



NZ ACCOUNTING
STANDARDS
BOARD

5 March 2012

Mr Hans Hoogervorst
Chairman
The International Accounting Standards Board
30 Cannon Street
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Email:commentletters@ifrs.org

Dear Hans

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

The New Zealand Accounting Standards Board (NZASB) is pleased to submit its comments on Exposure Draft ED/2011/6 *Revenue from Contracts with Customers*. We acknowledge that the International Accounting Standards Board (IASB) has consulted extensively on these proposals and has carefully considered respondents' comments on ED/2010/6. The NZASB has consulted within New Zealand on ED/2011/6.

We support many of the proposals in ED/2011/6. Our main concerns relate to the following which are further articulated in the Appendix to this letter:

- We disagree, in principle, with the assessment of transfer of control of the asset being made primarily from the perspective of the customer. We consider that the transfer of control should be assessed from the perspective of the entity that is reporting. An assessment of control from the customer's perspective is relevant, but only insofar as it is an important indicator to assist an entity in determining whether control has been transferred.
- We disagree with the proposal that amounts assessed to be uncollectible because of a customer's credit risk be presented, initially and subsequently in the statement of comprehensive income as a separate line item adjacent to the revenue line item. Not only do we consider this item to be an expense that should be presented as such, but also the proposed presentation could give a misleading impression of the "quality" of the revenue for the current period as the uncollectible amount may relate to prior period revenue and may be made up of customer credit risks and other changes in the measurement of impairment.
- We disagree with some of the proposed disclosures both in the annual and in the interim financial reports. Overall, we consider the disclosures to be excessive.

The Appendix to this letter sets out our Responses to the *Questions for Respondents* and our comments on specific matters.

If you have any queries or require clarification of any matters in this submission, please contact Joanne Scott (joanne.scott@xrb.govt.nz) or me.

Yours sincerely

A handwritten signature in cursive script, appearing to read 'Kimberley Crook'.

Kimberley Crook
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Appendix: NZASB's Specific Comments and Responses to the *Questions for Respondents on ED/2011/6*

Comment on Specific Matters

Control and the focus on the customer

We agree with the proposed principle that an entity recognises revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (paragraph 31). However, we disagree that an asset is transferred “when (or as) the customer obtains control of that asset” (paragraph 31, emphasis added).

We disagree with the assessment of control of the asset being made primarily from the perspective of the customer. We consider that the transfer of control should be assessed primarily from the perspective of the entity. An assessment of transfer of control from the customer's perspective is relevant, but only insofar as it is one of the indicators (albeit an important one) that would support and inform an entity's assessment of whether control has been transferred. We therefore disagree with the view set out in paragraph BC86 that control should be assessed primarily from the perspective of the customer.

We consider that our views on this matter are consistent with the way in which International Financial Reporting Standards (IFRSs) are normally applied. Entities applying IFRSs are required to make judgements in applying the standards. Where judgements are required, the judgement is made by the entity reporting, using the information available to that entity. Entities may have regard to outside factors in making the assessments required by standards, but they remain the assessments of the entity.

The notion of the transfer of control is critical to an entity's assessment of whether it has satisfied its performance obligations and must recognise revenue. We do not disagree with Board's view (paragraph BC86) that in many cases both perspectives lead to the same result. In deciding that control should be assessed primarily from the perspective of the customer, the Board states that this perspective would minimise the risk of an entity recognising revenue from undertaking activities that do not coincide with the transfer of goods or services to the customer. We consider that if the customer's perspective is retained in the final Standard, the Basis for Conclusions needs to better justify why and how using the customer's perspective minimises the risk of an entity recognising revenue from undertaking activities that do not coincide with the transfer of goods or services to the customer when compared to assessing it from the entity's perspective. We consider this necessary given that the corollary (of the statement in paragraph BC86 that in many cases both perspectives lead to the same result) is that there will be cases where this may not be so.

There is also a consistency issue: parts of the ED require a customer perspective and parts require an entity perspective. We recommend that the Board adopts a consistent approach to its proposals for assessing the transfer of control of an asset and that this approach be from the perspective of the entity.

Proposed disclosures for the annual financial reports

We consider that the proposed disclosures for both annual and interim financial reports are excessive and that the proposed disclosures in annual reports should be reconsidered by the

Board. Our comments on disclosures that we consider are unnecessary or whose purpose is unclear follow.

Reconciliation of contract balances (paragraph 117)

We are not clear about the purpose of the reconciliation between the opening and closing balances of contract assets and contract liabilities. If an entity has short-term contracts that will be fulfilled in less than one year, as many entities do, the amounts in opening and closing balances would be unrelated contracts. If this reconciliation is retained we consider that it should be required only where there are significant balances of contract assets and contract liabilities that span more than one reporting period.

Performance obligations (paragraph 118)

Paragraph 118 requires a description of various aspects about an entity's performance obligations. For some entities, such as retailers where most sales are for cash, the information required by paragraph 118 would be obvious to users of the financial statements. As such, we consider that this disclosure should be required in annual financial statements only when it is "not evident from other information provided in the financial statements, including information about the nature of the entity's business".

Onerous performance obligations (paragraphs 122 to 123)

We consider that disclosure of the nature and amount of onerous performance obligations, together with the other information required by paragraph 122, should be sufficient. We consider that it is the aggregate financial impact of onerous performance obligations that is important and any further disclosures about these obligations should be clearly justified. In particular, and similar to our comments on paragraph 117, we are not clear about the purpose or usefulness of the reconciliation required by paragraph 123 (in respect of the opening and closing balances of onerous performance obligations).

Rather than the detailed reconciliation proposed by paragraph 123, the approach in paragraph 120 could be applied. An entity could be permitted to disclose the information in paragraph 122 either on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations or by using qualitative information.

Significant judgements in the application of the [draft] IFRS (paragraph 124)

The ED proposes that the disclosures in paragraph 124 be required only in annual financial statements. We agree that they should not be required in interim financial statements.

However, we consider that these disclosures about judgements should be required in annual financial statements only where these judgements have a significant effect on the amounts recognised in the financial statements. We note that IAS 1 *Presentation of Financial Statements* paragraph 122 requires disclosure of only those judgements that have the most significant effect on the amounts recognised in the financial statements and we support that approach. We note that in a retail environment, there could be very little judgement required, and hence any judgements made are unlikely to significantly affect the amounts recognised in the financial statements. We do not consider that the minimum disclosures specified in paragraph 124(a) and (b) are necessary. If retained, it should be clarified that these disclosures are required only in respect of judgements that have a significant effect on the amounts recognised in the financial statements.

Determining the transaction price and the amounts allocated to performance obligations (paragraph 127)

The information proposed to be disclosed by paragraph 127 should be required only if it is not clearly evident in the annual financial statements, and if it is necessary to achieve the disclosure objective set out in paragraph 109.

Assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128)

We consider that the proposed reconciliation in paragraph 128 is excessive. We consider that information on the closing balance of such assets would be sufficient and should be required only when this balance is significant.

Support for paragraph 112

On a more general note we support the intent of paragraph 112 which states that an entity need not disclose information in accordance with this [draft] IFRS if it has provided the information in accordance with another IFRS. We consider that this is a general disclosure principle that should be included in IAS 1.

Contract modifications

Paragraph 19 deals with contract modifications where the scope of the modification has been approved but the price has not and the entity has an expectation that the price will be approved. Paragraph 19 requires that an entity applies the proposed requirements to a contract modification when an entity has “an expectation” that the price of the modification will be approved. We disagree with this proposal and suggest that an entity should apply the proposed requirements only when both the scope and the price of the modification have been approved. We are concerned that the proposals in paragraph 19 may result in the unwarranted recognition of revenue from a price modification. Moreover, if the price that is subsequently approved differs from the one expected or estimated by the entity it is unclear how the entity would account for the adjusted transaction.

Satisfaction of performance obligations

We support the first three sentences in paragraph 32 relating to control of an asset. We consider that the fourth sentence of the paragraph which states that “The benefits of an asset are the potential cash flows that can be obtained directly or indirectly ...” [emphasis added] is relevant (and consistent with the Conceptual Framework) only if control is assessed from the perspective of the entity.

If control is assessed from the perspective of the customer as is proposed in the ED, the benefits of assets to customers are not limited to potential cash flows. The focus on cash flows ignores the retail sector where customers are end users who purchase assets for the satisfaction they will get from using or consuming the asset, not for the potential cash flows that can be obtained from the asset. None of the examples listed in paragraph 32(a) to (f) appear to be relevant to customers that are end users. This observation reinforces our earlier comments about focusing on the reporting entity rather than the customer. However, if the focus on assessing control from the perspective of the customer is retained, we suggest the fourth sentence of this paragraph be amended to read:

“The benefits of an asset include ~~the~~ potential cash flows and other benefits that can be obtained directly or indirectly...”.

A similar issue arises in paragraph 28(b). The guidance on identifying separate performance obligations appears to ignore customers that consume goods and services as end users.

Reassessments of put options

Paragraphs B43 to B48 provide guidance on the initial assessment of a put option. They require differing treatment depending upon whether the customer has a significant economic incentive to exercise its right. Our concern is that there is no discussion of subsequent assessments. For example, an entity that has previously decided that the customer does not have a significant economic incentive to exercise its rights would have accounted for the agreement similar to the sale of a product with a right of return. It is unclear what an entity would do in a subsequent period if circumstances changed and the entity then considered that the customer did have a significant economic incentive to exercise its rights.

We recommend that this section be expanded and any guidance provided on subsequent accounting for such items should be consistent or in accordance with the relevant standards, such as IAS 17 *Leases* (and its replacement) and IFRS 9 *Financial Instruments* (in the case of receivables). The discussion of IFRS 9 in paragraph 68 is an example of the type of cross-referencing to other standards that we consider would be useful in this section.

Proposed clarifications and other comments

Complexity (paragraph 35, and elsewhere)

We consider that some of the proposals are too complex for a standard that will be applied by virtually every entity that applies IFRSs. For example, paragraph 35 which deals with performance obligations satisfied over time has two criteria. Of these two criteria at least one must be met. Criterion (b) then has three further criteria, of which one must also be met. We found the embedding of criteria within criteria to be confusing and difficult to follow.

Output methods – “value to the customer” (paragraph 42)

Paragraph 42 requires that an entity, in determining the amount of revenue to recognise, shall have regard to the “value to the customer” of the entity’s performance to date. If this proposal is retained, we suggest that the Board considers including some guidance on the term “value to the customer” and some parameters for the entity to make this assessment, for example by requiring the entity to make reasonable enquiries or use information that is reasonably available to the entity.

Constraining the cumulative amount of revenue recognised (paragraphs 81-85)

Paragraphs 81-85 set out the requirements for constraining the cumulative amount of revenue recognised where the amount of consideration is variable. These paragraphs use the terms “expects to be entitled”, “reasonably assured to be entitled” and “will be entitled”. We recommend carefully reviewing the draft IFRS to ensure that the terms are consistently used in a way that enables them to be understood and, where necessary, further guidance provided. For example, what does the term “reasonably assured to be entitled” mean in relation to revenue that an entity expects to receive but which is subject to exchange fluctuations?

Paragraph 82(b) states that “the uncertainty about the amount of consideration is not expected to be resolved for a long period of time” [emphasis added]. We recommend that the Board clarifies or provides some indication of what is meant by “a long period of time”.

Determining the timing of satisfaction of performance obligations (paragraphs 125-126)

We propose the following editorial change to paragraph 125(b):

“(b) an explanation of why such methods are a faithful depiction of the transfer of control of goods and services.”

Ordinary activities (paragraph BC36)

We note the use of the term an “entity’s ordinary activities” in the context of the definition of a “customer” and the comment in paragraph BC36 that the notion is derived from the existing definitions of revenue.

Notwithstanding that ordinary activities are referred to in the IASB’s existing Conceptual Framework, we recommend that the Board provides more guidance on this term as part of further work on the conceptual framework.

NZASB's Responses to Questions for Respondents

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?

We agree with the proposal that an entity recognises revenue over time when it satisfies a performance obligation over time. In other words, we support the higher level principle of recognising revenue when a performance obligation is satisfied.

In addition, while we disagree with the focus on the customer for the purpose of determining whether the entity has lost control of the asset, we do, however, agree generally with the approach that a performance obligation is satisfied and hence revenue should be recognised when an entity transfers control of an asset to a customer. To this extent, we agree with paragraph 35(a) as a criterion for determining when a performance obligation is satisfied over time.

However, we consider that the proposal in paragraph 35(b) conflicts with the principle in paragraph 31 which requires control of the promised good or service (the asset) to be transferred to the customer before a performance obligation is considered to be satisfied. We propose that the requirements be rewritten to acknowledge that paragraph 35(b) and its sub-criteria are exceptions to the transfer of control principle outlined in paragraph 31. We believe that the control model is appropriate and workable when a performance obligation is satisfied at a point in time, but can be difficult to apply when a performance obligation is satisfied over time by performing activities as specified in the customer contract but where no asset is transferred to the customer until the completion of the contract. We therefore support including the exception in paragraph 35(b), as a means of recognising revenue when a performance obligation is satisfied over time if specified criteria are met, but believe it should be acknowledged as an exception to the control model. Alternatively, paragraph 31 could be reworded to focus on the higher-level principle that revenue is recognised when an entity satisfies a performance obligation, with the following paragraphs focusing on transfer of control of an asset as being the usual determining factor for when a performance obligation is satisfied, but also including the other situations covered in paragraph 35(b). We believe that this would make the requirements in the ED easier to follow and apply.

For example, in relation to paragraph 35(b)(iii), we agree that where an entity has a contractual right to payment for performance completed to date, it should recognise revenue. However, we consider that this proposal, as currently worded, would result in an entity recognising revenue where no asset has been transferred. This conflicts with the principle in paragraph 31 and is a clear exception to that principle. We are not disagreeing with providing such an exception, but believe that it should be identified as such.

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?

We agree with the proposal to recognise revenue at the amount that the entity expects to be entitled to. We also agree that an entity should apply IFRS 9 (or IAS 39) to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk.

The ED proposes that amounts assessed to be uncollectible because of a customer's credit risk be presented, initially and subsequently, in the statement of comprehensive income as a separate line item adjacent to the revenue line item. We disagree with this proposal for two reasons:

- (a) We consider that such a presentation may give a misleading impression of the "quality" of the revenue for the current period given that the uncollectible amounts may relate to prior period revenue and may be made up of customer credit risks or other changes in the measurement of impairment.
- (b) We consider that an impairment loss arising on contracts with customers is an expense and should be presented in the same way as similar impairment expenses in accordance with IFRS 7 *Financial Instruments: Disclosures*.

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?

We agree, in general, with the proposals in paragraphs 81-85 on constraining the cumulative amount of revenue recognised.

We have some suggestions for clarifying these proposals in our *Proposed clarifications and other comments* above.

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?

We disagree with this proposal.

We note that the proposals in the ED are focused on separate performance obligations. We acknowledge that a contract may contain one or more separate performance obligations. However, we do not consider it appropriate for an entity to recognise a liability on an expected loss on an individual performance obligation that is part of a profitable contract. To this extent, we consider that the focus of the onerous test should be at the contract level, not at the level of the individual performance obligation.

We are also concerned with the proposal to limit the onerous test to performance obligations that the entity expects at contract inception to be satisfied over a period of time greater than one year. We consider that all onerous contracts should be subject to the same recognition and measurement requirements. If the Board proceeds to distinguish between onerous performance obligations on the basis of time periods, we suggest that the distinction be between those expected to be satisfied within the current annual reporting period from those expected to be satisfied beyond the current annual reporting period.

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.

** In the IASB exposure draft, see paragraph D19 in Appendix D.*

We do not agree with the proposed disclosures for an interim financial report. We consider that the disclosures as proposed are excessive for an interim financial report.

We consider that any disclosures proposed for an interim financial report should be consistent with the disclosure objective in IAS 34 *Interim Financial Reports*. IAS 34 requires disclosures in an interim financial report to provide an update on events and transactions that are significant to an understanding of changes in financial performance or financial position since the last annual reporting period¹. As such, we consider that any proposed disclosures about contracts with customers in an interim financial report should focus on, and disclose, information about significant new contracts and significant changes in judgements or estimates relating to existing contracts. We consider that the disclosures in the interim financial report, similar to that in the annual financial report², should provide information that is necessary to assist a user to analyse the current and future performance of the entity. As currently drafted, it is unclear to us how the proposed disclosures for an interim financial report relate to the disclosure principle in IAS 34 or assist users in analysing the current and future performance of the entity.

If the Board were looking to develop a new approach to disclosures in interim reports, one option would be to require disclosure of all key aggregates required in the annual financial statements. We would expect that if this approach were to be adopted the Board would critically review all existing disclosures required in annual financial statements.

Please also see our comments under *Proposed disclosures for annual financial reports* in our Comments on Specific Matters above in relation to paragraphs 117, 122-123 and 128.

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?*

** In the IASB exposure draft, see paragraph D19 in Appendix D.*

We do not agree with the proposal 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, as currently drafted. Our main concern is at a principles level – we consider that the standard should focus on the entity reporting. (See our comments on *Control and the focus on the customer* in our Comments on Specific Matters above).

We have concerns about the proposed requirements on control as it is currently drafted in the ED. We consider that derecognition should occur when an entity loses control of an asset – not when a recipient gains control. Moreover, at a practical level, derecognition can also result from natural disasters or accidents. In both of these cases there is no recipient.

¹ As articulated in paragraphs 6, 15 and 15C of IAS 34.

² Also see our earlier comments on disclosures in the annual financial statements.