



Accounting Standards Board

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International Accounting Standards Board
30 Cannon Street
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Dear Sirs

Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers'

This letter sets out the Accounting Standards Board's (ASB's) comments on the above Discussion Paper (DP).

The ASB considers that the proposals in the DP have the potential to provide a suitable basis for the development of an IFRS on Revenue Recognition. The ASB appreciates that there are many difficult issues that the DP has not covered (such as those outlined in Appendix C of the DP) and that these issues will be covered in the development of any Exposure Draft is produced. The ASB notes it may have additional comments on these issues when it considers the ED. In addition, the ASB is yet to be convinced that the proposals would mark a significant improvement on the existing models for revenue recognition.

The ASB's responses to the questions in the DP are set out in the Appendix to this letter.

While generally supporting the proposed approach, the ASB is concerned (as highlighted in our answer to Question 2) that the principle may in some circumstances not provide decision-useful information for construction-type or long-term contracts in which the asset is not transferred to the customer on a continuous basis. The IASB will need to consider carefully the practical effect of this proposal in further developing its approach, and we think this should be a key factor for examination as part of the 'Next Steps', as outlined in paragraphs S5-S8 of the DP.

The ASB considers that the DP has not demonstrated the superiority of 'control' over 'risk and rewards' (see the answer to Question 8 in the Appendix). In its response to the IASB's ED 10 'Consolidated Financial Statements', submitted on 18 March, the

ASB stated that it believed that the IASB should not remove the notion of 'risks and rewards' from the definition of 'control'. The ASB considers that the 'risk and rewards' model should still play a key role in providing answers to the more difficult cases for revenue recognition, where it can be helpful in assessing and determining control.

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

Yours sincerely



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APPENDIX

RESPONSE TO SPECIFIC QUESTIONS IN THE IASB Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers'

A CONTRACT-BASED REVENUE RECOGNITION PRINCIPLE

Question 1 - Do you agree with the board's proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

The ASB agrees that working towards a single, universally-applied revenue recognition principle is conceptually preferable to having two principles. The ASB notes the IASB's acknowledgement in the DP, for example, in considering the types of contracts referred to in paragraph S11 of the DP, that the reality may be that exceptions are necessary, but the ASB hopes that a single principle can be made operational.

The ASB agrees with the proposal to base a revenue recognition principle on changes in an entity's asset or contract liability.

Question 2 - Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

The ASB is concerned that the proposed principle may in some circumstances not provide decision-useful information for construction-type or long-term contracts in which the asset is not transferred to the customer on a continuous basis. Such contracts are currently normally accounted for under the percentage of completion method. As Example 7 in the DOP demonstrates, in future revenue would only be recognised at the end of the contract. The IASB will need to consider carefully the practical effect of this proposal in further developing its approach. It could lead to more changes to contracts, encouraging the specification of more stages of transfer to customers and the satisfaction of performance obligations within contracts, which may not reflect the substance.

Question 3 - Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

The ASB agrees with the proposed definition of a contract (DP paragraph 2.11). However, we consider that the definition of a contract should be consistent across all IFRS. While we agree with the IASB's view that the proposed definition in the DP is consistent with the current definition of a contract in IAS 32 Financial Instruments: Presentation, the ASB believes that for clarity the IASB should decide on one definition and apply this in all of its standards. Therefore, if the IASB considers that the proposed definition in the DP is preferable, the current definition in IAS 32 should be amended to be consistent with it.

Question 4 - Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

The ASB broadly agrees with the definition of a performance obligation (DP paragraph 3.2), but considers that it is not clear in the definition if the 'promise' is reciprocal. If the promise is not reciprocal then the revenue will not be recognised. Therefore the ASB considers that the definition would benefit from making clear that the promise to the customer is interdependent on the customer receiving the asset in order that revenue can be recognised. The DP indicates that the proposed approach helps focus on the transaction itself to ensure that recognition of revenue is more consistent than it is using present standards and the ASB welcomes this approach. The DP acknowledges that guidance needs to be developed to ensure consistent application of the proposed model and the ASB would welcome such guidance.

Question 5 - Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

The ASB agrees that, under the model proposed in the DP, the objective should be to depict faithfully the changes in the performance obligations over the life of the contract on the basis of when the entity transfers the assets to the customer.

Question 6 - Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

Yes, the ASB considers that the entity's obligation to accept and refund the customer's consideration for a returned good is a performance obligation which should be exercised in the event of return of a good which is either faulty or does not fulfil the promise implicit in the obligation. The customer's right to return (if exercised) is a separate performance obligation to that of the original transaction.

Question 7 - Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

While the ASB considers that sales incentives can give rise to performance obligations if they are provided in a contract with a customer, we do agree with the comment in paragraph 6.31 of the DP that identifying performance obligations in these cases can be difficult and requires judgement based on the facts and circumstances of the contract. The ASB considers that sales incentives should be considered as options which may or may not be exercised by the customer in the future. Hence, if the option is exercised by the customer, the entity has a separate performance obligation to honour. The entity therefore needs to stand ready to perform.

With regards to loyalty points; the ASB considers that as long as loyalty points accumulate and do not expire, then the entity has an obligation to the customer to convert the points to a discounted purchase or voucher which can be used in lieu of a monetary transfer (a separate performance obligation). In October 2006 the ASB's Urgent Issues Task Force (UITF) supported the draft of what became IFRIC 13, which requires that award credits should be accounted for as a separately identifiable component of the initial sales transaction when granted.

The ASB considers that the idea of 'free' goods is for promotional use. A 'free' good is in effect not free but has been prepaid for in the original purchase and this has been reflected in the price charged for the original good. Therefore these incentives should be accounted for in the same way as standard performance obligations.

Question 8 - Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred

The ASB considers that the DP has not demonstrated the superiority of 'control', as it is set out in Chapter 4, over 'risk and rewards'. There are also linkages to other projects. In its response to ED 10, the ASB stated that it believed that the IASB should not remove the notion of 'risks and rewards' from the definition of 'control'. The ASB considers that the 'risk and rewards' model should still play a key role in providing answers in the more difficult cases for revenue recognition, where it can be helpful in assessing and determining control.

The DP proposes that assessment of whether an asset has been transferred to a customer should be made by determining whether control of the asset has passed, rather than (as in the existing IAS 18) by assessing whether the risks and rewards have passed to the customer. The IASB considers that the idea of control is more consistent with the definition of an asset. The DP considers an example of a tool supplier (paragraphs 4.10-4.19). In the second case (where the tools are provided on approval for 30 days, with the supplier having the right to require their return at any time during the period) the DP proposes that the supplier has control, yet the customer is able to decide who will use the tool, where it will be used, for what purpose and, will pay for any eventual loss or damage of the tool. The ASB would suggest that in this case the customer bears the risks and rewards and therefore has control. Consequently, the ASB questions whether the example is as clear-cut as the DP suggests as to who has control.

Question 9 - The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

As noted above, the ASB is concerned that for long-term projects the proposal that an entity should recognise revenue only when a performance obligation is satisfied may not provide decision-useful information. An example could be the construction of a bridge, which is envisaged to take five years to complete. Under the proposal in the DP, the entity constructing the bridge would not be able to recognise revenue during the construction phase (as it would be able to under IAS 11), but would recognise revenue only when the bridge is completed.

Question 10(a) - Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

The ASB agrees that performance obligations should be measured initially at the original transaction price.

Question 10(b) - Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

The ASB favours the cost trigger approach (DP paragraphs 5.62-5.67). The ASB agrees that the proposal that a performance obligation should be deemed onerous if the expected cost to satisfy the obligation exceeds the carrying amount of the obligation is the more pragmatic and decision-useful of the two trigger approaches discussed in the DP.

Question 10(c) - Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristics of the obligation make that approach unsuitable? Please provide examples.

Question 10(d) - Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

The ASB is not convinced that the types of contract discussed (a) and (b) of paragraph 5.90 in the DP raise strong enough concerns to cause the use of a different measurement approach to the one proposed in the DP. However, for long-term contracts which are large in size and duration, relatively small changes in circumstances can have significant effects and these changes should be recognised as and when they arise and not just when they result in an onerous performance obligation.

The ASB response takes into account (as indicated in the scope of the DP) that financial instruments, insurance contracts and leasing contracts are outside the scope of the DP.

Question 11 - The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

(a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?

(b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

The ASB agrees with the DP's proposal that, if the costs of obtaining contracts are not eligible for capitalisation in accordance with other standards, then they should be expensed. The ASB considers that the principle that revenue should not be recognised to offset expenses is correct.

Question 12 - Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling price of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

The DP advocates that revenue should be recognised in the period in which each item is delivered, provided that, at that time control has passed to the customer. In this scenario utility to the customer is no longer an important consideration. Whilst the ASB considers that this proposal may present impracticalities, (although the customer has control of an item it may not be of any use to him/her without other items which complete his/her purchased package) it is a necessary consequence of the rationale for unbundling and therefore the ASB agrees with this proposal.

Question 13 - Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

The DP describes two possible estimation methods (DP paragraph 5.48) 'expected costs plus margin approach' and 'adjusted market assessment approach'. The ASB agrees with the view in the DP that, if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price. The ASB considers that the two possible approaches indicated (paragraph 5.48) are reasonable, pragmatic and would result in decision-useful information.

Other issues

The ASB notes that IASB has not addressed all issues related to the topic in the DP (as outlined in Appendix C to the DP), which could have a significant influence on the model to be proposed as a future standard. The ASB notes that one of the issues, relating to the effects of the time value of money, was considered at the IASB's March 2009 meeting and that, at that time, the IASB tentatively agreed that the carrying amount of an entity's net contract position should reflect the time value of money, whenever its effect would be material. The ASB would support this view.