation, given there are two examples of when it does not. IFRIC 18 *Transfers of Assets from Customers* gives an example of when up-front fees can be revenue, namely connection fees that represent stand-alone value to the customer.

Sale and repurchase

Paragraph B49 states that when a customer purchases an asset with a forward or call option, the customer is constrained in its ability to direct the use of, and receive the benefit from, the asset and hence the customer does not obtain control of the asset. The AASB thinks that that customer does obtain control of the asset, the existence of an option just creates another asset, 'a right', and control of this right has not passed to the customer. The AASB is concerned that this is a different notion of control from that which is currently in other IFRSs. For example, an airport owner may be restricted in its operation of an airport, with respect to operating hours and landing charges, limiting the cash flows it could generate from the airport. Yet most would conclude that the airport owner controls the airport. However, the implication of the exposure draft is that a resource cannot be an asset if its holder is constrained in its use of, or ability to benefit from, the resource.

The AASB disagrees that the customer does not gain control when there is a forward or call option as the customer is free to direct the use of and receive the benefit from the asset until the option is exercised. Resolution of this issue ultimately depends on determining which asset is being accounted for – the 'underlying' resource sold, or the rights to obtain benefits from the resource (the value of which may be constrained in various circumstances). This is symptomatic of the AASB's general concern that the ED's proposals focus on control of the wrong item in various cases. The approach proposed in the ED is also inconsistent with

the proposals in ED/2010/9 *Leases*, whereby control of the leased asset is not assumed until the purchase option is exercised.

Sale with a right of return

Where a contract contains a right of return the guidance in the exposure draft would involve the vendor recognising an asset for the goods to be returned and a refund liability.

The AASB agrees that a sale with a right of return creates a liability, but thinks this liability is a stand-ready obligation for the entity to take back the returned good from the customer. Therefore, it is another performance obligation that should be accounted for in the same manner as other performance obligations, rather than as a ‘return liability’ as the exposure draft proposes.

If these proposals proceed in terms of a sale with a right of return

If the IASB proceeds with the proposals and the ‘return liability’ is not treated as a performance obligation the AASB still does not agree that an asset exists as a conditional right to receive a resource is not a present right. The AASB would prefer that the value of the asset to be returned be incorporated (net) into the value of any corresponding liability.

Furthermore, if the proposals maintain that an asset should be recognised for sales with a right of return, the AASB thinks that the Basis for Conclusions should make it clear that this asset recognised is not the entity’s present ‘right’ to receive the good expected to be returned, as receiving that good is conditional on the customer deciding to exercise its put option. Therefore, the AASB disagrees with characterising the asset in the manner in paragraph BC71 (b) that, “an entity recognises an asset for the entity’s right to receive the asset upon settling that liability”.

The exposure draft also needs to be clear on how the asset and liability are to be presented. The refund liability can be remeasured, but there is no guidance as to how any changes to the measurement of the refund liability are allocated to satisfied performance obligations. However, the asset is only subsequently measured by reference to the refund liability.

Customer options for additional goods and services

Paragraph B88 states that material renewal options should be assigned a value and treated as a performance obligation. This is not consistent with the proposals in ED/2010/09 *Leases* where expectations of renewal are built into the overall recognition of the lease asset/liability, or the measurement of options under IAS 39 *Financial Instruments: Recognition and Measurement*. It is also not clear how perpetual contracts (with infinite option periods) would be accounted for.

For more detail on the AASB’s concerns with specific examples in the proposed application guidance, see Appendix 1.

Question 15:

The boards propose that an entity should distinguish between the following types of product warranties:

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

The AASB does not agree that a latent defect necessarily equates to a failed sale. A latent defect means that an entity has a stand-ready obligation to fix the asset. Why is an obligation to replace an asset treated differently from an obligation to repair an asset? The AASB finds it difficult to see how latent defects and warranty performance obligations will be distinguished in practice.

The AASB thinks that all types of warranties and returns should be accounted for similarly, that is, as performance obligations, unless they are immaterial, in which case it would be acceptable to account for the costs as expenses when incurred.

If the proposals proceed

Given the same approach is applied to latent defects as is applied to a product with a right of return, and an asset recognised for defective items to be returned, it is likely that the 'asset' has reduced, if any, value to the entity. Therefore, it would be important that the Standard includes guidance on how impairment of this asset is to be recognised.

Question 16:

The boards propose the following if a licence is not considered to be a sale of intellectual property:

- (a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and
- (b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

The AASB does not agree with this approach. The distinction seems artificial, given that the exposure draft is focused on the customer, and the type of licence provided will not

differ from the customer's viewpoint. The AASB thinks that exclusive and non-exclusive licences granted to customers should be treated the same, namely, that an entity has satisfied its obligation when the customer is able to use and benefit from the licence. [The AASB is assuming that these types of contracts will also be subject to the rest of these proposals, with any warranties or services (such as helpline for software implementation issues) provided with the licence being split out as separate performance obligations if distinct].

Some of the AASB's constituents have raised concerns in this area regarding the interaction with the leasing proposals. Given that leases of intangible assets are scoped out of ED/2010/9 *Leases*, they are concerned that entities may start transacting in the leasing of non-exclusive licences for their tangible assets and hence apply this accounting by analogy rather than apply the Leases Standard. For example, rather than leasing an aeroplane, entities may sell a licence that allows use of an aeroplane. The AASB suggests the solution is for the leasing requirements to cover leases of intangible assets.

If the proposals in the Revenue exposure draft do proceed, the AASB thinks the guidance should be expanded to include licences of all intangible assets (for example, fishing licences, taxi licences etc), not just licences of intellectual property. Example 12 relates to a non-exclusive software licence, where the entity sends a customer a disc and an access code. It concludes that revenue is not recognised until the customer obtains the access code. Another view could be taken that the entity has two performance obligations, delivery of the disc being one and the delivery of an access code being another. This example illustrates the difficulties in determining separate performance obligations and a discussion should be included as part of this example to explain why there is only one performance obligation.

Question 17:

The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

Yes the AASB agrees.

Question 18 [FASB only]:

Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement(s) and why?

It would help if consideration were given to the following not-for-profit issues:

- whether the definition of a contract could be expanded to include non-exchange transactions, including grants;
- if the notion of control in these proposals related to the entity losing control of an asset, rather than the customer gaining it, or instead, the proposals referred to control being obtained by a beneficiary or agent of the customer;

- the price interdependency principle for combining and segmenting contracts as prices may not always reflect the economics of a transaction in a not-for-profit situation;
- ‘distinct profit margins’ as transactions may not be commercial and hence profit margins are not a key consideration as to whether the goods and services are distinct;
- onerous social benefit contracts in the context of onerous performance obligations, as often a not-for-profit entity will intentionally provide goods or services at less than cost; and
- whether the proposals could be expanded to non-contract based revenues, such as taxes, fines, fees and grants, as contractual based revenues are often insignificant to not-for-profit entities.

Other Comments

Views on Scope of the exposure draft

IAS 18 *Revenue* currently accounts for forms of revenue that are not covered by these proposals, such as royalties and dividends. This raises a number of issues. It is not clear to the AASB how these other forms of revenue would be recognised and whether another standard will be issued to deal with them.

The AASB also seeks clarification of whether the limited scope of the exposure draft means that only revenue arising from contracts with customers can now be presented as revenue? Some constituents consider that this is an opportunity for the IASB to define ‘revenue’ as opposed to ‘income’.

The situation is further confused by the reference to ‘ordinary activities’ in the definition of a customer. The AASB thinks that this reference should be removed, because the principles for all contracts with customers should be the same.

The title of the proposals is ‘revenue from contracts with customers’, but it currently deals with liabilities, costs, impairment etc. Some constituents consider that these proposals should instead deal with contract accounting and hence address all aspects of contracts with customers, whilst others think the new Revenue Standard should be limited to revenue requirements and leave other standards to deal with the other elements arising from a contract. The AASB thinks that further consideration should be given to the scope and title of these proposals.

If the proposals proceed as they are, the IASB should reconsider the title of the proposals.

The disclosures in paragraph 74 refer to government versus non-government customers and consequently some constituents are questioning whether these proposals should be applied to grants and other non-exchange transactions. The AASB assumes this is not the case but considers that the IASB should make this clear.

The interaction with IAS 32 *Financial Instruments: Presentation*/IAS 39 *Financial Instruments: Recognition and Measurement* is not clear or consistent. The AASB has concerns that the definition of a contract in these proposals is not aligned with the definition of a contract in IAS 32/IAS 39. It is not clear how the IAS 32/IAS 39/IFRS 9 *Financial Instruments* requirements on embedded derivatives would interact with this

Standard. Also, a contract asset is measured under these Standards until it becomes unconditional, at which point it becomes a receivable to be accounted for under IAS 39. Therefore, some argue that the measure of the contract asset should be equal to the receivable.

It is not clear if asset-for-asset exchanges are covered in the scope. The AASB thinks that they should be if the transaction has commercial substance.

Given that most contracts are written under local law, the provisions of which may not be explicitly identified in the contract, it would be useful if the proposals dealt with how the terms of the contract and performance obligations should interact with local law. For example, it would be useful to know whether the law in a particular jurisdiction can be regarded as effectively imposing performance obligations in addition to those identified in contracts with customers.

Appendix 1 – Paragraph wordings and suggestions

Paragraph	Suggestion/Comment
The AASB think Paragraph 6(e) is unnecessary. Why wouldn't these principles apply? If this sentence is to exclude transactions with no commercial substance, paragraph 10 refers to these and hence mitigates this situation.	Remove paragraph 6(e).
Paragraph 10(a) equates substance with a resulting change in expected cash flows. This seems unduly restrictive.	Remove the second half of paragraph 10(a).
Paragraph 11 – The AASB disagree with the second sentence (note the AASB agree with the first sentence in this paragraph). The AASB would argue that a contract where work has started, but where no goods or services have been transferred to the customer, is not wholly unperformed as the entity will have built up WIP and has started to perform.	A wholly unperformed contract is where no work has been performed by the entity and the customer has not performed at all by paying any consideration.
Paragraph 27 – why refer to an asset's 'remaining economic life'? The customer may on-sell the asset subsequently, and hence this is irrelevant. This paragraph should only refer to present rights.	Remove reference to remaining economic life.
Paragraph 28 – may want to include reference to regulatory controls.	Include reference to regulatory controls.
Paragraph 30 (d) – use of the word 'major' versus 'minor' in relation to changes in the design or function of a good or service. This terminology, although used in IFRIC 15, is a distinction that is inconsistent with other standards.	Refer instead to 'significant' versus 'trivial' changes, and give some examples.
Paragraph 38 states that the 'transaction price can be reasonably estimated.' Yet paragraph BC107 states that the fair value of goods must be estimated reliably.	Change all references to 'estimated reliably'.
Paragraph 62 – how would assets created under paragraph 57 be an intangible asset? The AASB considers they would only ever be inventory or WIP? (Even if the assets are intangible, they would be WIP/inventory).	Remove reference in paragraph 62 to an intangible asset.
Paragraph 64 is obscurely worded for a simple proposition.	Say instead: "The entity shall present either a contract asset or a contract liability in the statement of financial position."
Example 11 – The AASB thinks that this example is not helpful. The AASB does not agree that site preparation and site finishing	Remove the references to risk and in the example justify why the contract is not treated as a single performance obligation.

<p>should be seen as distinct performance obligations just because they have distinct risks (note that, in our answer to question 2, the AASB does not agree that distinct risks are relevant to the performance obligation being distinct). The example states that the contract management service is not subject to distinct risks because the risks are inseparable from the risks of the related tasks. If the entity managed the profit of the contract management service as one profit margin, and if this entity and others do not sell site preparation and site finishing separately, using the principles in paragraph 20 and 23 (which the AASB agree with apart from the reference to risk), the AASB would reach a different conclusion that the contract management service was one performance obligation. Therefore, this example would be more helpful if there were a better justification, based on the principle of what constitutes a performance obligation, showing how judgement had been applied in this situation to the overall principle to lead users of the proposals to the same answer as reached in the example. Currently a different conclusion can be reached by referring to the principle rather than applying the ‘rules’ beneath it.</p> <p>The example also states that the facility will operate in accordance with agreed-upon specifications for two years after being complete. There is no discussion as to why the performance guarantee is a warranty obligation rather than a latent defect obligation. If a manufacturer guarantees a facility such as a building for two years for a 100-year life building, some may see that as just protection against latent defects.</p>	<p>The example should explain why the guarantee is a warranty rather than a latent defect.</p>
<p>Paragraph BC28 regarding the discussion of rights and obligations is educational and could be included in the standard.</p>	<p>Include paragraph BC28 in the standard.</p>
<p>Paragraph BC77 (b) states that one reason for rejecting measuring performance obligations at a current exit price is that, “any errors in identifying performance obligations or in measuring those performance obligations could affect</p>	<p>The AASB thinks that the Boards should include a better justification as to why performance obligations have not been measured at a current exit value.</p>

<p>revenue recognised at contract inception.” The AASB thinks that this argument is weak as it suggests that errors post contract inception are acceptable and the only type of error that the Boards are concerned with is day one errors.</p>	
<p>Paragraph BC158 states any costs of obtaining a contract are recognised as expenses when incurred because a contract asset and revenue are recognised only as a result of satisfying a performance obligation in the contract. This conclusion mixes revenue recognition and capitalisation of costs. It would be possible to capitalise the costs of obtaining a contract without recognising revenue, and therefore the same criterion should not apply to both issues.</p>	<p>The AASB thinks pre-contract costs that do not qualify for recognition as assets under another IFRS (e.g., IAS 2 <i>Inventories</i>) and are incurred in the process of satisfying a performance obligation eventually specified in the contract (e.g., initial design work) should be recognised as assets (but subjected to an impairment test). However, this should be made as a consequential amendment to other applicable standards.</p>

Appendix 2 – Disclosures and suggestions

<p>The unit of account for which disclosures are expected is unclear. Can disclosures be made by contract portfolios (especially due to the requirements to combine/segment contracts)? How do these proposals regarding combining/segmenting align with the disclosures?</p>	<p>Define the unit of account for disclosures.</p>
<p>Paragraph 73(b), 75 and 76 require reconciliations of contract assets and liabilities. The AASB question how much value these add to users. They are a useful ‘house-keeping’ tool for accountants and auditors to do a logic check. The AASB thinks it is excessive for entities to show a reconciliation of contract assets and liabilities.</p>	<p>Remove paragraphs 73(b), 75 and 76.</p>
<p>Paragraph 75(a)(ii) – for entities that have thousands of changes in price, which is part of their normal business (such as construction contracts), is it useful to show separately revenue from allocating changes in the transaction price to performance obligations satisfied in previous reporting periods? This is just a change in estimate and other standards do not require such detail.</p>	<p>Remove the requirement in paragraph 75(a)(ii).</p>
<p>Paragraph 75(b) requires cash received to be disclosed, which should be shown in the statement of cash flows anyway.</p>	<p>Remove the requirement in paragraph 75(b).</p>
<p>Paragraph 75(c) seems to require disclosure of a very minor accounting adjustment. Why has this one item had so much importance placed on it? The AASB thinks this to be unnecessary disclosure.</p>	<p>Remove the requirement in paragraph 75(c).</p>
<p>Paragraph 75(d) – The AASB have concerns that this disclosure is onerous. Does it matter how your customer pays you if the consideration is at fair value? A more useful disclosure would be non-cash consideration received that is not at fair value.</p>	<p>Remove the requirement in paragraph 75(d).</p>
<p>Paragraph 75(e) should already be disclosed under the requirements of IFRS 3.</p>	<p>Remove the requirement in paragraph 75(e).</p>
<p>Regarding paragraph 77, it is not clear if these disclosures require qualitative or quantitative information. The AASB would support a qualitative disclosure only, except in respect of (d) and (e), which would require quantitative.</p>	<p>Require a qualitative disclosure only, and clarify that, for paragraphs 77(d) and 77(e), amounts must be shown.</p>
<p>Paragraph 77(c) contains a requirement to</p>	<p>Remove the requirement in</p>

<p>disclose payment terms. If payment terms were significantly in advance or arrears the entity would recognise and disclose significant interest income or expense and hence The AASB do not think that this disclosure is necessary. In addition, disclosing whether the consideration amount is variable is unlikely to provide additional useful information, unless details of the contingencies and expected timing of cash flows were required. Also, even for a fixed price contract, if related expenses are subject to considerable uncertainty, the profitability of the contract may be equally uncertain. Accounting standards do not require disclosure of variations from budgeted costs. For these reasons, The AASB thinks it would be an <i>ad hoc</i> approach to focus particularly on the existence of variable consideration.</p>	<p>paragraph 77(c).</p>
<p>The AASB think that the reconciliation in paragraph 80 for onerous performance obligations is excessive and the information required by paragraph 79 with regards to onerous performance obligations is sufficient.</p>	<p>Remove the requirement in paragraph 80.</p>
<p>The AASB think that the disclosures in paragraph 81 are unnecessary as they are already covered by IAS 1.</p>	<p>Remove the requirement in paragraph 81. If the IASB decides to retain the disclosures, it should clarify that they are only needed if significant uncertainty exists regarding the amount and timing of revenue.</p>
<p>The AASB think that the disclosure required in paragraph 82 is only relevant to long term contracts, or contracts that span more than one period.</p>	<p>Refer to long-term contracts in this disclosure.</p>
<p>The AASB think the disclosures required by paragraph 83 are only relevant when the entity had multiple performance obligations arising from the contract.</p>	<p>Refer to multiple performance obligations in paragraph 83.</p>
<p>The AASB feel that the disclosure required by 83(d) is unnecessary given the disclosures required by paragraph 79.</p>	<p>Remove the requirement in paragraph 83(d).</p>