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Berlin, 29. Juni 2009

Dear Stig,

EFRAG Draft Comment Letter on IASB Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers'

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on EFRAG's draft comment letter on the IASB Discussion Paper '*Preliminary Views on Revenue Recognition in Contracts with Customers*'. We appreciate the opportunity to comment on EFRAG's draft comment letter.

For the detailed comments we refer to our comment letter to the International Accounting Standards Board's Discussion Paper, which we attached to this letter.

If you would like to discuss any aspects of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President



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Berlin, 24 June 2009

Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers'

Dear David,

We appreciate the opportunity to respond to the International Accounting Standards Board's Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers'. This letter represents the view of the German Accounting Standards Board (GASB). Our main views can be summarized as follows:

- While we support the development of a standard that uses the same revenue recognition approach for all transactions, we do not share the conclusions drawn in the Discussion Paper (DP) that this single revenue recognition approach should be that revenue is recognized upon fulfilment of contractual performance obligations. Instead, we prefer as the single revenue recognition approach the so called continuous approach under which revenue is recognised continuously over the course of the contract as the contract progresses (see EFRAG PAAinE Discussion Paper - Revenue Recognition – A European Contribution, pages 49 – 64). Compared to the approach proposed in the DP, the continuous approach provides more decision-useful information to users of financial statements about the activity and performance of the reporting entity.

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- We believe that the criteria proposed in the Discussion Paper for separating performance obligations are insufficient to appropriately account for multi element arrangements.
- Furthermore, we believe that certain cross cutting issues need to be addressed to achieve consistent accounting for similar events and transactions. Among those is the issue whether a liability that represents a performance obligation arising from a contract with a customer should be measured on the same basis as other liabilities.

For detailed comments we refer to the appendices to this comment letter. Appendix A provides our responses to the questions in the DP, while Appendix B provides our comments on issues discussed by the IASB after the issuance of the DP.

If you want to discuss any aspects of this letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President



APPENDIX A

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

The GASB agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability.

Some argue that the existing approaches in IAS 11 and IAS 18 have worked quite well and that the existing revenue literature works for the vast majority of transactions. In other words, if a change needs to be made, it does – according to those supporting this position - not need to be a big one, so it is not necessary to ask fundamental questions about revenue; instead it is necessary only to ask what 'add-ons' and exceptions need to be made to the existing material.

We do not share this view, because this would mean that different standards would still be based on different revenue accounting principles. That in turn would mean there would still be boundaries between principles that will be problematic and it would still be difficult to extrapolate the existing material to address new types of transactions that will emerge in the future. In addition different views of what revenue is and of how financial statements should portray an entity's revenue-related activities would continue. In other words, such a 'keep but improve current standards' approach would provide only temporary relief.

A focus on the contract asset or liability

The GASB is of the opinion that revenue can only arise on the basis of a contract. We are also in favour of applying the asset-liability approach as a starting point of a comprehensive revenue recognition model. We also agree that an entity should recognise revenue from increases in its net position in a contract with a customer. But, instead of presenting the corresponding assets and liabilities in the balance sheet on a net basis, we would go for a gross presentation, because this allows users to assess the amount of contract assets and contract liabilities.

However, applying the asset-liability approach in the context of revenue recognition, we prefer that only 'assets and liabilities' are recognised, which are agreed upon in the contract by the two parties. Accordingly, we would disagree with any other approach, which for example would consider expectations on future contract extension, because otherwise revenue recognition would not rest upon a reliable basis anymore.

Changes in an entity's contract asset or contract liability

We do not share the conclusions drawn in the DP that the fulfilment of the contractual performance obligation is the indicator for recognising revenue. Instead, we prefer the so called continuous approach under which revenue is recognised as the performance under the contract progresses (see EFRAG PAAinE Discussion Paper - Revenue Recognition – A European Contribution, pages 49 – 64). We believe that this approach provides more decision-useful information to users of financial statements about the activity and performance of the reporting entity.

In our opinion, the approach of the DP and the continuous approach result in the same pattern of revenue recognition whenever the contracted good or service is fully delivered in one accounting period. Such transactions comprise most sales of pre-produced (off-the-shelf) goods and thus account for the majority of all revenue generating transactions.



However, whenever the contracted good or service is (partially) delivered in more than one reporting period differences between the approach proposed in the DP and the continuous approach emerge (see answer to question 2). In our opinion, the key test of any proposed accounting solution is its usefulness to users of the financial statements. With regard to transactions with delivery in different reporting periods, we believe that critical event approaches like the approach in the DP do not give users the information that they want as it may present a loss position or zero-profit position for a reporting entity although it may be working on a highly profitable project and may be close to the completion of the project with the completion virtually certain. We believe that the profitability and thus performance of a reporting entity is better presented under an approach to revenue recognition that results in revenue being recognised as the reporting entity's performance under a contract progresses – and the approach that does that most effectively is the continuous approach.

Under the continuous approach, similar to the approach proposed in the DP, revenue would arise as a reduction of the performance obligation with the performance obligation being reduced by the vendor's performance in completing the promised good or service. Some could argue that the performance obligation does not change only by contract progress as long as the performance obligation is not fulfilled in total by delivery to the customer. However, we believe that this conclusion is based on a legalistic understanding of a performance obligation. If the performance obligation is seen as an economic obligation, a reduction is achieved by progressing in the contract. Alternatively, assuming the legal perspective of the performance obligation is preferred, the same effect could also be reached by recognising an 'asset in progress' where its measurement considers the profit expected for the contract according to the progress achieved (as long as such profit is probable). Hence, revenue would be recognised as an increase of this 'asset'.



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?

The GASB believes that the boards' proposed principle would not provide decision-useful information especially for the following contracts:

For long-term construction contracts with a non-continuous transfer of assets, the difference between the DP's approach and the continuous approach is obvious and fundamental. Under the approach in the DP, no revenue will be recognised until the work is complete and the contracted good is delivered. This issue was considered during the development of IAS 11 and at that time the conclusion was reached that recognising revenue only at the end of a long-term construction contract did not give users the information that they wanted. We are of the opinion that the information needs of users with regard to these contracts have not changed since then.

This is in particular true for some, if not many, construction-type contracts where control over the contracted asset is transferred to the customer at a single point in time at the end of the contract. Often that single point in time is in a later reporting period than the period in which most of the activities relating to the contract have been carried out. Under the revenue recognition model proposed in the DP, no revenue on such contracts would be recognised until the delivery of the contracted good. And that would mean, unless some other type of credit entry that considers the margin on the contract is made in the income statement, that no profit on the contract would be recognised until the end of the contract either. That would be the case even though the entity has in fact been very busy and successful on activities being carried out pursuant to contracts with customers prior to that. We do not think this will result in decision useful information.

This concern also applies for multi-element arrangements. If, for whatever reason, separate performance obligations resulting from one multi element arrangement can-



not be separated the approach proposed in the DP does not allow recognising revenue until the contract and hence all performance obligations are fulfilled. In such a case, the reporting may not show a positive margin although some of the deliverables under the multi element arrangement have already been delivered.

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.

The GASB does not agree with the boards' definition of a contract. We think the IFRSs should have only one definition of a contract because different definitions might be interpreted in different ways. We would prefer the definition of a contract given in IAS 32.13, but shift the focus from a legal perspective to a more economic view. In other words, we suggest not sticking to the term "enforceable" as the main delimitation criterion, but emphasising the term "the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law". Although the discussion paper describes the two definitions as consistent, we think that the definition in IAS 32.13 is more suitable for appropriate interpretation and application of the economic substance of such contracts. We would prefer that understanding because we are of the opinion that revenue should be based on the notion that a contract leads to economic consequences, rather than enforceable rights and obligations.

Some argue that applying an asset/liability approach and therefore focusing on increases in assets and decreases in liabilities, causes the need to focus on enforceable contractual rights and enforceable obligations. We do not share this view as outlined in the preceding paragraph. In addition, not all assets and liabilities are based on enforceable contractual rights or obligations. For example, liabilities that are based on constructive obligations might not be enforceable. It would therefore not be correct to argue that the asset/liability approach per se requires a focus on enforceable contractual rights and obligations.



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.

We think that the boards' proposed definition of a performance obligation provides a starting point but is not sufficient to identify consistently the deliverables in (or components of) a contract. We believe that the definition creates issues particularly in the determination whether a contract promises a good or a service, or both.

For example, take a translator who agrees to translate a text which consists of 100 pages. For such a transaction the definition of a performance obligation in the DP creates but does not answer the following questions:

- Is the translator obliged to provide a service (i.e. the translation) or is he obliged to provide a certain outcome, the whole translated text.
- Are the different translated pages separate goods or is the entire text one good?

We tend to the view that – independent of a possible stand-alone value of each page – the whole translated text is one good, because a pre-defined success (i.e. the translation of 100 pages) is agreed, rather than the pure service of translation. Nevertheless, we are aware that someone could argue that a service has to be provided. Both views would result in different revenue recognition patterns under the DP as for the service a continuous transfer is assumed.

The determination whether a deliverable is a good that is transferred upon completion or a service that is transferred continuously has to be made for each case on an individual basis and may be arbitrary or driven by form rather than substance (for ex-



ample if a continuous transfer is only assumed when each translated page, upon completion is faxed to the customer). In our view, the above unresolved issues arising under the DP's definition represent an additional argument in favour of the continuous approach. This is because the question, whether the translator is obliged to provide the translation or the whole translated text, does not matter and in both cases the revenue recognition pattern would be the same. The continuous approach avoids setting an artificial borderline.

Furthermore, take a customer who contracts with a cleaning company a one year cleaning service for the customer's offices. Under German civil law such a contract would not be classified as a service contract because not only the cleaning service itself is subject of the agreement, but also the clean rooms, i.e. the cleaning company's obligation is to accomplish cleaned rooms throughout a period of one year which is completed after one year only. We have serious doubts whether the distinction of services and goods as used in the DP is useful to accomplish an appropriate conclusion for our example as presented.

Because of these problems to distinguish between a contract which promises the transfer of a good and a contract which promises the provision of a service, we ask the IASB to reconsider and rework the definition currently stated in the DP.

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?

For two reasons, the GASB does not 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:



- Several accounting standards, including IAS 1, require separate disclosure (be it on the face of the income statement or in the notes) of different classes of revenue (e.g. product versus service revenue) and such reporting of different revenue streams is useful to investors. However, for such disclosures separate accounting for different performance obligations is needed even if the different performance obligations are satisfied in the same period.
- A separation of deliverables that is only based on the timing of delivery may divide one good into several performance obligations without economic substance. Take a machinery entity which sells to a customer a production machine. The vendor delivers to the customer the production machine but without engine in one period and delivers the engine in the following period. The machine without engine is likely without use to the customer. Nevertheless, a separation solely based on timing of delivery would view the production machine without engine and the engine as two performance obligations.

In our opinion, the unit of account (i.e. single performance obligation) should be driven by the substance of the contractual arrangement itself and not by the timing of the transfer of single components.

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?

We do not think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation. We prefer the so called 'failed sale' approach for the following reasons:

- If we look at many homogeneous transactions, both approaches should theoretically result in the same amount and timing of revenue recognition. Under the failed sale approach the amount of revenue to be deferred is determined based on the



probability of the returns (i.e., if three out of ten return rights are expected to be exercised, 30% of the revenue is deferred – in line with current application of IAS 18; see also SFAS 48 for details). On the other hand, under the performance obligation approach the return option has to be measured and the key driver of such measurement is the probability that the option is exercised. Thus, from a user perspective both approaches provide the same decision-useful information which results in no approach taking preference over the other for homogeneous transactions.

- For heterogeneous transaction the difficulty of measurement is obvious. How shall a stand-alone sales price for a return right be estimated if no probability of return can be estimated? Under the failed sale approach, at least as currently applied under IAS 18 as well as the guidance in SFAS 48, all revenue is deferred until the return right is exercised or expires, if the probability of a return cannot be reasonably estimated. One may argue now that also under the performance obligation approach a requirement could be established deferring all revenue until exercise or expiration of the return right whenever the return option cannot be measured reliably. We believe, however, that such requirement better fits with the failed sales approach than with the performance obligation approach.

Question 7

Do you think that sales incentives (e.g. 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 think that sales incentives give rise to separate performance obligations if they are provided in a contract with a customer and provide an incremental benefit for the customer. This is because if there is an incremental benefit for the customers, there must be some obligation on the side of the vendor and the vendor cannot avoid these economic consequences. In our opinion, this meets the nature of a performance obligation.

gation and hence, should be treated as separate performance obligations as far as it is not immaterial.

On the other hand, some do not believe that a separate performance obligation exists in this discount example because the offer is not considered part of the contract related to the first purchase which has been accepted by the customer. They believe that in the above future discount example the renewal option would need to be exercised and thus the discount offer accepted by the customer before a contract – and hence a performance obligation – exists in relation to the future purchases.

However, we are of the opinion that a performance obligation exists because the entity has to stand ready to give the incentives away, if the customer decides to make a second purchase. However, this performance obligation does not consist of the obligation to transfer an individual good, but rather consists of the obligation to enter into a contract with the customer under pre-defined conditions.

Therefore, we would conclude that in both cases mentioned in paragraph 3.27 a separate performance obligation exists:

- In the TuneCo case the incremental benefit consists of the gift card, which has a stand-alone value for the customer.
- The same applies for the SongCo case. In this case the customer receives a 40 per cent discount for purchases up to CU100, which also has an incremental value for the customer.

Furthermore, this approach solves the special case of so called front loading, e.g. selling a service for a period of an initial period of one year at a fixed price and granting a renewal option for the same service for a second year at a high discount. We believe that in such a case the revenue recognition for the initial period should consider that a high discount is granted as part of the renewal option. Qualifying the discount as separate performance obligation allows this consideration and provides an allocation effect.



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.

As already mentioned, we do not share the approach focusing on the customer perspective as described in the DP. Thus, we are of the opinion that revenue recognition should not be driven by the change of control. We prefer that revenue be a measure of activities carried out to fulfil contracts with customers. This notion is not necessarily connected with either the transfer of an asset or with the control of an asset.

Furthermore, we have doubts that the approach described in the DP is consistent. On the one hand the satisfaction of a performance obligation depends on the individual contract and the legal jurisdiction applicable to this contract. On the other hand, the DP appears to assume that transfer of control satisfies the performance obligation. Thus problems will arise whenever a jurisdiction (a) either does not require transfer of control to satisfy a performance obligation or (b) requires more than transfer of control to satisfy a performance obligation.

Additionally, it seems to us that the notion of control is not used consistently in different IASB standards.

Moreover, it seems to us that there is a conceptual conflict between the reference of control to a 'promised good' and the fact that with regard to the identification of separate performance obligations the 'promised good' itself may not represent the unit of account, as the DP proposes that, in concept, the 'promised good' can be separated into many performance obligations (see paragraph 3.21). Hence, conceptually the control of the 'promised good' is not necessarily identical with the satisfaction of the performance obligation.



Finally, with regard to the term ‘promised good’, we wonder how to draw the line between a wrong delivery and a supply failure. For example, if a buyer orders one good and gets a totally different good, he achieves control over this good, which is not the ‘promised good’. However, the question arises how different must a good be, in order to not be the ‘promised good’.

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.

In our answer to question 2 we expressed our opinion that the information needs of users with regard to IAS 11 type construction contracts with non-continuous transfer of assets – according to our experience the common type of such contracts - are not met by the proposal in the DP according to which revenue is recognised only when a performance obligation is satisfied. We note that the proposal would result in a significant change to existing practice, with the recognition of revenue occurring much later than at present on these construction-type contracts. As the objective of financial statements is to provide decision-useful information to users of financial statements, we have been considering whether this accounting effect would result in more decision-useful information than existing standards. We believe that the proposed model results in reducing the usefulness of the revenue number for construction-type contracts that do not involve a continuous transfer of the asset being constructed for the customer.

Furthermore, we are of the opinion that this is also true for contracts other than construction contracts with non-continuous transfer of assets. Focusing on satisfaction of a performance obligation does not make the revenue numbers reflect whether an entity has undertaken any activities to fulfil the performance obligation or not. For example, according to the proposal in the DP a contract, where the seller has fulfilled economically 99 % of the performance obligation, is – from a revenue perspective –



treated in the same way as a contract where the entity has not begun yet to carry out any activities to satisfy the performance obligation. The revenue recognition approach proposed in the DP does not mirror this important difference in the company's performance reporting.

MEASUREMENT OF PERFORMANCE OBLIGATIONS

Question 10 (a)

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

The GASB agrees that performance obligations should be measured initially at the transaction price because we share the opinion of the IASB/FASB that a current exit price would rarely be observable for the remaining performance obligations in a contract with a customer. Furthermore, we seriously doubt the relevance of a current exit price approach because the entity's reporting should reflect its own performance. This is underpinned by the fact that every selling situation is unique, so that different prices can not really be compared with each other, because the individual purchase decision is not only the result of a comparison of different prices for the same good, but rather is influenced by a variety of other factors (e.g. preference of a special brand, short-term availability of the good etc).

Nevertheless, a key issue that needs to be addressed is whether a liability that represents a performance obligation arising from a contract with a customer should be measured on the same basis as other liabilities; for example, a financial liability or a litigation liability or a liability arising from an insurance contract. We encourage the IASB to tackle this issue.



Question 10 (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 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 because we see no adequate alternative to this approach. In particular, we believe that a current price trigger approach is not an adequate solution because in our opinion the entire margin has to act as a buffer to absorb adverse changes in circumstances.

Bearing this in mind, we nevertheless encourage the IASB to clarify what is meant by the term 'cost' in the following exposure draft. In our view, only the direct costs of providing the good or service should be included in the onerous test because it seems to us that from a user's perspective this is the most relevant information.

Furthermore, we believe it would be helpful if the IASB clarifies the unit of account with regard to the onerous contract test. Some might argue that the whole contract is the unit of account, i.e. if a contract consists of more than one performance obligation, with regard to the onerous test these performance obligations have to be measured as a single obligation. We do not share this view. We believe that every performance obligation is a separate unit of account, and has to be accounted for separately from other performance obligations of the same contract. Our view seems to be consistent with allocating the transaction price to the performance obligations on the basis of the entity's stand-alone selling prices, which indicates that every performance obligation has to be seen as an individual obligation. Additionally, for presentation purposes this allows a clear allocation of the provision to the corresponding performance obligation. A further important benefit is that this approach is easier to apply in practice.

Take, for example, a multi element arrangement consisting of delivering a good (stand-alone sales price = € 100; cost = € 60) at the end of period one and a fixed fee installation service to be provided over the periods 2 to 5 (stand-alone sales price = €



80, estimated cost = € 70). The total contract price is € 180 and thus equals the total of the stand-alone sales prices. We believe that after allocating the stand-alone sales prices to the two deliverables, the deliverables should be accounted for separately. I.e. if the cost estimate for the installation service changes to € 90, the entity would have to recognise a provision of € 10 although the overall arrangement is still profitable. Thus for the accounting for the installation service it is not necessary to track whether the service was originally sold on a stand-alone basis or as part of a multi element arrangement.

Finally, we would like to clarify that in our opinion if an entity has a contract that becomes onerous, the difference between the stand-alone selling price of the good or service and the expected costs to satisfy the corresponding performance obligation should be recorded as a provision with a corresponding expense rather than an increase in the performance obligation with a debit to revenue. Thus the accounting for the contract becoming onerous is an additional expense for recording the provision which is released – (to reduce expense) in the periods in which the cost to satisfy the performance obligation are recorded. We believe that this accounting is preferable over both,

- an approach under which negative revenue is recognised when the performance obligation is remeasured and higher positive revenue is recognised when the performance obligation is satisfied;
- an approach under which an expense is recognised when the performance obligation is remeasured and higher positive revenue is recognised when the performance obligation is satisfied (this would result in total revenue exceeding the contractual consideration)



Question 10 (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.

Question 10 (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.

We notice that the IASB/FASB have not excluded any particular contracts with customers from the proposed model. In general, we agree that there should only be one measurement approach, which fits all different types of contract. As mentioned above, in our opinion this aim is met by the continuous approach, which measures the activity undertaken pursuant to a customer contract. However, we have doubts that the measurement approach proposed in the DP also meets this objective. We question if this approach provides decision-useful information especially for the following contracts:

- Financial instruments and some non-financial instrument contracts that otherwise would be in the scope of standards such as IAS 39 Financial Instruments: Recognition and Measurement. In the IASB's view, because of the potential volatility in the value of those contracts, the proposed revenue recognition model might not always provide decision-useful information about them.
- Insurance contracts that are in the scope of IFRS 4 Insurance Contracts. The IASB/FASB have an active project on the agenda for insurance contracts. In the IASB's view, the proposed revenue recognition model might provide decision-useful information for some contracts that the insurance project is considering, but not all of them.



- Leasing contracts that are in the scope of IAS 17 Leases. The IASB/FASB have a joint project on the agenda for lease accounting, but one concentrating initially on developing an improved lessee accounting model. The boards have not yet decided how the proposed revenue recognition model would apply to lessor accounting.

In general, we have doubts that the measurement approach proposed in the DP works for contracts whose measurement is based on the fair value concept.

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 (e.g. 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?

(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.

We 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, because it seems to be difficult to make a distinction between amounts charged to the customer for cost of obtaining a contract and fees charged for the deliverables under the arrangement.



We believe however, that all costs, which are triggered by the contract conclusion or which are necessary to satisfy the performance obligation, i.e. all incremental costs, should be matched with the respective contract revenue.

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?

We 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.

We alternatively discussed allocating the transaction price on the basis of the fair value of each good or service. We noted that this basis for allocation would be in line with the wording of IFRIC 13. Under this interpretation, the consideration allocated to the award credits shall be measured by reference to the fair value, i.e. the amount for which the award credits could be sold separately. Assuming the term 'fair value' in this context was understood as an exit price, we nevertheless doubt that a fair value would be the adequate basis of allocation, because of the problems which could occur to figure out the fair value of an individual good or service. We therefore prefer the approach proposed in the DP.

Nevertheless, we believe that the term 'entity's stand-alone selling price' needs to be clarified, particularly for scenarios in which an entity sells the same good to different customers at different prices. For such scenarios the definition of 'stand-alone selling price' needs to clarify with respect to what customer the term refers to: to the particular customer or to the average of all customers of the same good or service of the reporting entity? We think the stand-alone selling price should refer to the price the entity would have charged the particular customer, if this particular customer – and



not any other customer – would have bought the good or service separately, because the proposed concept of revenue recognition is based on the contract with the individual customer. So, it seems to be consistent that also the stand-alone selling price is referring to the individual customer.

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?

The GASB generally agrees with 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 the purpose of allocating the transaction price.

Nevertheless and in obvious contrast to the DP, we believe that there are circumstances in which a stand-alone selling price cannot be estimated reliably. For such scenarios guidance should be provided. We believe that the following hierarchy should apply:

- Level 1: As far as stand-alone selling prices for the contracted goods and services are observable these observable sales prices should be used.
- Level 2: As far as stand-alone selling prices for the contracted goods and services are not observable but reliably estimable these estimated sales prices should be used.
- Level 3: If stand-alone selling prices are observable or reliably estimable for some but not all contracted goods and services the residual method should be used; i.e. revenue based on the observable and reliably estimable sales prices are allocated to those goods and services that have such observable or reliably estimable prices



with the residual being allocated to the remaining goods and services on a “best estimate” basis.

- Level 4: Contracted goods and services for which an allocation is not possible based on level 1 to 3 should not be separated but be accounted for as one performance obligation

APPENDIX B

In addition to the questions raised in the DP we would like to comment on the following issues discussed by the IASB after publishing the DP:

Time value of money

The IASB has decided tentatively that:

- *An entity's net contract position should reflect the time value of money whenever the effect would be material. In considering whether to provide guidance on materiality in this context, the Board noted that IAS 39 states that short-term receivables and payables with no stated interest rate may be measured at the original invoice amount if the effect of discounting is immaterial.*
- *The discount rate should be the rate at which the entity and its customer would have entered into a financing transaction that did not involve the provision of other goods and services.*
- *The effect of financing should be presented separately from the revenue for other goods and services.*

We discussed these views and question, whether it is conceptually consistent to use as a discount rate the rate of a stand-alone financing arrangement. We believe that the financing component should not be treated differently from any other performance obligation, which would be measured by allocating the transaction price based on the stand-alone selling prices of the different goods or services. As the example below shows, a difference between our view and the IASB's tentative view arises whenever the total contract consideration does not equal the total of the stand-alone sales prices:

- Scenario 1: Assume an arrangement under which a vendor sells to a customer for a total price of €80 good A (stand-alone sales price = €80) and gives to the cus-



tomer for free good B (stand-alone sales price = € 20). The total contract consideration would be allocated to the deliverables based on relative stand-alone sales prices, thus € 64 would be allocated to good A and € 16 to good B.

- Now assume an arrangement under which a vendor sells to a customer for a total price of € 80 good A (stand-alone sales price = € 80) and grants to the customer extended payment terms without charging interest. If the vendor had granted a stand-alone loan to the customer for the same term the interest charge would have been € 20. Under the IASB's tentative view the discount rate of stand-alone financing transaction should be used to account for time value of money, i.e. € 20 (interest amount based on stand-alone financing transaction) would be allocated to the financing element. In contrast, we believe that the financing element should be treated like other performance obligations and thus – in analogy to Scenario 1 – only € 16 should be allocated to the financing element.

Non-cash consideration

The IASB has decided tentatively that:

- *An entity should measure non-cash consideration at its fair value.*
- *If an entity cannot estimate reliably the fair value of a non-cash consideration, it should measure the consideration indirectly by reference to the fair value of the promised goods and services.*
- *An entity should not recognise revenue if a transaction lacks commercial substance.*

With regard to the view, that an entity should measure the consideration indirectly by reference to the fair value of the promised goods and services, if it cannot estimate reliably the fair value of a non-cash consideration, we would prefer to measure the consideration indirectly by reference to the stand-alone selling prices of the promised goods and services. We think that the stand-alone selling prices should be the start-



ing point for the measurement, because at the end the consideration amount has to be allocated on the same basis.

Renewal options

The IASB has decided tentatively that:

- *A renewal option should be accounted for as a performance obligation if the stand-alone selling price of that option can be determined without undue cost.*
- *Some of the consideration would be allocated to the option and recognised as revenue when the obligation is satisfied.*

We agree that the renewal options should be accounted for as separate performance obligations if it provides an incremental benefit to the customer.