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Re.: EFRAG Draft Comment Letter: Revenue from Contracts with Customers

The Danish Accounting Standards Committee set up by FSR is pleased to respond to EFRAGs Draft Comment Letter on the International Accounting Standards Board's Exposure Draft ED/2010/6 Revenue from Contracts with Customers ("the ED"). We apologise for the delay of our response.

We generally agree with the direction of EFRAGs draft comment letter (DCL) as well as the responses suggested by EFRAG. Furthermore, we have followed the preparation of the comment letter from FEE which we also generally support. We have summarized below some minor comments. Appendix A contains our responses to questions raised to constituents in the draft comment letter.

EFRAG DCL para 10 - Recognition

EFRAG is overall supportive of the proposed guidance for combining and segmenting contracts and contracts modifications.

FSR comment

FSR agrees with segmentation of contracts that are independent and that interdependent contracts should be treated as a single contract.

We agree with the comments from FEE, which express that in the ED it is unclear whether some contracts should be considered as connected contracts or as several single contracts. It is recommended that either 1) more indicators are given, or 2) main principals and exceptions to these are more clearly spelled out.

We do not find that further examples alone will clarify the definition. Examples should help the reader in understanding the principles and indicators in the standard.

EFRAG DCL, para 15 – Separating performance obligations

EFRAG generally supports the proposed guidance for separating performance obligations, but believes that in considering whether goods or services are distinct, the entity's own customary business practice should be considered rather than the business practice of any other entity.

FSR comment

We agree that the entity's own customary business practice should be considered. We also agree that the business practice "of any other entity" (our emphasis) should not be considered. However, to ensure some consistency we think the entity should consider business practice of entities with a similar business model/business practice to the entity's own where such entity exists. It may be considered to ask for clarification of this point in the ED.

EFRAG DCL para 81 - Disclosures

EFRAG agrees with the disclosure objective. Also, EFRAG think that the disclosure requirements proposed by the ED will provide information that will be helpful.

FSR comment

Having seen the proposed disclosure reminds us of the urgent need for a disclosure framework and we appreciate the proactive work done by EFRAG as regards a Disclosure Framework.

We agree that some disclosures must be given to meet the objective of the proposed disclosure requirements. The draft includes a lot of required disclosure including information which we think would also have to be captured by IFRS 8 and also a number of suggested reconciliations where we would think the costs of providing the information exceeds the benefit.

The first part of the disclosure requirements are principle based demanding descriptions of circumstances relating to the contracts. We believe some further guidance is required to explain exactly what the IASB has in mind being reported. Otherwise, it may lead to diversity among the preparers.

ED Appendix 2, B28, example 7 – non-refundable upfront fees

The example includes two scenarios both resulting in the same outcome in regards a non-refundable upfront fee.

FSR comment

We take it that purpose of scenario 2 is to illustrate a scenario where the payroll processing entity is required to perform initial activity (establishing the necessary records in its system) to be able to deliver payroll services. In contrast, the health club in scenario 1 does not have to perform any initial activity but provide access to its chain of health clubs. In both scenarios, the non-refundable upfront fee is recognized over time. We wonder if it would not be helpful to also illustrate a scenario where a non-refundable upfront fee is recognized upon its receipt.

ED Appendix 2, B36 – licensing and rights to use

FSR comment

It might be considered to explain that when a right to use is “not exclusive” it means that the entity holding the right to use can transfer it.

Appendix A: FSR’s response to questions raised by EFRAG to constituents

4: Do you support:

(a) The approach of developing a new standard on revenue recognition, or do you think that amending IAS 11 and IAS 18 to address existing practical issues would be preferable?

(b) The alternative revenue recognition model presented in Appendix 3 or the model proposed by the IASB in the ED?

FSR response

The Danish Accounting Standard Setting Board is of the opinion that this proposal is a major change compared to the existing IAS 11 and IAS 18 which, in certain circumstances, requires revenue be recognised in accordance with the percentage-of-completion method. It is our understanding that many preparers as well as auditors in Denmark have a preference for the alternative model presented in Appendix 3 of the EFRAG DCL. We find that the IASB should consider redrafting the revenue recognition criteria and/or indicators to meet/describe the continues recognition model (activity-based approach) which seems to be more align with the percentage-of-completion methods.

55: Do you think that the proposals in the ED requiring adjusting revenue for the time value of money would result in significant costs compared to the current practice? If so, why, and do you have any suggestions on how the principle could be applied in a less costly manner?

FSR response

In general, we would not think so. We believe that some degree of estimation would be acceptable in arriving at the adjusted revenue. In certain industries, however, where large or significant prepayments are customary some additional cost compared to the current practice might be expected.

78: Do you agree with EFRAG that the onerous test should be carried out at contract level, and not at performance obligation level? If so, do you, as EFRAG accept that nevertheless loss making performance obligations are reported as such when performed, disregarding when in the course of the contract that performance obligation is satisfied?

FSR response

A majority of the DASC agrees with EFRAG that if the overall contract is not loss making no provision for onerous contract should be recognized. We do note, however, that the Committee has mixed views.

84: EFRAG would welcome comments regarding the usefulness and the cost of preparing the disclosures required by the ED and an assessment of whether an acceptable trade-off between costs and benefits is met.

FSR response

The proposed disclosure is massive and we are tempted to say out of control when we see what is being suggested here. We wonder what research has been done to justify the proposed disclosure. It would seem at no real evaluation of costs and benefits have been made. Once again, we believe the suggested disclosure underlines the need for a disclosure framework.

96: Assuming that the proposals are to be applied retrospectively, how many years do you think would be necessary to implement the new requirements?

FSR response

We believe this question mainly require input from preparers. In general, we think the number of years necessary to implement the new requirements depends on the industry. In some industries, entities will have to make significant changes to reporting systems etc. For them, the longest possible lead time is desirable. On the other hand, a long lead time will reduce comparability especially if the final standard might be early adopted.

100: Do you think that the application guidance is sufficient to make the proposals of the ED operational in particular industries or are there any issues requiring specific consideration? If so, what are the issues?

FSR response

We think the accounting for service contracts needs more guidance.

112: Do you agree with the proposals in the ED regarding accounting for and distinguishing between a warranty and a failed sale? If so, on what basis should the distinction be made?

FSR response

We find the ED difficult to understand on this point especially it would be helpful if it is better explained what the principle is. Also helpful would be further guidance or examples to better understand the difference between a warranty and a failed sale.

125: Which of the alternatives (Alternative 1 to 3) do you prefer?

FSR response

We prefer alternative 3.

Appendix 3

19. Are there issues that you would see in applying the proposed alternative model? If so, how could the model be further developed?

FSR response

FSR supports the alternative activity-based model for revenue recognition as proposed in appendix 3. However we find that the model should be developed further as the model as it is explained in appendix 3 in our opinion does not resolve all the addressed issues in relation to service contracts. In paragraph 4 it is stated that the following conditions should exist before revenue is recognized in accordance with the activity-based model:

- a) *A contract with a customer must be concluded, and the entity must have performed pursuant to that contract, i.e. made progress in fulfilling its performance obligations under the contract;*
- b) *The contract must be such that the entity, as it progresses towards fulfilling its performance obligation, holds an irrevocable right to consideration, subject to continued performance. This right must be stipulated in the contract itself, stem from law or from law enforcement practices. In other words, the customer must be obliged, in one way or another, to pay for any work completed to date, as long as the entity performs under the contract.*

The requirement in item b) is in our opinion much stricter than the current requirements in IAS 11 and IAS 18 in respect of the use of the percentage of completion method for construction contracts and service contracts. Our understanding of the current IAS 11 and IAS 18 is that it is not a requirement that the entity *holds an irrevocable right to consideration, subject to continued performance*. We therefore understand that the proposed activity based model will reduce the number of occasions where the model can be used compared to the current model in IAS 11 and IAS 18. For example we do not believe, that the proposed activity based model in appendix 3 necessarily will cover the shipping example in paragraph 27, which we think it should.

Because of the above we suggest that the conditions in paragraph 4 should be developed further to make sure that the conditions are in line with the conditions in the current IAS 11 and IAS 18.

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Best regards

Jan Peter Larsen
chairman of the
Accounting Standards Committee

Ole Steen Jørgensen
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