



# RESPONSE TO IASB EXPOSURE DRAFT: REVENUE FROM CONTRACTS WITH CUSTOMERS

14 MARCH 2012

## **INTRODUCTION**

The Institute's Accounting Standards Committee has considered the above exposure draft and I am pleased to forward its comments to the IASB.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires the Accounting Standards Committee to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Our key comments and responses to the questions in the invitation to comment are set out below.

Any enquiries should be addressed to Amy Hutchinson, Assistant Director, Technical Policy and Secretary to the Accounting Standards Committee.

## KEY COMMENTS

We support the overall approach taken by the IASB, and believe that in many respects, the Exposure Draft represents a significant improvement over the previous version. In particular, the IASB has taken note of constituents' concerns in relation to the recognition of revenue over time and has adequately addressed these concerns. However, we believe that the IASB should re-consider the following areas:

- The unit of account for the recognition of onerous contracts. We are not persuaded by the IASB's arguments for this to be measured at the level of individual performance obligations and believe that the contract is the correct unit of account.
- The presentation of the effect of customer credit risk as a separate line item on the face of the income statement. This will serve to add clutter to the statement and could set a precedent for detailed items being added to the requirements of IAS 1 via individual standards, in which the overall impact on presentation may not be considered.
- The proposed additional disclosure requirements in IAS 34. The requirements of IAS 34 are currently adequate – if the IASB has evidence that this is not the case, this should be addressed via a separate project on IAS 34.

Additionally, although the IASB has not requested comments on other areas, we would like to raise some concerns about the proposed disclosure requirements in the Exposure Draft for annual financial statements. It is widely accepted that the existing disclosures on revenue are inadequate and that therefore some increase in disclosure requirements is necessary, but we do not think that the IASB has found the right balance between assisting preparers in providing useful information whilst also avoiding an excessive level of disclosure. Given that the IASB expects to start a project on a disclosure framework, it is particularly important that in the meantime, a major standard such as this does not exacerbate the problem of disclosure overload.

We agree with the broad principle specified in paragraph 109 and find the information in paragraph 110 helpful, but until the disclosure framework is drafted, we believe that it would be useful to add some guidance on materiality in relation to disclosures within this standard. With the current proposed disclosures, we believe there is a risk that the really key information about revenue i.e. the key judgements and uncertainties regarding when and how revenue is recognised and measured, is obscured by highly detailed reconciliations and so on. Therefore, we believe that the requirement for a reconciliation of contract balances in paragraph 117 could be replaced with a 'summary of material changes' (similarly the reconciliation required in paragraph 123). In addition, the requirements under the headings 'performance obligations' (paragraph 118 onwards) and 'significant judgements in the application of the IFRS' (paragraph 124 onwards) are somewhat duplicative and could be reduced. The requirements in relation to judgements focus on performance obligations when a broader approach would provide more useful information to help users understand the substance of an entity's contracts with its customers.

## 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?

**Response:**

In our response to the previous Exposure Draft, we noted that we had concerns about the guidance in relation to goods or services transferred over time, and that we would prefer to see a 'continuous transfer' approach. The IASB has now added criteria to identify when revenue can be recognised over time, which adequately address our previous concerns. The proposals are sensible and would require entities to recognise revenue over time when this most closely reflects the underlying economic transaction.

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

**Response:**

On reflection we are happy with the proposal to present the effects of customer credit risk separately from total revenue to which the entity is entitled, as we understand that the majority of respondents to the previous ED were in favour of this approach. However, we do not believe the IASB has justified why this information must be presented as a separate line on the face of the income statement. We are concerned that this could set a precedent for individual standards requiring detailed information to be presented in the main financial statements, when the general principles in IAS 1 are adequate. This type of cluttering of the main statements risks obscuring the overall view of an entity's performance and position. We also believe that the standard should emphasise that this information is only required where it is material.

**Question 3:** 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?

**Response:**

We agree with the concept that an entity should only recognise revenue when there is reasonable assurance of its entitlement. However, over-explanation of principles can lead to unintended consequences and we are concerned that the indicators for recognition as listed in paragraph 82 include measurement criteria. In addition, while the intended meaning of paragraph 85 is appropriate the main principle in paragraph 81 should be clear enough that this type of additional explanation is not necessary. We do not disagree with the meaning of paragraph 85, but believe that it should be included in application guidance rather than in the main body of the standard. The IASB must look again at the wording of paragraph 81 – in particular at the use of the word 'amount' in the first three lines, as this currently refers both to revenue and consideration which is confusing.

**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?

**Response:**

We do not agree that the onerous test should be at the performance obligation level – as we stated in our response to the previous ED, this should be at the contract level. We note that the majority of respondents to the previous ED shared our view, and we do not find the IASB's arguments for continuing to use the performance obligation level convincing. We believe that performing the onerous test at the contract level will provide more useful information. We do not believe it useful to recognise a loss in relation to a performance obligation when the overall contract which that obligation is part of is expected to be profitable.

We do not agree with the scope of the onerous test being limited to performance obligations lasting more than one year as this merely introduces the potential for manipulation, as a long-term contract could be structured to include performance obligations of less than one year.

**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 (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.

**Response:**

We do not support the proposed amendments in IAS 34. We believe the broad principles in IAS 34 are appropriate, and if the IASB thinks it is necessary to re-visit these, this should be done through a separate project on IAS 34 (we do not think this is necessary). The key information about revenue should be presented in an interim report under the principles of IAS 34 anyway, and the level of detail proposed here is excessive. The IASB has not presented a robust justification for proposing these additional requirements.

**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?

**Response:**

We agree with the proposed amendments to other standards to align these with the ED.