
TO: IASB

FROM: Francis Richard Pereira BSc FIA ACA

Date: Friday 19th June 2009

Subject: Comments on Discussion Paper (DP) Preliminary Views on Revenue Recognition in Contracts with Customers - 4 pages

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?

Answer 1

Yes.

The only area in which this may be an issue is where there is a difficulty in measuring the asset or liability that arises from the good or service that is the output of the entity's ordinary activities.

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?

Answer 2

The principle in s14 of the DP is a good one.

'S14 The boards propose that revenue should be recognised on the basis of increases in an entity's net position in a contract with a customer.'

However for financial instrument and insurance contracts – this principle should be carefully extended to allow for the uncertainty – in financial instruments and insurance businesses – with an appreciation of the relevant risk parameters eg – investment risks/parameters – ie volatility , discount rate etc and also insurance risks/parameters i.e. mortality, longevity, morbidity etc – on contracts that sometimes can run for many accounting periods. These parameters affect the 'cost' of delivering the contract over time.

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.

Answer 3

Yes. It is based on important concepts such as the 'obtaining goods or services' and 'output'.

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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.

Answer 4

Yes.

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?

Answer 5

Yes. This may help with the timing of revenue recognition and perhaps with matching to the cost of providing the good or service.

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?

Answer 6

Yes.

An issue may arise if the terms are so uncompetitive that it leads to a distortion.

For example, analysis on the historical realization of this performance obligation may indicate how much uncertainty is attached to the revenue recognition. This information may help in forming a judgment on appropriate revenue recognition.

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?

Answer 7

Yes.

The factors that may be relevant may also include:

- a) 'take up' of the incentive and
- b) methodology to defer revenue recognition and
- c) the extent and period of deferral

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.

Answer 8

Yes.

But one concern may relate to the recognition of revenue where there is significant risk of a 'failed sale' or significant uncertainty in the measurement of the resulting 'net position' in a contract (i.e. the value of the resulting asset or liability).

For example, ultimate non payment or delays in payment for goods or service may create credit problems for the entity that provides the goods or service and may concern capital providers.

Revenue recognition policy should not promote moral hazard risks that than result in cancelled sales or higher bad debt write-offs.

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.

Answer 9

No further comment. I refer to my answer to Question 2.

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?
- (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.

Answer 10

a) Yes.

- b) Yes. This will ensure that the initial expected cost is updated and this change in liability is recorded in the financial statements.
- c) No further comment – please see my answer to Question 2.
- d) No further comment – please see my answer to Question 2.

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.

Answer 11

- a) Yes. Normally this is a prudent approach and reflects actual business dynamics. The capitalisation of costs is only relevant under particular circumstances.
- b) No further comment. I refer to my asset in Question 2.

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?

Answer 12

Yes – this would be transparent and helps decision making and recognizes the relative materiality of the stand-alone performance obligations at the right time.

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?

Answer 13

Yes – to help with transparency and decision making.

Constrain use of estimates to those based on commercially validated & viable pricing (quotes, models & methodologies). Allowance for competitive imbalances may be an issue that affects the pricing of components of performance obligations.