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Ref: DAH

22 October 2010

The Technical Director  
International Accounting Standards Board

By email to: [commentletters@ifrs.org](mailto:commentletters@ifrs.org)

### **ED ED/2010/6: Revenue from Contracts with Customers**

Our comments and recommendations regarding ED/2010/6 are provided in this submission. Responses to the specific questions as requested by the IASB are provided in the attachment on pages 3-6.

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities and small to medium sized enterprises.

In summary, we hold the following views which are described further in the attachment:

- We firmly believe that financial reporting should reflect the commercial substance of a transaction as presented in contractual arrangements. We do not concur with the proposed approach to combine contracts as this treatment does not have regard to the factors which prompt delivery of performance obligations in separate legal agreements (IASB Q1). Where there are contractual terms and conditions that require all performance obligations to be delivered as anticipated before the full contract price can be demanded, a stand-alone basis for revenue recognition should not be permitted (IASB Q7).
- We consider that the discussion and requirements on credit risk are somewhat convoluted. (IASB Q5). We consider that credit risk will be addressed through the terms and conditions for contractual payments. The standard should clearly address and differentiate the reporting requirements where contractual obligations require a customer to make progress payments to fund performance



delivery and/or address credit risk (which is often prior to delivery of the performance obligation), and the recognition of revenue when a performance obligation has been completed.

- We consider that adjustments for the time value of money should only be made where a contract explicitly includes a financing component (IASB Q6).
- We consider that disclosures of remaining performance obligations should be limited to circumstances where the entity is compelled to satisfy performance obligations under an onerous contract only (IASB Q11).
- We are concerned that the discussion relating to “exclusive” and “non-exclusive” licences is not meaningful and does not anticipate how the sale/rent/lease of intellectual property might evolve in the (short-term) future. We consider that the accounting requirements for the licence of intellectual property should follow the rights and obligations described in the contract transferring rights. (IASB Q16)
- We consider that the level of detail in the nature and extent of information to be provided to users in the proposed disclosure requirements will result in “information overload” and consequently is unlikely to be useful. We do not believe that increased complexity in financial statements is in the best interests of the Australian or New Zealand economies.

Please do not hesitate to contact Dianne Azoor Hughes (email: [dianne.azoor-hughes@pitcher.com.au](mailto:dianne.azoor-hughes@pitcher.com.au) or tel: +61386105384) if you wish to discuss further any matters arising from this submission.

Yours sincerely

A handwritten signature in black ink, appearing to read "Dianne Azoor Hughes", with a long horizontal flourish extending to the right.

**S. DIANNE AZOOR HUGHES**  
Partner

## **IASB Questions for Respondents**

### ***Question 1: Principle relating to price interdependence***

We generally concur with the principle as described in paragraphs 12-19 regarding the segmentation of contracts, and contract modifications. However, we have concerns regarding the requirements to combine two or more contracts and account for them as a single contract (as described in paragraph 13). We also consider that the “substance over form” requirements of paragraph 13 are inconsistent with other international financial reporting standards, which require due consideration of the legal form of a transaction.

We firmly believe that financial reporting should reflect the commercial substance of transactions. Although contract *prices* may be interdependent, other factors in performance obligation may be significantly different. For example, where performance obligations are deliberately delivered in separate contracts to recognise differences in the risk-reward relationship, it may be inappropriate to account for them as a single contract, whether or not the criteria in paragraph 13 are met.

We consider that determination that “the contracts are negotiated as a package with a single commercial objective” (paragraph 13(b)) does not recognise the commercial reality that requires the performance obligations to be scoped into legally separate agreements.

Recommendation: The discussion in paragraph 13 should be presented as matters to be considered rather than as an explicit requirement. The financial reporting should reflect the commercial reality as presented in contractual agreements.

### ***Question 2: Principle to determine when a good or service is distinct.***

We concur with the principle as described in the draft standard.

### ***Question 3: Determining when control of a promised good or service has been transferred to a customer.***

We have no significant concerns with the proposed guidance in paragraphs 25-31. However we consider that it would be preferable to include most of this discussion as application guidance, rather than in the main body of the standard.

### ***Question 4: Estimation of transaction price***

We agree that an entity should recognise revenue on the basis of an estimated transaction price and concur with the proposed criteria in paragraph 38.

### ***Question 5: Reflection of the customer’s credit risk***

We concur with a view that revenue should not include anticipated losses but consider that the discussion around customer credit risk is somewhat convoluted.

Although it may be reasonable to presume that prices are adjusted for credit risk, credit risk is more likely to be addressed through terms and conditions of payment rather than adjustment of the contract price. For example, the size and timing of progress payments on (say) a construction contract are more likely to be required



*before* the performance obligations are completed, if the customer is considered to be a high credit risk.

Recommendation: The standard should clearly address and differentiate the reporting requirements where contractual obligations require a customer to make progress payments to fund performance delivery and/or address credit risk (which is often prior to delivery of the performance obligation), and the recognition of revenue when a performance obligation has been completed.

***Question 6: Adjustments to reflect the time value of money***

Adjustments to reflect the time value of money may be necessary for consistency with other International Financial Reporting Standards. However, we consider that the contract price and required timing for payments throughout the period of the contract implicitly reflect the time value of money as determined through the commercial negotiations to agree these issues.

Recommendation: Adjustments for the time value of money should only be made where a contract explicitly includes a financing component.

***Question 7: Allocation of transaction price to separate performance obligations in a contract in proportion to the stand-alone selling price of goods/services underlying each performance obligation***

Although we generally concur with this principle we are concerned that the requirement provides opportunity to manipulate the timing of recognition of revenues and profits. In certain circumstances, the “unbundling” of performance obligations will not recognise the synergies and efficiencies that arise through a combined product/service delivery. An arbitrary allocation based on stand-alone prices ignores the commercial basis for the transaction.

Further, entitlement to the full contract price may be dependent on fulfilment of *all* contractual obligations to completion. In some contracts the performance of all contractual obligations may not be certain in the early stages of performance delivery. Therefore a pro-rata allocation of profit based on stand-alone prices may result in revenues and profits being recognised in the early stages, and losses in the later stages of contract delivery. This requirement has the potential to ignore the commercial reality of an agreement.

Recommendation: Financial reporting should reflect the commercial substance of transactions. Where there are contractual terms and conditions that require *all* contractual obligations to be delivered as anticipated before the full contract price can be demanded, a stand-alone basis for revenue recognition should not be permitted.

***Question 8: Contract costs***

We concur with the proposed requirements on accounting for the costs of fulfilling a contract and consider that they are operational and sufficient.

***Question 9: Costs relating directly to a contract and recognition of an additional liability regarding an onerous performance obligation***

We generally concur with these proposals.

***Question 10: Help users of financial statements understand the amount, timing and uncertainty of revenues and cash flows.***

We consider that the nature and extent of information provided will result in “information overload” for users, with too much detail in extensive note disclosures. Further, where the recognition and measurement of revenues and profits is not consistent with the way a business is managed, and is not in accordance with the legal form of contractual obligations, there is scope for considerable misunderstanding of future expectations. Consequently the disclosures are unlikely to help users understanding of these issues but may contribute to confusion in the intended meaning.

***Question 11: Disclosure of remaining performance obligations beyond one year***

We consider that these disclosures are onerous. Further, where it is normal practice to modify contract prices or performance obligations as a contract proceeds, these disclosures are not necessarily meaningful.

Recommendation: Disclosures of remaining performance obligations should be limited to circumstances where the entity is compelled to satisfy performance obligations under an onerous contract only.

***Question 12: Disclosure of disaggregated revenue***

We concur with disclosures of disaggregated revenue based on the broad categories included in paragraph 74.

***Question 13: Retrospective application***

We consider that retrospective application is onerous and impracticable. Considerable work would be needed to compile data in the format required for contracts that are now completed, with minimal benefit to preparers or users.

Recommendation: The draft standard should require prospective application only.

***Question 14: Application guidance***

We consider that the application guidance is sufficient to make the proposals operational.

***Question 15: Product warranties***

We concur with the distinction between the different types of product warranties and the proposed accounting for each type.

***Question 16: Licence of intellectual property***

We generally concur with the guidance provided, although we question whether it is needed.

Following the requirement to identify and recognise intangibles in business acquisitions (in previous revisions to IFRS 3) there has been considerable activity in the legal profession in Australia to provide a legal form to support the rights attaching to an intangible. We are therefore concerned that the discussion relating to



“exclusive” and “non-exclusive” licences is not meaningful and does not anticipate how the sale/rent/lease of intellectual property might evolve in the (short-term) future.

Recommendation: The accounting requirements for the licence of intellectual property should follow the rights and obligations described in the contract transferring rights.

***Question 17: Gain or loss on sale of non-financial assets***

We concur with the proposed accounting for disposals of non-financial assets.

***Question 18: Non-public entities***

No comment