1660-100 Comment Letter No. 192

ASSOCIATION OF INTERNATIONAL ACCOUNTANTS

Response by the Association of International Accountants to IASB Preliminary views on revenue recognition in contracts with customers discussion paper

Submitted: 26 June 2009

Introduction

These comments are submitted by the Association of International Accountants, with input from a technical committee and members of the Association. AIA would like to thank Mr Bob Greenwood for his input in this response.

About AIA

AIA is one of six statutorily Recognised Qualifying Bodies (RQBs) in the United Kingdom for statutory auditors under the Companies Act 2006. The AIA professional qualification is recognised throughout the European Union and in other major financial centres around the world.

The Association promotes and supports the advancement of the accountancy profession both in the UK and internationally. Whilst supporting international accounting and auditing standards the AIA seeks to ensure that its examinations and membership requirements support the development of the accountancy profession in the countries in which it examines.

The AIA's examinations for membership have been held half-yearly on a world wide basis for 80 years. The examinations are based on International Financial Reporting and International Auditing Standards and are complimented by a range of variant papers applicable to local tax and company law in key jurisdictions together with an optional paper in Islamic Accounting. As an RQB under the UK Companies Act 2006 the AIA offers to students who take its examinations commencing in or after June 1991 and go on as members to complete special audit-based practical training under the AIA, an accountancy qualification which is recognised by the UK Government under that Act as a recognised professional qualification for statutory auditors in the UK.

AIA members are fully professionally qualified to undertake accountancy employment in the public and private sectors.

AIA Response to Discussion Paper on Preliminary Views on Revenue Recognition in Contracts with Customers

Although the basic revenue recognition models under US GAAP and IFRS are similar, IFRS contains only two main standards on revenue recognition — IAS 11 Construction Contracts and IAS 18 Revenue which provide little application guidance, whereas over 100 different standards and other pronouncements in US GAAP address revenue recognition in specific industries or specific types of transactions. Both the IASB and FASB therefore believe that both US GAAP and IFRS can be improved by developing one global standard on revenue that provides more guidance than is currently available under IFRS and creates a single model for all revenue arrangements in place of different models for different industries and transaction types as is the case currently under US GAAP.

The key objective of this discussion paper is to develop a single, universally-applicable revenue recognition principle.

AIA supports this objective, as in a principles-based financial reporting system, it would be ambiguous to have more than one principle of what revenue represents and when it arises.

In situations where there is more than one principle, it will be necessary to distinguish between those transactions that should be accounted for using one principle and those that should be accounted for using the other; resulting in complexity and comparability issues which will be inconsistent with the key objective.

The discussion paper proposal that revenue should be recognised only when a performance obligation is satisfied could result in a significant change to existing practice, with the recognition of revenue occurring much later than at present on some construction contracts and service contracts.

AIA believe this would undermine the decision-usefulness of the information provided to users of financial statements from existing requirements.

CHAPTER 2: 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?

Question 2

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

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.

AIA agree that a single, universally applicable revenue recognition and measurement principle is desirable and conceptually preferable to having two or more different revenue recognition principles. Under existing IFRS, it is not always clear which standard should be applied and the existence of two different principles makes it difficult to find accounting solutions for issues not explicitly dealt with in either standards.

AIA does not agree that revenue should be recognised only when a performance obligation is satisfied or the revenue recognition principle should be based on changes in an entity's contract asset or contract liability; will result in decision useful information.

AIA believes revenue is a measure of activities carried out to fulfil contracts with customers and revenue arises when a contract with a customer is in place not when a performance obligation arising under a contract with a customer is satisfied.

Under the revenue recognition model proposed in the discussion paper, no revenue on construction contracts or contract for services would be recognised until the end of the contract.

In construction contracts and in the case of a contract for services when the service is delivered after a period of activity by the seller; it is these activities that should be measured and recognised as revenue.

AIA believes the financial statements would be most decision-useful if revenue were a measure of activity carried out and recognised as the entity progresses towards performance obligation fulfilment, rather than just on fulfilment or point of delivery (i.e. when control of the asset passes).

CHAPTER 3: 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.

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?

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?

Ouestion 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?

AIA agree with the proposed definition of a performance obligation and the proposals on the separation of performance obligations.

AIA further believes that the proposed definition of a performance obligation and the proposals on the separation of performance obligations will need to be supported by further guidance if entities are to be able to identify the deliverables in (or components of) a contract and apply the definition and principle in a consistent way.

For example, there is no difference conceptually between an extended warranty that has been purchased with a good and a statutory warranty that comes with the good. They are both terms of a contract and they both involve separate performance obligations.

However, the problem arises when interpreting the difference between a sale where the entity has not transferred an asset meeting the requirements of the contract in which case, should be regarded as a failed sale; and a sale with a statutory warranty attached where the warranty is later invoked in which case, should be treated as a successful sale.

Therefore AIA supports the discussion paper's proposals on the separation of performance obligations.

CHAPTER 4: 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.

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 key word here is control as the existing Framework defines an asset as a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. It follows that a resource will cease to be a particular entity's asset when that entity no longer has control of the resource.

Therefore AIA agrees that an act of performance by the customer (for example, paying the contract price) does not result in revenue being recognised because such a transaction in which an entity transfers goods to a customer as part of a sales transaction, but also grants that customer return rights means that in such circumstances does the customer actually control the goods?

CHAPTER 5: 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?
- (b) Do you agree that a performance obligation should be deemed onerous and re-measured 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.

Ouestion 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.

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?

Question 13

Do you agree that if an entity does not sell a good or service separately, it should estimate the standalone 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?

AIA agrees that on contract inception, both the contract asset and contract liability should be measured at the original transaction price and that an entity should recognise pre-contract costs and any costs involved in obtaining the contract (including commissions) as expenses as they are incurred unless they qualify for recognition as an asset in accordance with other standards.

AIA agrees with the proposal that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling price of the goods or services underlying those performance obligations.

AIA agrees with the discussion paper 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.

AIA agree that performance obligations should not be re-measured, unless they are onerous. If they are to be re-measured, this re-measurement should not affect revenue.

AIA also agree with the discussion paper's proposals on the identification and measurement of onerous performance obligations.