



23 June 2009

Mr. Stig Enevoldsen
Chairman
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Ref.: ACC/HvD/SS/LF/ID

Dear Mr. Enevoldsen,

**Re.: FEE Comments on EFRAG's Draft Comment Letter on IASB Discussion Paper
*Preliminary Views on Revenue Recognition in Contracts with Customers***

- (1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the EFRAG Draft Comment Letter on the IASB Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers* (the "DP").
- (2) We welcome the joint efforts by the IASB and FASB to develop a common standard on revenue recognition based on a single contract based recognition model to clarify the principles for recognising revenue in order to improve comparability and understandability of revenue for users of financial statements.
- (3) Regarding the objective of achieving convergence, we would like to reiterate FEE's views that only genuine improvements to financial reporting should be considered and although a level playing field between IFRS and US GAAP is important, this also risks to drive the global financial reporting towards the lowest common denominator. FEE supports the principle of seeking convergence, provided that this leads to higher quality accounting solutions and goes where needed beyond existing standards.
- (4) We welcome the idea of developing a fully converged revenue standard based on a single set of principles for recognition and measurement that would be applied to all types of revenue-generating activities. However, in our opinion, some of the main elements in the proposals of the DP, such as the definition of transfer of control and the notion of how a performance obligation is accomplished, require further work to achieve a revenue recognition model that can be clearly understood and consistently applied in practice across the various industries and jurisdictions.

- (5) We note that EFRAG presents a different model for recognising revenue compared to the DP, whereby revenue is recognised as the entity progresses towards performance obligation fulfillment rather than just on fulfillment as proposed by the IASB.
- (6) We regret like EFRAG that the DP does not explain why the IASB regards revenue as an important figure. The Conceptual Framework does not define revenue. The question of what revenue is has, so far, not been addressed. We are strongly of the opinion that the DP should provide a definition of revenue. A discussion is needed on what revenue aims to measure (“value of work carried out/in progress for customers under a specified contract”), how it is understood by users and what is its informational value for them.
- (7) Like EFRAG, we have reservations about the IASB proposals for revenue recognition. Firstly, the DP seems to suggest that service contracts typically involve a continuous transfer. We agree with EFRAG that there are many service contracts where the deliverable is delivered at the end of the contract and hence where there does not appear to be a continuous transfer. The treatment proposed would result in revenue recognition accounted for in the case of these types of contracts much later than is the case at present, constituting a significant change from current practice. The DP is not clear about the actual meaning of transfer of control over a service and therefore it is likely that based on the guidance provided, preparers will be unable to understand how it applies to most service contracts, leading to significant diversity in practice.
- (8) Similarly, the model for revenue recognition proposed by the IASB may represent a problem in particular in the case of construction contracts. If revenue is not recognised until assets are “transferred” to customers, this may result in a significant change to the current accounting treatment for construction contracts under IAS 11. As for services it is felt that further thoughts should be given to the notion of transfer of control in the case of construction type contracts because in many such contracts neither the customer nor the supplier really have full control over the asset under construction. The material contained in the DP appears to reduce the discussion to the customer having the right to take work in progress from the seller. We do not believe that this over-simplifying approach is appropriate. But, more importantly in our opinion, this would downgrade the decision-usefulness of financial statements since it might be misleading to treat all situations in the same way for accounting purposes, regardless of the stage of progress of the contract. For instance, we do not think that the situation where there is no contract in place is the same as a situation where a contract is 95% completed but control is not yet transferred, whereas the IASB proposals would account for both situations in the same way, reflecting no revenue at all in the financial statements.
- (9) We would like to note that in many cases in practice, aspects of control over an asset pass from an entity to the customer before the “legal” control is transferred when the asset is finished. Therefore, in order to recognise revenue properly it might be appropriate to switch from a principle of “control” to a principle that reflects this complex reading. In this sense, we would support EFRAG’s move towards a different model where the “activity” performed under the contract is considered for some service and construction type contracts.

- (10) However, the model proposed by EFRAG of recognising revenue as activities are carried out might not always be appropriate. It will cause problems in particular in the case of “standard” and “semi standard” products (products which are not tailor made for a specific customer). On the other hand, the model in the IASB proposals might result in an overly “legalistic” approach where revenue is only recognised when the “legal” transfer of an asset takes place despite the fact that some important aspects of control might have passed before. In any case, in our opinion the way control is defined in the DP should be reworked.
- (11) In our view, the cancellation rights are a critical factor for revenue recognition. These rights would not necessarily have to be specified in a contract to be considered but need to be taken into account following industry practice.
- (12) In conclusion:
 - (i) We agree with EFRAG that the model proposed in the DP may not be appropriate for some contracts, particularly service and construction type contracts;
 - (ii) We have some reservations about the model developed by EFRAG mainly since it is not clear how it will always work in practice for (semi) standard goods;
 - (iii) The IASB needs to rework the definition of transfer of control and the notion of how a performance obligation is accomplished;
 - (iv) We have a preference for a direction that is somewhere in the middle between the model proposed by the IASB and the model presented by EFRAG in order to appropriately reflect the economics of various types of contracts.
- (13) In addition, we have the following concerns regarding the proposals of the DP:
 - EFRAG calls for further guidance on the definition of a performance obligation. We support EFRAG on this call and would strongly recommend that the IASB looks at the definition of a performance obligation more thoroughly.
 - We agree with EFRAG that in the case of construction-type contracts in which the asset under construction is not transferred to the customer on a continuous basis, the proposed principle would not provide decision-useful information, since revenue would not be recognised until the contract is complete. In other words, it would not be appropriate to treat in the same manner (i.e. not recognise any revenue) a partly completed contract and a contract where no work has been performed yet.
- (14) Furthermore, we agree with EFRAG that future developments of standards, for instance in relation to derecognition, will have implications for the principles on which a general standard on revenue recognition should be based. To the extent possible there should be consistency between the model for revenue recognition and the proposals on other related topics.

Our responses to the questions in the Invitation to comment of the DP are included as an Appendix to this letter.

For further information on this letter, please contact Ms. Saskia Slomp from the FEE Secretariat.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Hans van Damme', written over a horizontal line. The signature is stylized and includes a large loop on the left side.

Hans van Damme
President

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers*

A CONTRACT-BASED REVENUE RECOGNITION PRINCIPLE

Question 1

Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

A single, universally-applied revenue recognition principle

- (15) We welcome the idea of developing a fully converged revenue standard based on a single set of principles for recognition and measurement that would be applied to all types of revenue-generating activities. However, in our opinion, some of the main elements in the proposals of the DP, such as the definition of transfer of control and the notion of how a performance obligation is accomplished, require further work to achieve a revenue recognition model that can be clearly understood and consistently applied in practice across the various industries and jurisdictions.

A focus on the contract asset or liability

- (16) We note that EFRAG presents a different model for recognising revenue compared to IASB. Under the EFRAG's model, revenue is recognised as the entity progresses towards performance obligation fulfillment rather than just on fulfillment as proposed by the IASB.
- (17) Like EFRAG, we have reservations about the IASB proposals on revenue recognition. Firstly, the DP seems to suggest that service contracts typically involve a continuous transfer. We agree with EFRAG that there are many service contracts where the deliverable is delivered at the end of the contract and hence where there does not appear to be a continuous transfer. The treatment proposed would result in revenue recognition accounted for, in the case of these types of contracts, much later than is the case at present, constituting a significant change from current practice. The DP is not clear about the actual meaning of transfer of control over a service and therefore it is likely that based on the guidance provided, preparers will be unable to understand how it applies to most service contracts, leading to significant diversity in practice.
- (18) Similarly, the model for revenue recognition proposed by the IASB may represent a problem, in particular in the case of construction contracts. If revenue is not recognised until assets are "transferred" to customers, this may result in a significant change to the current accounting treatment for construction contracts under IAS 11. As for services it is felt that further thoughts should be given to the notion of transfer of control in the case of construction type contracts because in many such contracts

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neither the customer nor the supplier really have full control over the asset under construction. The material contained in the DP appears to reduce the discussion to the customer having the right to take work in progress from the seller. We do not believe that this over-simplifying approach is appropriate.

- (19) More importantly in our opinion, it might be misleading to treat all contracts in the same way for accounting purposes, regardless of the stage of progress of the contract and doing so would downgrade the decision-usefulness of financial statements. For instance, we do not think that the situation where there is no contract in place is the same as a situation where a contract is 95% completed but control is not yet transferred, whereas the IASB proposals would account for both situations in the same way, reflecting no revenue at all in the financial statements.
- (20) We would like to note that in many cases in practice, aspects of control over an asset pass from an entity to the customer even if the “legal” form of control is only transferred when the asset is finished. Therefore, in order to recognise revenue properly it might be appropriate to switch from a principle of “control” to a principle that reflects this complex reading. In this sense, we would support EFRAG’s move towards a different model where the “activity” performed under the contract is considered for some service and construction type contracts.
- (21) However, the model proposed by EFRAG of recognising revenue as activities are carried out might not always be appropriate. It will cause problems in particular in the case of “standard” and “semi standard” products (products which are not tailor made for a specific customer). On the other hand, the model in the IASB proposals might result in an overly “legalistic” approach where revenue is only recognised when the “legal” transfer of an asset takes place despite the fact that some important aspects of control might have passed before. In any case, in our opinion the way control is defined in the DP should be reworked.
- (22) An approach between the IASB’s and EFRAG’s proposals could be an improvement of the current standards, especially for multi-element arrangements. In our opinion, the latter are the main weakness of the current standards.
- (23) In our view, the cancellation rights are a critical factor for revenue recognition. These rights would not necessarily have to be specified in a contract to be considered but need to be taken into account following industry practice.
- (24) In conclusion:
 - (i) We agree with EFRAG that the model proposed in the DP may not be appropriate;

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- (ii) We have some reservations about the model developed by EFRAG mainly since it is not clear how it will always work in practice for (semi) standard goods;
 - (iii) The IASB should rework the definition of transfer of control and the notion of how a performance obligation is accomplished;
 - (iv) We have a preference for a direction that is somewhere in the middle between the model proposed by the IASB and the model presented by EFRAG.
- (25) Regarding EFRAG's comment in paragraph 14 of its draft comment letter that the DP though only dealing with revenue recognition in contracts with customers it does not state that revenue could not arise outside such contract, we note that this is a valid comment. See also our response to Question 3.

Question 2

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

- (26) We agree with EFRAG that in the case of construction-type contracts in which the asset under construction is not transferred to the customer on a continuous basis, the proposed principle would not provide decision-useful information, since revenue would not be recognised until the contract is complete. In other words, it would not be appropriate to treat in the same manner (i.e. not recognise any revenue) a partly completed contract and a contract where no work has been performed yet. See also our response to Question 1.

Question 3

Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

- (27) We agree with EFRAG that IFRSs should have only one definition of a contract. We support EFRAG's suggestion that either the current definition in IAS 32 or the proposed new definition should be kept. However if the notion of contract for the purpose of revenue recognition is not exactly the same as defined in IAS 32, the IASB should consider using a different word and explaining the difference between both concepts.

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- (28) We note that, under the proposals of the DP, revenue can be recognised without a contract and that this is not possible under EFRAG's proposed model. It appears that, according to some jurisdictions, revenues transactions can be governed by law or by statute. If these transactions create rights and obligations similar to those embedded in a contract, we believe that they should be scoped in a revenue recognition standard. We also question whether clarification would be needed in order to distinguish an offer from a contract.
- (29) In addition, we would like to stress the importance of "testing" the definition of a contract in different industries. We encourage the IASB to carry out appropriate field-testing.

Question for EFRAG's constituents: We would like to know of any difficulties constituents think there might be in applying the proposed definition in particular jurisdictions.

- (30) Like EFRAG, we are not aware of any jurisdictions in which the proposed definition would be difficult to apply except what is already mentioned in paragraph 25 of this letter.

PERFORMANCE OBLIGATIONS

Question 4

Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

- (31) EFRAG calls for further guidance on the definition of a performance obligation. We support EFRAG on this call and would strongly recommend that the IASB looks at the definition of a performance obligation more thoroughly because we believe that guidance currently provided in the DP is insufficient to ensure that it will be understood and applied consistently.
- (32) In paragraph 32 of its draft comment letter, EFRAG notes that conceptually, there is no difference between an extended warranty and a statutory warranty and that they both are terms of the contract and that they both involve separate performance obligations. Even if we agree that both (an extended warranty and a statutory warranty) appear to involve performance obligations, we note that in circumstances where it would not be possible to sell an asset without a statutory warranty, this warranty should not be considered in our view as a separate performance obligation. In that case, the only

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performance obligation is to deliver a good in the agreed condition. If it is not the case, the performance obligation relating to the good has not been satisfied. Consequently, a guarantee given to deliver a good in a given working condition does not constitute a separate performance obligation. In that respect, we would disagree with EFRAG's view that a statutory warranty has to be considered as a separate performance obligation.

- (33) More generally, we believe that the IASB should reconsider the requirement to separate performance obligations taking into account some commonly used principles such as the stand-alone value for the customer or the existence of such separate elements on a stand-alone basis on the market.
- (34) In the case of a separate performance obligation, we think that the appropriate accounting treatment would be to value it separately and deduct it from the sales price.
- (35) Accordingly, the IASB should consider reworking the notion of how a performance obligation is accomplished.

Question 5

Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

- (36) We note that in the model presented by EFRAG, performance obligations in a contract would be unbundled on the basis that the entity transfers the promised assets to the customer, but we would tend to disagree with this. In particular, we are not convinced that performance obligations should be separated if they cannot be sold separately and if customers have no ability to refuse them as, for example, in the case of a statutory warranty. See also our response to Question 4.
- (37) Furthermore, we fail to see the informational value of separating performance obligation for goods or services that are never sold separately on the market. In those situations, it is likely that recognising revenue for such items will not appropriately reflect the business model, and therefore the actual performance of the suppliers, and that the measurement of such separate performance obligation would be arbitrary.

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Question 6

Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

- (38) We recognise that it might be difficult to make a distinction between what can be seen as a "failed sale" and a separate performance obligation, as a wide variety of this kind of obligation may exist. Contractual terms may permit a customer to return a good without condition or only in certain specified circumstances; the customer may have the right to a full refund or only to a replacement of goods. These characteristics must be considered by the IASB when developing the standard. At this stage and in our view a returned good should be considered as a "failed sale" and it should be booked as such with no revenue being recognised. Therefore, we support the "failed sale" approach in which a customer's right to return the goods "bought" for any reason does not involve a sale unless and until the right lapses.

Question 7

Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

- (39) We agree with EFRAG that sales incentives give rise to performance obligations if they are provided in a contract with a customer.

Question to EFRAG's constituents: We would particularly welcome comments on this issue. How would you analyse the transaction and why? And what are the consequences for the way it should be accounted for?

- (40) In our opinion, both views expressed on how to account for a discount as presented in EFRAG's response to Question 7 (see paragraph 55 (a) and (b)) could be supported.

SATISFACTION OF PERFORMANCE OBLIGATIONS

Question 8

Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

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- (41) We agree with EFRAG and the DP that, under the existing definition of an asset, an entity should derecognise an asset when it no longer has control of that asset. However we do not believe that the transfer of control over the asset should always be necessary for recognising revenue (See our response to Question 1).
- (42) We agree with EFRAG that, in general, the notion of control might not be well understood and, for this reason, that it is likely that there would be implementation issues. We encourage the Boards to rework the definition of transfer of control.

Question 9

The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

- (43) See our response to Question 1.

Question 10

In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

- (44) We agree with EFRAG and the DP that performance obligations should be measured initially at the original transaction price.
- (45) We agree with EFRAG that future developments of standards, for instance in relation to derecognition, will have implications for the principles on which a general standard on revenue recognition should be based. To the extent possible, there should be consistency between the model for revenue recognition and the proposals of other related topics.

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

- (46) We agree with EFRAG that a performance obligation should be deemed onerous if the expected cost to satisfy the obligation exceeds the carrying amount of the obligation.

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- (47) Like EFRAG, we also agree with the proposal of the DP that a performance obligation that is deemed onerous should be remeasured based on the entity's expected cost to satisfy the performance obligation.
- (48) In addition, we are not convinced by the manner a separate performance obligation is defined in the DP.
- (c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.**
- (49) As stated in our response to Question 2, we agree with EFRAG that, in the case of most construction-type contracts, the proposed principle would not provide decision-useful information, since revenue would not be recognised until the contract is complete. In other words, it would not be appropriate to treat in the same manner (i.e. not recognise any revenue) a partly completed contract and a contract where no work has been performed yet. See also our response to Question 1.
- (d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.**
- (50) In general we agree that for many contracts, the approach proposed by the DP not to remeasure the contract to reflect changes in selling price is both cost effective and decision useful. However there are cases where no external prices are available for individual performance obligations and estimates have to be computed. It then becomes relevant to adjust or revise the original estimates in order to better reflect the selling price and revise the allocation of the contract to the different performance obligations.

Question 11

The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

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(a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?

(51) We agree with the proposal to include any amounts that an entity charges customers to recover the costs of obtaining the contract in the initial measurement of the performance obligations.

(b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

(52) We note that some directly attributable costs are currently accounted for as contract acquisition costs and that the position taken in the DP seems to negate any value to these origination costs without providing convincing justification. As part of developing the future standard, we encourage the IASB to further elaborate on this issue to ensure consistency with other standards being developed or revised such as those related to insurance contracts, leases or financial instruments.

Question 12

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

(53) We agree with EFRAG and the DP that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices for the goods or services underlying those performance obligations.

Question 13

Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

(54) We agree with EFRAG and support in principle the proposal in the discussion paper that, if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price. (see our answer to Question 5).

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- (55) We note that in practice it might be difficult to carry out this allocation, for instance in the software industry where programming and maintenance or support often are closely linked. In these circumstances, it is likely that estimates might differ substantially. Limiting the subjectivity of estimations might be possible by requiring a reasonable and consistent assessment of estimations that reflect the entity's business model and the specific circumstances of the industry.

Other issues

Appendix C of the DP contains a list of issues not covered in the DP. As we expect these issues to be addressed in any ED developed from the DP, we would welcome any comments constituents have on those issues at this stage.

- (56) We have no further comments at this stage.