30 April 2009

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

Via email: standard@aasb.gov.au

Dear Mr Porter

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

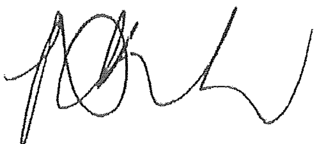
Thank you for the opportunity to comment on the AASB discussion paper Preliminary Views on Revenue Recognition in Contracts with Customers. CPA Australia, The Institute of Chartered Accountants and the National Institute of Accountants (the Joint Accounting Bodies) have considered the above discussion paper (DP) and our comments follow.

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

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

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

Yours sincerely



Geoff Rankin
Chief Executive Officer
CPA Australia Ltd

Graham Meyer
Chief Executive Officer
Institute of Chartered Accountants

Michael Carmody
Chief Executive Officer
National Institute of Accountants

Detailed questions posed by the AASB

The AASB would particularly value comments on whether:
(a) there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
(i) not-for-profit entities; and
(ii) public sector entities;
(b) overall, the proposals would result in financial statements that would be useful to users; and
(c) the proposals are in the best interests of the Australian economy.

(a)

We see no reason that the proposals could not be applied in a not-for-profit context, as long as appropriate NFP considerations have been included within the examples (such as grants, membership fees, etc). In fact, the treatment that may arise from these proposals in relation to grants would seem to be preferable to that currently required under AASB 1004 *Contributions*. As you are aware, problems with the current standard are based on the determination of whether the grant monies received are reciprocal or non-reciprocal. Unless specific performance obligations exist back to the grantor, many grants received are accounted for as non-reciprocal transfers thereby requiring up-front revenue recognition, even though the funds may take some time to be expended. This treatment is not seen as satisfactory by the not for profit sector. The approach suggested by the discussion paper would only recognise revenue once performance obligations are satisfied. This would delay the recognition of grant revenue until obligations under the grant agreement are met.

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

(b) We consider that further work needs to be done on the discussion paper before we can assess the usefulness to users on an overall basis. These concerns are outlined in our IASB letter.

(c) If the proposals are adopted overseas, they should be adopted locally as, like the conversion to IFRS generally, harmonisation is in the best interests of the Australian economy.

30 April 2009

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

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

Dear Sir David

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General comments

Overall we support one principles-based model for revenue recognition, and consider the theory behind the proposals in the DP to be reasonable, but more work is required in relation to the control concept. We are also concerned about how these proposals are derived from conceptual framework and what the impact on the revenue recognition project will be as the conceptual framework project progresses. We acknowledge the scope limitations indicated within the DP, however we would encourage those areas scoped out that have not been subject to a separate review, such as lessor accounting, to be reviewed as a matter of priority in light of this proposed model.

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

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

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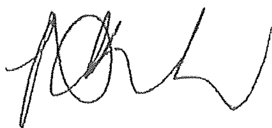

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Question 1

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

We agree with the proposed principle of a contract-based revenue recognition model. We consider it appropriate that an entity recognise revenue when the entity's net position in a contract increases as the result of the entity satisfying an obligation in the contract. We consider the recognition of revenue under this model is better able to satisfy the qualitative characteristics of financial information articulated in the Framework, than are the current revenue-recognition models. It is important that any standard on revenue recognition link appropriately to the Framework, therefore we would expect changes to the Framework to ensure this consistency – this may require further work in the definitions of revenue, gains and income.

Question 2

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

As mentioned in Questions 4, 5 and 9 certain long-term contracts will require more analysis as the project progressed, since it would not be decision useful in many cases to defer revenue recognition until the contract completion date.

Further, we consider that lessor accounting, while currently scoped out, should be reviewed applying these proposals as a matter of priority.

Question 3

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

We agree with the definition of a contract. However, some or our members have indicated they would prefer the proposal to use the term 'agreement' rather than the word 'contract' due to the legal implications of the term 'contract' in different jurisdictions.

Question 4

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

We consider it appropriate that a performance obligation exists when an entity promises in a contract to transfer an asset (a good or service) to the customer. However, we consider that more guidance and/or illustrative examples are necessary to make clear the distinction between the entity satisfying a performance obligation in the contract (e.g., the delivery of an asset [whether it be a good or a service]) and the activities that an entity undertakes in producing those goods and services. Without further guidance and/or illustrative examples we are concerned that preparers will have difficulty in operationalising the contract-based revenue recognition model for particular industries or sectors.

Question 5
Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

In theory it seems reasonable that an entity should separate performance obligations in a contract on the basis of when the assets are transferred to a customer. However in practice this may result in an inappropriate outcome, as it assumes that the transfer of assets is easily determined for both a good and a service and that the gain and loss of control of the asset by the entity and customer occur simultaneously.

An issue to consider in relation to when assets are transferred is a situation where the timing is uncertain – how is the separation to be undertaken? We suggest that guidance be included in the draft standard to address this issue.

The DP does not consider appropriately the concept of continuous transfer – this is an important issue particularly in the construction industry. On the one hand the DP appears to suggest that a performance obligation can only occur at one point in time, however in a different part of the DP it appears that continuous transfer may be possible if there is some right for the customer to take over a partially completed asset during the construction phase. Further guidance on this issue is required.

Further discussion on these issues is included in Question 9.

Question 6
Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

Technically we can see how some can accept that an entity's obligation to refund monies is a performance obligation. However we do not believe this is a practical outcome since it is likely to not be material and entities are not in the business of refunding money for returned goods. Similarly customers do not purchase items with the intention of returning them. As noted in paragraph 3.39 of the DP, it represents a failed sale, and should only be accounted for as such when it actually occurs.

Question 7
Do you think that sales incentives (e.g., discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

We agree that sales incentives can give rise to performance obligations, provided they meet the definition of a performance obligation. This is currently the method adopted in IFRIC 13 *Customer Loyalty* Programmes. There is some argument that discounts provided through a current sale on a future sale should not be an obligation until a future contract is entered into. However we consider that if a customer is entitled to a discount as a result of a current sale that a present obligation does exist by the entity to acknowledge such incentives in the event that such future contracts are entered into. The probability of a future contract existing should be taken into account in measurement of the obligation and not in recognition. We can see practical issues with arrangements for volume rebates,ie does the discount apply to each sale or only to the sales that take the volume to the target level, therefore consider this should be further explored and an illustrative example included.

Question 8

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

The approach in the DP in relation to transfer of the asset from the seller to the customer appears to be too simplistic. We do not think that the difference between receipt of the asset and control of the asset has been appropriately defined – the DP seems to assume that control and receipt of the asset is the same thing, when in fact the control of the asset can occur either before or after receipt of the asset.

The definition of control seems focussed on 'physical possession' and this is not easily understood in a services context. Further work is required in defining control and how it relates to those performance obligations which are goods, compared to those which are services. The DP also assumes that the loss of control by the seller simultaneously means that the customer has gained control, which is not necessarily always the case.

Similar to our comments to question eight in our submission to ED 10 *Consolidated Financial Statements*, we believe that risks and rewards should be referred to as application guidance, to assist in determining whether the customer controls the asset. In this way there will be consistency amongst standards when referring to control, and how to assess whether it exists.

It may be possible to change the focus from a control assessment based on 'physical possession' to one based on the unconditional obligation on the customer to pay for the service/good. We consider that this approach is worth exploring, at least to include as an indicator on the assessment of control, amongst others.

Question 9

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

The satisfaction of a performance obligation is based on the notion of control. As noted in Question 8 above, this concept has not been well thought through in the DP and therefore as currently drafted difficulties in providing decision-useful information have been identified in contracts currently used in some industries. Those areas of difficulty include the area of construction contracts and those service type contracts that have traditionally used a percentage of completion method for revenue recognition (which often will include the type of financial service fees currently detailed in the appendix to the current IAS 18 *Revenue)*.

Paragraph 4.8 of the DP states that the proposed model should reflect the transfer of goods and services and not the activities undertaken to produce those goods and services. As mentioned in our response to question 4, the distinction between the end product and the activities undertaken to deliver the end product needs to be explored further in order to understand firstly what constitutes a performance obligation, and then secondly when the performance obligation is satisfied.

Question 10

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

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

Yes because the transaction price is what the entity has determined is appropriate for their needs to charge the customer for the delivery/settlement of the performance obligation(s).

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

Yes. Since the entity no longer expects to earn the original margin on the sale of the good or service, re-measurement is required to reflect this.

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

The DP proposes remeasurement of onerous contracts only, but does not allow for other items which may require remeasurement to reflect an entities best estimate, such as warranties. We consider that the current measurement of warranties under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides more useful and reliable information than the DP proposals.

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

In relation to measurement of performance obligations upon initial recognition, we do not think that another measurement approach is required. However the issue of subsequent measurement needs to be further examined, such as in relation to warranties, as noted in question 10(c).

Question 11

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

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

Yes. The total transaction price, including any amount charged to recover costs of obtaining the contract, should be included in the initial measurement of an entity's performance obligations, because this is the amount the entity has determined as the transaction price for the item purchased. The alternative to split out this charge from the transaction price is not appropriate as the cost to do so would far outweigh any benefit.

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

Contract origination costs should always be expensed when incurred, except where they meet the definition of an asset in another accounting standard.

Given that these proposals will supersede IAS 11 *Construction Contracts*, it may be useful for the guidance in IAS 11 relating to the capitalisation of such costs to be incorporated into another standard, such as IAS 38 *Intangible Assets* or IAS 2 *Inventory*. Further consideration will also need to be given to some types of financial service origination fees where they are clearly an integral part of the effective interest rate of the relevant financial instrument. These should be reviewed to consider whether they are scoped out of the proposals through the IAS 39 *Financial Instrument: Recognition and Measurement* scope out or whether additional guidance will be required in another accounting standard to deal with these situations.

Question 12

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

We do not consider the stand-alone selling price to always represent the most appropriate value to use when allocating the transaction price to the performance obligations, as it may not necessarily be an accurate reflection of the economics of the transaction. For example, if a television is sold with a 3 year warranty together for a special price of $1000, and the normal retail price of the TV is $1000 and of the warranty is $300, then based on the proposals in the DP, revenue for the TV is booked at $770 and $230 for the warranty. The entity however may consider that a better reflection of the economics of the transaction (from its perspective) is that revenue for the TV should be $950, with the difference allocated to the warranty.

The basis of the allocation should reflect the economics of the transaction to the entity. In other words, the basis should be similar to the concept of 'looking through the eyes of management', as required by IFRS 7 *Financial Instruments: Disclosures* and IFRS 8 *Operating Segments*.

Question 13

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

As noted in the previous question, estimated prices should be allowed to be used in all areas if it better reflects the economic substance of the transaction. In estimating the price, an entity should rely on various assumptions and other data, which should be disclosed in the financial statements and can be supported by either external (which would be preferable) or internal evidence.