

3 April 2012

Our ref: ICAEW Rep 48/12

Your ref: ED/2011/6

Mr Hans Hoogervorst International Accounting Standards Board 30 Canon Street London EC4M 6XH

Dear Hans

Revenue from Contracts with Customers

ICAEW is pleased to respond to your request for comments on *Revenue from Contracts with Customers*.

Please contact me should you wish to discuss any of the points raised in the attached response.

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Yours sincerely

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ICAEW REPRESENTATION

REVENUE FROM CONTRACTS WITH CUSTOMERS

Memorandum of comment submitted in April 2012 by ICAEW, in response to IASB Exposure Draft *Revenue from Contracts with Customers* published in November 2011.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the exposure draft <u>Revenue from</u> <u>Contracts with Customers</u> published by the IASB on 14 November 2011.

WHO WE ARE

- 2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
- 3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
- 4. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

MAJOR POINTS

Support for the project

5. We have been keen supporters of the Board's project to establish a single consistent, conceptually coherent model for the recognition of revenue. We agree with the Board's instinct that it is desirable both to establish more robust principles in this area and also to move to international convergence on this important topic. We therefore urge the Board to carry this project, now largely complete in our opinion, across the finishing line.

We welcome the improvements made since the 2010 Exposure Draft

6. Although we are advocates of the project and supportive of the principles underpinning the control-based model, we did express some concern in our previous response (ICAEW REP 116/10) that the standard would not have been operable as drafted. The principles were not at that time communicated clearly enough to be applied consistently in practice. We are pleased to observe that the Board has taken note of these concerns and has produced an improved new exposure draft. We do have some specific observations on the drafting of this new ED which are explored below, but assuming these issues can be suitably addressed we feel that the Board should now move to implementation.

Revenue should not be inappropriately accelerated

7. Revenue is commonly used as a fundamental business metric, both on its own and as a major determinant in profitability. It is therefore essential that a robust regime is in operation in this area to ensure that value created is appropriately recognised while guarding against the inappropriate acceleration of revenue and profits. Overall we believe that the exposure draft strikes the right balance in this area. These

considerations are particularly relevant in relation to performance that occurs over a period and in general we feel that the exposure draft establishes acceptable principles in this area. In particular, paragraph 35 sets out a framework for determining whether or not performance is continuous that applies universally to goods and services. Indeed we believe it is crucial that a consistent approach can be applied to all sales contracts whether they are for the sale of goods or for services.

8. By establishing 'right to payment' as a key factor in determining, in cases where it is not clear whether benefit is transferred to the customer over time, whether revenue can be recognised continuously as performance progresses, the exposure draft attempts to guard against inappropriate acceleration of revenues. We welcome this and feel that this approach has the potential to operate effectively in practice. However, as currently articulated it is unfortunate that this logic appears to be communicated as a rule. This issue is discussed further in the paragraph that follows.

The importance of a clearly-articulated principles-based approach

- 9. In our view it is critical that a robust set of conceptually-coherent and clearly-articulated principles underpin the revenue recognition model so that preparers applying the standard around the world can reach broadly-consistent conclusions. In the exposure draft, the Board has indeed established a principles-based, five-step model for revenue recognition and we strongly support this focus on a principles-based approach. Unfortunately however, in a few areas, the exposure draft has replaced these principles with rules. For example, paragraph 35 (b)(iii) appears to have been drafted simply as a rule, in part because its links to the underlying principles have not been made clear. We support the approach, in cases where it is not otherwise clear whether benefit is transferred to the customer over time, of delaying recognition of revenue unless a right to payment exists. But we believe that this paragraph should make it very clear how this accounting results from the application of the underlying principles – in particular, the principle set out in paragraph 32 (control of an asset includes the ability to prevent other entities from directing the use of and obtaining the benefits from that asset), and the indicator in paragraph 37(a) (if a customer is presently obliged to pay for an asset, this indicates that the customer has obtained control of the asset). Moreover, we believe that the indicator 'right to payment' is simply that the customer is unable to avoid an obligation to pay at least for any work performed to date. In that case, it would be better to ensure the paragraph focuses on the customer's ability or inability in practice to avoid an obligation to pay. Such an approach would properly acknowledge that in a principlesbased environment surrounding facts or circumstances may be relevant when applying paragraph 35 (b) (iii). Any rewording necessary to address this point may be relatively minor, but could be essential to the consistent application of the principles on which the standard is based without the need in future for further clarification. This is discussed further in paragraphs 19-23 below.
- 10. A second example of an apparent departure from a principles-based approach can be found in paragraph 85. Here a very specific rule is established as an exception to the principle in paragraph 82. We do not believe this is an appropriate approach. We agree that constraints are appropriate in the circumstances described in paragraph 85, but we do not believe those constraints should take the form of a rule-based departure from a measurement principle. Rather, as discussed later in this response, we believe there is an associated recognition principle that should instead be brought out.
- 11. This point is important not only in the application of the continuous performance model but also in the general application and future development of the standard. We welcome the progress which the boards have jointly made in reaching a converged solution for revenue and we appreciate the scale of the achievement here, given that the US has

traditionally been accustomed to a rules-based regime for revenue recognition. The emergence of a converged standard in this area is a real boon to global comparability of financial reports and is likely to be enthusiastically welcomed by market participants. However, we are also conscious that the move to a converged platform may lead to fresh pressures on IFRS' principles-based approach and indeed such pressures may well emerge incrementally as rule-based solutions are sought to individual issues. In our opinion this must be strongly resisted and, as a firm step, we urge the Board to reset the areas we have identified above as rules into the form of principles.

Onerousness should not be assessed at the level of the individual performance obligation

12. In our response to the previous exposure draft ICAEW REP 116/10 we were opposed to the concept that onerousness be assessed at the level of the individual performance obligation. We felt that this would frequently give rise to counter-intuitive results as it is normal commercial practice in many industries to commit to individually onerous performance obligations within the confines of an overall profitable contract. We acknowledge that the scope of this requirement has now been softened but this does not address the underlying conceptual issue. In our opinion IAS 37 *Provisions, contingent liabilities and contingent assets* is adequate to address onerousness and therefore we do not agree that incremental requirements within the revenue standard are warranted.

Interaction with the leasing standard

13. We note that lease contracts will be specifically scoped out of the revenue standard. Although we agree with this exclusion, we note that this area will require careful consideration by an entity writing a composite sales contract, one part of which is in the form of a lease. These complexities are likely to be compounded by the present delay in finalisation of the new leasing standard. We suggest that the Board be mindful of entities in this situation as it works to finalise the requirements in this area. In addition, the issue of contingent income will arise in both a revenue context and a leasing context. It is important that the solutions found in those two contexts are compatible, and we encourage the Board to keep this in mind when progressing both projects.

Transitional arrangements

14. In general we agree with the transitional arrangements and agree that retrospective application should apply. We welcome the inclusion of a set of practical expedients to ease adoption. However, we have some concerns that, in some instances, entities with long-running contracts that commenced before the date of first application (given that existing system information may not necessarily indicate the commencement date for all contracts) may have difficulties in gathering all of the information necessary for retrospective application. We hope that the practical expedients listed will be adequate to provide appropriate relief in these situations but, without further research, we are unable to conclude that this will be the case. From our discussions we suggest that to provide additional relief the Board may wish to consider the deletion of the phrase 'that begin and end within the same annual accounting period' from paragraph C3a. But we also suggest that the Board should consider specifically approaching preparers for their views on the practical operation of the expedients before they are finalised.

Implications for the next revision of the IFRS for SMEs

15. We feel that the Board should be mindful, as it works to finalise the new revenue standard, of the implications for the updating of the IFRS for SMEs. We appreciate that relatively complex standards have effectively been condensed for inclusion within that document and, in theory, the clear conceptual model underpinning the present exposure draft should be well suited to such an adaptation. But there may be some important considerations to bear in mind when completing that transition in this case. For example, the application of the continuous performance model is fundamental to the operation of the standard, yet the articulation of these requirements runs over several pages. It is expected that this will be condensed for the IFRS for SMEs, but it is not clear how this can be effected or whether, ultimately, an entity applying that standard will come to the same recognition and measurement decisions as an entity applying full IFRS. These considerations are of particular importance given the pervasive nature of revenue and its relevance for almost all commercial entities. Consequently we suggest that the Board may wish to begin to consider these implications at this stage before the new standard is finalised.

The definition of 'revenue' should be revisited

16. We also have some concerns surrounding the definition of 'revenue', 'customer', and indeed of income as these terms are set out in appendix A. A detailed examination of these issues is contained in the article On the Definitions of Income and Revenue in IFRS by Professor Christopher Nobes as published in 'Accounting in Europe' Volume 9, Number 1, 2012. In particular we are concerned by the use of the term 'ordinary activities' in the definition. Because there are no 'extraordinary items' in IFRS, this term would appear to catch the income from all activities in which an entity may engage, with the result that all income would by default fall to be reported as revenue. We do not believe that this is the Board's intention and therefore suggest that the definition be revisited. In our view, there will often be an element of judgement required over how an entity determines which transactions are reported as 'top line' revenue and which as 'other income'. It is helpful for an entity to make clear in its accounting policies how this analysis is determined.

RESPONSES TO SPECIFIC QUESTIONS

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?

- 17. Differentiating between continuous performance and point in time performance is a fundamental component of the proposed revenue recognition model and an area where reaching a robust conclusion is essential. We therefore welcome the further consultation on this issue. Many commentators were critical of the lack of clarity in this area in the 2010 exposure draft and we appreciate the progress the Board has made in addressing these concerns. Nevertheless we have some reservations regarding paragraph 35, and feel that the wording of this key paragraph merits further refinement, as explained below.
- 18. ICAEW is a strong advocate of principles-based accounting standards, supported by the minimum of rules and guidance required to ensure that in practice reporting entities adopt a consistent approach to accounting for common transactions. We recognise the difficulty in this area of finding an appropriate balance between principles and rules. The previous exposure draft usefully set out a principle control to be applied to both goods and services. However, it did not supplement this with adequate guidance on how that

- principle should be applied in the context of services. Consequently, if implemented, we anticipated that it would result in confusion and an unacceptable level of diversity in practice when accounting for services.
- **19.** The position in the latest exposure draft is, in some respects, much clearer. However, we have some comments on how paragraph 35(b)(iii) has been drafted. With some clarification the paragraph does appear capable of being applied in practice. But as currently articulated it has the appearance of being a rule rather than a principle, which may not be ideal.
- 20. We think this is, in part, because the links between paragraph 35(b)(iii) and paragraphs 32 and 37(a), which discuss the principle of control, have not been made explicit. Paragraph 32 states that control of an asset refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset, including the ability to prevent other entities from directing the use of and obtaining the benefits from that asset. Paragraph 37(a) states that if a customer is presently obliged to pay for an asset, then that indicates that the customer has obtained control of the asset. We presume the logic underlying paragraph 35(b)(iii) is that the conditions described in paragraphs 32 and 37(a) are met if any 'work in progress' does not have alternative use to the seller and the seller has a right to be paid at least for performance to date.
- 21. We have considered very carefully whether this seems a reasonable conclusion. In the large majority of scenarios that we have considered, we think it is appropriate to conclude that the presence of both of these characteristics does demonstrate that the customer has control. But different views exist amongst our members over whether the presence of both characteristics is always sufficient to demonstrate that the customer has control; some believe that in the case of certain professional services, the customer does not yet have control notwithstanding the presence of both characteristics, and whether the application of the underlying principle of control is constrained unduly here by a rule.
- 22. It is essential that the final standard contains only requirements that are clear and capable of application consistent with the underlying principles. We believe that paragraph 35 broadly meets these objectives and have not identified drafting amendments that would adequately address the concern described above. Accordingly, although, subject to our further comments below, we broadly support the approach described in paragraph 35, we encourage the Board before it finalises the Standard to consider further these concerns and in particular the question of how paragraph 35(b)(iii) applies the principles and indicators already set out in paragraphs 32 and 37(a).
- 23. In respect of the detailed drafting, the current references in criterion B(iii) to a 'right to payment' for performance completed to date have caused some confusion, for example over whether merely having explicit contractual terms setting out such payments is always necessary or sufficient to establish such a right. We interpret the intention of the Board with regard to payment to be simply that the customer is unable to avoid an obligation to pay at least for any work performed to date. In that case, the payment part of the criterion may well be met if either the customer is not permitted to cancel the contract (and the seller expects to fulfil it) or the customer is permitted to cancel the contract but the terms of cancellation include a requirement to pay an amount that will always be sufficient to compensate the seller for work performed to date (although merely establishing a term in the contract will not always oblige a customer to pay in practice). If this is the Board's intention, it would be better to ensure the paragraph focuses on the customer's ability or inability in practice to avoid an obligation to pay as we suggest in our paragraph 9 above.

24. Finally, we are aware that progression through the various criteria is causing confusion to some. Specifically, some readers have read the paragraph expecting the criteria to be mutually exclusive, when in fact they are not. Although the paragraph correctly refers to 'at least one' of the criteria being met, it may be useful to state even more explicitly that the criteria are not mutually exclusive, to avoid any possible confusion.

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?

- **25.** Yes; in principle we agree that disclosing the effect of credit risk as a separate item is an appropriate presentation. The proposal is certainly a better answer than the original suggestion that a single revenue number, net of credit risk, be presented by default. We therefore agree that the effects of credit risk are best presented within costs. Disclosing the gross revenue number provides better information to users in most circumstances.
- **26.** However, we are not convinced that this disclosure should be required to be shown on the face of the income statement. IFRS 7 *Financial Instruments: Disclosures* already requires extensive credit risk disclosures and as the number may often be insignificant this disclosure could just clutter the primary statement. It is even possible that forcing a focus on this number could even lead to behavioural changes driven purely by financial reporting. In this context the Board may wish to consider EFRAG's <u>recent investigations</u> into the potential for accounting standards to have wider macro-economic effects.

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. 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?

27. Yes; we agree that the amount of revenue recognised should not exceed the amount to which the entity is reasonably assured to be entitled. We agree that 'reasonably assured' is a more appropriate threshold than 'reasonably estimated'. Nevertheless we do have some residual concerns that this provision could still lead to a pattern of recognition that is confusing in some circumstances. For example, the profile of revenue recognition may be counter-intuitive where an entity provides a service in exchange for a fixed amount of consideration(say 700) together with a contingent bonus (say 300), and that bonus is likely but not reasonably assured. In such cases, revenue will be recognised by applying the percentage of completion to the combined figure (1,000) until the 'reasonably assured' cap is reached, which will be when 70% of the service has been delivered. For the final part of service delivery (ie the final 30%), no revenue will be recognised until the bonus becomes reasonably assured – typically at or near contract completion. At present, the normal accounting in such scenarios would be to apply the percentage of completion only to the reasonably assured amount (700), which results in revenue being recognised throughout the period of service delivery, at a lower rate. Example 13 would

seem to suggest this conclusion, but as exposure draft is currently drafted it is not clear what the conclusion would be in this situation. We believe that this ambiguity should be clarified.

28. We support the Board's addition of 'the most likely amount' as an additional method of measuring variable consideration in paragraph 55. Expected value often does not give the most appropriate answer, particularly for small populations, and therefore it is useful to have an alternative here.

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?

- 29. No. In our previous response (ICAEW REP 116/10) we opposed the proposals to test for onerousness at the performance obligation level. We are appreciative of the Board's efforts to re-examine this area and acknowledge that the approach has now been softened. We also understand the Board's concerns that an onerous test is a necessary component of a revenue model in which initial measurements of performance obligations are not routinely updated. However, in our opinion the revised proposal is an unhappy compromise; introducing a requirement to make performance obligation level provisions will lead to anomalous results in many circumstances. In our opinion the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* are adequate and indeed preferable for the purpose of providing against onerous revenue contracts and we do not think these need to be extended through inclusion in this standard. We understand that the Board plans to scope revenue contracts out of IAS 37 on the introduction of the new standard and we urge the Board to reconsider this position.
- **30.** Moreover, we think both preparers and users will be confused by the different approaches that are proposed depending on the nature and timing of a contract. As we understand it, the proposals will apply as follows:
 - supply of many goods provision only for onerous contracts (via IAS 2 if the goods in inventory)
 - supply of services (and eg, construction) over more than one year provision for onerous **performance obligations**
 - supply of services (and eg, construction) over less than one year no provision
 even when onerous
- **31.** It seems to us that there is no good justification for these different approaches. There appears great potential for users to misunderstand the extent to which provision has or has not been made for loss-making contracts. If the boards are concerned not to have different requirements in the revenue standard itself, a much better solution is not to deal with this subject in the revenue standard and instead to retain the existing GAAP requirements for provisions.
- **32.** Notwithstanding our concerns above; if the Board does decide to retain the requirements as drafted, entities should at least be permitted to provide for onerous performance obligations expected to be settled within one year.

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).

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.

- 33. We do not agree that the new revenue standard should mandate specific disclosures in the interim financial statements. The contents of this document are governed by IAS 34 *Interim Financial Reporting* which limits disclosures to a specified set of explanatory notes. To the extent that this is inadequate provision is also made to require inclusion of other relevant information, but only to the extent that its 'omission would make the condensed interim financial statements misleading'. If this model is really felt to be deficient it should be reconsidered in the context of a coherent overhaul of IAS 34. To attempt to address this issue on a disparate basis as other standards are revised risks producing a regime burdened by excessive disclosure and lacking cohesive unity. In our response to ED/2010/5 (ICAEW REP 89/10) we expressed concern at the tendency for disclosure requirements to accrete in an uncoordinated fashion over time this example unfortunately serves to illustrate that point.
- 34. We are also concerned that, as currently drafted, the ED could lead to excessive disclosure in the annual accounts. We have been given the impression that the Board does not intend paragraphs 109 to 130 to represent a checklist of disclosures but, rather, that the idea is to use judgment in determining which ones are useful to users and then to provide those. We would very much support an approach based on such judgement. However, as currently drafted, we question whether the ED actually achieves this result. In particular, the drafting in paragraphs 109 and 110 gives the impression that all the disclosures listed must be provided, with judgement only permitted around the associated level of detail.

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?

35. Yes; we agree that the principles proposed for the new revenue standard should be extended to encompass the situations referred to above.

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APPENDIX

SUGGESTED DRAFTING IMPROVEMENTS

In addition to the answers to the specific questions we provide above, in the table below we have included additional drafting points on the text of the standard which the Board may wish to consider.

Paragraph	Observation
6	It would be useful to expand on the application of the portfolio approach, for example by including an example in this area.
10	Suppliers could also usefully be referred to here. It would be particularly useful to consider the treatment where goods are 'sold' back to a supplier – e.g. where a supplier accepts a return of goods and refunds the price originally paid. We do not believe such a transaction should generate revenue for the entity returning the goods.
20	This appears to create a bright line difference with other modifications. It would perhaps be better instead to include these modifications within paragraph 22.
22 (a)	The last sentence of this sub-paragraph may be too broad and therefore may have unintended consequences.
	For example; if there is unsettled variable consideration relating to goods already supplied, then this should presumably still be allocated to the supplied goods.
	Separately, if we imagine that one part of a bundle of goods and services is the supply of telephone line rental for 12 months, and that has been treated as a single performance obligation for which revenue is recognised over time, it would appear that, if the contract was modified after 7 months, sub-paragraph 22(a) would still apply for the line rental – i.e. the remaining 5 months still to be supplied would be distinct, even though it wasn't analysed as a separate performance obligation before. Although we agree that this is the right answer, and believe that the current drafting supports this, the paragraph could be read ambiguously and we are concerned that consistent answers may not be reached in this area. Perhaps the wording could be made clearer.
22 (c)	We note that in situations where an entity has a combination of modifications under 22 (a) and (b), this paragraph does not specify how the changes should be allocated between them. We believe that the answer is that judgement should be used, and agree that this is appropriate, but that could be made explicit to avoid confusion.
25	This paragraph appears to provide a definitive answer that in the specified situation set-up activities are not a performance obligation. We question whether it is appropriate to conclude so definitely here. These concerns also affect Example 15.
26 (d)	In some situations standing ready to do something may not in itself be a service; indeed in many cases it would be most inappropriate to see it as such. For example a customer may have a voucher for a cup of coffee and be entitled to come in any time to claim it. In this situation we would only expect revenue to be recognised for the coffee itself, not for standing ready to supply it. Also, we question why software has been indicated an example. We suspect this is only intended to be applied narrowly – and wonder whether it should have some warning words or guidance added. We note that B4 does acknowledge this problem, but only in one specific context. We suggest the Board explores whether to limit 'standing ready' as a service to scenarios in which the amount of future goods or services

to which the customer is entitled is unaffected by the extent to which the customer has already chosen to demand goods or services (e.g. membership of a health club that permits the member to use the facilities as often as he or she wishes).

- 28 (a) 'Regularly' may not be the most appropriate word here as something can be regular but still occur only fairly infrequently. 'Often' may therefore be a more suitable term. This point also applies to paragraph 75(a).
- 28 (b) It would be useful to provide further clarification of how this criterion would work in practice. In particular there appears to be confusion regarding the appropriate treatment for items which, while distinct, are still highly integrated. For example:
 - An entity is the only seller of A and B.
 - B has standalone value but A can only be used in conjunction with B (i.e. A is an optional extra that can be purchased along with B).
 - B is sold separately but A is only sold with B.

If the entity has supplied A but not B, is A distinct? For example, an entity supplies a service (e.g. satellite TV) and also a device which is needed for the customer to receive the service. The device is not sold separately – the customer buys it with the first year of service – but thereafter, the customer can renew by buying additional years of service. Is the device distinct?

In this case it would seem that the device would not qualify as distinct under 28(b) because, although B can be bought separately by customers that have already bought A, a customer that has not yet bought A cannot buy B except as part of a package. We agree that this is an appropriate analysis but, given that it is a reasonably common scenario, we suggest it is included as an illustrative example.

Separately, in practice it may be onerous for an entity to have to research whether or not there are other products available to the customer that would affect whether part of a good or service is distinct. We do not believe that such research is intended, but rather that it is sufficient for the entity to rely on its knowledge of the market into which it is selling, but it might be helpful to make this explicit.

It would also be helpful to clarify whether this analysis is intended to be affected by whether the customer is contractually restricted from buying from other entities.

We question the purpose of subparagraph (b) and why (a) alone is insufficient.

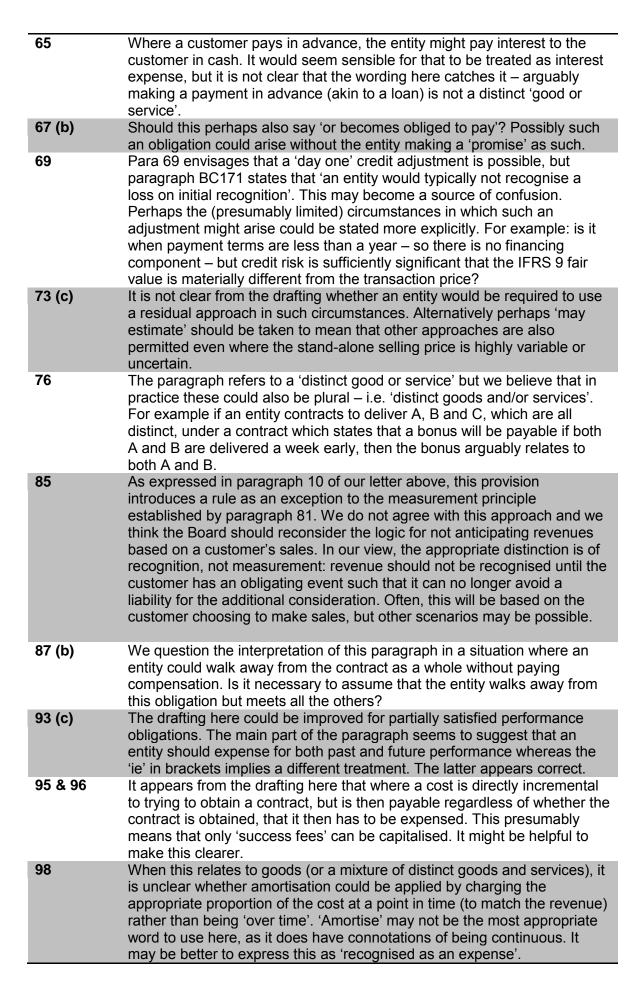
Furthermore, when applying (b), it is not clear whether all the goods or services should be significantly modified / customised, or just some of them. The drafting seems to imply the latter, which is a sensible position, but it is not completely clear. For example, in a construction contract, bricks may be part of the bundle. They would not themselves be modified or customised at all as part of the construction process (they are integrated, but not modified or customised). This suggests that only some of the goods or services need to be significantly modified / customised, but this could be better clarified. Another example is the land element of a construction contract and whether this would be treated as a separate performance obligation.

The word 'significant' seems an important qualifier in both 29 (a) and (b), but it is unclear how this is meant to be applied. Significance could be measured in binary terms, but this is often going to be inappropriate; some items might be of insufficient interest to be 'significant' yet not negligible enough to be dismissed as 'insignificant'. This area is very judgemental and some clarity would be useful on whether something can be more than insignificant and still not trigger paragraph 29. Given the difficulty of drafting absolute requirements here that are not too subjective and will achieve appropriate outcomes in a wide range of scenarios, we wonder whether it might be better to redraft paragraph 29 to focus on the underlying concept and then give indicators of when it might apply?

30 In practice, an entity may initially expect that two services will have the same pattern of transfer, but later unexpected events may mean that this changes. It may be helpful to clarify that, in these circumstances, the entity should split them on the basis that would have been used at contract inception. In the absence of such guidance an entity may think that it is not permitted to split them, even though they now have a different The sentence starting "For example" appears to focus on the wrong thing. 36 It seems to focus on whether an alternative asset could be supplied to this customer – but we believe that the Board intends the test to be whether (contractually and practically) this asset could be supplied to an alternative customer. 37 The term 'indicates' in (a) and in (c) could usefully be qualified (e.g. 'sometimes indicates'), as it is in (b). For example, in (a), customers can be contractually required to pay in advance for goods or services they have not yet received. We question the purpose of this paragraph. It appears to apply very 46 narrowly, and may not tie in with the concept that this is a single performance obligation. (This also affects Example 8.) 51 This paragraph explicitly excludes contract renewal. However, where a contract allows a customer to choose how much to take of a particular item, we assume that it is reasonable to take into account the seller's expectations of that amount. This could be clarified. 55 (a) It may be safer to add to the last sentence "but independent outcomes". We question the appropriateness of the statement 'in accordance with 59 (b) typical credit terms in the industry and jurisdiction'. It appears to us that a better comparison is just with prompt cash payment. There may be a danger that retailers of beds and sofas could conclude that it is normal to give a year's interest free credit and then compare with that. 61 It may be preferable to clarify the final sentence by adding "unless the contract is modified". 62 Under IAS 18, interest is just another class of revenue and – although it is uncommon – entities are permitted to present a single revenue line including goods, services, interest etc. It is unclear whether this changes that position. 63 It might be helpful to make explicit in the final sentence that the estimate of stand-alone selling price should take into account any discounts and other adjustments that would be usual for this customer (or class of customer). 64 It appears that this paragraph is the sole survivor from IFRIC 18. Consequently, in practice we fear that a number of issues will arise – the

Board may wish to consider whether more of the omitted material could

be included in appendix B and/or the illustrative examples.



104 & 106	These paragraphs reference receivables within the scope of IFRS 9 but do not mention payables. Nevertheless, where a customer pays in advance and is entitled to cancel and demand repayment, that would seem to be a liability within the scope of IFRS 9. Clarification on this point would be useful.
105	The last sentence appears to be incomplete – a contract liability can reflect not only amounts received but also amounts properly recognised as financial assets (as made clear in the first sentence).
110	For many businesses (e.g. those with exclusively short-term contracts) the reconciliation required by paragraph 117 may be of little interest to users. We believe it would be appropriate to allow judgement here over whether to include it or not.
114	The reference here to credit risk seems ambiguous - in particular whether analysis of the larger or the smaller figure is required (i.e. after deducting credit risk).
117	It is unclear whether this would have to include or exclude contracts that were wholly performed during the period (i.e that were neither in the opening nor the closing balance). This may be particularly onerous where gross cash receipts are required to be reconciled with net revenues recognised and we therefore question whether it would not be more appropriate to restrict disclosure to long-term contracts.
124	Where an entity decides to amortise the costs of obtaining a contract over a period longer than the contract period (i.e. taking hoped-for future contracts into account), that may well be a key judgement. However, we do not see any specific disclosures around this.
Appendix A	Perhaps some of the definitions should acknowledge that there may be different answers for different classes of customer. For example, at the moment, the definition makes it look as though there is only ever one stand-alone selling price for a particular good or service.
B7	The drafting of the penultimate sentence appears a little ambiguous. It may be intended to mean that corresponding changes should be made for the proportion of items expected to be returned, but the drafting could be interpreted as a requirement that the asset be remeasured by the same amount as the liability.
B21	The first sentence here seems ambiguously drafted. A customer buying a single loaf of bread in a supermarket will still typically qualify for loyalty points (if there is a scheme). However some may read this sentence as inapplicable because (before you have considered the loyalty points) the contract does not have more than one performance obligation.
B26	Given para 26(d), the reference to 'stand ready' here may cause some entities to recognise revenue merely for 'standing ready'. That may be inappropriate, as discussed in our comments on paragraph 26.
B34	We disagree with the second sentence. It is perfectly possible for an entity to transfer everything required under the contract before the start of the period in which the customer is first contractually entitled to use the transferred IP. In some cases, the customer may even have paid in full and neither party may have any outstanding obligations to the other. The example given is not an example of the second sentence – it is an example of a scenario in which the customer has not yet been supplied with access to the IP (which is quite different from not being contractually permitted to use it). It does not appear to be consistent with the principles of the ED to defer recognition of the transferor's revenue when it has fully satisfied all performance obligations and only the passage of time is necessary before the customer is entitled to use the IP. (This also affects Example 26.)

B41	It appears that this paragraph is intended to qualify how the words are used in B40, but it might be safer to draft B40 in a way that makes it less easy for readers to miss the effect of B41. For example, B40 could refer to "the original selling price of the asset (after adjusting for the time value of money)". Also, the adjustment required by B41 is somewhat opaque and could be better explained. (The same comments apply to B46 and B47.) It might be helpful to give more detail here or an example. B2 – B9 do not
	really explain what to do where the amount repaid is less than the original selling price. Also, we wonder if the time value of money plays a part in this.
C3 (b)	The meaning of the phrase "the date the contract was completed" is not entirely clear. Is this intended to be when all performance obligations have been settled? If so, variable consideration may still be variable at that date. It might be simpler to measure variable consideration at the amounts that actually arose.
IE1	At the start of the illustrative examples the customary phrase is used "These examples accompany, but are not part of, the [draft] IFRS". However, IE1 says they are "an integral part of the [draft] IFRS". This seems contradictory.
IE8	The calculation in Example 9 appears inappropriate as it results in an answer that seems out of line with the principles in the ED. There are in effect three elements to this contract – Product A, Product B and the effect of the time value of money. Presumably, once the effects of the time value of money have been stripped out, any remaining discount (and, presumably, surplus) should be allocated between A and B by reference to stand-alone selling prices. But in this case, the ratios are clearly different:
	Product A 42,135 / 40,000 = 105.34% Product B 150,550 / 120,000 = 125.46%
	This seems to show that too little revenue has been allocated to Product A and too much to Product B.
	Specifically, paragraph 74 could be read as requiring that the same percentage mark-up is applied to both products. In that case, if the mark-up is assumed to be y, it can be derived from:
	40,000(1+y)/ [(1.06)^2] + 120,000(1+y) / [(1.06)^5] = 150,000 (1+y) = 150,000 / [40,000/(1.06)^2 + 120,000/(1.06)^5)] (1+y) = 1.1974 Y = 19.74%
IE13	So revenue for Product A = 47,896, and revenue for Product B = 143,687. This is a very minor drafting point, but the answer in Example 14 seems to assume that CU10 is paid pro rata for each year (or part of a year) that the policy remains in force. But the fact pattern does not state this particularly clearly – readers might assume that an additional CU10 is paid annually at each renewal date, and that nothing would be paid in the year of cancellation (which might be more normal).
IE16	Another minor drafting point; it might be better to say that payment for X is 'conditional' on delivery of Y. The term 'contingent' has connotations of being outside the seller's control, which is not the case here.
IE18	It is surprising to see Example 20 using the most likely amount rather than the weighted average amount – given the high volume of sales the latter

	might have been expected. It may be helpful to explain why likely amount is more appropriate here.
IE20	In Example 22, the amount deferred is affected by the entity's intention to offer a seasonal discount. It might be helpful to indicate whether the accounting would subsequently be amended if the entity's plans change and it decides not to offer a seasonal discount after all.