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Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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UNITED KINGDOM

Dear Hans

Recent IASB discussions on the Revenue Recognition project

The AASB has asked me to write to you to express some significant concerns regarding the direction of the IASB's recent discussions on the Revenue Recognition project, as reported in the September and October editions of *IASB Update*. In particular, the AASB is concerned about the possible re-introduction of a collectibility threshold for revenue and the introduction of rules-based requirements relating to proxies for measuring an entity's performance.

Collectibility threshold

The AASB considers that the re-introduction of a collectibility threshold for revenue would be inconsistent with the core principle of the proposed model that an entity should recognise revenue to depict the transfer of promised goods or services to customers at an amount that reflects the consideration to which the entity *expects to be entitled* in exchange for those goods or services.

In its response to ED/2010/6 *Revenue from Contracts from Customers*, the AASB expressed concerns with how the impact of credit risk was proposed to be recognised in the model and disagreed with the proposal to include credit risk in the measurement of revenue. The AASB expressed a preference for revenue to be recognised gross and to account separately for any impairment of the corresponding receivable (either initially or subsequently) to reflect credit risk.

The reasons the AASB supports this view include:

- Introducing credit risk into the transaction price takes a 'valuation-driven' approach to revenue measurement, rather than a 'transaction-driven' (customer contribution) measurement of revenue, which contradicts measuring performance obligations at the transaction price.
- Credit loss is a function of financing the customer and not of providing goods or services. Credit loss is therefore arguably better, and more practically, measured through impairment of receivables.
- Users would otherwise be denied useful information about expected bad debts, which would be obscured by being netted against revenue.

- The focus on credit sales ignores the relationship of cash sales to credit sales for many retail and similar businesses that do not discriminate between the prices of goods sold in either fashion.

This view was confirmed in the AASB's subsequent response to ED/2011/6 *Revenue from Contracts with Customers*, in which the AASB commented:

> *The AASB agrees with the application of IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) to account for amounts of promised consideration that an entity assesses to be uncollectible because of a customer's credit risk and considers the proposals to be a significant improvement on the proposals in ED/2010/6. The AASB specifically agrees with revenue being recognised on a gross basis.*

Although it notes that the IASB has not made any tentative decisions in relation to collectibility, the AASB is concerned with the direction of the discussion regarding the potential re-introduction of a collectibility threshold and recommends that the IASB retains the focus of its discussion on the presentation of credit risk.

<u>Units produced v units delivered</u>

The AASB is concerned with a number of the tentative decisions made by the IASB at its October meeting that would appear to result in rules-based, rather than principle-based, accounting outcomes. It is particularly concerned about the following tentative decision (as reported in October *IASB Update*):

> *The boards tentatively decided that methods such as units produced or units delivered could provide a reasonable proxy for the entity's performance in satisfying a performance obligation in the following circumstances:*
>
> *(a) A units produced method could provide a reasonable proxy for the entity's performance if the value of any work in progress at the end of the reporting period is immaterial.*
>
> *(b) A units delivered method could provide a reasonable proxy for the entity's performance if:*
>
> *(i) the value of any work in progress at the end of the reporting period is immaterial; and*
>
> *(ii) the value of any units produced but not yet delivered to the customer at the end of the reporting period is immaterial.*

The AASB considers that it is not appropriate for an IFRS to include such rules-based guidance, as the concept of materiality is already addressed in the *Framework* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Conceivably, any method (i.e. not just one of those mentioned in *IASB Update*) that produces an outcome that is not materially different from a method prescribed by an IFRS would be acceptable. Further, an entity would be required to change its measure of progress (i.e. units produced or units delivered) if the value of work in progress and of completed units not yet delivered become materially different.

Accordingly, the AASB recommends that the IASB not amend the proposals in ED/2011/6 for the discussion of the use of 'units produced' or 'units delivered' as appropriate methods for an entity to use to measure its progress toward complete satisfaction of a performance obligation that is satisfied over time.

Other matters

The AASB also discussed other aspects of the IASB's discussions (for example, the accounting for contract modifications) that are more detailed in nature and therefore AASB staff have contacted IASB project staff to discuss the issues directly.

If you have any queries regarding any matters in this letter, please contact Nikole Gyles (ngyles@aasb.gov.au).

Yours sincerely

Kevin M. Stevenson
Chairman and CEO