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Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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UNITED KINGDOM

Dear Hans

IASB Exposure Draft ED/2011/6 *Revenue from Contracts with Customers*

The Australian Accounting Standards Board (AASB) is pleased to provide comments on Exposure Draft ED/2011/6 *Revenue from Contracts with Customers*. In formulating these comments, the AASB sought and considered the views of Australian constituents. The comment letters received are published on the AASB's website.

Overall, the AASB supports the broad direction of the proposals outlined in the ED. In particular, the AASB supports the conclusion that contracts with customers create rights and obligations that give rise to revenue when control of promised goods or services is transferred to customers. However, the AASB believes that revenue from contracts with customers can arise beyond such a transfer and that the ways in which the proposals are framed, in relation to continuous delivery and exceptions to the principle, do not adequately acknowledge this.

The AASB is also concerned that the number of exceptions to the underlying principle in the ED indicates a lack of refinement of the principle. The AASB is particularly concerned that, unless the proposals are clarified conceptually, diversity in practice is likely to arise when unanticipated circumstances arise and the principles are not sufficiently clear to condition the judgements required. Further, the AASB would expect the Revenue from Contracts with Customers project to inform the Conceptual Framework project. In that context we would like to see a tighter logic in the forthcoming Revenue from Contracts with Customers standard that could be transferred into the *Framework*. The AASB would also expect the IASB to give high priority to considering cross-cutting issues arising from the forthcoming Leases ED, the financial instruments impairment project, and other related projects that potentially impact Revenue from Contracts with Customers. In particular, it is important the IASB ensures that the scope of each project does not inadvertently create 'gaps' in the literature, or other unintended consequences.

Consistent with our general comments above, we also have a number of concerns on specific aspects of the proposals, as summarised below and expanded on in the attachment.

Transfer of control

The AASB agrees with the principle that an entity is able to transfer control of a good or service over time. However, the AASB does not agree with the way the proposals are expressed in paragraphs 31-35 of the ED. The AASB recommends:

- clarifying the concept of control and the nature of the assets that is the subject of that control;
- elevating the criterion in paragraph 35(b)(iii) relating to the entity having a right to payment for performance completed to date to be a requirement for all performance obligations satisfied over time;
- simplifying paragraph 35(b) to require that, where the entity's performance does not create an asset with an alternative use to the entity, an entity satisfies a performance obligation and recognises revenue when the customer receives a benefit from the performance completed to date; and
- incorporating the criteria outlined in paragraph 35(b)(i) and 35(b)(ii) into the Standard either later within paragraph 35, or alternatively, as part of the Application Guidance to the Standard.

Customer credit risk

The AASB agrees with the application of IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*, if the entity has not yet adopted IFRS 9) to account for amounts of promised consideration that an entity assesses to be uncollectible because of a customer's credit risk.

In addition, the AASB agrees with recognising, as an expense, any impairment of the corresponding receivable (whether on initial recognition or subsequently) to reflect credit risk. However, the AASB does not agree with the requirement in the second sentence of paragraph 69:

If the contract does not have a significant financing component in accordance with paragraph 58, an entity shall present any impairment of the receivable (or change in the measurement of an impairment) in profit or loss as a separate line item adjacent to the revenue line item.

The AASB is of the view that an impairment of receivables (whether on initial recognition or subsequently) should be required to be presented as an impairment expense, consistent with the requirements of IFRS 7 *Financial Instruments: Disclosure*.

Variable consideration

The AASB does not agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations. The AASB recommends:

- replacing the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations with requirements based on the *Framework* criteria for the recognition of revenue;

- the requirements in paragraph 81(a) be included as *indicators* of whether the information is reliable; and
- the requirements of paragraph 82 be modified to relate to indicators that the amount of consideration to which the entity will be entitled is not able to be *reliably measured*, rather than ‘not predictive of the amount of consideration to which an entity will be entitled’.

However, if the proposals proceed, we think the intended meaning of the term ‘reasonably assured’ should be clarified.

Onerous performance obligations

The AASB does not agree with including requirements for onerous performance obligations in a standard dealing with revenue recognition. If the proposals proceed, the AASB is of the view that:

- the scope of the onerous test should be modified to apply to all material onerous contract liabilities; and
- consistent with the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an onerous contract liability should be required to be recognised at the level of a contract rather than a performance obligation.

Interim financial report disclosure

The AASB disagrees with the proposed disclosures proposed for interim financial reports. In particular, taken as a whole, the proposed disclosure requirements appear to be excessive and appear to follow a ‘rules-based’ approach to interim reporting disclosure, rather than relying on the principles already provided in IAS 34 *Interim Financial Reporting*. The AASB believes that, if the IASB considers there to be a need to amend the requirements of IAS 34, such amendments should be made by revisiting the requirements of IAS 34 as a whole and considering, at a principles-based level, the disclosures that should be required in interim financial reports.

Other comments

The AASB also has a number of concerns in relation to the following aspects of the ED:

- the application of output and input methods of measuring progress toward satisfaction of a performance obligation;
- including paragraph 28(a) as a ‘practical expedient’ for determining whether a good or service would meet the criterion in paragraph 28(b).
- providing a choice of using the expected value or most likely amount to determine the best prediction of the amount of consideration to which the entity will be entitled in a customer contract with variable consideration;

- the lack of clarity as to whether price guarantees, for example, rental guarantees for commercial or residential property sales, would be considered to be variable consideration or a separate performance obligation;
- using ‘significance’ as a criterion for when the time value of money should be reflected in the transaction price and the ‘one year’ practical expedient for assessing whether a contract has a significant financing component;
- applying a different definition of a contract to that adopted in IAS 32 *Financial Instruments: Presentation*;
- providing guidance on how to account for incremental costs of obtaining a contract; and
- the costs to preparers in meeting the extensive disclosure requirements proposed in the ED.

If you have any queries regarding any matters in this submission, please contact Nikole Gyles (ngyles@asb.gov.au).

Yours sincerely

A handwritten signature in black ink that reads "K.M. Stevenson". The signature is written in a cursive style with a long horizontal stroke at the end.

Kevin M. Stevenson
Chairman and CEO

**AASB's Specific Comments on the IASB Exposure Draft
ED/2011/6 *Revenue from Contracts with Customers***

The AASB's views on the questions in the Exposure Draft are as follows:

Question 1:

Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

The AASB agrees with the principle that an entity is able to transfer control of a good or service over time. However, the AASB does not agree with the way the proposals are expressed in paragraphs 31-35 of the ED.

The AASB is concerned that there remains a lack of clarity around the concept of control and the nature of the asset that is the subject of that control. It is not clear to us whether control is intended to be control of a specific asset, or whether the concept of control is intended to include control of a beneficial interest in an asset. This is particularly important when applying the principle of transfer of control to the recognition of revenue on a continuous basis. The AASB thinks that the principle of transfer of control of a good or service over time needs to be clarified in the Standard to help clarify the revenue recognition principle and help ensure that diversity in practice does not arise.

The lack of clarity relating to transferring control of a good or service over time is highlighted in the treatment of the right to payment for performance completed to date (paragraph 35(b)(iii)). Within the model developed in the ED, this criterion of 'right to payment' is an exception to the principle, on the basis that a right to payment for performance completed to date does not necessarily coincide with transferring control of a good or service to a customer. The AASB thinks that a right to payment for performance completed to date is a fundamental requirement for revenue recognition and should be treated as such in the Standard.

Specifically, the AASB thinks that a right to payment for performance completed to date should be elevated to be a requirement for all performance obligations satisfied over time. The AASB is concerned that application of the proposals, as currently drafted, may result in revenue being recognised without the entity having a right to payment for performance to date. Similarly, the AASB thinks that the status of the indicator in paragraph 37(a), that the entity has a present right to payment for the asset, should also be elevated for performance obligations satisfied at a point in time.

In contrast to the IASB's view in paragraph BC103 that including a right to payment as an overarching criterion could potentially obscure the revenue recognition principle, the AASB considers that such a criterion *complements* the revenue recognition principle and provides a robust basis for assessing the transfer of control of an asset to the customer.

The AASB specifically disagrees with the statement in paragraph BC103(d) that the possibility that the entity will not ultimately retain the payment for its performance is dealt with in measuring revenue. In particular, the AASB disagrees with the example in

paragraph BC103(d), in which an entity is able to recognise revenue (subject to being reasonably assured of entitlement) even though the customer is able to terminate the contract and receive a full refund of its consideration. The AASB does not think this example reflects the intention of paragraph 35(b)(iii) that the entity has a right to an amount that is intended to compensate the entity for performance to date even if the customer could terminate the contract for convenience. Indeed, the AASB thinks that a payment that is fully refundable is not a right to payment for performance. Further, the AASB considers this scenario to be analogous to a scenario in which a customer has not made any payment for performance to date and is able to terminate the contract without making any payment to the entity. The AASB considers that the recognition of revenue in such circumstances would be inappropriate.

With regards to paragraph 35(b) (relating to circumstances where the entity's performance does not create an asset with an alternative use) the AASB thinks that the principle, as outlined in paragraph 32 (that control of a promised good or service (i.e. an asset) is the customer's ability to direct the use of and obtain substantially all of the benefits of the asset) should be required for recognising revenue in *all* circumstances, including circumstances in which the entity's performance does not create an asset with an alternative use to the entity. Specifically, the AASB considers the requirement that the customer must have the ability to obtain substantially all of the remaining benefits from an asset for the customer to obtain control of it to be the critical factor to consider.

Consequently, the AASB recommends simplifying paragraph 35(b) to require that, where the entity's performance does not create an asset with an alternative use to the entity, an entity satisfies a performance obligation and recognises revenue when the customer receives a benefit from the performance completed to date.

Alternatively, paragraphs 35(a) and 35(b) could be simplified to address revenue recognition over time with no specific distinction for assets with no alternative use. Paragraph 35(a) could be clarified to include reference to an entity satisfying a performance obligation and recognising revenue when the customer receives a benefit from the performance completed to date. The criteria outlined in paragraphs 35(b)(i) and 35(b)(ii), relating to the customer simultaneously receiving and consuming benefits of the entity's performance and another entity not needing to substantially re-perform, could be incorporated as *indicators* of when the customer receives a benefit. Therefore, the AASB recommends that these indicators not be included as criteria; rather, that they be incorporated into the Standard either later within paragraph 35 or, alternatively, as part of its Application Guidance.

If the proposals proceed

If the IASB chooses not to make the amendments recommended above and the proposals proceed, the AASB is concerned that the requirements of paragraph 35(b)(ii) are either redundant or inconsistent with the key principle, expressed in paragraph 31 of the ED, that revenue is recognised when a performance obligation is satisfied by transferring control of a promised good or service to a customer. Specifically, in the AASB's view, if there are any circumstances in which the requirements of paragraph 35(b)(ii) could be met and the requirements of paragraph 35(b)(i) not also met concurrently, we would consider this outcome to be inconsistent with the revenue recognition principle.

Furthermore, if the requirements of paragraph 35(b)(ii) cannot be met without paragraph 35(b)(i) also being met, we question the need to include paragraph 35(b)(ii) as a separate criterion. To resolve this concern, the AASB recommends that the requirements of paragraph 35(b)(ii) be deleted from paragraph 35 and included as application guidance for the requirements of paragraph 35(b)(i), and thus be included as a separate paragraph below paragraph 35. It should not be included as an ‘or’ alternative in paragraph 35.

With regards to paragraph 35(b)(iii), the AASB does not think that the ED is sufficiently clear as to what the ‘right to payment for performance to date’ represents in the model. The proposals are not clear as to whether the right to payment involves a customer receiving a benefit from the performance completed to date, and whether that benefit arises from the asset itself or the rights in the contract. Although the fact that a customer is receiving a benefit is implied economically, the AASB considers that the nexus between the performance to date and the customer receiving a benefit should be explicitly clarified in paragraph 35(b)(iii). Clarifying the relationship between the customer and the right to payment in (iii) would help ensure the application of the criterion is consistent with the core principle of the Standard.

In addition, the AASB is concerned that the requirements of paragraph 35(b)(iii), as currently drafted, contradict the core revenue recognition principle, and may result in revenue recognition being driven by timing of cash payments made, rather than satisfaction of performance obligations. Specifically, the AASB is concerned that the last sentence of paragraph 35(b)(iii) may be read to require a different application of the model than is proposed in paragraphs 38-48 of the ED. The AASB recommends replacing this sentence with a cross reference to the proposals relating to ‘Measuring progress towards complete satisfaction of a performance obligation’ outlined in paragraphs 38-48.

The AASB also disagrees with the discussion relating to SOP 81-1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* in paragraph BC91. In particular, the AASB disagrees with including a statement that the concept of control in paragraph 35(a) of the ED is similar to the basis for percentage of completion accounting in accordance with paragraph 22 of SOP 81-1. The AASB considers this to be an interpretation of the requirements of superseded GAAP and considers such a reference to be inappropriate within the Basis for Conclusions of an IFRS.

Question 2:

Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer’s credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer’s credit risk and why?

The AASB agrees with the application of IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) to account for amounts of promised consideration that an entity assesses to be uncollectible because of a customer’s credit risk and considers the proposals to be a significant improvement on the proposals in ED/2010/6. The AASB specifically agrees

with revenue being recognised on a gross basis. The AASB also agrees with the requirement in the first sentence of paragraph 69:

Upon initial recognition of the receivable, any difference between the measurement of the receivable in accordance with IFRS 9 and the corresponding amount of revenue recognised being presented in profit or loss as a separate line item adjacent to the revenue line item.

In addition, the AASB agrees with recognising, as an expense, any impairment of the corresponding receivable (whether on initial recognition or subsequently) to reflect credit risk. However, the AASB does not agree with the requirement in the second sentence of paragraph 69:

If the contract does not have a significant financing component in accordance with paragraph 58, an entity shall present any impairment of the receivable (or change in the measurement of an impairment) in profit or loss as a separate line item adjacent to the revenue line item.

These presentation proposals appear to imply a nexus with current period revenue that is not valid, in particular in relation to impairments that arise in subsequent periods. The impairment expense recognised in any particular period does not necessarily relate to the revenue of that period, because different customers may be the source, respectively, of the revenue and impairments.

For example:

Entity A recognises \$100 revenue from sales of goods to Customer B in year 1. All sales are expected to be collectible. In year 2 Entity A recognises a further \$50 revenue from sales of goods to Customer C. All sales are expected to be collectible; however, Entity A has reassessed the receivable relating to sales to Customer B in year 1 and has now determined that the receivable is impaired by \$10. Other costs incurred are: Year 1 – \$10 and Year 2 – \$5. Under the proposals in the ED, Entity A’s Statement of profit and loss and other comprehensive income would be presented along the following lines:

	Year 1	Year 2
	\$	\$
Revenue	100	50
Customer credit risk	-	(10)
Other costs	(10)	(5)
Gross profit	<u>90</u>	<u>35</u>

The AASB also notes that any subsequent impairment loss is presented differently depending on whether the contract has a significant financing component. The AASB is concerned that these different accounting treatments would result in different presentation of credit losses for similar contracts.

To remedy this issue the AASB thinks impairment of receivables (whether on initial recognition or subsequently) should be presented as an impairment expense, consistent with the requirements of IFRS 7 *Financial Instruments: Disclosure*.

The AASB is also concerned that impairments of trade receivables and contract assets are not specifically identified as being an expense in the ED. If the proposals are finalised in their current form the AASB recommends at least clarifying in the Standard that such amounts are expenses rather than contra revenue amounts.

Question 3:

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

The AASB does not agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations when consideration is variable.

The AASB does not find the IASB's reasons for including this constraint on the recognition of revenue, outlined in paragraph BC198, persuasive and thinks that such a constraint on the amount of revenue that an entity would recognise for satisfied performance obligations is inappropriate in a principles-based Standard. Further, in the second sentence of paragraph BC201, we believe there is no difference between reliably estimable and reasonably assured regarding the resolution of uncertainty on the price. Both concepts relate to matters of evidence.

In addition, the AASB thinks the reference to 'constraining the cumulative amount of revenue recognised' introduces a conservative bias to the recognition of revenue. The AASB notes that the concept of 'reliability of measurement' underpins the recognition of assets, liabilities, revenue and expenses in the *Framework*, and the *Framework* is neutral in its application of the concept to those elements.

Accordingly, the AASB thinks the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations should be replaced with requirements based on the *Framework* criteria for the recognition of revenue. That is, revenue should be recognised if it is probable that any future economic benefit associated with the satisfaction of the performance obligation will flow to the entity and the amount can be measured with reliability.

The AASB suggests that in relation to variable consideration, the requirements in paragraph 81 be included as *indicators* of whether the information is reliable. In addition, the AASB suggests that the requirements of paragraph 82 be modified to relate to indicators that the amount of consideration to which the entity will be entitled is not able to be *reliably measured*, rather than 'predictive of the amount of consideration to which an entity will be entitled'.

If the proposals proceed

If the IASB chooses not to make the amendments recommended above and the proposals proceed, the AASB recommends clarifying the intended meaning of the term 'reasonably assured'. The AASB thinks this is particularly important for this term as the term has been

applied in the United States with a particular meaning, and is also applied in audit literature with a different meaning. Providing a definition or additional guidance would help ensure that diversity in practice in interpreting the term, and/or a significant number of requests for interpretation of the term to the IFRS Interpretations Committee, does not arise.

It is not clear whether the ED imposes a higher threshold for the recognition of revenue than the ‘reliable’ criterion in paragraph 4.38(b) of the *Framework*. Is ‘reasonably assured’ intended to convey a different meaning to ‘reliable’? For example, paragraph BC202(b) refers to the experience being required to be predictive of the amount of consideration to which the entity will be entitled. This criterion appears to be consistent with the concept of reliability since the *Framework* says information is reliable when it is complete, neutral and free from error (footnote to paragraph 4.38(b)).

The AASB also has concerns about the interaction of the terms ‘reasonably assured’ and ‘estimating the amount of revenue to which an entity is entitled’. Specifically, paragraph 54 of the ED refers to an entity estimating the amount to which the entity ‘will be entitled in exchange for transferring promised goods or services to a customer’. It is not clear how the requirements relating to the entity ‘estimating the amount to which it will be entitled’ and being ‘reasonably assured to be entitled’ interact. Specifically, it is unclear whether these requirements relate to different thresholds. The AASB recommends these requirements be clarified in the Standard, and further recommend that consistent language be used throughout the document to help avoid diversity in practice.

The AASB is also concerned about the relationship between ‘reasonably assured’ and a measure of probability. In paragraph BC201 it is noted that the ‘reasonably assured’ constraint is a qualitative threshold, rather than a quantitative threshold. However, paragraph BC202(a) notes in relation to paragraph 81(a) that ‘[w]ithout that experience, the *level of uncertainty* in the amount of revenue recognised would be too high for users to find that amount useful...’ [emphasis added]. The *Framework* paragraph 4.40 notes that the ‘concept of probability is used in the recognition criteria to refer to the *degree of uncertainty* that the future economic benefits associated with the item will flow to or from the entity.’ [emphasis added]. In addition, paragraph BC170 provides ‘reasonably assured’ as an example of a probability threshold.

Therefore, paragraphs BC170 and BC202(a) appear to liken the ‘reasonably assured’ threshold to a measure of probability. This appears to be inconsistent with the stated intention of the Boards reflected in paragraph BC201. If ‘reasonably assured’ is used as a probability threshold, it would seem more restrictive than the ‘probable’ threshold in paragraph 4.38(a) of the *Framework* – if so, it would introduce a conservative bias to the recognition of revenue. The arguments in paragraph BC198 are an inadequate reason for biased recognition, which conflicts with the neutrality aspect of faithful representation in the *Framework*. The AASB recommends redrafting paragraphs BC170 and BC202(a) to help avoid any confusion in relation to this issue.

The AASB also notes that there is an apparent inconsistency between the requirements to allocate the transaction price to separate performance obligations and the treatment of variable consideration. The AASB’s understanding is that in circumstances where a contract with both fixed and variable consideration has a number of separate performance obligations, the total consideration (fixed and variable) would be required to be allocated to the separate performance obligations, but the constraint on the cumulative amount of

revenue recognised means that revenue may not be able to be recognised until later in the contract on performance obligations that have been satisfied (even though the consideration relates to all performance obligations). The AASB considers this outcome does not accurately reflect the economics of such transactions or the general principle underlying the allocation of the transaction price to various performance obligations. This issue also arises in relation to the sale of non-financial assets where part or all of the consideration is not reasonably assured (see our response to question 6 below).

Furthermore, the AASB thinks that paragraph 85 is inappropriate in a principles-based Standard. The AASB does not consider the Boards' justification, outlined in paragraph BC203, referring to concerns relating to consideration based on factors outside the entity's control, to be valid in a model in which the same issues arise in relation to other types of contracts that include variable consideration (such as that illustrated in Illustrative Example 14 – *Trailing commission*, in which a different conclusion is reached for economically similar circumstances). Similarly, the AASB is also concerned that paragraph 85 refers specifically to sales-based royalties related to licences of intellectual property. Sales-based royalties also exist in other areas; primarily the extractives industry. It is not clear why economically similar sales-based royalties should be treated differently.

For these reasons, the AASB is concerned that paragraph 85, if retained in the Standard, would result in inconsistent outcomes for similar transactions both within and between entities, industries and jurisdictions.

Additional disclosure

The AASB recommends that an additional disclosure be required for unrecognised contract assets when consideration is not reasonably assured (if the 'reasonably assured' criterion is retained).

Question 4:

For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

The AASB does not agree with including requirements for onerous performance obligations in a standard dealing with revenue recognition. The AASB notes that the ED effectively proposes separate models in IFRSs for onerous contracts and onerous performance obligations. We consider the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to be sufficient to address the accounting for onerous contracts.

If the proposals proceed

If the proposals proceed, the AASB does not agree with the proposed scope of the onerous performance obligations test. The AASB specifically does not agree with the limitation of the onerous test to be obligations that the entity expects to satisfy over a period of time greater than one year.

The AASB notes that this limitation is proposed as a ‘practical expedient’ to limit the risk of unintended consequences of applying the onerous test to some performance obligations. However, the AASB questions the validity of this argument on the basis that the current requirements of IAS 37 are not limited to long-term contracts.

The AASB thinks that limiting the proposed scope of the onerous performance obligations test to greater than one year could lead to material short-term onerous performance obligations not being recognised by an entity. The AASB does not think that recognition of liabilities should be based on the amount of time between incurring and settling the liability. Rather, recognition of liabilities should be based on the principles outlined in the *Framework*, with consideration given to materiality.

The AASB also disagrees that the onerous test should be applied at the performance obligation level. The AASB believes that, consistent with the requirements of IAS 37, an onerous contract liability should be recognised at the level of a contract rather than a performance obligation. The AASB recommends modifying the scope of the onerous test to apply to all (material) onerous contract liabilities.

The AASB also questions the statement in paragraph BC205(c) that the onerous test is not a liability recognition issue because there is no new obligating event. In particular, the AASB disagrees with characterising the recognition of onerous performance obligations as a remeasurement issue. Consistent with paragraph 67 of IAS 37, the AASB is of the view that it is the onerous contract itself that gives rise to a liability. Prior to the contract being onerous, although there were rights and obligations in the contract, there is no liability. Similarly, paragraph BC19 of the ED makes it clear that the customer contract is an asset or liability depending on the relationship between the rights and obligations under the contract. Therefore, recognising an onerous performance obligation is *not* the remeasurement of an obligation previously measured at nil. Rather, it is the recognition of an element that was not previously recognised – an ‘onerous performance obligation’ – a promise within a contract whose costs to satisfy exceed the allocated amount of consideration from the customer.

It is also not clear how this test is to be applied to interim financial reports. The AASB recommends that this be clarified in the Standard.

Question 5:

The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity’s remaining performance obligations (paragraphs 119–121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)

- A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

The AASB disagrees with the proposed disclosures proposed for interim financial reports. In particular, taken as a whole, the proposed disclosure requirements appear to be excessive and appear to follow a ‘rules-based’ approach to interim reporting disclosure, rather than relying on the principles already provided in IAS 34. The AASB believes that, if the IASB considers there to be a need to amend the requirements of IAS 34, such amendments should be made by revisiting the requirements of IAS 34 as a whole and considering, at a principles-based level, the disclosures that should be required in interim financial reports.

Consistent with the AASB’s comments made to the IASB in response to the Request for Views *Agenda Consultation 2011*, the AASB considers that narrow project scopes and resulting inconsistencies have contributed to voluminous and diverse disclosures being required in IFRSs because different decisions are often made on disclosure requirements on each topic. The AASB believes that disclosure issues, including disclosures required for interim financial reports, should be considered by the IASB at a holistic level.

If the proposals proceed

If the IASB decides to retain these disclosures the AASB recommends explaining in the Basis for Conclusions how the disclosure requirements improve the quality of information being reported to users of financial reports. In particular, it thinks the IASB should explain how such disclosures achieve an appropriate balance between the benefits to users of having the information and the costs to entities to prepare and audit that information.

Question 6:

For the transfer of a non-financial asset that is not an output of an entity’s ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity’s ordinary activities? If not, what alternative do you recommend and why?

The AASB agrees that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity’s ordinary activities (subject to its concerns about the guidance on control set out in its comments on Question 1).

However, the AASB notes that for sales of non-financial assets in which part or all of the consideration is variable, the application of the 'reasonably assured' criterion may result in a loss being recognised on the derecognition of the non-financial asset, even though the contract is expected to be profitable. The AASB believes that this outcome highlights that the application of the proposals may not reflect the economics of transactions. As noted in our response to question 3 above, the AASB thinks the IASB should reconsider its proposals in relation to variable consideration.

In addition, the AASB considers that the accounting for sales-based royalties under paragraph 85 would differ greatly according to whether prepayment occurs, and would not faithfully reflect economic similarities between royalty arrangements that differ only as to timing of payment.

Other comments

Input v output methods

The AASB has a number of concerns in relation to the application of the methods, particularly the input method, for measuring progress toward satisfaction of a performance obligation, as described in paragraphs 41 and 44 of the ED.

An input method appears to result in the calculation of a constant margin on cost over the life of the performance obligation, whereas applying an output method might, depending on the circumstances, result in the calculation of an appropriate variable margin over the life of the performance obligation. For some contracts, recognising a variable margin would more faithfully represent the economics of the entity's contractual performance. Applying the criteria in paragraphs 28 and 29 of the ED for determining whether promises to provide goods or services are distinct might often result in promises to provide numerous goods and services being identified as a single performance obligation. Therefore, we think it is important for an output method to be required except when the value of output to date cannot be measured reliably.

Further, the AASB is concerned that the risk profile of a particular contract may not be reflected in the pattern of revenue recognition under an input method. For example, if an entity generates higher returns on cost for some components of a performance obligation (for example, the risks and returns on project design might greatly exceed risks and returns on construction activity or vice versa), it would not be a faithful representation to report a constant margin for the composite performance obligation if a reliable estimate can be made of the value of output to date.

Specifically, we think that the application of an input model is inconsistent with the objective of measuring progress towards satisfaction of performance obligations – that is, depicting an entity's performance. As noted in paragraph 45, there may not be a direct relationship between the entity's inputs and the transfer of control of goods or services to the customer. The AASB considers this inability to establish a direct relationship between the measure and the transfer of control to be a fundamental shortcoming of this technique in its application within the revenue recognition model proposed by the Boards.

In addition, the AASB thinks input methods should only be based on costs incurred. The AASB is of the view that labour hours expended, time elapsed and machine hours used

(referred to in paragraph 44 of the ED) are inputs to determining the proportion of total expected costs that have been incurred to date. However, costs might not vary in direct proportion to these factors (for example, because of increases over time of employee benefit rates). Therefore, using labour hours expended, time elapsed or machine hours used may cause an entity to inappropriately recognise different margins over the period of satisfying a performance obligation (that is, achieve neither the objective of an output method nor input method) and may cause inter-entity diversity in the pattern of revenue recognition. The AASB recommends removing these three examples as input methods and including them as inputs to determining the costs incurred to date.

The AASB also recommends that the Standard includes examples and guidance on how the output method is applied.

Distinct goods or services

The AASB notes that the criterion in paragraph 28(a) of the ED is specifically identified in paragraph BC74 as a practical expedient for determining whether a good or service would meet the criterion in paragraph 28(b). The AASB does not agree with referring to this as a practical expedient. Although the term ‘practical expedient’ is not defined in the ED, it appears to be a form of ‘shortcut’ that would not otherwise be available to an entity. Using the term ‘practical expedient’ to describe something that is an example of how an entity would be able to meet a criterion seems inappropriate.

Furthermore, the AASB recommends removing criterion 28(a) and relocating it to the application guidance (as an example) following paragraph 28 (or as part of the Application Guidance in Appendix B).

Variable consideration

The AASB disagrees with providing a choice of using the expected value or most likely amount to determine the best prediction of the amount of consideration to which the entity will be entitled in a customer contract with variable consideration (paragraph 55 of the ED).

The AASB thinks the Boards should decide which of those measures is the better predictor of the amount, because that assessment should not vary according to entity-specific considerations. The AASB thinks the principle of expected value, rather than the most likely amount, should be required for the reasons given in paragraphs BC81–BC83 of the IASB’s Basis for Conclusions on IASB ED/2010/6 *Revenue from Contracts with Customers*. Furthermore, the AASB notes that using expected value would not preclude using the most likely amount where the possible outcomes for an item have a normal distribution (because the measure would be the same under either approach) or in other circumstances in which any difference between the results of applying the two approaches would be immaterial.

Distinguishing between performance obligations and variable consideration

It is unclear in the ED whether price guarantees, for example, rental guarantees for commercial or residential property sales, would be considered to be variable consideration or a separate performance obligation. The AASB notes that whether such guarantees are considered to be variable consideration or a separate performance obligation will affect the timing of revenue recognition. The AASB thinks the Boards should clarify this issue to help avoid diversity in practice arising.

Time value of money

The AASB disagrees with using 'significance' as a criterion for when the time value of money should be reflected in the transaction price (paragraph 58 of the ED) and with the 'one year' practical expedient for assessing whether a contract has a significant financing component (paragraph 60 of the ED).

The AASB thinks a principles-based Standard should only use materiality as a threshold for taking into account the time value of money, assessed using judgement (to determine whether calculations should be necessary). The Standard should be sufficiently robust to cater for more inflationary periods when the time value of money might be material for financing periods of less than one year. The AASB thinks that 'one-year' could be included in the Standard as a possible example of when a contract might not have a significant financing component.

Contract definition

The AASB is concerned that introducing a different definition of a contract to the definition adopted in IAS 32 *Financial Instruments: Presentation* may result in difficulties in practice in determining whether the legal definition is met. The AASB consider that this definition is likely to require significant judgement in practice. Consideration should be given to aligning the definition of a contract in the proposals with the definition in the IAS 32.

Contract costs

As expressed in its comment letter on IASB ED/2010/6 *Revenue from Contracts with Customers*, the AASB does not agree that the Standard replacing IAS 18 *Revenue* should provide guidance on how to account for incremental costs of obtaining a contract. The AASB believes that any guidance should be provided in other, more pertinent, Standards such as IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. In addition, the AASB is concerned that the proposal in relation to the capitalisation of incremental costs of obtaining a contract is inconsistent with the criteria for recognition of costs as an asset in other guidance such as IAS 16 and IAS 38, and also with IFRIC Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine*. All of these pronouncements base recognition on probability of future economic benefits and reliable measurement, rather than whether the contract costs are 'expected to be recovered'.

Accordingly, the AASB does not agree that these proposals should result in the recognition of assets if the principles in other Standards or the *Framework* would not result in those assets being recognised. If the IASB considers that other Standards do not sufficiently deal

with contract costs, the AASB recommends that consideration be given to updating those Standards.

Extensive disclosure requirements

The AASB is concerned that the disclosure requirements are both onerous and excessive. Accordingly, the AASB believes that the costs to preparers in meeting the extensive disclosure requirements of the proposals exceed the benefits to users of providing the information. In particular we question the usefulness of the reconciliations required in paragraphs 117, 123 and 128 of the ED.