

International Accounting Standards Board 30 Cannon Street London EC4M 6XH

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Dear Sirs

# Preliminary views on revenue recognition in contracts with customers

ACCA (Association of Chartered Certified Accountants) is pleased to have this opportunity to comment on the above discussion paper (DP). The DP was considered by ACCA's Financial Reporting Committee and I am writing to give you their views.

### Overall comments

Revenue recognition is significant to all enterprises, both as a key performance indicator and also in determining the timing of the recognition of profit and therefore of taxable profits in most cases. We therefore believe that it is important to have consistency in deriving revenue.

In principle, we support the IASB and FASB's broad objectives of developing a fully converged standard based on a single approach to the accounting for revenue. However, it is important that the principle is practicable, and does not add unnecessary complexity to the majority of transactions. It should also be the case, that a single principle can be consistently applied to reflect the economic substance of all transactions, and have a positive cost-benefit to both preparers and users. In this respect we believe that detailed field-testing of the proposals should be carried out.

The proposals in the DP, which put more emphasis on control of the assets than the transfer of risks and rewards, are clearly consistent with the general move towards using control as a basis for recognition and measurement, in IFRS. However, we are concerned that by proposing revenue recognition under contracts to be based on the transfer of assets to the control of the customer,



there could be greater importance given to legal form rather than the economic substance. This is likely to be a significant change from current practice in some cases, and could also result in an accounting treatment driving a commercial contract.

We also have concerns that the proposals could result in excessive unbundling of contracts into separate elements, adding significant and unnecessary complexity both in assessing the components and measuring them. While this is important for some contracts, we believe that it is not appropriate for many common 'elements' of goods and services, such as normal practice warranties and sales incentives to be treated as deferred revenue.

With regards measurement in general, we fully support the suggested customer consideration approach without remeasurement, as opposed to one of fair value. This will make the results more understandable and less complex to apply.

# ACCA responses to specific questions raised in the DP

A contract-based revenue recognition principle

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 certainly support the principle of a single approach to revenue recognition. This should help to ensure consistent treatment, especially for those transactions which fall near the boundaries of the requirements in different accounting categories, such as those in IAS11 and IAS18. However, it is important to ensure that by looking to resolve the issues with such boundary cases, further complexity is not added for the majority of transactions. It is important therefore, for any resulting standard to be accessible, by providing clear illustrated guidance on how terms such as 'performance obligation' is relevant to goods and service transactions in different cases.



### 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?

While we would expect the proposed principle to provide decision-useful information for most types of transactions, and indeed provide quite similar results to the current accounting, we do have concerns about its applicability to certain types of contracts. These would include consultancy service contracts and certain construction contracts where there is no continuous transfer of services or assets to the customer. Thus when the final good or service is delivered after considerable activity beforehand, revenue would only be recognised on its delivery. Similarly, certain industries could be significantly impacted by the proposals. For example software developers, who produce bespoke software, which again would not be transferred to the customer until completion. Were the customer to reject the software during the development process, the developer would not necessarily be able to sell that bespoke software to another party.

In such circumstances, while it could be argued to be a more prudent approach, we believe, not being able to recognise revenue despite having carried out much work would not provide useful information about the results for a period.

Another example where a move from the current transfer of risk and reward approach to transfer of control could cause significant change is in the extractive industries, where contracts for holding inventory (eg. crude oil on behalf of Governments) are common place. The holding company would be subject to the risk of holding the stock (eg. insurance and negative price movement) and the rewards (positive price movements). Therefore despite not having legal title they would recognise revenue for those positive price movements under current accounting, but would not be able to do so under the proposals in the DP, as they do have legal control subject to a contract.

As noted in our response to Question1, we would prefer a single principle that can be universally applied. However, we are equally aware that applying any single approach to all transactions will have practical problems in terms of the costs of preparation, compared to the additional value of the resulting information. We therefore believe it is important that field-testing is carried



across a variety of industrial and commercial sectors to see the different implications and problems that occur when trying to apply the proposals. It could be that additional guidance or explanation could be used to supplement a general principle.

### 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 not comfortable with the recognition of revenue outside contracts with customers. Indeed, the general focus of the DP is on contractual rights and obligations, and clearly these rights and obligations, typically in the form of contracts are fundamental to most companies. Much of the current literature both in the US and IFRS envisage a customer, and any transaction with a customer either explicitly or implicitly involves a contract.

We do not have any significant issues with the definition of a contract as proposed in the DP, and although we do not believe it is inconsistent with that used in IAS32, we would question the need to retain two definitions in IFRS.

We are not aware of any jurisdictions where there could be a problem in applying the definition.

Performance 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.

Although a performance obligation is similar to the current concepts of a 'deliverable', 'component' or 'element', the proposed definition in the DP appears to have a significantly wider range. The DP is suggesting that components will need to have a standalone value to the customer in order to be accounted for separately, and uses the example of legal requirements such as warranties and customary business practice. Similarly, guarantees which



currently preclude revenue recognition could also create separate performance obligations.

As we discuss in our responses to Questions 6 and 7, we have some practical issues with applying the definition of performance obligation, especially in the context of certain types of warranties and failed sales.

Therefore, while we believe that the definition itself is not unreasonable, it is essential that a final standard is able to supplement the definition with sound illustrative guidance.

### 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?

While we agree that where there are clearly separate performance obligations within a contract, these should be accounted for separately, we have significant concerns about excess unbundling of different elements of revenue in contracts.

We certainly agree with the Board that where goods and services are provided at the same point in time, there should not be a requirement to separate. We expand on our concerns in this area in our response to Question 7.

### 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?

In theory we would support rights of return being treated as a separate performance obligation, and dealt with as deferred revenue of the amount of sales that are expected to be returned.

A similar issue is that of treating a warranty as a separate performance obligation. We believe it is necessary to distinguish two types of warranty: extended warranties and those that are statutory requirements or normal practice. It is quite clear that when purchasing a consumer durable item and then purchasing an extended warranty from a shop, the customer is purchasing two separate items. The extended warranty is a separate obligation and should be accounted for as deferred revenue. In contrast, and although there are similarities, we believe that a legal (eg one year) warranty is actually a



necessary part of the sale of the good itself. It should therefore be provided for as a cost of sale in line with current practice and the requirements of IAS37, rather than as deferred revenue.

This is a difficult area, and there are subtle differences between different types of warranties returned goods and refunds. We are uncertain as to how significant an impact the proposal would have compared to current practice, and we would therefore like to see more field-testing in this area, to analyse what the impact might be.

# **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?

The approach taken to discounts on future sales and other forms of sales incentives such as customer loyalty schemes is similar to that of rights of returns. This could add significant and unnecessary complexity, compared to current practice.

Rather than treating sales incentives as deferred revenue, it seems to us the most practical route to account for them as probable costs of sales to be provided for when the main sale is recognised. Access to discounts on future sales do not seem to us a form of revenue at all, but as a sort of opportunity cost only needing to be accounted for where the contract might as a result be loss-making or onerous.

Satisfaction of performance obligations

# **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 have responded to Questions 8 and 9 together. Please see below.



### 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.

The general approach proposed is that revenue be recognised as performance obligations under contracts that are fulfilled by the transfer of the assets to the control of the customer. This seems to be putting more emphasis on the legal form than the economic substance and more emphasis on control of the assets than the transfer of their risks and rewards.

In our letter to the IASB dated 20 March 2009, responding to ED10 Consolidated Financial Statements, we raised concerns about abandoning the risk and rewards tests in SIC12. Indeed, we do not believe that risks and rewards or control are mutually exclusive, and that even in a controls based approach, analysis of risks and rewards is useful and taking this into account does provide useful information regarding the recognition of revenue.

Clearly in most cases, the current proposals are not likely to result in substantial change to current practice. However, this may not be helpful in some types of contract, where the impact could be quite significant. As we discussed in our response to Question 2, results for certain contracts, such as bespoke software, consultancy services and construction contracts, currently accounted for using a percentage-of-completion approach are likely to be significantly impacted. Similarly other contracts which currently rely on a risk and rewards model, such as inventory held by the supplier on a 'bill and hold' basis, will also be affected.

We are not aware of any major issues with the current accounting for such activities, which we believe does adequately reflect their economic substance, as opposed to accounting for revenue solely based on the pass of control, which unless stipulated in the contract, is not likely to pass until delivery of the equipment or programmes or of a completed report. All of this emphasises the need for field-testing in a wide range of cases, to ensure that the benefits of the resulting information outweigh the costs of producing that information.



Measurement of performance obligations

## 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 would agree that the transaction price would be the most appropriate initial measure for the performance obligation. Using a current exit price model, as the DP acknowledges, would add excessive complexity and there could be instances where measuring the performance obligation independent of the transaction price, could result in profits being recognised at inception, where the measurement of the rights exceed the obligations.

(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?

While the current price trigger approach is consistent with the measurement requirements in IAS37, we agree with the DP that a trigger with a margin is likely to increase frequency of remeasurement and is therefore likely to lead to unnecessary complexity for most contracts with customers.

(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.

The DP notes that certain contracts where outcomes are highly variable, due to volatile prices or significant likelihood of changes in circumstances, such as insurance contracts, leasing and certain derivative financial instruments. We agree that there could be issues with such contracts, and also note that are extensive projects underway for both leasing and insurance contracts, the results of which may need to be considered in the context of revenue recognition.



Again, any field-testing of the proposals should look at the impact on such contracts.

(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 believe the intention of the new standard is to apply a single principled approach to revenue recognition and therefore do no support the use of another measurement approach for particular performance obligations. As we previously outlined, there are likely to be instances where a single principle, either the one proposed, or another, are not likely to be practicable. However, we believe that this should be overcome by additional application guidance.

## 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?
- (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.

As mentioned in our response to Question 10(a), we agree that the transaction price should be used initially to measure the performance obligation. We therefore support also the inclusion of recovery costs, as this is essentially implicit in any contract price, and by not including this, additional measurement of the value of those recovery costs would need to be estimated.

We are note aware of any particular cases where recognising contract origination costs as expenses as they are incurred would not provide decision-useful information.



## 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 have responded to Questions 12 and 13 together. Please see below.

### 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 fully support the use of the transaction price for initial measurement of the contract asset and liability, and agree that in principle, when valuing components, this should be based on the standalone selling price of those components.

We do note however, the concerns we raised earlier about excessive unbundling into multiple components. We believe that requirements to allocate revenues on the basis of stand-alone selling prices could raise significant difficulties in practice. It may not always be possible to suitably de-consolidate a contract into components for which a readily available standalone price can be obtained without incurring unnecessary cost.

Unbundling should be kept to a minimum, only to cases where it would make a significant impact and where the good or service is clearly distinguishable.

# Other points for consideration

Appendix C of the DP outlines topics that it did not cover. Many of those topics are crucial to a final standard on revenue recognition. Together with the need to resolve the applicability of a single approach in the DP to certain contracts and to assess the practicability in terms of costs and benefits of the proposals on other contracts and industries, we believe that a further discussion paper may be needed.



If there are any matters arising from the above please be in touch with me.

Yours sincerely

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