



ICAC comments on IASB's Exposure Draft ED/2011/6 Revenue from contracts with customers

ICAC is pleased to give its comments on this project and we appreciate the effort made by the corresponding boards in asking and taking into account the input from different organisations.

ICAC's answers to the issues raised on the ED

Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

We analyse the question in addition with the change on the indicators of transferring the control.

The ED 2010 indicates in paragraph 30 d):

“An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:

[...]

d) The design or function of the good or service is customer-specific. A good or service with a customer-specific design or function might be of little value to an entity because the good or service lacks an alternative use. For instance, if an entity cannot sell a customer-specific asset to another customer, it is likely that the entity would require the customer to obtain control of the asset (and pay for any work completed to date) as it is created. A customer's ability to specify only minor changes to the design or function of a good or service or to choose from a range of standardised options specified by the entity typically would not indicate a customer-specific good or service. However, a customer's ability to specify major changes to the design or function of the good or service would indicate that a customer obtains control of the asset as it is created.”

As being said in the paragraph BC 87, “Many respondents in the construction industry were concerned that they would be required to change their revenue recognition policy from using percentage of completion method to a completed



contract method (on the basis that the transfer of assets occurs only upon transfer of legal title or physical possession of the finished asset, which typically occurs upon contract completion)”

Meanwhile, the paragraph BC90 includes under the scope of paragraph 35 a) many construction contracts when the customer controls any work in progress (tangible or intangible) arising from the entity’s performance, and the paragraph 91 is referred to most contracts for construction of facilities, production of goods, or provision of related services to a buyer’s specifications.

Hence, the concerns of the construction industry are solved.

But, we really do not clearly understand whether the paragraph 35 and 36 provoke a change in accounting of a contract for a standard house described in paragraph 12 of EFRAG’s paper. For example, in construction industry is common that the company and the customer sign a private contract in which the entity is expected to deliver a specific property (a certain floor and orientation) and correspondingly, the client has to make a payment in advance and pay the remaining amount when the delivery of keys of the house takes place (a circumstance which in turn causes the transfer of risks and benefits of the asset). To date, entities have been recognizing revenues from the operation when the house is finished and the keys are transmitted to the client. The question raised on EFRAG’s letter is whether it could be understood that the new criterion in the draft standard should lead to recognize revenue as long as they build the asset.

If so, we see a change in the revenue recognition policy of construction industry that is not accompanied with any reasons in BC, taking account that this was the reason to change the previous criteria referred above. This change is also seen by EFRAG as it is said in paragraph 11 of its paper and in the illustrative examples.

Notwithstanding, we do not see why the fact that the entity’s performance does not create an asset with an alternative use to the entity is considered in the ED as necessary but not sufficient criteria. We think that all of the three criteria stated in paragraph 35 b) i),ii) and iii) are enough on its own to consider that the entity transfer control of a good or service over time.

Question 2: Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer’s credit risk. The corresponding amounts in



profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

In ICAC's view, the first thing to consider is the nature and measurement of a contract asset. Applying the current standards, if the entity recognises revenue, a receivable appears, and conversely, if not an inventory appears. The paragraph 106 states that a new category of asset has to be presented when an entity recognises a revenue and the customer has not paid consideration and the right of the entity is conditioned on something other than the passage of time.

We think that it is necessary more clarification about this new asset, and why in such cases the entity can present an inventory in its statement of financial position.

We agree that a customer's credit risk should not affect how much revenue an entity recognises. The impairment of the receivable and how to present uncollectible amounts is matter of IFRS9 and IAS 1 respectively.

Additionally, we do not understand why the treatment would be different if the contract has a significant financing component in accordance with paragraph 58 and we wonder what the treatment would be.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

Accordingly with the standards about variable consideration, paragraph 53-57 of the ED, the promised amount of consideration in a contract can vary because of discount, rebates, refunds, credits, incentives, performance bonuses, penalties,



contingencies, price concessions or other similar items. If the promised amount of consideration in a contract is variable, an entity shall estimate the total amount to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

The paragraph 81 states that if the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue the entity recognises to date shall not exceed the amount to which the entity is reasonably assured to be entitled.

The paragraph 55 declares that to estimate the transaction price, an entity shall use either of the expected value or the most likely amount method, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled.

And according with paragraph 81, an entity is reasonably assured to be entitled with the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met:

- a) the entity has experience with similar types of performance obligations(or has other evidence such as access to the experience of other entities); and
- b) the entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.

Finally, the paragraph 84 states that if an entity is not reasonably assured to be entitled to the amount of the transaction price allocated to satisfied obligations, the cumulative amount of revenue recognised as of the reporting date is limited to the amount of the transaction price to which the entity is reasonably assured to be entitled.

The 2010 exposure draft proposed that an entity should recognise revenue from satisfying a performance obligation only if the transaction price could be reasonably estimated.

However, the paragraph BC 199 of the basis for conclusions on exposure draft indicates two reasons for changing the proposal of ED 2010, when most respondents had supported it. One of them is the possibility that an entity might not allocate any consideration to the remaining performance obligations in the contract. In such



cases, those remaining performance obligations would be identified as onerous even though the entity expects those performance obligations to be profitable. In ICAC's view, this fact could be resolved if the analyse about onerous performance obligations is transformed in onerous contract.

We understand the objective of this change but it seems that when estimating the transaction price the entity can not apply the reasonability that after when estimating the revenue to recognise, the entity must take into account. We think that every estimation the entity makes should apply reasonability, so if one paragraph of ED request reasonability in the estimation, this must be over the first estimation the entity make, that is the transaction price because this amount is the key in the process of recognition and measurement of revenue.

The paragraph 85 is referred to a specific situation, which is an entity licences intellectual property to a customer with a variable consideration on the basis of customer's sales. In ICAC's view, this situation is included in the a) paragraph of the number 82 of the ED. We do not see the added value to do so.

In addition, we are of the view that a licence could be considered as a 'right to use'. It is in substance a leasing agreement regardless of whether the right relates to the use of tangible or intangible assets. We therefore think that such arrangements should be scoped into the new standard on leases instead of being dealt with in within the revenue standard.

We also would like to note the interaction that exists between service contracts and leases. So therefore we suggest the boards to further explore this issue-The need to distinguish clearly between service contracts and leases. We believe that this distinction is hard to make in practice.

We think that for these licences, an entity will normally find it difficult to apply all requirements set in paragraph 4 of the introduction in ED.

Finally, in relation to variable consideration for revenue recognition brings us to mind if the recognition criteria are the same contained in IAS 37 for contingent assets, and the need of having a coherent accounting treatment for both.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree



with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

The paragraphs 86-89 state that an entity shall recognise a liability and a corresponding expense if the performance obligation is onerous, only for a performance obligation that the entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year.

ICAC disagree with the proposal. We think that the onerous test should have as unit of account the contract instead the performance obligation. We do not see why this could be inconsistent with recognising revenue at the performance obligation level as BC207 says. We consider the contract as the basis of the standard and this is why we understand the letter c) in the paragraph 17 combination of contract.

In addition, the BC207 and 208 reflects that the board decided to address respondents' concerns on the unit of account by modifying the scope of the onerous test, and the new proposed scope is closest to the scope of existing revenue standards that specify an onerous test. Precisely, IAS 11 states the onerous test with the contract as unit of account.

We do not find sufficiently explained the reasons for limiting the scope of the onerous test.

Question 5: The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.* The disclosures that would be required (if material) are:

- **The disaggregation of revenue (paragraphs 114 and 115)**
- **A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)**
- **An analysis of the entity's remaining performance obligations (paragraphs 119–121)**

*** In the IASB exposure draft, see paragraph D19 in Appendix D.**



- **Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)**
- **A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).**

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

We disagree with the proposal because the amendment of IAS 34, if so, requests a specific study in a specific project.

Question 6: For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply

(a) the proposed requirements on control to determine when to derecognise the asset, and

(b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset.*

Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

In ICAC's view, the references to the new standards in other standards should be done in most possible general terms. Hence, we totally agree with the comments done in EFRAG's paper in paragraphs 49-51.



ICAC's answers to the issues raised on the EFRAG's draft comment letter

We agree with EFRAG's comments on the following issues:

- Scope
- Allocation of contingent amounts
- Offsetting contract assets and advances received
- Disclosures
- Early application and effective date
- Other concerns

Time value of money

We agree with the proposal of the ED, but we have some concerns about this issue: Will the treatment be the same for the customer? Will the customer have to actualise? And when accounting this issue in other standards like IAS 16 and IAS 38, will it be the same for the seller and the buyer? We don't see the answer clear in the ED.

Right of return

We think it is not understandable the treatment given to repurchase agreements in application guidance because of the references to IAS 17 Leases. If these types of agreements are under the scope of the IAS 17 there is nothing to state in the ED.

Madrid, 12 march 2012