



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

19 June 2009

Sir David Tweedie
Chairman
International Accounting Standards Board
1st Floor
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear David

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

The Australian Accounting Standards Board (AASB) is pleased to submit its comments on the abovenamed Discussion Paper. In formulating these comments, the AASB sought and considered the views of Australian constituents, including through the conduct of Roundtables. The comment letters received are published on the AASB's website.

AASB's support for the project and particular proposals

The AASB supports the project to review and amend IAS 18 *Revenue* and IAS 11 *Construction Contracts*, because it supports the convergence of IFRSs and US GAAP in respect of revenue recognition and considers that the following proposals in the Discussion Paper would particularly improve IAS 18:

- (a) for sales of goods, basing revenue recognition on the transfer of control to the customer, rather than on transfer of the significant risks and rewards of ownership to the customer;
- (b) in respect of contracts with multiple deliverables to the customer:
 - (i) identifying separate liabilities in respect of each performance obligation and allocating total contract revenue to the various performance obligations; and
 - (ii) expanding the revenue recognition guidance currently contained in paragraph 13 of IAS 18;
- (c) providing explicit guidance on how liabilities to customers should be measured;
- (d) expanding the guidance on the general principle that revenue is measured at the fair value of the consideration received or receivable, including providing guidance that the

use of estimates is allowed in the absence of an observable price for each deliverable;
and

- (e) removing the requirement in IAS 18 that revenue is recognised only when the costs to be incurred in respect of the transaction can be measured reliably.

However, the AASB has a number of significant concerns with the preliminary views as summarised below and noted in the attached specific comments.

Main concerns

Relatively narrow focus

The AASB considers that the preliminary views in the Discussion Paper represent incremental change to the current revenue recognition model in IFRSs, and is concerned that the project represents a missed opportunity to address more fundamental revenue recognition issues. For example, the Discussion Paper starts with general acceptance of the definitions of revenue in IFRSs and US GAAP, rather than evaluating whether fundamental change to those definitions might be warranted. As a consequence, important issues regarding the definition of revenue have not been addressed, such as:

- (a) whether the restriction of revenue to inflows arising from ‘ordinary activities’ provides decision-useful information to users of financial statements and involves undue subjectivity in application; and
- (b) whether the definition means that sales of goods for prices equalling their carrying amount do not result in revenue because, arguably, an increase in equity has not occurred.

The AASB considers that major standards-level projects should be based on a conceptual examination of the issues, and is concerned that the considerable investment of the Boards’ resources in this project will discourage fundamental reconsideration of the principles when the Boards consider the concept of revenue in their joint conceptual framework project.

Other concerns

The AASB’s other main concerns with the preliminary views in the Discussion Paper are:

- (a) that, if a single revenue recognition principle for all entities were developed on the basis of the Discussion Paper’s proposals, revenue would arise only from contracts with customers. The AASB would not support such a narrow definition of revenue (see the attached comments on Question 1);
- (b) the practicality of applying the preliminary views about identifying separate performance obligations in cases where a ‘whole-of-customer’ approach is taken to a contract (see the attached comments on Question 5);
- (c) its strong suggestion that transfers of goods and services to customers are the only transfers of assets that give rise to revenue (see the attached comments on Question 8);
- (d) in relation to revenue from transfers of goods to customers, its strong suggestion that a customer obtains control of a promised good upon physical delivery of the good, and the consequent significance of the distinction between goods and services which may be difficult to make under some contracts (see the attached comments on Question 8);

- (e) its proposal that an entity should recognise contract origination costs as expenses unless they qualify for recognition as an asset in accordance with other Standards, given the deficiencies that the AASB considers exist in IAS 38 *Intangible Assets* (see the attached comments on Question 11(b));
- (f) its omission to address contracts with contingent or otherwise uncertain consideration (such as through contract variations). Whilst the AASB notes that the Discussion Paper is a first step in public consultation on this project and is not intended to address all issues, the treatment of contracts with contingent or otherwise uncertain consideration is a major issue for many entities, including many that enter long-term contracts. The Discussion Paper has significant implications for revenue recognition in long-term contracts (see the attached comments on Question 8), but excluding the treatment of contracts with contingent or otherwise uncertain consideration prevents affected parties from gaining an overall view of how this project may affect them;
- (g) its omission to provide substantial guidance on how the proposed model would be applied to financial services, which are a major source of revenue for many entities. Financial services contracts can give rise to significant difficulties in separating performance obligations and estimating the stand-alone selling price of each of them. The AASB considers that, to assist constituents to evaluate the proposed model, it is important that substantial guidance be provided on financial services;
- (h) its omission to address the important issue of when to identify an entity as acting as a principal or an agent, and the revenue recognition implications of that distinction (nor does Appendix C indicate that the IASB and FASB plan to address this issue in future work on this project); and
- (i) its omission to address exchanges of similar assets, which could conceivably be between entities that could be considered each other's customer.

The AASB's comments on the questions in the Invitation to Comment are in the attached submission.

If you have queries regarding any matters in this submission, please contact Angus Thomson (athomson@asb.gov.au) or me.

Yours sincerely



Bruce Porter
Acting Chairman

AASB's Specific Comments on IASB-FASB Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers*

The AASB's views on the questions in the Invitation to Comments are as follows:

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?

The AASB supports developing a single revenue recognition principle in the revised IASB *Framework* and at a standards level. A single revenue recognition principle would foster consistency in revenue recognition between entities in different industries and entities with different business models.

The AASB supports basing the recognition of revenue arising from contracts with customers on changes in an entity's contractual assets and liabilities. It agrees that contractual rights and obligations, and changes in them, are the source of an entity's revenue from contractual arrangements and reflect an entity's performance in generating that revenue.

However, the AASB does not consider that revenue should arise only from contracts with customers. It notes that revenue is an important metric in valuation models used by various users of financial statements, and considers that precluding the following types of income from being reported as revenue (because they arise outside contracts with customers) would reduce the relevance of the financial information reported:

- (a) returns to investors in equity instruments (for example, revaluation increments); and
- (b) growth of biological assets, particularly those that do not reach saleable condition for a long period of time.

Therefore, the AASB recommends that the Boards develop a robust concept of revenue that can be applied to all entities and activities and does not exclude the types of income identified above.

There would be merit in the Boards explicitly considering how their preliminary views in the revenue recognition Discussion Paper would impact on the views emerging in relation to the Phase 2 Insurance Contracts project. This could be particularly helpful in relation to issues surrounding the gross or net recognition of assets and liabilities arising from contracts, given the potential similarities between many insurance contracts and long-term non-insurance contracts such as some construction contracts. Where the Boards conclude that differences can be justified, these should be explained in the Basis for Conclusions.

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?

No. The AASB considers that when a contract with a customer exists, the entity's recognition of revenue should always be based on changes in its contractual assets and liabilities.

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.

Yes. The AASB supports the definition of a contract because it is principles-based and should be capable of application in various jurisdictions.

The AASB considers that the (highly similar) definitions of 'contract' in the revenue recognition project and in IAS 32 *Financial Instruments: Presentation* should be aligned to avoid any potential confusion.

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.

Yes. Basing performance obligations on contractual promises enables those obligations to be objectively determined and verified. Treating implicit promises as performance obligations should support consistency in identifying the components of contracts, because it reflects the substance of each contract rather than the way in which it is documented. However, it would be helpful to have further guidance on identifying performance obligations, in particular, to help demonstrate the likely level of componentisation that is expected. (See also the comments on Question 5.)

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?

Yes. The AASB agrees that an entity should be required to separate contractual promises when the customer receives the promised assets at different times, because the purpose of separating those promises is to ensure revenue is recognised at the appropriate times during a contract.

The AASB also notes that, even when the customer does not receive the promised assets at different times, there may be a need to separate contractual promises for the purposes of assessing whether a performance obligation in the contract is onerous. This does not appear to be explicitly addressed in the Discussion Paper and should be factor in the further deliberations of the Boards.

The AASB also has a concern about the practicality of applying the preliminary views about identifying separate performance obligations in cases where a 'whole-of-customer' approach is taken to a contract, such as is common with telecommunications contracts. In such cases, some of the performance obligations underlying the contract may be 'loss leaders' and other performance obligations underlying the contract could be highly profitable, yet the 'onerous' loss leader components alone would impact immediately on an entity's results based on the preliminary views. The AASB understands that such components of contracts may not be regarded as being standalone under the Discussion Paper model because each component depends on the others to achieve the sale. Accordingly, the concern may not arise in practice; however, there may be a need to make this more readily apparent. The AASB is concerned that the criteria for identifying the separate performance obligations in a contract need to be clarified if the proposals are to be practicable for all types of contracts and result in appropriate outcomes.

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?

The AASB considers that an entity's obligation to stand ready to accept a returned good and refund the customer's consideration is a performance obligation, and that a portion of the revenue from the contractual arrangement should be allocated to the satisfaction of that performance obligation (rather than treating the granting of a refund right as an expense). The AASB considers that all performance obligations should be treated consistently with regard to their effect on when revenue is recognised.

The AASB notes that some others hold the view that a return right is an option to unwind the transaction, rather than a performance obligation. It disagrees with this view because:

- (a) some return rights are unconditional (the goods may be returned regardless of whether a trigger event occurs that was uncertain when the goods were sold), whilst others are conditional (the customer may only return the goods in exchange for a refund if a trigger event occurs, for example, the goods are found to be faulty or their market price falls below a predetermined amount). It would not be representationally faithful to:
 - (i) treat conditional return rights as an option to unwind a transaction, because it implies that nothing of substance has happened under the contract; or
 - (ii) treat only unconditional return rights as options to unwind a transaction because doing so would disregard the risk that conditional return rights might lead to a refund;
- (b) adopting that view would logically involve deferring all of the revenue arising from the contract until the return right expires (as noted in paragraph 3.40 of the Discussion Paper); and

- (c) it would be inconsistent to treat standing ready to compensate a customer as a revenue-generating activity in a standalone guarantee (such as an insurance contract) but not as a revenue-generating activity in a guarantee (return right) embedded in a contract for multiple deliverables. Such a difference would be business-model specific, which would conflict with an objective of applying a single revenue recognition principle to contracts with customers.

Furthermore, the AASB considers that a return obligation is effectively a 'put option' that needs to have revenue allocated to it under the model in the Discussion Paper, and suggests the IASB considers the relevant proposals in ED/2009/3 *Derecognition: Proposed amendments to IAS 39 and IFRS 7* to ensure consistency between the revenue recognition and derecognition projects regarding the notion of the transfer of control.

Question 7

Do you think that sales incentives (e.g., 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?

Yes. The AASB considers that any enforceable promise to provide future economic benefits in the form of goods or services, including discounts on future sales, that are part of a contract should be treated as a performance obligation (to which a portion of the total contract revenue should be allocated). The AASB considers that the form of future economic benefits promised as a result of entering a contract (including whether a price discount is partial or 100%) should not determine whether revenue is allocated to that promise.

Consistent with the Discussion Paper's approach, if an offer were made to provide future economic benefits (such as discounts on future sales) but not as part of a contract, contract revenue should not be allocated to it. For example, if an entity offers a customer a discount on future purchases purportedly as a consequence of a past or current contract, but offers the same discount to parties with which it has no contractual relationship, consistent with the Boards' preliminary views, the AASB considers that the promise does not in substance emanate from a contract and therefore contract revenue should not be allocated to that promise. The AASB considers that the Boards should clarify that contract revenue should be allocated to a promised future discount only if it is part of a contract.

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.

The AASB supports the proposal to recognise revenue when the customer obtains control of assets under the contract. It generally agrees 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. However, the AASB considers that the differential treatment of the rights a customer acquires initially on signing a contract and the

rights subsequently transferred to a customer on passing control of the relevant goods or services needs to be better explained.

Key concerns

The AASB is concerned that:

- (a) the Preliminary View strongly suggests that goods and services are the only assets that may be transferred to customers (even though the definition of a ‘performance obligation’ in paragraph 3.2 suggests that goods and services are *examples* of assets that may be transferred to customers); and
- (b) in relation to revenue from transfers of goods to customers, the Discussion Paper strongly suggests that a customer obtains control of a promised good upon physical delivery of the good.¹ In this regard, the discussion of goods (for example, in paragraphs 3.10 – 3.12) implies that ‘goods’ exclude *rights* to receive physical items.

The AASB suggests that the Boards consider other possible models for revenue recognition that are not dependent on the distinction between goods and services or the physical delivery of goods or payment, but instead are more focused on the work performed and which remain broadly consistent with the transfer of control notion.

The AASB suggests that the following models be considered:

- (a) a model whereby an entity would recognise revenue as it performs work in creating the promised good or service when rights to the work transfer to the customer as that work is performed; and
- (b) a model whereby an entity that has performed work in creating the promised good or service would recognise revenue when it becomes unconditionally entitled to be compensated for the work performed if:
 - (i) the customer were to break the contract, even if the customer has no right to the work in progress (in which case, in some circumstances, revenue could conceivably be zero); or
 - (ii) the entity were to break the contract.

Explanation of key concerns

The AASB considers that when a provider (reporting entity) has performed work in creating or acquiring a promised good and the customer is unconditionally obligated to pay for the work performed by the provider:

- (a) the customer’s emerging obligation as work is performed is typically accompanied by a corresponding right of the customer to the work performed (which may or may not involve physical delivery);
- (b) therefore, there is continuous transfer of control of the right to the work as it is performed; and
- (c) the provider generates revenue progressively as it performs the work on the project.

¹ This is strongly suggested in paragraphs 3.20, 4.5, A43 and A44. Other points at which a customer obtains control of a promised good were not illustrated, although the last sentence of paragraph 4.8 refers to transfers of ‘assets’ (rather than ‘goods’ or ‘services’) to the customer that satisfy a performance obligation.

The AASB is concerned that, under the Discussion Paper's implied principles mentioned above, if:

- (a) a reporting entity has performed work in creating or acquiring a promised good; and
- (b) it is unconditionally entitled to compensation from the customer for the work performed,

it would not be entitled to recognise revenue in respect of that work until it delivers the related finished goods to the customer. The AASB considers that less relevant information about some contractors' performance in generating revenue would be reported as a result, particularly in relation to long-term contracts.

[In contrast, and notwithstanding the range of possible models identified for consideration earlier in the comments on this question, the AASB agrees with the implication of the Discussion Paper that if the customer is not unconditionally obligated to pay for the work performed by the provider (for example, because the work is generic and therefore readily saleable to other customers), the customer does not obtain control of the work as it is performed, and revenue should not be recognised until the customer is unconditionally obligated, as occurs when it takes possession of the work (or a component thereof).]

In some contracts, becoming unconditionally entitled to compensation from the customer for work performed may coincide with physical delivery of the promised good, but in others it may not. For example, in a contract for the delivery of a highly specialised piece of equipment, such as a military tank, specialised ship or railway carriage, the reporting entity may become unconditionally entitled to compensation from the customer for work performed as that work progresses. That is, in such a contract, the customer may need to pay the reporting entity in full for the work performed to date if it wishes to break the contract (in contrast to a contract for generic products, in which the customer might only be obliged on breakage of a contract to pay the difference between the contracted price of the goods and the current market price of the goods). Upon becoming unconditionally obligated to pay for the work performed, the customer typically obtains a corresponding unconditional right to receive the work performed in return for the compensation it must pay. (In this context, needing to pay for work performed includes relinquishing a right to a refund of any prepayment for that work.) Such an unconditional right of the customer to receive the work performed is an exclusive right—the AASB considers that obtaining an exclusive right to the future economic benefits embodied in an item gives rise to control of that item.

In the example above of a contract for the delivery of a highly specialised piece of equipment, the customer has only a conditional obligation to pay for work *before it is performed* by the reporting entity; until then, its only unconditional obligation is to stand ready to pay for work if it is performed. The performance of the work makes the obligation to pay become unconditional and thus a liability of the customer (or gives the reporting entity an unconditional right to retain any prepayment).

A practical illustration of where the AASB disagrees with the Discussion Paper's proposed treatment is found in paragraphs A43 and A44 (regarding Example 6 in Appendix A). Those paragraphs indicate that, although the customer in the example must pay the provider ('Boatbuilder') for any work completed if it cancels the contract before delivery, the customer does not receive *any assets* until the boat is transferred to the customer (that is, the customer does not control the boat until it is delivered) [emphasis added]. Paragraph A44 says that until the boat is delivered to the customer, it is the provider's inventory. However, if a customer is obliged to pay in full for any work performed to date upon breakage of the contract (due to the specialised nature of the good; for example, if the boat in the example has

special features), the AASB considers that control of the work in progress would pass continuously to the customer, and, therefore, the work in progress is not an asset of the provider. (Instead, the provider's asset would be the right to be compensated for the work performed.) In contrast, before materials are consumed in building the good(s), they are typically inventories of the provider.

Related and other concerns

There is a potential for inappropriate divergent treatments of similar transactions to arise because of the emphasis in the Discussion Paper's model on the distinction between goods and services, which can be difficult to make, combined with the emphasis on the physical delivery of goods, which seems likely to unduly delay revenue recognition in some cases. However, if the Boards decide to proceed with making a distinction between goods and services, there would be a need for more guidance on making that distinction.

The discussion of the distinction in paragraphs 4.38 – 4.48 of the Discussion Paper seems circular because:

- (a) a key objective of distinguishing between transfers of goods and transfers of services is to determine when the transfer occurs and thus revenue is recognised; but
- (b) paragraph 4.38 says "considering when assets are transferred to a customer helps to distinguish between the promise to deliver a finished good and the promise to provide a construction service".

The AASB considers that a robust principle for revenue recognition should not turn on the nature of the deliverable – a good or a service. The AASB considers that the alternative models identified above of when control of a promised good (or a component thereof) is transferred to a customer can equally be applied to services, and generally is consistent with the Discussion Paper's proposed treatment of services. The AASB also suggests the Boards consider, if longer-term construction contracts are not treated as 'service contracts', whether the value progressively created under such contracts could be treated as income (albeit not revenue) in a manner consistent with IAS 41 *Agriculture*.

Question 9

The boards propose 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.

The AASB agrees with this proposal, for the reasons given in the comments supporting the proposals that are the subject of Question 10. However, the AASB considers that the proposals would provide less decision-useful information for some types of contracts, including the following:

- (a) those contracts that are highly profitable (for example, contracts for products in which the reporting entity has market dominance and contracts for products for which the reporting entity has technological advantages that provide cost savings). This is because the value created by obtaining the customer's entry into the contract will not be recognised until promised goods or services are provided to the customer;
- (b) those contracts in which a significant proportion of the reporting entity's activities are obtaining the customer's entry into the contract (through selling services) and

developing systems before contract entry to enable the contract to be managed (for example, life insurance contracts).² This is because revenue is recognised in respect of significant activities after both the activities and the reporting entity's success in obtaining the customer's entry into the contract; and

- (c) those contracts under which the reporting entity provides services (for example, investment advice) from time to time under a retainer and the basis for allocating the transaction price between each service is difficult to establish (for example, when the relationship between the cost of each service and its market value can vary).

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.

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

Yes. The AASB considers that the reporting entity's activity in obtaining a customer's entry into a contract should not of itself be treated as revenue-generating. Revenue is generated by transferring promised assets to customers. Accordingly, the AASB agrees that performance obligations should be measured initially at the transaction price (that is, no day-one gains), unless a performance obligation is onerous at inception (in which case a day-one loss would arise).

- 10(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?

Yes. The AASB considers that, in the context of conventional (modified historical cost) accounting, the proposed treatment is consistent with the measurement of items at the transaction price until any impairment occurs. The AASB supports using the entity's expected cost of satisfying the performance obligation to determine whether that obligation is onerous because:

- (a) adding a margin is more consistent with using a current value basis to measure performance obligations, which would be inconsistent with:
- (i) using a primarily historical cost basis of accounting in financial statements; and
 - (ii) precluding the recognition of revenue on entry into contracts with customers;
- (b) adding a margin would give rise to frequent remeasurement of performance obligations, which would effectively depart from using the transaction price as the primary basis for measuring performance obligations; and

² These contracts would tend to also fall within (a) immediately above.

- (c) it would be consistent with the established treatment of onerous contracts in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, notwithstanding that it would be inconsistent with the measurement basis for provisions specified by IAS 37.

See also the comments on Question 5 in regard to identifying onerous performance obligations at a components or whole-of-contract level.

10(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.

The AASB considers that, on balance, the proposed measurement approach provides the most decision-useful information across a spectrum of contracts with customers in different industries, and that comparability between different entities is an important goal for revenue recognition.

However, the AASB considers that the proposed measurement approach would provide less decision-useful information for some types of performance obligations, such as those under contracts where settlement costs are highly uncertain or variable (for example, some contracts to develop infrastructure with emergent technology). The proposed measurement approach would provide less decision-useful information because changes in those expected costs will only be recognised when the performance obligation is deemed onerous.

The proposed measurement approach may also not be suitable for contracts that involve stand-ready obligations and conditional obligations that arise when particular events occur (for example, some insurance contracts and some warranty contracts). The measurement of each of these obligations might involve considerable uncertainty that might be better dealt with using a model such as that in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or those models being considered as part of the Phase 2 Insurance Contracts project.

The AASB observes that allocating revenue to the satisfaction of warranty obligations would result in a change to the existing basis of measuring warranty obligations. Warranty obligations would remain measured at their allocated transaction price, unless deemed to be onerous, whereas currently those obligations are remeasured at each reporting date based on the best estimate of the expenditure required to settle them (in accordance with paragraph 36 of IAS 37). Currently, when that estimated amount decreases (for example, because of new technologies) a gain is recognised in profit or loss. However, under the Discussion Paper's proposals, recognition of such gains would not occur. The AASB suggests that manufacturers' and dealers' warranties be treated as insurance contracts, or at least in a similar manner to insurance contracts in order that they are re-measured to provide decision-useful information.

In relation to the discussion in paragraphs 5.91 – 5.94 of the Discussion Paper of whether disclosures could overcome concerns about the relevance of transaction prices as measures of some performance obligations, the AASB supports the view in paragraph 5.94 (rather than the view in paragraph 5.92). The AASB would not support disclosing alternative measures of items in financial statements, due to the resulting information overload and risk of creating confusion.

10(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.

No. However, as mentioned in comments at Question 10(c), consideration should be given to treating warranties as insurance contracts.

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.

11(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?

Yes, because that policy is consistent with initially measuring performance obligations at the transaction price. However, this should not necessarily preclude revenue being recognised on entering a contract if a performance obligation specified in the contract has been performed before contract inception – for example, design work under a construction contract.

11(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.

The AASB considers that confining the recognition of assets in respect of the costs of originating contracts to those that would qualify for asset recognition in accordance with other existing Standards is too restrictive. This is particularly the case because IAS 38 *Intangible Assets*, which is one of the Standards under which assets (such as customer relationships) might be recognised in relation to contract origination costs, has many deficiencies and should be the subject of a thorough review.

In the meantime, the AASB suggests that the Boards consider approaches other than that in the Discussion Paper such as:

- (a) costs incurred in pursuit of a contract would be recognised immediately as expenses (unless they meet asset recognition requirements of other Standards), and costs incurred in establishing a contract that are directly attributable to the contract would be recognised as assets, consistent with the treatment of loan origination costs under IAS 39 *Financial Instruments: Recognition and Measurement*; and
- (b) costs incurred in satisfying a performance obligation (for example, initial design work) would initially be recognised as assets.

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?

Yes. This proposal is consistent with measuring performance obligations and revenue on the basis of the customer consideration received or receivable in respect of each performance obligation, and, where stand-alone selling prices exist for those goods or services, provides an objective basis for allocating the total contract revenue between the different performance obligations.

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?

Yes. The AASB considers this would be preferable to aggregating performance obligations (and revenue) at the level at which they are sold separately to customers, because doing so may defer the recognition of revenue even though some performance obligations to customers have been satisfied.

In relation to whether the use of estimates of standalone selling prices should be constrained, the AASB considers that such estimates should be made by applying the fair value hierarchy developed in the IASB's Fair Value Measurements project.