### Comment Letter - Revenue Recognition

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## Comment regarding how the standard may affect the renewable sector

In the renewable sector it is common in the UK for a contract with a customer to include various products such as MWh (electricity) as well as "Green" certificates related to the electricity supplied to the customer.

In these contracts, the electricity is sold/invoiced to the customer shortly after the time of supply.

However the "green" certificates may be sold to the customer from three months up to 18 months after the supply of the electricity and the customer is normally under obligation to purchase the certificates / the supplier only has the right to demand payment for the certificates / issue an invoice for the certificates only when the certificates have been electronically transferred to the customer.

My understanding of current practice is that the revenue relating to all elements (electricity & "green" certificates) is recognised at the time of supply of the electricity – although not all of the performance obligations (eg supply of certificates to the customer) has been fulfilled.

In accordance with paragraphs 28 & 29 of the ED (about distinct goods & services), my understanding of how the new standard on revenue recognition would affect these transactions is that revenue would only be recognised from the date of supply of the separate components of the supply – ie. revenue for the supply of the electricity would be recognised once it has been delivered and revenue for the supply of the related green certificates would only be recognised when the certificate is transferred to the customer.

From paragraph 29 of the ED, the performance obligations seem to be distinct; the goods are <u>not</u> highly interrelated and the goods are <u>not</u> combined into a single item for which the customer has contracted

(Maybe the existing standard on IFRS is not being applied correctly?)

I would agree with the ED in presenting revenue in this way.

# Responses to the six questions in the revenue recognition ED

# Q1

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?

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?

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?

## Example 14

I am uneasy with the plan to recognise revenue based on predictive values.

With regards to example 14 about trailing insurance, it does not seem transparent to recognise revenue for a future period even if it can be shown to be predictive. My concern is that there is a risk that revenue is overstated and that users are not fully aware that the revenue declared relates to possible future periods and is predictive.

Another concern is how adjustments to revenue originally declared are presented in later periods.

One suggestion could be

- Forcing a separate line in the IS, but this may be too onerous for preparers of financial statements but disclosures should not be (cf Q5 below)
- Highlighting Accounts Receivables calculated predictively in the SOFP may also be an answer.
- Forcing a separate line in the IS for adjustments to historical revenue calculated on predictive values but again, this may be too onerous

I don't think it's a good idea to base "reasonably assured" on past trends as this may be very misleading. My understanding is that (wrt eg. 14) I would only be reasonably assured of having a commission for the 4<sup>th</sup> year of service when the customer has not cancelled within 4 years - only then is it reasonably assured and not even certain. Adding the impairment line in the IS to show possible risks may help users' understanding.

I am also concerned that the predictive values are based on the <u>entity's</u> own experience. This could lead to similar contracts with similar contract prices with equal market risks but being declared using different amounts by different entities purely because one entity can't show it has the relevant predictive calculation experience. This would cause (at least short time) differences between entities which would not aid comparison of financial statements. This would not occur if revenue was based on actuals.

To avoid the predictive revenue amount altogether, I think that non predictive actual revenue should be used. This would mean that example 14 would

recognise revenue each year the customer retains its insurance contract and <u>not</u> all upfront. Disclosure notes can explain predictive future revenue.

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?

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.

I agree that some of this information should be provided at least <u>yearly</u> but my concern is that these reporting requirements may be too onerous and costly for users to prepare in interim financial reports and not all of them would help users of financial statements:

114 - 115

To help users of financial statements, I think it would be helpful to disaggregate revenue based on major product lines, type of contracts and contract duration in the interim financial reports but I think the remaining categories may be more useful yearly.

117

I think that these adjustments are important and should be done yearly and not in the interim financial reports.

119 - 121

I agree these are important notes but are of more use if completed yearly and not in the interim financial reports.

122 - 123

The onerous obligation notes very important and should be completed on an interim basis as this may show cause for concern for users.

128

I don't think this needs to be included in the interim reports. It would be on the SOFP but just not disclosed separately. Yearly reporting.

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?

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Thank you to the IASB in allowing us to comment on this ED and for the webcast and other very useful & educational outreach events it organised.