19 June 2009

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH

Dear Sir David,

IASB Discussion Paper: Preliminary Views on Revenue Recognition in Contracts with Customers

We are pleased to respond to the IASB Discussion Paper: Preliminary Views on Revenue Recognition in Contracts with Customers.

On the whole, we are supportive of the Board’s efforts towards a single revenue recognition model to be applied to all transactions under which revenue is earned, and generally do not disagree with the theoretical interpretations that the Board has made. However, we have a number of concerns over the proposals in the discussion paper, particularly in relation to the practical implementation issues that corporates will face. These concerns include:

- Lessor accounting, and in particular the revenue recognition rules as they relate to sales-type or dealer/manufacturer arrangements, have been scoped out of both the revenue recognition and leases discussion papers. We believe that the finalisation of any new accounting standards in these areas should also include guidance on lessor accounting.
- The application of the proposed revenue allocation model as it relates to service arrangements is not practical nor provides decision-useful information. In addition, the examples in the discussion paper need to be explained further as they do not appear to be in accordance with the proposed single revenue recognition model.
- The application of the proposed revenue allocation model as it relates to high turnover, homogenous goods sold as part of a bundled arrangement may be difficult to implement where the price of those items changes on a regular basis. Significant adjustments may need to be made outside of billing systems in order to appropriately allocate revenue in accordance with the discussion paper. This is not a preferred approach.
- While we support the decision to not include any guidance in a revenue recognition standard with regards to contract origination costs, we believe that IAS 38 should be enhanced to include specific guidance on such costs.

Our comments to the specific questions outlined in the discussion paper are detailed below.

Question 1: Do you agree with the boards’ proposal to base a single revenue recognition principle on changes in an entity’s contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

We agree with the proposal to move towards a universal basis for revenue recognition. In light of the existing definition of revenue that focuses on changes in assets and liabilities, it is appropriate for revenue to be recognised on the basis of increases in an entity’s net position in a contract with its customer.
However, we do have other concerns, particularly around practical application, which are discussed in the questions below.

**Question 2** Are there any types of contracts for which the boards’ proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

We believe that the proposed revenue recognition model would not provide decision-useful information in relation to construction contracts. Performance obligations within construction contracts are more likely to be satisfied in stages warranting revenue recognition more in sync with current percentage of completion method, rather than when there is an absolute transfer of asset at the end of a project. Users would place greater emphasis on cashflows as opposed to revenue recognition in these examples. Further guidance is needed in this area.

We also believe that the requirement to break down multi-year service agreements into discrete periods (years) would not provide decision-useful information as it represents an arbitrary allocation process involving significant management judgement and estimation. It also doesn’t reflect the fact that an entity has an obligation to provide a service to its customer at any time during the contract period, regardless of when that service is estimated to be consumed by the customer or even if it is consumed. Further details of our concern in this area are contained in question 5.

Furthermore, we are concerned that lessor accounting has been scoped out of the board’s proposed model. Current Accounting Standard on leases uses the risk and rewards model. In the case of sales type leases where a manufacturer/dealer relationship can be demonstrated the lease accounting standard permits upfront recognition of revenue from sale of equipment leased by the lessor.

Given that the board’s proposed contract based model will result in a major shift from the current risk and rewards model, we believe that the IASB should determine how the proposed model would apply to lessor accounting especially since this area has also been scoped out of the discussion paper on Leases. If the intention is to develop a single revenue recognition principle, then it should be considered in relation to all contracts. While exceptions to this principle may be appropriate, this should be considered and finalised now rather than reassessing at a future date.

**Question 3** Do you agree with the boards’ definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

We agree with the proposed definition of a contract. It is consistent with the current definition under IAS 32 Financial Instruments: Presentation.

**Question 4** Do you think the boards’ proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

We support the board’s proposed definition of a performance obligation and believe that it would assist entities identify consistently the deliverables in (or components of) a contract.

However, the proposed definition comprising of “the promise within a contract to transfer assets such as goods and services” is broad and likely to pose challenges for multiple deliverable arrangements. Accordingly, we believe that the boards need to adopt a pragmatic approach in setting the scope of a performance obligation and provide appropriate guidance for application purposes. This would be of paramount importance for entities that undertake a significant number of complex transactions and tend to manage deliverables on a group, rather than on an individual, basis.

The broad nature of the definition is further highlighted in question 6.
Question 5  Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

We appreciate the Board’s efforts in only requiring an entity to separate performance obligations based on the timing of when the relevant assets are transferred to the end customer. We understand that the aim is to help simplify the application of the principle by ensuring that performance obligations within contracts are not broken down into unmanageable detail.

However, we believe that for certain transactions (e.g. those relating to provision of services), the exact timing of transfer may not be as evident. Further guidance will need to be provided to address separation of performance obligations in such instances. In particular, we are concerned with the Board’s view as to how performance obligations relating to the provision of services should be determined and revenue recognised. Our concern is highlighted in examples 2 and 4 in Appendix A of the discussion paper. In example 2, measurement of performance obligations in relation to software services is based on estimated labour costs. Example 4 allocates the transaction price to the performance obligations on the basis of warranty costs.

We do not believe that the proposal model of using estimated costs as a basis for allocating revenue to service periods is practical or provides decision-useful information for a number of reasons, including:

- It will introduce a significant level of management judgement and estimation which may not reflect reality, particularly as the timing of the costs may differ to what was originally estimated or, as in the case of warranties, may not be incurred at all even though the performance obligation has been satisfied.
  In relation to warranties, some companies maintain a pool of surplus or second-hand stock that may be used for warranty purposes. As such, no costs are incurred during the warranty period as the cost has already been incurred with the original acquisition of the stock. Using a cost-based allocation model for revenue would not be meaningful in these situations.

- The examples in the discussion paper suggest that the Board’s view is that multi-year service agreements should be separated, with each year being treated as a discrete performance obligation. However, there is no basis to suggest why one year is the appropriate unit of separation. In addition, the revenue allocated to each year is recognised evenly over that year, even if the costs may not be estimated to occur evenly over that period. As such this allocation process may not necessarily achieve the Board’s objective. You could recognise revenue in one financial period, yet your estimated costs may not occur until next financial period;

- It would be extremely onerous for companies to implement and maintain this cost information, particularly for large scale outsourcing arrangements where equipment may also be provided, as well as for homogenous performance obligations such as warranty provisions for goods.

Given these reasons, we believe that revenue from service agreements should be recognised evenly over the service period. This would be more practical to apply and better reflect the ongoing nature of the entire obligation, rather than trying to arbitrarily separate the obligation into individual periods of service that don’t exist.

More generally, we also have concerns with the practical implementation of the proposed principles on the allocation of revenue to goods that are part of a bundled arrangement. This is particularly the case for high turnover, homogenous items whose value or selling price changes regularly (e.g. mobile phones that are sold with a service contract). Developing allocation models outside of billing systems to appropriately account for these items, and then having to continually update those models due to constantly changing prices, will be extremely difficult. The Boards should explore these difficulties with corporates before issuing their exposure draft.
Question 6  
Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

We do not believe that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation. We believe that that customer's right to return gives rise to a failed sale that should be recorded as and when the transaction takes place. This is consistent with our response to question 4 requesting the boards to adopt a practical approach to determining performance obligations.

Question 7  
Do you think that sales incentives (e.g. discounts on future sales, customer loyalty points and ‘free’ goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

We agree that sales incentives give rise to performance obligations in accordance with IFRIC 13 Customer Loyalty Programmes. Awards granted to customers as part of a sales transaction are a separately identifiable component of revenue which should be deferred at the date of the initial sale and recognised only when the award is delivered to the customer.

Question 8  
Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

We agree that an entity satisfies a performance obligation when it transfers an asset to a customer. Whether this arises when a customer controls the promise depends on the definition of control and performance obligation. Chapter 4 in the discussion paper notes that typically, the customer controls the good when it takes physical possession of the good which may not always be the case. However, in Chapter 3 the proposed definition of a performance obligation is a promise in a contract to transfer an asset (such as good or a service) to that customer. Hence, the proposed definition of a performance obligation does not refer to a transfer of control and is not aligned with the current concept of control. We believe that further work needs to be undertaken to better define and clarify the notion of control as well as align the concept of control with definition of performance obligation.

Furthermore, as noted in our response to question 5, the exact timing of provision of services may not be as evident. Additional guidance will be needed to clarify separation of performance obligations pertaining to service contracts.

Question 9  
The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

In principle, the above notion of recognising revenue upon satisfaction of a performance obligation appears reasonable. Enforceable obligations are created under a contract, which are satisfied by transfer of assets or delivery of services generating revenue for an entity.

However, as noted in question 8 above, the concepts of control need to be better aligned with the definition of a performance obligation. As currently drafted, this misalignment between these two concepts may limit decision-useful information for certain contracts such as construction contracts.

Furthermore, we do not agree with the rebuttable presumption proposed in paragraph 4.56 that “an asset is used in satisfying another performance obligation in the contract is not transferred to a customer until the asset is used in satisfying that performance obligation”. We do not believe this can be applied universally to all transactions. For example, telecommunication companies may provide customers with mobile handsets as part of an access or service agreement. While the customer cannot utilise the service without an appropriate handset, they take ownership over the mobile handsets from the start and are in a position to utilise another telecommunications company as their service provider. The boards will need to consider such transactions where the proposed rebuttable presumption might prove to be inappropriate.
Question 10  
In the boards’ proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

We agree. The transaction price should be used as the basis to measure and record the performance obligation as this is the actual value that an entity expects in return to extinguish its performance obligation.

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity’s expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

We agree. A liability is defined as a present obligation, hence a performance obligation should reflect what it will actually cost an entity which may require remeasurement.

(c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.

We cannot think of any performance obligations for which the proposed measurement approach would not provide decision-useful information.

(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

In the spirit of the boards’ proposal to move towards a universal basis for revenue recognition, we believe that all performance obligations should also be subject to a uniform measurement approach.

Question 11  
The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (e.g. selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

(a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity’s performance obligations? Why or why not?

We agree. Any amount charged to customers to recover costs would form part of the actual transaction price that an entity would require in exchange for taking on performance obligations. Hence, these amounts should be included within the initial measurement of an entity’s performance obligation and not separately identified.

(b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity’s financial position and financial performance? Please provide examples and explain why.

Given that the proposed revenue recognition standard will exclude guidance on accounting for contract origination costs, we are of the opinion that capitalisation policy of such costs should be specified clearly in other accounting standards. For example, while reference may be made to IAS 38 Intangible Assets for guidance in this area, we believe that the current accounting requirements do not adequately address capitalisation of contract origination costs and would be difficult to apply in practice. We believe that IAS 38 will need to be updated to reinforce the capitalisation policy regarding such costs once the current requirements superseded by the new revenue recognition standard.
Australian guidance pertaining to contract origination costs is contained in Urgent Issues Group (UIG) 1042 Subscriber Acquisition Costs in the Telecommunications Industry. In accordance with UIG 1042 direct subscriber acquisition costs can be capitalised when they meet the definition of an asset. These direct costs are those incremental subscriber acquisition costs that are directly attributable to establishing specific subscriber contracts and would not have been incurred had those contracts not been entered into. We believe that the boards should consider providing similar guidance adaptable across all other industries.

**Question 12**  
*Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity’s stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?*

We agree. Where available, the entity’s stand-alone selling price of the goods or services should be used to allocate transaction price to the performance obligations. However, as discussed in our responses to questions 5 and 11(a), the boards need to provide an appropriate basis to allocate the transaction price which entities are able to apply in practice. This would be particularly for entities that provide services and/or are subject to high inventory turnover with constant changes in stock prices.

**Question 13**  
*Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?*

We agree. In the absence of a readily available price, an entity would have to rely on the best estimate available.

We thank you for the opportunity to comment on these changes. Please contact me on +61 3 9634 6470 if you need any further explanation on the comments made in this letter.

Yours sincerely

David Anderson  
Director Corporate Accounting