5 October 2010

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
MELBOURNE VIC 3007

Via email: standard@aasb.gov.au

Dear Kevin

Comments on ED198 Revenue from Contracts with Customers

Thank you for the opportunity to comment on the AASB Exposure Draft ED198 Revenue from Contracts with Customers. CPA Australia, The Institute of Chartered Accountants (The Institute) and the National Institute of Accountants (the Joint Accounting Bodies) have considered this exposure draft (ED) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

We support the principle of revision of the revenue standard in the context of convergence, as outlined previously in our submission on the Discussion Paper. However, we do not consider that the ED in its current form will improve significantly current AASB reporting requirements. We consider that more work is required to establish consistent principles and guidance that clearly articulates the model as it relates to service arrangements and construction contracts in particular.

Further, we would expect the ED when issued as a standard to cover all revenue transactions (consistent with the current standard), not just revenue from contracts with customers. Before the standard is introduced into Australia, we consider that field testing work may need to be undertaken in the not-for-profit and public sectors to fully understand potential impacts. This could be undertaken in conjunction with the International Public Sector Accounting Standards Board (IPSASB).

Our response to matters on which specific comment is requested is included in the attached Appendix. Also attached is our submission to the IASB which includes our responses to the specific IASB questions for comment.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (The Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (NIA) at tom.ravlic@nia.org.au.

Yours sincerely

Alex Malley
Chief Executive Officer
CPA Australia Ltd

Graham Meyer
Chief Executive Officer
Institute of Chartered Accountants in Australia

Andrew Conway
Chief Executive Officer
National Institute of Accountants

Appendix – AASB Specific Matters for Consideration

The AASB would particularly value comments on whether:

(a) there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
(i) not-for-profit entities; and
(ii) public sector entities;

(b) overall, the proposals would result in financial statements that would be useful to users;

(c) the proposals are in the best interests of the Australian and New Zealand economies; and

(d) any of the proposed disclosures should be considered for exclusion from the reduced disclosure requirements.

(a) We consider that many not-for-profit and public sector entities would not be subject to the requirements outlined in this exposure draft as their revenue is not earned from contracts as defined in the ED. We do not believe the removal of AASB 118 *Revenue* as a consequence of the ED being issued will assist entities who do not earn their revenue from contracts with customers as defined in the ED, such as in tripartite agreements and reciprocal v non-reciprocal arrangements. We would encourage further research on implementation issues in the not-for-profit sector.

We continue to encourage further research, through field testing, regarding the applicability of this model to public sector entities in relation to the type of contracts commonly entered into by these entities. This should be done in conjunction with the International Public Sector Accounting Standards Board.

Other issues for consideration in the Australian environment are:

- the status of AASB Interpretation 1042 *Subscriber Acquisition Costs in theTelecommunications Industry* once a final standard is issued;
- the impact on the tax ruling IT 2450 *Income Tax: Recognition of Income from Long Term Construction Contracts,* which currently makes reference to Australian Accounting Standards to account for revenue under construction contracts for income tax purposes.

(b) A consistent and more thorough revenue standard will clearly be useful to the user community, particularly if convergence with the United States is achieved at the same time. We consider that whilst the ED is heading in that general direction, concerns that we have outlined in our IASB letter need to be fully explored and addressed before we can assess the overall usefulness to users of this specific ED. Our most significant concern relates to the assessment of control, and hence the timing of recognition of revenue for service arrangements and construction contracts.

(c) Adoption of new or revised IFRS is in the best interests of the Australian and New Zealand economies.

(d) We consider that the application of the recognition and measurement requirements of the revised revenue model will impose a significant burden to Tier 2 entities over and above any benefits achieved let alone the disclosure obligations associated with the new model. We believe that this issue again supports the proposal that Tier 2 entities should be eligible to apply IFRS for SMEs.

5 October 2010

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

Via "Open to comment" page on www.iasb.org

Dear Sir David

Comments on ED/2010/6 Revenue from Contracts with Customers

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We support the principle of revision of the revenue standard in the context of convergence, as outlined in our submission on the Discussion Paper. However, we do not consider that the ED improves significantly existing IFRS reporting requirements. We consider that more work is required to establish consistent principles and guidance that clearly articulates the model as it relates to service arrangements and construction contracts in particular.

Further, we would expect a Standard to cover all revenue transactions (consistent with the current standard), not just revenue from contracts with customers.

Our response to matters on which specific comment is requested is included in the attached Appendix.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (The Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (NIA) at tom.ravlic@nia.org.au.

Yours sincerely

Alex Malley	Graham Meyer	Andrew Conway
Chief Executive Officer	**Chief Executive Officer**	**Chief Executive Officer**
CPA Australia Ltd	**Institute of Chartered Accountants in Australia**	**National Institute of Accountants**

Recognition of revenue (paragraphs 8-33)

Question 1

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

We agree with the principle that price interdependence would help an entity determine whether to combine or segment contracts. However, in our view, it is not the sole principle that should be applied. Performance obligations and any other significant conditions specific to a contact should also be considered. Relying solely on price interdependence could force entities to change business behaviours surrounding the contract structure.

(a) We note that price interdependence is not defined. Only example 2 addresses services that have interdependent prices but does not clearly identify the principles on which the determination of interdependence was made.

(b) We agree with the need for guidance on contract modifications. We do not agree with the principle of accounting for contract modifications based on price interdependence as part of the original contract. We consider that unless a contract contains an automatic or predetermined renewal obligation then renewal should be considered as a separate event and accounted for as such. Similarly, contract modifications should be accounted for as a separate contract unless they address a fatal flaw in the initial contract.

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?

We agree that it is appropriate to identify the performance obligations that an entity is obligated to provide as a consequence of a contract with a customer. However, we believe it may be appropriate for an entity to account for goods *and* services as a single performance obligation if accounting for those performance obligations together would result in the same amount and timing of revenue recognition as if they were accounted for separately.

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?

Conceptually, we agree with the control-based principle outlined in paragraph 25. However, we have a major concern that applying the principle to many 'service' contracts will be challenging and will require the exercise of significant judgement to determine whether control passes continuously or at the end of the service arrangement.

To assist with exercise of this judgement, the associated guidance will be extremely important. This is where we consider the ED is deficient. We do not believe that the principle of control is clearly identified, nor is the principle of transfer of control clearly demonstrated. The focus appears to be on physical control and does not provide sufficient guidance in relation to the transfer of control when services or construction services are being provided.

While the indicators provided in paragraph 30 are intended to assist in determining when control has been transferred to a customer, the application of different indicators could result in different revenue recognition points based on similar circumstances depending on the emphasis placed. We consider that further work is required in improving the control principle and related guidance, especially in relation to when services or construction services are being provided. Leaving the model as is currently proposed could force entities to change business behaviours surrounding the structure on contracts. We believe that the proposed changes to revenue recognition will drive a change in the ways contracts are structured. Entities could opt for short-term rather than long term contracts to allow them to recognise revenue progressively, rather than only at the end of a contract. We question whether accounting standards should drive business practices in this regard.

There are many possible examples that indicate the difficulty in determining the timing of revenue recognition in the service and construction industries. The following is a practical example in determining the point of revenue recognition for private sector providers of Australian higher education .

These providers offer a number of units of study that must be passed to achieve an undergraduate degree of three or four years duration. In accordance with underlying legislation the point of control by the student (the customer) is the awarding of marks for the particular unit.

We understand that currently the Australian higher education sector takes up revenue as the unit of study is taught or delivered on a month by month pro-rata basis. Under the proposals in the ED, it would appear that the awarding of marks would be taken as the 'point of control' which would mean that revenue is not recognised until the unit of study has been completed, which could be either at the of the end of the academic year or at the end of a semester.

When a student receives a marginal failure, the student can elect for a re-mark to take place. This re-marking, which can lead to a pass being eventually awarded for the unit, often is not completed until after the financial year end. Under the proposals, it would seem that no revenue would be recognised until the student passed the unit.

Measurement of revenue (paragraphs 34-53)

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?

We agree that it would be appropriate to recognise revenue based on estimated transaction price and that the criteria provided in paragraph 38 are appropriate. However, we do not agree that a refund liability should always be recognised for individual contracts. This may be appropriate for individually material items but in other circumstances should be allowed on a pool basis when this is consistent with the manner in which management assesses its obligations.

Question 5

Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transactions 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?

We agree that it is appropriate for the customer's credit risk to affect how much revenue an entity recognises on day 1 and this is consistent with the current requirements in IAS 18 *Revenue*. However, we consider that the subsequent accounting for the financial asset should be accounted for solely in accordance with the requirements applicable to financial assets rather than imposing an additional requirement for changes in the credit risk to be recognised in the revenue standard.

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?

We agree that it is appropriate to include time value in contracts that include a material financing component.

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?

We consider that the requirement to allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the goods or services underlying each of the performance obligations should be a rebuttable presumption only. We consider that it may not always be appropriate to allocate based on a proportion of stand-alone selling price and also that all separate performance obligations might not be significant.

For example, it is common practice for software suppliers to offer 'free' upgrades to new releases of programs for purchases of an earlier version in periods between the announcement of the new release and its actual date of release. Without the upgrade offer sales of the old version would drop away significantly but the sales of the old program with the upgrade provide continued sales until release date. Allocation of the sale proceeds should result in the majority of the consideration being assigned to the new release rather then the old product. This is despite the customer taking possession of the old product and only having a right to acquire the new product once it is released. So based on the proposed requirements, revenue could be inappropriately allocated to the old product rather than the new.

Contract costs (paragraphs 57-63)

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?

We agree with the costs outlined in paragraph 58, as they are consistent with costs that can be capitalised under other standards. However, we do not agree that it is appropriate to include requirements for asset recognition in a standard about revenue recognition. Rather, we believe it would be appropriate to revise the scope requirements of IAS 2 *Inventory*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* to permit capitalisation of contract costs if the respective criteria for capitalisation under the individual standards are met.

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?

We agree with the costs outlined in paragraph 58, as they are consistent with costs that can be capitalised under other standards. However, consistent with our comment to the previous question, we believe it is appropriate to amend the scope requirements in IAS 2 *Inventory*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangibles* rather than include the requirements for capitalisation in a revenue standard.

We do not agree with the inclusion of an impairment requirement in this proposed standard and would prefer to see a cross reference to either IAS 36 *Impairment of Assets* or IAS 39 *Financial Instruments: Recognition and Measurement* as appropriate and amendments to these standards to address impairment of contract assets.

Disclosure (paragraphs 69-83)

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?

We support the objective of the board's proposed disclosure requirements but do not agree that the proposed disclosures will achieve this objective. There is insufficient definitive guidance on the level of disclosure required, rather it is determined by the entity. The capacity of management to determine the level of detail disclosed as stated in paragraph 70 will not necessarily improve the ability for users to compare disclosures across entities. In more specialised entities the disclosures could require disclosure of commercially sensitive information. We suggest that a minimal level of disclosure should be required of all entities.

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?

We agree that it is appropriate for an entity to disclose its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. However, for long term contracts there should either be a practicable exemption or further guidance to assist in ensuring consistency in calculating the obligations.

We do not support the inclusion of reconciliations of contract balances proposed in paragraph 73(b) and 75 as we do not consider that this disclosure is useful.

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?

We do not believe that it is appropriate for entities to disaggregate revenue into categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic facts. We consider that this information is a duplication of the segmental disclosures required by IFRS 8 *Operating Segments.*

Effective date and transition (paragraphs 84 and 85)

Question 13

Do you agree that an entity should apply the proposed requirements retrospectively (ie 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.

We agree that an entity should apply the proposed requirements retrospectively but note that this requirement could be onerous on both a time and cost basis and of little benefit to some entities. So, we believe that entities should be able to apply the requirements prospectively if it is impracticable to apply retrospectively. This is currently allowed in paragraph 42 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, therefore we do not consider that any particular reference needs to be made on this in the Standard, although mention in the basis of conclusions may be useful.

Because some entities may find transition a difficult and time consuming exercise, we encourage the IASB to provide a longer than normal lead time for entities to transition.

Application guidance (paragraphs B1-B96)

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?

We support the inclusion of application guidance but do not agree that the current application guidance is sufficiently clear to make the proposals operational. In some cases, it is necessary to refer to examples provided in the application guidance to interpret the requirements of the proposals rather than the proposals being able to stand on their own.

We have specific concerns with the following examples:

Example 2
We do not consider that the principles on which price interdependence are clearly defined in this example.

Example 3
We believe that the nature of the asset recognised by the entity should be identified and that the accounting entries should be clearly articulated as they are in example 14.

Example 4
Again, we consider that the accounting entries should be clearly articulated as they are in example 14.

Example 8
There is no explanation as to why a promise to stand ready does not represent a separate performance obligation. Further, we do not consider this example and the suggested accounting is consistent with the undertakings often given under franchise arrangements. Similarly, we believe the final paragraph is not consistent with business models that may be used by entities to price franchise arrangements and as such does not provide useful guidance of the principles.

Example 11
This example does not clearly identify how and when the revenue can be recognised. There is no demonstration of the application of the revenue model to the different type of contracts undertaken in the construction industry.

Example 13
This example is not realistic, and a more appropriate example of constructive obligations should be provided. If an entity sells goods on a free on board basis it would be highly unusual for them to provide the customer with a replacement product, at no additional cost, if the product is damaged or lost while in transit.

Example 14
We believe that accounting for sales with a right to return (as shown in example 3) should be consistent with the accounting outlined in this example. An obligation arising because of a right to return or other performance obligation does not result in any conceptual differences to accounting for a sale and repurchase of an asset.

Example 27
This example does not explain why a contract would include a material right to the customer as a consequence of having to undertake more maintenance work in later years and does not clearly establish the principles on which it is relying.

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?

We do not agree with the proposed distinction between types of product warranties but do agree with an entity recognising its warranty obligations. However, as noted earlier, we do not support including a provision recognition model in a revenue recognition standard. We believe that the measurement model applied should be consistent with the current measurement model in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* We consider that the distinction is not necessary to provide useful information to users of the financial statements and that detailed disclosure on the basis of determining the warranty obligations may require the disclosure of commercially sensitive information.

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?

We do not agree that the pattern of revenue recognition should depend on whether or not a licence is exclusive. Rather, we believe that the pattern of revenue recognition for a licence should depend on the terms of the contract and any performance obligations that it may include.

Consequential Amendments

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?

We agree that accounting for the disposal of any non-financial asset should apply recognition and measurement principles consistent with those required by the proposed revenue model.

Other comments

Scope
We note that this exposure draft only deals with revenue arising from contracts with customers. The current revenue standard deals with all revenue and includes specific requirements for interest, royalties and dividends. We would expect a Standard to account for all revenue transactions (consistent with the current standard), not just revenue from contracts with customers.

Pooling
We consider that the standard should include guidance stating that its requirements can be applied to a pool of contracts rather than just individual contracts. This is particularly relevant when considering rights of return, product warranties, onerous contracts, the consequences of other performance obligations and disclosures. Further, it is clear that the application guidance considers contracts on a pool basis in a number of example e.g. examples 3 and 4.

Onerous Contracts
We do not consider it appropriate for there to be accounting requirements for onerous contracts in two different standards nor for these requirements to apply different measurement models. All onerous contracts should be accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*