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Finance & Administration

Corporate Accounting
35/242 Exhibition Street
Melbourne 3000, Victoria
Australia

Tel: +61 3 9634 6470
Fax: +61 3 9634 2359

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

Dear Sir David

Exposure Draft 2010/6 Revenue from Contracts with Customers

We are pleased to respond to the IASB Exposure Draft (ED): Revenue from Contracts with Customers.

On the whole, we are supportive of the Board's efforts towards a single revenue recognition model to be applied to all transactions under which revenue is earned, and generally do not disagree with the conceptually-based principles that the Board has developed. However, we have significant concerns over the practical implementation issues that many organisations would face if the ED were to proceed in its current form. Indeed we are concerned that many of the proposals would be virtually inoperable for organisations like telecommunications operators, who have millions of customers, often with multiple low-dollar-value, high-volume transactions and contracts. Our main concerns are set out below:

- As noted above, telecommunications operators like Telstra often have millions of customers, many with multiple low-dollar-value, high-volume recurring transactions and contracts. In addition, the goods and services offered are constantly evolving both technologically and from a marketing perspective, with prices constantly changing and customers continually upgrading and downgrading their telecommunication 'bundles'. As a result, and because of significant differences in individual customer contracts, organisations like Telstra would be required to account separately for millions of contracts. We remain concerned that the following elements of the proposed model will therefore be impracticable to apply, and indeed inoperable, given the sheer volume of transactions and contracts, even considering our ability to potentially aggregate similar contracts:
    - Contract segmentation;
    - Contract modifications;
    - Identifying separate performance obligations within each contract;
    - Factoring in probability-weighted estimates for variable consideration and credit risk assessments when determining transaction prices;

- Allocating the transaction price, particularly in the case of bundled arrangements incorporating high-turnover homogenous goods whose prices change on a regular basis; and
- Disclosure requirements, particularly those relating to maturity analyses.

For Telstra, as is the case for many telecommunications organisations, some of the information required by the proposed model is not tracked in current systems, and multiple billing systems outside of the accounting system hold the detailed individual contract information. Significant adjustments will need to be made outside of billing systems (and in the accounting systems) in order to appropriately allocate revenue in accordance with the ED creating a disconnect between the billings and accounting systems. However, the accounting systems have not been designed with the capability to account separately for millions of individual contracts, nor are they (nor our billing systems) set up to calculate probability-weighted estimates for variable consideration or collectability assessments. They also do not currently hold information about standalone selling prices.

- We do not support having to recognise revenue on the basis of an estimated transaction price. In addition to our concern (set out above) that this approach would be impracticable to apply by telecommunications organisations given the sheer volume of transactions and contracts, we also disagree with its conceptual underpinning. Estimating the amount an entity expects to receive from a customer, as opposed to using the minimum contracted spend, would not be reflective of an entity's pricing model. The contracted transaction price should be used as the basis to measure and record the performance obligation as this is the actual value that an entity expects in return to extinguish its performance obligation. As such, we also do not support the use of a probability-weighted average amount in determining the transaction price as this would result in revenue amounts being recognised that would not ultimately reflect reality.
- We also do not conceptually support the transaction price reflecting the customer's credit risk as we question whether conceptually the determination of credit risk at origination is applicable for individual financial assets, or whether this is only relevant for portfolios of assets evaluated on a collective basis. Collectability is an impairment assessment issue i.e an estimate of expected credit losses, either at origination or subsequent measurement, and should be accounted for via the allowance account, rather than through the recognition and measurement of individual contract revenue.
- We do not support the proposal to include guidance in a revenue recognition standard with regards to contract costs, we believe that IAS 38 should be enhanced to include specific guidance on such costs and it also needs to be clarified whether current Australian Interpretations can continue to be applied.
- We believe the disclosure requirements are both <u>onerous</u> and <u>excessive</u>, and for the reasons set out above will be impracticable to implement. The disclosure requirements would need to be significantly reduced to enable implementation and to ensure the information is in fact useful and understandable to users.
- We believe further clarification is required regarding how the model would apply to revenue transactions associated with lessor accounting. In particular, in the case of sales type leases where a manufacturer/dealer relationship can be demonstrated, the current lease accounting standard permits upfront recognition of revenue from sale of equipment leased by the lessor. The proposals in this ED do not state explicitly that these classes of assets may also be de-recognised in a sale and leaseback transaction even though the transfer of control does not occur.

Our comments to the specific questions outlined in the exposure draft are detailed below.

<u>Question 1</u>
Paragraphs 12 – 19 propose a principle (price interdependence) to help an entity determine whether:

(a) to combine two or more contracts and account for them as a single contract;
(b) to segment a single contract and account for it as two or more contracts; and
(c) to account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

The first step in the proposed model involves identifying the contract with a customer. While we believe price interdependence is an appropriate way to determine whether contracts should be combined or segmented, there needs to be a clearer link between how this assessment then assists in making the assessment of identifying performance obligations and allocating the transaction price.

We question the relevance of the contract segmentation principle in addition to the requirement in paragraph 20 where the separate performance obligations in a contract are identified. This duplication causes confusion and we would suggest that the principles be combined.

Further, we do not agree with the proposal to account for a contract modification as part of the original contract where the contracts' prices are interdependent. Recognising the cumulative effect of a contract modification in the year of the modification distorts revenue in that year and will provide users with misleading information about the organisations performance for the year. Additionally, many service providers provide existing or long-term customers with preferential rates, and tracking these contracts and allocating the modifications at the individual contract level would be impracticable for telecommunications organisations given the sheer volume of contracts and the frequency of modifications. We believe that the amount of revenue recognised each period should agree with the value contracted with the customer for each period of service.

<u>Question 2</u>
The Board proposes that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Para 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Conceptually we agree with introducing guidance that can be applied to all revenue generating activities on identifying separate performance obligations. The principle of whether the good or service is 'distinct' appears reasonable and would result in greater comparability and consistency amongst entities. The difficulty however will come in accounting for the separate performance obligations and in determining when control has been transferred. Refer to question 3 where we highlight our concerns, particularly in relation to revenue recognition under long-term contracts.

<u>ED Question 3</u>
Do you think that the proposed guidance in paragraphs 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

We believe the proposed guidance on determining when control has been transferred to a customer is fairly consistent with existing guidance on the transfer of control, for example, in IFRIC Interpretation 14 *Whether an Arrangement Contains a Lease.*

However, we believe the guidance in relation to continuous transfer of goods or services could be clarified further. For example, if milestones are included in contracts and a customer certifies the acceptance of the work as these milestones are achieved, this should be a factor considered in determining whether goods/services are transferred continuously.

The application guidance does discuss the interaction between customer acceptance clauses and the assessment of whether a customer has obtained control of a promised good or service, however we propose that the standard should go further to provide a clear link between customer acceptance clauses and the ability to assess whether control has been transferred to a customer on a continuous basis or at a point in time.

ED Question 4
The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

We do not support having to recognise revenue on the basis of an estimated transaction price. In addition to our concerns set out previously that this approach would be impracticable to apply by telecommunications organisations given the sheer volume of transactions and contracts, we also disagree with its conceptual underpinning. Estimating the amount an entity expects to receive from a customer, as opposed to using the minimum contracted spend, would not be reflective of an entity's pricing model. The contracted transaction price should be used as the basis to measure and record the performance obligation as this is the actual value that an entity expects in return to extinguish its performance obligation. Further, continual pricing and contract changes will make allocation percentages impracticable to maintain because of an inability of the various systems to cope (see our previous comments on this issue).

We also do not support the use of a probability-weighted average amount in determining the transaction price as this would result in revenue amounts being recognised that would not ultimately reflect reality.

ED Question 5
Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

We do not conceptually support the transaction price reflecting the customer's credit risk as we question whether conceptually the determination of credit risk at origination is applicable for individual financial assets, or whether this is only relevant for portfolios of assets evaluated on a collective basis. We would argue that if, at the individual contract level, the full value of an asset were not expected to be received, typically the contract would not be entered into. In contrast on a collective basis it is reasonable to expect that some payments will not be received, without knowing specifically which assets will not be collectable. As such we believe collectability remains an impairment assessment issue, ie an estimate of expected credit losses, either at origination or subsequent measurement, and should be accounted for via the allowance account, rather than through the recognition and measurement of individual contract revenue.

We also have significant concerns with the practicability of factoring credit risk assessments into the transaction price of contracts given the sheer volume of transactions and contracts we face. Generally trade receivables are evaluated on a collective basis and at a point in time. Typically billings and accounting systems have not been designed with the capability to determine and track credit risk and subsequent changes in credit risk for each contract nor to determine the extent to which these need to be recognised against revenue, expense or a component of income. Given that this would need to be done at an individual contract level, this would cause considerable difficulties in terms of maintaining billing systems and debtor provisioning models.

Revenue should reflect the value of our sales to customers, with any credit risk and collectability issues highlighted to users separately via bad and doubtful debts expense. The proposed change would be confusing to preparers and users, impracticable and overly complex to apply and thus involve significant costs to implement.

ED Question 6
Paragraphs 44 and 45 propose that an entity should adjust the amount of consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree, if not why?

We agree with the proposal that, if the effect is material, the amount of consideration recognised should be adjusted to reflect the time value of money.

ED Question 7
Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when or why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

We agree with this proposal. The entity's stand-alone selling price (or in the absence of, the best estimate) of the goods or services should be used to allocate transaction price to the performance obligations.

ED Question 8
Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards, an entity should recognise an asset only if those costs meet specific criteria. Do you think the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

We do not support the proposal to include guidance in a revenue recognition standard on contract costs. We believe that IAS 38 should be enhanced to include specific guidance on such costs instead.

We would also request further clarification as to whether this will be the only relevant standard under which capitalisation of these contract costs can be evaluated. The ED only lists IAS 2, IAS 16 and IAS 38 as examples of standards which can be applied to assess whether costs can be recognised as an asset, however we believe that the current IFRSs do not adequately address capitalisation of contract origination costs as they are very broad in scope and are difficult to apply in the context of these types of costs.
We also require clarity as to whether guidance in current Interpretations will continue to be able to be applied. For example, entities in the telecommunications industry incur significant expenditures in setting up and establishing business operations that result in the acquisition of various intangible rights rather than tangible assets. Specifically, the expenditures often include direct subscriber acquisition costs, which are incremental costs that are directly attributable to establishing specific subscriber contracts and would not have been incurred had those contracts

not been entered into. Australian guidance pertaining to contract origination costs is contained in Interpretation 1042 *Subscriber Acquisition Costs in the Telecommunications Industry,* which allows these costs to be recognised as an intangible asset if they are clearly identified, can be reliably measured, the costs result in future economic benefits that are controlled by the entity and it is probable the contract will be obtained. We believe these costs should continue to be able to be capitalised based on this specific criteria because of the intangible rights that are created as a result of incurring these costs. We believe that the Boards should consider providing similar guidance adaptable across all other industries.

ED Question 9
Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Further to our concerns raised in Question 8 above regarding inclusion of guidance in a revenue recognition standard with regards to contract costs, we are also concerned about the inclusion of liability measurement principles in a revenue recognition standard in relation to the measurement of onerous liabilities. We are particularly concerned that the measurement of an onerous liability under the proposal (being the 'probability-weighted' costs), will be different to the current requirements for measuring onerous provisions under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which requires provisions to be measured as the 'best estimate' of the expenditure required to settle the present obligation.

We believe the existing guidance in IAS 37, being the 'best estimate' of the expenditure required to settle the obligation, is more appropriate for measuring onerous liabilities than the proposal in the ED. We are concerned that a probability-weighted amount would result in a liability being recognised that would not ultimately reflect the amount for which the liability is settled. This is consistent with our concerns raised in Question 4 above over the use of 'probability weighted' estimates in determining transaction prices.

While paragraph 58 includes appropriate examples of costs for inclusion in an onerous liability assessment, we also believe the principle of 'unavoidable costs of meeting an obligation' as used in IAS 37, is a useful summation of the costs which should be considered in onerous liability assessments. We therefore recommend that if the guidance on costs is to be retained in the final standard on revenue recognition, this additional principle from IAS 37 should also be included.

ED Question 10
The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Overall we believe the disclosure requirements are onerous and excessive and will be impracticable to implement for many organisations. This will particularly be the case for organisations, like Telstra, with millions of customers, often with multiple low-dollar-value, high-volume recurring transactions and contracts, with the goods and services being offered constantly evolving both technologically and from a marketing perspective. Prices are constantly changing and customers are continually upgrading and downgrading their telecommunication 'bundles'. As a result, there are significant differences in individual customer contracts. Given the sheer volume of transactions and contracts, even considering our ability to potentially aggregate similar contracts, we remain concerned that the proposed disclosure requirements are inoperable.

We also believe that both the presentation and disclosure requirements of the proposed standard are inappropriate and unlikely to provide information that is understandable or useful to users. Further, we believe that the objective of the Boards proposed disclosure requirements is already being met by current accounting standard disclosure requirements.

Contract balances: the proposed standard requires a contract asset or a contract liability to be recognised when either party to a contract has performed their obligation. For disclosure a reconciliation of the movements from opening to closing balances is required of the aggregate contract asset and aggregate contract liability.

Under current requirements of IAS 11, for construction contracts using the percentage of completion method, an entity would present the gross amount due from customers as an asset and the gross amount due to a customer as a liability. Both of these are often presented as a component of inventory. For other types of contracts under the current requirements of IAS 18, entities present accrued revenue, unearned revenue or revenue received in advance as separate assets and liabilities in the statement of financial position.

The proposed changes would group each of these elements into a single contract asset and single contract liability. This means that progress billings under construction contracts, which currently form part of construction contract WIP inventory would be grouped under the proposals into an account called 'contract liability', together with other liabilities such as pre-paid phone contract revenue received in advance. Then for disclosure purposes, the movements in this contract liability would be aggregated with the movements in contract assets and disclosed on a net basis.

We do not agree that these types of assets/liabilities should be grouped and labelled as 'contract assets/liabilities' as this provides less useful information to users in relation to the nature of the assets/liabilities. Further, the disaggregation of the movements into the various categories (ie movements from amounts recognised in income arising from; (i) revenue from performance obligations satisfied during the period, (ii) revenue from allocating changes in the transaction price to performance obligations satisfied in the previous reporting period, (iii) interest revenue and expense, and (iv) foreign exchange; as well as movements relating to cash received, amounts transferred to receivables, non-cash consideration received and contracts acquired in business combinations and disposed), is excessive and would be impracticable for high volume short-term contracts. Additional difficulties arise when attempting to reconcile receivables where taxes are included in the balance, but are excluded from revenue balances. We also do not see the benefit to users in receiving information regarding the net movements in these accounts.

Practically for preparers of accounts, this disclosure would be complex, time consuming and would further complicate the financial statements. No cost benefit analysis of these disclosure requirements is contained in the Basis for Conclusions, and no thought as to how a company might practically implement this is provided. Further, these disclosures would pose considerable issues for auditors; we question the audibility of these disclosures.

We believe users will be less likely to understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers because of these changes.

Onerous contracts: In addition to the issues raised in question 9 with regard to inclusion of guidance on onerous liabilities in a revenue recognition standard, we believe the proposed disclosure requirements around onerous performance obligations are again excessive. Specifically requiring extensive disclosures about the reasons for contracts becoming onerous, combined with requirements to reconcile movements in these liabilities will be overly burdensome for preparers, particularly given that in many cases the balances will not be significant.

Significant judgements: the disclosures proposed in paragraphs 81 – 83 appear to potentially duplicate existing requirements in IAS 1. Additionally, we are concerned that complying with the level of detail proposed by these disclosure requirements would be impracticable for entities with high-volumes of revenue contracts that contain constantly evolving goods and services and that require a large number of significant judgements in determining accounting treatments and measurements. We are also concerned that the volume of information that would be disclosed as a result of complying with these proposals would be overwhelming and therefore less likely to be understandable or useful to users.

ED Question 11

The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

We disagree with the proposed maturity analysis disclosure as it would be overly burdensome for entities to track and report this information. Indeed we believe the disclosure would be inoperable for entities that have a significant number of low value and relatively short term-contracts (eg 24 month contracts), and would provide little value to users. Again, the sheer volume of information that would need to be disclosed would be overwhelming and therefore less likely to be understandable or useful to users.

We also believe current disclosures required by existing standards such as IFRS 7 *Financial Instrument Disclosures* and IAS 17 *Leases* for liquidity risk maturity analysis and future minimum lease payments respectively are sufficient, combined with the current/non current distinction presentation requirements of IAS 1 *Presentation of Financial Statements.*

ED Question 12

Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

We disagree with the proposal to disaggregate revenue into categories essentially based on risk. We believe it is more useful for users to understand the nature and significant categories of revenue in accordance with the current disclosure requirements of IAS 18.

In addition to IAS 18, IFRS 7 disclosures in relation to credit risk, credit quality of assets, age analysis and impairment already sufficiently depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors. These existing disclosures, as well as those required by IFRS 8 whereby information is disclosed to enable users to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates, are in our view sufficient.

We also believe disaggregating revenue into these risk related categories will change from period to period as the nature of risk changes and as revenue segments change. As such we would argue that this would reduce comparability from period to period and would provide information that is less useful to users than the information currently required under IAS 8, IFRS 7 and IFRS 8. We also believe that these disclosures would be impractical to implement without companies incurring significant system modification costs.

The disclosures may also be difficult to present for entities where the amount, timing and uncertainty of revenue and cash flows are affected by several factors, ie type of good/service, type of customer, type of contract, geography etc. These disclosures are often more appropriately presented by way of commentary rather than being the basis of segmenting revenue disclosures. As such we disagree with the proposed disaggregation of revenue disclosures.

ED Question 13
Do you agree that an entity should apply the proposed requirements retrospectively, if not why? Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so please explain the alternative and why you think it is better.

This standard by its very nature removes trend information and makes revenue reporting more volatile from year to year.

We do not agree with the proposal to apply the changes retrospectively. We believe there will be varying impacts across different industries and the changes may create misleading results. For example, entities with long term contracts where revenue may have previously been recognised progressively over the contract period may instead be required to defer recognition until completion of the contract. It is our understanding that retrospective application would require an adjustment to retained profits to decrease revenue previously recognised, with revenue being recognised again once the contract has been completed. We believe this would result in misleading information to users.

We also believe the changes would cause significant discrepancies between accounting and taxation numbers if we are to apply these changes retrospectively. In many jurisdictions, including in Australia, there is a high correlation between telecommunications billings and collections and revenue recognised. This will change significantly under the proposed model creating immense challenges in retrospectively accounting for the tax effects. Given the high-volume (millions) of customers, often with multiple low-dollar-value contracts, we believe that retrospective application of the proposals would be inoperable.

There will also be significant impacts for entities that previously capitalised contract costs under existing guidance, which would require a one off adjustment to expenses or retained profits, which again would be misleading for users.

We also believe the disclosure requirements would be extremely difficult to apply retrospectively to comparatives, particularly for reconciliations of contract assets and liabilities, in addition to onerous performance obligations. Further guidance is needed to show how the changes should be applied in practice.

Guidance on how to apply principles retrospectively, such as: probability weighted estimates of variable consideration and collectability of transaction prices would be required if the IASB moves forward with the impractical and onerous disclosure requirements on entities.

The proposed ED should have prospective application only, as we believe the alternative would be impracticable and that prospective application will be more readily understandable to users (subject to the disclosures being significantly reduced).

<u>ED Question 14</u>

Do you think the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

As we have flagged throughout this letter, we have significant concerns over the practical implementation issues that many organisations would face if the ED were to proceed in its current form. Indeed we are concerned that many of the proposals would be virtually inoperable for organisations with high-volume low-dollar-value contracts. The application guidance does not assist in addressing these concerns nor in making the proposals in the ED operational. We also believe further clarity is required in a number of areas, consistent with our comments made in relation to the proposed standard itself.

As noted in Question 1 above we question the principle of contract segmentation as it appears to be a duplication of other principles in the standard. This is highlighted in Example 1 in the guidance. While the example is in relation to contract segmentation, it also could be an example of how to identify separate performance obligations and allocate the transaction price. This mix of concepts is confusing and a clearer link needs to be made between these two principles.

Example 2, scenario 2 in the application guidance highlights our concerns raised in Question 1 in relation to the treatment of contract modifications. In the example revenue is distorted in the modification year because the revenue accounting is combined in the original agreement and the subsequent agreement, simply because a discount was provided to an existing customer. Not only will this provide misleading information, we believe executing this process for high volumes of contracts would be impracticable.

Section B69 – B73 of the application guidance discusses the interaction between customer acceptance clauses and the assessment of whether a customer has obtained control of a promised good or service. As highlighted in Question 3 above we propose that the standard provide a clear link between customer acceptance clauses and the ability to assess whether control has been transferred to a customer on a continuous basis or at a point in time.

Example 31 in the guidance in relation to disclosure highlights that the disclosure requirements are excessive. As discussed in Question 10 we believe complying with this level of detail would be impracticable for entities with high volumes of revenue contracts that contain constantly evolving and different sources of revenue and that require a large number of significant judgements in determining accounting treatments and measurements. We are also concerned that the volume of information that would be disclosed as a result would be overwhelming and therefore less understandable or useful to users.

Further our concerns raised in question 13 on retrospective application, we believe application guidance is required in relation to presenting disclosures retrospectively.

<u>ED Question 15</u>

The boards propose that an entity should distinguish between the following types of product warranties:

(a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

(b) A warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

We do not feel the proposed guidance in relation to warranties is sufficient and clarification is required in a number of areas. Firstly, where a warranty is provided by a party other than the seller of the product, the ED is unclear as to whether the seller is still required to recognise a refund liability for those products that are expected to be returned. It can be argued that in transferring the product to the customer that the entity has satisfied its performance obligation to transfer the product specified in the contract, however if a product is returned, it is also the responsibility of the entity to organise for the product to be replaced or repaired as required, despite the fact that the entity would not bear the cost for the replacement/repair. We suggest this issue be addressed and would argue that where the entity is not financially responsible for fulfilment of the warranty that no refund liability be recognised.

In addition, further clarity is required in how to account for warranties that cover the customer for both latent defects in addition to post-sale faults. For example, traditionally there is a 12 month warranty provided in relation to handsets which would cover the customer for latent defects, however there are proposals in Australia currently being considered which would require a 24 month warranty to be provided to customers free of charge.

As mentioned above, under normal circumstances an initial 12 month warranty would cover the customer for latent defects and a warranty in excess of 12 months would traditionally cover for post sale faults. The guidance in paragraph B18 highlights a number of factors to consider when determining the objective of the warranty, and using the first two criteria (being that the warranty is required by law and that the product could not be sold without the warranty) this would suggest the warranty is not a separate performance obligation. However the third criteria (being the length of the warranty coverage period) would suggest that this is a separate performance obligation. Difficulty therefore arises as this type of 24 month warranty would appear to cover the objectives of both types of warranties. As such, we request that further guidance be provided to cover this scenario and detail if/how the warranty should be split and accounted for.

We would suggest that this would be a common problem for many entities, and believe in many cases it may not even be possible to distinguish between repair under warranty for latent defects and repair under warranty for defects that have arisen subsequent to the sale of goods.

We also do not agree with the use of probability weighted estimates in relation to returns and refunds. As discussed in question 4, not only would this be difficult to apply but the calculation would result in overly complex amounts being recognised that would not reflect reality. Users are more concerned with the most likely amounts, particularly where there is only a discrete number of outcomes.

ED Question 16

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

We agree with the patterns of revenue recognition proposed by the Boards. This is a reasonable basis for determining revenue recognition.

ED Question 17

The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

We agree that recognition and measurement principles of the model should be applied to these transactions to ensure a consistent approach.

We do however believe further clarification is required regarding how the model would apply to revenue transactions associated with lessor accounting. In particular, in the case of sales type leases where a manufacturer/dealer relationship can be demonstrated, the current lease accounting standard permits upfront recognition of revenue from sale of equipment leased by the lessor. The proposals in this ED do not state explicitly that these classes of assets may also be de-recognised in a sale and leaseback transaction even though the transfer of control does not occur.

If the intention is to develop a single revenue recognition standard, then these situations should also be considered and guidance provided on.

ED Question 18

Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirements and why.

No comment.

We thank you for the opportunity to comment on these changes. Please contact me on +61 3 9634 6470 if you need any further explanation on the comments made in this letter.

Yours sincerely

David Anderson
Director Corporate Accounting