

24 February 2012

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

Dear Mr Stevenson

ED 222 – Revenue from Contracts with Customers and the IASB’s ED/2011/6 – A revision of ED/2010/6 Revenue from Contracts with Customers

Attached is the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft 222 – *Revenue from Contracts with Customers* and a copy of the ACAG response to the International Accounting Standards Board regarding Exposure Draft - 2011/6 – *A revision of ED/2010/6 Revenue from Contracts with Customers*.

The views expressed in this submission represent those of all Australian members of ACAG.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely



Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

ED 222 – Revenue from Contracts with Customers

1. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of these proposals, particularly any issues relating to:**
 - (a) **not-for-profit entities; and**
 - (b) **public sector entities including any implications for GAAP/GFS harmonisation**

[Note: This Exposure Draft is seeking comments from the perspective of not-for-profit, including public sector, entities at this time even though Income of Not-for-Profit Entities is subject to a separate AASB project.]

Other than the item noted below, ACAG is not aware of any regulatory or other issues.

ACAG notes that in relation to the presentation of revenues for certain not-for-profit entities, it is not unusual to disclose gross or potential revenues less allowed rebates, concessions or other community service obligation amounts waived under certain policies or legislation, thus presenting the foregone value of services provided to the community. This follows a core principle of the proposal that an entity should present “gross” amounts for users to analyse separately. The Exposure Draft does not appear to consider the presentation of revenue foregone in the presentation of gross revenues.

ACAG acknowledges the Board’s decision, during their February 2011 meeting, that Australian not-for-profit entities should continue to apply the requirements of AASBs 118 and 1004 when the standard resulting from ED 222 is issued and becomes operative.

Nevertheless, ACAG recommends the Board consider the comments raised in our submission on ED/2010/6, dated 24 September 2010, when developing the revenue recognition model for not-for-profits.

Areas of concern raised in that submission relate to: non-refundable upfront fees; variable considerations; and the recognition and fulfilment of performance obligations attached to contracts with customers.

2. **Whether, overall, these proposals would result in financial statements that would be useful to users.**

As noted in our previous response to ED 198, ACAG do not believe that these proposals will result in financial statements that would be useful to users.

ACAG supports a framework that establishes strong principles instead of relying on detailed rules to ensure faithful representation of financial information. While ED 222 identifies an overall principle, ACAG is concerned this principle is compromised by detailed and complex rules open to manipulation. In particular ACAG finds the criteria for recognising performance obligations over time to be overly complex given the relatively simple concept that revenue should be recognised incrementally when control passes to the customer on a similar basis.

Furthermore, although paragraph 110 of the ED expresses the principle that entities must present disclosures at a level of detail relevant and understandable to users of the financial statements, there is potential for the actual disclosures to be complex and difficult to understand.

We are not convinced that categorisation of revenue is particularly useful. Users are more likely to be interested in the sensitivity of any assumptions made and the financial impact of movements in these assumptions.

For many entities, including the majority of those in the not-for-profit and public sector, the option of utilising similar existing segment reporting disclosures, enhanced to meet the requirements specified in paragraph 114, is not an option. Indeed we believe that the disclosure requirements will be more extensive than current segment reporting requirements.

ACAG also notes it will be difficult for entities to keep track of all information required for the disclosures. For example, sophisticated databases will be required to record the terms, duration and other details of all performance obligations and contracts to be able to provide the disclosures required by paragraphs 114-123 of the ED. Accountants will require a far more detailed knowledge of contracts and performance obligations to be able to provide accurate disclosures and auditors will need a greater understanding of the client's business and transactions than previously.

ACAG believes that the additional cost of applying the disclosure requirements is not justified because they do not provide more relevant and understandable disclosures.

3. Whether these proposals are in the best interests of the Australian economy.

ACAG does not believe that the proposals are in the best interests of the Australian economy for reasons outlined under question 2 above.

4. Unless already provided in response to specific matters for comment 1-3 above, the costs and benefits of the proposals, whether quantitative (financial or non-financial) or qualitative.

The costs for preparers and auditors are likely to be significant. Accounting systems and processes will need to be modified to capture all the required information. The proposals move to a 'form over substance' approach that may result in additional legal costs to determine whether a contract exists, whether a transfer has occurred, whether the entity has met performance obligations and to rewrite contracts to meet accounting requirements.

Also accountants and auditors will need a greater understanding of both the legal requirements of specific contracts and of the business itself leading to increased compliance costs.

Also refer to comments under question 2 above.

Given the nature of revenue for many public sector entities does not involve actual contracts with customers, ACAG does not expect any benefits to users of the financial statements for such entities.



AUSTRALASIAN
COUNCIL OF
AUDITORS-GENERAL

24 February 2012

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Chairman

ED/2011/6 – A revision of ED/2010/6 Revenue from Contracts with Customers

Attached is the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft referred to above. The views expressed in this submission represent those of all Australian members of ACAG.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S O'Neill', is written over a horizontal line.

Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

Questions for Respondents

1. **Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?**

ACAG agrees with the basis of recognition of revenue over time as control is transferred. However, ACAG notes, as previously mentioned in our preliminary views discussion paper response, that substance over form appears to be lost resulting in an opportunity for contracts to be worded to achieve a particular outcome.

ACAG is also concerned with the drafting of paragraph 37(a) that notes a customer has obtained control of an asset if they are presently obliged to pay for the asset. Where the customer has a contractual requirement to make an advanced payment before receiving the goods, ACAG is concerned that preparers may consider these payments meet the control guidance at paragraph 37(a).

2. **Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?**

As noted in our previous response to ED/2010/6, ACAG prefers the approach where collectability is not reflected in, or adjacent to, the amount of revenue earned. Credit risk is more correctly related to the value of an asset.

The impacts of credit risk on the entity are addressed adequately by impairment testing of receivables at each reporting date (Para 58 of IAS 39 Financial Instrument: Recognition and Measurement) and disclosure by IFRS 7 Financial Instruments: Disclosures.

ACAG believes that adjusting revenues to reflect credit risk would introduce greater subjectivity and complexity to the measurement of revenue and would not improve the usefulness of information. In some cases, it may be difficult to assess a customer's credit worthiness at the time of sale especially for new customers. We interpret the proposal as requiring entities to make customer-specific credit adjustments to each contract, which may require extensive system changes.

3. Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

ACAG agrees with the proposed constraint that the amount of revenue an entity recognises should not exceed the amount that will be ultimately received. ACAG's concern is that revenue may be recognised in a way which does not truly represent the timing and amounts of actual revenue earned. Increased subjectivity in measuring revenue will make it more difficult to obtain objective audit evidence to support judgements, assumptions and probabilities used to estimate revenue.

As discussed in our previous response to ED/2010/6, ACAG notes that allowing entities to recognise variable revenue is inconsistent with the recognition of contingent assets under IAS 37 Provisions, Contingent Liabilities and Contingent Assets. An entity cannot recognise a contingent asset unless the realisation of income is virtually certain because it may result in recognition of income that may never be realised (refer para 31-35 of IAS 37). This is inconsistent with the proposals in the ED.

4. For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

ACAG does not agree that the onerous test should be applied at the performance obligation level. The proposed definition of, and measurement basis for, onerous performance obligations (para 86 of the ED) is inconsistent with IAS 37 Provisions, Contingent Liabilities and Contingent Assets, which applies at the material contract level and not to items within a contract. The introduction of the onerous obligation for contracts expected to be greater than one year conflicts further and introduces an artificial separation rule that will not always reflect the long term reality. Having different accounting treatment for similar liabilities will result in financial statements that are confusing for users and difficult for entities to prepare.

The ED does not explicitly state that the time value of money should be duly considered as part of the onerous test calculations. ACAG believe that it would be beneficial to specifically refer to para 58 to 62, similar to the referencing in para 89 for impairment.

5. The Boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119-121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfil a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

ACAG does not support the provision of the above disclosures in interim financial reports because the costs to prepare and audit that information would far outweigh any benefit to users.

Also refer to "Other Comments" for general feedback on proposed disclosures.

6. For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

In terms of the transfer and derecognition of assets, ACAG agrees with the principle of maintaining a consistent approach between standards.

Other Comments

As noted in our previous response to ED/2010/6, ACAG do not believe that these disclosures will result in financial statements that would be useful to users. Although paragraph 110 of the ED expresses the principle that entities must present disclosures at a level of detail relevant and understandable to users of the financial statements, the actual disclosures will be complex and difficult to understand.

We are not convinced that categorisation of revenue is particularly useful in terms of improving the quality of information being reported to users. Users are more likely to be interested in the sensitivity of any assumptions made and the financial impact of movements in these assumptions.

ACAG also notes it will be difficult for entities to keep track of all information required for the disclosures. For example, sophisticated databases will be required to record the terms, duration and other details of all performance obligations and contracts to be able to provide the disclosures required by paragraphs 114-123 of the ED. Accountants will require a far more detailed knowledge of contracts and performance obligations to be able to provide accurate disclosures and auditors will need a greater understanding of the client's business and transactions than previously.

ACAG believes that the additional cost of applying the disclosure requirements is not justified because they do not provide more relevant and understandable disclosures.

Applicability to the Not-For-Profit and Public Sectors

For the purposes of the ED, 'A contract exists if ... the contract has commercial substance (i.e. the entity's future cash flows are expected to change as a result of the contract) ...' (para 14(a) of the ED). Not-for-Profit and Public Sector entities may be able to avoid accounting for revenue in accordance with the requirements of the ED by arguing their contracts with customers do not have commercial substance, even though the contract is expected to affect future cash flows

Timing Differences

The proposals will create more timing differences with the recognition of contract assets and liabilities. This could complicate the tax records that must be maintained and increase the complexity of the reconciliation of tax to accounting profit.

Non-refundable upfront fees – para B29-B32:

The ED requires an entity to recognise a non-refundable upfront fee over the period that the entity expects to provide the relevant service to the customer. It is unclear how the ED intends entities to account for an up-front fee that relates to a service the entity expects to provide for an indefinite time period. ACAG recommends the IASB provide guidance on how to determine an appropriate time period over which to recognise such revenue.

Variable Consideration

ACAG disagrees with the proposal that revenue should be measured at the probability-weighted amount of consideration the entity expects to receive (para 55) because it introduces a degree of subjectivity and guess work that will decrease the usefulness of the information in the financial statements. Such an approach would make revenue more susceptible to earnings management and fraud.

Revenue other than from contracts with customers

It is not clear how revenues arising from royalties, interest and dividends will be accounted for. Previously these types of income were accounted for under IAS 18 'Revenue'. ACAG recommends similar provisions are included in the final revenue standard.

It is also unclear whether statutory revenue from exchange transactions will be within the scope.