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Dear Kevin

EXPOSURE DRAFT REVENUE FROM CONTRACTS WITH CUSTOMERS (ED 222 – IASB ED/2011/6)

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Australian Accounting Standards Board with its comments on ED 222 which is a re-badged copy of the International Accounting Standards Board's (the Board) Exposure Draft IASB ED/2011/6 Revenue from Contracts with Customers

Grant Thornton's response reflects our position as auditors and business advisers to the Australian business community. We work with listed and privately held companies, government, industry, and not-for-profit organisations (NFPs). This submission has benefited with input from our clients, Grant Thornton International which will be finalising a global submission to the IASB by its due date of 13 March 2012, and discussions with key constituents.

General comments

We welcome the Boards' decision to re-expose their revenue recognition proposals. We also commend the Boards for continuing to work jointly on this critical and high profile project and remaining on-track to publish a converged Standard.

We believe these revised proposals are a substantial development of, and improvement on, the exposure draft published in June 2010 (the 2010 ED). This in turn reflects the Boards' and Staff's careful attention to the large number of comments received on the 2010 ED, and also the.extensive and continuing outreach process.

Improvements from the 2010 ED

The ED incorporates numerous changes that should clarify and simplify application and reduce unnecessary disruption to established accounting practices. Some of these changes

are practical expedients, such as the use of a twelve month cut-off period for the recognition of onerous obligations and embedded financing components. These and certain other revisions, particularly in the area of obligations satisfied over time, may not be fully consistent with the ED's core principles. Nonetheless, we consider that the overall package of changes reflects a pragmatic approach that takes account of costs and benefits.

We particularly welcome the following revisions:

- elimination of a requirement to segment certain contracts
- the proposal to treat contracts involving substantial integration and modification of a bundle of goods or services as a single performance obligation
- the expansion of the guidance on performance obligations satisfied over time, which we believe will result in revenue recognition over time for most services and construction contracts (although, as noted below, we believe the revised guidance should be simplified)
- permitting entities to apply a 'most likely outcome' approach to estimating revenue from some contracts with variable consideration
- amending the 'exclusive' versus 'non-exclusive' distinction for revenue recognition from licencing.

The revised ED also amends the 2010 proposal that expected credit losses should be factored into the measurement of revenue. We supported the previous proposal, while also recognising that it would require a significant change to established practice and was opposed by many commentators. We understand the Boards' reasons for this change, although we do have some concerns over the new proposal to present credit losses in an adjacent income statement line item.

Concerns with the revised ED

Although we support the general direction of the changes, we believe there are certain areas in which the revised guidance should be clarified or simplified. In particular we believe:

- the revised guidance on performance obligations satisfied over time will generally result in appropriate revenue recognition outcomes. However, we find the guidance overly complex and suggest that it should be simplified and clarified. Our specific suggestions on how to do this are included in our response to Question 1
- the interaction between the proposals on estimating contingent revenue and constraining the amount recognised needs attention. In particular we suggest the extent to which the estimates and assessments are made at a portfolio level or single contract (or distinct performance obligation) level needs to be clarified.

We also have continue to believe that:

- liabilities for onerous obligations should be determined at the contract level. We also question the need and basis for limiting the recognition requirement to obligations satisfied over more than one year
- the proposed disclosures as excessive. We question the usefulness of some of the information prescribed.

Non-publicly accountable entities

We note that the IASB has not indicated whether it will amend the existing requirements for non-publicly accountable entities, and on that basis we believe the AASB should not consider any decisions on RDR disclosures until the IASB has considered this further, given that the RDR is 'loosely' based on IFRS for SMEs disclosures.

Grant Thornton does not believe that at this time amendments to the existing revenue standard should apply to non-publicly accountable entities. Instead Grant Thornton believes that the AASB should allow the IFRS for SMEs accounting standard as an option for non-publicly accountable entities. Adoption of IFRS recognition and measurement principles which the AASB believes necessitates an increase in disclosures compared to IFRS for SMEs, does add significant complexity and costs that would not be borne by similar structured overseas entities.

Detailed comments

We expand on the comments in this letter, along with various other points, in Appendix 1. This includes:

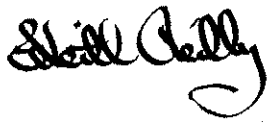
- our responses to the questions in the Invitation to Comment
- other substantive comments
- various minor comments and drafting points.

Some comments specific to IFRS and to US GAAP are in Appendices 2 and 3 respectively, and our comments on the particular issues raised by the AASB are contained in Appendix 4.

We expand on these comments in our responses to the specific questions raised in the ED's Invitation to Comment section, which are set out in the Appendix.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED



Keith Reilly
National Head of Professional Standards

Appendix 1

IASB Invitation to comment questions

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?

General comments

We welcome the Boards' efforts to provide clearer guidance on when goods or services are transferred over time. This is a critical issue that affects the timing of revenue recognition for long-term contracts including services, construction and real estate.

We also support the general direction of the revised guidance in paragraphs 35 and 36. Put broadly, we think the new guidance will result in revenue recognition over time when:

- control over underlying work-in-progress is transferred to the customer over time
- the customer receives the benefits of the entity's performance continuously
- the entity has an accumulating right to consideration as a result of its performance.

We think these are all appropriate reasons to recognise revenue.

We also acknowledge the concerns in the Alternative Views (AV6 – 7) that aspects of the revised guidance may create inconsistencies with the core control principle. However, in our view, while 'control' is a good starting point to determine principles for revenue recognition, a purely control-based model would be difficult to apply and might not result in the most useful information for every type of revenue transactions. We believe the practical application of a control model differs for goods, services, continuous transfer of work-in-progress and rights to use the entity's assets.

In our comment letter on the 2010 ED we also suggested that the Boards should consider the introduction of a rebuttable presumption that services are transferred continuously over time. Although the Boards have not taken up this suggestion, we believe that the revised guidance will have a similar effect in practice.

Detailed comments and suggestions

Without qualifying our overall support, we have a number of more detailed comments and suggestions on the revised guidance as follows.

Customer controls the work-in-progress (paragraph 35(a))

Paragraph 35(a) specifies that control is transferred over time if the entity's performance 'creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced'. We support this criterion, noting that it follows intuitively from the core principle of control transfer in paragraph 31.

However, we suggest that the final standard should clarify (probably in the application guidance section) that this assessment is not necessarily dependent on whether the customer would recognise a related asset in its own financial statements (in accordance with applicable US GAAP or IFRS). Our concern is that customers might, as a matter of policy or practice, recognise an asset such as work-in-progress or prepayments on various different bases (such as cash, accruals or invoicing). This accounting recognition may or may not reflect a continuous transfer of control of the underlying (ie the contracted for) asset.

Other criteria (paragraph 35(b))

Arguably, in a pure control model, some or all of the other proposed criteria in paragraph 35(b) would be unnecessary. However, as noted above, in our view a pure control model would be difficult to apply and might not result in the most useful information for every type of revenue transaction. We therefore support the inclusion of somewhat broader criteria.

In evaluating these broader criteria we have considered their effect on the timing of revenue recognition for service-type contracts. In our analysis we have been unable to identify any such contracts that would not meet one or more criterion for transfer over time. We therefore believe it would be more straightforward to replace these criteria with a requirement to recognise revenue for services based on performance over time (along the lines of our suggestion in our letter on the 2010 ED). That said, we acknowledge that this approach would require a robust definition of services and that this might be difficult to develop.

That aside, we suggest that, to the extent that these broader criteria represent exceptions to the control principle, or presumptions that control is transferred, they should be described as such.

We also believe this guidance could be significantly simplified and clarified. To achieve this we suggest that:

- the conditions in paragraphs 35(a), 35(b)(i) and possibly 35(b)(ii) are recast as indicators that, or circumstances in which, control has been transferred in accordance with the core 'control' principle in paragraph 31

- the 'no alternative use' condition should apply only to paragraph 35(b)(iii), which should be refined and presented as a carefully circumscribed exception to the core principle in paragraph 31.

We comment in more detail below.

Alternative use to the entity (paragraphs 35(b) and 36)
Paragraph 35(b), supported by paragraph 36, limits the application of the criteria in paragraphs 35(b)(i) – (iii) to situations in which the entity's performance does not create or enhance an asset with an alternative use to the entity. Alternative use would seem to imply that the entity retains control, although it is not synonymous with control. We also note that, if the customer obtains control over the work-in-progress, then paragraph 35(a) applies and paragraph 35(b) is irrelevant. Accordingly, the criteria in paragraphs 35(b)(i)-(iii) become relevant when the entity's performance:

- creates or enhances an asset controlled by the entity but that has no alternative use to it. An entity may retain control over work-in-progress even though it has no alternative use, or a limited use such as scrap value (although we agree that the entity has more incentive to seek to achieve continuous transfer of an asset that is highly customer-specific)
- does not create or enhance any asset (while paragraph 32 states that all goods and services are assets even, if only momentarily, we think this is a debatable assertion).

Moreover, the supporting guidance (paragraph 36, Example 7) restricts the circumstances in which an asset is regarded as having an alternative use. This is because:

- alternative use is prevented by contractual as well as practical limitations. Accordingly, a standardised asset or one that is inherently marketable to another customer (such as a unit in an apartment building or a standard specification ship or aircraft) is regarded as having no alternative use if the contract identifies the specific asset to be provided to the customer
- contractual limitations on redirection of an asset would cease to exist on contract cancellation in which event either the customer or the entity would retain or obtain control of the work-in-progress. However, the ED does not appear to consider a cancellation scenario in applying the alternative use concept. Accordingly, it would appear that a contractual limitation prevents alternative use even if the asset is marketable and the limitation would cease to exist on cancellation.

Taken together, the overall effect seems to be to create a limited exception to the control principle when the entity's obligation is to supply a contractually-specified asset (rather than an asset with no alternative use), and one of the following criteria also applies. If this reflects the Boards' intention we suggest that the guidance might be expressed better in these terms.

Customer simultaneously receives and consumes benefits (paragraph 35(b)(i))
We agree that transfer to the customer has occurred if this criterion is met. However, we suggest combining this guidance with paragraph 35(a). We believe this would simplify the

final Standard. We also believe that the 'no alternative use' pre-condition is not relevant to situations in which the customer simultaneously receives and consumes benefits.

We also suggest the reference to consuming those benefits is unnecessary. We think it is sufficient that the customer receives the benefits.

Another entity would not need to substantially re-perform work (paragraph 35(b)(ii))
Paragraph 35(b)(ii) states that control is transferred over time if another entity would not need to substantially re-perform work completed to date. We are not convinced that is necessary or appropriate as a separate criterion. This is because:

- we have difficulty in identifying arrangements for which this criterion would be the decisive factor. We acknowledge the freight haulage example in BC97, but suggest this fact pattern is also addressed by paragraph 35(b)(i) or (iii)
- its removal would simplify the final Standard.

Although we find this criterion redundant as presented, we suggest the 'no need to re-perform' notion could be recast as an indicator that the customer has obtained control in accordance with the basic principle in paragraph 31, or has received the benefits in accordance with paragraph 35(b)(i).

Should the Boards decide to retain this criterion, we also comment that:

- this paragraph states that the entity should presume that another supplier fulfilling the remaining obligation would not have the benefit of any asset controlled by the entity. This seems to duplicate the requirement in paragraph 35(a). We suggest the interaction should be clarified, or this part of the requirement removed
- on a related point, instead of considering which entity controls the work-in-progress in the normal course of contract fulfilment, we suggest it may be more relevant to consider whether or not the customer is able to take control of any work-in-progress in the event of contract cancellation. As drafted, this criterion implicitly considers what would happen in the event of contract cancellation, but not necessarily in a complete or consistent manner
- practical and contractual limitations that prevent the entity transferring the performance obligation to another entity are disregarded. There is no similar reference to limitations preventing the customer from transferring. We suggest the Boards should expand the explanation in BC99 to explain why the guidance refers to such limitations only from the entity's perspective (rather than limitations on transferring the performance obligation in general).

Entity has a right to payment for its performance to date (paragraph 35(b)(iii))
Paragraph 35(b)(iii) states that control is transferred over time if the entity has a right to payment for its performance to date and it expects to fulfil the contract as promised. We support the notion that an entity should recognise revenue if its performance creates an accumulating right to consideration (in accordance with contract or statute for example).

We acknowledge that any such approach could create an exception to a strict control-based model. However, the extent of this exception depends on how a right to payment for performance to date is interpreted and applied. We find the current guidance confused on this, particularly with regard to the role of customer cancellation. For example:

- paragraph 35(b)(iii) itself and BC101 refer to a presumption that the entity expects to fulfil its obligations. This implies that the assessment considers the total contractual pricing basis and whether it compensates the entity for the work done
- paragraph 35(b)(iii) itself and BC 102 also indicate that the entity should instead consider whether it would be entitled to compensation for performance to date if the customer terminated the contract
- Example 7 makes no reference to customer termination.

In our view, in the context of a cancellable contract it is reasonable to conclude that the supplier has earned revenue if the customer is obliged to compensate it for its performance on cancellation.

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?

We disagree. In our view, it would be sufficient for the majority of entities operating in a normal credit risk environment to provide information on credit losses in the footnotes. This would enable most entities to maintain the existing structure of their income statements, including the presentation of traditional performance measures such as a gross margin.

In our comment letter on the 2010 ED we supported the previous proposal that the effects of customer credit risk should be reflected in the measurement of revenue, while also noting that information on gross or contractual revenue, and subsequent credit losses, is useful. Although the Boards have moved away from this proposal, we acknowledge that the revised approach will also provide decision-useful information by another means. However, we have a number of new concerns which we explain below.

The revised proposal will involve a significant change to well-established presentation practices. We question whether a change of this nature is appropriate in the context of a revenue (rather than a financial statement presentation) project.

We note that any subsequent impairment loss is presented differently depending on whether the contract has a significant financing component (paragraph 69). For a long-term receivable, the effects of credit risk after initial recognition are presented as part of the

financing element and not within the new line item adjacent to revenue. Although we appreciate the explanation for this in BC 174 – 175, in our view this raises doubts as to whether the proposal is the best way of providing increased transparency on the effects of credit risk. The proposed practical expedient to use a one year 'bright line' to determine whether a contract has a significant financing component exacerbates the concern. This expedient, in conjunction with the presentation proposals, will result in differences in presentation of credit losses for very similar contracts.

We are also concerned that, in rare situations where an entity enters into contracts with high credit risk customers, the effects of the new proposal might be misleading. We note that existing revenue standards address this concern through a probability recognition threshold. As drafted the ED would not address this concern.

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?

We agree that recognition of revenue that is significantly uncertain should be subject to a constraint of some type. However, we have several concerns with these proposals.

Firstly, we believe the ED is unclear as to whether the constraint is intended to be a probability-based, quantitative assessment or a qualitative, binary assessment. The reasonably assured constraint is part of the measurement principle in paragraph 49. It is then described in paragraphs 81 – 85. Paragraph 49 implies that 'reasonably assured' relates to an amount of revenue (ie a quantitative view). Paragraphs 81 – 85 appear to describe a qualitative threshold based on the availability or otherwise of sufficient, predictive past experience. This is a binary assessment (as suitable evidence is either available or not). Accordingly, in the absence of suitable evidence, an entity's estimate of variable consideration would fail to satisfy the recognition criterion in its entirety (even if the entity has a high level of confidence of receiving some amount within the estimated range).

We therefore suggest that:

- the Boards should consider whether this binary outcome, based on a qualitative threshold, reflects their intention

- if so, the Boards should clarify that entities that do not meet this threshold cannot recognise any variable portion of the consideration until the variability is resolved (in other words, only the fixed portion can be recognised).

We are also concerned about the 'reasonably assured' terminology. 'Reasonably assured' is used in current US GAAP revenue recognition guidance, especially real estate and leasing. In these contexts it implies a high threshold for recognition (greater than more likely than not but less than reasonably certain) and is not synonymous with reasonably estimable. As an alternative, we suggest using neither this term nor 'reasonably estimated' as in the 2010 ED. Instead the final standard should combine the guidance on the constraint with the guidance on estimation in paragraphs 53 – 57.

We are also concerned that the interaction between the most likely amount method and the 'reasonably assured' constraint could be problematic. For example, consider an entity that has a number of contracts with success fee arrangements (ie the entity is paid on an 'all or nothing' basis). Assume the entity (i) selects the most likely amount method as its accounting policy; and (ii) has relevant experience that it has, say, an 80% likelihood of success. The most likely amount method would seem to result in recognition of 100% of potential revenue, before considering the constraint. It is then unclear whether the constraint is applied at a portfolio level and limits the revenue to 80%, or whether the entity's relevant experience implies that the constraint does not apply.

We disagree with paragraph 85. This constrains revenue on licences of intellectual property with sales-based royalties and similar. We think this guidance is too narrow and rule-based. The requirement applies only to contracts in the legal form of a licence, only to contracts involving intellectual property and only to payment terms that are based on customer's subsequent sales. If the Boards decide to retain this proposal we think it should be described as an exception to the general principle.

Finally, we believe there are some other ambiguities as to the scope of the variable consideration and revenue constraint guidance, and its interaction with other requirements. We comment in more detail in Appendix 1.

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?

We disagree. As explained in our comment letter on the 2010 ED, we believe that an onerous contract liability should be recognised at the level of a contract rather than a performance obligation.

We also disagree with the proposed limitation of the onerous test to performance obligations expected to be satisfied over more than a year. This is because:

- the one year cut-off would lead to non-recognition of liabilities
- we doubt that this is an appropriate or necessary practical expedient given that recognising a liability for onerous contracts is well-established in IFRS, and is not currently limited to longer-term contracts. While in a US GAAP context existing onerous contract recognition requirements are somewhat narrower, we suggest that any broadening of the requirements should be principle-based
- we are not persuaded by the argument in BC210 to the effect that liabilities arising from shorter term onerous performance obligations would typically be addressed through inventory write-downs and similar impairment requirements. For example, an entity may enter into an onerous contract or performance obligation that doesn't involve inventory, or prior to purchasing the related inventory.

We make some other comments on the onerous test guidance and related areas under 'Other substantive comments'.

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.

We agree with the proposed disclosure of disaggregation of revenue (paragraphs 114 and 115), although this should not duplicate segment information required by IFRS 8 or ASC Topic 280.

We disagree with the other proposed disclosures in the context of condensed, interim financial statements. This is because:

- the proposed disclosures in interim reports are a subset of those proposed in annual financial statements. We continue to be concerned that the proposed annual financial statement disclosures are excessive (see 'Other substantive comments')
- we consider that the detailed asset and liability-oriented disclosures referred to above do not fit well into the current disclosure package in IAS 34 Interim Financial Statements and would adversely affect the balance of that standard. We share the Alternative Views of Mr Engstrom to the effect that IAS 34 should be reviewed comprehensively rather than amended on a piecemeal basis.

Question 6 - For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply

a the proposed requirements on control to determine when to derecognise the asset, and

b the proposed measurement requirements to determine the amount of gain or loss to recognise upon de-recognition of the asset.

Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

We agree.

Other substantive comments

We have the following substantive comments on matters not addressed in the Invitation to Comment questions:

Unit of account

We comment elsewhere on particular unit of account issues – specifically the onerous test (Question 4) and the interaction between the reasonably assured constraint and the most likely outcome approach for variable consideration (Question 3).

More generally, paragraph 6 includes a practical expedient that permits an entity to apply the principles to a portfolio of similar contracts 'if the entity reasonably expects that the result of doing so would not differ materially'. We agree that application on a portfolio basis may be appropriate. However, allowing this basis only when the outcome is materially the same as the benchmark approach seems to negate any intended relief. (We note in passing that the IASB has recently removed similar references in other Standards, such as IFRS 13's consequential amendment to IAS 39's expedient regarding discounting short-term receivables and payables if the effect is immaterial).

We also note that different parts of the ED use different units of account, for example:

- *the contract* – the basic unit of account, before combining contracts and separating distinct performance obligations, and the stated unit of account for the cost capitalisation requirements in paragraphs 91 - 97
- *each separate performance obligation* – for the control transfer test, and therefore for revenue recognition, and for recognising onerous liabilities and several other requirements
- *a portfolio of contracts* – for many of the required estimates. In relation to variable consideration, we suggest a probability-weighted best estimate is more of a portfolio view. The 'most likely amount' method seems to be more a single contract view.

On this third point, we note that estimates such as customer return rates, variable consideration estimates, applying the 'reasonably assured' threshold and redemption rates for customer loyalty awards necessarily look to an entity's experience for a large number of similar contracts. However, subject to paragraph 6, those estimates are then applied to single contracts or separate performance obligations.

Aside from our specific comments, we do not object to the ED's approach to the unit of account. However, we suggest the Boards should consider whether the ED:

- offers sufficiently flexibility on use of a portfolio approach when estimates are required (in other words, whether paragraph 6 provides adequate relief)
- is clear on the unit of account across all its requirements.

Impairment of contract assets

The final sentence of paragraph 68 requires that an entity accounts 'similarly' for the effects of credit risk in a contract asset as it does for a receivable (that is, in accordance with IFRS 9/IAS 39 or ASC 310). We have the following concerns with this:

- the word 'similarly' is vague. We suggest the final Standard should be clearer on what is intended
- we believe it will be difficult to apply some aspects of the financial asset impairment model to contract assets. For example, assessing impairment of receivables involves identifying objective evidence of a credit loss event such as a default, which would be difficult to apply to a contract asset. Also, measuring impairment also involves applying an effective interest rate. This rate would not routinely be determined for contract assets
- it is difficult to evaluate this proposal until the Boards have completed their project on a revised impairment model (and determined whether it will apply to trade receivables).

We recommend that the Boards should replace this reference with a specific description of the intended impairment model for contract assets. We also suggest that the Boards should consider whether the contract asset impairment requirement could be combined with the onerous test and the impairment requirements for contract fulfilment and acquisition costs (see below).

Interaction between onerous test and impairment requirements (see also Question 4)

The ED includes requirements on impairment of contract assets (paragraph 68), impairment of contract fulfilment and contract acquisition assets (paragraphs 100 – 103) and onerous

performance obligations (paragraphs 86 – 90). The requirements differ, thus increasing complexity and reducing consistency. The requirements also seem incomplete in that the overall contract position (including contract liabilities) is not factored into the required assessments.

We think the final Standard might be improved by combining these requirements into an overall 'contract recoverability' test. This might operate along the lines that an entity is required to determine, using estimates where necessary:

Transaction price (net of amounts already recognised as revenue)
- lowest costs of exiting contract (as described in paragraph 87)
+ contract assets (including capitalised fulfilment and acquisition costs)
- contract liabilities

If this amount is negative, the contract assets would be written down accordingly. The Standard might need to set out the order of write-down. If this asset write-down is insufficient an onerous contract provision would be recognised for the excess.

Disclosures

We continue to be concerned that the proposed annual financial statement disclosures are excessive and question whether certain of the requirements will yield the expected information for financial statement users. For example:

- it is unclear to us how an investor will use the information required by paragraph 117 to make a better decision since it requires information only about the net contract asset/liability and does not provide information about future cash flows, quality of earnings, or any other indicator that is of importance to financial statement users.
- in addition, the descriptions in paragraph 117(b) and 117(c) are inconsistent with those used in IE17/IG75 and the variation in wording is significant. Under 117(b), the requirement is 'Cash received' and the example in IE17/IG75 has 'Cash sales'. This requirement could be interpreted as requiring the direct method of cash flows and we believe that decision should be made in the context of a discussion regarding the Statement of Cash Flows, rather than in the development of a revenue recognition Standard. Under 117(c), the requirement is to disclose 'Amounts transferred to receivables', while the description in IE17/IG75 is 'Amounts recognized as receivables'. Those are two distinct amounts – one is for balances transferred from contract assets to receivables, while the other could be interpreted to be all amounts recognized as receivables during the period, including amounts that were not initially recognized as contract assets.
- paragraph 119. The usefulness of this information is reduced by the limitation on the requirement to disclose only contracts with an initial duration of greater than one year. The word 'when' in paragraph 119(b) is subject to interpretation. It could mean 'a date specific' or 'upon a certain event occurring'. The meaning here seems to be completely different to the meaning of the word as used in paragraph 118(a). This paragraph (119(b)) will also create an audit issue since there will be a need to audit the future.
- paragraphs 119 and 120. When taken together, the requirements of these two paragraphs are not likely to provide the expected information. If only qualitative information is provided in accordance with paragraph 120, will that be useful to

financial statement users? We also question how it is possible to disclose information qualitatively on the aggregate amount of the transaction price allocated to remaining performance obligations (paragraph 119(a))

- paragraph 121. We are not convinced that this type of transaction should receive an exception to the disclosure requirements.

We welcome the inclusion of paragraph 112 which clarifies that an entity need not duplicate disclosures required in accordance with other Standards. However we note that paragraphs 32 and 33(a) of IFRS 8 *Operating Segments* (and ASC 280 *Segment Reporting* in a US GAAP context) set out somewhat different disclosure about revenues for each product or service, and geographical areas, to those in paragraph 114 – 116. We suggest the Boards should make a consequential amendment to IFRS 8/ASC 280 to eliminate the overlap and align the requirement.

Contract costs

The main change from the 2010 ED in this area relates to the requirement to capitalise incremental costs of obtaining a contract that are expected to be recoverable (paragraphs 94 -97). We have no strong views on the substance of the change. However, we suggest that the guidance could be strengthened by:

- emphasising that costs are capitalised only if directly attributable to a specific contract
- placing this guidance before paragraph 93. This would serve to clarify that the types of cost mentioned in that paragraph are expensed when they relate to contract acquisition as well as to fulfilment-type activity.

We also note that paragraphs 91 - 97 are expressed in terms of a contract rather than separate performance obligations. We believe that, in order to apply the amortisation and impairment requirements, such costs would need to be allocated to separate performance obligations.

Licensing

The ED states that control over licences and rights of use transfers at a point in time (paragraph B34/IG34). This is an important change from the 2010 ED, which drew a distinction between exclusive and non-exclusive licences. We agree with this change.

Licences and rights of use commonly relate to unrecognised, intangible assets. However, where they relate to a recognised asset a question arises as to how much (if any) of that asset should be derecognised when the licensor transfers control of the licence. The ED is silent on this. We note that the Boards' leasing proposals may in due course require de-recognition of the recognised asset and recognition of a new residual asset by lessors.

Repurchase agreements

B40/IG40 requires that a sale with a call option to repurchase at a price lower than the selling price is accounted for as a lease. A repurchase option at an equal or higher price is regarded as a financing.

We believe that a comparison of the strike price with the fair value of the transferred asset will generally be more relevant than a comparison with selling price. Moreover, we believe this guidance takes insufficient account of the substance of some options to repurchase the asset. We are not convinced that this proposal will reflect the substance of such transactions in a number of cases. For example:

- the sale of an asset with a repurchase option exercisable only at a future date when the asset's economic benefits have been largely consumed would seem to result in the outright transfer of control in substance. This comment also applies to a forward contract with these characteristics
- a purchased option to call the asset at a price equal to or greater than the selling price will typically (although not always) be out-of-the-money. Exercise may therefore be unlikely. The proposed accounting takes no account of the likelihood of exercise (which is inconsistent with the corresponding guidance on written put options in B45/IG45). The accounting involves accreting the selling price to the (equal or higher) strike price and, if the option lapses unexercised, recognising the strike price as revenue. This accounting seems prone to overstating both liabilities and revenue.

We also share the views expressed in AV8 to the effect that arrangements should be accounted for as a lease if, and only if, they meet the definition of a lease (as revised in due course).

Finally, we note that the guidance on repurchase agreements only addresses unconditional rights and obligations (emphasis added). There is no guidance in the ED on conditional repurchase features in customer contracts. A common example of a conditional feature is a buy-sell agreement entered into among the parties to a real estate joint venture. We believe that conditionality in a repurchase agreement should be included as part of an assessment of its substance, which should in turn determine how the agreement affects revenue recognition.

Drafting points and other minor comments

We have the following drafting suggestions and other minor comments:

Main standard

General

Paragraph 4 sets out a five-step model to apply the core revenue recognition principle. However, that structure is not clearly carried through in the remainder of the draft Standard. We suggest the final Standard might be clearer and easier to navigate if organised in accordance with the five steps.

Identifying separate performance obligations

Paragraph 28(b) includes the criterion 'the customer can benefit from the good or service on its own or with other readily available resources...'. BC73(a) includes a slightly fuller description of this criterion ('ie the good or service is an asset that, on its own, can be used, consumed, sold for an amount other than a scrap value, held, or otherwise used in a way that generates economic benefits'). We think it would be helpful to include this fuller explanation in the main body of the final Standard.

Paragraph 29 provides that a bundle of highly interrelated goods or services is treated as a single performance obligation if the entity both provides a significant integration service, and significantly modifies or customises the bundle. The drafting therefore treats 'integration' and 'modification or customisation' as separate conditions - both of which are necessary. We are not convinced that the latter condition is necessary, partly because the two conditions seem very similar. However, if the Boards believe there is a substantive need for the modification or customisation condition, and that this differs substantially from integration, we suggest this should be explained more fully.

Satisfaction of performance obligations

Paragraph 32 states 'Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services)'. We question the usefulness of this sentence, particularly as it relates to goods. We suggest there is no question that goods are assets, and also that they are assets whether or not received and whether or not they are used.

Paragraph 35(b)(iii) states 'However, the entity must be entitled to an amount that is intended to at least compensate the entity for performance completed to date even if the customer can terminate the contract for reasons other than the entity's failure to perform as promised'. We suggest this would be better expressed along the lines: 'If the customer can terminate the contract (for reasons other than the entity's failure to perform as promised) the entity must be entitled to an amount that is intended to at least compensate the entity for performance completed to date'.

We think the material explaining 'right to payment' BC101 and 102 is necessary to understand the Boards' intentions in this area. We suggest this or similar explanatory guidance should be included in the core final standard or mandatory application guidance.

Measuring progress towards complete satisfaction of a performance obligation

As a drafting point we find the discussion in paragraphs 38 – 48 quite lengthy and suggest that much of it could be relegated to the Application Guidance.

Paragraph 48 addresses circumstances in which revenue is recognised only to extent of costs incurred. We suggest that the amount of revenue and costs should be restricted to those in the second sentence of paragraph 45 (ie excluding costs of wasted material and similar).

Measurement of revenue

Paragraphs 49 and 81 – 85 constrain cumulative revenue recognised to date to the amount that is 'reasonably assured'. However, the drafting is ambiguous for a partly-satisfied performance obligation. Specifically, the draft guidance could be read to mean that the cumulative revenue for a partly-satisfied obligation is limited to the amount to which the entity is entitled when it has satisfied the obligation in full. For example, consider an entity that has satisfied 50% of a performance obligation that meets the criteria for continuous transfer. Assume that its best estimate of the revenue for the entire obligation is CU120, but of this amount only CU100 is reasonably assured. We suggest there is some ambiguity as to whether the entity should recognise CU50 (50% of the amount to which it is

reasonably assured to be entitled) or CU60 (50% of the best estimate, which is less than the amount to which it is ultimately reasonably assured to be entitled).

Paragraph 55 requires an entity to select either a best estimate (ie a probability-weighted amount) or the most likely amount approach, based on the method that represents a better prediction. We agree with the decision to provide some flexibility on the basis of estimation. However, we have two detailed comments:

- the ED does not indicate how entities should select the approach that represents a better prediction. In the absence of an operational principle or guidance to support this selection, we suggest it should be described as an accounting policy choice
- we suggest the interaction between these methods and the cumulative revenue constraint (paragraphs 49 and 81– 85) needs some attention. In particular, we question whether the constraint is consistent with the most likely amount approach, unless applied on a portfolio basis.

Variable consideration and consideration payable to customer

Arrangements such as volume rebates seem to be addressed by the guidance on variable consideration (paragraphs 53 – 57) and the guidance on consideration payable to customer (paragraph 67). The recognition and measurement principles differ.

Example 10 implies that these arrangements are addressed by paragraph 67, although paragraph 53 refers to 'discounts, rebates, credits, incentives…'.

Also, paragraph 67(b) has the effect that a retrospective reduction is recognised only when the entity 'pays or promises to pay' the consideration. For the type of arrangement in Example 10 the promise to pay could be viewed as arising at inception, at the point the target is achieved or – as indicated in the Example - at the point the entity's (reasonably assured) estimate includes the reduction.

The final standard should clarify whether volume rebates and suchlike are within the scope of the variable consideration requirements (as implied by paragraph 53), are addressed by paragraph 67, or both. Our suggestion is that consideration payable that is linked solely to the customer's purchases from the entity is a form of variable consideration. The guidance on consideration payable would then apply when the customer also provides goods or services to the entity.

As noted in our comments on the Illustrative Examples below, Example 24 raises further questions as to the scope of the variable consideration and revenue constraint material.

Time value of money

The final sentence of paragraph 61 states: 'After contract inception, an entity shall not update the discount rate for changes in circumstances or interest rates'. We support this requirement in general, but note in some cases the contracted might include a stated interest rate that varies in accordance with a benchmark rate. In such circumstances we suggest the rate should be updated to reflect movements in the benchmark rate. It might also be useful

to clarify that this type of feature is not within the scope of the variable consideration guidance.

Non-cash consideration

Paragraph 63 includes a requirement to measure non-cash consideration (or its promise) at fair value. There is no guidance on the measurement date for this purpose. While this would be straightforward in a simultaneous exchange, complications arise if control of the 'sold' goods or services transfers to the customer at a different time to obtaining control of the consideration. We suggest the Boards should consider adding guidance.

Presentation of credit losses for long-term receivables

As noted in our response to Question 2, we have some substantive concerns in this area.

If the proposed presentation is retained, we suggest that paragraphs 62 and 69 should be clarified as regards receivables with a significant financing component. We suggest that both paragraphs should set out the presentation requirement for impairment losses on these longer-term receivables by adding text along the lines: 'the presentation of any impairment losses [after initial recognition] from receivables with a significant financing component shall be consistent with the presentation of impairment losses for other financial assets'.

Onerous test

Paragraph 87 is drafted from the perspective of a wholly-unperformed contract. We suggest that the test should compare (i) the total allocated transaction price less amounts recognised as revenue to date; and (ii) the lower of remaining costs of satisfying the obligation(s) and exit costs.

We suggest that the final Standard might usefully include an example of the subsequent measurement (amortization) and ultimate de-recognition of the onerous liability as costs are incurred and revenue recognised.

See also our comments in response to Question 4 and under 'Other substantive comments'.

Amortisation and impairment

As noted under 'Other substantive comments', we believe the final Standard could be simplified by combining the requirements on impairment of contract assets, fulfilment and contract acquisition cost assets, and onerous contracts.

On a point of detail, we believe that the wording of paragraph 100(a) is ambiguous. The phrase: 'the remaining amount of consideration to which the entity expects to be entitled...' could be interpreted as (for example):

- the total amount of consideration allocated to a performance obligation less the amount recognised as revenue to date; or
- the remaining cash to be received.

We suggest this should be clarified if the guidance is retained.

Application guidance

Material right

B21/IG21 uses the term 'material right' and provides an example of a discount that is incremental to the range of discounts typically given. We suggest that:

- a different phrase that avoids the word 'material' would be preferable. 'Material' has particular meaning in financial reporting and auditing standards that may not reflect its intended application here. One possible alternative is 'incremental right'

the Boards should consider including a definition of this phrase (or its replacement) in the defined terms in Appendix A. This would also clarify whether the incremental discount example is intended to be the de facto definition.

Warranties

B14/IG14 appears to establish a rule to the effect that a service included in a warranty that goes beyond product assurance is always distinct. If so, this would seem to override the guidance on distinct in paragraphs 28 -30. If the Boards do not intend to establish a rule in this area we suggest that B14/IG14 should be amended to require an evaluation of whether such a service is distinct in accordance with paragraphs 28 -30.

Licensing and rights to use

B36/IG36 describes circumstances in which an entity provides a licence along with another (non-distinct) service, and states '...the entity shall account for the combined licence and service as a single performance obligation satisfied over time.' We suggest this should be changed to '...over time or at the appropriate point in time'.

Forward or call option

We suggest the wording in B40/IG40(a) and (b) '...the entity can repurchase the asset...' should be amended to '...the entity can or must repurchase the asset...'.

Put option

In B44/IG44 the word 'significant' should be added in the penultimate line.

Illustrative examples

Before the introduction there is a paragraph that indicate that the examples are not part of the IFRS. Paragraph IE1/IG59 indicates the contrary ('the following examples are an integral part of the IFRS'). This should be clarified.

[IE4/IG62] Examples 4 and 5 - these two examples serve to illustrate the paragraph 29 concept of treating as a bundle of goods and services as a single performance obligation if a bundle of goods or services is highly inter-related and a significant service of integration is provided. The broader concept of 'distinct' is not illustrated. We suggest it would be useful to add an example of the application of the distinct principle.

[IE5/IG63] Example 6 – this example concludes that there are two performance obligations (the goods and risk coverage during shipping). It does not indicate whether those two obligations are distinct by reference to the principles in paragraph 28. We think it would be

useful to do so (our understanding is that the risk coverage is distinct from the goods on the basis of paragraph 28(b)).

[IE8/IG66] Example 9 – we suggest this example could usefully explain why the supplier uses its own incremental borrowing rate as the financing rate, by reference to the principle in paragraph 61 (to use a rate that reflects the credit characteristics of the party receiving the finance).

[IE13/IG71] Example 14 – we suggest this example could be expanded slightly to provide guidance on the definitions of 'contract asset' and 'receivable' in paragraph 106, and the implications thereof. Our understanding is that, on the initial sale, the fixed payment of CU100 would be a receivable in the scope of IFRS 9 *Financial Instruments* and the remaining CU45 is a contract asset because it depends on something other than the passage of time. Also, this example does not address the time value of money financing element although it would seem that there is a financing element.

[IE18/IG76] Example 20 – we think it would be useful to include journal entries in this example to help preparers.

[IE19/IG77] Example 21 – consistent with our comment on Example 6, we think it would be helpful to explain why the training is distinct by reference to paragraph 28.

[IE21/IG79] Example 24 – the example refers to past experience and if it is predictive when estimating the stand-alone prices of loyalty points. The Example therefore implies that the revenue constraint (paragraphs 49 and 81 – 85) applies to this type of multiple-element arrangement. However, the revenue constraint guidance is stated to apply to 'variable consideration'. The guidance on customer options (B20/IG20 etc) makes no reference to the revenue constraint. We suggest the scope of the constraint should be clarified and the guidance in B20/IG20 amended accordingly.

[IE22/IG80] Example 25 – the statement 'The expected amount of consideration for each contract that is renewed twice is CU2,710 [CU1,000 + (90% × CU1,000) + (90% × 90% × CU1,000)]' is not quite right. We think this calculation reflects the expected consideration for each contract, period.

Appendix 2

IFRS-specific comments

We have the following comments that are specific to IFRS:

Transition

C3 defines the date of initial application as 'the start of the reporting period in which an entity first applies this [draft] IFRS'. We suggest this definition is amended to be consistent with the proposed (and, in due course, final if different) definition of the same phrase in IFRS 10 Consolidated Financial Statements ('the beginning of the reporting period in which this IFRS is applied for the first time'). An example would also serve to clarify.

Amendments to other IFRSs

[D2] This amendment refers to 'beginning of the first IFRS reporting period' while the explanation in BC350-351 inconsistently refers to the 'date of the first IFRS reporting period'.

[D3] It is not immediately clear how the principles in the draft IFRS would apply to contingent liabilities. Contingent liabilities are often non-contractual.

[D9, D23] It is not immediately clear how the principles in the draft IFRS would apply to financial guarantees and loan commitments (see paragraph 35) in a way that gives revenue over the contract period. The customer obtains the full asset as soon as they pay the fee.

[D21] Similar comment as for D9 for example 9.

[D23] Insertion of paragraph 2(k) scopes out from IAS 39 and IFRS 9 Financial Instruments 'assets and liabilities within the scope of [draft] IFRS X Revenue from Contracts with Customers'. Paragraph 9(c) scopes out from the draft ED contracts in scope of IFRS 9. See also paragraph 106. The intention seems to be that the revenue standard applies to a contract asset and IAS 39/IFRS 9 to a receivable but this mutual scope out may confuse matters. It would be better to define "financial instrument" in a way that would exclude a contract asset rather than apply scope-outs.

[D28] The ED establishes the term 'contract asset' and includes guidance to distinguish this from a receivable (financial asset). We suggest references to 'financial asset' in IFRIC 12 Service Concessions should be reconsidered in the light of this distinction (eg IFRIC 12.16,

IE8 and IE15). Under IFRIC 12's financial asset model, revenue from performance to date seems to be viewed as creating a financial asset irrespective of whether it is dependent on factors other than passage of time (eg if it is billable only on achieving a future milestone). We note that IGA7 makes consequential changes to the Examples accompanying IFRIC 12, but it does not appear to address this point.

Appendix 3

AASB invitation to comment questions
Question 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;

We are not aware that there are regulatory or other issues arising in the Australian environment, apart from our earlier comments on the proposals. We believe that there are regulatory and other issues arising in the Australian environment for non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.

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

We are not aware of any reasons that would impact on the usefulness of these proposals to users for publicly accountable entities, apart from our earlier comments on the proposals. However we do not believe that these requirements should apply to non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.

Question 3
Whether the proposals are in the best interests of the Australian economy; and

For publicly accountable entities, apart from our earlier comments on the proposals, we are not aware of any reasons that would impact on the interests of the Australian economy and our New Zealand firm will comment direct to the AASB if there are any New Zealand implications. We do not believe that these requirements should apply to non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.

Question 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.

We note that the IASB has not indicated whether it will amend the existing requirements for non-publicly accountable entities, and on that basis we believe the AASB should not consider any decisions on RDR disclosures until the IASB has considered this further, given that the RDR is 'loosely' based on IFRS for SMEs disclosures.

Grant Thornton does not believe that at this time amendments to the existing revenue standard should apply to non-publicly accountable entities. Instead Grant Thornton believes that the AASB should allow the IFRS for SMEs accounting standard as an option for non-publicly accountable entities. Adoption of IFRS recognition and measurement principles which the AASB believes necessitates an increase in disclosures compared to IFRS for SMEs, does add significant complexity and costs that would not be borne by similar structured overseas entities.