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International Accounting Standards Board 30 Cannon St., London EC4M 6XH

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Dear Sir / Madam

# <u>Preliminary Views on Revenue Recognition in Contracts with Customers</u>

The Chartered Institute of Management Accountants (CIMA) is pleased to have the opportunity to comment on this consultation. CIMA, founded in 1919, is the world's leading and largest professional body of Management Accountants, with 171,000 members and students operating at the heart of business in 165 countries. CIMA is committed to high quality, global, principle-based, neutral financial reporting standards and supports the widespread adoption of International Financial Reporting Standards.

We attach responses to the individual questions raised in the discussion paper but would like to draw your attention to some of the specific points we make.

CIMA appreciates that the IASB wishes to reduce the number of standards relevant to revenue recognition and is supportive of the board's intention to develop a single revenue recognition principle but questions whether the basis in the discussion paper produces sensible, consistent and comparable answers in all cases. We note that the IASB plans to conduct field visits and we believe these will be very important as our concerns are primarily with the practical application of the principle as opposed to a conceptual disagreement.

We are concerned with the proposal to remove the provisions of IAS 11 for the recognition of revenue for long-term contracts. We believe that the proposed changes will lead to the generation of artificial performance obligations within long-term contracts to allow revenue recognition as the project progresses.

We do not agree with the separation of the concept of control from the transfer of risks and rewards. We believe that the concept of 'risks and rewards' is integral to the control principle and the identification and evaluation of risks and rewards should be an indicator of control.

We believe that the proposed definition of performance obligations is theoretically robust however there may well be practical difficulties in its application. For instance, it would be



very difficult to allocate revenue between the supply of goods and associated warranties where there is no independent verifiable selling price for each. The only practical way might well be to use cost plus a margin and then the question arises as to what margin to use – the overall contract margin or some apportionment of the total margin based on relative perceived value. We do not believe that this is a basis for consistent application leading to decision-useful information and would question whether the benefit of reporting the information outweighs the cost of generating it.

We would be pleased to discuss with you any aspect of this letter that you may wish to raise with us.

Yours sincerely

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# Responses to the specific consultation questions:

# **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?

CIMA is generally supportive of the IASB's intention to develop a single revenue recognition principle but question whether the basis in the discussion paper would produce comparable and sensible answers in all cases. We are particularly concerned with the application of the contract asset or liability basis to long-term contract accounting.

We accept that inconsistency in existing standards is not desirable but believe that any improvement to the current position should allow for recognition of revenue based on activity for long-term contracts that span financial periods. We also do not believe that the current approach based on activity is fundamentally flawed and in need of significant improvement.

We recognise the Boards' joint desire to reduce the number of standards applicable to revenue recognition but do not consider it as necessary for international accounting standards as it appears to be for US GAAP which, according to the discussion paper, has more than a hundred sources of guidance in this area.

We would prefer a single principle but would be content to continue with two principles for revenue recognition based upon whether the contract is either long-term or short-term. Clearly the principle for long-term contracts needs to be carefully defined in terms of scope inclusion.

# **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 boards' proposed principle would not provide decision-useful information with respect to long-term construction contracts. In our view the proposed principle <u>c</u>ould lead to contracts containing artificial 'delivery' markers designed to allow revenue recognition as the contract progresses. There is a risk that these markers would not relate to any significant contract event but rather simply be suitably positioned in terms of the chronology of the project. We believe that there is a significant risk that the proposed standard will be inconsistently applied.

We would prefer that the revenue recognition methodology of IAS 11 is maintained.

# **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 are concerned with the use of the word 'enforceable' in the definition. The use of this word implies a legalistic approach which we do not believe has a place in accounting standards. What is 'enforceable' in one jurisdiction may not be 'enforceable' in another and we do not believe that similar contract arrangements should be treated differently on this basis.

In addition the definition seems imply that 'unenforceable obligations' may exist and this is not a concept that we recognise. We would prefer that the definition is revised to be 'a contract is an agreement between two or more parties that creates obligations'

# **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 believe that the proposed definition is conceptually valid however there may well be practical difficulties applying the definition. For instance, it would be very difficult to allocate revenue between the supply of goods and associated warranties when there is no independent verifiable selling price for each. The only practical way might well be to use cost plus a margin and then the question arises as to what margin to use – the overall contract margin or some apportionment of the total margin based on relative perceived value.

We do not believe that this is a basis for consistent application leading to decision-useful information and would question whether the benefit of reporting the information outweighs the cost of generating it.

#### 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.

# **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 believe that this is a performance obligation and that revenue related to a likely level of returns should be deferred based upon past experience.



# **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 believe they are a separate performance obligation and that sales incentives should be separately accounted for from the other performance obligations in a contract.

#### **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 do not agree with the separation of the concept of control from the transfer of risks and rewards. We believe that the concept of 'risks and rewards' is integral to the control principle and the identification and evaluation of risks and rewards should be an indicator of control.

# **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 believe there are contracts, such as long-term construction type contracts, for which the proposal would not consistently provide decision-useful information. We note that the IASB plans to conduct field visits and we believe it will be very important to test the practical application of the proposed principle to long-term construction type contracts.

# **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.

(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 believe that the designation 'onerous' should only be assessed at a total contract level rather than at an individual performance obligation level.

(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 are not aware 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.

We do not agree with the use of alternative measurement approaches for some performance obligations

# **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 (eg 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

(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.

We agree that contract origination costs should be accounted for as expenses unless they qualify for recognition as an asset in accordance with other standards.

# **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 this would be the ideal and preferable method but do not believe that it will always be possible. Some services, such as warranties, may not be available for standalone sale and so no separate selling prices might exist. In these cases some sort of 'cost plus a margin' approach would have to be used but the risk of inconsistent application is high. See also our reply to question 4.

# **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?

Please see our replies to questions 4 & 12.