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13 March 2012

Dear Board Members,

Exposure Draft ED/2011/6 – Revenue from Contracts with Customers

Deloitte Touche Tohmatsu Limited (DTTL) is pleased to respond to ED/2011/6 *Revenue from Contracts with Customers* ('the exposure draft' or 'the current ED').

We welcome the decision by the boards of the IASB and the FASB to re-expose the revenue proposals. In our view, the current ED is a significant improvement and the boards have addressed a number of the issues about which we were concerned in respect of the initial exposure draft (ED/2010/6). Nevertheless, we continue to disagree with some of the proposals in the current ED. In addition, certain aspects would benefit from further clarification to ensure that the final Standard will be of benefit to both users and preparers of financial statements.

Our main comments, which are discussed in more detail in the Appendix to this letter, are as follows.

- The requirements in respect of onerous contracts and onerous performance obligations are confusing, inconsistent and unhelpful to users of the financial statements. In our view, the boards should not proceed with the proposals in the current ED. Instead, they should issue a converged revenue Standard that does not deal with provisions arising from onerous contracts or onerous performance obligations. Although convergence in this area is important, the accounting for such provisions should be considered in a separate project, based on the principles set out in IAS 37, with the current IFRS and US GAAP requirements continuing to apply in the meantime.
- The drafting of paragraph 35 should be improved to focus on the underlying principles and to improve clarity.
- The guidance on variable consideration should be refined to avoid unintended consequences, as explained in our response to Question 3. Unless the guidance is refined,

it is possible that an entity expecting to receive variable consideration may be required in the early stages of a contract to recognise profits that are not yet reasonably assured, and then to reverse them in the later stages, even where expected outcomes have not changed. Also, an entity supplying goods or services in exchange for a valuable income stream may be required to report a loss even though the fair value of that income stream is in excess of the associated costs.

- Any changes to the disclosure requirements for interim financial reports should be considered as part of work on a disclosure framework, and not as consequential amendments from a revenue Standard.
- More consideration is required before extending the proposed derecognition and measurement requirements to transfers of other non-financial assets.
- The guidance on when not to separate performance obligations (paragraph 29) will not work well in its current rule-based form. It should be redrafted to set out an underlying principle and associated indicators.
- The restriction in paragraph 85 relating to sales-based royalties should be re-expressed as a general principle relating to the recognition of contingent revenue rather than an exception to the measurement requirements.
- Further guidance is required in relation to transfers of intangible items, such as rights of use for intellectual property, and when control of such items is obtained by a customer.
- Historically, there have been various aspects of revenue on which, because of their complexity, the boards have found it necessary to issue specific guidance. The boards should look critically at the existing literature and consider whether the underlying issues addressed are still of sufficient significance as to warrant additional application guidance or illustrative examples.

In addition, we believe more guidance is needed on how to address the significant practical questions that will arise for some entities when seeking to apply the guidance in the current ED, particularly in circumstances, such as in the telecommunications industry, in which an entity's revenue is generated from a large portfolio of small contracts. In the Appendix to this letter, we describe an approach that we believe would be appropriate in such circumstances.

Our detailed responses to the questions in the invitation to comment, and our other observations, are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884 or Robert Uhl in the United States at +1 203 761-3152.

Yours sincerely,

Veronica Poole
Global Managing Director
IFRS Technical

Appendix

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?

We welcome the proposals in this draft, which provide greater clarity over when revenue should be recognised over time, and we are broadly supportive of the underlying thinking that the boards have developed. However, we suggest that the current drafting could be improved.

In particular, paragraph 35 appears, at present, to be a mixture of principles and absolute rules. It would be better to set out the principles more clearly, explaining how they relate to the underlying control concept, and to keep them separate from any characteristics or indicators that should be considered when seeking to apply them. This would also help to clarify that the criteria currently described in paragraph 35 are not mutually exclusive, which may be a source of confusion in the existing drafting.

In our view, paragraph 35 should explicitly identify two principles (which are not mutually exclusive) that demonstrate the customer obtains control over time, either of which can be satisfied for revenue to be recognised over time.

- The customer receives the benefits of the entity's performance as the entity performs. This may be because an asset controlled by the customer is created or enhanced [35(a)], or because the customer receives and consumes benefit as the entity performs [35(b)(i)]. If, without the benefit of any asset controlled by the seller, another entity would not need to substantially re-perform the work completed to date, that demonstrates that the customer has received benefit over time [35(b)(ii)].
- The customer, rather than the seller, has the ability to direct the use of and obtain substantially all of the remaining benefits arising from the seller's performance to date (echoing the words used in paragraph 32). In circumstances in which it is not clear whether the customer receives benefit over time (see above), the following characteristics will typically be both necessary and sufficient for this principle to be met: (i) the seller's performance does not create an asset with alternative use to the seller, and (ii) the customer cannot avoid paying for the seller's performance to date [35(b)(iii)]. But it is possible that alternative compelling evidence may demonstrate that the principle has been satisfied even in the absence of one of these characteristics.

Related to the point above, we do not see any need for the 'no alternative use' restriction to apply in paragraphs 35(b)(i) and (b)(ii).

The drafting in paragraph 35(b)(iii) in relation to customer payment should be improved as we are aware that it is being interpreted in different ways. In particular, there seems to be confusion over whether stage payments are required and whether there will always be a need for explicit contractual terms setting amounts of compensation payable in the event of customer termination. In our view, the appropriate characteristic is that the customer cannot avoid paying at least an amount that is commensurate with the seller's performance to date. Accordingly, there is no requirement for stage payments and it is only necessary to consider any termination payments if the customer is permitted to terminate the contract.

Our further comments on paragraphs 35 and 36 are set out later in this response.

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?

Overall, we agree with the proposals in the current ED not to reduce revenue for the effects of a customer's credit risk. This will enable users of the financial statements to understand clearly the level of bad debts that an entity experiences and how this relates to its reported revenue.

We note that for many entities the amounts that would be reflected in the separate line item will not be material and, accordingly, it will not be necessary to present them as a separate line item adjacent to the revenue line item. But where the amounts are material, we agree that separate presentation is important.

However, we encourage the boards to provide further guidance on how these proposals should be applied when an entity is recognising a contract asset rather than a receivable within the scope of IFRS 9 (or IAS 39) or ASC Topic 310. In our view, the final sentence of paragraph 68, which states only that an entity "shall similarly account for the effects of a customer's credit risk on a contract asset" is not sufficiently specific, particularly when dealing with issues such as variable consideration (which may or may not be reasonably assured). It would be helpful to include an example illustrating how the requirements should be applied in a more complex scenario and addressing the following issues:

- how credit risk should be assessed on initial recognition of a contract asset measured not at fair value but resulting from an allocation of the contract price to completed or partially completed performance obligations;
- how subsequent adjustments to the credit risk of a contract asset should be measured and presented in profit or loss; and
- whether this treatment is affected by the subsequent measurement of a receivable from the customer at amortised cost or at fair value through profit or loss.

It would be helpful for the final Standard to comment explicitly on the presentation of impairment losses relating to contracts for which there is a significant financing component. Paragraph BC175 notes that the presentation would be consistent with the presentation of impairment losses for other types of financial assets within the scope of the financial instruments standards, but we are not aware of any constraints that would prevent such impairment losses being presented adjacent to revenue. Accordingly, our understanding is that an entity would be permitted, but not required, to present those impairment losses adjacent to revenue, in the same place as impairment losses relating to transactions without a significant financing component.

Finally, we note that the boards are deliberating the accounting for impairment of financial assets separately from the revenue project, which may ultimately have consequences for this part of the current ED's proposals. Future decisions may affect both the timing and the amount of adjustments to be presented in the proposed separate line item. We encourage the boards to keep the potential consequences for revenue recognition in mind when further developing the impairment proposals, and to seek constituents' views if and when necessary.

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?

We broadly support the proposals in the current ED relating to this area but there are two problems which we envisage and would suggest that the boards address.

The first issue relates to the profile of revenue and profit recognition when variable consideration is likely but not reasonably assured. In the situation in which an entity enters into a contract to provide a service, for which it receives a fixed fee but will also receive a contingent fee if certain conditions are met, this may result in the entity recognising revenue at a faster rate over the initial stages of the contract and at a slower rate (or even not at all) over the latter part of the contract. In some circumstances, this may result in an entity recognising losses in the latter part of the contract even though the contract is profitable overall.

To illustrate, suppose that an entity agrees to provide a service in exchange for a fixed fee of CU1,200 and a possible contingent bonus of CU800 (which is considered likely to be received, but will not be reasonably assured until the end of the contract). The entity estimates that the costs to complete the contract will be CU1,000. Under current GAAP, entities would typically apply a percentage of completion approach using only the fixed fee – e.g. when 55% of the work is complete, revenue of CU660 will have been recognised. This gives a 'sensible' profile of revenue (and profit) over all of the work performed. However, under the new ED, if the entity estimates the transaction price using the most likely amount, then it appears that percentage of completion would be based on the likely outcome of CU2,000 – so when 55% of the work is complete, revenue of CU1,100 and a profit of CU550 (which is in excess of the profit that is reasonably assured on the contract) will have been recognised. After the entity has performed 60% of the work, the 'reasonably assured' cap on revenue will apply and the entity will recognise further costs, but no corresponding revenue. If the additional bonus of CU800 does not become reasonably assured until the end of the contract, the entity will have recognised revenue of CU1,200 (and profit of CU600) over the first 60% of the contract, and revenue of nil (and losses of CU400) for most of the remainder of the contract. (Although the numbers would be different if the entity estimated the transaction price using a weighted average amount, the same underlying issue would arise. For example, if the entity judged that there was a 75% probability of receiving the CU800 bonus, the transaction price would instead be estimated as CU1,800. The entity would recognise revenue of CU1,200 (and profit of CU533) over the first 67% of the contract, and revenue of nil (and losses of CU333) for most of the remainder of the contract.)

This is not a helpful depiction of the underlying economics, particularly for an entity that has a small number of large and independent contracts of this type which cut across reporting dates. We would recommend that the boards consider how the proposals in the ED could be modified to give an answer that better reflects the economics of the situation.

One approach might be to require an entity to devise and adopt an appropriate basis for recognising revenue, subject to the constraint that the amounts of revenue recognised should not exceed the amounts that would be determined in accordance with the draft Standard, with the method adopted being disclosed and explained in the financial statements. Alternatively, a second way of

eliminating this anomaly would be to impose a further cap on revenue so as to limit the cumulative profit recognition to the amount that is reasonably assured. In the example above, this would mean that the cumulative profit would not be able to exceed CU200 until the contingent payment of CU800 became reasonably assured. Using the 'most likely' estimate, this would result in revenue of CU400 (and profits of CU200) being recognised over the first 20% of the contract and, thereafter, revenue being recognised only to the extent of costs during the period (i.e. retaining a cumulative profit of CU200) until such time that the entity considers that the contingent amount is reasonably assured. (Similarly, using the weighted average estimate, this would result in revenue of CU450 (and profits of CU200) being recognised over the first 25% of the contract and, thereafter, revenue being recognised only to the extent of costs during the period.)

The second issue arises where an entity transfers a non-financial asset for an amount of cash that is less than its carrying amount plus a right to further amounts (e.g. royalties) based on usage (which are not reasonably assured, but which are expected to be in excess of the difference between the cash and the carrying amount). If the fair value of the consideration as a whole (including the fair value of the additional income stream) is believed to be in excess of the previous carrying amount, it seems inappropriate to recognise a loss on the initial disposal of the asset merely because the additional income stream is not reasonably assured. Again, we encourage the boards to consider how the proposals in the ED could be modified to give an answer that better reflects the economics of the situation.

A possible solution might be to adopt an accounting treatment similar to the 'intangible asset' model used in IFRIC 12, whereby an intangible asset is recognised in respect of the valuable conditional right to receive an additional income stream. If the idea of a 'reasonably assured' cap on profits was also adopted, as discussed above, the effect would be for the entity to recognise revenue equal to previous carrying amount on the initial disposal of the asset, thus reflecting a nil profit margin. This would avoid the practical difficulties of trying to place a fair value on such an additional income stream while still recognising that, in many cases, the entity will expect to recover the costs incurred (as discussed in paragraph 48).

We note that such an approach would be relevant for royalty arrangements, but it may also have wider implications. In particular, it might help in addressing an apparent issue that may otherwise arise for some telecommunications entities ('telcos'), namely the mismatch between accounting for contracts acquired directly and indirectly. To illustrate, suppose that a telco is prepared to pay CU50 to sign up a new customer – either by paying a CU50 subsidy to another party (who will supply the handset, perhaps at an equivalent discount) or by giving the customer a CU50 discount on a handset to be provided directly. The problem is that the accounting and profit is different in each case.

- For the contract acquired indirectly, CU50 is capitalised and amortised. Subsequent revenue for calls and other services does not need to be adjusted.
- For the contract acquired directly, no amounts are capitalised and instead some of the subsequent revenues are reallocated to the handset. This leads to three potential differences:
    - a possible day one loss on the handset (even after reallocating some call revenue);
    - different (reduced) ongoing revenue from calls; and
    - no subsequent amortisation of initial costs (because none are capitalised).

It is hard to see that it is meaningful to have a day one loss for direct contracts when no such loss arises for indirect contracts. Although it is true that the entity is in a slightly different economic position for contracts acquired directly and indirectly, because for the latter it has no responsibility for the handset, this difference is relatively minor in the context of the overall contract economics. (Moreover, for direct contracts, the amount of the day one loss will potentially be affected, arbitrarily, by the value of the handset supplied. If a relative stand-alone selling price basis is used, differently priced handsets will produce a different reallocation of revenues and, hence, a different

day one loss – even where the same discount is given.) Applying the logic of the 'intangible asset' model detailed in IFRIC 12 would seem to produce an outcome that is more consistent and more helpful to users.

- On day one, the entity would recognise revenue equal to the cost of the handset (e.g. CU200). If the amount of cash receivable for the handset is lower (e.g. CU150), the difference (i.e. the CU50 discount) would be capitalised as an intangible.
- Thereafter, the intangible would be amortised in the same way as the costs of acquiring the contract under the indirect sale.
- There would be no reallocation of subsequent revenues. As discussed later, such reallocation would be a major practical issue for many telcos, and arguably would also impair comparability for analysts and other users.

Irrespective of the above suggestion, we believe it will be necessary to consider the interaction between the new revenue Standard and IFRIC 12. The current ED does not scope out revenue transactions that would also be within the scope of IFRIC 12, and we note that there are no proposals to amend the intangible asset model used for service concession arrangements. Accordingly, we assume that the approach currently required by IFRIC 12 is considered to be consistent with the model in the current ED. Consequently, it appears possible that the approach currently required by IFRIC 12 can, and sometimes should, be applied more widely. We believe the final Standard should include specific discussion of this topic, including the circumstances in which it is or is not appropriate to recognise revenue and an intangible asset. When an entity supplies goods or services in respect of an asset (e.g. intellectual property or a service concession asset) in exchange for a valuable right to related variable income that is not yet reasonably assured or for which the customer has not yet had an obligating event, and any fixed cash element would not be sufficient to cover the cost of the goods or services supplied, we believe use of the intangible model may be appropriate. Conversely, it would not be appropriate to use the model merely because an item is sold at a loss as part of a general promotional campaign or because changing prices have made the goods or services provided at an early stage of the contract unprofitable.

Finally, we note that one consequence of applying the intangible model is that, as in IFRIC 12, revenue is 'recognised twice' – i.e. the total revenues recognised are in excess of the cash inflows. This is accepted as the appropriate outcome under IFRIC 12 and we believe the logic is equally applicable here. However, an alternative approach, which would achieve the same profit profile and still address most of the issues highlighted above, would be to defer costs as an intangible asset, and this solution would be equally acceptable to us. Clearly, it is important that consistent principles are adopted in IFRIC 12 and in the final Standard, so this might require further amendments to IFRIC 12.

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?

We disagree with the proposals in the current ED. We remain strongly of the view, as expressed in our response to ED/2010/6, that liabilities should not be recognised for onerous performance obligations per se but instead should be recognised for contracts that are onerous – a method that currently works under IAS 37 and is familiar to both preparers and users. Retaining that approach will not 'add complexity' as suggested in paragraph BC207 but will instead preserve the status quo for IFRS reporters. For the reasons set out below, we believe that the proposals in the current ED will result in accounting treatments that are confusing, inconsistent and unhelpful to users of the

financial statements. In our view, the boards should not proceed with the proposals in the current ED. Instead, they should issue a converged revenue Standard that does not deal with provisions arising from onerous contracts or onerous performance obligations. The accounting for such provisions is part of a broader issue and should be considered in a separate project, based on the principles set out in IAS 37, and in the meantime should remain within the scope of IAS 37 (and equivalent US standards), rather than being included within the parameters of the final revenue Standard.

The rationale for our disagreement is set out below.

Firstly, we disagree with the statement in paragraph BC207 that assessment at the contract level would be 'arbitrary'. Paragraph BC207 suggests that different accounting would result depending on whether an entity entered into one contract or two. However:

- if the entity entered into those two contracts at the same time, it seems likely that they would be combined in accordance with paragraph 17; whereas
- if not, an entity that has entered into a loss-making contract, in the hope that a profitable contract may follow later, is in an entirely different position from an entity that has entered into a contract that is profitable overall. There is nothing arbitrary about this difference. In the first scenario, the entity may well make a loss. In the second, it will not.

We would instead argue that it will often be arbitrary to apply the onerous test at the performance obligation level. Typically, entities negotiate and agree pricing for contracts, not performance obligations. The current ED mandates a methodology for allocating revenue to performance obligations that will sometimes result in an allocation that differs, arbitrarily, from the underlying economics of the contract. Also, since paragraph 30 allows performance obligations to be combined if the pattern of delivery is the same, a performance obligation that would otherwise have been onerous will result in reduced or no provision if it has the same pattern of delivery as another that is profitable.

Moreover, the different approaches proposed by the current ED where revenue is recognised over time or at a point in time, and depending on the length of a contract, appear not just arbitrary but confusing. As explained below, it seems to us that this unnecessarily complex approach greatly increases the risk of unintentional non-compliance and is likely to result in confusion for both preparers and users.

For IFRS reporters, the current ED proposes that the consideration of whether provisions are required for onerous contracts will be scoped out of IAS 37 and instead onerous performance obligations will be within the scope of the new revenue Standard where revenue is spread over a period of time. However, based on paragraph BC210, it appears that contracts for the sale of goods (where performance obligations are satisfied at a point in time) will, indirectly, be scoped back into IAS 37 due to them relating to the sale of inventories which are within the scope of IAS 2 and, as such, the scope of IAS 37. This will result in entities making provisions for onerous contracts for the sale of goods. We note that this results in an inconsistent basis for measurement between performance obligations satisfied over time (onerous test applied at the performance obligation level) and performance obligations satisfied at a point in time (onerous test applied at the contract level). We do not see a convincing rationale for this difference. (Moreover, it is unhelpful to make the link to IAS 2 only in the Basis for Conclusions and not in the draft Standard itself.)

When revenue is expected at inception to be recognised over time and over a period of more than one year, the current ED proposes that provisions should be recognised for any onerous performance obligations. Conversely, when revenue is anticipated to be recognised over time but over a period of less than one year, an entity would not be permitted to provide for any elements of the contract that are onerous, even if the contract is onerous overall. We note that this results in an inconsistent basis for measurement depending only on the length of time expected to be required to

satisfy a performance obligation over time. Again, we do not see a convincing rationale for this difference. It is likely that both preparers and users will be confused by this. Indeed, we suspect most users would assume that an entity would have provided for a contract that has become loss-making, even if that loss is expected to crystallise entirely within the next financial year; under the current ED's proposals, such users may mistakenly believe that an entity's financial position is better than is really the case.

Finally, it is not helpful to users or preparers to split these requirements across different Standards (for IFRS reporters, the proposed new revenue Standard and IAS 37 via IAS 2). There is much less potential for confusion and error if the requirements are set out clearly in one place. We strongly believe that entities should make provisions based on the expected loss from a contract as a whole, as is currently the case under IFRSs, and that this should be applied consistently to all contracts rather than having differing treatments depending on the length of the contract and the pattern of revenue recognition.

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.

We do not agree with the proposals in the ED to specify mandatory disclosures in respect of revenue in interim financial reports. It is inappropriate for the revenue Standard to amend IAS 34 and ASC 270 in such a way as to require disclosures that are not in line with the principles currently set out in those Standards. Any change to the principles for disclosure in IAS 34 and ASC 270 should be considered as a separate project and, at this stage, insufficient thought has been given to the purpose of disclosures in interim financial reports.

In our response to the Agenda Consultation we stated that we consider the development of a Disclosure Framework to be both critical and urgent and it would be appropriate to consider whether revenue disclosures should be incorporated into IAS 34 as part of this wider project. This is consistent with the overall thrust of responses to the Agenda Consultation, as discussed at the IASB's board meeting in January 2012.

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?

We disagree with these proposals. In our view, more consideration is required before extending the derecognition and measurement requirements. The discussion of this topic in the Basis for Conclusions is thin. It makes clear why, for US GAAP reporters, a change is appropriate but does not consider alternative solutions or discuss why the proposed solutions are best.

For US GAAP reporters, we are unsure why the FASB's proposed amendments to the codification in ASC 605-40-25-1A and 605-40-40-1 (which would be the guidance that these types of transactions would follow) limit the references to the revised ED's paragraphs on transferring control at a point in time and determining the transaction price (without reference to the guidance on constraining the amount of revenue recognised to the cumulative amount that is reasonably assured in accordance with paragraph 81 of the revised ED). Other aspects of the proposed Standard might also be helpful when accounting for a transfer of a non-financial asset in terms of timing of derecognition and measurement of the gain or loss (e.g. contract existence criteria) and should be considered by the boards within the amendments to the codification.

For IFRS reporters, as discussed below, the proposal to extend the measurement requirements would apparently result in two quite different models being applied overall:

- gains on disposals of financial assets and certain other assets would be recognised on a fair value basis;
- gains on disposals of other non-financial assets would be recognised on a 'reasonably assured' basis, as described in the current ED.

This could produce some anomalous results. For example, consider an entity that is selling a portfolio of investment properties, for proceeds that may include a contingent element. If the portfolio is regarded as a business, the gain on disposal will reflect the fair value of that contingent element in accordance with IFRS 9 (or IAS 39); if not, the contingent element would not be recognised until it is reasonably assured.

Moreover, when an entity has adopted the fair value model for its investment properties, it may seem odd to move away from a fair value model when accounting for their disposal – particularly if the contingent element of proceeds is closely related to the value of the property. For example, land held as investment property may have a fair value that reflects its existing use, together with an uplift relating to the possibility of obtaining permission for a more profitable alternative use. If that property is sold for proceeds that include a contingent element relating to obtaining permission for alternative use, it seems counterintuitive to include that element while the property is held, but to exclude it on disposal.

Accordingly, although we see merits in both a fair value model and a 'reasonably assured' model, we recommend the boards give more thought as to which is more appropriate for each particular scenario.

A similar issue arises for derecognition. For IFRS reporters, the extension of the derecognition requirements would result in two different models being applied overall:

- derecognition of financial assets within the scope of IFRS 9 (or IAS 39) would be based on the model used for financial instruments, which combines concepts of control and risks and rewards; and
- derecognition of non-financial assets would be on the basis described in the current ED.

It is not clear to us which model would apply to disposals of financial assets, such as investments in subsidiaries and associates, which are scoped out of IFRS 9 (and IAS 39). More generally, we recommend again that the boards give more thought as to which model is more appropriate for each type of asset that might be affected.

We note that Appendix D proposes amendments to IASs 16, 38 and 40 in respect of disposals of non-financial assets that are not an output of an entity's ordinary activities. We would welcome clarification of whether the proposals would extend to other such assets; for example, would they apply to the sale of tax assets such as tax losses?

Finally, we refer you to our response to Question 3 above, and the issue that arises where an asset is sold for cash consideration of less than its carrying value, together with an anticipated incoming royalty stream that is not reasonably assured. That issue will also arise for some disposals of non-financial assets that are not an output of an entity's ordinary activities.

Other major points and matters for which we disagree with the ED's proposals

Constraining the cumulative amount of revenue recognised (paragraph 85)

We agree with the outcome that paragraph 85 achieves, but not with the logic presented for this treatment. We believe that the constraint imposed should not be based on an inability to estimate future outcomes but, rather, on a customer not yet being committed to future payments. Accordingly, to deal better with the various scenarios that can arise, we suggest paragraph 85 should be rewritten to state a general principle that, where revenue will arise only to the extent that a customer chooses to use an item, it should not be recognised until the customer has an obligating event such that it can no longer avoid a liability for the additional consideration. Although royalties from licensing intellectual property are often based on the customer choosing to make sales (as discussed in paragraph 85), other scenarios are possible, such as a royalty based on manufacturing activity. Moreover, some sales-based payments from customers are not related to intellectual property: for example, the customer of an advertising agency may make incremental payments to the agency based on additional sales that result from the advertising services provided. As currently drafted, paragraph 85 would not seem to address these scenarios, even though they are very similar.

As the principle that we outline above relates to recognition of revenue, rather than measurement, we suggest that it would be better dealt with in the section dealing with recognition (i.e. paragraphs 31 to 48).

Disclosures (paragraphs 109 to 130)

We welcome the use of judgement to assess the level of detail in the various disclosures required. We would further suggest that the final Standard makes clear that judgement may be applied to determine whether or not a particular disclosure is required at all as for some entities certain disclosures will not provide meaningful information (e.g. the reconciliation in paragraph 117 may be of limited relevance for most retailers).

We recommend that the final Standard clarifies whether contracts that were wholly performed within the reporting period, and therefore do not form part of the opening or closing statement of financial position, should be included in the reconciliation required by paragraph 117. Example 19 appears to suggest that this would be the case. We are concerned that, for some entities, this reconciliation may be overly burdensome to produce and may not result in the provision of information that is genuinely useful.

As noted in our response to the previous exposure draft, we do not support the forward-looking disclosures proposed by paragraph 119 of the ED. We do not believe the disclosures required by this paragraph provide meaningful information as they do not provide a complete picture of future revenues. We continue to believe that such disclosures could be encouraged in the management commentary, but should not be required in IFRS or US GAAP financial statements.

Finally, we reiterate the position expressed in our response to the IASB's recent agenda consultation that we consider the development of a Disclosure Framework to be both critical and urgent. We anticipate that the revenue Standard will be finalised before completion of work on the framework. If so, the boards should in due course revisit the disclosure requirements in light of the framework.

Licensing and rights to use (paragraph B34)

We believe further clarification is required in respect of paragraph B34, which states that control of rights to use intellectual property cannot be transferred before the beginning of the period during which the customer can use and benefit from the licensed property. In particular, without

additional explanations or guidance, it is unclear to us whether this statement is consistent with the performance obligation model, and this will have implications for how that model is understood and applied.

- Some would argue that this statement is correct. Paragraph 31 states that a performance obligation is satisfied by transferring a promised good or service and, further, that "an asset is transferred when (or as) the customer obtains control of that asset". Thus, in their view, the focus is not on whether the seller has any further activities to perform; the focus is on whether the customer has obtained control of the asset. The fact that the customer is not yet contractually permitted to use the licensed property means that the performance obligation has not yet been satisfied.
- Others would argue that, at least in some circumstances, the statement need not be correct. In their view, a performance obligation is satisfied through the seller's performance, and not merely through the passage of time. Thus, it is necessary to focus on the legal mechanism by which the associated rights are transferred. They believe it is sometimes possible for an entity to transfer irrevocably the right to intellectual property and have no remaining performance obligations, even though the licence cannot be used by the customer until a specified date in the future.

In our view, the ED does not include sufficient guidance to make clear which of these interpretations is correct. We note that the example given at the end of paragraph B34 does not assist, because it does not illustrate the statement made in the sentence that precedes it. In that example, there is clearly an outstanding performance obligation, because the access code has not yet been supplied.

In order to address these uncertainties, we recommend the boards provide guidance on how to apply the performance obligation and control concepts in the context of intangible items, such as intellectual property. We encourage the boards to consider at least the following three scenarios:

- a transfer of software for which an access code has not yet been supplied (and, hence, not all performance obligations have been satisfied);
- a transfer of an intangible (for example, a motion picture) with an associated contractual restriction on timing of use. The customer would physically be capable of using the intangible prior to the permitted date, but would be in breach of contract if it did so; and
- a transfer of a licence originally issued by a third party (for example, a taxi licence), for which the licence period has not yet commenced.

When considering these issues, we believe it may be helpful to consider the following factors.

- Who has imposed the restriction on use of the item? Was the restriction imposed by the seller or another party?
- Should the restriction on use be considered as something separate from the item itself, or as an inherent part of the item?

To illustrate why these factors may be important, consider an emissions trading scheme. Entities may buy and sell certificates that, ultimately, can be used only to settle emissions liabilities on a specified future date. If a buyer cannot be said to have control of such a certificate until it can be used then, arguably, control can only pass on that specified future date. But this does not seem to reflect the reality of emissions trading – because that restriction on use appears to be an inherent part of the certificates being sold. It is a restriction imposed by the government or other body sponsoring the scheme, not one party selling certificates to another.

The issue discussed above may also have implications for Example 26.

Limiting separate performance obligations (paragraph 29)

We agree that it is appropriate to limit the circumstances in which it is necessary to identify separate performance obligations. However, for the reasons set out below, we suggest that the boards refine the approach taken in paragraph 29. We are concerned that the drafting currently proposed is too rules-based and may sometimes result in inappropriate outcomes. We would favour an approach based on a principle and associated indicators, rather than a set of rules.

If paragraph 29 continues to be drafted as a set of rules, there is a danger that preparers will focus too much on the interpretation of particular words in the paragraph and too little on the underlying objective. It seems to us that the underlying objective of paragraph 29 is that performance obligations should not be accounted for separately where to do so would not properly depict the nature of the combined item(s) for which the customer has contracted. In some cases, the combination of performance obligations into a single contract changes the overall nature of what is being supplied, and to account as though the customer had purchased each of the performance obligations separately would fail to reflect the overall substance.

If the current approach is retained, we believe clarification will be required of how the word 'significant' should be interpreted in paragraph 29. Is it intended to be a low threshold (anything that is not insignificant) or a higher threshold? Example 4 states that, in a particular scenario, an entity is providing a significant service of integrating goods and services and that software is significantly customised, but does not explain the basis on which these views have been reached. We would not wish the example to become a yardstick against which entities then judge their own scenarios, but without further guidance the thresholds intended by paragraph 29 would be unclear and likely to result in diversity of interpretation.

In addition, it is not clear to us whether paragraph 29(b) is appropriately drafted, as we have not identified any situations where paragraph 29(a) would 'wrongly' catch performance obligations that paragraph 29(b) would then exclude. Paragraph BC79 suggests that, without paragraph 29(b), there is "a risk that all contracts that include any type of integration service might be deemed to be a single performance obligation even if the risk that the entity assumes in integrating the promised goods or services is negligible (for example, a simple installation of standard equipment)". However, it seems unlikely that a simple installation would qualify as "a significant service of integrating" in paragraph 29(a). Moreover, it is possible that setting 29(b) as a rule may have the opposite outcome from what is intended in some cases. For example, we believe the boards had some construction contracts in mind when drafting paragraph 29; yet it may be argued that bricks are not "significantly modified or customised" as part of a construction contract and, therefore, that the criteria in paragraph 29 are not met.

Given the inherently subjective nature of the thresholds to be considered when applying paragraph 29, and the difficulty of drafting rules that will achieve appropriate outcomes in a wide variety of circumstances, we suggest the boards instead set out the underlying principle, together with indicators of when it may become applicable.

Contract assets and receivables (paragraph 106)

More clarity is required in respect of when balances are within the scope of the draft Standard (contract assets) and when in the scope of IFRS 9 (or IAS 39) (receivables). In particular, an entity may have fully performed its obligations and, as a result, may have an unconditional right to consideration, but that consideration may be variable and not yet reasonably assured. Such a right would seem to be a receivable based on paragraph 106(b) but, in that case, it would be recognised initially at fair value in accordance with IFRS 9 (or IAS 39) – which would apparently conflict with the draft Standard's requirements for variable consideration.

A similar question of scope arises for contracts that involve provisional pricing. For example, an entity may deliver goods on a particular date, but the price may be determined at a subsequent date (e.g. by reference to a subsequent market price). It would seem sensible to treat this truing-up of price as a change in estimate. However, it appears that the balance recognised on the date of delivery is an unconditional right to cash and, therefore, a receivable rather than a contract asset. This would apparently mean that subsequent changes in measurement would be within the scope of IFRS 9 (or IAS 39), rather than the draft Standard.

We encourage the boards to reconsider the guidance on contract assets and receivables to ensure that balances more appropriately treated as contract assets are not instead classified as receivables.

Contract modifications (paragraph 20)

With one exception, we support the proposed approach to contract modifications. The exception is the requirement in paragraph 20, which states that when the only modification to the contract is a change in transaction price, this should be accounted for retrospectively (by reference to paragraphs 77 – 80). We would agree with this where the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied at the date of modification. But where the remaining goods or services are distinct, this creates a 'bright line' difference with other contract modifications: e.g. if, as well as a change in transaction price, the entity supplies one extra good or service, however small, this will result in the contract modification being accounted for prospectively from the date of modification (by reference to the guidance in paragraph 22). We believe it would be appropriate to apply a consistent treatment to all contract modifications in accordance with the guidance set out in paragraph 22, including where the only modification to the contract is a change in transaction price.

Input methods (paragraph 46)

We question whether this guidance is appropriate. It is applicable only in very limited circumstances and results in revenue recognition on a basis that appears to conflict with the idea that the goods are not a separate performance obligation. When such goods do not represent a separate performance obligation, we believe it is instead appropriate to account for the single performance obligation (goods plus services) using a measure of the extent to which the associated services have been performed.

Allocating the transaction price to separate performance obligations (paragraph 75)

Paragraph 75 restricts the ability to allocate a discount entirely to one (or some) separate performance obligation(s), so that it is only available if the entity regularly sells each good or service (or each bundle of goods or services). We suggest that this is unnecessarily restrictive, and that the focus should instead be on the quality of evidence that supports the stand-alone selling prices. Paragraph 81 envisages that the experience of other entities may be relevant when assessing whether variable amounts are reasonably assured. In our view, evidence based on the experience of other parties could also be sufficient to justify the allocation of a discount entirely to one (or some) separate performance obligations under paragraph 75.

Example 9 (paragraph IE8)

We disagree with the methodology used and with the answer obtained in this example. We believe that paragraph 71, which requires the transaction price to be allocated on a relative stand-alone selling price basis, must require that allocation to be done after making any necessary adjustments for the time value of money. Paragraph 58 states clearly that, in determining the transaction price, the promised amount of consideration must be adjusted to reflect the time value of money where there is a significant financing component – i.e. the transaction price is the price after such adjustments.

To illustrate why this matters, suppose that an entity always sells an item for CU100. A customer wishes to purchase one unit of the item now, and another in one year's time, but wishes to pay for both immediately. The entity calculates that the effect of the time value of money where an amount is paid one year in advance is to reduce the amount payable by 5%. Accordingly, the customer pays CU195 for the two items.

The 'correct' allocation here is CU100 to each of the items and CU5 of interest expense. But the methodology illustrated in Example 9 will allocate CU97.5 to the first item and then unwind a discount of CU5.1, resulting in CU102.6 being allocated to the second item. This is clearly a distortion of the underlying economics.

Although the application of a relative stand-alone selling price basis is more complex where it is necessary to split out a financing component, in our view it is no more complex than many impairment calculations. We suggest that the boards modify this example to illustrate an appropriate methodology. It would also be helpful for the boards to provide additional examples to clarify when and how the time value of money concept should be applied, especially in more complex contracts.

Example 17 (paragraph IE16)

For IFRS reporters, it would be helpful to clarify the interaction of the draft Standard and IFRS 9 (or IAS 39) in a scenario in which the contract requires the customer to pay before any goods or services have been provided. We find Example 17 confusing in this regard. In the draft Standard, paragraph 105 and Example 17 both seem to assume that a receivable within the scope of IFRS 9 (or IAS 39) can arise before the seller has delivered any goods or services. However, it is not clear how this interacts with paragraph AG21 of IAS 32, which says:

"A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred."

If it is not possible for a seller to recognise a financial asset before it has supplied goods or services, then Example 17 appears incorrect – there should be no accounting entries on 31 January. The first entry should arise on receipt of cash.

Conversely, if it is possible for a seller to recognise a financial asset before it has supplied goods or services, why is the receivable in Example 17 not recognised until 31 January? The right to consideration seems to exist from 1 January, when the contract is entered into, in that it is not conditional on the seller supplying goods or services.

Time value of money (paragraph 59)

We do not understand why paragraph 59(b) refers to prompt cash payment 'in accordance with typical credit terms in the industry and jurisdiction'. Some retailers almost invariably provide interest free credit for extended periods (sometimes more than one year), but the fact that this is 'typical' does not in itself alter whether there is a financing component. We believe that the appropriate comparison is simply with prompt cash payment, irrespective of typical credit terms.

Appendix C

In paragraph C3(a), we believe the expedient is drafted too narrowly. We encourage the boards to allow the expedient for all contracts completed before the date of initial application, irrespective of whether they began and ended within the same accounting period.

Requests for additional guidance

Appendix B and illustrative examples

Given the very wide range of scenarios that can arise for revenue recognition, it is important to find the right balance in producing the final Standard. We support the boards' approach that the body of the revenue Standard sets out only the core principles, with more detailed application guidance being included in Appendix B.

Historically, there have been various aspects of revenue on which, because of their complexity, the boards have found it necessary to issue specific guidance. Some of these are dealt with in Appendix B, but others are not (e.g. customer loyalty programmes, advertising barter transactions, slotting fees and co-operative advertising, to name just a few). We encourage the boards to look critically at that existing literature and to consider whether the underlying issues addressed are still of sufficient significance as to warrant additional application guidance. For example, we believe there is useful and important guidance in IFRICs 13 and 18 that is not currently reflected in Appendix B.

Where the boards judge that there is no need to set out additional principles on topics for which guidance currently exists, we encourage them instead to consider including examples illustrating how the final Standard's principles would be applied for such situations.

Portfolio approach (paragraph 6)

It would be helpful to preparers of financial statements if there was additional guidance provided, perhaps in the form of an illustrative example, as to how to apply the portfolio approach.

We believe there will be significant practical questions for some entities when seeking to apply the guidance in the current ED, particularly for entities such as those in the telecommunications industry ('telcos') with a large portfolio of relatively small revenue contracts. Although an illustrative example would not mandate a particular methodology for any entity, it would help to clarify the types of assumption that could legitimately be made when implementing the final Standard, and this would be beneficial.

Therefore, we suggest that the boards at least consider illustrating how a telco might implement the final Standard. We set out below some initial thoughts on what such an example might include, in part drawing on other matters discussed in this response. There should be a clear statement that use of the proposed methodology would not be mandatory, so alternative approaches would not be precluded.

The example would assume that a customer is buying a bundle of a handset, plus line rental and minimum amounts of calls and texts, for a specified contract period, with payment being made over that period and (possibly) some upfront payment as well. The contract may set a price for any additional calls and texts over the minimum and a price at which line rental can be renewed at the end of the contract period.

The example would illustrate one possible methodology, which consists of the following steps.

- Determine whether it is appropriate to regard the contract as enforceable in respect of any future payments – i.e. could the customer just walk away without making the future payments? (Please also see the discussion of 'reasonably assured' variable consideration earlier in this response.) For the rest of this illustration, it is assumed that the contract is enforceable –the consequences if it is not are set out after these bullet points.

- Calculate the total minimum contract price, i.e. the future minimum payments plus any upfront amount.
- Apply a residual approach to determine what part of the total minimum contract price if any – the appropriate allocation might be nil – should be assigned to the handset. (Two possible methodologies are suggested below, but others might be employed instead. This would be a matter of judgement in any specific scenario.
    - If there is an equivalent 'SIM only' contract available to customers (i.e. a package that is equivalent except that the handset is excluded), the difference in price between the two contracts may be indicative of the residual for the handset.
    - Alternatively, if the prices set for any additional calls and texts and any renewal of line rental appear to be realistic stand-alone prices, they might be used to calculate the value within the package of calls, texts and line rental. Then if the total minimum contract price is less than the value calculated for calls, texts and line rental, no amount would be allocated to the handset. Any discount on the normal price of calls, texts and line rental would be allocated to the calls, texts and line rental and recognised over the contract period. Conversely, if the total minimum contract price exceeds the value calculated for calls, texts and line rental, the excess would be allocated to the handset.)
- If the residual allocated to the handset results in a profit on the handset, no further adjustment is required.
- If the residual allocated to the handset results in a loss on the handset, recognise additional revenue equal to the loss and capitalise as an intangible. (This entry is based on the logic set out in our response to Question 3 above, and assumes that the handset was deliberately sold at a loss to acquire the customer – see also the further discussion below.)
- Treat the intangible in the same way as a cost of acquiring a contract, i.e. amortise it over an appropriate period determined using judgement, as proposed by the current ED.
- Thereafter, recognise revenue for calls, texts and line rental over time, as supplied.

If at the first step the contract is judged not to be enforceable, then the same process would be applied but it will be simpler. The total minimum contract price will consist only of the amounts paid upfront (if any). The difference between this and the cost of the handset would be capitalised as a cost of obtaining a contract / customer relationship. Thereafter, any cash received will relate to the calls, texts and line rental and be recognised as such.

One potentially important aspect of this approach is the idea that there is not a single stand-alone price for an item such as a call or a text – the appropriate price can depend on the type of customer and the type of contract. There are many examples of this in practice – for example, a customer buying goods in large quantities often pays a lower unit price – but it is worth spelling out.

We believe the methodology proposed above is a reasonable application of the ED's principles in the context of a large portfolio of contracts. We note that it would have a number of benefits.

- It would go some way to address the issue described in our response to Question 3 of the lack of comparability for direct and indirect sales.
- In particular, it would avoid the distortion that will otherwise arise for revenues associated with ongoing calls, texts and line rental. Thus, it would preserve an important key performance indicator for analysts and other users.
- If the amount of intangible capitalised is broadly similar from user to user (which might often be the case), it might enable a portfolio approach to be applied to subsequent accounting for the intangibles (i.e. amortisation and derecognition) by looking at overall churn.

As noted in our response to Question 3 above, one consequence of the intangible model described above is that, as in IFRIC 12, revenue is 'recognised twice' – i.e. the total revenues recognised are in excess of the cash inflows. An alternative approach, which would achieve the same profit profile

and still address most of the issues highlighted above, would be to defer costs as an intangible asset, and this solution would be equally acceptable to us.

Definition of customer (paragraph 10)

We suggest that it would be helpful to discuss here the scenario in which goods are purchased from a supplier (with or without an explicit right of return) and some of them are subsequently transferred back to the supplier for a refund. In such circumstances, we do not believe that the supplier would be a customer for the purposes of the current ED, even though the definition might sometimes appear to be met. For example, if a distributor allows a retailer to return goods, even though there was no pre-agreed right of return, those goods would appear to be an output of the retailer's ordinary activities and the distributor will have contracted to obtain them – so the distributor may appear to meet the definition of a customer of the retailer.

Further clarification would also be helpful in relation to the scope exclusion for collaborators or partners. For example, in the pharmaceutical industry, is the development of a drug by an entity for another in exchange for milestone payments plus royalties a contract with a customer or a collaborative type of contract? Paragraph 10 seems to imply that the distinction is based on sharing 'the risks and benefits of developing a product to be marketed' whereas we might instead have expected the distinction to be based on control. It would be less confusing for users if the final Standard makes clear whether another Standard applies to collaborative arrangements (e.g. for IFRS reporters, presumably IFRS 11 applies where there is joint control and, for US GAAP reporters, ASC 808 or 810 could apply) or whether there is no applicable Standard (which might be the case if some arrangements are scoped out on the basis of shared risks even though joint control is not present).

Contract modifications (paragraph 22)

It would be helpful for paragraph 22(a) to address the scenario in which where there is unsettled variable consideration that relates to goods or services already supplied. Notwithstanding the final sentence of paragraph 22(a), we believe this should still be allocated to the original goods or services and not to the goods or services supplied after the date of the contract modification.

Where a contract modification would be accounted for under paragraph 22(c), we assume that the entity would be required to use judgement to determine how to allocate consideration between the items in (a) and in (b). It might be helpful for the Standard to clarify that judgement is required in such circumstances.

Identifying performance obligations – standing ready (paragraph 26)

We are concerned that, without further explanation and constraint, the inclusion of 'standing ready to provide goods and services' within the list of possible promised goods and services in paragraph 26 may be confusing and result in companies recognising revenue inappropriately. For example, where a customer contracts to purchase a specified quantity of goods under a 'take or pay' contract, there is a sense in which the seller is 'standing ready' to provide those goods, but we do not believe that it would be appropriate to allocate any revenue to that activity. In our view, the circumstances in which it is appropriate to recognise revenue for 'standing ready' relate primarily to scenarios (such as membership of a health club) in which the extent to which a customer demands goods or services (e.g. by choosing to use the facilities) does not, in itself, affect the amount of remaining goods or services to which the customer is entitled. We recommend that the boards give additional thought to this matter and include further guidance in the final Standard.

Identifying separate performance obligations (paragraphs 28 and 29)

To what extent would an entity be required to seek information on what other products are available to the customer? We would assume that an entity should be able to rely on its own knowledge of the market without doing further research, but clarification of this in the final Standard would be helpful.

Would the interpretation of 28(b) be affected by whether the customer is contractually restricted from buying from other entities (e.g. if it has an agreement to buy only from this entity)? Again, we would welcome clarification.

If paragraph 29(b) is required, it would be helpful to clarify whether it is all of the goods or services which need to be significantly modified, or just some of them. We assume the intention is the latter. For example, it seems that a contract to construct a building is intended by the boards to be a single performance obligation under paragraph 29, but it is questionable whether the bricks used in such a contract are themselves "significantly modified" as part of the construction process.

We suggest that it may be more appropriate to use the word 'often' instead of 'regularly' in paragraph 28(a). Sales can occur frequently without being regular, just as sales can occur regularly but infrequently. The same comment applies to paragraph 75(a).

Identifying performance obligations – practical expedient (paragraph 30)

In some cases, the practical expedient offered in paragraph 30 might be available for items that would need to be separated for other purposes, e.g. disclosure. Should the practical expedient be limited to exclude such cases? If not, what approach should be taken for disclosure purposes?

Where an entity has taken advantage of the practical expedient offered in paragraph 30, at a later date it may discover that the two performance obligations in fact have a different revenue recognition profile. It would be helpful to clarify that, in such circumstances, the two performance obligations should be accounted for separately and, to the extent practicable, the allocation of revenue to each individual performance obligation should be assessed on the basis that would have been used at the outset of the contract.

Transfer of control over time (paragraphs 35 and 36)

We would welcome additional illustrative examples with more complex fact patterns of how to apply the principles and indicators in practice. In particular, it would be beneficial to include an example clarifying how the principle in paragraph 35(b)(iii) would be applied in the case of a single non-refundable deposit without further stage payments.

In some cases, the 'no alternative use' criterion may be met only part way through the entity's performance. For example, work in progress may be capable of being supplied to an alternative customer during the earlier stages of construction, but may become customer-specific during the later stages. It would be helpful to illustrate how to account for such scenarios, which might involve moving from the 'point in time' model to the 'over time' model. We assume the entity would recognise an asset of work in progress and no revenue during the earlier stages, but would derecognise the asset and recognise corresponding revenue once the 'no alternative use' criterion is met and, thereafter, recognise the remaining revenue using the 'over time' model.

There may be some uncertainty over how paragraph 35(b)(iii) should be applied when both a land element and a construction service are provided and they are not considered to be separate performance obligations. If 35% of the construction activity has taken place, is the requirement that the customer is obliged to pay approximately 35% of the total contract value, or just 35% of the value of the construction service (i.e. excluding any amount for the land element)?

The third sentence in paragraph 36 focuses on whether an alternative asset could be supplied to this customer. But the logic of paragraph 35 is such that the test should be whether this asset could be supplied to an alternative customer.

In paragraph 35(b)(iii), it would be more helpful to state that 'the entity has a right to payment for performance completed to date and it expects to fulfil the contract (***or the relevant part of the contract***) as promised'. This will be important in situations where a contract may include several stages but will stop if a certain stage is deemed unsuccessful, e.g. some research and development activities performed for customers.

It would be helpful to clarify how the requirement set out in paragraph 35(b)(iii) is affected by the entity's ability and intention to enforce the customer's obligation to pay. We believe it is necessary that the entity could enforce the customer's obligation if it wished, but we do not believe that it is necessary that it would intend to do so. The fact that a seller might sometimes decide to waive amounts that would otherwise be due from a customer should not alter the profile of revenue recognition.

Sales taxes (paragraph 50)

Paragraph 50 rightly excludes sales taxes from revenue, but the draft Standard does not offer any guidance on how to determine whether something is or is not a sales tax. This is an issue under existing GAAP, so further guidance would be helpful.

Time value of money (paragraphs 61 and 62)

The final sentence of paragraph 61 states that, after contract inception, the discount rate should not be updated for changes in circumstances or interest rates. But where a contract is modified, might this result in a need to update the discount rate?

It would be helpful to clarify the requirement in paragraph 62 to present the effects of financing separately from revenue in the statement of comprehensive income. Under IAS 18, interest income is another class of revenue and, although an analysis is required in the notes to the financial statements, there is nothing in IAS 18 or IAS 1 to prevent it being shown as part of revenue. Further, FASB Concepts Statement No. 6 states that cash inflows, such as interest, that are the result of an entity's major on-going operations represent revenue (e.g. a subsidiary whose major activity is the financing of products of the parent). Is it the intent of the boards to change this position?

Non cash consideration (paragraphs 63 and 64)

In some cases, the fair value of non-cash consideration may change materially between the date on which the contract is entered into and the date on which the consideration is received. Accordingly, paragraph 63 should be expanded to include guidance on the appropriate date at which to measure the fair value of non-cash consideration.

Paragraph 64 appears to be a summary of the current requirements of IFRIC 18. Due to the number of issues that currently arise in applying this guidance, as mentioned earlier, we would recommend including more of the material from IFRIC 18 in Appendix B and/or the illustrative examples, particularly the guidance on when connection fees correspond to separate performance obligations.

Collectibility (paragraph 69)

This paragraph clearly envisages situations in which a credit adjustment may need to be recognised at the time that revenue is recognised in the financial statements. However, paragraph BC171 in

the basis of conclusions indicates that 'an entity would typically not recognise a loss on initial recognition'. This aspect of the proposed Standard may be confusing for users. We recommend that some guidance is added to illustrate the (presumably limited) circumstances in which a credit adjustment would be required at the time that revenue is recognised.

For example, for US GAAP reporters we do not believe it was the intention of the boards to change the accounting result for a health care entity's patient service revenue in the scope of ASC 954 as amended by ASU 2011-07. Specifically, we do not believe the boards intended to prevent these entities from recording revenue and an estimated loss for a credit risk adjustment upon performing certain patient services. However, as currently drafted, there may be inconsistent application of the requirements for when a contract exists in accordance with the guidance in paragraph 14 for the health care entities affected by ASU 2011-07.

Constraining revenue – reasonably assured (paragraph 81)

It would be helpful to provide more guidance on how widely paragraph 81 and the 'reasonably assured' constraint would be applied. Paragraph B5 indicates that the reference to consideration that is 'variable' apparently also encompasses fixed amounts that may or may not become revenue under a sale with a right of return. Are there other circumstances in which the concept might apply? For example, in some industries it is very common for a seller to allow a customer to renegotiate a contract when it is only part-performed; in effect, echoing the words from paragraph BC34(b), the parties may not be committed to perform their respective obligations for all parts of the contract (particularly the later stages). Might a 'reasonably assured' constraint also be applicable in such circumstances?

Onerous provisions (paragraph 87)

In our response to Question 4, we explain why we disagree with providing for onerous performance obligations per se. However, if the boards retain the approach proposed in the current ED, we suggest that further clarity is required in relation to paragraph 87(b). If the entity could walk away from the contract as a whole without paying compensation, is that sufficient to meet the criteria? Or is the entity required to assume that it walks away from the onerous obligation but meets all the others?

Principal versus agent considerations (paragraph B18)

We believe that the first indicator included in paragraph B18 (primary responsibility for fulfilment) is a particularly strong indicator, and we would favour stating this in the final Standard.

Non-refundable upfront fees – examples (paragraphs B29 to B32)

The previous ED included an example (example 7) illustrating the application of the guidance on non-refundable upfront fees in two scenarios. This example is not reproduced in the illustrative examples accompanying the current ED. We believe that the example was useful and we encourage the boards to reinstate it.

Customers' unexercised rights (paragraphs B25 to B28)

At present, IFRIC 13 includes useful guidance on how to deal with breakage in the context of customer loyalty schemes, including illustrations. As mentioned earlier, it would be helpful for that guidance also to be reflected in the final Standard.

Repurchase agreements (paragraphs B38 to B48)

The discussion in these paragraphs deals with unconditional rights and obligations, but not with conditional rights and obligations. In circumstances in which control of an item is judged to have passed to a customer, but there are conditional rights or obligations for the entity to repurchase that item, it is unclear whether the entity should analogise to the material on sales with a right of return or adopt some other accounting. For example, an entity constructing an office building for sale to a customer as an investment property may grant a conditional put allowing the customer to sell the property back to the entity if pre-agreed tenancy / occupancy levels are not reached.

It would also be helpful to address the accounting when puts and calls are included in the same arrangement but are exercisable in consecutive accounting periods rather than simultaneously, and the accounting for puts and calls that are at fair value / market value.

A put option (paragraph B45)

It would be helpful to provide more detail or an example here, as paragraphs B2 to B9 do not fully explain what to do where the amount repaid is less than the original selling price. Also, it would be helpful to explain whether and how the time value of money should be reflected, as it seems likely that any refund liability should often be recorded at its present value.

Customer acceptance (paragraphs B55 to B58)

There may be some perceived overlap between a scenario in which a customer has a right of return and a scenario in which there is an explicit customer acceptance clause. We suggest further guidance is included to help users determine when it is appropriate to apply the guidance on sales with a right of return (for which revenue will often be recognised on transfer to a customer) and when it is appropriate to apply the guidance on customer acceptance (for which revenue will generally be recognised later).

Appendix C

In paragraph C3(b), it is not clear what is meant by ‘the date the contract was completed’. Is it the date on which all performance obligations were satisfied, the date on which all variable consideration was determined, or the date from which neither party had any remaining obligations? Paragraph C3(b) appears to assume that variable consideration will be a finalised amount at the date the contract was completed, but there may be circumstances where consideration is still variable even though all performance obligations have been satisfied. We suggest that measuring variable consideration at the amounts that actually arose would be a more practical approach to transition in this area.

Appendix D

It would be helpful for IFRS 3 and ASC 805 to include some guidance on how to deal with contract assets and contract liabilities that are acquired in a business combination. For example, suppose that a customer of the acquiree has, prior to the business combination, contracted to buy goods for a price of CU100 (the market price at that time) and paid in advance in full. By the time of the business combination, the market price of those goods has changed to CU101. Should the contract liability be measured at CU100 or CU101?

Other revenue questions that arise in the context of business combinations, and for which further guidance would be appropriate, include:

- whether the identification of separate performance obligations, including potential options, should continue to be as determined at inception of the contract, or updated at the time of the business combination;
- whether the allocation of the transaction price should continue to be as determined at inception of the contract, or updated at the time of the business combination; and
- whether contingent amounts relating to performed (or partly performed) obligations should be measured at fair value or in accordance with the methodology set out in the draft standard (i.e. should the reasonably assured constraint be applied)?

Example 20 (paragraph IE18)

In paragraph IE18, the entity has chosen to use the most likely amount rather than the weighted average amount in its estimate of the variable consideration. Given that there is a high volume of sales, it might have been expected that the weighted average amount would have been more predictive of the amount to which the entity will be entitled. We suggest that either the example is modified or an explanation is added of why the entity believes the most likely amount is more predictive. Also, it appears that in this example the most likely amount is being determined on a portfolio basis, rather than for each individual contract. But paragraph 55(b) appears to indicate that, where the most likely amount is used, it is the most likely amount for the individual contract – which in this case is CU100. If this is an example of applying the draft Standard to a portfolio of contracts, as described in paragraph 6, it would be helpful to make that clear as it is otherwise confusing.

Example 22 (paragraph IE20)

In Example 22 (paragraph IE20), the amount deferred is affected by the entity's intention to offer a seasonal discount. It would be helpful to clarify whether the accounting would subsequently be amended if the entity changes its plans and no longer offers the discount.

Editorial comments

Contract modifications (paragraph 22)

To avoid any confusion, it might be helpful to state that, for a good or service to be distinct, it is not necessary that it has previously been identified as a separate performance obligation. For example, the remaining 5 months of a 12 month telephone line rental contract would typically be distinct, even though the line rental was previously identified as a single performance obligation satisfied over time.

Identifying performance obligations (paragraph 25)

We suggest that paragraph 25 should be redrafted, as it appears capable of misinterpretation. There are some activities, which might be regarded as 'set-up activities' by some users, that should nevertheless be considered separate performance obligations. For example, in some cases data transfer may be necessary as part of setting up an outsourcing contract, and the customer may have a choice over whether to use the outsourcer or another supplier for that transfer. In that case, the transfer of data should be regarded as a separate performance obligation. The same comment applies to Example 15. Some of the potential confusion here arises because the first sentence of paragraph 25 refers to activities that an entity must undertake to 'fulfil' a contract, but the example given is of administrative tasks to set up a contract. These will often relate not to fulfilment of a contract (i.e. delivery of promised goods or services) but rather to administration of a contract. It would be clearer first to distinguish between fulfilment activities and other activities; the latter can never be performance obligations, whereas the former can be, but only if the entity transfers a good or service to the customer as the activities occur.

Performance obligations satisfied at a point in time (paragraph 37)

We suggest that sub-clauses (a) and (c) should be qualified to say 'often indicates', as in sub-clause (b). For example, in (a), customers may be contractually required to pay in advance for goods or services they have not yet received.

Measurement of revenue (paragraph 49)

Where paragraph 49 refers to the amount that is 'reasonably assured', it would be helpful to include an explicit cross-reference to paragraph 81.

Determining the transaction price (paragraph 51)

We recommend that the boards clarify the drafting of this paragraph. There is a tension between the requirement to assume that the contract will not be renewed and paragraphs B20 to B24, which rightly require deferral of revenue for valuable renewal options.

Variable consideration (paragraph 55)

We recommend that sub-clause (a) is amended to specify that it applies where an entity has a large number of contracts 'with similar characteristics ***but independent outcomes***'.

Where an entity has a large number of contracts, whose outcomes are independent, the expected value may represent a good prediction of the aggregate consideration to which the entity will be entitled – because different contracts may have different outcomes. But where outcomes are not independent, this is not the case. For example, if an entity has many contracts but either they will all achieve a performance bonus or none of them will, the aggregate consideration to which the entity is exposed is still binary. In that case, the most likely amount may be a better prediction of the aggregate consideration to which the entity will be entitled.

Non cash consideration (paragraph 63)

We suggest that it would be helpful to state that the estimate of stand-alone selling price referred to in the final sentence of paragraph 63 should take account of any discounts and other adjustments that would be usual for this customer or class of customer.

Consideration payable to a customer (paragraphs 65 and 67)

We suggest that paragraph 65 should also allow for the circumstances, albeit rare, in which a customer pays in advance for a good or service and the entity pays interest to the customer in cash on the amounts advanced. In our view, it would be appropriate to recognise these payments as an interest expense rather than a reduction in revenue. For example, if a customer pays CU100 in advance, and the seller pays interest in cash at a market rate on that prepayment (say, CU15 in total), we believe the seller should ultimately recognise revenue of CU100 and interest expense of CU15. At present, it seems paragraph 65 could be interpreted as instead requiring the seller to recognise revenue of CU85 and no interest expense.

In sub-clause (b) of paragraph 67 we would suggest that the wording should be '**the entity pays or becomes obliged to pay....'** to more accurately reflect what we believe to be the intent of the boards. Such an obligation could arise without the entity making a 'promise' as such.

Collectibility (paragraph 69)

It would be better for paragraph 69 to refer to "an impairment loss" rather than "an impairment". Where a receivable is measured at fair value through profit or loss, we assume that paragraph 69 is not intended to require any changes in fair value to be presented adjacent to the revenue line item. But such a receivable may have suffered 'impairment', even though no 'impairment loss' will have been recognised.

We assume when paragraph 82 of IAS 1 refers to revenue, it would mean the gross amount without any adjustment for the adjacent line item. It would be helpful to make this clear so as to avoid any possible confusion.

Allocating the transaction price to separate performance obligations (paragraphs 73, 75 and 76)

Paragraph 73(c) states that an entity may use a residual approach when the stand-alone selling price is highly variable or uncertain. To avoid confusion, it would be helpful to make clear that this is still a choice, and that the proposed Standard does not mandate the use of a residual approach.

In order to avoid confusion, we suggest the drafting of paragraph 75 is amended to refer only to "some" separate performance obligations and not "one (or some)". Example 11 illustrates a scenario in which a discount is allocated entirely to some performance obligations but, given the requirement in paragraph 71, we cannot envisage a scenario in which the discount could be allocated entirely to just one performance obligation. If such a scenario is possible, without departing from the requirements of paragraph 71, it would instead be helpful to include an illustration. We do not believe it would be appropriate to depart from the requirements of paragraph 71.

We would suggest referring to distinct goods and services in paragraph 76 (i.e. in the plural) as there may be circumstances in which, for example, a bonus payment relates to two performance obligations within a contract but not the third.

Costs to fulfil a contract (paragraph 93)

We suggest that the boards reconsider the drafting of paragraph 93(c) in relation to partially satisfied performance obligations. If costs relate to work already done (past performance), they should be expensed, but if they relate to future work (future performance) they should not be expensed. Both scenarios can arise but, as drafted, the paragraph seems to require such costs to be expensed in both cases (whereas the guidance in brackets rightly focuses only on past performance).

Incremental costs of obtaining a contract (paragraphs 95 and 96)

To minimise any potential for confusion, it would be helpful for paragraph 96 to spell out that an entity is not permitted to capitalise costs merely because they would not have been incurred had it not chosen to bid for a contract.

Amortisation (paragraph 98)

It might be helpful to use a term other than 'amortisation' to describe the process by which these costs are recognised as an expense, as it has strong connotations of expense being recognised over a period of time. Where the costs that have been capitalised relate to a good (or a combination of goods and services) it is presumably appropriate for the element relating to that good to be fully expensed at a point in time and not over a period of time.

Presentation (paragraphs 104, 105 and 106)

The exposure draft clearly envisages that a receivable relating to a contract should be accounted for in accordance with IFRS 9 (or IAS 39) or ASC 310 but remains silent with regards to payables. We suggest that the guidance is expanded to state that where a customer pays in advance but is entitled to cancel and demand repayment, the associated liability is also within the scope of IFRS 9 (or IAS 39) or ASC 310.

The last sentence of paragraph 105 appears not to be quite complete. A contract liability may reflect not only amounts received but also amounts properly recognised as financial assets (as made clear in the first sentence).

Disclosures (paragraph 114)

The current drafting of paragraph 114 does not make clear whether this particular disclosure should be made gross or net of adjustments for customers' credit risk.

Significant judgements in the application of the standard (paragraph 124)

We suggest that the disclosures of significant judgements should also cover the scenario in which an entity is amortising the costs of obtaining a contract over a period longer than that contract (i.e. taking hoped-for future contracts into account).

Appendix A

It would be helpful to clarify that, in respect of certain definitions, there may be different answers for different classes of customer. For example, in the current ED, the definition implies that there is only one stand-alone selling price for a particular good or service, but in fact there may be a different price for different classes of customer.

Sales with a right of return (paragraph B7)

The drafting of the penultimate sentence appears ambiguous. We assume it is intended to mean that corresponding changes should be made for the proportion of items expected to be returned, but it could be read as saying that the asset is remeasured by the same amount as the liability.

Customer options for additional goods or services (paragraph B21)

We suggest that the drafting of paragraph B21 should be amended as the reference to the contract containing more than one performance obligation is confusing and superfluous. If a customer buys a single item from a supermarket, he or she will still typically qualify for loyalty points (if there is a scheme). But some may read this sentence as inapplicable because (before considering the loyalty points) the contract does not have more than one performance obligation.

To avoid any possible confusion, it would be helpful to clarify that if, at contract inception, the customer was judged not to receive a material right to acquire additional goods or services then, when the option is exercised, this is treated as a new contract and not combined with the initial contract.

Finally, we recommend paragraph B22 is amended to state that, for a customer loyalty programme, the materiality of a right to obtain additional goods or services may need to be assessed in the context of a series of transactions rather than just against a single transaction. Although the customer loyalty points granted in a single transaction may not be material, the entity's obligations under the programme may become material when other transactions are also taken into account.

Customers' unexercised rights (paragraph B26)

We would recommend that the drafting of this paragraph be reconsidered in line with our earlier comments on paragraph 26(d) of the exposure draft. Use of the phrase 'stand ready' here may cause some entities to recognise revenue for 'standing ready', and we doubt that would be appropriate.

Licensing and rights to use (paragraph B36)

Paragraph B36 deals with the scenario in which a licence is not distinct, and explains that the associated revenue should be recognised over time. To avoid possible misunderstanding, it would be helpful to specify that the converse is not necessarily true: where a licence is distinct, revenue will not necessarily be recognised at the outset (see also our comments on paragraph 85).

A forward or a call option (paragraphs B40 and B41)

We assume that the guidance given in paragraph B41 is intended to qualify how the words are used in paragraph B40 but it might be safer to draft paragraph B40 in a way that makes it less easy for readers to miss the effect of paragraph B41. For example, paragraph B40 could refer to 'the original selling price of the asset (after adjusting for the time value of money)'.

Also, the adjustment required by paragraph B41 is not particularly clear, and further explanation would be helpful. (The same comments apply to paragraphs B46 and B47.)

Illustrative examples

The statement in paragraph IE1 that the examples are an integral part of the IFRS appears to contradict the statement prior to this that the examples accompany, but are not part of, the IFRS.

Example 13 (paragraph IE12)

We find the second paragraph of Example 13 confusing. There appears to be only one performance obligation here, which is to provide asset management services. Therefore, paragraphs 28 to 30 do not appear to be relevant. The final sentence states that "the services have the same pattern of transfer to the customer" but this would only be meaningful if there was more than one service.

Example 14 (paragraph IE13)

Although not specifically stated, the example in paragraph IE13 implies that CU10 is paid pro rata for each year (or part of a year) that the policy remains in force, including the year of cancellation. We suggest that this fact pattern is made explicit, as it may not be the norm. As currently drafted, readers may assume that no payment would be made in the year of cancellation and therefore not understand how the estimate of revenue has been calculated.

Example 18 (paragraph IE16)

Example 18 states that payment for Product X is 'contingent' upon delivery of Product Y. In our view, it would be more appropriate to use the word 'conditional'. The word 'contingent' has connotations of being outside the control of the vendor, which is not the case in this example.

Example 22 (paragraph IE20)

In order to support the seasonal discount, we recommend the example states explicitly that it is consistent with practice in prior years.