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Sir David Tweedie
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International Accounting Standards Board
30 Cannon Street
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Dear Sir David,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organized standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on the Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers (December 2008). Principal authors of this comment letter are Helmut Kerschbaumer, Harald Mair, Michael Rab, and Alfred Wagenhofer.

General comments

We commend the IASB (and the FASB) for developing a single standard for revenue recognition for contracts with customers. We believe that contracts with customers are different in economic substance from other business activities of entities so as to warrant separate accounting (and presentation) of assets and liabilities arising from them and from other business activities.

The DP's focus on contracts with customers, which triggers recognition of a (net) asset or liability, bears close resemblance to the recognition criteria for financial instruments, where according to IAS 39 the contract itself is necessary and sufficient for recognition. Similarly, focusing on contracts with customers implies that every contract is recognised (maybe at nil) rather than recognised late or only under some circumstances (eg onerous executory contracts).

As Chapter 1 discusses, the accounting standards for such contracts are presently not fully coherent and consistent. We particularly note the efforts of the IFRIC to develop an interpretation (IFRIC 15) on construction agreements of real estate based on current IFRSs. The accounting varies substantially depending on how one assesses the specification of main elements of the structural design of the real estate and also on whether services or goods are delivered. We find that the DP is helpful to avoid complex rules for various special situations.

The proposal in the DP is based on the asset-liability approach that is favoured by the boards (see also DP 5.13). We do note, however, that many businesses do not think in terms of changes in assets and liabilities but in terms of cash flows and business processes that determine these cash flows. To many companies, the revenue-expense approach with allocations is a more intuitive concept than the asset-liability approach. We do not believe there is more (undesirable) flexibility with the revenue-expense approach, as both approaches depend on a variety of allocations and judgments. For example, the proposed relative fair value measurement of contract elements is clearly an allocation rather than an individual measurement of the respective elements or any group of elements. A similar observation holds for the continuous recognition of, say, a warranty obligation as in DP A28 – which obviously is an allocation.

Moreover, the DP combines elements from a more formal, legalistic approach and an approach based on the substance of the contracts. This is particularly apparent from the discussion of when a performance obligation is satisfied, that is, with the transfer of control. In many cases, particularly if services are transferred continuously, it is hard to apply on a consistent basis.

Specific comments

Q1. *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?*

We agree that the proposal should state a single revenue recognition principle as it is the objective of the DP. The proposed asset-liability approach is consistent with the boards' preference for this approach relative to the revenue-expense approach (but see our general comments above).

The boards note in DP 2.10 the possibility to recognise revenue "earlier", which depends on the measurement model of the assets that will be subject to a contract. Of course, such a possibility may ultimately interact with the single revenue recognition principle and create inconsistencies.

The DP proposes netting of contract assets and liabilities. We do not consider the parallel with forward contracts (as stated in DP 2.24) convincing; derivatives are usually settled by transferring the net of the claims, whereas customer contracts are not as the main feature of such contracts is the delivery of goods or services in total, rather than some net position. We believe that the gross performance obligation and the consideration are important for investors to assess the future expected capacity usage, particular in industries that heavily rely on construction contracts. Therefore, it might provide decision-useful information to present or disclose the gross assets and liabilities.

Q2. *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?*

Some contracts include terms which provide that the supplier of – say a power plant – transfers the plant, but is responsible for operating the same plant for a long time, and the compensation strongly depends on the outcome of the operations. The control-based revenue recognition model would require recognition of revenue although there is high uncertainty about the future compensation. In such a case risks and rewards or a cash based-model may be more suitable to determine revenue recognition.

Q3. *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.*

We agree with the definition of a contract.

There may be issues of withdrawal from a contract within a prespecified period, based on customer protection legislation, with options of both parties to enter a contract, or with linkages among different contracts.

The boards' reliance on net contract assets and liabilities may be at odds with the legal enforcement of the underlying claims. For example, many contracts stipulate that the contribution is enforceable only if the entity has delivered the whole good or service. If there is a (more than remote) possibility that the good is not at a satisfactory level (eg for technical reasons), under normal IFRSs the contribution would not qualify as an asset (but would be a contingent asset under the current IAS 37). More generally, the reliance on enforceable contractual claims may introduce a dependence on the "form" rather than the "substance" of a contract.

In certain cases a performance obligation (or a part of a performance obligation – see also DP 3.5) may not result from a contract (an “agreement”), but from a legal requirement or other sovereign order (eg to deliver certain goods to the public). Such transaction would not be covered in the present definition, although – in our opinion – satisfying such order does constitute revenue.

Q4. *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.*

We do find the definition of services as assets as a little bit of a stretch of the definition of an asset. What other “assets” do the boards have in mind, which are not goods or services?

Q5. *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?*

We find the timing of delivery a practicable and useful criterion for separately accounting of performance obligations.

Q6. *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?*

Our understanding of the DP’s proposal is that the right of return should be a separate performance obligation (a “service asset”). The entity recognises revenue when it transfers the good to the customer because the entity loses control over this asset. The obligation to accept a return remains and revenue is recognised only after the 90 days period has expired – regardless whether the good has been returned or not. While this concept is consistent with the asset/liability approach in the DP, we do not agree with it, and we think that it is difficult to apply in practice. For example, if the customer returns the good (and therefore uses the “service asset” right of return) the entity would recognise revenue from granting the right of return; hence, it would recognise revenue despite, economically, no sale has occurred. We do not believe such an outcome fairly portrays the results of the entity’s operations.

This result may be reasonable for transactions where customers pay an additional consideration for the right of return (see the examples in DP 3.37), but not for situations where the right of return is granted by law or general business practice (as it is the case in many retail transactions) and the customers do not pay separately for the “service asset”. We suggest testing this concept thoroughly in field tests before including it in the final standard.

Q7. *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?*

We have not come to a unanimous conclusion on this issue. The solution suggested in DP 3.27 seq is that a discount is valuable and, therefore, is a performance obligation. While some agree, others believe that this result is over-conservative if the future "performance promise" still generates a positive margin. So, a gift card would qualify as a performance obligation, but a discount would be a performance obligation only if the cost of fulfilling it is higher than the consideration received. In the particular case where music downloads are probably costless the discount would not qualify as a performance obligation.

Q8. *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.*

We agree that control of the good or service should be the criterion for satisfying a performance obligation. We note, however, that control is not a much more clear-cut criterion than the risks and rewards, as is suggested in the DP. Considering the example in DP 4.14 the accounting would seem to depend on several facts, including, eg, who bears the risk of theft or functioning.

To be consistent with other IFRSs, we suggest using similar criteria as for consolidation and derecognition.

There are specific contracts in which the customer controls the good, but the entity continues to bear substantially all risks and rewards of ownership because the promised consideration depends on the performance of the good (eg for a power plant). Although the control model may be applied in such circumstances it will require significant estimates when measuring the performance obligation.

We agree with the proposed rebuttable presumption that an asset subject to one performance obligation is not transferred until used in another performance obligation (DP 4.56).

Q9. *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.*

We do not agree with the distinction between goods and services in DP 4.38 seq. In Chapter 3, the idea seems to be that services are goods that are consumed immediately at delivery. In the example in DP 4.42 we believe that the steel girders are still goods and not services. The customer does not care how they are produced, but is interested in obtaining the girders. Hence, revenue should be recognised in the example when each girder is completed, as this is the time when the customer takes over (takes control of) the girders. We are not aware that a customer would take over an incomplete girder.

Q10. *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?

We agree with the boards' proposal to initially measure the performance obligation at the original transaction price. This avoids day-1 gains and better depicts the substance of the performance obligation. Day-1 gains are particularly troubling if the costs that are incurred to obtain the contract(s) are material and are incurred in periods other than that in which the contract is signed. Moreover, using the transaction price does not provide the entity with a high degree of discretion as in the case of the current exit price.

(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?

We agree that the performance obligation should not be remeasured except if it is deemed onerous. This approach avoids a high level of discretion for remeasurement.

We agree with requiring a cost trigger for the onerous test. A current price trigger would require the estimation of a selling price of work in progress, which is difficult and subject to a high degree of discretion. Using the selling price to determine whether the performance obligation is onerous may imply recognising of a remeasurement loss that is solely based on opportunity cost rather than on a "real" (nominal) loss. Conversely, as is discussed in DP 5.73 seq, it may lead to a remeasurement loss although the performance obligation is expected to earn a profit margin in future periods.

The DP proposes that each performance obligation should be measured separately and, in particular, should be remeasured if it deemed onerous. Since a contract can contain several performance obligations and the performance obligations are based on an allocation of the transaction price, it may be

that one performance obligation is deemed onerous whereas others are expected to earn a margin. We believe that a remeasurement should only occur if the contract in total is onerous.

The DP is silent on whether a remeasurement of a performance obligation that is deemed onerous should be reversed if the situation changes in a subsequent period. We believe that a reversal should be recognised.

(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.

A current exit value approach may provide useful information if the performance obligation is such that it could effectively be sold in every stage of the work in progress. However, we believe that this case is extremely rare, if existent at all.

(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.

No. Any differentiation would introduce inconsistencies, difficulties in differentiating, and ultimately management discretion.

Q11. *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.*

(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?

Yes. We find it difficult to distinguish between any charges to a customer. It is the total amount that is relevant for the customer to agree to the contract, whatever it is labeled. The entity also has discretion how to label certain amounts of the total contract value.

(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.

The immediate expensing of contract origination costs may distort the entity's financial performance if the expenses are necessary to obtain the respective contract and are directly attributable to the contract. We believe that this situation does not occur often, so is preferable to focus on the typical situation.

We do not understand the reasons for the solution of Example 8 (DP A49-A51). Please expand.

Q12. *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?*

Yes. Any allocation of a surplus due to the bundling of performance obligations in a single contract with a customer is to some extent arbitrary, so the stand-alone selling prices of the performance obligations are an intuitive allocation base. Other potential allocation bases either require much more effort to determine them or are less intuitive.

Q13. *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?*

Yes. This proposal is an immediate consequence of selecting stand-alone selling prices as the allocation base. Using estimates is not an exception but is required in the application of many IFRSs.

Please do not hesitate to contact me if you wish to discuss any aspect of our comment letter in more detail.

Kind regards,

Romuald Bertl
Chairman