ASC
ACCOUNTING STANDARDS COUNCIL

12 March 2012

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

(By online submission)

Dear Sirs

RESPONSE TO REVISED EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS

The Singapore Accounting Standards Council (ASC) appreciates the opportunity to comment on the revised Exposure Draft on Revenue from Contracts with Customers (the revised ED) issued jointly by the International Accounting Standards Board (the IASB) and the Financial Accounting Standards Board (collectively the Boards) in November 2011.

We support the Boards' decision to re-expose the proposals to avoid unintended consequences resulting in the final standard. We appreciate the Boards' efforts in taking greater cognizance of Asia-Oceania centric issues, particularly the fact patterns in real estate sales in various Asia-Oceania jurisdictions, in developing the revised ED proposals. We also applaud the IASB members and staff's efforts in increased outreaches to our constituents in the Asia-Oceania region.

Though the revised ED had addressed some of our concerns raised in our comment letter to ED/2010/6 issued in June 2010 (the 2010 ED), we believe that there are some key aspects of the revised ED that require further refinement by the Boards. Our broad views are as follows:

Refine the drafting of the proposed requirements for performance obligations satisfied over time

We are an advocate for a single robust control-based revenue recognition model that can be applied to all types of contracts with customers which will reflect the economic and legal substance of the transactions. We appreciate that the Boards had incorporated our views expressed in our comment letter to the 2010 ED, notably the recognition to augment the proposed revenue recognition model with indicators of the concept of continuous transfer of control.

Broadly, we agree with the principle that an entity is able to transfer control of a good or service over time. We also agree with the criteria listed in paragraph 35(b) on how an entity could transfer control of a good or service over time. However, we believe that the Boards should refine the drafting of the criteria in paragraph 35(b) to strengthen the overall consistency of the proposed model of determining whether a performance obligation is satisfied over time.

Specifically, we note that the three sub-criterions of paragraph 35(b) are built around the notion that the customer obtains the benefits of the entity's performance as the entity performs.

In respect of the first sub-criterion of paragraph 35(b), if the customer simultaneously consumes the benefits of the entity's performance as the entity performs, it must necessarily mean that the customer had obtained the benefits. However, consuming the benefits of the entity's performance simultaneously as the entity performs is just one facet of demonstrating that the customer obtains the benefits of the entity's performance as the entity performs.

If the second or the third sub-criterions of paragraph 35(b) are met, the customer also obtains the benefits of the entity's performance as the entity performs. We drew this inference from the Boards' Basis for Conclusions. In respect of paragraph 35(b)(ii), we note that it was introduced in situations where it is less clear that the customer benefits from the entity's performance as it occurs. For paragraph 35(b)(iii), we note that the Boards had concluded that "if an entity's performance completed to date does not create an asset with an alternative use to the entity and the customer is obliged to pay for that performance to date, then the customer could be regarded as receiving the benefit from that performance."

As such, we see good grounds to clarify in the main standard by refining the drafting of the criteria in paragraph 35(b) to explicitly associate the linkage between the customer obtaining the benefits of the entity's performance as the entity performs in all of the three sub-criterions of paragraph 35(b) rather than doing so in the Basis for Conclusions. Currently, this linkage between the customers obtaining the benefits of the entity's performance as the entity performs is only explicitly established in the first sub-criterion of paragraph 35(b). We do not believe that this is appropriate as the same linkage should be explicitly established for all three sub-criterions of paragraph 35(b). Establishing this direct linkage for all three of the sub-criterions of paragraph 35(b) would strengthen the internal consistency of the three sub-criterions and the consistency of the criteria in paragraph 35(b) with the core principle in paragraph 31.

In summary, we consider that paragraph 35(b) should be redrafted along the following lines:

35 An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if at least one of the following two criteria is met:

(a) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced. An entity shall apply the requirements on control in paragraphs 31–33 and paragraph 37 to determine whether the customer controls an asset as it is created or enhanced; or

(b) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the customer obtains the benefits of the entity's performance as the entity performs. The customer obtains the benefits of the entity's performance as the entity performs if at least one of the following criteria is met:

(i) the customer simultaneously ~~receives and~~ consumes the benefits of the entity's performance as the entity performs.

(ii) another entity would not need to substantially re-perform the work the entity has completed to date if that other entity were to fulfil the remaining obligation to the customer…

(iii) the entity has a right to payment for performance completed to date and it expects to fulfil the contract as promised….

We are of the view that if paragraph 35(b) is re-expressed, the resulting criterion of "the entity's performance does not create an asset with an alternative use to the entity and the customer obtains the benefits of the entity's performance as the entity performs" is also consistent with the Boards' articulation of the control notion in paragraph 32, i.e. control of an asset refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset.

Identification of separate performance obligations

We note that the revised ED proposals in this area are an improvement to the 2010 ED proposals and we appreciate the Boards' efforts to incorporate our comments on this area. However, the revised ED proposals are still insufficient to address our primary concern that the business model of an entity is disregarded in the identification of separate performance obligations.

Specifically, paragraph 28(b) requires an entity to consider if a customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer in identifying separate performance obligations even if the good or service is not regularly sold separately by the entity and is viewed by the entity as marketing incentives rather than as revenue. Such an approach would also result in goods or services that are incidental to the primary goods or services sold by an entity to be accounted for as separate performance obligations even though from the entity's perspective, the incidental goods or services are considered as marketing incentives bundled in a contract to incentivise the purchase of the primary goods or services.

We note that the Boards had considered whether the entity's business model is suitable to identify the "main" goods or services in a bundle of goods or services for which the customer has contracted. The Boards rejected the use of the entity's business model as the assessment of identifying the "main" goods or services in a bundle of goods or services could vary significantly

depending on whether an entity performs the assessment from the perspective of its business model or from the customer's perspective.

As such, an entity would have to determine if all of its marketing incentives are separate performance obligations simply because the assessment between the entity's business model perspective and the customer's perspective is not uniform in some contract arrangements. We do not agree with this conclusion and believe that it is more appropriate that the entity makes such an assessment from the perspective of its business model given that financial statements are prepared for the entity. Moreover, paragraph 28(b) appears inconsistent with paragraph 10 since such goods or services recognised as separate performance obligations would not be an output of an entity's ordinary activities.

Furthermore, we find it surprising that the Boards do not accept the merit of utilising the business model concept for the purpose of identifying separate performance obligations, taking into consideration that the business model is a concept increasingly used in IFRSs. For instance, business model is used in IFRS 9 *Financial Instruments* as a key determinant to determine the classification and measurement of financial assets and in the Exposure Draft on Investment Entities (ED on IE) to identify an entity for which an exception to the principle of consolidation would apply. As such, we find it difficult to reconcile why the Boards are of the view that it is appropriate for the business model concept to be utilised in IFRS 9 and the ED on IE but not the revised ED.

In addition, we recommend that the Boards remove paragraph 29(b), i.e. "the bundle of goods or services is significantly modified or customised to fulfil the contract", in the determination of whether a bundle of goods or services would qualify as a single performance obligation. We believe that introducing this criterion could create an unintended consequence in that some construction contracts (e.g. the construction of a dwelling house) may be deemed to comprise multiple performance obligations rather than a single performance obligation as the bundle of goods or services in such contracts may not be considered significantly modified or customised.

We note that the criterion in paragraph 29(b) was added as the Boards believe 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 risks that the entity assumes in integrating the promised goods or services is negligible (for example, a simple installation of standard equipment). However, we believe that the Boards' concern may not be valid as we think such contracts would not meet the requirement that the entity provides a "significant" service of integrating the goods or services into the combined item under paragraph 29(a).

Our comments on the specific questions to the revised ED are as follows:

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?

Apart from our comments in the opening paragraphs on the recommendation to refine the drafting of paragraph 35(b), we have the following specific comments on the "alternative use" criterion:

We strongly support the introduction of the alternative use criterion.

However, as the alternative use criterion is a new concept in IFRSs, we believe that clarity is needed on its intended application in order to avoid unintended consequences and to pre-empt any potential interpretation issues. We note that the illustrative example provided for determining whether an asset has alternative use is a rather straight forward example given that the asset (i.e. an apartment unit) is a specific unit which the entity cannot contractually redirect to another customer. It would be useful if the Boards can develop another example to illustrate the application of the concept to situations where it is less clear cut that the assets created have an alternative use to the entity such as assets falling in between standard inventory-type assets and highly customised assets that only a specific customer can use.

In addition, we note that the Boards had concluded in paragraph BC 94 in the Basis for Conclusions that the level of customisation of the asset (and hence whether or not an entity would need to incur significant costs to reconfigure the asset for sale to another customer) should not be the determinative factor in considering whether an asset has an alternative use. However, we are concerned that if this is not articulated in paragraph 36 in the main standard, there could be unintended consequences in that the costs of rework would be the only factor entities take into consideration to determine whether the asset has an alternative use to the entity in situations where the entity is not contractually precluded from directing an asset to another customer. Consider the 2 following examples.

Example 1

Entity X enters into a long-term contract to build a vessel based on Customer Y's specifications. Entity X is not contractually precluded from redirecting the vessel to another customer. There are other users of vessels with similar specifications to that of Customer Y's vessel only in jurisdictions in which Entity X does not operate and the cost to rework the vessel to meet other users' specific requirements is insignificant. Entity X does not have access to a ready pool of alternative customers for the vessel constructed for Customer Y because it does not operate in jurisdictions where there is demand for such vessels. Hence, if the alternative use criterion only considers the costs of rework, and not whether the entity has ready availability of alternative customers for the asset created, this may preclude Entity X from recognising revenue over time even though practically, the vessel does not have an alternative use to Entity X at any point in time during construction as it would be difficult for Entity X to readily resell the vessel to an alternative customer.

Example 2

Entity X enters into 2 long-term contracts to build a vessel each for Customer Y and Customer Z. Both vessels are of similar specifications. Customer X's vessel is to be delivered within 3 years whereas Customer Z's vessel is to be delivered within 6 years. Entity X's current production capacity only allows it to build a vessel at any one time and both vessels require 3 years to construct. As such, Entity X first constructs Customer Y's vessel before constructing Customer Z's vessel.

Entity X is not contractually precluded from redirecting Customer Y's vessel to Customer Z and the cost of rework to redirect the vessel is insignificant given that both vessels are of similar specifications.

However, Entity X would be unable to redirect Customer Y's vessel to Customer Z because in so doing, it would breach its contract with Customer Y as it would be unable to deliver the vessel to Customer Y within 3 years as contracted.

In the two aforesaid examples, an entity would conclude that the asset would have an alternative use to the entity if the cost of rework is the only factor used to consider whether the asset has an alternative use to the entity. We do not believe that this is the Boards' intent. As such, we recommend that the Boards clarify in the main standard that the costs of rework is not the only factor to consider whether the entity is practically able to readily redirect the asset to another customer.

Moreover, contracts for the sale of long-term built-to-purpose assets would usually contain certain agreed-upon performance milestones which the customer is required to certify. We are of the view that this provides sufficient evidence that the built-to-purpose asset is unique and non-fungible which the customer is able to identify readily. This is sufficient to indicate that the built-to-purpose asset has no alternative use to the entity because the entity is unable practically to readily direct the asset to another customer even if the costs of rework is insignificant.

It will be particularly useful for constituents if the Boards can develop application guidance or another illustrative example to articulate the application of the alternative use criterion in situations where the entity has to take into account the practical limitations on the entity's ability to readily redirect the promised asset to another customer. This will most definitely aid the application for contracts for the sale of long-term built-to-purpose assets and avoid difficulty in application or application divergence in practice.

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?

We agree with the application of IAS 39 to recognise and measure an allowance for recognised amounts of promised consideration that the entity assesses to be uncollectible because of customer's credit risk. On the appropriateness of applying IFRS 9, this would depend to a large extent on how the proposed impairment model is developed by the Boards.

We also agree that impairment loss (whether on initial recognition or subsequently) should be recognised as an expense separately from revenue. However, we do not agree with presenting impairment loss in profit or loss as a separate line item adjacent to the revenue line item as we find no basis to associate amounts of subsequent uncollectible consideration with current period revenue when those amounts relate to revenue recognised in previous reporting periods. As revenue and impairment loss have different characteristics/predictive values, it is questionable if the proposal would generate decision-useful information.

Accordingly, we recommend that impairment loss be presented in the profit or loss as an expense item "below the line" rather than as a separate line item adjacent to the revenue line item.

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 agree that the Boards should introduce a constraint on the amount of revenue that an entity would recognise for satisfied performance obligations if the consideration is variable.

However, we are concerned with the introduction of the new term "reasonably assured" and how this term would interact with the conceptual framework's criteria for the recognition of revenue. It is not clear whether "reasonably assured" imposes a different threshold for the recognition of revenue as compared to the two criteria of "probable" and "reliability" stated in paragraph 4.38 of the conceptual framework. We urge the Boards to clarify the interaction of "reasonably

assured" with the conceptual framework's criteria for the recognition of revenue to avoid diversity in practice and inconsistencies between the conceptual framework and the final standard.

Moreover, we believe that paragraph 85 is inappropriate in a principles-based standard. We are of the view that the Boards should not create a deviation from the overall principle of constraining the cumulative amount of revenue for a specific type of contract arrangement[1]. We note that paragraph 85 was introduced to address concerns that factors outside the entity's control could significantly affect the amount of revenue recognised. We believe that the same concerns would also arise in other types of contracts that include variable consideration, such as trailing commissions as illustrated in illustrative example 14. Hence, we are concerned that the retention of paragraph 85 in the final standard would result in inconsistent revenue recognition for economically similar transactions.

In addition, we are concerned that there could be unintended consequences of applying this requirement to contracts where the amount of consideration to which an entity expects to be entitled is variable comprises (1) a variable fee with a minimum base fee or (2) a fixed base fee and a variable fee component, that an entity has no experience dealing with or has no other evidence such as other entities' experiences. A possible interpretation is that the entity is precluded from recognising the minimum/fixed base fee until the uncertainty with regard to the variable component is resolved. We do not believe that this is the Boards' intention and we recommend that paragraph 81 be amended accordingly to prevent such an interpretation.

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 this proposal.

Scope of onerous test

We do not agree with the proposed limitation of the scope of the onerous test.

We are concerned that if an entity does not recognise an onerous performance obligation that is satisfied over a period of time less than one year which straddles over two financial periods, there would be an impact on the faithful representation of the period end financial statements particularly if the effect of the onerous performance obligation is significant.

[1] Licensing of intellectual property to a customer that the customer promises to pay an additional amount of consideration that varies on the basis of the customer's subsequent sales of a good or service (for example, a sales-based royalty).

Furthermore, although IAS 2 *Inventories* requires an entity to recognise loss from firm sales contracts even if the entity has not yet acquired those goods that would be recognised as inventory, we are concerned that there could be contracts where the loss is unrelated to the purchase of inventory within the scope of IAS 2. An onerous liability would therefore not be recognised for performance obligations within such sales contracts if the performance obligations are satisfied at a point in time in the future.

The Boards explained in the Basis for Conclusions that the limitation of the scope of the onerous test is proposed as a practical expedient to limit the risk of unintended consequences of applying the onerous test to some contracts. We disagree with this approach as we believe the risk of unintended consequences should be addressed by introducing robust principles rather than by employing practical expedients to plug weaknesses in the proposed requirements. As such, we urge the Boards to reconsider this proposal.

Unit of account for onerous test

As highlighted in our comment letter to the 2010 ED, we disagree with the Boards' proposal to carry out the onerous test at the performance obligation level. We think that the onerous test should be carried out at the contract level. In our view, it would be inappropriate for an entity to recognise a loss on a performance obligation that is part of a profitable contract. Furthermore, applying the onerous test at the performance obligation level may result in an entity recognising a day one loss (i.e. at contract inception). We are not convinced that the proposed approach provides decision-useful information.

Moreover, we note an inconsistency in the unit of account for onerous test between contracts for the sale of inventories where the performance obligations are satisfied at a future point in time and contracts where the performance obligations are satisfied over time. Specifically, we note that the unit of account for the former is the contract level as the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* would continue to apply to such contracts. This contradicts the Boards' proposal in the revised ED. As such, the Boards would need to clarify why the unit of account for onerous test should differ between contract situations as we do not see a convincing rationale for this difference.

However, if the Boards do proceed with the performance obligation as the unit of account for onerous test, we would like to reiterate our views expressed in our comment letter to the 2010 ED that the Boards should consider refining the proposal on allocating discount to take into account an entity's pricing methodologies or strategies in allocating the discount. Alternatively, the Boards should consider allowing the discount to be allocated to each performance obligation in proportion to the stand-alone profit margins of the underlying goods or services if this improves the discipline of allocation/reduces abuses. This is particularly important for bundle transactions when an entity bundles a low-margin performance obligation with a high-margin performance obligation and offers a discount on the latter to its customer. Allocating the transaction price in accordance with the revised ED proposals would result in some discount being allocated to the low-margin performance obligation which may cause the low-margin performance obligation to turn onerous despite that this was not contemplated by the entity.

In this regard, we note that the Boards had considered but rejected the profit margin method to allocate a discount on the basis that it would create additional complexity and that different treatments in the way costs are allocated to performance obligations could significantly affect how the transaction price is allocated. We are not convinced by these arguments as entities would need to determine the costs for each separate performance obligations in any case so that these could be recognised as and when the entity satisfies the performance obligations.

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 disagree with this proposal.

Whilst we acknowledge that revenue is an important number, we urge the IASB not to make piece-meal amendments to IAS 34 *Interim Financial Reporting* without first undertaking a holistic review of what kind of interim financial information would be decision-useful and relevant to users of interim financial reports.

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?

Subject to our comments to the earlier questions, we agree with this proposal.

We hope that our comments will contribute to the Boards' deliberation on the revised ED. Should you require any further clarification, please contact the project manager Ivan Koo at ivan_koo@mof.gov.sg.

Yours faithfully

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