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Mr Kevin Stevenson
 Chairman
 Australian Accounting Standards Board
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Dear Mr ^{Kevin}Stevenson

ED 222 Revenue from Contracts with Customers

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the Exposure Draft ED 222 *Revenue from Contracts with Customers* (the ED).

HoTARAC commends the IASB submitting its revised ED for re-exposure and welcomes the comprehensive consideration given to respondents' comments on ED 2010/6 *Revenue from Contracts with Customers*.

HoTARAC reiterates its support for the core principle of a single revenue model, based on the recognition of revenue by an entity as control of goods and services is transferred to the customer.

HoTARAC also supports the majority of changes outlined in the revised ED and particularly welcomes the clarification to the proposals for separating performance obligations, determining when a performance obligation is satisfied over time and determining when control has passed to the customer.

HoTARAC's concerns primarily relate to clearly delineating those transactions which fall within the scope of the ED. These include:

- ensuring the contract definition captures relevant transactions;
- capturing the right to use intangible assets other than intellectual property; and
- reconsidering the onerous test, or, at minimum, excluding performance obligations from the onerous test where there is a contract with a social obligation (as explained in HoTARAC's detailed comments).

HoTARAC reiterates its concerns, expressed in its submission on the ED 198 *Revenue from Contracts with Customers*, regarding the extensive disclosure requirements and the cost to preparers relative to the benefits to users.

Comments by HoTARAC on questions from the exposure draft are attached, and include detailed discussion in the context of the issues raised above.

HoTARAC understands that the AASB is currently undertaking the *Income for Not-For-Profit Entities* project, with the aim of using the principles in the IASB revenue ED to account for all income transactions for the Not-For Profit (NFP) entities. HoTARAC understands that the AASB is still undecided on whether the *Income for Not-For-Profit Entities* project will result in a new standard or simply the insertion of NFP-specific Aus paragraphs in an eventual revenue standard.

HoTARAC is currently reviewing the draft Basis for Conclusions on the *Income for Not-For-Profit Entities* project. HoTARAC has concerns on the draft Basis for Conclusion and will engage with the AASB shortly to discuss these. The comments provided in this submission do not incorporate all the comments that HoTARAC has on this project.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 02 6215 3551.

Yours sincerely



Grant Hehir
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY
COMMITTEE

8 February 2012

AASB Specific Matters for Comment

1. whether 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:

(a) not-for-profit entities; and

(b) public sector entities – including any implications for GAAP/GFS harmonisation;

HoTARAC is not aware of any regulatory issues for public sector entities. HoTARAC cannot comment on other NFP entities.

As the AASB may already be aware, GFS does not acknowledge the concept of “onerous contracts” or “onerous performance obligations”, so this represents an accounting difference between GFS and GAAP.

2. whether, overall, the proposals would result in financial statements that would be useful to users;

HoTARAC agrees that overall the proposals would result in financial statements that are useful to users. However, HoTARAC has concerns with the proposals that are outlined below.

One of HoTARAC’s main concerns relates to which transactions come within the scope of the ED.

Contract Definitions

HoTARAC notes that strict application of this definition would exclude transactions between entities within the single legal entity of a government (as a legal personality cannot enforce an obligation against itself). The standard may still be effectively applied under the provisions of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* which provides that accounting standards dealing with similar or related issues be considered if no accounting standard applies to the transaction. Although HoTARAC notes that the AASB has proposed NFP modifications to the wording in the definition of ‘contracts’ as detailed in the AASB draft Basis for Conclusions for the forthcoming Income for NFP exposure draft, HoTARAC views this as insufficient and recommends inclusion of NFP-specific guidance in the Income for NFP project confirming application to exchange transactions similar in nature to legal contracts between reporting entities within a government. This would prevent later confusion between preparers and auditors on the application of the proposals.

HoTARAC has provided further comments on the “contract definitions” in the first part of our general comments later in this attachment.

Onerous Performance Obligations and Not-For-Profit Contracts

The US Financial Accounting Standards Board (FASB) version of the ED specifically excludes not-for-profit entities from the requirements to recognise onerous performance obligations where the purpose of the contract is to provide a social or charitable benefit (paragraph 90 and BC 353 of the FASB ED). HoTARAC recommends this paragraph be

included in the International Accounting Standards Board (IASB) version of the standard (refer to our “General Comments” below). If the paragraph is not incorporated into the final standard, an Aus paragraph scoping out these types of transactions should be considered for the Income for NFPs project. HoTARAC understands that this issue may have already been the subject of some discussion at Board meetings.

Right to Use Assets

HoTARAC has requested clarification of the application of the ED to rights to use for intangible assets other than intellectual property in the IASB ED (please refer to our “General Comments” below). HoTARAC would also recommend the AASB’s Income for NFP Project includes guidance on whether the government’s regulatory role gives rise to a performance obligation when issuing a licence.

3. whether the proposals are in the best interests of the Australian economy;

HoTARAC has no comments.

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

HoTARAC has ongoing concerns with the costs to preparers in meeting the extensive disclosure requirements of the proposals and whether this really provides commensurate benefits to users. HoTARAC welcomes the removal of the requirements to disclose remaining performance obligations and satisfaction of those performance obligations in one-year time bands and the decision to relieve entities of the requirement to disclose remaining performance obligations where the contract recognises revenue as invoiced (paragraphs 119-121). HoTARAC also welcomes paragraph 110, which considers the level of detail necessary to meet the disclosure objectives.

However, HoTARAC reiterates its strong concerns raised in the response to the 2010 ED that the disclosures, particularly in respect to performance obligations of paragraphs 118, 119, 122 and 123 are likely to prove burdensome, particularly for entities having a large number of performance obligations or providing specialised goods or services and may require the disclosure of information that is commercially sensitive.

HoTARAC Detailed Comments on ED2011/6: *Revenue from Contracts with Customers* (“the ED”)

General comments

HoTARAC believes the ED addresses many of the issues raised by respondents in relation to IASB ED /2010/6: *Revenue from Contracts with Customers* released in 2010 (“the 2010 ED”). In particular HoTARAC welcomes:

- the removal of distinct profit margin as a means of separating performance obligations and the inclusion of the criteria in paragraphs 28 and 29;
- the addition of criteria in paragraphs 35 and 36 for determining when a performance obligation is satisfied over time;
- the addition of risks and rewards in paragraph 37 as an indicator of control;
- measurement of consideration as the amount the entity is reasonably assured to be entitled to in paragraph 81, rather than the amount that can be reasonably estimated;
- the removal of the requirement to include expected credit losses in the transaction price;
- the clarification of the distinction between service and assurance warranties and accounting for assurance warranties as cost accruals in paragraphs B10-B15; and
- the removal of the requirement to disclose certain information about remaining performance obligations where revenue is recognised as invoiced in paragraphs 121.

These amendments addressed many of the issues raised by HoTARAC in response to the 2010 ED.

HoTARAC’s remaining concerns are outlined below:

Scope

It was proposed in the 2010 ED that, SIC 31 *Revenue – Barter Transactions Involving Advertising Services*, to be withdrawn. However, it is unclear to HoTARAC whether SIC 31 would still be superseded under the current ED.

Contract Definition

The proposed definition of a contract in Appendix A refers to ‘enforceable rights and obligations’ and paragraph 13 of the ED makes clear that enforceability is a matter of law. As acknowledged in the Basis for Conclusions (BC 32), this definition is different from extant IAS 32 *Financial Instruments: Presentation* (IAS 32), which includes agreements that are not enforceable at law. Adoption of the proposed definition will mean that there will be two definitions of contracts under accounting standards.

HoTARAC believes consideration should also be given to practical difficulties that entities may encounter in determining when the legal definition is met and the significant judgements that this will entail. While paragraph 14 of the ED includes criteria to be applied in establishing the existence of a contract, contract law is a specialised area and may be practically difficult for accountants to apply in establishing the point at which a contract commences; consideration should be given aligning the definition of a contract in the proposals with the definition in the financial instruments’ standards.

HoTARAC is unconvinced by the reasoning provided in paragraph BC32 for not aligning the definition of a contract in the proposals with the definition in the financial instruments' standards. Paragraph BC32 seems to indicate that an enforceable contract gives rise to rights and obligations – HoTARAC questions if this is not the case for contracts relating to financial instruments.

Appendix A includes promises within the definition of a performance obligation and BC63 explains that the ED does not require a performance obligation to be enforceable and could arise from a promise if the customer has a valid expectation that the entity will transfer a good or service. Having different requirements in respect of contracts and their component performance obligations may cause practical difficulties in the timing of recognition, particularly where a contract consists of a single performance obligation. Adoption of the broader financial instruments' contract definition may be considered a better match to the performance obligation definition.

Right to Use Intangible Assets (Permits and Royalties)

Paragraph 26(f) of the ED suggests that "services" includes the granting of licences or rights to use intangible assets. However, the application guidance of paragraphs B33 to B37 of Appendix B is restricted to licences or other rights to use for intellectual property. Consequently, it is unclear if the ED covers all rights to use intangible assets or only intellectual property.

HoTARAC reiterates its comments from the 2010 draft that the principles enunciated in the ED have broad application to other rights to use intangible assets. HoTARAC views transactions arising from the recognition of revenue from these types of rights as presenting similar features to licences and right to use intangible assets and would recommend the use of more generic guidance in the Application Guidance of Appendix B.

HoTARAC also disagrees with the boards' conclusion that a licence usually represents a performance obligation that the entity satisfies at a point in time and finds this conclusion insufficiently justified in paragraph BC316. HoTARAC is of the view that, depending on the nature of the agreement, a licence could represent access to an entity's intellectual property or other intangible asset that is satisfied over time (as contemplated in paragraph BC315(b)). This would be similar to a service contract that is satisfied over time. HoTARAC notes that IAS 18 *Revenue* presently permits royalties paid for use of an entity's assets to be recognised in accordance with the substance of the agreement, which is often on a straight line basis over the life of the agreement where the licensor has remaining obligations to perform under the agreement (paragraph 20 in Appendix) – HoTARAC is of the view that this principle should be incorporated into the eventual revenue standard.

HoTARAC notes that Paragraph 44 of the ED also states that if the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.

Application of the Onerous Obligations Provisions to Not-For-Profit (NFP) Entities

Paragraph 87 of the ED defines a performance obligation as onerous if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to that performance obligation. HoTARAC notes that the Financial Accounting Standards Board

(FASB) includes the following exemption for not-for-profit entities providing a social benefit:

90. A not-for-profit entity shall not recognize a liability for an onerous performance obligation if the purpose of the contract is to provide a social or charitable benefit.

HoTARAC endorses the views of BC353 of the FASB ED:

Not-for-profit entities also enter into contracts with customers; however, those contracts may not always have a profit-making objective because they are intended to provide a social benefit or charitable purpose. Because the latter contracts are usually loss making, applying the onerous test to them would result in recognition of a loss when the contract is entered into, which may be in advance of when the service is provided and the costs incurred. That result would be inconsistent with the objective of financial reporting for not-for-profit entities, particularly in providing information about the relation of services provided to the resources used to provide them (paragraphs 38, 39, 51, and 52 of FASB Concepts Statement No. 4, Objectives of Financial Reporting by Non Business Organizations). Thus, the FASB observed that applying the onerous test to those contracts would not provide meaningful information to a not-for-profit entity's donors and other resource providers when the objective is not to achieve a profit on the contract. Therefore, the FASB decided that when a not-for-profit entity enters into a contract with a customer for a social benefit or charitable purpose, those contracts should be exempt from applying the onerous test.

The IASB has excluded this paragraph from their version of the exposure draft. HoTARAC presumes the reason for this exclusion is the focus of the IASB on for-profit entities (whereas FASB has a broader focus), but strongly recommends paragraph 90 (or equivalent) be included in the final standard.

HoTARAC also recommends consideration be given to circumstances in which a 'for-profit' entity may also enter into contracts which provide a social benefit. This is particularly pertinent to 'for-profit' entities that are government owned and often have broader service obligations than their private sector counterparts. For example, an entity providing public transport may be obligated to provide services at a loss, either through concessional fares or an obligation to service unprofitable routes. In these circumstances, similar to not-for-profit entities, the objective of the contract is not to make a profit and application of the onerous test would be unlikely to provide useful information to users.

HoTARAC has provided further comments on the onerous obligations' provisions in response to Question 4.

Relation to other Accounting Standards

Paragraph 11 of the ED proposes that for contracts partially in scope of the ED and another standard, the other standard applies to initial measurement and separation if that other standard does include such requirements. HoTARAC notes that the IASB has ongoing projects to update the standards on insurance, financial instruments and leases and the full extent of the separation and measurement requirements may not be apparent until work on

these projects is completed and it is not possible to assess the full implications of paragraph 11 at this time.

B38 of the ED requires a lease to be recognised for certain repurchase agreements and paragraph B3 requires a refund liability to be recognised for sales with a right of return. Guidance of this type would normally fall within the provisions of IAS 17 *Leases* (IAS 17) and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (IAS 37) respectively. HoTARAC has no conceptual difficulties with the proposals, but would recommend consideration be given to including this guidance in IAS 17 and IAS 37, rather than incorporating it directly into the proposed revenue standard. HoTARAC also supports cross-referencing between standards, regardless of which standard the guidance is based.

HoTARAC has provided further comments on the proposed accounting for onerous contracts and amendments to IAS 37 in Question 4 below.

Unit of Account for Measurement of Discount Rates

Paragraph 61 of the ED requires consideration to be adjusted for the time value of money using the discount rate that would be reflected in a separate financing transaction between the customer and the entity. HoTARAC notes that this contrasts with paragraph B5.1.1 of IFRS 9 that uses a market approach based on instruments with a similar credit rating.

HoTARAC notes that the second sentence of paragraph BC144 states that a contract has a financing component if the consideration differs from the cash-selling price of the goods or services. However, as there may be other reasons for such a difference, HoTARAC suggests that the sentence be qualified accordingly.

Capitalisation of Contract Costs

The ED proposes capitalisation of certain costs for obtaining and fulfilling a contract (paragraphs 91-97 of the ED). HoTARAC recommends that consideration be given as to whether this is consistent with the approach taken in other accounting standards and in particular to inventory costs under IAS 102.

Duplicated Requirements

One of the black letter requirements is duplicated. Paragraphs 49 and 81 both state that:

“If the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue an entity recognises to date shall not exceed the amount to which the entity is reasonably assured to be entitled.

HoTARAC suggests paragraph 81 includes a cross reference to paragraph 49.

Questions for Respondents

Question 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?

HoTARAC agrees with the proposals. HoTARAC believes that the criteria and guidance added since the 2010 ED are useful in clarifying the recognition of revenue over time.

Question 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?

HoTARAC agrees with the proposals for recognising credit risk under IFRS 9 and believes these are a considerable improvement over the proposal in the 2010 ED to reflect credit risk in the initial transaction price. However, HoTARAC disagrees with proposed presentation as a separate line item adjacent to the revenue line item. HoTARAC notes that BC169(b) includes the rationale that:

“any impairment losses should be presented as a separate line item adjacent to the revenue line so that those losses on contracts with customers can be easily compared with the revenue recognised (as discussed in paragraphs BC171–BC173).”

BC170 (b) notes:

“in many cases, collectability is assessed at a portfolio level because an entity typically does not know which customers will default. Consequently, a revenue recognition hurdle may be difficult to apply to individual contracts.”

BC172 also acknowledges that impairment losses presented adjacent to revenue may relate to uncollectable revenue from a previous period. HoTARAC agrees the statements of BC170(b), and BC172 and therefore questions whether the comparison referred to in BC 169(b) can be effectively achieved as impairment losses will be assessed under IFRS 9 at the portfolio level and may relate to revenue recognised in prior periods.

Accordingly, HoTARAC is unconvinced that the proposal would facilitate assessment of revenue from contracts with customers against impairments. HoTARAC recommends that impairment losses from revenues from contracts with customers be treated in the same way as other impairment losses of financial assets under IFRS 9 and treated as expenses. If additional transparency is required this could more consistently be achieved by separate disclosure of impairment losses from revenues in the notes to the financial statements.

In addition to the above issues, HoTARAC recommends that the final requirements clarify whether a “contract asset” (as distinct from a receivable) should be subject to impairment testing.

Question 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?

HoTARAC agrees with the general principles and welcomes the clarification that this only applies to variable revenue and inclusion of the indicators of paragraph 82 in assessing whether evidence is available.

HoTARAC notes that the question is somewhat misstated. Paragraph 81 allows the entity to use 'other evidence such as access to the experience of other entities' in addition to its own experience with similar performance obligations. HoTARAC would recommend the final standard include some further clarification of what constitutes "other evidence" to ensure this does not lead to differing interpretations between auditors and preparers.

Question 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?

HoTARAC disagrees with this proposal. HoTARAC believes that users of financial reports are more interested in the profitability of overall contracts than individual performance obligations. HoTARAC also observes that it is quite possible for a contract to be profitable overall, yet an entity may be required to recognise a loss on an individual performance obligation. HoTARAC views this result as a skewed and overly conservative approach, as well as not being useful (or even misleading) to users. Again, any relevant information for users could better be communicated through note disclosures, rather than recognition as expenses/liabilities.

HoTARAC welcomes the amendments since the 2010 ED that the requirement to evaluate whether a performance obligation is onerous only applies to those expected to be satisfied over a period of time greater than one year. HoTARAC also welcomes the use of the lowest cost of settling the obligation. However, HoTARAC also observes that the lowest cost of settling the obligation (performance or exit) may depend on the contract's overall profitability.

Currently IAS 37 only applies the requirement for recognition of a liability to contracts rather than at the performance obligation level that are onerous, which, as mentioned above, HoTARAC considers to be of most relevance to users.

BC206 acknowledges that the unit for account for the onerous test in the ED of performance obligations is different to the current unit of account in IAS 37 of the whole contract. BC208 states that the boards propose to limit the scope of the onerous test by only applying it to performance obligations satisfied over time and the ED amends IAS 37 such that rights and

obligations within the scope of the ED are excluded from IAS 37. The consequence of these changes is that where a contract is onerous under the provisions of extant IAS 37 and consists of performance obligations satisfied at a point in time, this would be excluded from the requirements to recognise a liability as onerous under the proposals. HoTARAC questions why the provisions in relation to onerous contracts under IAS 37 should be repealed for contracts with customers consisting of performance obligations recognised at a point in time. In HoTARAC's view this will provide considerably less useful information to financial statement users than the current provisions of IAS 37.

BC205(c) posits that the onerous test is not a liability recognition issue because there has been no new obligating event. It is unclear how this differs from the onerous test for contracts in IAS 37. HoTARAC also questions the rationale of BC207 that specifying the contract as the unit of account could be arbitrary because the entity may deliver goods and services in more than one contract. In HoTARAC's view where multiple contracts form a single performance obligation, it is likely that financial statement users have a legitimate interest in knowing if one of the contracts has become onerous.

In HoTARAC's view the provisions of IAS 37 are sufficient in regard to onerous contracts and provide the most relevant information to users and there is no need for additional requirements in this standard.

HoTARAC is also of the view that more guidance could be provided for the measurement of provision for onerous performance obligations. For example, IAS 37 requires a provision to be discounted if the effect of time value of money is material. For the measurement of provision recognised for onerous performance obligations, HoTARAC notes that the ED is silent on whether discounting is required.

Question 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 recognised 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.

HoTARAC does not support the proposed amendment to IAS 34. HoTARAC notes that this is a new proposal and was not canvassed in the 2010 ED. HoTARAC considers the ED to include substantial disclosures and expressed similar concern in its response to the 2010 ED regarding the extent of required disclosures and the cost to preparers relative to the benefits to users. These costs would be amplified if entities are also required to provide the majority of these disclosures in interim reports.

In HoTARAC's view the current requirements of IAS 34, outlined in BC272, that entities disclose information about significant changes in financial position and performance since the last annual report, are sufficient in respect to disclosures in interim reports. Where individual contracts or other changes are material to the financial result, they would warrant particular disclosure. BC273 states that the disclosures specified by the boards are consistent with the general disclosure principles of IAS 34 and the specified disclosures are intended to prevent diversity in practice, given the judgement associated with identifying what represents a significant change in revenue. However, HoTARAC considers this exercise of judgement to be consistent with the requirements of principle-based standards.