MASB MALAYSIAN ACCOUNTING STANDARDS BOARD
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22 October 2010

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London ED 4M 6 XH
United Kingdom

Dear Sir David

IASB EXPOSURE DRAFT – REVENUE FROM CONTRACTS WITH CUSTOMERS

The Malaysian Accounting Standards Board welcomes the opportunity to provide comments on the IASB Exposure Draft – Revenue from Contracts with Customers.

Generally, we support the proposals in the ED except for the following which are elaborated in the responses to the respective questions as enclosed in the Appendix to this letter:

(a) With regard to the proposed guidance for determining when control of a promised good or service has been transferred to a customer, we are of the view that paragraphs 30(b) and 30(c) of the ED should be expanded to include situations where beneficial interest has passed but not necessarily legal title or physical possession. The ability of a customer to sell, exchange, use or pledge a good is frequently predicated on the transfer of beneficial interest, despite there not having been legal title or physical possession yet, and this ability is frequently as much an indicator of control.

(b) With regard to the application of the proposed control model to long term contracts, we are concerned there would be significant divergence in the interpretation of "continuous transfer" of goods or services. Based on our experience, the assessment of whether control is transferred on a continuous basis or at a point in time will frequently require the use of critical judgment. There can be difficulty in applying the concept due to the fact that the term "continuous transfer" is not clearly defined in IFRS literature. Therefore, we recommend that the new standard provides further explanation and guidance to address such concerns i.e. by way of creating a definition and providing an illustrative example for "continuous transfer".

    In particular, we are extremely concerned for the real estate industry. In the Asia-Oceania region, the "Sell then Build" model is common, where the customer, upon signing the contract assumes much of the key risks and rewards of property ownership. This is in contrast to the "Build then Sell" model adopted by other jurisdictions where effective control as defined in the ED only passes to the customer upon completion of construction and handover of the property. Guidance on "continuous transfer" could therefore greatly assist in interpretation and application of the standard in such circumstances and its consistent application.

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(c) With regard to the proposed disclosure requirements, we have serious concerns with the volume of disclosures that may result if the requirements anticipated in the ED are to be met. We are concerned the disclosures have the potential to be overly detailed, with the resulting volume of information thereby obfuscating other useful information within financial statements. Furthermore the additional level of disclosures will entail a significantly higher level of costs, including investments in IT systems, associated with preparing the information for the disclosures, threatening the cost-benefit equation;

We are also concerned with the proposal to analyse revenues by economic factors as a further perspective, in addition to typical disclosures by product, geography and other relevant segments. The proposal would not only be onerous but also be subject to widely varying subjectivity between preparers, such that consistency would be compromised. In addition, we are concerned that an overly detailed analysis based on subjective economic factors could purport a degree of accuracy that may be misleading.

We are of the view that economic factors should be discussed in the Management Discussions and Analysis or other discussion sections of a reporting entity's annual report, rather than be accorded the "accuracy" that the proposed disaggregating and disclosure would purport.

(d) The ED proposes distinguishing between exclusive and non-exclusive licences with respect to how revenue is to be recognized. We disagree that the pattern of revenue recognition should depend on whether the licence is exclusive or non-exclusive whilst there are no changes to the performance obligation. No clear justification has been set out to support this analysis. We believe revenue from contracts granting rights to use an entity's intellectual property, whether exclusively or non-exclusively, should be assessed by applying paragraph 25 of the ED which adopts the notion of control.

Our detailed responses are enclosed in the Appendix of this letter.

If you need further clarification, please contact Ms Tan Bee Leng at +603 2240 9200 or by email at beeleng@masb.org.my.

Thank you.

Yours sincerely,

Mohammad Faiz Azmi
Chairman

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Question 1

Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether:

(a) to combine two or more contracts and account for them as a single contract;

(b) to segment a single contract and account for it as two or more contracts; and

(c) to account for a contract modification as a separate contract or as part of the original contract.

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

We agree with the proposed principle which ensures that the accounting reflects the substance of the underlying transaction.

We also note that the ED-proposed approach to combining and segmenting contracts appears to be similar to IAS 11 Construction Contracts *requirements and in this respect, we do not expect current accounting practices to change significantly. However, minor differences between the proposals and current practice will have to be evaluated as these may result in different outcomes.*

Question 2

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

We agree with the proposals.

The last sentence of paragraph 25 reads: "A good or service is transferred when the customer obtains control of that good or service." It would be useful to enhance this by providing guidance to the effect that the transferred good or service itself should reflect reasonably what the customer expected to receive and the seller expected to provide when entering into the contract, so that minor defects upon delivery of a large item of good or service do not unreasonably delay recognition.

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Practical application

Determination of whether a good or service is distinct will require judgement on the part of management and an understanding of how other goods or services sold in the market may interact with the entity's products. For example entities in the telecommunications industry that currently enter into bundled arrangements with customers will need to evaluate the extent to which the components need to be accounted for separately.

In this regard, the proposals may have broad implications on these entities' processes and controls which presently may not unbundle multiple element contracts. These entities may need to change existing IT systems and internal controls in order to capture information to comply with proposals and the effect may extend to other functions such as income tax, for both direct and indirect taxes.

Question 3

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

We believe the proposed guidance are sufficient except for the following:

(a) paragraph 30(a) – unconditional obligation to pay

In the interest of clarity, we recommend the new standard includes language detailing the additional explanation found in paragraphs 4.32–4.33 of the Discussion Paper:

> *... customer payment does not determine when an entity would recognise revenue. However, in some cases, considering customer payment terms ... may help the entity to assess whether the customer has an asset. For instance, consider an entity's contract to build an asset for a customer. Over the life of the contract, the customer is obliged to pay for the partially completed asset and cannot recover that payment, even if the entity fails to build the rest of the asset. In the absence of other indicators, the fact that the entity has a right to a non-refundable payment from the customer may suggest that the customer controls the partially completed asset. Typically, a customer would not make a non-recoverable payment without receiving an asset in exchange.*

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(b) *paragraphs 30(b) and 30(c) – legal title and physical possession*

The explanations in Paragraphs 30(b) and 30(c), in our view, illustrate that a customer can obtain control of a good when it acquires the beneficial interest of the good from the entity.

Therefore, we suggest that the standard includes language to clarify that the passing of beneficial interest to the customer could be a determinant in assessing whether the customer has obtained control of an asset. This would provide further clarity to the interpretation of paragraphs 30(b) and 30(c) particularly for situations where the customer is able to sell, exchange, use, or pledge a good but has as yet neither obtained legal title nor physical possession.

(c) *paragraph 31*

Whilst the explanations provided are helpful, i.e. that none of the indicators determines by itself whether the customer has obtained control of the good or service, we believe further clarification is required in situations with mixed indicators. In this regard we recommend that the standard could add language to clarify that in a situation with mixed indicators, the overriding principle falls back to the control definition in paragraphs 26 and 27 ie whether the customer can obtain cash flows from an asset directly or indirectly in ways such as by using, consuming, selling, exchanging, pledging or holding the asset.

(d) *service contracts*

Paragraph 31 acknowledges that two out of four indicators provided in paragraph 30 would not be relevant to services. We believe further clarification should be provided on indicators relevant to service contracts (eg consulting services). Although paragraph B67 has provided guidance for consulting services, we believe indicators specific to service contracts would be required to prevent any divergent interpretation in determining whether the entity has satisfied its performance obligation in this regard.

Continuous transfer of goods or services – paragraph 32

(a) *Definition of "continuous transfer"*

The notion that control of a good or service may be transferred to a customer continuously is similar to the notion in IFRIC 15 Agreements for the Construction of Real Estate. *Based on our experience, the assessment of whether control is transferred on a continuous basis or at a point in time can require the use of critical judgment. The difficulty in applying the concept could be due to the fact that the term "continuous*

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transfer" is not clearly defined in IFRS literature. Therefore, we propose the following definition for IASB's consideration:

> *Continuous transfer arises when the transfer of control, as defined in paragraphs 26-29, is effectively met throughout the contract performance period and:*
>
> *(i) the contract requires the entity to undertake progressive performance of work or service throughout the duration of the contract;*
>
> *(ii) the progressive payments received by the entity for the agreed scope of work are non-refundable to its customers, whether defined in the contract or by law; and*
>
> *(iii) the customer has the ability to sell the beneficial interest over the underlying asset at its own discretion during the duration of the contract.*

(b) Illustrative examples

<u>Paragraph B64</u>

We find the explanation in paragraph B64 of the application guidance helpful as it highlights the key in assessing which party controls the asset as it is constructed (i.e. who owns the work-in-progress). Therefore we recommend that paragraph B64 be included as part of the standard to provide clarity to paragraph 32. In addition some could interpret that the good or service referred to in paragraph 25 is the completed property and therefore it would alleviate such uncertainty if paragraph B64 were to be included in the standard itself.

<u>Paragraph B68</u>

We note that Example 17 in paragraph B68 attempts to illustrate a contract in which the entity promises to transfer a completed asset. We believe the illustration is relevant in those countries where the real estate industry effectively adopts a "Build then Sell" model where effective control as defined in the ED only passes to the customer upon completion of construction and handover of the property. In such a situation the completion method would be appropriate to reflect the economic substance of the transaction.

In the Asia-Oceania region, however, the "Sell then Build" model is common, where the customer, upon signing the contract assumes much of the key risks and rewards of property ownership (whilst the new standard speaks of control, the way in which it is defined appears to refer to the customer having obtained effective / beneficial ownership rights – see our comment on paragraph 30(b)).

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Question 4
The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

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

We agree with the proposal.

However, significant exercise of management judgement will be required in estimating a transaction price that is subject to a number of variables. Therefore, it would be useful to clarify whether the threshold of "can be reasonable estimated" is similar or not similar from "can be measured reliably" in the existing requirements in IAS 18.14(c).

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

We are in favour of the proposal because the consideration of uncertainty of collectibility in the measurement of revenue would enable reflecting the amount of consideration that the entity expects to receive. In other words, revenue should be measured based on consideration or net present value of cash flow expected to be received by the entity.

We also would recommend disclosure of the amount of revenue not recognised on these grounds, through a reconciliation of revenue before adjustment for credit risk to that after such adjustment. Thereby, comparisons on the level of sales activity could also be facilitated.

We note also that tax issues may arise regarding the amount of revenue not recognised on grounds of credit risk, in jurisdictions where tax authorities allow deduction of credit losses for income tax purposes only for proven bad debts.

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

We note that although IAS 18.11 currently requires an entity to discount the consideration to present value when the arrangement effectively constitutes a financing arrangement, the proposal is an explicit requirement which adds clarity in the measurement of revenue.

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

We generally agree with the proposal, but are concerned that a single prescribed method may be too prescriptive which may result in an outcome that may not meet the economic reality of a transaction. For example, the approach would not recognise management's deliberate pricing differentials made on the basis of risk where stand-alone prices of separable obligations might reflect their different risk characteristics. To evenly spread pricing across these obligations on the basis of (presuming their even risk relative to) price would ignore the effects of such factors. We therefore encourage further consideration of when the proposed approach can be flexed to recognise such factors and their effects to ensure the new standard maintains a principle based approach in measuring revenue.

In addition, it is our view that stand-alone selling price need not be the only method of allocating transaction price to separate performance obligations. In fact BC 125 acknowledges that the residual technique may be an appropriate method and we support this contention particularly in circumstances when stand-alone selling price may not always be observable for one or more obligations.

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

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

We believe the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient.

In addition, the requirements could be enhanced by specifying in Paragraph 57 that the recognition of a new type of asset should be consistent with the principles as set out in the Framework for the Preparation and Presentation of Financial Statements.

Editorial suggestion:

We believe that the drafting of paragraph 57 could be improved in the following manner to ease readers' understanding of the requirements:

> *"An entity shall recognise as an asset the costs incurred in fulfilling a contract only if the costs give rise to recognition as an asset under another IFRS or if those costs: ..."*

Question 9
Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

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

We agree with the costs specified in paragraph 58.

Question 10
The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Do you think the proposed disclosure requirements will meet that objective? If not, why?

We appreciate the efforts of the board to develop this comprehensive and cohesive set of disclosure requirements. The proposals will require significantly more extensive detail than the

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existing requirements in IAS 18 Revenue *and IAS 11* Construction Contracts. *We understand that the proposed disclosure requirements are meant to help users of financial statements understand and analyse how contracts with customers would affect an entity's financial statements.*

We note, however, that the additional level of disclosures:

(a) will entail a potentially significant higher level of costs associated with preparing the information for disclosure;

(b) will require many entities to invest additional resources, including in IT systems, to get prepared for the disclosures;

(c) has the potential to be overly detailed, even in its accuracy, with the resulting volume of information thereby obfuscating other useful information within financial statements.

We urge, therefore, that further development of these proposals be considered in the context of concerns about the level and extent of detail. Indeed, too much detail could lead to less rather than more transparency, which eventually may diminish its usefulness.

We recommend serious consideration be given to the adequacy of time between the finalisation of the standard and the date by which it is to become effective, to allow preparers time to get ready their systems and processes.

Question 11

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

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

The proposed disclosure requirements in paragraph 78 are new and will likely require judgement by management in estimating time frames for the expected satisfaction of remaining obligations. As noted in our response to Question 10 above, adequate time should be provided for preparers to get ready their processes and systems in order to meet these additional disclosure requirements.

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

We are of the view that to analyse revenues by economic factors as a further perspective, in addition to typical disclosures by product, geography and other relevant segments, would not only be onerous but also be subject to widely varying subjectivity between preparers, such that consistency would be compromised. In addition, we are concerned that an overly detailed analysis based on subjective economic factors could purport a degree of accuracy that may be misleading.

We are of the view that economic factors should be discussed in the Management Discussions and Analysis or other discussion sections of a reporting entity's annual report, rather than be accorded the "accuracy" that the proposed disaggregating and disclosure would purport.

Question 13
Do you agree that an entity should apply the proposed requirements retrospectively (ie as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

We agree that an entity should apply the proposed requirements retrospectively provided a sufficient transitional period is given to enable entities to put in place the required systems to capture and compile the information. In our view, a transition period of more than 3 years would be required in this regard.

Question 14
The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Other than the additional illustrative example mentioned in our response to Question 3, we would like to propose amending the application guidance for sale and repurchase transaction so as to cover Islamic sale and buy back agreements.

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In Islamic finance, sale and buy back agreements may be used to indirectly obtain financing whilst adhering to Islamic proscriptions against interest. Typically, an entity would sell an item to a counterparty, whether via the transfer of legal title or beneficial ownership, for a price, x. The sale would be accompanied with a wa'd, or promise, that the entity would re-purchase the item from the counterparty at a specified time for a pre-agreed price, x+p. The counterparty would make a corresponding promise to re-sell the item to the entity at the specified tome for the pre-agreed price. Technically, neither of the promises to re-purchase nor to re-sell is binding in law. However, customarily, the re-purchase / re-sell transaction is almost always executed. Moreover, to deter breached promises, there may be regulations to penalise a defaulting party and/or protect an aggrieved party.

The underlying item in a sale and buy back agreement is usually a financial instrument, but it could without much difficulty be substituted for a non-financial instrument, e.g. commodities, properties, plant and machinery. Although financial instruments are excluded from the scope of the ED, the use of any other underlying item may place a sale and buy back agreement within the scope of Revenue from Contracts with Customers.

Should that be the case, it is of some concern that an entity may be able to recognise as revenue the proceeds from the initial sale, as paragraph 25 states that:

"An entity shall recognise revenue when it satisfies a performance obligation identified in accordance with paragraphs 20-24 by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service."

Indeed, within the context of paragraphs 26-27, between the first and second transactions, the purchaser may be deemed to have control over the item transferred. However, allowing the selling entity to recognise revenue upon the initial sale would be counterintuitive, since the series of transactions is meant to achieve what is in substance financing – its most common use is to mimic conventional repo - despite the transfer of control to the buyer between the first and second 'legs' of the sale and buy back agreement.

We note that there is an attempt to address sales and repurchases which are financing arrangements in paragraphs B47–B53 of Appendix B. However, that section alludes to only two circumstances where a sale and repurchase may be accounted for as financing, i.e. when:

(a) the entity has an unconditional obligation to repurchase the asset (a forward); and
(b) the entity has an unconditional right to repurchase the asset (a call option).

Legally, the wa'd, or promise by a selling entity to re-purchase an item, is unlikely to constitute an 'unconditional obligation' or 'unconditional right'. However, even in the absence of an

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unconditional right or unconditional obligation, the repurchase transaction is almost always carried out.

We would like to propose that the application guidance to be amended to provide for a sale and repurchase transaction to be accounted for as a financing arrangement when:

(a) it is highly probable that an entity will repurchase an asset, and that probability, along with other accompanying circumstances would constrain the purchaser's ability to direct the use of, and receive the benefit from, the asset; and

(b) the entity repurchases the asset for an amount that is equal to or more than the original sales price of the asset.

In addition, we understand that the IASB is currently discussing the accounting treatment for repurchase agreements (repos) within the project on derecogniton. We would like the IASB to also consider this proposal in its discussion because financial instruments are the most common underlying items in Islamic sale and buy back agreements, and repos are its most common use.

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

(a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

(b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

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

The distinction between the types of product warranties, as proposed, is theoretically sound. However, in practice, it may be difficult for entities to distinguish clearly between post-delivery faults and latent defects. Significant judgment may be required to assess the nature of warranties in certain circumstances.

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

- **if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and**

- **if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.**

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

We disagree that the pattern of revenue recognition should depend on whether the licence is exclusive or non-exclusive whilst there are no changes to the performance obligation. No clear justification has been set out to support this analysis. We believe revenue from contracts granting rights to use an entity's intellectual property, whether exclusively or non-exclusively, should be assessed by applying paragraph 25 of the ED which adopts the notion of control.

Question 17
The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

We agree with the proposal, which would amount to consistent principles being applied.

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