2011-230
Comment Letter No. 325

Accounting Standards Board
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17 February 2012

Dear Henry

IFRS ED 'Revenue from Contracts with Customers'

This letter sets out the Accounting Standards Board's (ASB) comments on the Exposure Draft (ED) '*Revenue from Contracts with Customers*'.

The ASB is supportive of the single approach to revenue recognition based on the contract–based approach proposed in the ED. Whilst we had some concerns with the previous ED, we are pleased that the IASB has taken the time to refine its proposals and re-issue a further ED.

The ASB's previous concerns, the difficulty in applying the ED to service based contracts and the lack of clarity in determining when control has been transferred during production, or whilst a long-term construction contract is in progress, have been resolved.

However the main concern that the ASB expressed at the first ED stage still remains; that onerous contracts should be dealt with at contract level in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* rather than at a performance obligation level in the revenue standard. This is fundamental to the core principal of Step 1 – Identifying the contract. We consider that this solution resolves the problem of having an onerous performance obligation within an overall profitable contract. We do not support the reasons cited in BC207 (a) – (c) and BC208 for not considering the contract as the unit of account. Specifically the argument put forward in BC208 of limiting the scope of the onerous test to performance obligations because it is closer to the scope of IAS 11 *Construction Contracts,* fails to acknowledge that the onerous test in IAS 37 applies to contracts that are not covered by IAS 11. (Question 4)

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Other concerns can be summarised as follows:

- Paragraph 85 of the ED is in need of amendment. Whilst we understand the reason behind the introduction of paragraph 85 (to cover software upgrades and award credits associated with customer loyalties BC63), we consider that it is not clear in paragraph 85 how a customer is different to a collaborator or partner as described in paragraph 10, which concludes that contracts with collaborators/partners are outside the scope of the ED. (Question 3)

- The ASB does not agree that the corresponding amounts in profit or loss should be presented as a separate line item adjacent to the relevant to the revenue line item. The issue we have in presenting it as a separate line item is that it could add to clutter in the financial statements and, if a precedent is shown in this standard, it increases the probability of other separate line items being added in other standards, We therefore consider that the requirement to present as a separate line item should not be a mandatory requirement. (Question 2)

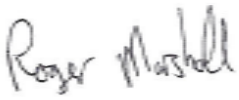
- With regards to the ED's proposal of limiting the onerous test to contracts over a period of time greater than one year, the ASB is concerned that this proposal will not necessarily provide useful information to users and may introduce inconsistencies into financial statements as well as making comparability between different entities difficult for users. The ASB consider that the onerous test should apply to all contracts with customers. (Question 4)

- That the list of specific disclosure requirements proposed to be introduced to IAS 34 *Interim Financial Reporting* as a result of the *Revenue from Contracts with Customers* ED do not achieve an appropriate balance between the benefits to users and the costs to preparers of financial statements. (Question 5)

Please find attached, as an appendix to this document, our detailed responses to the invitation to comment questions.

Should you wish us to expand on any aspect of this response, please contact me or Jennifer Guest j.guest@frc-asb.org.uk

Yours sincerely



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RESPONSE TO SPECIFIC QUESTIONS IN THE ED
'Revenue from Contracts with Customers'

1.1 *This Appendix sets out the ASB's responses to the questions set out in the exposure draft's Invitation to Comment.*

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?

The ASB agree with the proposed requirements in paragraphs 35 and 36.

The ASB considered that the first ED, '*Revenue from Contracts with Customers*', was not clear on when revenue should be recognized over time, and we had expressed some concerns with regards to the implications for the construction sector and the case of contracts for services. In the previous ED it was also unclear how it was determined that control had been transferred during production, or whilst a long-term construction contract was in progress.

The ASB considers that its previous concerns have been addressed in this ED which has benefitted from a comprehensive evaluation for all sectors of when performance obligations are satisfied over time.

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 the proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

The ASB response to the 2010 ED highlighted that we agreed that the transaction price should be adjusted for the customers' credit risk. Whilst we acknowledge that many other respondents took issue with this proposal the ASB does not agree that the corresponding amounts in profit or loss should be presented as a separate line item adjacent to the revenue line item. The issue we have in presenting it as a separate line item is that it could add to clutter in the financial statements and, if a precedent is shown in this standard, it increases the probability of other separate line items being added in other standards, We therefore consider that the requirement to present as a separate line item should not be a mandatory requirement.

The ASB also observes that the proposal introduces an inconsistency with the accounting for a receivable, which incorporates assessments of collectability in the measurement of a financial asset.

Question 3

Para 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?

The ASB agrees with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations.

Nevertheless, the ASB believes that the wording of paragraph 85 of the ED is in need of consideration. Whilst we understand the reason behind the introduction of paragraph 85 (to cover software upgrades and award credits associated with customer loyalties BC63), we consider that it is not clear in paragraph 85 how a customer is different to a collaborator or partner as described in paragraph 10, which concludes that contacts with collaborators/partners are outside the scope of the ED.

An alternative suggestion would be for the IASB to relegate paragraph 85 to application guidance.

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?

The ASB does not agree with the proposed scope of the onerous test.

The ASB does not believe that onerous contracts should be assessed at the performance obligation level. Instead, the ASB considers that onerous contracts should be dealt with at contract level in IAS 37 *Provisions, Contingent liabilities and Contingent assets* rather than at a performance obligation level in a revenue standard. This is fundamental to the core principal of Step 1 – Identifying the contract. Including the 'onerous test' at performance obligation level could result in the

recognition of a provision for an onerous performance obligation within a contract, which remains profitable overall. Further the proposal has the potential for abuse.

The ASB expressed this concern at the first ED stage and we noted that this was also a concern of a number of other respondents to the first ED. We do not support the reasons cited in BC207 (a) – (c) and BC208 for not considering the contract as the unit of account. Specifically the argument put forward in BC208 of limiting the scope of the onerous test to performance obligations because it is closer to the scope of IAS 11 *Construction Contracts*, fails to acknowledge that the onerous test in IAS 37 applies to contracts that are not covered by IAS 11.

The BOC states (B207) that performing the onerous test at contract level could result in an arbitrary outcome because the ED does not appropriately describe how to bundle promised goods and services in contracts. The ASB consider that the ED should provide guidance on how to bundle promised goods and services.

With regards to the ED's proposal of limiting the onerous test to contracts over a period of time greater than one year, the ASB is concerned that this proposal will not necessarily provide useful information to users and may introduce inconsistencies into financial statements as well as making comparability between different entities difficult for users. The ASB consider that the onerous test should apply to all contracts with customers.

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 (paragraph 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? I your response, please comment on whether those proposed disclosure 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.

The ASB considers that the list of specific disclosure requirements proposed to be introduced to IAS 34 *Interim Financial Reporting* as a result of the *Revenue from Contracts with Customers* ED do not achieve an appropriate balance between the benefits to users and the costs to preparers of financial statements.

The ASB believes that since the proposed revenue related disclosures are only required if material, then the existing wording of IAS 34,

'requires an entity to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period'

ensures that any material change in revenue streams are likely to be captured by this requirement.

Introducing a list of revenue related disclosure requirement to IAS 34 therefore contravenes its underlying principles. Specifically paragraph 6 of IAS 34:

'The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events and circumstances and does not duplicate information previously reported.'

If the IASB considers that the revenue related disclosures for interim reporting are inadequate, then this should be undertaken as a separate project related to interim reporting.

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?

The ASB agrees with 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 which is consistent with the approach under other IFRS's and takes into consideration the ASB response to the first ED (Question 7) where we suggested that any subsequent changes should be allocated to different performance obligations based on the facts and circumstances.