

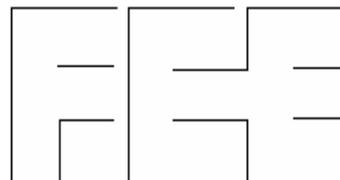
Date  
11 January 2008

Le Président

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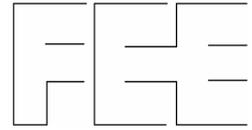
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Dear Mr. Enevoldsen,  
Dear Ms. Knorr,

**Re: Pro-active Accounting Activities in Europe (PAAinE) - Discussion Paper on Revenue Recognition**

**General**

1. FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) is pleased to submit its comments on the Discussion Paper on Revenue Recognition (the DP), issued by the DRSC (Deutsches Rechnungslegungs Standards Committee), EFRAG and the French standard-setter CNC (Conseil National de la Comptabilité), as part of Europe's PAAinE initiative.
2. We welcome the PAAinE initiative to provide a European contribution to the debate on revenue recognition, notably as an input to the joint IASB and FASB project on Revenue Recognition and Measurement. In that respect we support the methodology adopted in the European DP of contemplating different approaches for revenue recognition and stating the merits and the constraints of each of them.
3. We welcome the DP's objective to search for a unique approach suitable for all type of businesses and sufficiently robust to apply to all industries in response in particular to the difficulties currently encountered in resolving inconsistencies between IAS 11 and IAS 18 (continuous approach versus critical events approach). This is an appropriate objective even though it is an ambitious exercise, as it will require the definition of very clear and robust underlying principles to revenue recognition and measurement.
4. However, we believe that any new approach should be assessed in order to demonstrate that it represents a real improvement over the current literature and that it can be made operational without undue costs and efforts.



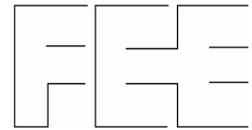
5. We would suggest that the paper be further developed to clarify certain key notions such as:
  - The definition of the key characteristics of a contract as it is proposed that revenue cannot arise without a contract with a customer but that revenue recognition does not necessary imply “enforceable rights and obligations”;
  - Under the continuous approach (Approach D) based on the activity towards completion, it would be necessary to further clarify the basis for recognition of the asset representing the production in progress in relation with the definition of an asset currently discussed by the IASB and FASB (Framework Project);
  - It would also be necessary to provide guidance on how to measure the progression of the contract for non-specified or non-identifiable goods.
6. We understand that the paper does not explore sector-specific issues in detail. The scope of the paper as described in paragraph 1.26 makes reference to financial institutions to specifically note that these are outside the scope of the paper. We would appreciate if a similar observation is made for the public sector. We would like to clarify that our response is confined to private sector commercial (for profit) transactions and made on the assumption that public sector non – exchange revenues are outside its scope.
7. Our responses to the questions asked in the Invitation to Comment Section of the DP are contained in the Appendix to this letter.

We would be pleased to discuss any aspect of this letter that you may wish to raise with us.

Yours sincerely,

Jacques Potdevin  
President

Ref: ACC/JP/LF-SR



## APPENDIX

Responses to the questions asked in the Invitation to Comment Section of the DP.

**Q1 It is stated in the discussion paper (paragraphs 1.4 - 1.10 and Appendix II) that there are weaknesses in the IASB's existing revenue recognition standards, IAS 11 and IAS 18. In particular, the standards do not address certain types of transaction (for example they say little about multiple-element arrangements), they are based on different principles (which leads to inconsistencies and uncertainties and makes it difficult to know how to use the standards to fill the gaps) and there are internal inconsistencies within IAS 18. The paper goes on to say that these gaps, inconsistencies and uncertainties are causing real practical problems. Do you think these comments about the existing standards are fair? (If you do not, could you please explain which comments you think are not fair and why.) Do you have any additional concerns about existing standards? (If you do, please could you explain them.)**

We agree that it is sometimes difficult to draw a clear distinction between IAS 11 and IAS 18 and that there are conceptual inconsistencies between both standards. Part of the problem is due to the fact that revenue recognition is addressed in two different standards rather than in a single one. This results in practical application difficulties. For example, IAS 18 does not distinguish clearly between what are goods and what are services. Also, it is difficult to determine the appropriate policies for multiple-element arrangements due to the lack of standards addressing these arrangements. The implementation of the existing standards has proven to be difficult in some specific situations and has caused problems in practice in certain industries, for example in the circumstances specific to the Real Estate, as suggested in our letter to EFRAG on the EFRAG Draft Comment Letter on IFRIC D21 Real Estate Sales (dated 29/10/2007).

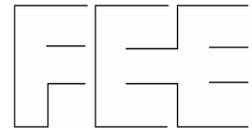
In addition, we would consider it helpful to add more illustrations, for example, the issue of customer loyalty programmes could be used in the context of the Revenue Recognition project to illustrate some of the current difficulties encountered on revenue recognition in practice for certain sales transactions.

All in all, these are only some specific issues that cause the problems mentioned. Therefore, we believe that any new approach should be assessed in order to demonstrate that it represents a real improvement over the current literature and that it can be made operational without undue costs and efforts. In addition, it has to be shown that the principles are practicable and capable for reliable implementation. Otherwise, there is a danger that the new "solution" would cause more problems than it solves, with the effect of a decrease in relevance and reliability of financial statement information.

**Q2 Paragraph 1.20 states that the objective of the paper is to develop a framework within which to address revenue recognition issues in a consistent way. Paragraph 1.26 explains further that the ultimate objective of the revenue recognition debate should be to develop a set of principles that can be applied to all kinds of industries and business. In other words, rather than have different, competing principles like we do now, we would have a single principle or a single set of principles that apply generally and can be used to address any future gaps in standards.**

**(a) Do you believe this is an appropriate and realistic objective? (If you do not, please could you explain your reasoning and what you believe is an appropriate and realistic objective.)**

We agree that the DP's objective of searching for a unique approach suitable for all type of businesses and sufficiently robust to apply to all industries is an appropriate objective even though it is an ambitious exercise, as it will require the definition of very clear and robust underlying principles to revenue recognition and measurement.



However, as said before, we believe that any new approach should be assessed in order to demonstrate that it represents a real improvement over the current literature and that it can be made operational without undue costs and efforts. Accordingly, when the principles are developed, supplementary research will need to be undertaken to assess whether these principles are appropriate for all sectors. This will be necessary to identify and address potential future gaps in standards. See our response to Question 2 (b) below.

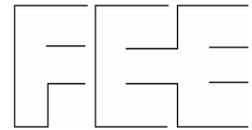
- (b) **Although the objective is to develop principles that can be applied to all kinds of industries and businesses, the paper does not explore sector-specific issues in any detail; the analysis and discussion is generic and not based on any particular sector. (For example, the paper's only reference to financial institutions is to note, in paragraph 1.26, that banks and insurers do not present a revenue number and to observe that it is outside the scope of the paper to consider whether such entities should present a revenue number and what such a number should represent were it to be provided.) Do you believe this approach is appropriate? If you do not, please could you explain which sector specific issues the paper should explore and why you think that would improve the quality of the analysis.**

We believe that the objective of developing a single set of principles applicable for all industries and sectors is appropriate. However, further research demonstrating whether the principles developed are applicable to specific sectors such as in the banking, insurance and agricultural industries would enhance the analysis. In our response to Question 1 above, we highlighted the difficulties specific to the real estate.

**Q3 Chapter 2 of the paper discusses what revenue is. It does so by examining what the Framework says about revenue (paragraphs 2.5 - 2.13) and what other attributes revenue should have (paragraphs 2.14 - 2.33). It concludes that:**

- (a) **Revenue is a particular type of increase in assets or decrease in liabilities.**
- (b) **Revenue is a gross notion. In other words, if an entity sells an item for €10, making a profit of €2, it will be the €10 rather than the €2 that will be recognised as revenue.**
- (c) **Revenue does not necessarily arise only from enforceable rights and obligations.**
- (d) **Revenue is some sort of measure of activity undertaken pursuant to a contract with a customer. Therefore, without a contract there can be no revenue. Furthermore, revenue will not arise simply from entering into the contract, because at that point there will have been no activity undertaken by the supplier pursuant to the contract.**
- (e) **Revenue does not necessarily involve an exchange.**
- (f) **Revenue is something that arises in the course of ordinary activities.**
- (g) **On the basis of the conclusions summarised above, a working definition of revenue is that revenue is the gross inflow of economic benefits that arises as an entity carries out activities pursuant to a contract with a customer.**

**Do you agree with these conclusions? (If you do not, please could you state which conclusion you do not agree with and explain your reasoning.) Do you believe that revenue has some additional attributes that should have been referred to? (If you do, please could you describe those additional attributes and explain your reasoning.)**



We agree with these conclusions.

To assist in the application of the principles based approach, it would be useful to describe the characteristics of what is meant by a contract in (d) above.

We can understand conclusion (c) in that revenue does not necessarily arise only from enforceable rights and obligations as a way to allow recognition of revenue (in particular under Approach D) even if the rights contained in the contract are not yet enforceable, as activities in progress from the supplier's perspective are not yet valuable by the customer.

Finally, we share the view expressed under some of the approaches presented in the paper that revenue does not necessarily involve an exchange (physical delivery), i.e. conclusion (e), in particular when revenue is recognised based on a work in progress approach or more generally in accounting for long-term contracts.

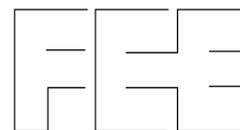
**Q4 As mentioned in Q3 (d), revenue is some sort of measure of activity undertaken pursuant to a contract with a customer. However, the paper's analysis is not conclusive as to exactly what "sort of measure of activity" revenue measures; it could for example be a measure of completion activity (in other words, a measure of the things the supplier has completed) or a measure of activity towards completion (in other words, a measure of the things the supplier has done under the contract). This issue arises again and again in the paper and is the main issue that separates the critical event approaches discussed in Chapter 3 from the continuous approaches discussed in Chapter 4. The authors believe that a very important test of any proposed accounting solution is whether it is the most useful approach from a user perspective. Which activities do you believe the revenue number should measure: completion, or activity towards completion? Or are there other alternatives that need to be considered? (Please give your reasons for the answer you have given.)**

We consider that the DP's analysis of different approaches is helpful in order to illustrate which activities the revenue number should represent. Based on this analysis, we believe that revenue may be viewed as a measure of activity towards completion. This measure could provide a relevant figure of the business activity, in particular when the realization of a contract is spread over several accounting periods, such as construction contracts. In our opinion however, further research and assessment is required in order to conclude on how the measurement of activity towards completion may be applied in practice. In particular, this approach may need to be further elaborated to apply to circumstances in which goods sold are not individually allocated to the sales transaction or when goods have short production cycles.

However, views are split about the importance of the right to consideration in the revenue recognition definition and the fact that from the perspective of financial statements' users, it may be more important to know what can be hauled out than what efforts have been made to date (independent of whether the efforts are successful). Therefore, in order to depart from a risks and rewards- approach it is considered necessary to prove the superiority on an "activity toward" approach not only from a conceptual point of view but also on practical grounds.

**Q5 Chapter 3 discusses when revenue arises and, in doing so, introduces various critical event approaches to revenue recognition and explores three of them (Approaches A, B and C) in detail.**

**(a) Do you believe the discussion of Approaches A to C is fair and complete? For example, do you believe that one of the approaches has some additional benefits or weaknesses that have not been mentioned? Or that some of the weaknesses mentioned are not weaknesses? (If you do, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.)**



- (b) Do you believe there are any critical event approaches other than Approaches A to C that have merit and are worth exploring in greater detail? (If you do, please could you describe those approaches and explain why you think they are worth exploring further.)**

We believe that the discussion of Approaches A to C is fair.

We do not believe that there are any additional critical event approaches that would be worth exploring in greater detail.

- Q6 Chapter 4 continues the discussion of when revenue arises by introducing and exploring another type of approach to revenue recognition: the continuous approach (Approach D). Again, do you believe the discussion is fair and complete? (If you do not, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.)**

We believe that the discussion is fair.

However, we consider that it would be necessary to further clarify the basis for recognition of the asset representing the production in progress, as we are not fully convinced that Approach D has been sufficiently assessed in conjunction with the revenue recognition models that the IASB and FASB are currently exploring, i.e. fair value model and customer contract model. Further elaboration and examination of these issues would help in providing a comprehensive picture of Approach D.

We think that it would also be necessary to provide further guidance on how to measure the progression of contracts for non-specified or non-identifiable goods.

Furthermore, the question of the reliability of assessing progression of activities and consequently recognition of revenue needs to be addressed thoroughly.

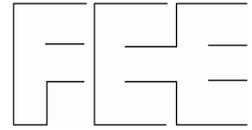
- Q7 The discussion in the paper is about concepts and principles—and not at this stage practicalities—and the paper uses a variety of simple examples to illustrate the various approaches and various conceptual discussion points. The examples are set out in Appendix IV. Do you believe there are other examples that would illustrate or highlight issues of concept or principle that are not so far identified in the paper? If you do, what are those examples and what new aspect of the debate is it that you think they illustrate or highlight?**

We believe that other examples outside the manufacturing sector would offer additional issues that are relevant in the discussion. See our responses to Questions 1 and 2(b) above. For example, within the insurance sector, revenue recognition has been a critical element in the discussions on the IASB Discussion Paper on Insurance Contracts. Furthermore, other examples of contracts involving multiple deliverables would be helpful.

More widely, it would be helpful to assess whether any new approach would give an appropriate answer to the concerns raised in Question 1 relating to the current literature on revenue recognition.

- Q8 What are your views on the relative merits of the approaches discussed in the paper? Do you believe that one approach is preferable to the others and could—perhaps after some further development work—be applied satisfactorily in all circumstances? (Please explain your reasoning.)**

We believe that Approach D is an interesting approach which needs to be further investigated, assessed and developed as mentioned in Questions 2 (a) and 6 in order to identify the relative merits of this approach as compared to those currently contemplated by the IASB and FASB.



Further research is needed to assess whether the benefits of applying Approach D will outweigh the costs of monitoring activities and of determining the revenues to be deferred for future activities.

However, the application of the continuous approach requires the ability to measure the outcome of the contract reliably.

**Q9 At various points in the paper the authors discuss the issue of perspective; from whose perspective or point of view (ie through whose eyes) should performance be assessed? The suppliers or the customers? For example:**

- (a) the issue is first mentioned in paragraphs 3.36-3.39, where it is explained that one perspective is not necessarily better than the other, although one may be better suited (or even an inherent feature) of one particular approach, whilst another might be better suited or a feature of another approach;**
- (b) the issue is also discussed in paragraphs 4.4(c), 4.5(b) and 5.7(c), where it is explained that critical event approaches generally (but not necessarily always) apply a customer perspective whilst continuous approaches tend to apply a supplier perspective.**

**In your opinion is this discussion complete and sufficiently conclusive? If you think it is not, could you please explain what more you think should be said and why.**

Depending on the perspective, different measurements can apply. We tend to favour the suppliers' perspective since it appears to be more consistent with the continuous approach. The suppliers' perspective may be viewed as providing more relevant information about the performance of the entity.

However, we believe that the question of the perspective, which should prevail, is intrinsically linked to the measurement approach adopted. Accordingly, we would need a definite position on the measurement issue prior to being able to conclude unambiguously on the question of perspective.

**Q10 Do you believe there are particular aspects of the revenue debate that have not been covered in this paper but are worthy of consideration. If you do, what are they and why do you believe they are worth exploring further?**

We believe that additional aspects as detailed in the responses to the questions in this Invitation to Comment are worthy of consideration.