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Dear Kevin

AASB EXPOSURE DRAFT ED 198 REVENUE FROM CONTRACTS WITH CUSTOMERS

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Australian Accounting Standards Board (AASB) with its comments on ED 198 which is a re-badged copy of the International Accounting Standards Board's (IASB - the Board) ED 2010/6 (the ED), which has been jointly issued by the IASB and the US Financial Accounting Standards Board. We have considered the ED and set out our comments below.

Grant Thornton's response reflects our position as auditors and business advisers both to listed companies and privately held companies, and public and private businesses, and this submission has benefited with input from our clients, Grant Thornton International which is working on a global submission to the IASB, and discussions with key constituents.

The views expressed here are preliminary in nature, and a more detailed Grant Thornton global submission will be finalised by the IASB's due date of 22 October 2010.

General Comments

As stated in our comment letter on the Boards' December 2008 Preliminary Views document, we support the reasons for undertaking a comprehensive review of revenue recognition principles. The case for change has been well articulated by the Boards and we welcome the development of a converged solution.

We also welcome the development and refinement of the proposed model since the Preliminary Views document. In particular, we support the Boards' efforts to:

- define control in the context of revenue transactions and provide supporting guidance
- specify principles to determine the separation of performance obligations
- address gaps in the Preliminary Views document such as variable consideration.

We think the ED generally strikes an appropriate balance between broad principles and supporting guidance to clarify the principles and support consistent application.
We also congratulate the Boards and Staff on their extensive and ongoing outreach efforts.

The proposed model

We agree with the Boards' reasoning for proposing a single revenue recognition model that would apply to a wide range of industries and transactions. We also agree that revenue should be derived from the satisfaction of performance obligations in contracts with customers.

We further agree with the Boards' decision to introduce a principle ("distinct") to determine which performance obligations should be accounted for separately. This should serve to clarify the treatment of multiple element arrangements and (to some extent) limit the number obligations to be separated. However, we believe that some aspects of the supporting guidance - in particular the references to distinct margin and distinct risks - need to be strengthened and clarified.

We are not convinced that the proposed requirements on contract segmentation are necessary or desirable. We suggest that this requirement can be removed if some minor changes are made to the requirements on allocation of the transaction price to distinct performance obligations.

Consistent with the 2008 Preliminary Views document, the Boards propose to base the recognition of revenue on a transfer of control to the customer. While we do not disagree with the use of control-based concepts to determine the timing of revenue recognition, or with the proposed definition of control, we think the practical application of a control model differs for:

- goods
- services
- continuous transfer of control over work-in-progress
- rights to use the entity's assets.

Although we welcome the Boards' efforts to provide indicators of when control is transferred, we are not convinced that the same broad indicators can be applied to all four categories. We also have a number of comments on the usefulness of certain indicators in any context. We do not believe that the current text is adequate in this area to support the judgements that need to be made. Although there may be some merit in enhancing the indicator approach, we suggest the better way forward would to provide more specific guidance on the practical meaning of control when applied to the different categories noted.

We believe that a control principle is operational if supported with appropriate clarification and guidance. 'Our view is that application of the standard would be helped by the existence of examples where the fact pattern had factors or indicators that were mixed as to whether control had transferred and hence revenue was recognized. Such examples could conclude that in these circumstances management judged that factors A and B were of greatest weight

and hence control had (or had not) passed, and that this judgement would be disclosed in accordance with ED paragraph 81. Such an example would reinforce the importance of management judgement and of disclosure of such judgement, both of which would be good.

Other comments

We have a number of comments in our responses to the Invitation to Comment questions in the Appendix. Most of these comments address matters of detail or drafting but we draw attention to the following more substantial concerns:

- we do not agree that an onerous contract liability should be recognized at the level of a distinct performance obligation if the contract as a whole is not onerous
- we question the practical usefulness of certain of the proposed disclosures and suggest that the Boards should provide more robust explanations of the basis for these proposals if retained
- the Boards' proposals regarding the scope of the revenue and leasing proposals and right-of-use contracts appear to be motivated by current practice and expedience rather than a conceptual analysis. We support the scope proposal in the circumstances but hope that the conceptual basis for applying different models to rights to use tangible and intangible assets will be revisited at a later stage.

Non-publicly accountable entities

We note that the IASB has not indicated whether it will amend the existing requirements for non-publicly accountable entities, and on that basis we believe the AASB should not consider any decisions on RDR disclosures until the IASB has considered this further, given that the RDR is 'loosely' based on IFRS for SMEs disclosures.

Grant Thornton does not believe that at this time amendments to the existing revenue standard should apply to non-publicly accountable entities. Instead Grant Thornton believes that the AASB should allow the IFRS for SMEs accounting standard as an option for non-publicly accountable entities. Adoption of IFRS recognition and measurement principles which the AASB believes necessitates an increase in disclosures compared to IFRS for SMEs, does add significant complexity and costs that would not be borne by similar structured overseas entities.

We expand on the above comments in our responses to the questions in the ED's Invitation to Comment Questions, and the AASB's request for comments, which are set out in the Appendix to this letter.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED

Keith Reilly
National Head of Professional Standards

Appendix 1: Response to the invitation to comment questions

Invitation to comment questions

Recognition of revenue (paragraphs 8–33)
Question 1
Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:

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

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

Combining contracts
We agree with the proposed principle for combining two or more contracts, subject to some detailed comments below.

We also agree with the guidance in paragraph 14 concerning discounts arising solely as a result of existing customer relationships. We note however that entities typically have both contracts and relationships with their customers. It may be difficult in practice to objectively determine whether a discount relates to pre-existing contract or to the customer relationship, particularly for entities that negotiate contracts individually rather than trade on standard terms. This assessment could be especially difficult for contract modifications (see below).

We note that the phrase "interdependent prices" is not defined. A definition or explanation would be useful.

Sub-paragraphs 13(a)-(c) set out indicators that two or more contracts have interdependent prices. In our view these are not true indicators but instead describe certain aspects of contract negotiation that may accompany interdependent pricing. Our concern is that all three indicators might be present in situations in which prices are nonetheless independent. We therefore suggest that it would be preferable to describe sub-paragraphs 13(a)-(c) as circumstances in which two or more contracts are more likely to have interdependent prices.

Segmenting contracts

We do not agree with proposed principle for contract segmentation. This is for the reasons explained below. We believe the Board should remove this guidance and instead amend the proposed requirements on allocation of the transaction price to distinct performance obligations.

We acknowledge the Boards' reasons (in BC38) for including requirements on contract segmentation. We believe however that separating distinct performance obligation requirements will have the same practical outcome as contract segmentation in most cases.

The single situation in which segmentation might have a different outcome relates to the allocation of variable consideration to contract segments. In our view the Boards can address this by requiring that variability in a transaction price that relates clearly to a specific, distinct performance obligation should be allocated only to that obligation and not across all performance obligations. The inclusion or exclusion of variability in the standalone selling prices of the performance obligations in question would provide evidence to support this more specific allocation.

If the Boards decide to retain the proposed guidance we suggest:

- the interaction with the material on identifying separate performance obligations should be clarified
- the requirement to "allocate the total amount of consideration to each identified contract in proportion to the standalone selling prices" (paragraph 16) should be amended. This does not sit well with the requirement to allocate changes in the consideration to the identified contract segment. If the prices are independent, contracts should be segmented using those independent prices including any variability attributed to those prices.
- the Boards should consider whether the guidance is operational when there are multiple interdependencies. Consider a variation to Example 1 in which in the entity also regularly sells products A and C for CU25. This implies that products A and C form a contract bundle that should be separated from product B.

Contract modifications

We agree with the need for guidance on contract modifications. Without appropriate guidance opportunities may arise to structure contracts in a way that circumvents the requirements on separation of distinct performance obligations. We are however concerned that it may be difficult to objectively determine whether discounts in a modification or renewal relate to the pre-existing relationship or the customer relationship (consistent with the comments in the preceding paragraphs).

The guidance in B3 and example 2 does not assist (and does not refer to the need to make this assessment). We suggest that, as a minimum, the second scenario in Example 2 should refer to the reasons for the evident discount. If the discount offered is similar to that available to other customers that extend their contracts this would suggest pricing interdependence. Conversely, an abnormal discount may suggest that it relates more to the customer relationship.

Question 2
The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

General principle
We agree that multiple element arrangements should be disaggregated into separate deliverables when that reflects their substance. We recognize however that it is challenging to develop a principle-based approach to disaggregation that is capable of robust and consistent application to all types of arrangement. We believe that the Boards' proposed principle (to identify "distinct" performance obligations) is appropriate subject to some minor drafting suggestions below.

Definition of distinct
We agree that a good or service is distinct if it or a similar good or service is sold separately by the entity (paragraph 23(a)).

Paragraph 23(b) captures performance obligations that the entity could sell separately. While we agree that distinct performance obligations should not be limited to items that are sold separately by the entity, determination of what could be sold separately is hypothetical and will naturally require more judgement. We acknowledge the need for reasoned judgement in a principle-based standard. However, we think some aspects of the proposed guidance could usefully be clarified to provide a more robust and consistent framework for those judgements.

With regard to paragraph 23(b)(ii), we find the term "distinct profit margin" unclear. This requirement is important because that almost any element of a contract could be argued to meet the condition in 23(b)(i) concerning utility in combination with other goods or services.

We think that:

- The term distinct profit margin does not fit well with its definition which refers to risks and resources. The definition is also circular in that a profit margin requires a selling price. A price is attributed only once a performance obligation is determined to be distinct. It might therefore be preferable to refer directly to distinct resources rather than distinct profit margin.
- The reference to "distinct risks" should also be clarified and the term should be defined. The problem is that bundling more than one element into a single contract itself creates links between the risks inherent in each element. This is particularly the case for contracts in which the elements are integrated.
- In this context Example 9 concerns a sale of specialized equipment with installation and suggests that the risks of the equipment and the installation service are distinct. Example 11 includes addresses a situation in which a contract management service has the effect that the risks associated with various tasks are not distinct. We think both examples include elements with inter-related risks, with the difference possibly being the degree of inter-relationship. We suggest that the Examples should be amended to acknowledge this.

It might also be helpful to add some discussion as to the types of risk the Board has in mind (e.g. variability in fulfillment costs, changes in value, and other execution risks).

Specific application
We support without further comment the draft guidance on:

- Sale of a product with a right of return (B5-12)
- Principal versus agent (B20-23)
- Customer options for additional goods or services (B24–26)
- Nonrefundable upfront fees (paragraphs B27–30).

We have commented on the following in our responses to questions 15 and 16:

- Product warranties and product liabilities (B13-19
- Licensing and rights to use (B31-39)

As noted above we believe that the role of "distinct risks" in B40-43 and Examples 9 and 11 should be clarified.

Question 3
Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

General principle
We agree with the control-based principle proposed in paragraph 25. We also agree with the proposed definition of control in paragraph 26. We agree that control in this context should encompass concepts of ability to direct and access to benefits.

Although we support the principle, we note that applying a control model to some service contracts (primarily those that have an "end product" as opposed to contracts for repetitive services delivered over time) will be challenging. Considerable judgement may be required to determine whether control is transferred continuously or on completion in some cases and this will place emphasis on the clarity of sufficiency of the supporting guidance. Nonetheless, given the Boards' stated aim of developing a single model for revenue contracts, we believe control is the most appropriate principle.

Indicators
We have concerns regarding the proposed indicators of transfer of control in paragraph 30:

- The proposal that an unconditional obligation to pay indicates control the seems circular as customer has unconditional obligation to pay only once the supplier has satisfied its obligations. This also creates tension with the guidance on nonrefundable upfront fees (which shows situations in which nothing has been transferred even once the customer has paid).
- Legal title and physical possession are enablers or mechanisms for the exercise of control (over goods). We suggest that they are described in those terms rather than as indicators. More importantly, given that these factors are acknowledged to of little relevance to

services, the main body of the ED lacks guidance on applying the control principle to services.

- The fact that the design or function of a good is customer specific may indeed provide a n incentive for the supplier to negotiate terms that result in control being transferred as work is performed. However, the design does not of itself have any bearing on the transfer of control. We suggest that this discussion of the customer's ability to specify changes to the design or function confuses obtaining control of the work to date with re-specifying the work to be done in the future. Also, suppliers commonly protect themselves through various other mechanisms such as advance payment and guarantees. We therefore feel that this is a weak indicator.
- Overall we believe that the manner in which these indicators are stated leads to them being seriously inadequate as a basis for effective operation of the standard: they are likely to lead to unwarranted diversity in application on the central principle.

Application to continuous transfer

We believe determination of whether a contract results in a continuous transfer of goods or services to the customer will be critical under the proposed model. We suggest that both the ED and the supporting application guidance are insufficient to provide a basis for robust and consistent application in this area.

The ED refers to continuous transfer in paragraph 32 but does not define that term. In our view continuous transfer contract should be defined broadly along the lines as a contract in which the customer obtains control of the work in progress its current state as the work is performed.

The application guidance on continuous transfer should also be strengthened. In general we feel the examples provided are not realistic, omit material facts and obscure the primary basis for their conclusions through over-reliance on "indicators" (on which we have commented above). Specifically:

- *Example 15, Scenario 1 - Manufacturing services:* We have no major concerns with this example but feel it could be strengthened as follows:
  - The reference to non-refundable payments should be elaborated. Are the progress payments non-refundable only if the customer decides to terminate the contract. Would be entity be obliged (either under the specific contract terms or jurisdictional laws) to refund the customer if the entity terminates?
  - We suggest that an ability to re-specify the contract for additional consideration would be a modification (see also our comments above on the control indicators). We question whether an ability to modify a contract is relevant to assessing the extant contract.
  - The reference to the various rights and obligations on contract termination appears to be critical but the Example does not describe the circumstances in which the contract might be terminated. In our view the customer's right to obtain the work in progress is substantive only if the customer is able to terminate the contract (non-punitively).
  - We are also unclear as to whether the Boards believe an ability to obtain the work in progress must be economically viable and technically feasible to contribute to continuous transfer.
  - This Example suggests that all the relevant facts indicate continuous transfer which is not the case (because legal title passes on completion).

- We suggest that this Example could helpfully describe the relevant factors and state a conclusion that management have decided that it qualifies for continuous transfer because they regard factors X and Y to be strong evidence in these particular circumstances, and that this judgement will be disclosed in the financial statements in accordance with paragraph 81.

- *Example 16 - Consulting services:* We believe the key facts in this example are that the customer receive the outputs (findings) continuously and can obtain any underlying analysis. The payment profile does not of itself seem relevant. The salient fact regarding payment is whether all or some of the installments would be retained by the service provider, or would become refundable if the contract were to be terminated. The ability of the customer to specify the services provided throughout the contract seems unrealistic. Re-specifying the end product would normally have consequences for the contract price and would be a modification. Moreover, we suggest that this discussion confuses obtaining control of the work to date with re-specifying the work to be done in the future.

- *Example 17 - Sale of apartments:* we believe that this is an important example and note that accounting for off-plan real estate sales continues to be controversial and problematic (even after the publication of IFRIC 15). In the circumstances, we suggest that the draft guidance may need to be elaborated. Additional examples explaining the impact of variations on the basic fact pattern might also be useful. We also note the Boards' comment in BC66 that the ED's outcomes are expected to be consistent with IFRIC 15's. We question this comment given hat IFRIC 15 interprets the models in IASs 11 and 18, neither of which is consistent with the ED's model. Regarding the specific example:
  - The example should consider the effect (if any) of the customer having the ability to sell its interest in the part-completed apartment. Such ability could be characterized as the customer having the ability to direct the use and obtain the benefit of the work in progress. Alternatively, IFRIC 15 characterizes a right of sale as a transfer of an interest in forward contract over the completed real estate.
  - The example does not discuss the effect (if any) of jurisdictional law that requires the entity to transfer immediately to the buyer ownership of the real estate in its current state of completion and that any additional construction becomes the property of the buyer as construction progresses.
  - Consistent with other comments we suggest the example overstates the relevance of whether the asset is "customer-specific". We note in any case that, irrespective of the customer's role in the design, the developer is contracted to deliver a specific apartment (in contrast to Example 15, Scenario 2, in which the asset appears to be interchangeable).

Other application guidance

We generally agree with the other application guidance and believe it is sufficient. We support without further comment the guidance on:

- software with an access code requirement (Example 12)
- free on board shipping with risk of loss (Example 13)
- vendor call options (B49)
- customer put options (B52)
- consignment inventory (B54-57)

- bill-and-hold arrangements (B60)
- customer acceptance (B69).

Measurement of revenue (paragraphs 34–53)
Question 4
The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

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

We agree subject to the following comment.

We agree with the proposed principle that variable consideration is included in the transaction price only if it can reasonably estimated. We are however concerned that the criteria in paragraph 38 creates a rule that constrains and potentially negates that principle. We suggest that the proposed conditions in paragraph 38 should instead be characterized as circumstances in which in entity is more likely to be able to make a reasonable estimate rather than as necessary conditions.

Question 5
Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect *how much* revenue an entity recognizes when it satisfies a performance obligation rather than *whether* the entity recognizes revenue? If not, why?

We agree. Most revenue transactions are an exchange of goods or services for a financial asset (receivable). Given that financial assets are recognized at fair value on initial recognition (which takes credit risk into account) it is appropriate to include the effect of credit risk in the measure of customer consideration (the transaction price).

Without qualifying our support we suggest that information on gross or contractual revenue, and subsequent credit losses, is useful. We recommend that the Boards should consider whether the proposed disclosures in this ED and in their respective financial instruments proposals requirements provide adequate transparency on these metrics.

Question 6
Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?
We agree.

We suggest that Examples 21 and 22 should be expanded slightly to include the requirement to present the financing component separately (consistent with paragraph 45).

Question 7
Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

We agree subject to the following comments.

As noted in our response to Question 1, we believe that variability in a transaction price that relates clearly to a specific, distinct performance obligation should be allocated only to that obligation. This relationship would be evidenced by standalone selling prices for the performance obligation in question to include the equivalent variations.

We also think it would be helpful to add some discussion regarding the reference market to which the entity should look to identify (or estimate) standalone selling prices.

Contract costs (paragraphs 57–63)

Question 8
Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, *Intangible Assets*), an entity should recognize an asset only if those costs meet specified criteria.

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

We do not object to the recognition of specified fulfillment costs as an asset although we have a number of comments and suggestions on this proposal. Once a contract has been obtained we believe that the types of fulfillment cost discussed would mainly be recognized under IAS 2 (under existing IFRSs) and are not therefore a major change to existing practices in an IFRS context. The impact will be more significant under US GAAP, especially for service contracts.

We note that the proposal could be criticized on the basis that it is founded on a matching concept not on whether the definition of an asset is met. We suggest that the discussion at BC149 - 155 could usefully be expanded to explain the Boards' reasons for concluding that fulfillment activity does or may give rise to an asset.

We also suggest that paragraphs 57(a) and 59(a) may conflict. Paragraph 57(a) refers to a specific contract under negotiation, while 59(a) prohibits the recognition of an asset for costs of obtaining a contract. We note that entities in some sectors incur significant costs in developing and submitting design proposals (and other fulfillment-type activity) as part of their contract bidding or negotiation process. It is unclear whether such costs may be eligible for capitalization under 57(a) on the basis that they are fulfillment costs, or must be expensed as bid costs under 59(a).

We note that the proposed guidance would be incremental to the requirements of other standards and should not therefore create conflicts. Nonetheless, we are concerned that the

effect of placing the proposed requirements in a revenue standard will be that preparers need to consider multiple sources to determine the appropriate accounting for costs in connection with customer contracts. This may create confusion and inconsistent practice. For example, although paragraph 59(a) prohibits the recognition of an asset for costs of obtaining a contract we consider that costs paid to a third party in exchange for a customer contract may qualify for recognition on accordance with IAS 38. We suggest that the Boards consider these interactions in the consequential amendments to other Standards.

Question 9
Paragraph 58 proposes the costs that relate directly to a contract for the purposes of

- **a recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract; and**
- **b any additional liability recognized for an onerous performance obligation.**

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

We agree.

Disclosure (paragraphs 69–83)
Question 10
The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

We have a concern with the proposed disclosure objective in paragraph 69. We think it is inconsistent with the Boards' Exposure Draft *An Improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information.* That document (at OB18 for example) explains that the users of financial statements make an assessment of the amount, timing and uncertainty of its future cash flows. The proposed objective in paragraph 69 could be viewed as shifting responsibility to the reporting entity to make this assessment. This concern also applies to the ED's overall proposed objective at paragraph 5 (to an even greater degree).

We suggest that paragraphs 5 and 69 should be amended to be more consistent with the objectives proposed in the conceptual framework project, in particular in relation to the respective roles of the entity and users in performing an analysis of future cash flows.

We welcome the flexible approach to the level of detail and emphasis in paragraph 70, and the proposal in paragraph 72 aimed at avoiding duplication.

We agree with the specific disclosure proposals subject to the comments below and in our response to Question 11.

We are not convinced that the reconciliation of contract balances proposed in paragraphs 73(b) and 75 will be useful in practice. The discussion in BC176-178 suggests that users are interested in a gross reconciliation without explaining the perceived usefulness of the ED's net approach. The proposed reconciliation does not show the cash flows received from

customers in the period, because cash flows more often arise after the transfer to receivables. Also, as most contracts are recorded at zero the closing balance provides no indication of future cash flows. We suggest the Boards should explain how this proposal will result in useful information.

Question 11
The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

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

This disclosure aims to portray an entity's "backlog" or order book. Limiting the scope of disclosure to contracts with an expected duration of more than one year seems intended to reduce the burden of the requirement. However, we are concerned that the effect of this limitation is that the information on backlog will be incomplete and may be difficult to understand and interpret.

We suggest the Boards should explain how this proposal will result in useful information.

Question 12
Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

We agree.

Effective date and transition (paragraphs 84 and 85)
Question 13
Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why? Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

Retrospective application will be clearly be challenging for some entities but the alternatives are unattractive. We therefore agree with the Boards' proposal provided that the effective date allows a sufficient period for the transition.

We suggest that a sufficient period would be a minimum of two years.

Implementation guidance (paragraphs B1–B96)
Question 14
The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

We believe the Boards have struck an appropriate balance between the articulation of principles and the use of guidance and examples to support their application.

However, we have an overall comment that most of the examples describe clear-cut situations. We think the overall usefulness of the implementation guidance would be enhanced by the inclusion of some examples with mixed indicators and a greater need for management judgement. Such examples might clarify how different indicators carry different weight depending on the fact and circumstances and also emphasise the role of judgement and disclosure.

We have commented on specific aspects of the implementation guidance in our responses to various other questions.

Question 15
The Boards propose that an entity should distinguish between the following types of product warranties:

- **a a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.**
- **b a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.**

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

We believe the analysis of product warranties into latent defect- and insurance-types is useful. We also agree with the proposed accounting. However, we suggest that many warranties cover both latent defects and subsequent faults. An expected level of reliability (ie non-susceptibility to subsequent faults) can also be viewed as a feature of a non-defective product. We suggest that this should be acknowledged in the guidance.

Question 16
The Boards propose the following if a license is not considered to be a sale of intellectual property:

- **a if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and**
- **b if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.**

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

We largely agree. However, we suggest this guidance should:

- include some discussion concerning the unit of account for intellectual property transactions. This is because paragraph B33 requires an entity to determine if it has transferred substantially all the rights associated with intellectual property. If, for example, an entity grants an exclusive right to broadcast a film in a specified geographic region it might be argued that it has transferred all the rights associated with that component (the unit of account comprises the actual rights transferred, delineated by region). Alternatively it might be argued that the unit of account comprises the overall film rights, of which only a portion is transferred (the unit of account is the film);
- be expanded to discuss situations in which the licensor of intellectual property has obligations to provide services during the licence term. For example, an entity might issue a one year, non-exclusive licence over a database that it undertakes to maintain and enhance over the year. We suggest that such a contract might sometimes comprise a single performance obligation (or two non-distinct obligations). Revenue should then be recognized over time. In other situations the grant of the licence and the services might be two distinct performance obligations. Paragraph 35 could be misinterpreted in such situations to imply that that the entity has always satisfied its obligations in granting a licence if the licence is non-exclusive. Paragraph B38 might also usefully be expanded to cover this type of scenario.

Consequential amendments

Question 17

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

We agree.

Other issues

We have the following comments on matters not addressed in the Invitation to Comment questions:

- *Scope:* we have the following comments:
  - In our response to the Boards' previous discussion paper that we expressed a concern at the promulgation of different models for different "right-of-use" contracts. Broadly, the Boards now propose that right-of-use contracts over tangible assets are covered by the Leases proposals if the underlying asset is tangible, and by the Revenue proposals if the underlying asset is intangible. The Boards acknowledge (in the BC36 of their Leases Exposure Draft) the lack of a conceptual basis for the proposed scope distinction. We recognize that this scope proposal is expedient in view of the Boards' goal to complete the revenue and leases projects in 2011. We support the scope proposal on those grounds. However, we hope that this matter will be revisited at a later stage.
  - Revenue that arises in the absence of a contract is outside the ED's scope. Accordingly, revenue recorded at the point of harvest is outside scope and is recognized at fair value in accordance with IAS 41 *Agriculture*. If the entity then enters into a contract to sell the produce it appears that is in the scope of the ED and gives rise to a second tranche of revenue. This seems counter-intuitive and the scope interaction should be clarified if this is not the intended outcome.

- *Onerous contracts:* we do not agree that an onerous contract liability should be recognized at the level of a distinct performance obligation if the contract as a whole is not onerous. We think that recognizing a liability in those circumstances is counter-intuitive and does not depict the entity's economic position.

- *Customer credit risk (Example 20):* the initial measurement of the revenue needs to be consistent with its initial measurement of the receivable in accordance with IAS 39 or IFRS 9, taking account of the possible future introduction of an expected loss approach to amortised cost and impairment

- *Payments to customers (paragraphs 48-49 and Example 23):* we agree with the proposed principles and accompany guidance subject to the following comment. We believe the Boards should clarify an entity that also purchases goods/services a customer should apply the proposed guidance on combining (in this case) sales and purchase contracts before applying paragraphs 48-49. In the absence of such a requirement entities could circumvent the paragraphs 48-49 by entering into different contracts for the sale and the (possibly related) purchase.

AASB request for comments

The AASB would particularly value comments on whether:

a There are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

i not-for-profit entities; and
ii public sector entities.

b overall, the proposals would result in financial statements that would be useful to users;

c the proposals are in the best interests the Australian and New Zealand economies; and

d any of the proposed disclosures should be considered for exclusion from the reduced disclosure requirements.

a We are not aware that there are regulatory or other issues arising in the Australian environment, apart from our earlier comments on the proposals. We believe that there are regulatory and other issues arising in the Australian environment for non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.

b We are not aware of any reasons that would impact on the usefulness of these proposals to users for publicly accountable entities, apart from our earlier comment son the proposals. However we do not believe that these requirements should apply to non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.

c For publicly accountable entities, apart from our earlier comments on the proposals, we are not aware of any reasons that would impact on the interests of the Australian economy and our New Zealand firm will comment direct to the AASB if there are any New Zealand implications. We do not believe that these requirements should apply to non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.

d We note that the IASB has not indicated whether it will amend the existing requirements for non-publicly accountable entities, and on that basis we believe the AASB should not consider any decisions on RDR disclosures until the IASB has considered this further, given that the RDR is 'loosely' based on IFRS for SMEs disclosures.

Grant Thornton does not believe that at this time amendments to the existing revenue standard should apply to non-publicly accountable entities. Instead Grant Thornton believes that the AASB should allow the IFRS for SMEs accounting standard as an option for non-

publicly accountable entities. Adoption of IFRS recognition and measurement principles which the AASB believes necessitates an increase in disclosures compared to IFRS for SMEs, does add significant complexity and costs that would not be borne by similar structured overseas entities.