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By e-mail: [commentletter@efrag.org](mailto:commentletter@efrag.org)

9 March 2012

Dear Sir/Madam,

**Re. EFRAG Draft Comment Letter: Revenue from contracts with customers**

The Danish Accounting Standards Committee set up by "FSR – danske revisorer" is pleased to respond to EFRAG's Draft Comment Letter on IASB Exposure draft 2011/6: Revenue from contracts with customers.

The Committee has discussed the EFRAG Draft Comment Letter and we generally agree with the comments and observations made by EFRAG.

Especially, we support strongly EFRAG's answers regarding onerous contracts as we do not agree in the Exposure draft wording on this issue and the requirement to test onerous contracts at performance obligation level. Furthermore, we support the EFRAG concerns raised on right of return, customer acceptance clause and put options as we find it difficult to define the different situations and accounting treatments when using the current wording in the ED.

As an appendix to this letter we have summarised observations made by the Danish Accounting Standards Committee when discussing EFRAG's draft comment letter.

We would be happy to elaborate further on our comments should you wish so.

Kind regards

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**Q1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?**

Side 2

We agree with EFRAG; the issues that raised concerns in the former exposure draft seem to be solved with the new wording of sections 35 and 36. As regards the right to consideration, DASC believes that a reference to section 82 would help specify that the entity must be reasonably certain of being entitled to the consideration before revenue is recognized.

**Q2: Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?**

*EFRAG questions for constituents:*

*(a) In which standard(s) do you think guidance for impairment of conditional and unconditional rights to consideration should be provided?*

*(b) Should specific guidance be developed for how to present uncollectible amounts or should the general guidance of IAS 1 be applied?*

*(c) If you think specific guidance should be provided:*

*i. Should this guidance be included in the standard on revenue recognition or in IAS 1?*

*ii. How should uncollectible amounts be presented in the statement of comprehensive income initially?*

*iii. How should subsequent changes in the estimates of uncollectible amounts be presented in the statement of comprehensive income?*

(a): We think the guidance should be presented together. Whether this means that the guidance cannot be presented in IAS 39/IFRS 9 as the contract asset is not a financial instrument is for the IASB to decide. Furthermore, specific references between IFRS 9/IAS 39 and the new revenue standard should make discussions about which standard is the right one unnecessary.

Side 3

(b): We think IAS 1 should be applied as long as the notes include disclosure of the amounts specified for uncollectible receivables and contract assets. Until IASB develops a new presentation standard, there seems to be no need for the IASB to require specific presentation of uncollectible receivables or contract assets as a separate line item in the statement of comprehensive income. In addition, we think that for many entities the amount that would be reflected in the separate line item will not be material and should therefore not require separate disclosure.

(c1): If, on the other hand, new guidance is provided, the guidance should be included in IAS 1.

**Q3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?**

DASC agrees with EFRAG but finds that the standard would be easier to understand and use if section 53 was also referred to section 81. This would eliminate doubts as to whether a contingent consideration is subject to section 81 on reasonably assured considerations.

Regarding section 82 (b), DASC tends to agree with EFRAG but does not find the current wording in the ED so misleading as to make it unacceptable. Section 82

only lists a number of indicators of when an entity's experience might not be enough to conclude that the consideration is reasonably assured. IASB does not say that the indicator is conclusive on its own.

Side 4

Regarding section 85, DASC agrees with EFRAG. If the section is necessary for purposes of licensing intellectual property, the section should both include sales-based and production-based royalty and other types of royalty where the consideration depends on a future event which the entity does not control. Furthermore, we agree that the wording should be changed to include both fixed and variable consideration and a combination of both.

**Q4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?**

DASC agrees with EFRAG on all issues. As stated in relation to the discussion paper and the first ED on revenue from contracts with customers, the requirement to address onerous contracts at performance obligation level does not make sense if the contract as a whole is profitable. Therefore, we would strongly support EFRAG's remarks in the comment letter to IASB and supports that the onerous contracts are evaluated at contract level.

We do not think that the current ED can be used in practice as many entities are parties to contracts with customers where the contract as a whole is profitable but certain performance obligations might be onerous. In such a situation, we do not find it appropriate to recognize an onerous contract as it does not consider the economic facts behind the contract.

Furthermore, we do not support the IASB proposal in the ED to only recognize onerous performance obligations when they are based in a contract which is recognized over time and for a period longer than 1 year. If a company enters into a contract in December and has a financial year ending on 31 December, an onerous contract lasting only, say, 6-9 months can be material and should therefore be recognized even if it runs for less than one year. Also, we do not support that only onerous contracts with customers recognized over time should be recognized. Contracts with customers where the control changes at one point

in time can also be onerous and should, like other contracts (IAS 37), be recognized at the time when they become onerous.

Side 5

**Q5: The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:**

- (a) The disaggregation of revenue (paragraphs 114 and 115);**
- (b) A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117);**
- (c) An analysis of the entity's remaining performance obligations (paragraphs 119–121);**
- (d) Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123);**
- (e) A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).**

**Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports?**

DASC agrees with EFRAG. The proposed disclosure in IAS 34 seems onerous and burdensome to preparers and does not achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. In addition, we think the IASB is on a slippery road here. We don't see it appropriate for a standard on revenue to amend IAS 34 in such a way as to require disclosures that are not in line with the principles currently set out in IAS 34 (see IAS 34.IN6). What would come next? Extended disclosure on leases in the interim financial report? If IASB wants to

make changes to the standard on interim reporting, they should consider this as a separate project. Furthermore, some of the proposed disclosures does not seem important for an interim report, e.g. the reconciliation of balances. When such changes are suggested we would also ask why those reconciliations are more important to interim financial reporting than reconciliations from other standards, e.g. IAS 16, which are currently not required under IAS 34.

Side 6

**Q6: For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?**

DASC agrees with EFRAG's comments on the proposed accounting treatment of a sale of non-financial assets according to IAS 16 and IAS 38. Furthermore, DASC agrees with EFRAG's concerns that the wording should be changed.

#### **Further EFRAG Questions**

**Time value of money: EFRAG thinks it should be clarified how to allocate different payments to various transfers of promised goods or services when accounting for the time value of money.**

##### *Question to constituents*

*Do you think a practical expedient regarding the time value of money should be included in the ED (see paragraphs 10 - 13 above)? If so, what should be included in its scope?*

DASC supports the group of EFRAG TEG members arguing for the removal of the practical expedient. In our view, the time value of money should only be guided by its significance and thus only reflected in the financial statements if the time value of money is significant to the financial statements.

**Offsetting contract assets and advances received: EFRAG disagrees that the remaining rights and performance obligations in a contract should always be presented on a net basis.**

Side 7

Contrary to EFRAG, the DASC supports the current wording of the ED. We agree that current IAS 32 requires a legal right to offset and thus the treatment of contract assets and contract liabilities would be different from the treatment of financial assets and financial liabilities. It is our view that the IASB has a point in saying that if offsetting would not be allowed it would be counterintuitive and difficult due to the fact that the entity at contract interception in such a situation would have to foresee what the legal outcome would be if the contract were breached and what the entity would be awarded by the court if litigation were to take place.

**Right of return: EFRAG is concerned that (1) it is difficult to distinguish between sale with a right of return; customer acceptance and repurchase agreements and (2) the guidance will result in economically similar transactions will be accounted for differently.**

*Questions to constituents:*

*a) Are you concerned that in practice it will often be difficult to distinguish between the different situations listed in paragraph 25 above where a customer has not irrevocably taken control of assets provided by the entity?*

*b) Do you think the three situations listed in paragraph 25 above differ economically? If so, how and in what circumstances would it be important to distinguish between the three circumstances?*

*c) Do you think there are situations where a customer has a significant economic incentive in exercising a return right, but the transaction should not be accounted for as a lease?*

*d) How do you think the three situations listed in paragraph 25 above should be accounted for?.*

a) DASC supports EFRAG's concerns. We think that it will often be difficult in practice to distinguish between the three situations listed. Furthermore, DASC thinks that the different accounting treatment could be questioned; in our view a transaction where the customer has a right of return is not obviously different from the acceptance clause situation. On the other hand, we acknowledge that it

is difficult to make a new accounting standard in this area now, but we think the IASB should consider looking into defining the three situations more narrowly and provide further examples of transactions.

Side 8

b) We think the three situations differ depending on what type of goods is sold. Rights of return are often used in retail where the return period is short. In that situation, revenue recognition based on historical experience makes sense also economically and makes even more sense than deferring the recognition until the right of return period expires. Customer acceptance clauses are often used in sales of larger manufactured goods which cannot be recognized over time and where the buyer has to accept the delivery before the goods are sold. In that situation, the control of the asset is handed over to the buyer at acceptance and revenue recognition only takes place at that time, which also makes economic sense to us as the buyer only at that specific point in time accepts control of the asset. The last situation with a put option is often used when goods are transferred to a buyer and the buyer is using the goods for a time period in the business but subsequently returns the used goods to the seller. In that situation, the transfer of control has the same economic characteristics as the transfer of a right to use the goods for a specific time period and therefore is the same as a lease and should be recognized in the same way as a lease.

c) We actually think there are situations where a buyer has a right of return which should not be accounted for as a lease. As mentioned before, the retail industry often uses rights of return where the buyer has a right of return which expires after 1-2 months. In these situations, accounting treatment as a lease would not make economic sense as this is more a question of whether the specific sale ends in a sale or a return of the goods and not a period in which the buyer has had the right to use the goods. Often the buyer cannot use the right of return if the goods have been used.

In our view the IASB should define the three situations more clearly and in doing so consider whether right of return and customer acceptance clauses are likely to be the same but whether the historical experience on which revenue recognition is based is more uncertain in a transaction with a customer acceptance clause, and revenue recognition therefore only takes place when the customer accepts the delivery and the "right of return" lapses.

**Disclosures: EFRAG agrees with the objective of the proposed disclosure requirements and thinks that most of the disclosure requirements will help in meeting the objective. However, we are concerned about the**

costs of providing the information and question whether the benefits of providing a reconciliation of contract balances exceed the costs.

Side 9

*Question to constituents*

*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.*

In general, DASC is always concerned about extensive disclosure requirements as one has to question whether they are acceptable from a cost/benefit point of view. As is usually the situation when new standards are exposed, this exposure draft also includes extensive disclosure requirements. We reiterate our previously expressed view on extensive disclosure requirements and once more would encourage the IASB to discuss a disclosure framework and under which criteria a disclosure requirement is acceptable to both users of financial statements and preparers. We would also suggest that the IASB consider making the disclosure requirements more principle based.

We agree that some disclosures must be provided to meet the objective of the proposed disclosure requirements. The ED includes a lot of required disclosures, including a number of suggested reconciliations where we would think the cost of providing the information exceeds the benefit.

**Early application and effective date: EFRAG thinks that the effective date should be three years from the publication of the standard.**

*Question to constituents*

*EFRAG has discussed whether early adoption should be allowed for existing IFRS reporters. Permitting early adoption by existing IFRS reporters would reduce comparability between companies, but it would allow them to move to the improved standard sooner.*

*Do you think early application of the new standard on revenue recognition should be allowed for entities already reporting under IFRS?*

We think early adoption should be allowed as preparers would otherwise be unable to implement a new accounting standard ahead of its effective date even if it would improve the financial statements. On the other hand, a long implementation period will reduce comparability between companies and therefore, an implementation period which is not too long is preferable.

In general, the IASB might consider whether early adoption should still be an option in the future. We would not think that the choice should be made on a standard by standard basis or change by change basis; it has to be discussed in general.

Side 10