

13 March 2012

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom
Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON THE EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

In response to your request for comments on the exposure draft on *Revenue from Contracts with Customers*, attached is the comment letter prepared by the Accounting Practices Committee (APC) of The South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of the APC, which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Financial Reporting

cc: Paul O’Flaherty (Chairman of the Accounting Practices Committee)

SAICA SUBMISSION ON EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

GENERAL COMMENTS

We welcome the revised exposure draft *Revenue from Contracts with Customers*, issued by the International Accounting Standards Board (IASB/Board), and support the revenue recognition model as contained therein. We are pleased that a number of comments that we raised on the initial exposure draft (ED/2010/6), have been addressed.

In finalising the proposals, we would like the Board to carefully consider the interaction between IFRS 9 – *Financial Instruments*, and the requirements of the new revenue standard. Specifically, we stress the need for consistency in the measurement of financial assets that arise as a consequence of revenue transactions. We therefore recommend that the Boards align the effective dates of IFRS 9 and the revised revenue standard.

SPECIFIC COMMENTS

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 agree with the criteria proposed for identifying when a performance obligation is satisfied over time, and appreciate the Board's decision to include this specific guidance.

We agree with the Board's view, as explained in paragraph BC100, that paragraph 35(b)(iii) be included in the criteria for recognising revenue over time, because there are circumstances when applying paragraph 35(b)(i) and (ii) alone would not result in the recognition of revenue over a period of time for service contracts, such as consulting services.

Example 7 in paragraph IE6 concludes, that based on the facts provided therein, the construction of the individual apartments should be accounted for as a performance obligation that is satisfied over time. Applying IFRIC 15 – *Agreements for the Construction of Real Estate*, to those same facts, however, we would conclude that since the customer is not able to specify the major structural elements of the design of the house, revenue should be recognised at a specific time and not on a percentage completion basis. Based on our understanding, the application of paragraph 35(b)(iii) will therefore change the pattern of revenue recognition for long-term contracts dealing with the construction of a good that is not significantly customised as defined by IFRIC 15.

SAICA SUBMISSION ON EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS

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?

Paragraph 68 of the exposure draft requires that where an entity has an unconditional right to receive consideration, the entity shall account for the receivable in accordance with IFRS 9, except as specified in paragraph 69.

Paragraph 69 states that upon initial recognition of the receivable, any difference between the measurement of the receivable in accordance with IFRS 9 and the corresponding amount of revenue recognised shall be presented in profit or loss as a separate line item adjacent to revenue. Paragraph 60 of the exposure draft states that, as a practical expedient, an entity does not have to adjust the promised amount of consideration to reflect the time value of money where the entity expects at contract inception that the customer will settle within a period of twelve months after contract inception. We are concerned that the effect of an inconsistency between the two standards as a result of the practical expedient will create a difference in the measurement of gross revenue and the financial asset under IFRS 9, which includes both credit risk as well as the effects of discounting the receivable.

For example, a contract with a single performance obligation has a transaction price of R100 million. It is expected that the customer will be able to settle only R98 million of the total transaction price and that settlement will take place 11 months after the performance obligation is satisfied. The fair value of the financial asset, in terms of IFRS 9, is R93 million, which therefore includes the effect of both the time value of money and expected credit losses. Based on our understanding of the requirements of paragraph 69, we would recognise revenue of R100 million, a financial asset of R93 million, and R7 million adjacent to revenue as an expected credit loss. The adjustment for credit losses will therefore include the effects of both the time value of money as well as credit risk.

Credit risk

If the effective dates of the revenue standard and IFRS 9 are not aligned, the final standard should clarify whether credit risk is based on the expected credit loss model being proposed as part of the Board's IFRS 9 Impairment project, or whether the incurred loss model of IAS 39 – *Financial Instruments: Recognition and Measurement* should be applied.

We are in broad agreement that the expectation of future credit losses should be accounted for on the date of initially recognising revenue. In addition, we agree that the presentation of expected credit losses adjacent to revenue will allow for users to easily assess the amount of an entity's gross revenue, relative to the initial and subsequent estimates of non-collectability.

SAICA SUBMISSION ON EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS

The exposure draft requires the adjustment for credit losses to be presented adjacent to the revenue line item. We request that the Board provide clarity on whether, in the case of an income statement where more than one type of revenue is presented on different lines, an adjustment for credit losses needs to be disclosed adjacent to each revenue line item or whether it can be presented for all revenue line items as a single line item with supporting disclosures in the notes. For example, in the case of one of our commentators that is a banking group, at least four different items of revenue may, in terms of the exposure draft, be required to be presented on the face of the income statement, such as fee and commission revenue, other revenue, investment incomes and gains, and management and service fee income.

While we believe the exposure draft's proposals are appropriate for corporates, it may result in the disclosure of a number of additional impairment line items (in addition to impairments for financial assets) for financial institutions which may best be served through disclosure in a single line item with supporting notes.

Portfolio assessment

Paragraph 6 of the exposure draft allows an entity to apply the proposals to a portfolio of contracts with similar characteristics, provided the entity reasonably expects that the result of doing so would not differ materially from the result of applying the proposals to individual contracts. We believe that in practice most sales contracts will be assessed for credit risk on a portfolio basis and therefore we welcome the inclusion of this paragraph in the standard.

Question 3

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.

Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

We are in broad agreement that there should be a constraint on the amount of revenue that an entity recognises in respect of performance obligations where there is an element of variable consideration.

IAS 18 does not allow for revenue to be recognised when it is not probable that economic benefits associated with the transaction will flow to the entity. We believe that constraining the recognition of revenue when an entity is not reasonably assured to be entitled to it, constitutes a more conservative approach than constraining revenue on the basis that settlement is not considered probable. This interpretation of the term

SAICA SUBMISSION ON EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS

“reasonable assurance” may result in the deferral of revenue to a time that is later than under the current standard.

Paragraph 83 provides that where an amount of consideration is highly susceptible to factors outside the entity’s influence, an entity’s experience may not be predictive of the amount of consideration to which it will be entitled and therefore the recognition of revenue should be constrained. We believe that this guidance could result in many companies, such as asset managers, being forced to significantly delay the recognition of revenue. We are of the view that the threshold of probability provides a better reflection of the revenue earned in a period.

We would like the Board to reconsider the reference made in paragraph 84 of the exposure draft to the cumulative amount of revenue that can be recognised, as the wording is not clear. This paragraph deals with the situation where the requirements in paragraph 81 for reasonable assurance are not met. One interpretation is that paragraph 84 requires no revenue to be recorded seeing that the requirements of paragraph 81 are not met; the other interpretation is that paragraph 84 is an exception to paragraph 81 and that the same amount of revenue would be recorded regardless of whether the criteria in paragraph 81 are met or not, and thus nullifies the requirements of paragraph 81. As neither of these interpretations is considered to be the intended interpretation, we believe the wording in paragraph 84 needs to be reconsidered as the use of the term 'reasonably assured' creates what appears to be circular reasoning.

Paragraph 53 states that the consideration to which an entity is entitled could vary because the customer holds a right to claim a refund. In many sales contracts, it is at the discretion of the customer that a product be returned, that is to say, the right of return is not dependent on the product being defective. A company would therefore not be reasonably assured to be entitled to the consideration from any contract until the expiration date of the returns policy. It is only when the assessment of reasonable assurance is performed on a portfolio basis that revenue can be recognised on the date of sale. It is for this reason that we welcome the guidance in paragraph 6.

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 majority of our constituents agree that to perform the onerous test at a performance obligation level is appropriately in line with the principles of revenue recognition underlying the exposure draft.

Some of our constituents are, however, of the view that performing the onerous test at the performance obligation level might not result in useful information for users of financial statements. They believe that a future loss related to a single performance obligation within a profitable contract does not meet the definition of a liability. In addition, they argue that when entities negotiate and agree pricing, this is done on the basis of an entire contract instead of an individual performance obligation. In

SAICA SUBMISSION ON EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

addition, the method proposed for allocating discounts to different performance obligations in a contract could result in a performance obligation being assessed as onerous.

To support the view that the onerous test should be performed at the contract level, the following example is provided, which highlights the impracticality in some circumstances of performing an onerous test at the performance obligation level. This is evident in the situation where a contract comprises a large number of component performance obligations. For example, an entity transfers a handset to a customer together with the following services, which we believe constitute distinct services with a different pattern of transfer in return for a fixed monthly fee:

- 100 minutes worth of local calls to be made between 7pm and 7am (off-peak calls);
- 50 minutes worth of local calls to be made between 7am and 7pm (peak calls);
- 200MB of monthly data usage; and
- 150 free text messages.

It is common that in addition to receiving the aforementioned services, a customer is able to purchase a prepaid voucher, which is loaded when they need to make out-of-bundle purchases. The top up value can be used for peak calls, off-peak calls, text messages, data usage, multimedia messages, or any combination thereof,

The detailed process of tracking the costs that will relate directly to satisfying each separate performance obligation could have significant cost implications for an entity, since each service requires the use of very different technology, and therefore will result in very different costs. This is particularly difficult where there are a large number of individual performance obligations, as in the above example. Costing is by its nature subjective and dependent on management's allocation, which makes the comparison of revenue to costs at the level of a performance obligation less reliable.

Paragraph BC208 explains the Board's rationale for limiting the scope of the onerous test in the exposure draft to performance obligations satisfied over time. This limitation was drafted so as to limit the risk of any unintended consequences that could arise from applying the onerous test to some contracts. We are of the view that a performance obligation to be satisfied at a specific time, which could be in a future financial period, should also be subject to an onerous test and that this test should not be limited to performance obligations satisfied over time.

We note that the reference made to IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*, in paragraph 31 of IAS 2 – *Inventories*, has not been removed and therefore contracts for the sale of goods will, indirectly, be scoped into IAS 37. This will result in entities performing the onerous test for the sale of goods at the contract level, as required by IAS 37, while the onerous test will be performed at the performance obligation level for services rendered.

Furthermore, we disagree with the proposal in paragraph 86 that limits application of the onerous test to circumstances in which the entity expects that a performance obligation will be satisfied less than twelve months after contract inception. Applying paragraph 86 to a performance obligation that is expected to be satisfied over a period

SAICA SUBMISSION ON EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS

of 360 days would mean that, even if the performance obligation is onerous, no loss would be recognised, until the loss is actually realised. However, if a performance obligation is expected to be satisfied over 370 days, and is assessed to be onerous, a loss would be recognised. We do not understand the rationale behind this difference and deem it be contrary to the intentions of the Board to draft a principle-based standard. We believe it is likely that both users and preparers will be confused by this requirement.

We lastly request that the Board clarify where the income statement effect of recognising an onerous contract should be recognised, and whether the debit should be presented as a reduction in revenue or as an operating cost outside of gross profit.

Question 5

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

- *The disaggregation of revenue (paragraphs 114 and 115)*
- *A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)*
- *An analysis of the entity's remaining performance obligations (paragraphs 119–121).*
- *Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)*
- *A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).*

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

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 consider the list of specific requirements proposed in the exposure draft to be in conflict with the principles underlying IAS 34 – *Interim Financial Reporting*.

Currently IAS 34 prescribes only nine specific disclosures in a set of interim financial statements, provided that such disclosures are material. In addition, IAS 34 requires the inclusion of an explanation of events and transactions that are significant to understanding changes in the financial position and performance of the entity since the end of the last annual reporting period. We agree with the principles underlying IAS 34 and are concerned that, by increasing the number of disclosures in IAS 34, an imbalance might be created between the benefit to users of providing such information and the costs to preparers of doing so.

We acknowledge the importance of revenue to users of financial statements. Nevertheless, we believe the required disclosures will result in a disproportionate

SAICA SUBMISSION ON EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

focus on a single element and, in many cases, the provision of information that is not of particular importance to users. This would be observed in the case of a services company with a limited number of contracts, where the contract terms and the major assumptions underpinning revenue recognition have not changed during the interim period.

We also note that there is a potential conflict that could arise between IFRS 8 – *Operating Segments*, and the disclosure requirements for the disaggregation of revenue. Paragraph 115 provides a number of possible categories for disaggregating revenue, which would be considered appropriate to disclose if they can provide useful information. We believe that situations might arise in which the suggested level of disaggregation might provide information that is useful to users, but is not actually provided to the chief operating decision maker, and therefore would not be required to be separately disclosed under IFRS 8. We suggest that the Board considers the requirements of IFRS 8 when finalising the disclosure requirements in the new revenue standard.

We therefore do not support these additional disclosures. Should the IASB believe the current set of disclosures in IAS 34 to be inadequate, we request that the IASB investigate this as a separate 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 the IASB exposure draft, see paragraphs D17, D22 and D26 in Appendix D.

We agree with the proposals to extend the principles governing the transfer of control to the sale of non-financial assets that are not transferred in the ordinary course of business. However, it is our view that the Board should carefully consider the consequences of extending the measurement principles of this exposure draft.

We believe that this requirement will create two different models for recognising gains on disposals of assets, that is a model based on the fair value of the proceeds receivable and a model based on the amount of proceeds to which an entity is reasonably assured to be entitled.

When a financial asset or a business, as defined in IFRS 3 – *Business Combinations*, is sold, the gain on disposal will be recognised based on the fair value of the consideration receivable. However, when a non-financial asset is sold, not in the ordinary course of business, the gain will be recognised on the basis of reasonable assurance.

SAICA SUBMISSION ON EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

Notwithstanding the fact that we believe reasonable assurance to be an acceptable basis for measuring the gain on the sale of a non-financial asset, we are cognisant of certain anomalies that might result and wish to articulate one such instance through the following example: The proceeds from the sale of an apartment block contain a contingent element. If the property constitutes a business, the gain recognised will include the fair value of the contingent element. If the property does not meet the definition of a business, the gain will exclude the contingent element until the seller is reasonably assured to be entitled to such amount.

OTHER COMMENTS

Scope

Paragraph 9(e) requires non-monetary exchanges between entities in the same line of business that are made in order to facilitate sales to customers, other than parties to the exchange, to be excluded from the scope of the exposure draft. The current IAS 18 provides that when goods or services are exchanged for other goods or services of a similar nature and value, the exchange should not be regarded as one that generates revenue. As we understand paragraph 9(e), even if the non-monetary exchange is in respect of dissimilar goods, the exchange will be outside the scope of the exposure draft if the entities are within the same line of business. We disagree with this change in accounting treatment because, where the goods or services exchanged are dissimilar, the exchange has commercial substance and revenue should be recognised.

Paragraph 10 states that contracts with collaborators or partners will fall outside the scope of the exposure draft. We would like the Boards to consider including additional guidance on how to distinguish between a customer and a collaborator/partner. For example, paragraph 85 of the exposure draft provides guidance on the situation where an entity licences intellectual property to another party, and the consideration varies based on that party's subsequent sales. Without clarification on the meaning of the term collaborator or partner, one might argue that the counterparty in paragraph 85 should be regarded a collaborator.

Contract modification

We request that the Board reconsider the wording in paragraphs 18, to clarify when a contract modification might exist. Based on the current wording, we do not believe the distinction is clear in the following example:

- An entity provides a handset to a customer on contract inception, thereafter providing network access and 100 free talking minutes per month over a period of 24 months. The pricing of the contract takes into account the probability that a customer will talk for more than 100 minutes per month, thereby resulting in additional costs (hereafter referred to as out-of-bundle purchases). The price per minute of out-of-bundle purchases is inflated by management to provide a recovery on the handset and additional committed services to be provided over the contract period. The contract stipulates that the customer will receive a handset, will have 100 free talking minutes, as well

SAICA SUBMISSION ON EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS

as access to the network so as to make calls and send text messages. The price per text message and per talking minute is specified in the contract.

The out-of-bundle purchases are stipulated as a service available in the original contract, and there is an inextricable link in the pricing of the original contract and the out-of-bundle purchases. For these reasons, one might argue that when the customer elects to make the out-of-bundle purchases, this does not constitute a modification of the original contract, but merely the provision of a service that both the customer and the supplier had always contemplated.

Another argument provided could be that the out-of-bundle purchases are stated in the original contract as being an additional service that the customer could choose, but that the entity is not committed to provide. Using this reasoning, the provision of additional talking time could be seen as a modification of the original contract. We believe that the correct accounting treatment would be to treat the out-of-bundle purchase as a contract modification, rather than as variable consideration, but request clarity on this issue.

Input methods

We believe the guidance provided in paragraph 46 is inconsistent with the principles provided in the exposure draft, particularly as it appears to conflict with the idea that the goods and the related services transferred, do not constitute separate performance obligations. In our opinion, since the goods and services constitute a single performance obligation, revenue from satisfying the performance obligation should be measured on a consistent basis as the services are provided.

In addition, we note that in Example 8 of the Illustrative Examples, the revenue recognised on the transfer of the specialised goods and on the other costs may not be appropriate as the relative margin that the entity would earn on the two elements is not taken into account in allocating revenue.

The time value of money

The current wording in paragraph 60 could be interpreted as implying that the period of time that should be less than a year is the period that spans from delivery of the good or service to receipt of substantially all the consideration relating to the whole contract. We are of the view that paragraph 60 should rather make reference to the time difference between satisfying the performance obligation and receiving the consideration allocated to that performance obligation.

We believe that this practical expedient may provide entities with the potential to manipulate the accounting treatment. For example, an entity might enter into a contract with a customer to provide a handset on contract initiation, together with access to the cellular phone network over a period of 24 months. A fixed monthly payment will be made on the contract over the 24 month period. In order to prevent having to discount the sales revenue recognised on transfer of the handset, an entity may allocate the initial payments received in terms of the contract entirely to recovering the standalone selling price of the handset. Since recovery of this

SAICA SUBMISSION ON EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

receivable is likely to take place within 12 months, the entity could argue that the practical expedient should apply. We request that the Board provide guidance on the allocation of a total transaction price to individual performance obligations where the timing of the cash flows are different to satisfaction of the performance obligations, and where some of the cash flows take place more than 12 months after contract inception and therefore should be discounted.

Construction contracts usually contain a clause that allows a customer to retain a stipulated amount until certain specified contractual conditions have been satisfied. Retention monies are portions of progress billings issued, which are withheld until the conditions of the contract have been complied with. It is common in South Africa for contracts to provide a construction company with the right to demand settlement of the retention, in return for which the construction company has to provide the customer with a letter of guarantee from the bank. This provides the customer with the right to request payment of the retention at a later stage in the event that the particular contractual conditions are not satisfied. The provision of a letter of guarantee is entirely at the discretion of the construction company and it is usually a formality to be issued by the bank. In this way, the practical expedient provides the construction company with an opportunity to adjust the amount of revenue recognised by deferring settlement of the retention. If the construction company intends to demand the retention monies within 12 months, that portion of the transaction price will not be discounted and vice versa. In addition, it is not clear how the revenue would be allocated to different performance obligations when it is received in advance of the various performance obligations being fulfilled and invoiced. We request that the Board provides an Illustrative Example that addresses this issue, particularly as we feel this issue is widespread.

Non-cash consideration

Paragraph 64 deals with the scenario where a customer contributes goods or services to facilitate the entity's fulfilment of the contract. We recommend that the Board provides more guidance from IFRIC 18 – *Transfers of Assets from Customers*, in the application guidance or illustrative examples. We do not think that the guidance provided in paragraph 64 is adequate. We are therefore concerned that the diversity in practice, which the IFRS Interpretations Committee sought to redress by issuing IFRIC 18 could recur.

Allocating the transaction price to separate performance obligations

We would like the Board to reconsider the reference made in paragraph 76(b) of the exposure draft to the principle in paragraph 70. We think that this reference is confusing and somewhat circular, because paragraph 76 is in fact an exception to the general application of the principle in paragraph 70 as explained in paragraphs 71 to 74.

The requirements of paragraph 76, as well as the related implementation examples, seem to indicate that revenue for contingencies is not recognised until the contingency is resolved. Scenario 1 to Illustrative Example 11 concludes that the entire contingent royalty payment should be allocated to Licence B, whilst Scenario 2 concludes that that the entire amount should not be allocated to Licence B. Both scenarios, however,

SAICA SUBMISSION ON EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

arrive at the exactly the same result for revenue recognition, so it is unclear how the guidance provided by paragraph 76 assists users.

Repurchase agreements

Paragraph 33 and paragraphs B38-B48 detail the proposed guidance relating to the treatment of repurchase agreements.

While we acknowledge that the exposure draft removes from its scope contractual rights relating to financial assets and financial liabilities, we are concerned that the principles contained in the abovementioned paragraphs will, in certain instances, differ significantly to the derecognition guidance currently contained in IAS 39 relating to repurchase agreements for financial assets.

This divergence in principles may result in identical repurchase agreements being treated in a materially different manner, simply because the underlying asset meets the definition of a financial asset (and hence IAS 39's derecognition criteria are applied), or does not meet that definition (in which case the requirements of the exposure draft will apply).

An example demonstrating the above is that of commodities in which commodity repurchase and related transactions frequently arise in practice. Commodities, in of itself, would be excluded from the scope of IAS 39 as they do not meet the definition of a financial asset. This is despite the fact that, in substance, commodities are similar to other assets that are included in the scope of IAS 39. Repurchase agreements relating to commodities would therefore fall within the scope of the exposure draft, whilst repurchase agreements relating to financial assets (such as bonds, equities etc.) would fall within the scope of IAS 39. The substance of the underlying agreements, i.e. whether the repurchase agreements have a bond, equity or commodity underlying, are inherently no different from one another.

To illustrate the application differences between IAS 39 and the exposure draft: a sale of a financial asset (e.g. a bond) together with a call option that is deeply out of the money (i.e. an option that is so far out of the money it is highly unlikely to go into the money before expiry) results in an entity having transferred substantially all the risks and rewards of ownership, and hence the asset would, in terms of IAS 39, AG39(c), be derecognised. In contrast, applying the guidance in paragraphs B38 to B48 of the exposure draft to the same fact pattern where the underlying asset is a commodity, results in the asset **not** being derecognised. This is because, in terms of paragraph B40 of the exposure draft, the customer in such an instance “*does not obtain control of the asset because the customer is limited in its ability to direct the use of and obtain substantially all of the remaining benefits from the asset*”. Such a transaction would rather be accounted for as a financing transaction. Therefore, whilst the two transactions are both similar and in substance identical, vastly different accounting treatments arise.

Paragraph B45 similarly requires that an entity account for a repurchase agreement, with an attached put option, similar to the sale of a product with a right of return (as discussed in paragraphs B2 – B9), if the customer does not have an economic incentive to exercise its right. This would be the case, for example, where the put

SAICA SUBMISSION ON EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

option was deeply out of the money. We note that in terms of IAS 39, such a repurchase agreement relating to a financial asset would result in the derecognition of that financial asset, which differs to the treatment required by the exposure draft. It is also unclear how the guidance in paragraphs B2–B9 would be applied to such a repurchase agreement. Paragraph B5 requires an entity to determine the amount of consideration to which the entity is reasonably assured to be entitled (considering the products expected to be returned). It is unclear how this determination would be made where a put option is deeply out of the money, as the customer has no economic incentive to exercise the put option and return the product to the seller.

In addition, paragraph B42 of the exposure draft requires that the entity recognise a financial liability where the repurchase agreement is a financing agreement. We note that, where such a repurchase agreement includes a call option, recognising a financial liability would be inconsistent with the definition of a financial liability in terms of IAS 32 – *Financial Instruments: Presentation*. This is because the call option does not give rise to a contractual obligation on the part of the entity to deliver cash or another financial asset to another entity. In that instance, the repurchase agreement, in substance, is akin to an outright sale with the consideration received from the customer representing the sales proceeds.

As a result of the divergence in principles described above, we recommend that:

- the Board considers aligning the principles under the exposure draft for repurchase agreements with those contained in IAS 39. As part of that alignment, we recommend that the Board amend the guidance relating to call options, contained in paragraphs B40 to B42, to require the entity to consider whether an economic incentive exists to exercise the option based on the relationship of the repurchase price to the expected market value of the asset at the date of repurchase, similar to the guidance included under paragraphs B43 to B48 relating to put options and similar to that prescribed within IAS 39's derecognition accounting requirements;
- the Board amends the guidance in paragraphs B43 to B48, to include guidance regarding the principles to apply to the sale of an asset together with an option to repurchase the asset at its fair value at the time of repurchase. We note that paragraph AG 39 of the Application Guidance to IAS 39 currently provides guidance on the treatment of such transactions, where the asset that is the subject of the repurchase agreement is a financial asset. We therefore suggest that the Board include a similar principle in the exposure draft's guidance, which is consistent with that contained in IAS 39, for repurchase agreements that fall within the scope of the exposure draft; and
- the Board clarifies the treatment in paragraphs B43 to B48 regarding the treatment of put options relating to repurchase agreements, where those put options are deeply out of the money.

SAICA SUBMISSION ON EXPOSURE DRAFT ON *REVENUE FROM CONTRACTS WITH CUSTOMERS*

Interest and dividends

Paragraph BC29 of the exposure draft states that the requirements will only pertain to a subset of revenue and more specifically it states that revenue does not arise from a contract with a customer that is not within the scope of the exposure draft. The exposure draft clarifies that dividends are not included in the scope, but remains silent on interest income. Currently, the requirements for the recognition of interest income are contained across both IAS 18 and IAS 39 with IAS 18 stating that interest is only to be recognised if it is both probable that economic benefits will flow to the entity and the amount can be estimated reliably. The scope of the exposure draft makes it clear that contractual rights and obligations within the scope of IFRS 9 are excluded and hence IAS 39/IFRS 9 would apply.

Our concern is that the revenue recognition requirements, as currently contained in IAS 18, will not reside in IAS 39/IFRS 9. We believe that IAS 18's requirements for interest, especially with respect to the probability criterion should remain applicable for the recognition of interest income. This is especially important from a banking perspective as illustrated in the following example: Interest is recognised on debt financial assets typically up to the customer being classified as non-performing (typically 90 days overdue) with interest thereafter being suspended (suspend recognition of interest income into income statement at that point since it is not regarded as probable that interest income will be received). By no longer having this IAS 18 requirement for the recognition of interest income it is questionable whether one would be required to recognise the interest income and raise a full impairment loss (for post 90 days where it is not considered probable that such amounts will be received). We do not believe that that answer would be appropriate in light of the requirement of paragraph 68 that collectability be considered and further that the amendment to IFRS 9 for dividend income (on OCI election) requires that such income is required to meet the probability criterion for recognition (paragraph D6: 5.4.5). There should hence be symmetry between the requirements for the recognition of interest and dividend income.

Accordingly, we request that IFRS 9 (or IAS 39 depending on effective dates) be amended to require similar revenue recognition principles as currently contained in IAS 18 and the exposure draft, especially with regard to probability of such benefits flowing to the entity (similar to the collectability requirement in the exposure draft and similar to the requirements for recognition of dividend income).

Integral fees

The exposure draft proposes amendments to IAS 39 relating to fees that are an integral part of the effective interest rate of a financial instrument ("integral fees"). The proposed amendments include the addition of paragraphs AG8A–AG8C. AG8A states the following:

'In applying the effective interest rate method, an entity distinguishes between fees that are an integral part of the effective interest rate of a financial instrument and fees that are receivable in exchange for distinct services provided.'

SAICA SUBMISSION ON EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS

We note that the proposed amendment to IAS 39, AG8B, states '*Fees that are an integral part of the effective interest rate of a financial instrument include...*' and then lists examples of such fees. The use of the word '*include*' implies that the list of fees that are an integral part of the effective interest rate of a financial instrument is not exhaustive. This brings into question whether other fees receivable in exchange for services that are not distinct could be considered as integral fees.

We therefore request clarification as to whether the intention of this amendment is to indicate that integral fees are fees that are receivable in exchange for services that are not distinct, as the amendment very clearly makes the distinction between integral fees and fees receivable in exchange for distinct services provided.

Disclosure

We note that there is a potential conflict that could arise between IFRS 8 – *Operating Segments*, and the disclosure requirements for the disaggregation of revenue, as identified in our response to question 5. Paragraph 115 provides a number of possible categories for disaggregating revenue, which would be considered appropriate to disclose if they can provide useful information. We believe that situations might arise in which the suggested level of disaggregation might provide information that is useful to users, but is not actually provided to the chief operating decision maker, and therefore would not be required to be separately disclosed under IFRS 8. We suggest that the Board considers the requirements of IFRS 8 when finalising the disclosure requirements in the new revenue standard.

Effective date and transition

We recommend that the Board to consider the significant time constraints that will be placed on preparers should the final revenue standard only be issued in 2013, with an effective date of 2015. In accordance with the transitional requirements of the standard, retrospective adoption will be required (except to the extent that stipulated relief is offered), and therefore an entity will be required to disclose a third balance sheet together with related notes. Should the revenue standard be issued in the same year that companies are expected to start recording revenue under a new recognition model (for the purposes of retrospective adoption and the related disclosures), this will create implementation problems, particularly where companies will be required to make significant systems changes.

379709