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Sir David Tweedie
Chairman
The International Accounting Standards Board
30 Cannon Street
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Dear David

DISCUSSION PAPER Preliminary Views on Revenue Recognition in Contracts with Customers

The Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants is pleased to submit its comments on the Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers*.

Support for the project

The FRSB supports the project to replace the current revenue standards and supports convergence of International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (US GAAP). The FRSB considers that some of the proposals in the Discussion Paper will improve accounting for revenue.

Scope and objective of the revenue project

The FRSB is concerned that one of the main objectives of the project may not be achieved, being to develop a single comprehensive revenue recognition standard applicable to a range of industries. Ideally the proposed revenue recognition model should be applied to revenue from all contracts with customers including, for example, lease contracts and insurance contracts. We acknowledge that the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have not yet excluded any particular types of contracts with customers from the potential scope of the model proposed in the Discussion Paper and we encourage the IASB and the FASB (the Boards) to continue down the route of considering the application of the proposed revenue recognition model to revenue from all types of contracts with customers.

It is not clear from the Discussion Paper whether revenue from contracts with customers will be considered the only form of income that may be classified as revenue, or whether revenue from contracts with customers will be considered one possible category of revenue. The proposed revenue recognition model is limited to revenue from contracts with customers. However, many sources of "revenue" may not arise from contracts with customers (for example, revenue arising from remeasurement of assets to fair value). We recommend that the IASB clarify whether or not such other income could still be presented and described as revenue. We also encourage the Boards to consider the application of the proposed revenue recognition model to revenue from all sources in order to achieve the objective of developing a single comprehensive standard on revenue.

Application of the proposals to contracts for the provision of services and long term contracts

We have some concerns over the application of the proposals in the Discussion Paper to contracts for the provision of services and long term contracts. We suggest that the proposals be field tested to confirm that the proposals will achieve an appropriate outcome and that the field tests include application of the proposals to insurance and lease contracts.

FRSB response to questions for respondents

Included in the appendix to this letter are our responses to the specific questions for respondents raised in the Discussion Paper and our views on the proposals in the Discussion Paper.

If you have any queries or require clarification of any matters in this submission, please contact me.

Yours sincerely



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Appendix – FRSB responses to specific questions for respondents raised in the Discussion Paper and views on the proposals in the Discussion Paper

Chapter 2: A contract-based revenue recognition principle

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?

1. The FRSB agrees with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability. This approach should ensure that the model is an improvement on the current model by eliminating the inconsistency between the current model and the asset and liability definitions resulting in more consistent revenue recognition.
2. However, the FRSB is concerned that one of the main objectives of the project may not be achieved, being to develop a single comprehensive revenue recognition standard applicable to a range of industries. Ideally the revenue project should establish the overarching principle to be applied to all forms of revenue from all types of contracts with customers including, for example, lease contracts and insurance contracts. Once the overarching principle is established, more detailed guidance could then be developed to deal specifically with the recognition and measurement of particular types of revenue, such as lease and insurance revenue. We acknowledge that the Boards have not yet excluded any particular types of contracts with customers from the potential scope of the model proposed in the Discussion Paper and we encourage the Boards to continue down the route of considering the application of the proposed revenue recognition model to revenue from all contracts with customers. We also encourage the Boards to consider the application of the proposed revenue recognition model to all types of revenue, not just revenue from contracts with customers.
3. We recommend that the Boards clarify whether or not income arising other than from a contract with a customer could still be presented and described as revenue. The proposed revenue recognition model is limited to revenue from contracts with customers. However, many sources of "revenue" do not arise from contracts with customers (for example, revenue arising from remeasurement of assets to fair value). It is not clear from the Discussion Paper whether revenue from contracts with customers will be considered the only form of income that may be classified as 'revenue', or whether revenue from contracts with customers is one possible category of 'revenue'. We suggest that precluding the following types of income from being reported as revenue simply because they arise outside of contracts with customers would reduce the relevance of financial information reported:
 - returns to investors in equity instruments such as dividends and fair value increments; and
 - the growth of biological assets, particularly the growth of biological assets that take a substantial period of time to become ready for sale.

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?

4. The FRSB has not identified any other customer contracts (other than those already identified in the Discussion Paper) for which the proposed revenue recognition principle would not provide decision-useful information.

Questions 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.

5. We largely agree with the Boards' definition of a contract. The definition appropriately captures contracts that have either the substance or the legal form of a contract and, therefore, should be capable of being applied in various jurisdictions. The definition is also consistent with the current definition of a contract in IAS 32 *Financial Instruments: Presentation*.
6. However we recommend that the definition be clarified. The definition of a contract is expressed as only creating obligations. Whilst we agree that if one party to a contract has an obligation, that obligation is a right of the other party to the contract, we suggest that the definition would be clearer if it described a contract as creating both rights and obligations. We suggest that the definition be modified as follows (new text is underlined):

A contract is an agreement between two or more parties that creates enforceable rights and obligations.

Chapter 3: Performance obligations

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.

7. The FRSB agrees that the proposed definition of a performance obligation should help entities to identify deliverables in (or components of) a contract consistently. If performance obligations are identified based on promises within a contract those performance obligations can be objectively determined. Treating implicit promises as performance obligations provides a consistent basis for identifying the obligations within the contract irrespective of the legal form of the contract and therefore should improve consistency of reporting.
8. In addition, determining the recognition and measurement of revenue relating to the components of a contract is also a significant issue at present. This is because the current standards do not provide consistent guidance on the recognition and measurement of the components identified. The proposed model simply but effectively requires separate recognition depending when the goods and services are delivered.
9. However, the FRSB recommends that the definition of a performance obligation be amended to clarify that:
 - goods are not the only type of asset that can be transferred to a customer;
 - a performance obligation does not only include an obligation to provide physical assets as is implied by the term 'good', a performance obligation could include an obligation to provide intangible assets; and
 - services provided to a customer are not necessarily an asset to either the service provider or the customer.
10. The FRSB recommends that the definition of a performance obligation be amended as follows (deleted text is struck through and new text is underlined):

An entity's performance obligation is a promise in a contract with a customer to transfer an asset (~~such as a good or a service~~) or provide services to that customer.

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?

11. The FRSB agrees that performance obligations within a contract should be grouped on the basis of when the performance obligations will be satisfied (i.e. when the promised asset will be transferred to the customer or when the promised services are performed). Each performance obligation could be accounted for separately. However, if a group of performance obligations were to be satisfied simultaneously, whether the performance obligations were accounted for as a group, or separately, would not affect the total amount of revenue recognised. Grouping the performance obligations on the basis of when they will be satisfied is an appropriate and practical approach.
12. However, we recommend that the IASB clarify that performance obligations need to be accounted for separately only to the extent that they are satisfied in different financial reporting periods and that the extent to which an entity keeps detailed records of performance obligations satisfied within the same financial reporting period is a matter to be determined by management. It is possible to interpret paragraph 3.24 of the Discussion Paper as requiring performance obligations to be identified and accounted for separately if they are satisfied at different times even if they are satisfied within the same accounting period. Keeping such detailed accounting records is not necessary. This is because the objective of accounting for performance obligations separately on the basis of when an entity transfers the promised assets to its customer is to ensure that: (i) at each reporting date, performance obligations are appropriately and completely reported; and (ii) revenue is recognised in the correct reporting period.

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?

13. The FRSB agrees that an entity's obligation to accept returned goods and refund the customer's consideration should be a performance obligation (rather than an expense). A standalone guarantee (such as an insurance contract) is treated as a revenue generating activity. Consistently, guarantees or return rights embedded within a contract with a customer should be treated as a performance obligation. Treating rights of return as options to unwind a transaction where the customer does not actually have control over the right of return would require an entity to defer the recognition of any revenue arising from the contract until the right of return has expired. Such an approach inappropriately implies that the contract with the customer has not resulted in anything of substance. Reporting revenue in this manner would provide users with misleading information.
14. However, there is a need to distinguish between different types of return rights. We suggest that if an entity sells goods with a right of return, the right of return is a performance obligation. However, if a customer takes delivery of goods for a trial period after which the customer can either: (i) return the goods with no obligation; or (ii) keep the goods and make payment, the right of return is not a performance obligation. This is because, until the trial period has expired, there is no contract between the entity and the customer and therefore, no obligation.
15. The obligation to accept returned goods and refund the customer seems to meet the definition of a performance obligation. However, when read with the definition of 'customer' in chapter two of the Discussion Paper, this is not clear. It would be useful if further explanation were provided of why the entity's obligation to accept returned goods is considered to be a service to a customer. It may be necessary to refine the definition of a performance obligation or redefine 'customer' to ensure that an entity's obligation to accept returns is appropriately and clearly captured as a performance obligation.

Question 7

Do you think that sales incentives (eg 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?

16. We agree that sales incentives offered within a contract with a customer give rise to performance obligations. This is because the entity providing the sales incentives is promising to transfer to its customer an asset or provide future services. However, sales incentives offered free of charge and independently of another transaction do not give rise to performance obligations and should not be recognised in an entity's financial statements (except where the redemption of the vouchers will result in products or services being sold at a loss). For example, assume a retailer publishes a coupon in a national newspaper giving a discount off any purchase of specified products. The retailer should not recognise the distribution of the coupons in its financial statements. When the vouchers are redeemed we suggest that the retailer should recognise the discount off the normal selling price of the products as an expense. This is because, when a customer purchases an item from the retailer, the customer is agreeing to purchase the item for the normal selling price. The customer then has the option of either (i) settling the full selling price in cash (if the customer chooses not to use a voucher or does not have a voucher); or (ii) settling the selling price partly in cash and partly with a voucher. The reduction in the selling price offered in the voucher is in substance a marketing expense being an offer by the retailer to entice the customer to purchase goods from the retailer.
17. We recommend that further guidance be provided on how to deal with discounts and volume rebates as these incentives can be the cause of significant difficulty and divergence in practice. Take the example of a wholesaler agreeing with a retailer that, if the retailer purchases less than a specified number of goods, the retailer will be charged a certain amount for each item of goods purchased. However, if the retailer purchases more than the specified number of goods, the retailer will be charged a reduced price per item purchased for all the items purchased during the financial year. Such sales incentives could be considered either a reduction in the sales prices to be dealt with through measurement of revenue or could be considered a performance obligation to which part of the initial transaction price should be allocated. We suggest that the former approach is appropriate. This is because the future delivery of goods is not a performance obligation until the retailer actually places an order for more goods.

Chapter 4: Satisfaction of performance obligations

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.

18. The FRSB does not agree entirely with the IASB's proposals. In respect of services, a service is not necessarily an asset of the service provider. Suggesting that a service is an asset potentially would restrict transactions that could be considered revenue generating to only those transactions that involve the derecognition of an asset already recognised by the service provider. In respect of goods, we are concerned by a number of paragraphs in the Discussion Paper strongly suggesting that a customer obtains control of promised goods only upon physical delivery. In addition, we are concerned that the manner in which the proposed model is explained and the view expressed in question 8 suggests that goods (and services) are the only assets that may be transferred to customer. We elaborate on these concerns below.

Services

19. In respect of services we agree that an entity transfers an economic resource to a customer (and satisfies a performance obligation) only when the customer receives a promised service. However, we suggest that a service provider should recognise revenue as services are provided to the customer. We suggest that the proposals in the Discussion Paper could give rise to inappropriate revenue recognition because: (i) a service is treated as an asset that must be transferred to a customer before revenue can be recognised; and (ii) a service provider may be prevented from recognising revenue as services are provided.
20. A service is not necessarily an asset of the service provider. Suggesting that a service is an asset implies that there is an asset recognised by the service provider which is then transferred to the service recipient. This implication is too restrictive as it potentially would restrict transactions that could be considered to generate revenue to only those transactions that involve the derecognition of an asset already recognised by the service provider.
21. A service provider should be permitted to recognise revenue as services are provided. If not, revenue reported will not provide relevant information that reflects the economic activity of the service provider.
22. To illustrate our concerns we use the example of an audit. Assume that an audit firm provides its client with an annual audit report and the audit firm conducts its audit through two visits to its client: (i) an interim visit part way through the year; and (ii) a final visit shortly after financial year-end. Under the proposals in the Discussion Paper, if we consider an audit to be the delivery of an asset (i.e. the audit report) the audit firm would be permitted to recognise revenue only once the audit report has been delivered to its client. This is because the client obtains 'control' of the asset only upon physical delivery at completion of the audit. On the other hand, if we consider the contract with the client to be a contract for the provision of assurance services over the period during which the audit is conducted, the audit firm would be permitted to recognise revenue as the audit progresses. This is because the client obtains the benefit of the audit services as the audit is conducted. We suggest that the audit firm should recognise revenue as the audit progresses regardless of whether an audit service is considered to be the delivery of a good (i.e. the audit report) or the delivery of an audit service.
23. Rather than determining whether revenue should be recognised on the basis of delivery, it may be possible permit the recognition of revenue when both of the following criteria are met:
 - the reporting entity has performed work; and
 - the reporting entity is unconditionally entitled to compensation for the work performed (i.e. the customer is unconditionally obliged to pay for the work performed by the reporting entity).
24. Under this approach the FRSB suggests that the customer's obligation to make payment that emerges as work is carried out by the reporting entity is accompanied by a corresponding right of the customer to the work that the reporting entity has undertaken so far. As a result, there is a continuous transfer of a right to the work that has been performed by the reporting entity and the reporting entity generates revenue progressively as it performs.
25. Where a service provider does build up a work-in-progress inventory as a service is provided we suggest that it may be appropriate for the service provider to recognise as part of work in progress the margin expected on the services.

Goods

26. In respect of goods, we agree that an entity transfers an economic resource to a customer (and satisfies a performance obligation) only when the customer obtains control of the promised goods. Under the proposed model, revenue is recognised as a result of changes in an entity's assets or liabilities. Considering goods as an example, an entity's assets (the goods) will only change when the goods are no longer an asset of the entity i.e. when the goods become an asset of the entity's customer. An entity's goods would become an asset of its customer only when the customer controls the goods so as to be able to obtain future economic benefits from the goods. Therefore, it follows that an entity's performance obligation is satisfied only when its customer obtains the enforceable rights to the promised goods.

27. However, we are concerned at the suggestion that a customer obtains control of an asset only upon physical delivery and the suggestion that goods (and services) are the only assets that may be transferred to customer.

Suggestion that a customer obtains control of an asset only upon physical delivery

28. A number of paragraphs in the Discussion Paper strongly suggest that a customer obtains control of promised goods only upon physical delivery of the goods¹. As summarised in paragraph 4.60 of the Discussion Paper, an entity is considered to have satisfied a performance obligation when the customer obtains control of the goods which typically occurs when the customer takes physical possession of the goods. We suggest that replacing the term 'typically' with 'often' would remove the suggestion that a customer obtains control of goods only upon physical delivery.
29. The FRSB is concerned that, under the Discussion Paper's implied principles, even though a reporting entity has performed work in creating promised goods and is unconditionally entitled to receive payment from the customer, the entity would not be entitled to recognise revenue until it delivers the related finished goods to the customer. Such an approach will not provide decision-useful information in respect of long-term contracts.
30. In some contracts, becoming unconditionally entitled to receive payment from the customer for work performed may coincide with physical delivery of the promised goods. In other contracts this may not be the case. For example, in a contract for the delivery of a highly specialised piece of equipment, until the entity starts performing work under the contract, the customer only has a conditional obligation to make payment to the reporting entity and the entity should not be entitled to recognise revenue. However, as work is performed, the performance of the reporting entity results in the customer's obligation to make payment (and the reporting entity's right to receive payment) unconditional and the reporting entity should be permitted to recognise revenue.
31. Rather than determining whether control over promised goods has been transferred to a customer on the basis of physical delivery, it may be possible to determine that control has been transferred to a customer when both of the following criteria are met:
- the reporting entity has performed work in creating or acquiring the promised goods; and
 - the reporting entity is unconditionally entitled to compensation for the work performed (i.e. the customer is unconditionally obliged to pay for the work performed by the reporting entity).

Under this approach the FRSB suggests that the customer's obligation to make payment that emerges as work is carried out by the reporting entity is accompanied by a corresponding right of the customer to the work that the reporting entity has undertaken so far. As a result, there is a continuous transfer of control of or a right to the work that has been performed by the reporting entity and the reporting entity generates revenue progressively as it performs.

Suggestion that goods and services are the only assets that may be transferred to customers

32. The proposed model is to some extent explained through its application to revenue from the sale of goods and revenue from the rendering of services. This creates the impression that, like the current revenue standards, to apply the proposed model a clear distinction between contracts for the sale of goods and contracts for the rendering of services is fundamental to determining the timing of revenue recognition. However, in many cases, distinguishing between a contract for the sale of goods and a contract for the rendering of services is highly subjective; may not be necessary; and forces a distinction to be made that can give rise to inappropriate revenue recognition. Whilst guidance on the application of the proposed model to revenue from the sale of goods and services is required, the same revenue recognition principle should apply to both contracts for the sale of goods and contracts for the rendering of services.

¹ This is strongly suggested in paragraphs 3.20, 4.5, A43 and A44. Other points at which a customer obtains control of promised goods are not illustrated, although the last sentence of paragraph 4.8 refers to transfers of 'assets' (rather than 'goods' or 'services') to the customer that satisfy a performance obligation.

33. In addition, the view expressed in question 8 seems to suggest that goods and services are the only assets that may be transferred to customers (even though the definition of a 'performance obligation' suggests that goods and services are examples of assets that may be transferred to customers). However, other forms of asset (such as intangibles) can equally be transferred to a customer and should rightfully fall within the scope of a general revenue standard. We suggest that restructuring the discussion of the proposed model as a single model to be applied to all forms of revenue should eliminate the suggestion that goods and services are the only assets that may be transferred to customers.
34. We therefore recommend that the proposed model be described and explained as one model to be applied to all forms of revenue arising from all types of contracts. Thereafter, the application of that model to revenue from the sale of goods and services can be provided as application guidance.

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.

35. The FRSB has not identified any contracts (other than those already identified in the Discussion Paper) for which the recognition of revenue from the satisfaction of performance obligations would not provide decision-useful information. However, we recommend that the IASB:
- clarify the unit of account to be used in situations where an entity has a pool of similar performance obligations; and
 - provide more guidance on how the proposed revenue recognition model might be applied to contracts for the provision of financial services.

Clarify the unit of account

36. In the Discussion Paper it is proposed that an entity determine the amount of the transaction price to allocate to a performance obligation for a warranty on the basis of an entity's experience with warranties and the entity's portfolio of warranty obligations. However, it seems that an entity is required to assess other performance obligations on a contract by contract basis rather than based on a portfolio of similar contracts. If this approach is applied to the recognition and measurement of contingency fees reported revenue will be misleading.
37. By way of example, assume a lawyer provides services and charges fees on a contingency basis. If the lawyer achieves a particular outcome for a client the client must pay the lawyer a specified or determinable amount (e.g. a proportion of settlement received). However, if a particular result is not achieved the lawyer does not receive any remuneration. If we measure the amount of revenue to be recognised as the probability weighted estimate of the possible outcomes on a contract by contract basis, the amounts reported can be misleading. This is because there are only two possible outcomes, either: (i) the desired outcome is achieved and the lawyer receives the full remuneration and should recognise all of the revenue; or (ii) the desired outcome is not achieved and the lawyer receives no remuneration and should not recognise any revenue. To determine the amount of revenue to recognise the lawyer would need to assess the probability that the desired outcome will be achieved. Unless the lawyer is virtually certain of a particular outcome, the amount of revenue recognised will be misleading because it will not represent either of the two possible outcomes.
38. We suggest that if the lawyer in the above example assessed the probability of an outcome on a portfolio basis, more relevant and reliable revenue recognition will result. A lawyer is unlikely to have only one client but rather a portfolio of clients and, from the portfolio of clients, will expect to be unsuccessful in some cases but successful others. Operating in this manner the lawyer would be experienced in estimating the probable outcomes of the portfolio of cases. This approach will ensure that financial reporting more appropriately reflects the manner in which the lawyer operates and is also consistent with the approach to be taken in assessing the performance obligation associated with a warranty suggested in the Discussion Paper.

More guidance on how the proposed revenue recognition model might be applied to contracts for the provision of financial services

39. Financial service fees arise in many forms including origination fees, commitment fees as well as management and performance fees in relation to funds and unit trusts. Determining an appropriate approach to recognition of revenue from such fees can be difficult in practice. We therefore recommend that further guidance be provided to ensure that the proposed revenue recognition model can be applied consistently.
40. In particular, more guidance should be provided on how to determine the appropriate accounting for performance based management fees, such as fees receivable by investment fund managers. Significant difficulties and variation in approach is encountered when determining the appropriate accounting for performance based management fees. Often a performance period considered in determining the fees payable to a fund manager may not coincide with a financial reporting period and may cover many years. As a result, assessing when to recognise performance-based management fees can be difficult and inappropriate revenue recognition can significantly affect a fund manager's reported performance. For example, an investment manager may prepare interim financial statements for the six month period ended 30 June 20x9, and the performance period considered in determining the performance fees may be for the twelve months ending 31 December 20x9. If the performance fee is only payable in the event that the investment manager achieves the performance condition at the end of the 12 month financial reporting period, the fee is contingent upon a future event.
41. We suggest that performance-based management fees should be recognised as revenue over the period during which the fund manager provides the fund management services. Therefore, in the above example for instance, the fund manager should recognise in its June 20x9 interim report a proportion of the expected performance-based fee measured as the best estimate of the outcome expected for the twelve months ending 31 December 20x9. Recognising revenue in this manner:
- provides users of financial statements with the most decision-useful information regarding the fund managers performance during the interim period;
 - is consistent with the proposals in the Discussion Paper because the fund manager satisfies its performance obligation (its obligation to manage the investment fund effectively) continuously over the performance period; and
 - is consistent with the IASB's emerging approach to dealing with uncertainty by incorporating uncertainty in the measurement of amounts recognised rather than dealing with uncertainty through recognition.

Chapter 5: Measurement of performance obligations

Question 10

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?

(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?

(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.

(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.

Question 10 (a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

42. The FRSB agrees that performance obligations should be measured initially at the transaction price. The act of contracting with a customer should not of itself be treated as revenue generating. Sometimes the transaction price may need to be estimated. As discussed in our response to question 9, more reliable and relevant measurement may result if a reporting entity is permitted to measure transactions prices based on portfolios of similar contracts rather than on a contract by contract basis.

Question 10 (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?

43. The FRSB agrees that a performance obligation should be deemed onerous, and remeasured to the entity's expected cost of performance, if the expected cost of performance exceeds the performance obligation's carrying amount.

Question 10 (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.

44. The FRSB has not identified any performance obligations (other than those already identified in the Discussion Paper) for which the proposed approach would not provide decision-useful information at each financial statement date. We agree with the suggestion in the Discussion Paper that performance obligations within contracts with highly variable outcomes may require regular remeasurement, not only when the performance obligations become onerous. For example, fund manager contracts that include variable performance-based management fees should be remeasured on a regular basis to provide users with up-to-date and decision-useful information.

Question 10 (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.

45. As far as possible, all performance obligations dealt with in the same revenue recognition standard should be subject to the same measurement approach. This is especially so because a number of performance obligations may be aggregated into a single net contract position. It would be confusing for a single net contract position to be an aggregate of a number of performance obligations determined using different measurement approaches. In addition, using a single measurement approach will avoid unnecessary complexity and promote consistency.
46. Ideally the same revenue recognition model should be applied to revenue from all sources. We encourage the Boards to consider application of the proposed revenue recognition model to revenue from all sources. However, as noted above, we agree that some performance obligations within contracts with highly variable outcomes may require regular remeasurement and therefore there is a need for an alternative approach to subsequent measurement where this is necessary to provide users with decision-useful information on an ongoing basis.

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?

(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.

Question 11 (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?

47. We agree that no gain or loss and no revenue should arise simply as a result of entering into a contract with the customer. Until the parties to a contract are performing under the contract, the contract is an executory contract. To prevent the recognition of gains or losses and revenue simply from the act of entering into a contract with a customer, some may consider it appropriate to specify that amounts charged to a customer to recover contract origination costs must be included in the initial transaction price allocated to performance obligations within the contract established. However, under the Boards' proposed model, an entity's activity does not give rise to revenue recognition unless a resource is transferred to its customer. Activities undertaken by an entity to secure a contract with a customer often do not result in resources being transferred to its customer. As such, the entity is already precluded from recognising revenue in relation to such pre-contract activities. Specifying that any amounts that an entity charges customers to recover any costs of obtaining the contract be included in the initial measurement of the performance obligations appears to be an "anti-abuse" provision that is not necessary.
48. In addition, an entity should not inadvertently be precluded from recognising revenue when initially entering a contract with a customer if the entity has, simultaneously with entering the contract, transferred an asset to its customer or performed a service for its customer. For example, a broadband internet service provider may provide new customers with a broadband modem when entering a contract for internet access for a specified period of time (say 12 months). The contract with the customer is comprised of two performance obligations (i) the delivery of a modem; and (ii) the provision of internet access for 12 months. Assume that, if the customer cancels the service contract before 12 months have passed, the customer would not be required to either return or pay for the modem. The service provider should be permitted to recognise revenue upon delivery of the modem to its customer because the service provider has fulfilled its performance obligation of providing its customer with a modem. Entities should be able to exercise judgment in determining when assets are transferred to their customers and, therefore, when revenue should be recognised.

Question 11 (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.

49. There should not be a presumption that contract origination costs are to be expensed and it is not sufficient to leave their accounting treatment to be determined based on other IFRSs.

50. Contract origination costs can be significant and can be incurred for a wide variety of reasons. Preparatory work for a contract (such as design work) may give rise to a resource that will assist the entity in providing goods or services to its customer and thereby generate cash inflows from the contract with the customer. Recognising such costs as expenses when incurred but recognising revenue from the customer contract only as promised goods or services are provided to the customer may not provide the most decision-useful information to users. Rather such costs should be deferred and subsequently recognised as expenses resulting from the provision of the promised goods or services.
51. Existing requirements of IFRSs do not provide clear and consistent guidance on how to account for contract origination costs. We believe that the IASB should consider fully the appropriate accounting treatment for contract origination costs. A single principle needs to be established which should be applied to all IFRSs.
52. We suggest that the accounting treatment of contract origination costs could depend upon (i) whether a contract is secured as a result of the origination costs incurred; and (ii) the nature of the contract secured. For example, if the entity is not successful in securing intended contracts or no longer believes that it may be successful in securing intended contracts, it would be appropriate to expense the origination costs or write-off any previously capitalised costs. This is because the entity is no longer expecting to derive future economic benefits as a result of the contract origination costs. If an entity secures contracts, the contract origination costs capitalised could either be: (i) amortised over the term of contract or the expected period of service if the contract is to provide services; or (ii) added to the cost of inventory and expensed as part of cost of sales when the inventory is sold.
53. Contract origination costs also need to be more clearly defined. A clear distinction needs to be made between costs associated with obtaining a contract (such as costs incurred in order to tender for a contract) and preliminary costs incurred before performing under a contract (such as system or infrastructure related costs to establish systems or infrastructure that is necessary to fulfill contracts with customers).

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?

54. The FRSB agrees that the transaction price should be allocated to performance obligations identified within a contract on the basis of the entity's selling price of the individual goods or services underlying those performance obligations. The proposed approach will provide the most reliable decision-useful information for users. It would not be appropriate to aggregate performance obligations (and hence revenue) at the level at which goods or services are sold separately. This is because aggregating performance obligations at this level could result in the deferral of revenue recognition even though some performance obligations have been satisfied.
55. In addition more guidance is required on how to allocate a transaction price between different financial services provided by, for example, an investment manager. An investment manager generally provides a number of services including investment advice, research services and certain administrative services under an investment advisory agreement to an investment fund in return for a management fee. It is often difficult to establish the basis for allocating the transaction price between each service where, for example, the relationship between the cost of each service provided and its market value varies. Providing further guidance on the basis of allocation would improve consistency of reporting. The FRSB suggests that allocation based on selling price (including a margin) is preferable to allocation based on cost (excluding a margin). Allocation of the transaction price based on selling price will result in a more relevant apportionment of the transaction price.

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?

56. We agree that, if an entity does not sell goods or provide services separately, it should estimate the stand-alone selling price for the purposes of allocating the transaction price to the identified performance obligations. Under the current standards, management is already required to exercise judgment in this area and so this requirement should not create new difficulties. We are not aware of any instances where the use of estimates would need to be constrained.
57. However, we do foresee some practical difficulty in determining the amount of the transaction price to allocate to obligations to accept returned goods. This is because, in a competitive market, there will be little or no information available on the amount a customer would be charged for the right of return. In a competitive market competing entities simply match the selling price of their competitors so that even if one entity sells goods at a particular price including a right of return and another sells the same goods without a right of return, the selling price will be the same.