ACAG AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL

18 June 2009

Mr Bruce Porter
Acting Chairman
Australian Accounting Standards Board
P O Box 204
Collins Street West
MELBOURNE VIC 8007

Dear Mr Porter

IASB Discussion Paper:
Preliminary Views on Revenue Recognition in Contracts with Customers

Attached for your information is a copy of the Australasian Council of Auditors-General (ACAG) response to the Discussion Paper referred to above.

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

Yours sincerely

Simon O'Neill

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Chairman
ACAG Financial Reporting and Auditing Committee

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ACAG AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL

18 June 2009

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Dear Sir David

IASB Discussion Paper
Preliminary Views on Revenue Recognition in Contracts with Customers

Attached is the Australasian Council of Auditors-General (ACAG) comments to the Discussion Paper referred to above.

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

The principles-based model for revenue recognition, as a whole, in this Discussion Paper is supported by ACAG.

The attachment to this letter provides ACAG's comments to specific questions raised in the Discussion Paper.

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

Yours sincerely

Simon O'Neill

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IASB Discussion Paper
Preliminary Views on Revenue Recognition in Contracts with Customers

ACAG has reviewed the Discussion Paper and provides the following comments on the specific matters raised by the IASB.

Question 1

Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

ACAG agrees that a single revenue recognition principle for exchange transactions is ideal. The proposed contract asset or liability approach appears to meet this objective. However, there is the potential for increased complexity without commensurate improvements to relevant and reliable financial reporting.

Question 2

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

ACAG believes the proposed principle may not provide decision-useful information for long term contracts as revenue would be deferred rather than being recognised on a stage of completion basis.

Also it is not clear what the treatment would be for recognising emerging assets for privately funded infrastructure where ownership reverts to the public sector after a certain number of years.

Question 3

Do you agree with the boards' definition of a contract? Why or why not?
Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

ACAG is in agreement because the boards' proposed definition of a contract is consistent with a general contract definition commonly used that states;

> *"An agreement between two or more parties creating obligations that are enforceable or otherwise recognisable at law."*[1]

The proposed definition emphasises that a contract exists when an agreement between two or more parties creates enforceable obligations between those parties. Such an agreement does not need to be in writing to be considered a contract.

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1 *Black's Law Dictionary, 8th edition, page 341* (paragraph 2.13)

Question 4

Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

ACAG agrees with the boards' definition "*An entity's performance obligation is a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer. That contractual promise can be explicit or implicit.*"

ACAG is of the view the definition together with summary notes S21 and S22 would assist entities to identify consistently the deliverables in (or components of) a contract. However, there could be more clarity in relation to goods vs services and determination of control. These principles form part of the definition and could therefore cause increased complexity in practice.

Question 5

Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

ACAG agrees that the entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer.

ACAG agrees with paragraph 3.45 whereby '*an entity should account for performance obligations separately if the promised assets (goods or services) are transferred to customer at different times. The objective of separating performance obligations is to ensure that an entity's revenue faithfully represents the pattern of the transfer of assets to the customer over the life of the contract*'.

There is still the issue of assessing when the transfer has occurred and what the performance obligation is for example, in relation to construction contracts is it the whole building at the end or the service?

Question 6

Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

ACAG considers that an entity's promise in a contract with a customer to provide a right of return with the sale of a good is a performance obligation.

ACAG considers that the right of return is a service (an asset) that is transferred to the customer. In practical terms it is likely that the return of goods is not considered to be material and would ordinarily be accounted for as a failed sale when it occurs.

Question 7

Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

This question is not considered relevant to the public sector generally. Should the public sector be involved in sales incentives then sales incentives can give rise to performance obligations consistent with IFRIC 13 *Customer Loyalty Programmes*.

Question 8

Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

ACAG agrees that the performance obligation is satisfied when the customer either controls the promised good or receives the promised service. In theory, this basis appears to be more simple than the current risks and rewards of ownership approach. However, we note that substance over form appears to be lost and there is an opportunity for contracts to be worded to achieve particular timing of revenue recognition.

Question 9

The boards' proposal that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

ACAG considers there may be some difficulty in relation to existing construction contracts and service contracts that apply a stage of completion basis recognising revenue. We are not convinced that this approach would provide decision-useful information.

Question 10

In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

ACAG agrees that the performance obligations should be initially measured at the transaction price. This model basis appears to be simple and depicts an entity's performance in a contract.

We agree with your assessment of other measurement bases, such as current exit price, as not being appropriate.

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

ACAG agrees with this principle as the original margin has been eroded so remeasurement is required.

The measurement of a performance obligation should not be updated unless that performance obligation is deemed onerous.

(c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable?
Please provide examples.

ACAG considers the lack of guidance on how to measure the elements in a multiple-element arrangement as being a weakness of the proposed measurement approach. Without a specified measurement objective for the remaining elements in such an arrangement, entities could apply different measurement approaches to similar transactions, which reduces the comparability of revenues across entities.

Without a clear distinction between goods and services, some entities may account for real estate contracts as construction (service) contracts, recognising revenue throughout the construction process. Other entities may account for similar contracts as contracts for goods, recognising revenue when the risks and rewards of owning the real estate are transferred to the customer. The lack of a clear distinction between goods and services could reduce the comparability of revenue across entities.

Also, ACAG considers other standards such as IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides additional information than the discussion paper in terms of allowing for remeasurement of an entities best estimate of other items such as warranties.

(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

ACAG considers long term contracts should be subject to another measurement approach which is consistent with the response provided in question 10 (c) above.

Question 11

The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

(a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?

ACAG agrees that costs of obtaining the contract should be included in the initial measurement of an entity's performance obligation to capture all costs and not over inflate margins. In the proposed model, costs are capitalised only if they qualify for capitalisation in accordance with other standards.

(b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

In some cases, for example, commissions paid to a salesperson for obtaining a contract with a customer typically do not create an asset qualifying for recognition in accordance with other standards. As a result, an entity would recognise such costs as expenses as incurred, which may not be the same period in which revenue is recognised.

Question 12

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

ACAG agrees that the transaction price should be allocated to each performance obligation on the basis of the relative stand-alone selling prices of the goods and services underlying the performance obligation.

For most contracts with customers, ACAG considers that an allocated transaction price approach results in decision-useful information to users of an entity's financial statements.

However, in practice it could be difficult where there is cross subsidisation and/or bundling of goods and services.

Question 13

Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

ACAG considers that estimating a stand-alone selling price for a promised good or service can be difficult. Nevertheless, if an entity was not required to estimate a price, then the entity would have to account for that performance obligation together with other performance obligations. That could result in an entity accounting for a satisfied performance obligation as if it was unsatisfied (in other words, accounting for a delivered good or service as if it was undelivered).

Failing to account for the satisfaction of a performance obligation would impair the depiction of an entity's financial position and performance in a contract with a customer. Consequently, ACAG considers estimated prices should be used when observable prices are not available, which is consistent with the boards' proposal.