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March 13, 2012

The International Accounting Standards Board, 1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.

Dear Sirs,

# Sub: Our Comments on the Exposure Draft (ED/2011/6) Revenue from Contracts with Customers

With reference to the above, we appreciate the efforts taken by IASB for developing a single set of high quality standards for financial reporting and we believe that the above exposure draft is a step towards achieving that objective.

Our response to specific questions and proposal set out in the document containing the exposure draft is enclosed vide **Annexure A.** 

Thanking you,

Yours faithfully,

for LARSEN & TOUBRO LIMITED

Valshali P. Koparkar Joint General Manager Corporate Accounts

#### Annexure A

# Response to ED/2011/6:-Revenue from Contracts with Customers

#### **Question No. 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?

#### Our Response:

We agree with the proposal.

The criteria specified in paragraphs 35 and 36 for determining as to when an entity satisfies a performance obligation and hence, recognizes revenue over time, are appropriate and comprehensive. All other performance obligations that do not meet the criteria for being satisfied over time should be accounted for as performance obligations satisfied at a point in time.

We also agree with the view mentioned in BC94 that level of customization should not be a determinative factor when evaluating whether an asset has an alternative use or not.

We also agree that when the entity's performance does not create an asset with an alternative use to the entity and neither of the criteria in paragraphs 35(b)(i) or (ii) is met, the entity should consider whether it has a right to payment for its performance completed to date and it expects to fulfil the contract as promised in determining whether its performance transfers goods or services over time. We also agree that, in this context, it is not necessary that entity must have a present unconditional right to payment and it should suffice if right of payment exists at an agreed-upon milestone or on complete satisfaction of the performance obligation.







#### **Question No. 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) 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?

## **Our Response:**

We agree with the proposal that company should recognise revenue at the amount of consideration to which the company expects to be *entitled* (*and not receive*) as the core revenue recognition principle is about determining whether promised goods or services have been transferred to a customer. Further, it would be consistent with the accounting for a receivable, which incorporates assessments of collectibility in the measurement of that financial asset.

However, we do not agree to the proposal to present any impairment losses due to customer's credit risk as a line item adjacent to the revenue line. In case of transfer of goods and service over time, revenue is recognized based on progress measured and not on actual invoicing to customer. Accordingly, impairment losses due to customer's credit risk may relate to amounts of uncollectible consideration that was recognised as revenue in either current or previous reporting periods.

We believe that proposed guidance could result in misleading information as users may consider revenue at net level after offsetting the impairment losses pertaining to uncollectible consideration which will not be reflective of the performance of the entity. It would be inappropriate to conclude that operational performance of the entity should be subdued to the extent of non-collection of promised consideration due to customer's credit risk. The "credit risk" factor is not related to the operational performance viz. "the top line" and should not be allowed to influence the reporting of the same.

The proposed presentation may also not achieve the envisaged objective of appropriately reflecting the "uncollectible" portion of entity's revenue since impairment losses are more likely to related to earlier reporting periods and any comparison with the current period revenue and any conclusion drawn therefrom will be equally inappropriate.

Hence, in our view, impairment loss on account of customer's credit risk should be reported as a separate line item under "other expenses" (not even "operating expenses") as compared to a line item adjacent to revenue earned.







# Question No. 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?

#### **Our Response:**

Yes, we agree that the cumulative amount of revenue the entity recognizes to date should not exceed amount to which the entity is reasonably assured to be entitled.

We also agree with the proposed indicators in paragraph 82 which are sufficient to provide appropriate guidance. Many a time, the consideration agreed with the customer is on the basis of Bill-of-Quantities (BoQ) wherein the rates of items are fixed and consideration is derived based on actual quantities of material used. In such circumstances, the consideration is dependent on actual quantities of material used which is subject to certification by customer as per his pre-determined norms of measurement of work done. Hence, we suggest that one of the factors envisaged in paragraph 82(a) could also be "judgement of customer"

# Question No. 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?

#### **Our Response:**

No. We do not agree with the proposed scope of the onerous test in so far as it relates to the practical expedient of the time period of one year. In our view, the time period of more than one year seems arbitrary and it will also add to complexity as the entity will be required to





segregate all the performance obligations satisfied over time into less than and greater than one year and then apply the onerous test.

We suggest that the scope of the onerous test should be extended to all performance obligations which are satisfied over period. This is because entities subject to quarterly reporting are performing this test on a quarterly basis and the one year time period has little significance when viewed in the context of quarterly reporting. On the other hand, such practical expedient would end up complicating the existing reporting practices where performance obligations are onerous.

# Question No. 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 recognized 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.

#### **Our Response:**

We agree with the proposed disclosures (if material) regarding revenue and contracts with customers in interim financial reports. These will provide useful, detailed and meaningful information to users of financial statements. We do not foresee any additional costs as most of the information can be derived from the existing reporting systems and some of it is already part of the management information system.





#### **Question No. 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?

# **Our Response:**

Yes, we agree.

This would ensure consistency across standards and a standard measure would be applicable for transfer of assets whether or not they are an output of an entity's ordinary activities or not.

#### **Other Comments:**

# Time value for Money [Para 58]

We agree with the boards' view of adjusting the promised consideration to reflect the time value of money in instances where contracts include a significant financing element as it would result in correct representation of profit on the contract.

Para 59 has identified other factors that indicate that a contract has a financing component that is significant. As mentioned in BC 147, one of those factors refers to the typical credit terms in an industry and jurisdiction because, in some circumstances, a payment in advance or in arrears in accordance with the typical payment terms of an industry or jurisdiction may have a primary purpose other than financing.

We request board to extend the above guidance in BC 149 & 150 for advances received from customers which reflects typical payment terms of an industry or jurisdiction having primary purpose other than financing. We would like to make specific reference to the practice of payment of advances by customers in construction industry where the advance is not a part of any financing arrangement in spirit but as a matter of common trade practice in that particular line of business. Such advances are generally paid in order to assure performance in terms of quality and time rather than as a part of financing element and may not warrant determining the time value of money of the expected consideration. In view of the above, the guidance given in BC 149 and 150 should be appropriately amended to clarify that where the primary purpose of the advance is other than financing, the time value of money is not significant in the circumstances envisaged in BC 149 (c).



🕏 Larsen & Toubro Limited





# Satisfaction of performance obligation – Shipment of a product with risk of loss [IE 5]

Example 6 given under IE 5 envisages a situation where the terms of the contract are Free on Board (FoB) shipping point and yet the entity bears the risk of loss during transit based on its past business practices. This situation sounds too theoretical and has little application in practice and can be replaced with separate examples giving the application of the standard when terms of the contract are either FoB or Carriage-insurance-freight (CIF) to clarify the application of para 31-37.

An appropriate example for situation envisaged in para 37(d) (viz. transfer of control to customer with additional obligation to provide maintenance services) can also be introduced.

# Input method for goods that customer obtains control before receiving service [Para 46]

Para 46 requires an entity to recognize revenue for the transferred goods that customer obtains control of significantly before receiving service at an amount equal to the costs of those goods if following both conditions are satisfied:

- the cost of the transferred goods is significant relative to the total expected costs to completely satisfy the performance obligation; and
- the entity procures the goods from another entity and is not significantly involved in designing and manufacturing the goods.

Accordingly, IE 8 clarifies that cost of such uninstalled materials should be excluded while measuring progress towards complete satisfaction of performance obligation.

We disagree with the above proposal for following reasons:

- 1. It requires revenue and cost to be same for the specialised equipment. Accordingly, margin recognition pertaining to specialized equipment will take place based on service element of the contract which is not appropriate in our view.
- 2. The supply of specialized equipment itself may qualify as a performance obligation satisfied over time in so far as the transaction between the entity and the supplier of specialized equipment is concerned. This normally happens in cases where the supplier has right to payment for performance completed as envisaged in para 35(b)(iii). In such cases, the entity normally recognises the cost based on the progress of the contract with the supplier (as a mirror image of revenue recognised by the supplier) and such cost is incurred not at a point in time but over the period up to delivery of the specialised equipment. The application of input method in such circumstances follows the actual progress of the work ("manufacture of specialised equipment, the risk of which is borne by entity") and therefore is an appropriate measure of the entity's performance. The installation of such equipment is one more service in the bundle of promised goods or services which are accounted as a single performance obligation under para 29. Hence, we do not agree with the Boards' conclusion that recognition of contract-wide margins (proportionate based on progress of the contract) before the goods are installed leads to overstatement of the measure of entity's performance.









- 3. Even after transfer of control, the service portion of the contract requires the contractor to deal with the equipment in a manner usually associated with ownership. So segregation based on control is not fully reflective of the actual practice.
- 4. Para 46 is in conflict with para 29. As per para 29, an entity shall account for the bundle of promised goods and services as a single performance obligation if they are highly interrelated and transferring them to a customer requires that the entity also provide a significant service of integrating the goods or services into the combined item and it is not the simple installation of standard equipment [BC 79]. Hence the entire performance obligation (*incl specialized equipment in example 8*) is required to be recognized over time based on progress towards complete satisfaction of performance obligation.

Alternatively, we would propose to boards that the method envisaged in para 46 can be recommended as an option to input method in appropriate cases.





