**DISCUSSION MATERIAL**

# Revenue Recognition

Asian-Oceanian Standard-Setters Group (AOSSG)

4 – 5 November 2009

## WORKING GROUP ON REVENUE RECOGNITION

*The Working Group on Revenue Recognition of the Asian-Oceanian Standard-Setters Group (AOSSG) consists of the staffs of the following organizations. Views expressed in this paper including appendices thereof are those of such staffs and do not necessarily represent those of respective organizations with which such staffs are associated.*

**LEAD**

Accounting Standards Board of Japan (ASBJ)

**CO-LEAD**

Accounting Standards Council of Singapore (ASC)

**MEMBERS**

Australian Accounting Standards Board (AASB)

Accounting Regulatory Department of MOF, China (ARD)

~~Accounting Standards Board, Indonesian Institute of Accountants (ASB)~~

Committee for the Registry of Auditors and Accountants, Macao SAR (CRAC)

Financial Accounting Standard Board – Indonesian Institute of Accountant (DASK – IAI)

Financial Reporting Standards Board, NZ Institute of Chartered Accountants (FRSB)

Hong Kong Institute of Certified Public Accountants, Hong Kong SAR (HKICPA)

Malaysian Accounting Standards Board (MASB)

## Introduction and purpose

1. Revenue recognition is one of the most important areas in financial reporting in providing decision-useful performance information. The IASB and the FASB are now pursuing total review of this cornerstone of the financial reporting.

2. The purpose of this discussion paper is to check and evaluate the ongoing IASB-FASB deliberations from both theoretical and practical perspectives, and, based on such analysis, to make any constructive suggestions for improvements.

## Background

3. Accounting Standards Board of Japan (ASBJ) and Accounting Standards Council of Singapore (ASC) has conducted a preliminary survey on selected topics among Working Group (WG) members to consider possible issues to be discussed. Based on this survey, the ASBJ and the ASC prepared this paper to facilitate the discussion at the first AOSSG meeting, which will be held at Kuala Lumpur, Malaysia on 4 and 5 November 2009. Questions and responses are summarised in the Appendix A to this paper.

4. The responses from the WG members indicate that their primary areas of concern are:

   (1) transfer of control (notion of control);

   (2) construction contracts (or other long-term contracts); and

   (3) removal of the notion of risk and reward of ownership (or the adoption of the strict component approach).

5. These topics may also relate to the main feature of the proposed revenue recognition model; the key concept under asset-liability model is ‘transfer of control’ and another feature of the proposed model is the adoption of strict ‘component approach’. Accordingly, the ASBJ and the ASC decided to frame our discussion around these topics. By focusing our discussion on these three points, we can make the most of the limited time of our discussion.

## Objective of accounting standards

6. Before going on to the individual topics, it may be helpful to reconfirm the objective of accounting standards to make our discussion fruitful because how well the proposed idea can actually improve the current financial reporting can only be judged against the objective.

7. The discussion paper addresses many issues, including inconsistency with the conceptual frameworks, inconsistent application in practice, and the lack of guidance. Although they are important areas to be addressed, proposals are meaningful only if they align with the ultimate objective: to provide more decision-useful information that can better achieve the objective of financial reporting. Any idea needs to be checked from this point of view.

## Discussion points

8. Our discussion will focus on transfer of control, construction contracts (or long-term contracts), and removal of risk-and-reward notion. Since these issues are interrelated, we will consider the interrelationship among these issues at the end of our discussion.

**Transfer of control**

9. ‘Transfer of control’ is the key notion under the proposed asset-liability model of revenue recognition. The nature of revenue to be reported depends on how this notion is interpreted and applied.

10. Many WG members pointed out the need for setting clear guidance to make the proposed model workable and to achieve consistent application.

11. The IASB’s staff paper prepared for September meeting proposed possible definition of ‘control’ as well as several indicators of control, without showing any specific priority among them (for more detail, see Appendix C). We will take the current development of the IASB’s discussion into consideration to make our discussion updated and useful input to the IASB.

*What is the essential nature of ‘control’?*

12. The staff paper proposed the definition of control of a good or a service as ‘an entity’s present ability to direct the use of and receive the benefit from that good or service’. Is this definition clear enough? What is the common nature of ‘control’ each indicator is expected to indicate?

13. Some proposed indicators seem to suggest the essential nature of control is an entity’s ability to use a good freely for its benefit and to dispose of a good freely at any moment. Meanwhile, other indicators do not seem to require to such an extent. For example, customer specification may not necessarily indicate such ability of an entity. To be consistent, using the same word ‘control’ in each case is not enough. The meaning of ‘control’ should also be consistent in each case.

**DISCUSSION QUESTION 1**

What is the essential nature of ‘control’ common to each case?

*Indicators of control*

14. If we can make clear the essential nature of ‘control’, the next question would be whether the proposed indicators are suitable for assessing such ‘control’.

15. The IASB’s staff paper proposed several indicators (paragraphs 52(a) to 52(h)) without showing any specific key factors or priority among those indicators. However, if each indicator points to different directions, how can we achieve consistent judgment, which is one of the main motives of this project? Some WG members pointed out in their responses the importance of showing ‘determinative factors’ or ‘principal element’. Do we need to show what the key factor is?

16. If we are to show the key factor, what will it be? Some WG members proposed suggestive idea such as ‘unconditional entitlement to compensation from customer’ and ‘work performed in creating the promised goods’. The last question closely relates to the next topic ‘construction contracts’ and may be better discussed in relation to such contracts including construction contracts.

**DISCUSSION QUESTION 2**

(1) Are the indicators proposed in the IASB’s staff paper (Sept. 2009) suitable to indicate essential nature of ‘control’ identified in Question 1?

(2) Do we need to show key factor or priority among the indicators?

(3) If so, what should be a key factor?

**Construction contracts (or other long-term contracts)**

17. While a WG member supported the discussion paper's proposal on construction contracts, many others opposed it from a decision-usefulness perspective.

18. The WG member supportive of the discussion paper's proposal suggest that the key criteria for a customer obtaining control of a promised good (or a component thereof) should be (a) the reporting entity has performed work in creating or acquiring the promised good; and (b) the reporting entity is unconditionally entitled to compensation from the customer for the work performed. They think the same criteria for control should apply to all contracts. The WG member also stated that, '(in their country) the interpretation that control can be transferred to a customer when deliverables are constructed at the customer's site is possible'. This may suggest that, in their country, an entity may obtain entitlement to compensation, which is enforceable by legal or equivalent means, as the construction progresses in such a situation. But many other WG members commented differently. They seemed to feel that in many cases the interpretation of continuous transfer of control is difficult.

19. In order to develop a truly global standard, it is imperative to ensure the provision of decision-useful information under any legislative or contractual environments in different jurisdictions.

20. The criteria for control to transfer suggested by the WG member above are possible solution. Although this solution is similar to the 'activity model' to which IASB is negative, the similar conclusions can be achieved even under the 'control model'.

21. The purpose of financial reporting is not to report legal form but to report economic substance. The notion of 'entitlement to the compensation' need not be limited to the legal entitlement. By doing so, provision of decision-useful information about economic substance is made possible.

22. The solution proposed by the IASB's staff paper introduces indicators similar to those found in IFRIC 15 as guidance for assessing control. This may imply changing the meaning of 'control' in construction contracts, although the same word 'control' is used.

| **DISCUSSION QUESTION 3** |
| --- |
| In order to provide decision-useful performance information regardless of jurisdiction or contractual environment, what is the best way to report revenue for construction contracts or other long-term contracts? |

**Risk and reward of ownership**

23. Many WG members suggested that we should retain the 'risks and rewards (of ownership)' notion in the proposed model. However, as a WG member suggested, this may be a matter of unit of accounting.

24. Traditionally, the unit of accounting is based on the unit of transaction made between an entity and its customer. Under these circumstances, risk and reward notion is a necessity.

25. One of the main features of the proposed model in the discussion paper, however, is adoption of strict 'component approach'. Under this approach, continuing involvement should be treated as a separate component or a different accounting

unit. Therefore, under such strict component approach, ‘risk and reward’ notion may not be necessary anymore.

26. Based on this understanding, concerns among many WG members might not come from the removal of the notion of ‘risk and reward of ownership’ itself, but come from the adoption of strict ‘component approach’.

27. Transactions similar in its economic substance need to be reported similarly. Some insist that adopting component approach can contribute to this end. However, others may disagree with this understanding.

28. Under strict ‘component approach’, transactions are always regarded as having similar commercial substance if underlying deliverables are similar. However, even if underlying deliverables are similar, commercial substance of a transaction may be influenced by the terms of contract as to how and when the reporting entity is unconditionally entitled to compensation for the work performed.

29. Consider, for example, BoatBuilder Co. enters into a contract with Customer to build a specialized boat that could not readily be sold to other customers and BoatBuilder is unconditionally entitled to compensation from the Customer as it builds the promised boat. Generally, under strict component approach, BoatBuilder would recognize revenue when it satisfies its performance obligation (ie to transfer promised asset (boat) to the Customer) no matter how payment terms are specified. However, it could be argued that the commercial substance of this transaction is different from that of another transaction in which BoatBuilder is unconditionally entitled to compensation (and payment

will be made) upon delivery of finished boat because the boat to be delivered is a non-specialized boat that could readily be sold to other customers. Because the consequences of the customer breaking the contract would be different for BoatBuilder in the two scenarios, the remedies for contract breakage contained in the contracts are different. That is, commercial substance might differ depending on contractual terms even if underlying deliverables are similar.

**DISCUSSION QUESTION 4**

(1) Do you agree to the above mentioned understanding of the issue?

(2) If so, are you happy with the strict 'component approach' proposed in the discussion paper?

# Appendix A: Results of survey among WG members

In order to explore common concerns among WG members, we conducted quick survey during the period between 7 July and 3 August 2009. The questions and the responses are shown below. Views expressed in this appendix are those of staffs of WG member organizations and do not necessarily represent those of respective organizations with which such staffs are associated.

# Overall assessment of the asset-liability model

### Question 1 Do you agree with the proposed model and framework by the DP?

**AASB** We support the proposed model because it is more consistent with the Conceptual Framework than IAS 18, provides a more faithful representation of changes in obligations to customers, and fills in some gaps in IAS 18. For example, the following proposals in the IASB DP would improve on IAS 18:

(a) for sales of goods, basing revenue recognition on the transfer of control to the customer, rather than on transfer of the significant risks and rewards of ownership to the customer;
(b) in respect of contracts with multiple deliverables to the customer:
  (i) identifying separate liabilities in respect of each performance obligation and allocating total contract revenue to the various performance obligations; and
  (ii) expanding the revenue recognition guidance currently contained in paragraph 13 of IAS 18;
(c) providing explicit guidance on how liabilities to customers should be measured;
(d) expanding the guidance on the general principle that revenue is measured at the fair value of the consideration received or receivable, including providing guidance that the use of estimates is allowed in the absence of an observable price for each deliverable; and
(e) removing the requirement in IAS 18 that revenue is recognised only when the costs to be incurred in respect of the transaction can be measured reliably.

**ARD** We fully appreciate the boards' effort to establish a single Revenue Recognition principle, which will be helpful to enhance the comparability of revenue recognition and the understandability of revenue information for users of financial statements. Meanwhile, we also realize that the proposed approach confronts tremendous challenges, because it needs to keep an appropriate balance between over-generalized and over-detailed, not only to ensure the internal consistence and integrity of the revenue standard, but also to cover all kinds of recognition problems related to contracts with customers in different industries, including commodity sales, providing services and construction contracts.

The discussion paper provides only a framework of revenue recognition rather than specific requirements and applications, such as accounting for contracts with multi components and the distinction of commodity sales and services, which will be discussed in the next step of the project. We noted that solutions to those specific issues are so critical to the revenue principle as a whole that it's hard to determine whether a single revenue recognition principle is feasible without a full deliberation of those application issues.

**ASC** We generally agree with the boards' preliminary views to improve the existing guidance in IFRS and US GAAP by developing a single, contract-based revenue recognition model that could be applied across industries. However, we also note that there could be actual application issues of such broad revenue recognition concepts. The proposed model introduces more complexity and subjectivity in the measurement process, through the requirement to recognize revenue as the change in an entity's contract asset or contract liability. In S24 of the DP, the proposal acknowledges that the boards have not yet expressed a preliminary view on how an entity would measure the rights in a contract's asset. Reliability issues may limit the effectiveness of the boards' proposal to achieve consistency in revenue recognition. As such, we encourage the boards to provide more specific measurement guidance on the determination of the balance sheet amounts of an entity's contract asset and contract liability. Our further views on the DP are documented in respective questions below.

**CRAC** We agree with the efforts to develop a single model so that consistency can be achieved in recognizing revenues under different scenarios, enhancing the characteristics of comparability in financial reporting.

**FRSB** We agree with the proposed model. It should be an improvement on the current model because it eliminates the inconsistency between the current model and the asset and liability definitions. However, we are concerned that one of the objectives of the project may not be achieved, being to develop a single comprehensive revenue recognition standard. We encourage the IASB to consider the application of the proposed model to all forms of revenue from all types of contracts with customers (including, for example, lease contracts and insurance contracts) and to all types of revenue, not just revenue from contracts with customers. We also recommend that the IASB clarify whether or not income arising other than from a contract could still be presented as revenue. Many sources of "revenue" do not arise from contracts with customers. Precluding these types of income from being reported as revenue would reduce the relevance of financial information reported.

**HKICPA** Overall, we support the boards' objective to develop a single, contract-based revenue recognition model to address the inconsistencies and lack of guidance currently in IFRSs and US GAAP. In addition, this should enhance comparability of revenue across industries and geographical boundaries.

We are concerned that there may be undue focus on a single legalistic indicator of which party has "control" of the asset, which may result in inconsistency in revenue recognition between those long term contracts completed "off site" (such as the construction of a ship) and those completed "on site" (such as the construction of a building on land owned by the customer). More examples might help to clarify the board's intended meaning of key concepts such as "enforceable obligation" and "transfer of control" in order to ensure proper interpretation and application on a consistent basis.

**MASB** We agree with the proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability. The proposed approach aligns the revenue recognition process to that articulated in the Framework.

The focus on changes in assets and liabilities will also address inconsistencies in existing standards that arise from having different revenue recognition principles. As a result, users of financial statements should benefit because economically similar transactions would be reported similarly.

**ASBJ** We believe that the primary emphasis should be placed on the objective of financial reporting (i.e. providing information about an entity's performance results that helps predicting future cash flows) in developing accounting standards on revenue recognition. From this perspective, we support the original transaction price measurement approach that the Boards propose in the DP for the measurement of performance obligations.

The DP states: "[b]y focusing on changes in assets and liabilities, the Boards do not intend to abandon the earnings process approach. On the contrary, the Boards think that focusing on changes in assets and liabilities will bring discipline to the earnings process approach so that entities can recognise revenue more consistently."(paragraph 1.19) This statement means that, in a customer consideration measurement approach, it is revenue that determines the amount of assets and liabilities when an entity satisfies its performance obligations. In this regard, the Boards' proposed approach is similar to the earnings process approach.

## Customer consideration measurement model—any unsuitable type of contracts?

### Question 2 Do you agree to specify the types of contracts to which the customer consideration approach should not be applied?

**AASB** The customer consideration measurement approach should be used to measure all performance obligations to customers, even though it would provide less decision-useful information for some types of performance obligations (see adjacent 'Example' column). This is because the customer consideration approach provides the most decision-useful information across a spectrum of contracts with customers in different industries, and comparability between different entities is an important goal for revenue recognition.

Given our view, it is not relevant to answer "yes" or "no" to this question.

Types of performance obligations for which the customer consideration measurement approach would provide less decision-useful information are:

(a) those under contracts where settlement costs are highly uncertain or variable (e.g., some contracts to develop infrastructure, or remediate environmental contamination, using emergent technology). Changes in expected costs would only be recognised if a performance obligation is deemed onerous; and

(b) stand-ready obligations and conditional obligations arising when particular events occur (e.g., obligations under some insurance contracts and some warranty contracts). The uncertainties surrounding these obligations might better be dealt with under IAS 37 or models being considered as part of the Phase 2 Insurance Contracts project.

**ARD** We considered whether the proposed principle would provide decision-useful information for the types of contracts below : Financial and non-financial instrument contracts that are within the scope of financial instrument accounting guidance ; Insurance contracts ; and Lease contracts. In addition, we do not believe that a revenue standard should apply to contracts that lack commercial substance.

**ASC** The DP proposes that customer consideration approaches such as
i) customer's acceptance of the promised goods and services,
ii) the customer's intended use of those goods and services, and
iii) the customer's payment would affect the way as how the performance obligation is satisfied.
We generally agree with this proposal.

**CRAC** We in general do not support the allowance of exceptions (other than those types of contracts specifically scoped out) to this fundamental measurement basis unless the customer consideration clearly does not reflect the economic substance, like in the situation of a non-arm's length transaction.

**FRSB** We have not identified any other customer contracts (other than those already identified in the DP) for which the proposed revenue recognition principle would not provide decision-useful information.

**HKIPCA** In general, we believe that the Boards should attempt to develop a model that will be applicable to all types of customer arrangements. We acknowledge that arrangements with highly variable outcomes, including financial instruments and insurance contracts, as outlined in 5.90 of the Discussion Paper, may need to be scoped out of the standard. Additionally, the Boards may find that a different model may provide more decision-useful information for other arrangements, such as long-term contracts. We do believe, however that the Boards should not scope out such arrangements from the project at this point in time, instead, they should continue to consider whether the application of the proposed model might not result in decision-useful information for certain other arrangements.

**MASB** Despite the IASB's proposal to base a single model for revenue recognition, there will continue to be scope exclusions for certain types of contracts due to the different nature of the contracts.

Types of contracts for which the customer consideration approach would provide less decision-useful information are:

- Financial instruments
- Insurance contracts
- Long-term contracts

**ASBJ** We believe that, for the construction-type contracts that meet certain criteria, revenue recognition using the percentage of completion method provides more useful information that serves the objective of financial reporting. Existing accounting standards have required or permitted revenue recognition using the percentage of completion method for construction-type contracts because, for certain types of contracts, it is believed that revenue recognition using the percentage of completion method results in more relevant information in predicting future cash flows compared to other methods. The Boards' proposal overturns the established view on the usefulness of information resulting from the percentage of completion method.

Type of contracts for which the customer consideration approach would provide less decision-useful information is the construction-type contracts that meet certain criteria.

## Matching concept

### Question 3 Do you think this change (ie elimination of matching concept) will result in useful accounting information?

**AASB** We have difficulty understanding the question because costs are only capitalised by Australian entities if they meet the capitalisation criteria in the relevant IFRS, such as IAS 2.

If assets do not result from incurring costs, deferring those costs would be inappropriate. Given our comments, it is not relevant to answer "yes" or "no" to this question. However, we consider that the criteria for recognising contract origination costs as assets in IAS 38 Intangible Assets are too restrictive and should be reviewed. For example, such costs might be regarded as costs of acquiring or enhancing customer relationships, but paragraph 16 of IAS 38 permits recognition of customer relationships as assets in only limited circumstances.

**ARD** We agree that an entity should recognise contract origination costs as expenses as they are incurred, unless they qualify for recognition as an asset in accordance with other standards. We believe that the entity's activities to obtain the contract occur before the contract with the customer is established and do not meet the definition of performance obligation. Therefore, customer consideration should not be allocated to ,nor revenue derived from, the entity's activities to obtain the contract.

On the other hand, there are a number of cases where significant amounts are paid to third parties to obtain a contract with a customer. We suggest the boards to consider whether there is sufficient guidance in the relevant asset standards to enable an entity to determine when the costs associated with the acquisition of such cash flow streams results in the recognition of an asset.

**ASC** We support the proposals of the DP that costs associated with contacts with customers would be recognised as expenses when incurred unless they were eligible for capitalisation in accordance with other standards, such as IAS 2, IAS 16 and IAS 38.

Commission and salary paid to a real estate sale agent for obtaining a property contract with a customer typically do not create an asset qualifying for recognition in accordance with other standards. As a result, an entity would recognise such costs as expenses (such as marketing expense), which may not be the same period in which revenue is recognised.

**CRAC** While the revenue recognition principles are important to determine the revenue to be reported in a period, we believe that to achieve the objectives of financial reporting, the matching principle should be emphasized and applied to depict the actual performance of an entity for each period.

Hence, contract acquisition cost should be accrued to match the corresponding revenue in subsequent periods if it is highly probable that the revenue will be realized.

**FRSB** There should not be a presumption that contract origination costs are to be expensed and it is not sufficient to leave their accounting treatment to be determined based on other IFRSs. Contract origination costs can be significant and can be incurred for a wide variety of reasons. Existing requirements of IFRSs do not provide clear and consistent guidance on how to account for contract origination costs. We believe that the IASB should consider fully the appropriate accounting treatment for contract origination costs. A single principle needs to be established which should be applied to all IFRSs.

Preparatory work for a contract (such as design work) may give rise to a resource that will assist the entity in providing goods or services to its customer and thereby generate cash inflows from the contract with the customer. Recognising such costs as expenses when incurred but recognising revenue from the customer contract only as promised goods or services are provided to the customer may not provide the most decision-useful information to users. Rather such costs should be deferred and subsequently recognised as expenses resulting from the provision of the promised goods or services.

**HKIPCA** We believe that, when the cost is only payable in the event of a successful sale, the contract origination costs should be matched with the revenue that they generate. For example, a property developer might agree to pay a sales commission to a real estate agent in respect of pre-sales of properties. In such cases, in our view it would not provide decision-useful information to charge the expense of the commission at the time of the pre-sales contract, if the revenue from the property sale will not be recognised until the property is completed and handed over to the buyer. We consider that either the expense should be deferred until the pre-sale is recognised, or a proportion of the revenue from the property sale should be recognised earlier, at the time that the expense is incurred in order to provide decision-useful information. However, we believe that there is sufficient guidance in the relevant asset standards to enable an entity to determine when the costs associated with the acquisition of such cash flow streams results in the recognition of an asset.

Another example is related to the costs incurred to acquire contractual relationships with customers (e.g. in telecommunication industry) which, under current practice based on matching principle, are capitalised if it is probable that future economic benefits will flow from the customers to the entity and such costs can be measured reliably. Capitalised customer acquisition costs are amortised on a straight-line basis over the minimum enforceable contractual periods. In such case, it would not provide decision-useful information to expense off the customer acquisition costs at the time of the commencement of the contract.

**MASB** Generally, we believe the cost to perform contractual obligation must firstly meet the definition of an asset that can be measured with reliability before being capitalised in accordance with other standards.

To this, where costs on long term contracts, such as for property development, are capitalized, the revenue relating to such costs should not be recognised until the costs themselves are capable of being recognised in the statement of comprehensive income. Thereby, we believe that revenues and the associated costs would be matched.

Acquisition cost of general insurance contracts which is normally amortised over one year on a straight line basis.

# Transfer of control

### Question 4 Do you think it is possible in your jurisdiction to identify clearly when an entity transfers control?

**AASB** We think it is possible to identify with sufficient clarity when control of assets is transferred to a customer. We note that, in some cases, such as those addressed in IFRIC 15 Agreements for the Construction of Real Estate, applying judgement may be necessary to identify when control passes. We consider this is acceptable in the context of applying principles-based Standards. We emphasize that, in many cases involving sales of goods, it is more difficult (and subjective) to identify when the significant risks and rewards of ownership transfer to the customer, than to identify when control passes to the customer.

We think the IASB DP's guidance on the transfer of control of goods could be enhanced by indicating that control of a promised good (or a component thereof) is transferred to a customer when the reporting entity has performed work in creating or acquiring the promised good and is unconditionally entitled to compensation from the customer for the work performed. Under that approach, continuous transfer of control could occur without goods being constructed at the customer's site (for example, it could occur during construction of military equipment or a specialised ship).

**ARD** We think that the DP lacks of a clear principle and sufficient application guidance of when control of assets transfers from an entity to a customer. However, the judgment of control transfer is very crucial in recognizing revenue. From the examples presented in the DP, it seems that the transfer of control is ultimately determined by the legal transfer of title. If so, we think that

it will not match the principle of substance over form. If not, we suggest that the Boards give a clear principle and sufficient application guidance of when control of assets transfers from an entity to a customer, especially in the cases where control continuously transfers.

**ASC** We do not support the DP where revenue is recognised when control transfers to a customer. Please refer to our response on "Control" vs "Risk and Rewards" in point 8.

**CRAC** For a principles-based set of standards, there are always scenarios when the point of transfer of control is not clear and professional judgment is needed. The important point is to specify the criteria and decision tree on which the professional judgment is based.

These criteria may include legal title to the asset, physical possession of the asset, risks and rewards associated with the assets, etc. The decision tree may specify which criterion is the principal element for consideration and which elements are secondary.

**FRSB** We do not agree entirely with the IASB's proposals. In respect of services, a service is not necessarily an asset of the service provider. Suggesting that a service is an asset potentially would restrict transactions that could be considered revenue generating to only those transactions that involve the derecognition of an asset already recognised by the service provider. In respect of goods, we are concerned by a number of paragraphs in the DP strongly suggesting that a customer obtains control of promised goods only upon physical delivery.

If an audit firm provides its client with an annual audit report but conducts its audit through two visits, an interim and a final visit, under the IASB's proposals, if we consider an audit to be the delivery of an asset (the audit report) the audit firm would be permitted to recognise revenue only once the audit report has been delivered because the client obtains 'control' of the asset only upon physical delivery at completion of the audit. However, if we consider the contract with the client to be a contract for the provision of assurance services over the period during which the audit is conducted, the audit firm would be permitted to recognise revenue as the audit progresses because the client obtains the benefit of the audit as the audit is conducted. We suggest that the audit firm should recognise revenue as the audit progresses.

**HKICPA** We agree in principle that performance under the contract is key to determining when to recognize revenue. However, we consider that the Board should field test the principles against a range of contracts typically found in practice and give clear indication in the proposed standard (or any accompanying implementation guidance) as to which factors in those contracts in the Board's view were determinative in identifying that control had, or had not, passed.

In general we would not request such additional guidance in a standard, but in this particular case, we consider that without such guidance entities may frequently be unable to understand the intended meaning of the principle, and without such understanding, entities may be unable to apply the principle to their own facts and circumstances with any degree of certainty that they are complying with the standard.

Without such analysis of common fact patterns of the examples quoted, we are concerned that entities will be unable to operationalise this principle consistently other than in respect of straightforward sales contracts, for example those where the goods are on hand and are delivered immediately or shortly thereafter or services are provided on-site at the customer's premises.

For example, areas where the application of the principles is at best unclear to us include the following:

(1) goods constructed to a customer's order where the construction takes place on the supplier's premises but there are significant financial penalties if the order is cancelled. This may also apply to major repairs, such as dry-docking a ship;

(2) extended service engagements, for example research projects or sustainability audits, where it is unclear under the proposals whether the performance obligation is to provide services or to deliver an asset of a report of the findings (or a combination of both components) (and consequently it is unclear when the researcher or auditor should recognise revenue);

(3) revenue relating to providing fund management services, where the amount of the revenue is dependent on the fund's performance exceeding a specified hurdle on a single date (e.g. at the end of 3 years);

(4) goods shipped overseas where the physical good is neither under the control of the producer nor the customer for the duration of the voyage;

(5) bill and hold sales, where physical access to the goods may or may not be conditional on settlement of the purchase price;

(6) sales subject to retention of title clauses, where the goods are physically transferred to the customer but the customer does not obtain legal title until it settles the amount due to the supplier; and

(7) consignment stock, where stock may be shipped to a customer's premises irrespective of whether the customer has indicated that it intends to use such items in production or sell the items to others.

**MASB** It may be difficult to identify clearly when control actually transfers in long term continuous transfer situations. Preparers may therefore compromise by relying on other indicators such as payment-related milestones to recognise continuous transfers. Such compromises would really be surrogates for the notion of transfer, and may not always be reliable.

**ASBJ** The DP implies that transfer of control should be determined not solely on the basis of the form of the physical possession of individual goods and services, but based on the substance. This notion is appropriate and we strongly support it. However, the transfer of control is a highly abstract concept and there is vast room for interpretation when applying it to a specific transaction. The concept of the transfer of assets could potentially lead to divergent practice in revenue recognition, depending on how it is interpreted. To achieve the objective of this project, which is to reduce inconsistencies in the practice of revenue recognition and room for interpretation, clarifying the meaning of this notion is required.

We are of the view that the timing of transfer of control would be unclear if the Boards intend to require the control notion to be legal title, because preparers and auditors would not determine whether the controls of goods or servise are transferred without the court decision or legal professional's advice.

# Decision-useful performance information

### Question 5 Do you think the proposed change can lead to the provision of more decision useful performance information?

**AASB** We agree that the percentage of completion method of revenue recognition should not be applied if the transfer of control of assets to customers is not continuous. This is because we support basing the recognition of revenue arising from contracts with customers on changes in an entity's contractual assets and liabilities. We think it is decision-useful to distinguish:

(a) work performed under a contract that could be sold to any entity (control of which therefore does not transfer continuously to a customer), e.g., because it is a generic product; and

(b) work performed under a contract for which the reporting entity is unconditionally entitled to compensation from the customer (e.g., in the event of the customer breaking the contract). As mentioned in our comments on Question 4, we think guidance should be provided that control of a promised good (or a component thereof) is transferred to a customer when the reporting entity has performed work in creating or acquiring the promised good and is unconditionally entitled to compensation from the customer for the work performed.

The value added by the work mentioned in (a) should be recognised by the contractor as income other than revenue as the work is performed.

In Australia, the interpretation that control can be transferred to a customer when deliverables are constructed at the customer's site is possible.

**ARD** We noted that, considering features in manufacturing and operating of construction enterprises and aircrafts, ship and large equipments manufacturers, recognizing the revenue under the existing construction contract standard is reasonable.

If the construction contract cost can be measured reliably, using the percentage of contract completion method to recognize the revenue is in accordance with the accrual basis principle. Furthermore, with the continuing improvement of measuring techniques and accounting methods, the percentage of completion method will be more reasonable and scientific. Recognizing the revenue over years on the basis of the extent of completion will improve the stability and comparability of revenue in different years as well as the understandability of financial statements.

For example, for a construction contract with a long time, only when the clients get the product, i.e., it is delivered for use, the construction enterprise shall recognize the revenue. It will result in extreme fluctuation in the revenue between and incomparability of revenues in different financial years. The financial statements prepared under proposal of the DP may mislead the users on company's' profitability.

**ASC** We do not think the proposals made in the DP in relation to construction-type contract would enhance a more decision making information. In fact, this would increase the burden of the entity to segregate different components of the construction contract into separate performance obligations. Depending on the complexity of the construction, entity might have difficulty segregating the performance obligation into separate components. Continuous transfer of different component of assets to customer might be segmented into more units of account than at present. We do not see any economical benefit by segregating the components of the construction accounts.

We do not agree that control can be transferred to a customer when deliverables are constructed at the customer's site. This argument is particularly true when a builder erects a building at the customer's site. Generally, customer would be reluctant to take control of partially completed building, unless the entire deliverables (construction of building) is completed.

**CRAC** While we agree to the proposed model, we believe certain transactions/industries, such as the construction industry, should be scoped out if the paramount objective is to provide decision useful information.

**FRSB** We are concerned that, even though a reporting entity has performed work in creating promised goods and is unconditionally entitled to receive payment from the customer, the entity would not be entitled to recognise revenue until it delivers the related finished goods to the customer. Such an approach will not provide decision-useful information in respect of long-term contracts. Rather, it may be possible to determine the transfer of control to a customer when the reporting entity: (i) has performed work in creating the promised goods; and (ii) is unconditionally entitled to compensation.

In some contracts, becoming unconditionally entitled to receive payment from the customer for work performed may coincide with physical delivery of the promised goods. In other contracts this may not be the case. For example, in a contract for the delivery of a highly specialised piece of equipment, until the entity starts performing work under the contract, the customer only has a conditional obligation to make payment to the reporting entity and the entity should not be entitled to recognise revenue. However, as work is performed, the performance of the reporting entity results in the customer's obligation to make payment (and the reporting entity's right to receive payment) unconditional and the reporting entity should be permitted to recognise revenue.

**HKICPA** We consider such change would not lead to more decision-useful information for construction-type contracts when performance takes place over a period of time but the asset under construction is not transferred to the customer on a continuous basis. It is currently the case that, under some construction-type contracts consisting of only one major performance obligation, control of the contracted asset is transferred to the customer at a single point in time—at the end of the contract. Often that single point in time is in a later accounting period than the period in which most of the activities relating to the contract have been carried out. Under the revenue recognition model proposed in the discussion paper, no revenue on such contracts would be recognised until the end of the contract. That would mean that no profit on the contract would be recognised until the end of the contract. That would be the case even though the entity has in fact been very busy on activities being carried out pursuant to contracts with customers prior to that. We opine that an entity that has progressed towards satisfying a performance obligation (i.e. construction progresses) is better off than an entity that for example has not even begun the fulfilment and that this fact should be reflected in the financial statements. The proposed model in the discussion paper does not appear to have reflected this fact and could even lead to revenue being recognised at a time which does not match the period in which the entity carried out the activities under a contract with a customer. Therefore, we consider this not to be decision-useful information.

In addition, we do not consider that revenue for the same kind of construction activities recognized at different time purely due to different location of construction or different party possessing the partially constructed assets will provide more decision-useful information. That comes to the question as to whether physical transfer the only criteria of "control". What is not clear to us is the focus on "control" of the asset and what this means. The discussion paper appears to focus the concept of "control" on legal title and physical possession, which in fact, there could be other determinative factors in identifying that control had, or had not, passed as mentioned in Q4.

In long-term construction contracts such as ship building contracts, "control" over the asset does not pass to the customer until completion, however this does not recognize the economic substance of the transaction in our view as substantial performance activities have been carried out before the completion. On the other hand, the customer does retain "control" over the design features and amendments to the original design although physical control over the use of the asset may not happen until sea trials and acceptance have been completed. The application of the principles would not, in our view, give rise to decision-useful information if revenue is not recorded until sea trials are complete and the ship handed over.

**MASB** We are concerned the proposal may not provide decision-useful information for certain long-term contracts. In long term contracts where the "economic delivery" may differ from the pattern of "economic activity", application of the control model may not adequately reflect the pattern by which revenue is progressively earned.

It may be possible to continuously transfer control for certain long term contracts.

Example of contracts which control is transferred continuously: Contracts for construction of property based on a customer's design or specification on the land that belongs to the customer.

**ASBJ** The revenue should be recognised as the actual result when such result (e.g. cash inflow) in a contract becomes certain. This leads to the provision of useful information with feedback value for users of financial statements in predicting future cash flows. In most cases, revenue is recognised when the obligation in a contract is satisfied because it indicates when the performance becomes certain. However, if the DP proposes to recognise revenue based solely on the satisfaction of performance obligations in isolation from the original purpose described here, the proposed model would not always result in providing decision-useful information.

We think such interpretation is impossible in Japan.

## Construction contracts

### Question 6 If interpretation of continuous transfer is not possible in your jurisdiction, do you think revenue for same kind of construction activities at completely different timing lead to more decision useful performance information?

**AASB** We think recognising revenue on a different basis than when control passes would not provide more decision-useful information. Therefore, we agree that the transfer of control of goods or services to customers, rather than the reporting entity's activities, should determine when revenue is recognised.

As mentioned in our comments on Question 4, we think continuous transfer of control could occur without goods being constructed at the customer's site. Therefore, we do not think the location of construction activities determines when revenue would be recognised under a 'transfer of control' approach. Given this view, it is not relevant to answer "yes" or "no" to this question.

### Question 7 Would the proposed change in the DP cause any issues in your jurisdiction from the IFRIC 15 compliance perspective?

**AASB** We think the DP's proposals are broadly consistent with the revenue recognition criteria in IFRIC 15. The DP seems to give greater emphasis than IFRIC 15 to the transfer of control of goods coinciding with their physical delivery to the customer (see paragraphs 3.20, 4.5, A43 and A44 of the DP). In its submission on the DP, the AASB suggested that less emphasis should be given to physical delivery, and to the distinction between goods and services. One way of doing this would be to add the suggested guidance mentioned in our comments on Question 4.

**ASC** The DP does not provide a clear guidance as how the proposed framework is linked to IFRIC 15. We recommend the Board to provide further clarification on this matter, such as its potential consequential to IFRIC 15. Singapore has not adopted IFRIC 15 and we are in the process of analyzing the potential impact of IFRIC 15 to the real estate industry in Singapore.

**CARC** Please refer to answer to Q5.

**FRSB** We believe that the proposals in the DP do not present a substantial change from the requirements of IFRIC 15.

**MASB** Revenue from certain construction contracts recognised only on completion of construction eg sale and development of condominiums.

## Risk-and-reward notion

### Question 8 Do you agree to the proposed change of removing risk-and-reward notion?

**AASB** As noted in our comments on Questions 1 and 4, we support removing the revenue recognition criterion that, for sales of goods, the significant risks and rewards of ownership of the goods have transferred to the customer. The 'risks and rewards' criterion requires an overall assessment of a sale involving the transfer of various deliverables and remaining obligations of the vendor (e.g., put options, minimum revenue guarantees, and product warranties). This gives rise to the following problems:

(a) it is subjective to apply;

(b) it does not integrate well with the components approach to revenue recognition in paragraph 13 of IAS 18; and

(c) significant rewards can pass to the customer while significant risks remain with the vendor. Consequently, a vendor may continue to recognise an asset after it loses control of it, which would not be representationally faithful.

We are not aware of any revenue transactions that cannot be explained solely by applying the control notion.

**ARD** We believe that the move from recognizing revenue based on the transfer of risks and rewards to a model in which revenue recognition is based on the transfer of control of an asset is significant. However, it seems that the Boards have not appropriately explained this change. In many cases, there is any difference between the test of control and existing test of related risks and rewards in nature. In other cases, it is not easier to judge the transfer of control of an asset than the transfer of risks and rewards. In some cases when collectibility is not reasonably assured, the boards' proposed model could result in the recognition of revenue sooner than at present. We believe that is not consistent with the prudence concept.

**ASC** We do not agree that the consideration of "risks and rewards" to be removed from the revenue recognition framework. We understand the DP proposes that satisfaction of performance obligations is measured based on a "control-based" approach. We are of the view that the "risks and rewards" should be included as one of the criteria to measure the satisfaction of performance obligation, as the "risks and rewards" approach reflects the economic substance of transaction. Financial statements are read, in the main, for the purpose of making economic decisions. The financial statements should therefore faithfully represent the

economics of the transactions, rather than the legal attributes of the transactions. Therefore, we recommend that "risks and rewards" should be taken into consideration as part of the primary framework for revenue recognition in addition to the "control-based" approach

Delivery of air-crafts and oil rigs are typically two types of revenue transactions that cannot be explained solely by control notion. The construction of air-crafts and oil rigs required high engineering and technical skills and it is impossible to transfer the "control" of a "partially" completed project to customer, one way or another. In these examples, the manufacturer would / might bill the customer on a progressive basis, based on an agreed percentage of completion method of the undertaken project. We believe the notion of "control" might not be the best indicator for revenue recognition in these examples. Generally, customers would only accept the entire "control" of the air-craft or oil rigs when the project is completed and a comprehensive acceptance test is conducted and passed through.

**CRAC** We believe a combination of factors should be used to determine the notion of control. Please refer to answer to Question 4.

**FRSB** Refer to our response to question 5 above.

**HKICPA** However, it has sometimes been argued that control and risk and rewards are not alternatives. Risk and rewards could be one of the indicators of control. In Q4 & Q5, we have discussed that the discussion paper appears to focus the concept of "control" on legal title and physical possession, which we believed that these are not the only determinatives in identifying that control had, or had not, passed.

Sales transactions that attach customer return right as explained in paragraphs 4.11-4.13 of the discussion paper. Please also refer to examples 4, 5 & 7 quoted in Q4.

**MASB** We believe the element of risks and rewards should be an input in applying the control model in the assessment of whether a promised good or service is transferred. This would be consistent with, and would provide additional clarity to support the proposed revenue recognition principle. It would also support consideration of the substance of a transaction.

**ASBJ** We can understand the Boards' proposal that revenue should be recognised when an entity transfers not significant risk and reward of ownership of the bundle of the goods but the control of each underlying asset or service in order to exclude confusing the satisfaction of performance obligations. However, we believe that additional consideration for transactions as described in example.

For example, the timing of a sales transaction with repurchase right which seller can exercise at any time would be unclear. We think such transaction is obviously different from transactions with return rights which are addressed in the DP.

### Question 9 Do you think the element of risk-and-reward approach should be considered as part of the criteria for control notion approach?

**AASB** Whilst we think analysing risks and rewards can assist in identifying when control of an entity exists (for the purpose of preparing consolidated financial statements), we do not think analysing risks and rewards would assist in identifying when control of assets transfers to a customer. The 'significant risks and rewards of ownership' test in IAS 18 is applied to groups of rights and obligations as a single unit of account (for example, when goods are sold with a put option and various warranties). Under the IASB DP's approach, each asset and liability would be accounted for separately, and a significant risks and rewards of ownership approach becomes unnecessary.

**ARD** Please see comment to Question 8.

**ASC** Please see comment to Question 8.

**CRAC** Please see comment to Question 4.

**FRSB** Please see comment to Question 5.

**MASB** Please see comment to Question 8.

**ASBJ** As described above, we are of the view that the risk and reward notion is not needed, in principle.

However, we think that indicators of control are needed in order to clarify the notion of control (see #4) and that risk and reward may be part of such indicators for transactions such as those described in #8 example.

## Stand-alone selling price

**Question 10 The Boards suggest considering cost with margin approach or adjusted market assessment approach for the estimation of stand-alone selling price. Do you agree?**

**AASB** We agree with the DP's proposals that, when different deliverables are transferred to a customer at different times:

(a) the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations; and

(b) if the entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price.

These proposals are consistent with measuring performance obligations and related revenue on the basis of the customer consideration received or receivable in respect of each performance obligation. Where stand-alone selling prices exist for those goods or services, they provide an objective basis for allocating the total contract revenue between the different performance obligations.

We consider that estimating the stand-alone selling price of each good or service would be preferable to aggregating performance obligations (and revenue) at the level at which they are sold separately to customers, because doing so may defer the recognition of revenue even though some performance obligations to customers have been satisfied.

We agree that an 'expected cost plus margin' approach and an 'adjusted market assessment' approach should be considered, and that the particular estimation technique should be left to the entity's judgement. Such estimates are likely to be more difficult when a vendor's products are unique or highly specialised (e.g., software tailored to a customer's needs), but not to an unacceptable degree.

**ARD** We think that for the sale contract with multi components, the approach to allocate the transaction price among the individual performance obligations should be considered for its feasibility. We acknowledge that in certain circumstances it may be difficult to estimate the stand-alone selling price of an asset .We are afraid that the wide use of estimation may decline the quality of accounting information. Therefore, we suggest that an entity should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price, only when the price can be estimated reasonably; otherwise, it should use other allocation bases such as the entity's expected cost (at contract inception) of the promised goods and services.

**ASC** Technically, we agree with the proposal. However, there would be specific scenario where entity finds it difficult to assess the estimated stand-alone price if any parts of the bundle sale that delivered at different times are not separately identifiable and sold separately in the open market. In such situation, it is inappropriate to use the expected cost plus a margin approach or adjusted market assessment approach to determine the estimated stand-alone selling price.

As illustrated in paragraph 5.49 of the DP, entity could possibly find different ways to estimate the stand-alone price for those products that are not sold separately (in order to comply with the standard). However, such procedures would be very "administrative", time consuming and increase operating costs for the entity.

**CRAC** We in general support this approach if they are determined to be separate performance obligations.

**FRSB** We agree with this proposal. Under the current standards, management is already required to exercise judgment in this area and so this requirement should not create new difficulties. However, we do foresee some practical difficulty in determining the amount of the transaction price to allocate to obligations to accept returned goods.

We do foresee some practical difficulty in determining the amount of the transaction price to allocate to obligations to accept returned goods. This is because, in a competitive market, there will be little or no information available on the amount a customer would be charged for the right of return. In a competitive market competing entities simply match the selling price of their competitors so that even if one entity sells goods at a particular price including a right of return and another sells the same goods without a right of return, the selling price will be the same.

**HKICPA** We generally agree as this allows for appropriate profit margins to be recognized on the different components of the contract. We also think that, generally speaking, stand-alone selling prices ought also to be readily available and the method ought to be relatively simple to apply. However, it may be impractical to apply in some industries (e.g. telecommunication industry) which is subject to frequent changes to pricing and contract terms, and entities manage their customers on a group basis and the customer base is large.

**MASB** We believe it would be possible to make a reasoned estimate of selling prices of assets sold by profit-making entities, however packaged to the customer.

**ASBJ** We agree that the transaction price should be allocated to performance obligations based on the stand-alone selling prices of the goods or services. The selling price is usually the transaction price determined by the agreement between an entity and its customer.

# Remeasurement with cost trigger (not including margin)—onerous contract

### Question 11 Do you agree with the cost trigger for remeasurement of performance obligation?

**AASB** We support using the entity's expected cost of satisfying the performance obligation (cost trigger) to determine whether that obligation is onerous, and should therefore be remeasured, because:

(a) adding a margin would give rise to frequent remeasurement of performance obligations, which would effectively depart from using the transaction price as the primary basis for measuring performance obligations; and

(b) it would be consistent with the established treatment of onerous contracts in IAS 37.

**ARD** The Board proposed that, in the subsequent period, only when the performance obligation become onerous should it be remeasured. We agree in principle with the proposal, however, we noted that in some circumstances , such as where there is uncertainty in initial recognition amount, it is appropriate to adjust the initial recognition amount of obligation. Absolutely, this judgment should improve the relevance of the assessment of the sale price of the date the contract signed on rather than to reflect any price changes since the contract signed.

For onerous contracts, we concern that a provision for a onerous contract should be based on the total amount of a performance obligation rather than an individual performance obligation. If the provision is recognized based on individual performance obligations, it may result in a provision in initial recognition only when some components deemed onerous while the contract as a whole is profitable. We commend that the revenue recognition standard should provide clear guidance on when the onerous contract provision should be recognized and the how to measure it. Particularly, guidance is needed on which costs are relevant and assumptions of future changes of those costs, especially for the contracts with high fixed costs).

**ASC** We agree that cost trigger is appropriate to remeasure the performance obligation that deemed onerous.

This approach is commonly used for construction contracts in IAS 11 and relevant project-based manufacturing sector. The cost trigger approach, in effect, deems a contract onerous when the total expected contract costs exceed the expected inflow (revenue) in contract (i.e. when the total contract is expected to generate a cash loss). When the loss becomes probable, the contract is remeasured and the loss is recognised as an expense immediately.

The cost trigger approach would apply to those executory contracts where the entity does not have any right to renegotiate the terms of the contract with the customer. For contract that provides renegotiation conditions, whether the performance obligation required remeasurement will be depending on the outcome of renegotiation.

**CRAC** Remeasurement of performance obligation with the inclusion of the profit margin would distort the true picture of the entity's performance over different periods. If the increase in the expected cost is so substantial as to justify its recognition, we believe this should be done separately, such as through the creation of a provision.

**FRSB** We agree that a performance obligation should be deemed onerous, and remeasured to the entity's expected cost of performance, if the expected cost of performance exceeds the performance obligation's carrying amount.

**HKICPA** Yes as this is because we do not consider it appropriate, or providing decision useful information, to recognise a larger loss, simply in order to be able to report a profit margin at a future date. However, we do not believe that remeasurement of performance obligations when deemed onerous should be addressed in a revenue recognition standard. Guidance on the existence, recognition and measurement of onerous contracts should be included in a liability standard (such as IAS 37 at present) not a revenue standard.

**MASB** We believe a liability should be recorded when the entity has a contractual obligation to provide goods or services where the expected cost exceeds the cost of the performance obligation.

We support the "cost test" approach as it is similar to requirements of current standards such as IAS 11 and IAS 37.

**ASBJ** A trigger with a margin or the remeasurement with a margin would be unnecessarily complex for most contracts with customers due to the high frequency of remeasurement. In addition, it would also report gains and losses that do not reflect the economic substance of an entity. Such information would be detrimental to predicting future cash flows.

In addition, the loss arising from an onerous contract should be accounted through the recognition of separate liability (e.g. a provision) other than performance obligations.

The onerous trigger and the remeasurement when deemed onerous should exclude the margin.

# Other concerns

## Question 12 Any other concerns or issues that you would like to highlight in relation to the DP?

**AASB** We do not think revenue should arise only from contracts with customers. Revenue is an important metric in valuation models used by various users of financial statements. Therefore, we think precluding the following types of income from being reported as revenue (because they arise outside contracts with customers) would reduce the relevance of the financial information reported:

(a) returns to investors in equity instruments (for example, dividends and revaluation increments); and

(b) growth of biological assets, particularly those that do not reach saleable condition for a long period of time.

**ASC** The control concept introduced in the DP should provide further guidance/clarification. The DP contains a few examples of the control concept. However, it does not provide a clear enough definition of control or provide sufficient guidance on when control transfers. These two areas are most significant in the effective application of the new control model.

**CRAC**

(1) The revenue recognition model should be developed in consideration of the directions in the conceptual framework project and other principles applied in financial reporting such as the matching principle and the materiality concept.

(2) For product warranty, we believe that separate warranty or extra period warranty bought by the customer is clearly separate performance obligation and should be accounted for accordingly. For standard warranty that comes with the product sold, the amount of the estimated warranty cost should be considered in determining whether this is a separate performance obligation.

(3) For contract acquisition costs, the rule "those costs should be recognized as expenses unless they qualify for recogniton as an asset in accordance with other standards" is too rigid because the standards issued cannot cover all situations.

**ASBJ** It is inappropriate to specify that the measurement objective of performance obligations is to depict the entity’s obligation at each financial statement date. It is unclear how such depiction enhances predicting future cash flows, and specifying such measurement objective could potentially hinder the communication of certain revenue information that has proven to be useful and reflects the actual performance of the entity, by theoretically making the original transaction price approach an exception. Accordingly, we disagree that such objective is included in the accounting standard for revenue recognition.

## Appendix B: Selected definitions and proposals

An entity satisfies a performance obligation and, hence, recognizes revenue when it transfers a promised asset (such as a good or a service) to the customer. The Boards propose that an entity has transferred that promised asset when the customer obtains control of it. (4.59)

The Boards propose that the customer has the promised asset when it controls the resource underlying the promised asset. That view of control is consistent with the Boards' recent discussions on a revised asset definition in their joint conceptual framework project. (3.20)

### Customer

A customer is a party that has contracted with an entity to obtain an asset (such as a good or a service) that represents an output of the entity's ordinary activities. (2.21)

### Performance obligation

An entity's performance obligation is a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer. (3.2)

### Working definition of an asset the Boards have tentatively adopted

An asset of an entity is a present economic resource to which the entity has a right or other access that others do not have. (*Project Update*, Conceptual Framework—Elements and Recognition)

- *Present* means that on the date of the financial statements both the economic resource exists and the entity has the right or other access that others do not have.
- An *economic resource* is something that is scarce and capable of producing cash inflows or reducing cash outflows, directly or indirectly, alone or together with other economic resources. Economic resources that arise from contracts and other binding arrangements are unconditional promises and other abilities to require provision of economic resources, including through risk protection.
- A *right or other access that others do not have* enables the entity to use the economic resource and its use by others can be precluded or limited. A right or other access that others do not have is enforceable by legal or equivalent means.

## Working definition of control of a good or a service

Control of a good or a service is an entity's present ability to direct the use of and receive the benefit from that good or service. (IASB's Agenda paper 5A (September, 2009), paragraph 29)

- *Present ability:* The staff thinks it is important for a definition of control to emphasize that a customer must *presently* have the ability to direct the use of and receive the benefit from a good or a service for the selling entity to recognize revenue.
- *To direct the use of:* The ability to direct the use of a good or a service refers to an entity's power to (a) deploy that asset in the entity's business activities, (b) allow another entity to deploy that asset in its business activities, or (c) restrict other entities from deploying that asset.

  The Source of that power in the context of revenue recognition typically is an enforceable right as a consequence of a contract. The ability to direct the use of a good or a service implicitly includes the ability to restrict or limit another entity's ability to direct the use of that good or service.

  Directing the use of a good typically involves using that good in a business process, consuming it, disposing of it, or storing it and preventing other entities from using it. Directing the use of a service might include specifying how and when that service is provided, and determining who receives the services.
- *To receive the benefit from:* For a customer to obtain control of a good or a service, the customer must have the ability to receive the economic benefit from that good or service. The economic benefit of a good or a service is a potential cash flow (either an increase in cash inflows or a decrease in cash outflows). An entity can obtain those benefits directly or indirectly in many ways such as by using, consuming, disposing of, selling, exchanging, pledging, or holding an asset.

## Proposed indicators of control (IASB's Agenda paper 5A (September, 2009), paragraph 52)

(a) The customer has an unconditional obligation to pay for the asset (and the payment is non-refundable)

(b) The customer has legal title to the asset

(c) The customer can sell the asset to (or exchange the asset with) another party

(d) The customer has physical possession of the asset

(e) The customer has the practical ability to take possession of the asset

(f) The customer specifies the design or function of the asset

(g) The customer has continuing managerial involvement with the asset

(h) The customer can secure or settle debt with the asset

## Appendix C: Control

(Please refer to IASB staff paper 5A, September 2009.)