

28 October 2010

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

RESPONSE TO EXPOSURE DRAFT – REVENUE FROM CONTRACTS WITH CUSTOMERS

The Institute of Certified Public Accountants of Singapore (ICPAS) appreciates the opportunity to comment on the above exposure draft (ED) issued by the International Accounting Standards Board (IASB) in June 2010.

Part A: Specific Comments

We have specific comments on questions 2, 3 and 14 as follows:

Question 2 (Recognition of revenue)

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 generally agree with the principle set out in paragraph 23 of the ED for determining whether a good or service is distinct for the purposes of identifying separate performance obligations in multiple-element arrangements. However, the wordings in this paragraph may inadvertently lead to anomalous situations in which a good or service, which is not related to the core business of the entity and given away free as part of the entity's marketing programme for its core products, may qualify as being a distinct good or service. For instance, it is not uncommon in Singapore for telecommunication companies to entice new subscribers by offering free gifts such as electrical appliances (e.g. television and rice cookers) which are not related to its core telecommunication business but are sold by another entity as part of its core business.

We believe that the potential anomaly can be averted by removing the phrase "or another entity" in paragraphs 23(a) and 23(b)(i) and including the phrase "within its ordinary activities" in paragraph 23(b). The proposed amended paragraph would then read as follows:

“23 A good or service, or a bundle of goods or services is distinct if either:

- (a) the entity, ~~or another entity~~, sells an identical or similar good or service separately; or
- (b) the entity could [within its ordinary activities] sell the good or service separately because the good or service meets both of the following conditions:
 - i. it has a distinct function-a good or service has a distinct function if it has utility either on its own or together with other goods or services that the customer has acquired from the entity or are sold separately by the entity ~~or by another entity~~; and
 - ii. it has a distinct profit margin-a good or service has a distinct profit margin if it is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service.”

Question 3 (Recognition of revenue)

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 are of the view that the indicators of control as proposed in paragraph 30 of the ED and the related application guidance would probably apply to typical sale of goods over which the passing of control is obvious, but are otherwise overly simplistic and insufficiently robust to address the transfer of control in other situations such as those involving sale of goods that are under collective control and service contracts.

In the case of sale of goods that are subject to collective control, the entity would transfer control of the promised goods to customers collectively as a group. Individually, none of the customers could ever obtain control of the promised goods by virtue of the fact that the absolute control is held collectively by the group. This is especially pertinent in the sale of multi-unit real estate development whereby the individual buyers would not have obtained absolute control of the completed units even after they have assumed the full ownership rights over the completed units. The indicators of controls should be sufficiently robust to address the concept of transfer in the context of goods that are subject to collective control.

The proposed indicators of control similarly do not provide sufficient guidance on the transfer of control for services. Paragraph 31 of the ED acknowledged that two of the four proposed indicators of control would not be relevant to services, which further highlights our concerns that the proposed indicators may not be appropriate in the context of services.

In some situations, the customer may have an irrevocable obligation to pay for the construction of a unique non-fungible asset and there is strong consumer protection of the buyer’s rights and the funds provided by the buyer. It is unclear in these situations when the control of the promised good passes under the proposed principles and indicators of control.

The assessment of transfer of control is arguably one of the most judgemental areas in the ED. The indicators of control must be sufficiently robust to be applicable to all situations envisaged under the ED in order to provide adequate guidance on the proposed principles,

and achieve the objectives of removing inconsistencies in revenue recognition practices and providing a more robust framework for addressing revenue recognition issues.

We propose that the Board consider incorporating exposure to risks and rewards as a possible indicator of control. Risks and rewards are generally derived from control and would provide a strong indicator of where control lies, especially in situations where the transfer of control is not obvious. This is also consistent with the tentative decision reached by the Board on the Consolidation project that exposure to risks and rewards is an indicator of control and an important factor to consider when assessing control. We believe that incorporating exposure to risks and rewards as an indicator of control would alleviate the difficulty in assessing control under the ED for the above situations.

In order to make paragraphs 30 (b) and 30 (d) clearer, we propose the following additional wordings, which are underlined:

Paragraph 30(b)

The customer has legal title or beneficiary ownership – legal title or beneficiary ownership often indicates which party has the ability to direct the use of, and receive the benefit from, a good. Benefits of legal title or beneficiary ownership include the ability, or preventing others from having the ability, to sell a good, exchange it for another asset, or use it to secure or settle debt. Hence, the transfer of legal title or beneficiary ownership often coincides with the transfer of control. However, in some cases, possession of legal title is a protective right and may not coincide with the transfer of control to a customer.

Paragraph 30 (d)

The design or function of the good or service is customer-specific or the good or service involves the construction of a unique non-fungible asset, even though the design or function is not 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; instead, the value of that good or service accrues to the buyer. Similarly, a unique non-fungible asset that has been sold to a customer might be of little value to an entity because the entity is unable to sell the same asset to another customer; instead, the buyer is able to sell the same asset to another customer, even before the asset is physically completed. Furthermore, if an entity cannot sell a customer-specific or a unique non-fungible 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. Similarly, a customer's ability to prevent the entity from selling the same unique non-fungible asset to another customer would indicate that a customer obtains control of the asset as it is created.

Question 14 (Application Guidance)

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?

With regards to the application guidance for the time value of money relating to customer payments in advance in paragraph B84 of the ED, we are of the view that the principles are appropriate. However, it creates unnecessary complexity and the costs of implementation outweigh their benefits.

In our view, the users may not gain a better understanding of the financial statements with the introduction of an element that was never previously raised as an issue. Under this ED, when a customer pays the supplier, the supplier recognises interest expense on the prepayment and recognises revenue at a higher amount (contract revenue plus interest expense) than the contracted value. The incremental revenue from the interest expense has no cash flow. Moreover, if the revenue contains the imputed interest expense element, it would be impossible for an entity to analyze its internal rate of return.

From an operational perspective, separate systems would have to be maintained to track the different cash flows and revenue transactions, as the current billing systems are unlikely to be able to support. The implementation may cause businesses to invest in separate discounting modules.

With regards to paragraph B68 of the ED (Example 17), we are of the view that it is overly simplistic as it does not appear to provide for due consideration for the economic, market and legal perspectives of the property development sector in various countries. For instance, the legal framework for multi-unit residential property development and the strong consumer protection of the buyer's rights in Singapore would require careful interpretation as to whether control of the property units is passed to the buyers continuously or at a single point (e.g. upon completion).

Due to our comments above, we propose amendments be made to Example 17 – Sale of apartments in the ED as follows:

~~“An entity is developing residential real estate and begins to market individual apartments during their construction. An entity enters into a contract with a customer for the sale of a specific apartment. The customer pays a deposit that is refundable only if the entity fails to deliver the completed apartment in accordance with the contract. The remainder of the purchase price is paid on completion of the contract when the customer obtains possession of the apartment. [is required to make progress payments that match the stage of physical completion of the property. The customer is also able to use the property as a collateral for obtaining financing from a bank for the purchase of the property or sell the apartment to another customer at any point in time.] The customer is able to choose from a range of~~

standardised options specified by the entity (for example, flooring, colour schemes and fixtures) [but is unable to specify major structural changes to the design of the apartment].

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer obtains control of the apartment [continuously during the construction of the apartment.] ~~on completion of the contract.~~ [Notwithstanding that t]The customer obtains title and physical possession of the apartment only on completion of the contract [and that]-~~Additionally,~~ the customer cannot specify major structural changes to the design of the apartment, [the indicators that the apartment is an unique, non-fungible asset that only the customer can sell to another customer, the customer's right to use the apartment as a collateral for obtaining bank financing and that the customer has unconditional obligation to pay for the work-in-progress, the customer has obtained control continuously over the construction of the apartment. ~~the rights to which suggests that the apartment is not a customer-specific asset.~~

~~Consequently, the entity's performance obligation is to provide the customer with a completed apartment because the customer does not control the apartment until completion of the contract.~~

Part B: Other Comments

For certain multiple-element arrangements, it is not uncommon for entities to negotiate and enter into contracts by looking at the package as a whole as opposed to individual elements. The concept of measuring liability on onerous performance obligations on a stand-alone basis is counterintuitive. The package may contain certain performance obligations which satisfy the definition of onerous performance obligations. Although the entity would have to recognise the losses on that particular performance obligation eventually, the requirements in the ED essentially bring forward the recognition of the losses. We propose that if an entity enters into a contract with multiple performance obligations and if one of the elements was showing up to be an onerous performance obligation, then the entity should allocate that liability proportionally to the other profitable elements.

Should you require any further clarification, please feel free to contact Mr Andrew Chua, Technical Manager, at the Institute of Certified Public Accountants of Singapore via email at andrew.chua@icpas.org.sg

Yours faithfully,



Janet Tan
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