

17 June 2009

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom
Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON DISCUSSION PAPER ON *PRELIMINARY VIEWS ON REVENUE RECOGNITION IN CONTRACTS WITH CUSTOMERS*

In response to your request for comments on the IASB's discussion paper on *Preliminary Views on Revenue Recognition in Contracts with Customers*, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

We are generally supportive of the proposed revenue recognition model that aims to create a single revenue recognition principle under the contract position model to recognise revenue and to eliminate the existing inconsistencies between the main revenue recognition standards, that is, IAS 18 – *Revenue* and IAS 11 – *Construction Contracts*.

Our concerns regarding this model, relate particularly to the difficulty that entities might experience in applying the proposed principles in practice including identifying performance obligations in a contract. Although we acknowledge that, as set out in paragraph S11 of the Discussion Paper, the boards have not concluded on their positions regarding the application of this proposed model to contracts such as financial instruments, some non-financial instrument contracts, insurance contracts and lease contracts, we would recommend that clear and explicit application guidance be provided at the Exposure Draft phase to alleviate any practical issues that may be encountered in these areas. These concerns mentioned and other concerns have been elaborated further in our responses to the questions below.

SPECIFIC COMMENTS

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?

Yes, we agree with the proposal to establish a single revenue recognition principle that is applicable to all contracts. We believe such a principle would ensure that similar transactions across all industries are accounted for in the same way, thus promoting comparability. We do envisage that entities could encounter practical issues in applying this principle (refer to our responses on questions 4, 8 and 12). We encourage the Board to provide clear guidance in the Exposure Draft phase to clarify the application of the principle to these situations.

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?

Yes, we believe that the proposed principle would not provide decision-useful information for contracts relating to the sale of items that are measured at fair value through profit or loss, such as investment property as defined in IAS 40 – *Investment Property*, agricultural produce or biological assets under IAS 41 – *Agriculture* and financial instruments measured at fair value through profit or loss. For example, an entity may trade in financial instruments as its primary business. The gains related to the sale of such financial instruments would meet the definition of revenue in IAS 18. If the financial instruments are measured at fair value through profit or loss, these instruments are currently required to be remeasured at each reporting date. In such circumstances we believe that the proposed model will not provide decision-useful

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information, since all the gains or losses on such instruments would have already been recognised at each remeasurement date. Therefore, on settlement there would not be any additional revenue or gains to be recognised.

Question 3

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

Yes, we broadly agree with the boards' definition of a contract.

We note that the definition refers to enforceable obligations and therefore implies that this would not include contract extensions, even if highly probable. In certain industries, such as the cell phone industry, contracts extend beyond legal terms and are managed on a statistical probability of extension despite no legally enforceable rights to insist upon extension.

We would recommend that the definition of a contract be expanded to also include 'rights' in order to emphasise that a reciprocal relationship exists when an entity enters into a contract. We propose that the definition should be revised as follows "A contract is an agreement between two or more parties that creates enforceable obligations and rights." (added words have been underlined).

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 agree that the proposed definition of a performance obligation would help entities to identify consistently the deliverables in a contract.

We have noted the deliberate use of the word 'promise' to support the understanding of implicit and explicit obligations. The word 'promise' may not be consistently understood and we propose that the definition include the words 'implicit and explicit' before the word 'promise' to avoid any possible ambiguity.

We also believe that inconsistencies could arise where, for example, an entity has entered into a verbal agreement with a customer. In this case we envisage that it might be practically difficult to identify and to consistently apply the definition of a performance obligation.

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?

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We 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. We believe that this reflects the pattern in which control of the related assets is transferred to the customer.

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?

We agree in principle that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation.

Question 7

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

Yes, sales incentives do give rise to performance obligations if they are provided in a contract with a customer.

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.

Whilst we agree in principle that an entity transfers an asset to a customer when a customer controls the promised good or when the customer receives the promised service, we are concerned that the term 'control' has not been clearly defined.

This definition becomes clearer only when read in conjunction with the examples provided in the Discussion Paper. For example, if a non-refundable upfront payment of 50% of the sales price is added to the example in paragraph 4.39 of the Discussion Paper, then it is unclear when the entity has transferred control of an asset to the customer. The guidance around the customer payment only becomes clear when read in combination with the illustrative examples. This also hinges on the definition of an asset which is still to be finalised in the Conceptual Framework project. The application of this definition becomes particularly complex where a service is rendered. Consider an example where an entity undertakes to provide a certain service to a customer, but fails to comply with the agreed upon terms by walking away before the service is completed. It is not clear, based on this example, whether control has ultimately been transferred to the customer or not.

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.

We agree in principle with the proposal to recognise revenue only when a performance obligation is satisfied.

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We envisage that application issues will arise when determining whether performance obligations are satisfied and whether the contracts entered into with customers are to provide services or goods. For instance, in the example provided in the Discussion Paper in paragraph 4.35 the only way to determine that the contract relates to a service and that such services are satisfied over the life of the contract, is a customer payment. We do not believe that payment is necessarily an appropriate determinant of whether a good or service has been transferred.

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, we agree that performance obligations should be measured initially at the transaction price and we acknowledge that the boards intend to take a different approach for specialised transactions such as financial instruments and insurance contracts.

We believe that remeasurement should be required for contracts with a variable transaction price. For example, consideration for contracts to provide litigation services may be based on possible outcomes of the litigation. In this example, if changes in the expected outcome of the case occur, the performance obligation should be remeasured when the change occurs.

Furthermore, the accounting, particularly the measurement of revenue arising from exchanges of dissimilar goods and services, is not currently dealt with in the Discussion Paper. We recommend that the boards consider addressing these revenue transactions in the resulting Exposure Draft.

(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?

We 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.

(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.

No, we have not identified any performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date.

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- (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.*

None, other than those identified in paragraph S11 of the Discussion Paper, and the proposal discussed in Question 10(a) above to require remeasurement of contracts with a variable transaction price.

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 (e.g. 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?*

We 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. Moreover, we would propose that the principles be expanded to ensure consistent application when a contract results in multiple deliverables. This would particularly be true where an entity incurs the recovery costs that relate to more than one performance obligation. In this instance, entities would need to appropriately allocate the recovered costs amongst the various performance obligations so that the related revenue is recognised when such performance obligations are satisfied.

- (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.*

We believe that origination costs should be capitalised if they meet the definition of an asset, as defined in the boards' framework. Furthermore, if additional costs relating to that contract are contingent upon a possible obligation, the possibility of that cost should be anticipated in the calculation of the remaining obligations.

We are, however, of the view that the decision of determining whether origination costs are accounted for as expenses fall outside the scope of this project.

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?

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We agree that the transaction price should be allocated to performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations.

However, we are of the view that, in certain circumstances, measuring some elements of a revenue transaction could be quite complex. For example, it could be relatively simple to price a right of return, for some transactions, particularly where an entity has implemented a differential pricing policy, depending on whether a right of return is attached or not. This could particularly be true where airline tickets are sold at a discounted price with no right to cancel or change it, compared to tickets that are sold for a higher price with the ability to cancel or change the ticket. On the other hand, it might be difficult to measure the right of return in instances where all transactions are priced the same and customers are entitled to receive a refund or exchange the assets within a certain period of time. This would be the case in the retail industry where customers are generally entitled to return purchased goods for a refund or exchange within a specified period of time. Since all customers are equally entitled to such rights, and these rights are not sold separately, we believe that entities may encounter difficulties in measuring the related performance obligations. The fact that an entity's past practice indicates a low percentage of customers exercising this right may further create complexities in measuring the performance obligations. Therefore, we recommend that guidance be provided in the discussion paper that provides more useful information than current US practice.

Moreover, the discussion paper does not provide sufficient guidance on how the accounting of the allocated transaction price would be affected in instances where the terms and conditions change (for example, the transaction price) over the contract period. This may occur in contracts with variable transaction prices or where contract terms are renegotiated. It is not clear whether specific remeasurement requirements should be applied or not.

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?

We agree that if neither the entity nor any other entity sells 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.

OTHER COMMENTS

Single definition of revenue

In paragraph 1.18 of the discussion paper, the boards have provided both the definition of revenue under the current IAS 18 and US Generally Accepted Accounting Practice (GAAP). It is therefore not clear which definition the boards are likely to adopt as the ultimate definition for the revenue recognition model. We suggest that a single revenue definition be provided in the Exposure Draft.

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Distinguishing between rights in the net contract position and financial assets

Some commentators have noted that the rights in the net contract position and the financial asset (the receivable) arising from a contract share a common definition: the right to receive cash/consideration. We request that the scope of the resulting Exposure Draft be clarified to distinguish between the rights to receive consideration - which are included in the measurement of the net contract position - and financial assets - which would be recognised once the performance obligation is satisfied and a right to receive the related consideration has been established.

Agency versus Principal

The discussion paper has not addressed how the proposed revenue recognition principle would apply to the agency and principal relationship. We urge the boards to consider this important issue and to deal with it at the Exposure Draft stage.

Presentation of revenue

We have concerns regarding the disclosure requirements that the boards will include in the resulting Exposure Draft, for instance we believe that requiring entities to separately present the revenue related to each of the performance obligations included in a contract might reveal important pricing strategies to entities' competitors.

Construction Contracts

We envisage that the construction industry will be affected by the proposals contained in the Discussion Paper. We recommend that the Exposure Draft include additional examples of construction contracts in order to enhance our understanding of the proposed principles and their application implications for this industry. Example 5 and 6 provided in the discussion paper only illustrate a construction renovation contract and building a boat. We suggest that these be expanded to traditional construction contracts such as building a bridge, commercial building or a road.

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