Dear Mr Rees

Exposure Draft: Revenue from Contracts with Customers

We welcome the opportunity to comment on the joint IASB and FASB exposure draft (ED) and support the IASB in its efforts to refine the proposals originally included in the 2010 ED on revenue recognition in order to replace the existing IAS 11 and IAS 18 whilst moving towards a truly international standard which can be adopted across the globe.

As we were generally supportive of the previous ED and had commented that with some limited amendments and guidance, particularly to explain how the “continuous transfer” approach would be used in practice for construction and service contracts, we are pleased to note that these issues have been resolved.

Our responses to the questions raised in the Exposure Draft are set out in the Appendix to this letter.

Our main concerns on the current ED surround the new proposal to amend IAS 34, and the continuing proposal to have onerous contract obligations measured at the performance obligation level and not at the contract level.

If you wish to discuss anything further please do not hesitate to contact me.

Yours sincerely

Colin D Burns
Technical Manager
Baker Tilly UK Audit LLP
IASB Exposure Draft: Revenue from Contracts with Customers, ED/2011/6
Appendix 1 - Detailed response

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?

Response:

In response to the previous ED, we noted that we would prefer to see a ‘continuous transfer’ approach as opposed to a contract driven model, however we were satisfied that with some limited amendments and guidance the control model as proposed would be a suitable basis for revenue recognition under contracts. As the IASB has now added criteria to identify when revenue can be recognised over time, this addresses our previous concerns and permits entities to recognise revenue over time when this most closely reflects the underlying economic transaction. We therefore agree with the proposal.

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?

Response:

In response to the previous ED, we disagreed with the concept that in general, customer credit risk should be included in a measure of revenue where the financing component was immaterial. We also provided examples where the financing component was material to the transaction, and so, in our opinion, revenue should be adjusted. We are pleased that the current proposals take these concerns into account and we expect the standard as current proposed will provide useful information to users.

We therefore agree with the proposals that credit risk should not be reflected in revenue where there is not a significant financing component. However, we are concerned that including a requirement (as opposed to guidance) for the inclusion of an extra line item adjacent to revenue, could add clutter as preparers would see this as a requirement and not, as paragraph BC171 notes “subject to the usual materiality considerations for line item disclosures”. Whilst we appreciate that users want to see separate information about sales and collection rates, this should only be required to be disclosed where it is material and hence, in all likelihood, would form part of the entity’s business model.

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.
IASB Exposure Draft: Revenue from Contracts with Customers, ED/2011/6
Appendix 1 - Detailed response

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?

Response:

We agree that the principle in paragraph 81 and guidance in paragraph 82 are sensible. However, paragraph 85 introduces an exception rule for income from licensing intellectual property. We do not consider this carve out is required, as the principles and guidance in paragraph 81 and 82 are clear, and we question the requirement to make industry specific rules. We encourage the board to include guidance on the recognition of income from the licensing of intellectual property as an addition to the 11 scenarios of revenue recognition listed in paragraph B1 and expanded upon in paragraphs B2 - B58 of the Application Guidance.

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?

Response:

In our previous response, we encouraged the board to consider a model which allows preparers to reflect the economic substance of a multiple element contract instead of setting a prescriptive and arbitrary methodology which may have unintended consequences. From paragraph 76 of the comment letter summary document 3A from the IASB/FASB Meeting, December 2010, we note that “almost all respondents disagreed with the boards’ proposals for an onerous performance obligation” and “most respondents were troubled that an onerous performance obligation could be recognised even though the contract as a whole is profitable”. We agree with the majority of respondents, and do not consider that the boards have provided a persuasive argument for us to change our view on this area. We consider that the onerous test should be at the contract level and do not consider that a future loss related to a performance obligation within an overall profitable contract represents a liability for an entity.

Finally, we are not convinced by the argument put forward by the IASB that it would be too complex to measure an onerous obligation at the contract level given the majority of respondents, as noted above, also consider that the onerous measurement should be at the contract level.

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).

Baker Tilly
IASB Exposure Draft: Revenue from Contracts with Customers, ED/2011/6
Appendix 1 - Detailed response

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.

Response:

We disagree with the proposal insofar as it relates to interim financial information. As the proposed disclosures are only required where material we note that IAS 34 “requires an entity to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period” and consider that this will ensure that any material change in revenue streams are captured without having to resort to additional rules based standards.

The underlying principle of IAS 34 can be found in paragraph 6: ‘The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events and circumstances and does not duplicate information previously reported.’ We consider that the list proposed by IASB duplicates information already provided in information previously reported.

We encourage the board to undertake a complete review of IAS 34 if evidence available to it indicates inadequacies in interim reporting.

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?

Response:

We agree with the proposals.