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Technical Director, File Reference No. 2011-230
Financial Accounting Standards Board
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09 March 2012

Dear Sir,

Re: Exposure Draft ED/2011/6 Revenue from Contracts with Customers

Thank you for the opportunity to comment on the above noted document. We have reviewed the Exposure Draft (ED) and have provided our comments below:

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?

We agree in principle with the proposals as to when an entity satisfies a performance obligation over time; however, we suggest that the paragraphs be re-grouped to facilitate a clearer understanding of the requirements. For example, in determining whether the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced, entities are required to apply the requirements on control in paragraphs 31-33 and paragraph 37. Paragraph 37 lists indicators of control that may potentially be used by entities as a checklist for determining whether or not control has passed. Although paragraph 37 notes that the indicators are not limited to the ones listed in the standard, and that these indicators are to be considered together with the requirements for control, having these indicators in a separate place from the definition may result in them not being considered in the context of the definition. We propose that the final standard includes these indicators of the transfer of control together with the definition in paragraphs 31-33 instead of including them under the section pertaining to performance obligations satisfied over time. If entities do not consider the indicators in the context of the definition, they may incorrectly assume that they do not meet the criteria for recognising revenue over time and this may affect the timing of the revenue these entities report. Conversely, an entity may incorrectly assume that control has passed by virtue of the fact that they meet some of the indicators listed in paragraph 37 when they have not actually met the definition of control as articulated in paragraphs 31-33.

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?

We do not agree with the proposals to present amounts considered to be uncollectable because of a customer's credit risk as a separate line item adjacent to the revenue line item. The proposals may result in presentation of three different categories of credit losses – those arising on initial recognition of a receivable, subsequent measurement of a receivable in a contract that does not have a significant financing component and impairment losses on a contract that does have a significant financing component. This presentation may be confusing as there will be different presentation requirements for short-term and long-term receivables. Furthermore, there is not necessarily a connection between the revenue recognised in a particular reporting period and the impairment losses recognised in that period and so it is unclear how the proposed presentation will facilitate users' understanding of the amount that an entity ultimately expects to receive from a customer. We believe that the presentation of impairment losses as per the current standards adequately allows users to determine the amount that an entity ultimately expects to receive from a customer.

If this requirement is to remain in the final standard, then we suggest having this disclosure in the notes to the financial statements (rather than on the face of the statement of comprehensive income), differentiating between current year impairment losses and impairment losses recognised relating to revenue recognised in previous reporting periods. In addition, this disclosure could distinguish between impairments recognised on initial recognition as well as impairments on short and long-term receivables.

We would also suggest amending paragraph 69 to explicitly state what accounting treatment is required for contracts that do have a significant financing component, as per the explanation included in the basis for conclusions, BC174-175. As the *basis for conclusions* only accompany the IFRS and do not form an integral part thereof, users may be unclear as to the accounting treatment required in the absence of this information in the actual standard.

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?

We agree with the proposal to constrain the amount of variable consideration that an entity would be entitled to. However, the wording of paragraph 81 may be unnecessarily complex. We suggest that paragraph 81 could simply state that where an entity has already satisfied a performance obligation, but the amount of consideration that it is entitled to is variable, the entity should constrain the amount of revenue recognised to the amount that it is “probable” that the entity will receive. As the word probable is generally understood to mean whether it is more likely than not that the entity will be entitled to the revenue, this may be less complex and have more consistent application in practice than the more ambiguous “reasonably assured to be entitled to”. The two criteria currently listed in sub-paragraphs 81(a) and 81(b), as well as the non-predictive indicators described in paragraph 82, would then provide additional clarification of when an entity would not assess variable consideration as “probable”.

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?

We do not agree with the proposed scope of the onerous test and recommend that entities recognise a liability and a corresponding expense only if the contract as a whole is onerous. Recognising liabilities for separate performance obligations which form part of a contract may not provide a fair reflection of the economic substance of such a contract which generates revenue in its entirety. For example, an entity may intentionally include one or more low-margin services in a multiple-element contract in order to maintain or secure a customer relationship. Such a contract may result in a loss on the service element of the contract, but the contract is priced to record a profit on the provision of goods. Therefore, the overall profitability of the entity is increased as a result of entering into the contract and disclosing a loss based on one of the performance obligations does not take this into account.

Furthermore, the scope of the onerous test should extend to all contracts and not just those that the entity expects to satisfy over time and over a period of time greater than one year. Application of the onerous test requirements is open to potential manipulation and it can result in an entity reaching different conclusions about performance obligations that are otherwise identical. For example, an entity has two performance obligations that are satisfied over time – one is expected to take less than a year to complete and the other is expected to take more than one year to complete. Shortly after contract inception, the entity expects that the direct costs to fulfil each performance obligation would exceed the allocated transaction price. As the proposed standard requires that the entity recognise a liability and a corresponding expense when a performance obligation is onerous, but only if the performance obligation will be satisfied after a period of time greater than one year, the entity would recognise this liability for the potential loss on the one performance obligation, but not the other. The final standard should require entities to recognise a liability and a corresponding expense where events make a contract onerous, regardless of the contract term.

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.

We agree that enhanced disclosures with respect to revenue and revenue recognition are required as the current disclosure requirements are inadequate. Although the Board has confirmed that the proposed disclosure requirements are not intended to be a checklist and that entities need not provide the disclosure for items that are not material, we still have concerns that the cost of providing the enhanced disclosures may exceed any potential benefits to be derived from these disclosures.

This is particularly relevant with respect to smaller entities, where items requiring disclosure may be material to the entity, but the costs to accumulate some of the information required to meet the disclosure objectives may become onerous due to smaller accounting departments and lack of sophisticated information systems. Providing enhanced disclosures pertaining to revenue recognition policies, significant judgements made in recognising revenue and the disaggregation of revenue will enable users to better understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. However, preparing additional disclosures requiring reconciliation of contract assets and liabilities and onerous performance obligations, as well as disclosures describing the entity's performance obligations may be particularly challenging for these smaller entities. In addition, requiring all of these disclosures for interim reporting periods, where reporting deadlines are significantly shorter, may result in the situation where the cost of accumulating this information outweighs the potential benefit.

We believe that the disclosures pertaining to the reconciliation of contract assets and liabilities and onerous performance obligations, as well as the disclosures describing the entity's performance obligations, are better suited for presentation in, for example, the MD&A, rather than forming part of the final standard.

If these proposed disclosures do remain in the final standard, then these should not be required at an interim period as well (with the exception of the disclosures pertaining to revenue recognition policies, significant judgements made in recognising revenue and the disaggregation of revenue). Further specific comments regarding the proposed disclosures have been included below.

Reconciliation of contract balances

The current example, IE 17, does not provide sufficient information or clear facts to reconcile the change in the net contract asset (liability) balance over the year. There may be different interpretations as to the calculation of amounts recognized as receivables and the treatment of payments received in advance, resulting in different analysis. The examples provided should clearly articulate the disclosure requirements as set out in the Standard and leave little room for interpretation.

Examples have been included below illustrating some of the potentially different ways that IE 17 can be interpreted.

The opening balance of contract liabilities at 31 December 20X0 is CU2,000. The facts in the example state that the entity received CU3,500 payments in advance and, as a result of a business combination on 31 December 20X1, contract liabilities increased by CU1,900. Therefore, the closing balance of contract liabilities as at 31 December 20X1 (assuming, in the absence of further information, that the CU2,000 opening balance is still outstanding at 31 December 20X1) should be calculated as follows:

Opening balance	2,000
Payments received in advance	3,500
Effect of business combination	<u>1,900</u>
Closing balance	7,400

The closing balance of contract assets appears to be correctly calculated as CU4,500.

Therefore the aggregate closing balance of contract assets and contract liabilities could be calculated as CU2,900 and not CU100 as per the example. The closing balance is derived as follows:

	CU
Contract assets	–
Contract liabilities	<u>(2,000)</u>
Net contracts at 31 December 20X0	(2,000)
Revenue from contracts with customers	
Performance obligations satisfied during the reporting period	18,000
Amounts allocated to performance obligations satisfied in previous periods	<u>500</u>
	18,500
Amounts recognised as receivables	(17,000) [1]
Payments in advance	(3,500) [2]
Cash sales	(1,000)
Effects of a business combination	
Increase of contract assets	4,000
Increase of contract liabilities	<u>(1,900)</u>
Net contracts at 31 December 20X1	(2,900)

Note [1]

The illustrative example has CU14, 000 as the amount recognised as receivables – it is not clear how this number is derived. It is possibly CU18,500 less CU3,500 payments in advance less CU1,000 cash. We do not agree with the deduction of the payments in advance from revenue as we believe this represents a contract liability or deferred revenue for which the journal entry would be:

DR Cash
 CR Deferred Revenue (contract liability)

Revenue would not have been recognised for this amount as the entity has not yet satisfied its performance obligations.

Note [2]

We suggest including specific references to the paragraph 117 to indicate which of the disclosure requirements this meets. We have assumed that the payments in advance have been deducted in the reconciliation as this meets the definition of paragraph 117 (f) – “any additional line items that may be needed to understand the change in contract assets and contract liabilities”. In the absence of information to clarify this, users may incorrectly assume that the payments in advance were recognised as revenue during the period which is not correct as we have outlined in Note [1] above.

The second possible scenario in IE 17 is that the opening liability balance of CU2,000 is settled during the year – i.e. revenue is recognised and the liability is reversed, resulting in the following journal entry being passed:

DR Deferred Revenue (contract liability)
 CR Revenue

The closing balance of contract liabilities as at 31 December 20X1 should then be calculated as follows:

Opening balance	2,000
Deferred Revenue earned	(2,000)
Payments received in advance	3,500
Effect of business combination	<u>1,900</u>
Closing balance	5,400

The closing balance of contract assets would still be calculated as CU4,500.

Therefore the aggregate closing balance of contract assets and contract liabilities is CU900 and not CU100 as per the example. The closing balance is derived as follows:

	CU
Contract assets	–
Contract liabilities	<u>(2,000)</u>
Net contracts at 31 December 20X0	(2,000)

Revenue from contracts with customers	
Performance obligations satisfied during the reporting period	18,000
Amounts allocated to performance obligations satisfied in previous periods	<u>500</u>
	18,500
Amounts recognised as receivables	(15,000) [1]
Payments in advance	(3,500)
Cash sales	(1,000)
Effects of a business combination	
Increase of contract assets	4,000
Increase of contract liabilities	<u>(1,900)</u>
Net contracts at 31 December 20X1	(900)

Note [1]

This amount has been calculated as CU18,500 revenue recognised during the period, less CU500 relating to contract assets recognised, CU1,000 cash received and CU2,000 for which cash was received in the prior period.

Performance Obligations

Paragraph 119 (a) and (b) require entities to disclose information pertaining to the aggregate amount of the transaction price allocated to remaining performance obligations as well as when the entity expects to recognise this revenue.

This disclosure is essentially requiring entities to forecast how much revenue they anticipate to earn in future periods and when this revenue will be earned. This will require a significant amount of judgement and estimation uncertainty and as such, the amounts disclosed in one period may materially differ from actual results. This could expose an entity to risks if decisions are made by users on the basis of this estimated information. From a practical perspective, this information may also be difficult to compile and audit and therefore the costs of such disclosures seem to outweigh the potential benefits, if any.

We note that paragraph 120 provides entities with the options of providing this disclosure either on a quantitative or a qualitative basis; however, it is not clear how an entity would be able to meet the disclosure requirements of paragraph 119 without making quantitative disclosures. In addition, paragraph 121 makes an exception for entities that account for performance obligations using an output method which would result in inconsistent disclosures between entities who use output methods and those that use input methods.

Onerous performance obligations

We propose that the wording for the disclosure required in terms of paragraphs 122 and 123 be amended to replace “performance obligations” with “contracts”, consistent with our proposals noted in response to Question 4.

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?

We agree with the above proposal. We would however recommend that the final standard specify which non-financial assets would be within the scope of this standard.

We are pleased to offer our assistance to the IASB in further exploring issues raised in our response or in finding alternative solutions to meet the needs of financial statement users.

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Yours truly,

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