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18 June 2009

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Advance copy by electronic submission via www.iasb.org

Attention: Mr Alan Teixeira

Dear Alan

DISCUSSION PAPER PRELIMINARY VIEWS ON REVENUE RECOGNITION IN CONTRACTS WITH CUSTOMERS

1. Please find attached the Securities Commission’s submission on Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers.

2. If you wish to discuss further any of the matters raised in our submission, please contact Lay Wee Ng, Senior Accountant – Financial Reporting (lay.wee.ng@seccom.govt.nz).

Yours sincerely

Jane Diplock AO
Chairman

cc Ms Patricia McBride
Technical Director - Accounting Standards
New Zealand Institute of Chartered Accountants
PO Box 11342
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SECURITIES COMMISSION'S SUBMISSION ON DISCUSSION PAPER
PRELIMINARY VIEWS ON REVENUE RECOGNITION IN CONTRACTS WITH CUSTOMERS

General comments

1. The Securities Commission supports the work of the International Accounting Standards Board (IASB) and commends the IASB in its efforts to clarify the principles for recognising revenue. The Commission agrees that revenue is a crucial part of an entity’s financial statements. It is important for analysing the entity’s financial position and financial performance and as a basis for making economic decisions about an entity.

2. The Commission supports the proposal for a single, contract-based revenue recognition model. The Commission considers that the proposed model should improve financial reporting by providing clearer guidance for when an entity should recognise revenue, and by reducing the number of standards to which an entity has to refer for such guidance. Ensuring that entities recognise revenue consistently for similar contracts (regardless of the industry in which an entity operates) should improve the comparability and understandability of revenue for users of financial statements.

3. The Securities Commission, like other similar market regulators, has an interest in ensuring that markets receive all material and relevant information so that market participants are not misled. We consider that, in general, the proposals in the Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers (DP) will go some way to assist in this regard.

4. Our responses to the questions from the IASB Discussion Paper follow.
Responses to IASB questions

Chapter 2

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 base a single revenue recognition principle on changes in an entity’s contract asset or contract liability.

We support the use of a common principle for revenue recognition. We think that the proposal explicitly acknowledges and clarifies what is generally implicit in current standards for recognising revenue. By such an explicit statement, the proposals should ensure that there is more consistency in how entities recognise revenue.

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 consider that the proposed principle will apply generally to most contracts.

We note that in paragraph S11 of the DP, it is stated that the boards have not excluded any particular contracts with customers but have considered whether the proposed model would provide decision-useful information for some contracts including those for financial instruments and some non-financial instrument contracts that otherwise would be in the scope of standards such as IAS 39 Financial Instruments: Recognition and Measurement and SFAS 133 Accounting for Derivative Instruments and Hedging Activities.

We note that the scope of a proposed ED on revenue recognition, being focused on contracts with customers, could potentially be very broad. Given that a customer may act in different capacities in relation to a particular contract with an entity, it may be useful for the proposed ED to provide further guidance/commentary to clarify that not all contracts with customers give rise to performance obligations (and therefore revenue) and the substance of the contract, taken as a whole, should determine whether those contracts result in a financial liability, equity or revenue. We assume that the proposed ED will make it clear that a contract between an entity and its customer that arises to a financial liability (for example, a financial institution’s contract with its depositor) or to equity (for example, a cooperative company’s contract with its members/suppliers) would be scoped out of the proposed ED.

In relation to a contract between an entity and a customer that results in a financial liability that involves the transfer to the customer of the title, or rights, to an asset, as security for the financial liability, it may be useful for the proposed ED to differentiate between such a transfer and a transfer of an asset that is in satisfaction of a performance obligation.
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” as set out in paragraph 2.11 of the DP. However, the IASB may wish to consider whether, to prevent confusion, the definition of the same term in IAS 32 Financial Instruments: Presentation should be amended to be the same as the proposed definition in the DP so that only one definition of the term “contract” exists in the IFRS literature.

Chapter 3

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 consider that, in most instances, the proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract. (Please also refer to our response to Question 2.)

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 agree that an entity should separate performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer. We consider that this is will ensure consistent application of the principle that revenue is recognised when performance obligations are satisfied by the entity and when the good/service transferred to the customer.

However, we are aware that, particularly in relation to long-term construction contracts (where control of the asset as proposed in the DP is not passed on to the customer on a continuous basis), it is argued by some that an “activity-based” model (for example, percentage of completion basis) may provide more decision-useful information than the proposed “economic delivery” model for recognising revenue.

In general, we are not in favour of exceptions to a principle to account for particular transactions or to apply to different industries. To address the concerns of proponents of the activity-based model, the IASB may wish to consider whether additional disclosures should be required to be made by an entity about the stage of fulfilment of its performance obligations to enable users to receive the appropriate relevant information during the term of such long-term contracts.
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 agree that that an entity’s obligation to accept a returned good and refund the customer’s consideration is a separate performance obligation.

We consider that the entity has a performance obligation arising from the contract with the customer – a promise to refund the customer’s consideration for the returned good – and this promise is separate from the promise to transfer the good to the customer in the first instance.

Question 7
Do you think that sales incentives (eg 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 (eg 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.

Again, we consider that the entity has made separate promises (from that of the initial sale of the goods/services) to customer and separate performance obligations arise from such promises.

Chapter 4

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.

In general, we agree with the principle 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. (Please also refer to our response to Question 5.)

However, as transactions are accounted for, and financial statements are presented, from the entity’s perspective, we consider that control should be stated from the entity’s perspective. We also consider that it would be useful for the ED to clarify that the definition of “customer” be taken to include any other party specified by the customer to be the recipient of the good/service. This is because while a customer may be a party to the contract with the entity for the good/service, it may not necessarily be the recipient of the good/service. A customer who is a party to a contract may direct that the good/service be delivered to a nominated third party. An entity should be able to recognise revenue when it has fulfilled its performance obligation and transferred the asset/service to the third party. In this regard, we note that the proposed definition of “performance obligation” in paragraph 3.2 of the DP links the transfer of the asset (good/service) to “…that customer”. We think this is may be too limiting.
It would be useful if the ED clarifies that the definition of “customer” encompasses a party who is not party to the contract but who receives or obtains the asset (good/service) from the entity.

**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.

We agree that an entity should recognise revenue only when a performance obligation is satisfied.

Other than those entities involved in long-term construction contracts (see our response to Question 5), we are not aware of other contracts for which that proposal would not provide decision-useful information.

**Chapter 5**

**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?

(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?

(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.

(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.

(a) We agree that performance obligations should be measured initially at the transaction price. We consider that it is a simple and verifiable measure and will apply to most transactions that occur within an annual operating period.

(b) In principle, we consider that to be neutral, all material changes in the carrying value of performance obligations whether positive or negative should be taken into account throughout the life of a contract. However, for practical reasons (cost-benefit and simplicity), we are comfortable with the proposal that only performance obligations that are deemed onerous should be remeasured to the entity’s expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation.
(c) As stated in the DP, the proposed measurement approach may not provide decision-useful information at each financial statement date for some transactions, for example, those performance obligations arising from contracts that are long-term and/or have highly volatile prices. For those contracts, carrying the performance obligations at "cost" (transaction price) would not be useful. Notwithstanding our response to Question 10(b) above, we support an approach that would, at contract inception, measure a performance obligation at transaction price (cost) and, subsequent to contract inception, measure the performance obligation at some form of current price/fair value. This approach will provide more decision-useful information. We consider that this issue relates to the generic issue of the carrying amount of a liability in the financial statements and is not solely a revenue recognition/measurement issue. As such, we do not consider that it is inconsistent with the proposed revenue recognition model in that it does not affect the amount of revenue to be recognised or the timing of the revenue recognition.

(d) We are generally not in favour of exceptions to an agreed principle. However, as stated in our response to Question 10(c) above, it may be necessary for some performance obligations in a revenue recognition standard to be subject to another measurement approach. However, we do not consider that such an approach is necessarily inconsistent with the proposed revenue model.

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**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?

(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.

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(a) We agree with the proposal that an entity should allocate the transaction price at contract inception to the performance obligations and an entity should recognise any amounts that it charges customers to recover any costs of obtaining the contract (e.g., selling costs) as expenses, unless they qualify for recognition as an asset in accordance with other standards. We consider such an approach to be a simple, practical approach and may be less prone to manipulation of the revenue amounts in the financial statements. In addition, it is consistent with the proposed revenue recognition model as well as with existing standards.

(b) Notwithstanding our comment in Question 11(a) above, recognising contract origination costs as expenses as they are incurred may not provide decision-useful information about an entity's financial position and financial performance where such
costs paid upfront (being non-refundable) form a significant amount of the contract price. Where this is built into the contract price, allocation of the contract price to the performance obligations would not be representative of the cost or carrying value of those obligations, especially where the contract is a long-term contract and no re-measurement of those obligations are required (unless onerous). The resulting overstatement of the performance obligations may understate the profit resulting from the contract during the period of the contract.

**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 that at contract inception, 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. We consider that this is a practical approach to the measurement of the performance obligations at contract inception.

**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 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. Estimates should be constrained only if they are not representative of the expected selling price of the good or service, that is, where they are not reliable or representative of the standalone selling prices.