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Ref.: ACC/PRJ/TSI/IDS

Dear Ms. Flores,

**Re: FEE Comments on EFRAG's Draft Comment Letter on the revised IASB Exposure Draft Revenue from Contracts with Customers**

- (1) FEE (the Federation of European Accountants) is pleased to comment on the EFRAG Draft Comment Letter on the revised Exposure Draft Revenue from Contracts with Customers (the "ED").
- (2) FEE welcomes the decision by the boards of the IASB and FASB to re-expose the revenue proposals. Therefore, we commend the progress that the Board has made in addressing concerns raised by many respondents in respect to the 2010 exposure draft. The principles, in particular around the control concept, were not robust enough and needed to be further developed in order to ensure consistent application. In our view, improvements have been made in some key areas compared to the previous draft.
- (3) However, we still believe that the final objective to develop a single standard which works well in practice and represents real conceptual improvements to the current revenue recognition model has not been fully achieved yet. The revised ED is more closely aligned with the existing revenue recognition model but requires further clarifications to increase consistency in application.
- (4) Therefore, we still have some reservations regarding the operability of the proposed model and think that the Board needs to further clarify some of the key elements of the proposal, as explained in this letter.
- (5) We support the Board's proposal for additional requirements assisting companies in determining when performance obligation is satisfied over time. Differentiating between continuous performance and point in time performance is a fundamental component of the proposed revenue recognition model.
- (6) Nevertheless, we think that the 'right to payment' criterion in paragraph 35 (b)(iii) results in a too legalistic approach for determining when a performance obligation is satisfied over time. The focus should rather be on a reasonable expectation to recover the payment and therefore we recommend replacing this criterion with the principle of *reasonable assured* as described in paragraph 81 or B3 of the ED.

- (7) Similar to EFRAG, we disagree with the proposal that the onerous test should be performed at the performance obligation level and should be limited to obligations that an entity satisfies over a specified period of time. The requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets are adequate – and indeed preferable – for the purpose of providing reserves against onerous revenue contracts. Therefore we urge the Board not to scope out revenue contracts of IAS 37.
- (8) In principle, we agree that disclosing the effect of credit risk as a separate item is an appropriate presentation, subject to materiality consideration. However, we do not support the proposal prescribing that the impairment loss arising on the initial recognition of the receivable and impairment loss arising after the initial recognition of the assets should be presented as a separate line item adjacent to the revenue line item, but rather the principles established in IAS 1 should apply.
- (9) We agree that when the amount of consideration is variable the amount of revenue recognised should not exceed the amount to which the entity is reasonably assured to be entitled. However, we consider that the rule-based exception to the general requirements in paragraph 85 of the ED has not been appropriately justified; the Basis for Conclusions seems to be insufficiently explanatory. Furthermore, we encourage the Board to further clarify instances where variable consideration can be reasonably estimated but not be reasonably assured.
- (10) We agree that the receivable should be accounted for in accordance with IFRS 9 (IAS 39) while the contract assets should be accounted for under a guidance to be developed that is to be in the scope of revenue recognition standard.
- (11) We agree with EFRAG that the revenue forms an important part of the financial statements and therefore it should also be included in the interim financial reports. However, we do not think that the new revenue standard should mandate specific disclosures in the interim financial statements. The contents of this document should be governed by IAS 34 Interim Financial Reporting.

*Additional comment*

- (12) We agree with EFRAG that the guidance on scope is unclear on determining whether or not a contract is a contract with a customer or a contract with a partner or collaborator. Further it would be helpful to clarify which standard would apply to the transactions that are scoped out of the revised standard.

Our Comments on Appendix 1 and 2 of the EFRAG draft comment letter including responses to the questions in the Invitation to comment section of the ED are contained in the Appendix to this letter.

For further information on this letter, please contact Tibor Siska, Project Manager, at the FEE Secretariat on +32 2 285 40 74 or via email at [tibor.siska@fee.be](mailto:tibor.siska@fee.be).

Yours sincerely,



Philip Johnson  
President

Appendix – Comments on Appendix 1 and 2 of the EFRAG draft comment letter including responses to the questions in the Invitation to comment of IASB Exposure Draft on Revenue from Contracts with Customers

## Appendix 1

### 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?**

- (13) We welcome the Board's proposal for additional requirements assisting companies in determining when performance obligations are satisfied over time. Differentiating between continuous performance and point in time performance is a fundamental component of the proposed revenue recognition model.
- (14) In our previous response to the 2010 exposure draft, we raised some concerns that the principles addressing "control" were not robust enough and would not assist in assessing when control has passed for services arrangements, in particular construction and bespoke service contracts. We commend the progress that the Board has made in addressing these concerns.
- (15) We particularly welcome the Board's decision that the entity should consider the notion of "an asset with alternative use to the entity" as a determinative factor when assessing whether a performance obligation is satisfied over time. Nevertheless we are concerned that paragraph 35 presents as "criteria" elements that would be more appropriate as indicators. Further, the principles could be more clearly laid out.
- (16) In particular, we have some concerns over the future application of criterion 35 (b)(iii), i.e. the existence or otherwise of a 'right to payment' for performance completed to date. It is unclear how this criterion relates to the transfer of control, it appears more related to the transfer of risk and rewards.
- (17) Further, criterion 35 (b)(iii) appears to restrict revenue recognition to circumstances where the entity holds an enforceable right to receive payment for the work performed to date (subject to continued performance) which is specified in the contract.
- (18) In practice, a contract usually does not specify that the compensation is proportional to the condition of the asset at the time the contract is broken or the amount the defaulting party would need to pay. The right to payment when the customer cancels the contract without being permitted by the contractual clauses would often be just an implicit right following the outcome of a court case.
- (19) On that basis, we think that the right to payment criterion results in a too legalistic approach and is too restrictive for determining when a performance obligation is satisfied over time. The focus should rather be on a reasonable expectation to recover the payment for the performance to date commercially, i.e. the right to a "fair compensation". Therefore, we recommend replacing the right to payment criterion with the principle of *reasonable assured* as described in paragraph 81 or B3 of the ED.

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**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?

**Question to constituents**

EFRAG is asking constituents for their views on the following:

- (a) In which standard(s) do you think guidance for impairment of conditional and unconditional rights to consideration should be provided?
- (b) Should specific guidance be developed for how to present uncollectible amounts or should the general guidance of IAS 1 be applied?
- (c) If you think specific guidance should be provided:
  - (i) Should this guidance be included in the standard on revenue recognition or in IAS 1?
  - (ii) How should uncollectible amounts be presented in the statement of comprehensive income initially?
  - (iii) How should subsequent changes in the estimates of uncollectible amounts be presented in the statement of comprehensive income?

- (20) We agree that the receivable should be accounted for in accordance with IFRS 9 (IAS 39) while the contract assets should be accounted for under a guidance to be developed that is to be in the scope of revenue recognition standard.
- (21) In our view, the reason for accounting for the effects of credit risk in a contract asset similarly to a receivable is not enough developed nor convincing particularly when dealing with issues such as variable consideration or re-negotiation of a contract. Hence the Board should further consider the practicability of the requirement to account for the effects of a customer's risks on contract assets distinctly. If appropriate, additional guidance should be provided.
- (22) In principle, we agree that disclosing the effect of credit risk as a separate line item is an appropriate presentation, subject to materiality consideration. The proposal is certainly a better answer than the original suggestion that a single revenue number, net of credit risk, be presented by default. Disclosing the gross revenue number provides better information to users in most circumstances since the revenue growth and the receivable collection function can be analysed separately.
- (23) We note that in cases in which the transaction includes both the delivery of a product or service and a loan due to a significant financing component, the discount rate used to calculate the time value of money will reflect the credit risk associated with that customer. In this case the consideration allocated to the financing component should be recognised as an adjustment to revenue.
- (24) However, under normal credit terms where the time value of money component of the transaction price is not material, which is the case in most transactions, the credit

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risk should not reduce the recognised revenue amount. The collectability risk, if any, should be recognised as an impairment of receivables.

- (25) Therefore, we do not support the proposal prescribing that the impairment loss arising on the initial recognition of the receivable and impairment loss arising after the initial recognition of the assets should be presented as a separate line item adjacent to the revenue line item, but rather the principles established in IAS 1 should apply.
- (26) Equally, IAS 1 provides sufficient guidance on how to present impairment losses on receivables and impairment losses on contract assets by distinguishing gains, losses and costs arising from financial and non-financial instruments.

**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?**

- (27) We agree that when the amount of consideration is variable, the amount of revenue recognised should not exceed the amount to which the entity is reasonably assured to be entitled.
- (28) In paragraph 85 of the ED the IASB describes how 'reasonably assured' should be understood when an entity licences intellectual property to a customer and the customer promises to pay an additional amount of consideration that varies on the basis of the customer's subsequent sales of a good or service. We regard that rule-based exception to the general requirements as not really justified. In this context, we think that the Basis for Conclusions is not sufficiently explanatory. It only states that it is considered to provide the most useful information without explaining why such an exception has been introduced. It would be also important to clarify if similar transactions should be treated in the same way.
- (29) Furthermore, we believe that it would be useful to provide some instances where variable consideration can be reasonably estimated but not be reasonably assured.
- (30) In some instances where the variable consideration can be estimated but not reasonably assured, the proposed method may lead to an accounting treatment that does not properly reflect the economic substance of the transaction from our point of view. For example, an entity may sell an asset in exchange for proceeds that include a royalty stream. The fair value of the proceeds (including the royalty stream measured on a probability weighted basis) exceeds the carrying amount of the asset,

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and accordingly the entity expects to realise a gain on the transaction. However, to the extent that the royalty stream is not reasonably assured, revenue would not be recognised at the time of the transfer and consequently, the transaction would initially result in a loss. We question whether this situation would result in an appropriate accounting treatment and therefore we encourage the Board to consider this situation in order to determine how the reasonably assured model should be adjusted.

**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?**

- (31) Similar to EFRAG, we disagree with the proposals that the onerous test should (1) be performed at the performance obligation level and (2) be limited to performance obligations that an entity satisfies over a specified period of time.
- (32) Performing the onerous test at the performance obligation level may result in the recognition of a loss at the inception of a contract that will be profitable as a whole. It is counter-intuitive for an entity to recognise a loss due to an onerous performance obligation within a contract that remains profitable as a whole. We think that the onerous test should be performed at the contract level.
- (33) We are appreciative of the Board's efforts to re-examine this area but in our view the revised ED only introduces an arbitrary line for onerous tests which does not seem to serve any purpose.
- (34) We agree with EFRAG that the arguments in the Basis for Conclusions, paragraph BC207, are not convincing. We do not believe that it adds complexity to perform the onerous test at a contract level. Further, contrary to what is implied in that paragraph, we do not believe that this would open the door to structuring opportunities. For example, if two contracts are entered into at the same time, the requirements of paragraph 17 would result in the two contracts being considered as one.
- (35) To the contrary, we believe that applying the onerous test at the performance obligation level is more likely to be arbitrary and complex. Pricing is usually negotiated at the contract level and not at the performance obligation level. The allocation methodology required in the ED will sometimes result in an allocation that differs from the economics of the contract and show losses where none exists.
- (36) In our opinion the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets are adequate – and therefore preferable – for the purpose of providing reserves against onerous revenue contracts. We do not think that these requirements need to be extended through inclusion in this standard. We understand that the Board plans to scope out revenue contracts of IAS 37 when introducing the new standard. However, we urge the Board to reconsider this position.

**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).

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.

- (37) We agree with EFRAG that revenue forms an important part of the financial statements and therefore it should also be included in the interim financial reports.
- (38) However, we do not think that the new revenue standard should mandate specific disclosures in the interim financial statements. The contents of this document should be governed by IAS 34 Interim Financial Reporting which limits disclosures to a specified set of explanatory notes. If this model is really considered to be deficient then it should be reconsidered in the context of a coherent overhaul of IAS 34.
- (39) The Board should also consider establishing an overarching framework for disclosures and define the criteria for inclusion and exclusion of information in the annual and interim financial statements. Many standards tend to define very prescriptive and rule-based disclosure requirements which have resulted in information overload.

**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?

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- (40) We agree that the principles proposed for the new revenue standard should be extended to include the situations referred to above. However, some other consequential amendments are also recommended to be made such as more clarification about the de-recognition principles for non-financial assets. We note that sale transactions may involve assets within the scope of standards other than those identified in paragraph D (i.e. IAS 16, 38 and 40). It would be appropriate to clarify how the sale of such assets (e.g. sale of tax credit from tax losses) would be treated.
- (41) Further, the consequences of applying the measurement principles in the ED to all non-financial assets that are not an output of an entity's ordinary activities must be assessed. Certain non-financial assets are measured at fair value (e.g. investment properties). When these assets are sold in exchange for proceeds that include a variable component, the reasonably assured test may result in the recognition of a loss. This may happen, for example, when the fair value of the investment property is determined on the basis of an alternative use (the highest and best use) and the investment property is sold for proceeds that include a contingent element based on obtaining the permit necessary for this alternative use. To the extent that the contingent element does not meet the reasonably assured threshold, it appears that the transaction will result in recognising a loss. It seems counter-intuitive to require an on-going measurement of the investment property that should reflect this *contingent* alternative use, whereas the recognition of revenue upon disposal is subject to more stringent requirements.

## Additional comments

### Scope

- (42) The ED defines a customer as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities. We think that most output would be of the entity's ordinary activities as IFRS prohibits any activity from being considered extraordinary.
- (43) It is unclear whether partners in a partnership would be included in the scope of the standard. In some countries, partners form a partnership from which, for instance, the customer orders the construction of a building. Each partner of the partnership then contributes with transfer of goods or services to the partnership in order to finalise the contract. It is unclear whether the revenue generated by the partners when selling goods or services to the partnership is included in the scope of the standard, or the partnership is rather a collaborator or a partner that shares with the entity the risks and benefits of developing a product to be marketed (paragraph 10 of the ED).
- (44) We agree with EFRAG that the guidance on scope is unclear on determining whether or not a contract is a contract with a customer or a contract with a partner or collaborator. Further it would be helpful to clarify which standard would apply to transactions that are scoped out of the revised standard.

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### Allocation of contingent amounts

- (45) Similar to EFRAG we welcome the Board's decision to introduce exemptions to the strict allocation based on standalone selling prices in cases of discounts and contingent considerations. In our previous response to the 2010 exposure draft, we disagreed with the proposal that subsequent changes in a transaction price should be allocated in all cases to performance obligations based on the initial standalone selling prices rather than based on the relevant facts and circumstances at the date of the modification.
- (46) We also agree with EFRAG that the requirements on how to allocate contingent amounts of consideration to distinct goods or services should be further clarified. There are cases in which the allocation of the contingent amount to more than one performance obligations would better reflect the economic substance of the underlying transaction.

### Time value of money

#### Question to constituents

**Do you think a practical expedient regarding the time value of money should be included in the ED (see paragraphs 10 - 13 above)? If so, what should be included in its scope?**

- (47) The factors provided in paragraph 59 to help identifying whether a transaction includes a financing component need clarification. In particular, it is not clear how the "typical credit terms in the industry and jurisdiction" should be used. Accordingly, we believe that the factor in paragraph 59 (b) should not refer to the typical credit terms in the industry and jurisdictions.
- (48) When considering the significance of the financing component, it is also not clear if the interest rate mentioned as a factor in paragraph 59 (c) should be considered as an absolute amount or in comparison to the prevailing interest rate. We encourage the Board to clarify its position in this regard.
- (49) Further, we note that paragraph 61 indicates that the discount rate is not updated for changes in circumstances or interest rates. It would be useful for the Board to specify whether an update to the discount rate is necessary upon a modification to the contract.
- (50) Finally, we question the basis of the requirement in paragraph 62 that the effects of financing be presented separately from revenue. Under IAS 18, interest income is considered as a class of revenue. Neither IAS 18 nor IAS 1 prevents the presentation of interest income as part of revenue. Is it really the intention of the IASB to change this position?

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### Offsetting contract assets and advances received

- (51) Like EFRAG we disagree that the remaining rights and performance obligations in a contract should always be presented on a net basis.

### Right of return

#### Questions to constituents

**Are you concerned that in practice it will often be difficult to distinguish between the different situations listed in paragraph 25 above where a customer has not irrevocably taken control of assets provided by the entity?**

**Do you think the three situations listed in paragraph 25 above differ economically? If so, how and in what circumstances would it be important to distinguish between the three circumstances?**

**Do you think there are situations where a customer has a significant economic incentive in exercising a return right, but the transaction should not be accounted for as a lease?**

**How do you think the three situations listed in paragraph 25 above should be accounted for?**

- (52) We share EFRAG's concerns about the lack of clarity in (1) what distinguishes (in substance) a right of return and an explicit customer acceptance and (2) what justifies the difference in treatment between these two similar situations.
- (53) The Board should assess the practicability of such a distinction and reconsider whether (and explain why) the difference in treatment is warranted.

### Early application and effective date

#### Question to constituents

**EFRAG has discussed whether early adoption should be allowed for existing IFRS reporters. Permitting early adoption by existing IFRS reporters would reduce comparability between companies, but it would allow them to move to the improved standard sooner.**

**Do you think early application of the new standard on revenue recognition should be allowed for entities already reporting under IFRS?**

- (54) As a general principle, we support early application of the standard unless facts and circumstances would suggest otherwise.

### Other concerns

#### Identification of separate performance obligations

- (55) We agree with the revised proposals that restrict the performance obligations to be identified separately. However we believe that some aspects should be clarified.
- (56) Paragraph 28 (b) requires that the "customer can benefit from the good or service". Should the customer ability to benefit separately from a component of the transaction be assessed in theory (i.e. to the extent that the contract indicates that the

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component should be used solely along with the other elements of the contract, the customer would be considered as not being able to benefit separately from the component) or in practice (because it is feasible for the customer to do so in practice and the seller does not enforce the contract clause).

- (57) Regarding the criterion included in paragraph 29(a) it should be explained clearly what is meant by a significant service of integrating goods and services and when a bundle of goods and services are highly interrelated.

#### **Contract modifications**

- (58) The ED introduces an artificial distinction between modifications that affect only the price vs. modifications that affect goods/services and the price. This distinction could result in significantly different accounting treatments even though the modified goods/services are not significant. To avoid reflecting transactions differently that are similar, we suggest that all modifications should be treated in accordance with the paragraph 22.

#### **Input methods**

- (59) We do not believe that paragraph 46 is justified. It appears to address very specific and infrequent transactions in a manner that is inconsistent with the fact that the goods in question do not represent a separate performance obligation. If indeed the goods do not represent a separate element, the overall performance obligation should be assessed and measured in a manner that reflects the extent to which the services have been performed.