

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Our Ref: TECH-CDR-957

22 October 2010

Dear Sirs

Revenue from contracts with customers

ACCA (Association of Chartered Certified Accountants) is pleased to have this opportunity to comment on the above exposure draft (ED). The ED was considered by ACCA's Financial Reporting Committee and I am writing to give you their views.

Overall comments

In principle, we support the Boards' broad objectives of developing a fully converged standard based on a single approach to the accounting for revenue. There are contradictions in the current standards in IFRS, which can cause confusion and lack of consistency in treatment for similar transactions, especially those which do not naturally or wholly fit into either the IAS11 or IAS18 models. However, it is equally important that the principles set out in any revised standard are both clearly presented and practicable, without adding unnecessary complexity to the majority of transactions.

The proposals in the ED, which put more emphasis on control of the assets than the transfer of risks and rewards, are clearly consistent with the general move towards using control as a basis for recognition and measurement in IFRS. While we do not have any objections to the use of a control-based approach in principle, we are concerned that by proposing revenue recognition under contracts to be based on the transfer of assets to the control of the customer, there could be greater importance given to legal form rather than the economic substance. This is likely to be a significant change from current practice in some cases, and could also result in an accounting treatment driving a commercial contract.

Overall we view many of the proposals as being appropriate and workable. However, we do believe that in some areas, the ED has not set out a clear and robust set of principles, and this in turn has led to the need to provide unnecessary guidance in certain areas, which could be interpreted as being a set of prescriptive requirements. By contrast, we do appreciate that for certain types of business, such as those that offer services or produce large scale plant and equipment, where the accounting is likely to be quite complex, further detailed guidance than that offered in the ED would be helpful.

ACCA responses to specific questions raised in the exposure draft

Question 1

Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether:

- (a) to combine two or more contracts and account for them as a single contract;***
- (b) to segment a single contract and account for it as two or more contracts;***
- and***
- (c) to account for a contract modification as a separate contract or as part of the original contract.***

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

We support the principle of price interdependence in determining whether contracts should be combined and segmented. We note that the principles are in essence fairly similar to the guidance currently offered in IAS11, although these would of course now apply to all contracts with customers.

However, we have concerns that this first step of the proposals to separate or combine contracts overlaps with the second step in terms of identifying separate performance obligations. This not only appears to add unnecessary complexity, but we question whether it adds any value for users, especially where a single contract is to be segmented at this first stage, only for the separate performance obligations to be considered again as part of the second stage. We would expect that in most cases, the same outcome would occur.

We believe clearer principles on why this first step is needed and guidance on its application would certainly be helpful.

Question 2

The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

In our response to the Boards' discussion paper, [Preliminary views on revenue recognition in contracts with customers \(DP\)](#), we raised concerns about some of the proposals for separating performance obligations in a contract. In particular we were concerned that they would result in excess unbundling of different elements of revenue, and would therefore add much complexity and cost for relatively simple contracts in the case of many entities.

While we still have some concerns in this area, we do welcome the ED emphasising that an entity should only separate performance obligations if the goods or services being offered within a contract are distinct from each other. This coupled with the caveat in paragraph 24 for goods and services being transferred at the same time not necessarily having to be recognised and measured separately should minimise excessive unbundling of contracts.

We do however have concerns again regarding the clarity in the ED in this area. Paragraph 23 states that a good or service should be unbundled if either "the entity, or another entity, sells an identical or similar good or service separately". By contrast, paragraph 20 suggests that an entity should use its own business model or "its customary business practice" to determine whether separate performance obligations exist. In principle we would support the accounting treatment reflecting management's own practices and therefore the substance of the transaction, rather than being dictated by practices of other entities.

Question 3

Do you think that the proposed guidance in paragraphs 25–30 and related application guidance is sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

The proposals on assessing control from the customer's perspective are the key change from current accounting for certain types of contracts. While there would be no discernible difference for goods and services transferred in a point of time, there would be more difficulty in determining whether control is transferred continuously or at a point in time for services and other construction contracts which are specific to a customer.

Overall, we still have concerns about the general approach that is being proposed by the Boards, in that revenue is recognised as performance obligations under contracts fulfilled by the transfer of the assets to the control of the customer. Clearly this control model is certainly in keeping with the general approach to financial reporting being taken by the Boards and we do not have any objections in principle in using control when determining whether a good or service has been transferred. However, we believe that the proposed approach, by stressing the importance of control of the assets from the customer's perspective rather than that of the entity, could result in revenue being recognised that does not reflect the economic substance of contracts. This could have a significant impact on current accounting practices for certain contracts such as bespoke software, consultancy services, and construction (property and generalised equipment) contracts, which are currently accounted for on a continual transfer basis.

The proposals would result in revenue solely based on the pass of control from a customer's perspective, which unless stipulated in the contract, is not likely to pass until delivery of the equipment or programmes or of a completed report. Ultimately this could well result in an accounting treatment being driven by the legal form of a contract.

We appreciate that it is not the intention of the Boards to curb the percentage completion method for services and construction contracts, but we feel that further clarity and guidance, is required to ensure that the recognition of revenue matches more appropriately the activities being conducted by the entity.

We further note that paragraph 30 of the ED notes a number of indicators in order to assess when control has been transferred. While the ED does state that no single indicator should be seen in isolation, we have concerns that these could be seen as definitive and prescriptive. This should be made clear.

Question 4

The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

We generally support the proposals on determining the transaction price and certainly agree that revenue should be recognised based on an estimated transaction price only if it can be reasonably estimated according to the criteria in paragraph 38.

However, we do not believe it is appropriate to use a ‘probability weighted’ transaction price in all circumstances. In our response to the recent DP on *Measurement of liabilities in IAS37*, dated 18 May 2010, we raised concerns about whether using probability weighting would be appropriate for a single, distinct liability. Similarly, while it would be reasonable to use probability weighting to ascertain a transaction price for a large portfolio of similar transactions, for businesses with fewer and larger distinct contracts a best estimate approach would be more appropriate.

Question 5

Paragraph 43 proposes that the transaction price should reflect the customer’s credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue

an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

The proposal to reflect credit risk in the initial transaction price and thereby reduce revenue is a controversial one. While paragraph B78 clearly states that only material adjustments to the transaction price should be made, for many users of financial information, where an adjustment is made, it will distort the understanding of what the revenue figures represent. It may also lead to practical issues for preparers who will also need to keep and reconcile records of actual amounts invoiced.

We accept that the proposals are consistent with the recent proposals by the IASB with regards adjusting the value of loans and receivables to reflect expectations of default. Indeed, we also note that there are similar provisions in UK GAAP for example (IFRS5, Application Note G), where revenue is adjusted at the time of supply when there is expectation that costs may not be recovered.

By proposing to recognise any subsequent recovery of the amount contracted and not recognised in the transaction price in other income rather than as revenue, the Boards appear to be presuming that the entity itself has inflated the sales price to account for the customer's likelihood of defaulting. In such circumstances the proposed treatment does seem reasonable.

However, we are not convinced that this is likely to be the case in most circumstances and on balance we would prefer a deferral of the credit risk element as revenue upon recovery.

Question 6

Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

We agree that in principle where there is a material financing component within a contract that the consideration should be adjusted to reflect the time value of money.

Question 7

Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate and how should the transaction price be allocated in such cases?

We agree that the transaction price should be allocated to all separate performance obligations in proportion to their stand-alone selling prices. As explored in our response to Question 9, we believe there may be an issue where two contracts are deemed interdependent, but still have separately identifiable performance obligations. If there are subsequent changes to the estimate of the overall transaction price brought about by one of the performance obligations only not being fulfilled the overall change would still affect both when accounted for under the proposals.

Question 8

Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

We agree that as a general principle, only those costs which meet the definition of an asset should be recognised as such when incurred.

While this principle is reasonably stated in paragraph 57, we do have some specific concerns about whether the guidance in the ED is wholly appropriate. We note for example, that paragraph 57(a) mentions “a specific contract under negotiation” – without clear guidance on what is meant by ‘negotiation’, this could result in inconsistency of application. Similarly, the guidance in paragraphs 58 and 59, while helpful, could be seen as being a complete and prescriptive list. We do not believe that this is the case, as for example some costs of obtaining a contract (Paragraph 59(a)) can be retrieved if the contract

is unsuccessful and should legitimately be capitalised. The Boards should instead provide principled guidance on what type of costs should be expensed or capitalised.

Question 9

Paragraph 58 proposes the costs that relate directly to a contract for the purpose of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include and why?

We support the inclusion of other allocated costs directly related to the asset in the measurement of that asset and that these costs should also be used to determine whether a contract is onerous.

We do however note that under IAS37, a contract loss is recognised in advance of performance if the contract is assessed as being onerous or if it is probable that a construction contract will make a loss (IAS11). The proposed requirements differ to current practice in two key aspects and we do not support them for the reasons outlined.

The unit of account

The unit of account for recognising a loss in the ED is the individual performance obligation. Both IAS11 and IAS37 require this assessment to be made on whether the contract as a whole will be loss making. Thus it is quite conceivable to have a situation where a loss on a performance obligation would have to be recognised, while the contract which it is part of is still expected to be profitable. This clearly does not support the economic substance of the contract and the reality of how many contracts are priced. We therefore believe that an assessment should be made at the contract level, rather than on each performance obligation.

Probability weighting

Similar to the arguments expressed in Question 4, we do not agree that an entity should consider the probability weighted amount of the direct costs required to satisfy the performance obligations. Under current practice, entities assess the 'unavoidable costs of meeting an obligation' under IAS37 and the

'total contract cost' under IAS11 and we believe that this provides useful information.

Question 10

The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

We support the objectives of the proposed disclosure requirements and generally they would appear to provide decision-useful information.

However, we are concerned that the requirements are in some areas considerably more extensive than those under IAS11 and IAS18 and that they may not be practicable for all entities.

For example, while the reconciliation of contract balances with revenue recognised during the period would provide quite useful information for long term contracts for example, the requirements could be difficult and costly for some companies to comply with. An example of this might be identifying the aggregate amounts required, when various sales taxes are included in accounts receivable, but excluded from revenue.

The disclosure requirements for onerous performance obligations are also more detailed than the existing requirements in IAS37. More significant however, is the provision made in IAS37 to exclude disclosure which may be 'seriously prejudicial', which we believe should also be included in any final standard.

We do note however, that the ED does clearly state in paragraph 70, that entities should make a judgement on the level of detail that is provided for each of the requirements.

Question 11

The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

As with some of the other disclosure requirements, we do not believe that there is a compelling case for many of the requirements in paragraphs 77 and 78 on performance obligations, especially as many of them go beyond the requirements of existing standards, such as IFRS8.

Question 12

Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

These requirements are essentially the same as those in IFRS8, and again we see no reason to duplicate requirements that exist in other standards.

Question 13

Do you agree that an entity should apply the proposed requirements retrospectively (that is, as if the entity applied the proposed requirements to all contracts in existence at the effective date and in the comparative period)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost to preparers? If so, please explain the alternative and why you think it is better.

We agree that the proposed requirements should be made retrospectively as any form of prospective application could result in confusion for users as to whether revenue from contracts spanning over periods has been double-counted or recognised at all.

Question 14

The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposal operational? If not, what additional guidance do you suggest?

In general we support robust principles underpinning standards. Excessive application guidance suggests that the principles within the standard are unclear and also such guidance might be seen as prescriptive by preparers and users.

However, and as we noted in our response to Question 3, in the context of service and long term construction contracts in particular where there is likely to be complexity faced by entities, industry-specific application guidance would be useful.

Question 15

The Boards propose that an entity should distinguish between the following types of product warranties:

(a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation, but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

(b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

Rights of return are a clearly a difficult area, with there often being quite subtle differences between various types of warranties. Thus a level of judgement will have to be applied as to which type of warranty is applicable. In principle we agree that there is a distinction between warranties that provide coverage for

future faults and those that relate to statutory requirements or normal practice for latent defects.

Coverage for future faults usually provided through an extended warranty does represent a separate performance obligation from the sale of the good or services themselves. We therefore agree that this should be accounted for as deferred revenue of the amount of sales that are expected to be returned.

In contrast, and although there are similarities, we agree that a legal (eg one year) warranty whereby a customer can return a good that does not meet the specifications or required quality is actually a necessary part of the sale of the good itself. In these circumstances it may be more appropriate to account for a provision for the costs to repair or replace the items, in line with IAS37.

Question 16

The boards propose the following if a licence is not considered to be a sale of intellectual property:

(a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and

(b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and satisfies that obligation when the customer is able to use and benefit from the licence.

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

If exclusivity is the determining factor then we would agree with the proposed accounting in the ED. However, and as we have stated throughout this letter, we believe it is important that clear principles are adhered to and therefore question whether the distinction should be made at such a level. We note that paragraph 32 clearly sets a principle on continuous involvement, which is more relevant.

Furthermore, we also note that a key feature in such as licence agreements is the 'right to use'. As this concept is a critical factor in the exposure draft on lease accounting, the Boards should consider whether this should be scoped

into the leasing project, rather than being dealt with as part of a standard on revenue.

Question 17

The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

We agree with this proposal.

If there are any matters arising from the above please be in touch with me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Aziz Tayyebi', with a horizontal line underneath.

Aziz Tayyebi
Financial reporting officer
ACCA
aziz.tayyebi@accaglobal.com