

17 April 2012

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re: Revenue from Contracts with Customers

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the revised exposure draft, *Revenue from Contracts with Customers*, issued by the IASB on 14 November 2011 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG welcomes the IASB's decision to re-expose the proposals. We note that significant concerns that we raised in the first consultation phase have been addressed in the revised proposals. We welcome the thoroughness with which our concerns have been considered in the re-deliberation process. However, EFRAG still disagrees with the proposals to focus on the transfer of goods and services to a customer when recognising revenue. As explained in our comment letter in response to the 2010 ED, EFRAG believes that revenue should be recognised as an entity is establishing a right to consideration. Although the outcome of the two different approaches can be similar, we believe that focusing on the right to consideration would make a principles-based standard easier to explain and to apply.

The re-exposure has allowed constituents to assess whether the revised requirements provide meaningful revenue information, are easy to understand and can be implemented in practice without unjustified costs or difficulties. To support the IASB's effort in developing a robust standard for revenue recognition, EFRAG has, in addition to its usual analysis and due process, organised field-tests with participants from industries which we assessed would be most affected by the proposals. This includes industries with long-term contracts, pharmaceutical companies, utilities, telecommunication companies and software developers. We appreciate the active participation of IASB staff in this effort.

The remarks included in this comment letter are focusing on the specific questions raised in the ED and implementation issues identified by the activities described above. We refer to our comment letter in response to the 2010 ED for more general remarks regarding the proposals of the ED.

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We note that one overall and significant concern that emerges from this second consultation is that the proposed requirements are difficult to understand and lack the clarity necessary for consistent application. We urge the Board to ensure that the final requirements can be easily understood and implemented.

EFRAG is particularly concerned that the ED is unclear on whether or not recognition of revenue is always limited to amounts to which an entity is reasonably assured to be entitled. We note that users, that we have talked to, consider that there should be a close link between revenue and the right to consideration. EFRAG therefore considers that requirements on limiting the amount of revenue recognised as of the reporting date to the amount to which the entity is reasonably assured to be entitled should apply in all circumstances.

EFRAG agrees with the ED that - in few circumstances - it may be necessary to introduce specific guidance on when an entity is considered to be reasonably assured to be entitled to an amount of consideration. We therefore agree with the requirements included in the ED on sales-based variable consideration related to licence agreements for intellectual property, although they represent an exception to the general requirements. However, we recommend that the scope of the exception is broadened to include, for example, production-based variable consideration.

One of the concerns that has been considered by the IASB since the 2010 ED relates to the allocation of the transaction price to the performance obligations included in a contract. We welcome the changes that under certain circumstances require discounts to be allocated to particular performance obligations within a contract. We do, however, disagree with the restriction that contingent amounts of consideration can only be allocated to one or to all performance obligations within a contract.

We acknowledge that the IASB has discussed the onerous test since its 2010 ED. However, we do not agree with the outcome of these discussions. We remain opposed to the onerous test being applied at the performance obligation level, and reaffirm that no loss should be recognised on an overall profitable contract. Furthermore we believe that the onerous test should not be limited to obligations satisfied over a period of time longer than one year. Finally, we think that if there is evidence of an entity's customary practice of satisfying onerous performance obligations, the loss should reflect this expected outcome and not any lower amount the entity could pay for exiting the contract.

In relation to presentation and disclosure, we would firstly like to welcome the change from the 2010 ED that the revenue figure should not be adjusted to reflect the effect of customer credit risk. However, we disagree with the proposal to include material subsequent changes in estimated credit losses in a line item adjacent to revenue as this could distort performance indicators such as gross margin. We also believe that including a requirement to present, as a separate line item adjacent to revenue, the amounts of promised consideration that an entity assesses to be uncollectible because of customer credit risk is overly prescriptive. We believe that existing requirements in IAS 1 *Presentation of Financial Statements* are sufficient to ensure that material items are presented separately when such presentation is relevant to an understanding of the entity's financial performance. That said, we do believe that it is appropriate to require separate disclosure of initially estimated credit losses and subsequent changes to these estimates to the extent they are material to understanding the portion of reported revenue that is expected to result in cash inflows.

In relation to the statement of financial position, EFRAG thinks that advances received should be offset against contract assets only if the entity has a legal right and intention

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to offset advances received against any assets recognised as a result of a transfer of goods or services.

In terms of disclosures, EFRAG believes that the IASB has identified the disclosures that might be necessary to provide users with relevant information. We would, nevertheless, urge the Board to ensure that the requirements are such that disclosures are provided only when relevant and in a cost effective manner. We disagree with the proposal to include a list of specific disclosure requirements in IAS 34 *Interim Financial Reporting*. EFRAG believes that the existing approach to disclosures in IAS 34 strikes the right balance between requiring information that is relevant to users and limiting the costs to preparers. Furthermore, EFRAG does not think disclosure requirements for interim reporting should be considered on a piecemeal basis.

Similar to our concern about the cost-benefit effectiveness of the proposed disclosures, EFRAG believes that the costs of complying with the proposals should be considered for entities with certain types (for example, telecommunication companies).

Our detailed responses to the questions in the ED are set out in Appendix 1. Appendix 2 includes some additional comments for the IASB's consideration. Appendix 3 includes a number of areas where participants in the European field-test (which EFRAG conducted with in cooperation with some European national standard setters) believed the wording of the requirements should be clarified.

If you would like to discuss our comments further, please do not hesitate to contact Rasmus Sommer or me.

Yours sincerely,

Françoise Flores

EFRAG Chairman

APPENDIX 1

The remarks included in this comment letter are focusing on the specific questions raised in the ED and implementation issues identified by the activities described in the cover letter. We refer to our comment letter in response to the 2010 ED for more general remarks regarding the proposals of the ED.

EFRAG's responses to the questions raised in the exposure draft

Question 1

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?

EFRAG's response

EFRAG thinks that a resulting standard on revenue recognition should clarify that revenue should be limited to the amount to which an entity is reasonably assured to be entitled.

- 1 In its comment letter in response to the 2010 ED and during the re-deliberations following the 2010 ED, EFRAG's two main concerns were that:
 - (a) the proposals did not result in revenue being recognised over time when this approach would provide the most useful information, and
 - (b) revenue could be recognised without the entity being reasonably assured of having a right to consideration.
- 2 We think that our concern in paragraph 1(a) above has been resolved by the IASB, as the ED includes specific guidance in paragraphs 35 and 36 on when an entity satisfies a performance obligation over time. EFRAG generally agrees with these criteria. In our view, the criteria are sensible and reflect that the IASB has listened to criticism of the 2010 ED. Nevertheless, as discussed in paragraph 3(e) of Appendix 3, we believe that the criteria need to be clarified.
- 3 We are not convinced our second concern (listed in paragraph 1(b) above) has been solved.
- 4 It is our understanding, from meetings with our User Panel, that users consider that there should be a close link between revenue and the right to consideration. We therefore welcome that one criterion for applying percentage-of-completion accounting in the ED is that the entity's performance does not create an asset with an alternative use to the entity and the entity has a right to payment for performance completed to date.
- 5 However, we note that in other circumstances percentage-of-completion could be applied according to the ED even when the entity does not have a right to consideration. That could happen when either criterion (a), (b)(i) or (b)(ii) in paragraph 35 of the ED is met without criterion (b)(iii) being met. In these cases, the entity has transferred something to the customer without having a current right to payment. We believe that in these cases, where the right to consideration is contingent on future events, the ED should limit the amount of revenue recognised to the amount to which the entity is reasonably assured to be entitled.

- 6 We appreciate that paragraph 81 of the ED limits revenue to the amount that is reasonably assured in cases where the amount is variable. Paragraph 53 of the ED, which explains when an amount is considered 'variable', also refers to 'contingencies'. However, the meaning of 'contingencies' in this context is unclear to us.
- 7 We think that revenue should generally be limited to the amount to which the entity is reasonably assured to be entitled. For example, in some cases an entity may have to deliver two distinct goods to a customer, and may only be entitled to consideration for the first item when it has also delivered the second item. In such cases, we believe that if the entity is not reasonably assured that it will be able to deliver the second item, it should not recognise any revenue when it transfers the first item to the customer. Conversely, if the entity is reasonably assured that it will be able to deliver the second item, we believe it should recognise revenue on the first item when this is transferred to the customer.
- 8 We are, however, aware that some members of the IASB and FASB interpret the ED in a manner that would not result in revenue being limited as explained in paragraph 7 above. They only consider that variable amounts like incentive payments, where the entity is certain that it will receive something, and circumstances that are not under the control of the entity, would result in revenue being limited to the amount to which the entity is reasonably assured to be entitled.
- 9 If the ED is intended to result in the accounting as described in paragraph 7 above then we believe the drafting should be improved to make this clearer. However, we disagree with the ED if it were to require the accounting described in paragraph 8.
- 10 EFRAG acknowledges that the ED will mean that some entities, which currently apply percentage-of-completion accounting, will not be able to do so under the proposed criteria. If criterion (b)(iii) in paragraph 35 of the ED were less restrictive, and would allow for percentage-of-completion accounting when the entity would only have a right to recover its costs (rather than a right to payment that approximates the selling price of the goods or services transferred to date), more entities could apply percentage-of-completion accounting. However, we do not think this alternative would provide useful information when revenue at the same time is constrained to the amount to which the entity is reasonably assured to be entitled. Permitting entities that only have a right to recover costs to apply percentage-of-completion accounting and at the same time limiting the amount of revenue recognised to the amount to which the entity is entitled (the cost), would in our view not result in useful reporting of profit margins and revenue.

Question 2

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's response

EFRAG disagrees with including a requirement to present, as a separate line item adjacent to revenue, the amounts of promised consideration that an entity assesses to be uncollectible because of customer credit risk. Instead, EFRAG thinks it could be appropriate to require separate information about initially estimated credit losses and subsequent changes to these estimates when it is material to understanding the portion of reported revenue that is expected to result in cash inflows.

- 11 As noted in our comment letter in response to the 2010 ED, EFRAG does not think the revenue figure should be reduced to reflect customer credit risk. EFRAG therefore agrees with the 2011 ED that revenue should be reported without deducting estimated credit losses.
- 12 EFRAG also agrees that an entity should account for amounts of promised consideration that the entity assesses to be uncollectible because of the customer's credit risk in the same manner, no matter whether the credit loss is related to a receivable or a contract asset. We appreciate that contract assets are different from receivables, and the risks related to a contract asset are different from those of a receivable. However, we consider that the same risk, the customer credit risk, should be accounted for identically in the two cases. If different requirements were introduced for receivables and contract assets, gains or losses related to credit losses could be reported without changes having occurred in the assessment of a customer's credit risk. These changes could follow from the simple fact that a contract asset had become a receivable. We do not think this would provide useful information.
- 13 While we consider that credit losses related to receivables and contract assets should be accounted for similarly, we can currently not express any opinion about whether the requirements of IFRS 9 are suitable for the impairment of contract assets and receivable, as it is unclear what direction the IASB will follow on this issue. We do, however, stress the importance of the proportionality principle. In other words, the IASB should avoid requiring the use of complex techniques for determining impairment losses that are not material and not a part of the pricing decisions. Therefore, the IASB should develop specific guidance for the impairment of trade receivables that should also be applied for contract assets.
- 14 EFRAG does not agree that a standard on revenue recognition should explicitly require impairment losses on trade receivables and contract assets to be presented in a separate line item adjacent to the revenue line item. In the view of EFRAG, paragraphs 85 and 86 of IAS 1 *Presentation of Financial Statements*, requiring an entity to present additional line items when such a presentation is relevant to an understanding of the entity's financial performance, are sufficient.
- 15 We consider that IFRS should offer some flexibility on whether and how to present credit losses. We note that in most cases credit losses are not material, which means that introducing specific requirements on the presentation of these amounts could result in the presentation of immaterial amounts on the face of the statement of comprehensive income. This would contribute to clutter rather than provide insight to users. Similarly, when credit losses are important, but not very material, we think that in some circumstances it may be most useful only to disclose the amount in the notes to the financial statements to avoid clutter in the statement of comprehensive income.

- 16 While we do not think that specific requirements should be introduced on where to present the impairment losses in the statement of comprehensive income; we do believe that it is appropriate to require separate disclosure of initially estimated credit losses and subsequent changes to these estimates to the extent they are material to understanding the portion of reported revenue that is expected to result in cash inflows.

Question 3

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?

EFrag's response

EFrag thinks that the scope of paragraph 81 needs to be clarified and the scope of paragraph 85 of the ED should be considered and clarified.

- 17 As we mentioned in our response to Question 1, we do not consider the scope of paragraph 81 to be clear. Paragraph 81 refers to situations where the 'consideration to which an entity expects to be entitled is variable'. Paragraph 53 of the ED lists the factors that result in an amount being variable according to the ED. This list includes 'contingencies'. We note that this term is not interpreted consistently by constituents (e.g. some constituents referred to the definition of a contingent asset in IAS 37 paragraph 10 in interpreting 'contingencies'). Therefore, rather than using the term 'contingencies', we think that paragraph 53 (and the heading preceding it) should more clearly describe the intended scope of the paragraph. As explained in our answer to Question 1, we think it is essential that revenue, in all cases, is limited to the amount to which the entity is reasonably assured to be entitled.
- 18 EFRAG agrees with the guidance provided in paragraphs 81 to 83 of the ED. We question whether the indicators listed in paragraph 82 of the ED would always result in an entity's experience not being predictive of the amount of consideration to which the entity will be entitled. However, paragraph 83 of the ED also clearly explains that the presence of any one of the indicators listed in paragraph 82 does not necessarily mean that the entity is not reasonably assured to be entitled to an amount of consideration.
- 19 We generally agree with paragraph 85 of the ED, but we consider the paragraph to represent an exception to the general requirements of the ED, particularly those in paragraphs 81 to 84. If an entity, for example, sells a licence to a customer and the consideration depends fully on the customer's subsequent sales, it is possible that the entity is still reasonably assured that the customer will sell a given minimum quantity. Paragraphs 81 to 84 would therefore require revenue to be recognised at the time when the customer is able to use the licence and at an amount based on the minimum quantity the entity would be reasonably assured

the customer would sell. However, paragraph 85 requires recognition of revenue to be postponed until the customer's subsequent sales occur. While EFRAG considers this treatment to be in conflict with the more general requirements, EFRAG notes that neither users nor preparers according to paragraph BC203 of the Basis for Conclusions considered it useful to apply the general requirements in the situations covered by paragraph 85 of the ED. We, therefore, agree with the decision of the IASB to include an exception to the general requirements in order to make the information provided useful.

20 This being said, we have the following comments on paragraph 85:

- (a) EFRAG thinks it is necessary to consider the scope of the paragraph. In paragraph BC203 of the Basis for Conclusions, it appears as if the paragraph has been introduced to consider situations where factors outside the entity's control could subsequently affect the amount of revenue recognised. In some of these circumstances, an entity would be required to report, throughout the life of the contract, significant adjustments to the amount of revenue recognised at inception of the contract as a result of changes in circumstances. This is considered not to result in useful information. Sales-based royalties are mentioned as an example of such a situation.

As sales-based royalties are just mentioned as an example in paragraph BC203 of the Basis for Conclusion, it is unclear why paragraph 85 of the ED only covers sales-based considerations. In the view of EFRAG, there are many other situations where factors outside the entity's control could affect the amount of revenue recognised and result in significant adjustments to the amount of revenue recognised at inception. For example, it appears as if the paragraph does not cover cases in which an entity is licensing intellectual property for a consideration that varies based on the customer's subsequent production of goods. As the customer's production in many cases will depend on its ability to sell the resulting goods, EFRAG does not understand why a sales-based royalty according to the ED shall be accounted for differently than a production-based royalty. EFRAG believes that the IASB should provide a more robust conceptual argument for the scope exception in paragraph 85.

- (b) As we will further explain in paragraphs 2 and 3 of Appendix 2, we find it difficult to distinguish between contracts covered by paragraph 85 and those that are scoped out of the ED because the counterparty is not a customer but a collaborator or a partner according to paragraph 10 of the ED. We therefore think the IASB has to clarify this distinction.
- (c) Paragraph 85 of the ED refers to 'an additional amount of consideration', which suggests that it only applies in circumstances where the consideration consists of a fixed part and a variable part that depends on the level of the customer's subsequent sales. EFRAG doubts whether this is the intention. In any case we believe that the guidance should also apply to contracts that do not contain a fixed part, because we do not think that contracts where the consideration includes an insignificant fixed amount should be accounted for differently than contracts where the entire consideration varies on the basis of the customer's subsequent sales. Consequently, we think paragraph 85 should be amended as follows:

Notwithstanding the requirements in paragraphs 81-83, if an entity licences intellectual property (see paragraph B33) to a customer and the customer promises to pay an ~~additional~~ amount of consideration that is fully or partly contingent ~~that~~

~~varies on the basis of~~ the customer's subsequent sales of a good or service (for example, a sales-based royalty), the entity is not reasonably assured to be entitled to the ~~additional part of the amount of consideration that is contingent on the customer's subsequent sales~~ until the uncertainty is resolved (ie when the customer's subsequent sales occur).

Question 4

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?

EFRAG's response

EFRAG does not agree with the proposal. EFRAG believes that: (1) the onerous test should be performed at a contract level, (2) it should cover all contracts with customers and (3) an entity's past behaviour when settling onerous contracts (or performance obligations) should be considered when assessing the cost of settling a contract (or performance obligation).

21 EFRAG disagrees with the proposals of the ED that require that:

- (a) the onerous test should be performed at the performance obligation level;
- (b) the onerous test should be limited to obligations that an entity satisfies over a specified period of time; and
- (c) the amount that the entity would pay to exit the performance obligation should always be considered when determining whether a performance obligation is onerous.

EFRAG thinks that the onerous test should be performed at the contract level, should cover all contracts with customers and that an entity's past behaviour when settling onerous performance obligations should be considered when assessing the cost of settling a performance obligation.

The onerous test should be performed at a contract level

22 EFRAG thinks that the onerous test should be performed at a contract level rather than at the level of the performance obligation, as we consider this would result in more useful information. We do not think a future loss related to a performance obligation within an overall profitable contract represents a liability for an entity.

23 Paragraph BC207 of the Basis for Conclusions states that the onerous test is suggested to be performed at the level of the performance obligation, because considering the contract as the unit of account would:

- (a) add complexity;
- (b) be inconsistent with recognising revenue at the performance obligation level; and
- (a) be arbitrary because the unit of account would depend on whether the entity provides its goods or services in one contract or in more than one contract.

- 24 EFRAG does not consider these arguments to be convincing. Firstly, it is not clear from the Basis for Conclusions why the IASB thinks it adds complexity to perform the onerous test at a contract level rather than the level of the performance obligations. EFRAG is not aware that current requirements of IFRS, requiring the test to be performed at a contract level, are considered complex. The responses to the 2010 ED, which showed that most respondents thought the onerous test should be performed at a contract level, confirm that constituents do not think that it is complex to do so. If the proposed model for revenue recognition causes the complexity then we think the IASB should reconsider the model itself in resolving the issue.
- 25 Secondly, while we appreciate that it might be more consistent with the proposed model to perform the onerous test at the level of the performance obligation as revenue is recognised at the performance obligation level, it introduces other inconsistencies. In particular, losses recognised on individual performance obligations in an overall profitable contract would not meet the definition of a liability under the IASB's Conceptual Framework. Similarly, the approach would be inconsistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which applies to 'contracts' as a whole, rather than to elements within contracts, and in fact prohibits recognition of future operating losses.
- 26 Thirdly, from the Basis for Conclusion it appears to be the IASB's view that performing the onerous test at the level of the contract could result in arbitrary outcome because the ED does not appropriately describe how to bundle promised goods and services into contracts. The unit of account therefore depends on whether the entity provides its goods or services in one or more contracts. If the ED does not provide sufficient guidance on how to combine and segment contracts for the purpose of revenue recognition, we think this issue should be addressed. In our view, it is not a valid argument in favour of requiring the onerous test to be applied at the level of the performance obligation.

The scope of the onerous test should not be limited

- 27 Paragraph BC208 of the Basis for Conclusions states that limiting the scope of the onerous test to performance obligations that are satisfied over a period of time that is greater than one year, limits the risk of unintended consequences of applying the onerous test to some contracts. Paragraph BC208 argues that this scope is closest to the scope of the existing revenue standard that specifies an onerous test (i.e. IAS 11). However, this ignores the onerous test in IAS 37, which applies to contracts that are not covered by IAS 11.
- 28 According to paragraph D21 of the ED, IAS 37 would no longer apply to rights and obligations arising from contracts with customers within the scope of the ED. The ED will therefore result in no onerous test for:
- (a) performance obligations that are satisfied over a period of time that is less than one year; and
 - (b) performance obligations that are satisfied at a point in time (in the future).
- 29 We do not agree with this outcome. For example, we think it is inconsistent that an 11-month contract would not be tested, while a 13-month contract would be covered by the onerous test even though the loss on the 11-month contract could be significantly higher than the loss on the 13-month contract.

- 30 We acknowledge that assets developed to satisfy performance obligations should still be tested for impairment and that the IASB has not removed the reference to IAS 37 in paragraph 31 of IAS 2 *Inventories*. However, for some contracts where the loss is not related to the purchase of inventory within the scope of IAS 2, there may be a period where there is no asset to impair or the measurement of the asset cannot include the total loss on the performance obligation or contract. In these situations we consider the existence of an onerous test to be important.
- 31 Limiting the onerous test as suggested in the ED will result in fewer cases where a performance obligation within an overall profitable contract is deemed onerous at contract inception as a result of the proposed requirements on how to allocate the transaction price and discounts to separate performance obligations. When we oppose to limiting the scope of the onerous test, we realise that the cases described will appear more frequently everything being equal. We would therefore like to repeat the comment included in our comment letter in response to the 2010 ED that the transaction price should be allocated to performance obligations based on the margins of the performance obligations. This would reduce the problem of performance obligations being deemed onerous as a result of the allocation of an overall discount. Paragraph BC191 of the Basis for Conclusions explains that allocation on the basis of margins would require an entity to estimate the costs to satisfy a performance obligation, which would add additional complexity. In addition, it is noted that different treatments in the way costs are allocated to performance obligations could significantly affect the calculation. EFRAG notes, however, that the onerous test suggested by the IASB requires that costs are allocated to performance obligations. In addition, IAS 2 and the proposals include requirements on how to determine the costs related to satisfying a performance obligation. EFRAG does therefore not assess allocating the transaction price based on margins to be overly complex or subjective.
- 32 We also think that in cases where a performance obligation becomes onerous after the initial allocation of the transaction price, the loss on one performance obligation within an overall profitable contract should be allocated to remaining performance obligations based on their margins, so that no loss on an overall profitable contract is recognised.

Past behaviour when settling onerous performance obligations should be considered

- 33 EFRAG disagrees with the approach chosen in paragraph 87 of the ED for determining whether a performance obligation is onerous. The ED requires an entity to compare the lower of (1) the cost of satisfying the performance obligation and (2) the cost of exiting the performance obligation, with the transaction price allocated to the particular performance obligation. We think that in some cases, the cost of satisfying a performance obligation would be the only relevant figure to compare with the allocated transaction price.
- 34 We consider that in some cases an entity may rationally choose to satisfy a performance obligation even though the cost of exiting the performance obligation is lower. This could, for example, be because the entity knows it will be difficult to get another contract with the customer if it chooses not to satisfy a performance obligation. Therefore, in cases where an entity has an established practice of satisfying onerous performance obligations rather than exiting them, we believe the entity should only consider the costs of satisfying the performance obligation when assessing whether the performance obligation is onerous. Reflecting the more probable outcome results in our view in more meaningful information to users.

- 35 We note that our comments in paragraphs 33 and 34 also apply if the IASB should decide that the onerous test should be performed at the level of the contract. In addition, we think that the approach that is chosen for the onerous test in relation to a revenue recognition standard should also be required under IAS 37 in order to ensure consistency. Currently IAS 37 refers to 'unavoidable costs of meeting obligations under a contract'. Without a consistent wording in a forthcoming standard on revenue recognition and IAS 37, unintended differences in interpretations may arise.

Question 5

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.

EFRAG's response

EFRAG disagrees with the proposal as it considers that the list of specific requirements would not necessarily result in information that is most useful in accordance with the principles on which IAS 34 is based.

- 36 EFRAG acknowledges that revenue is an important figure and information about it should therefore be included in financial reports. From the input we have received in response to our draft comment letter, we have also learned that users find many of the suggested disclosures relevant for the annual financial statements.
- 37 However, in relation to interim reporting, we consider that the list of specific requirements proposed in the ED would not necessarily result in the most useful information in accordance with the principles underlying IAS 34 *Interim Financial Reporting*.
- 38 Currently paragraph 16A of IAS 34 includes a list of only nine items for which disclosures should always be provided, if material. However, paragraph 15 of IAS

34 requires an entity to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. This information should provide an update of the relevant information presented in the most recent annual financial report.

- 39 Accordingly, if presenting the disclosures proposed by the ED is necessary to explain events and transactions that are significant to an understating of the changes in the financial position and performance of the entity, the disclosures should be provided. On the other hand, if the proposed list of requirements is either not sufficient or not necessary to meet this objective, additional or less information should be presented.
- 40 EFRAG believes that the existing approach to disclosures in IAS 34 strikes the right balance between requiring information that is relevant to users and the costs to preparers. We are concerned that increasing the number of specific requirements would set a precedent that could lead to excessively detailed and unbalanced disclosure requirements for interim reporting which, among other things, could also affect the timeliness of this reporting. In addition, we believe that the disclosure requirements under IAS 34 should not be reconsidered on a piecemeal basis as this leads to an uneven level of detail in the disclosure requirements.

Question 6

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?

EFRAG's response

EFRAG agrees with the idea behind the proposal but believes the wording of the consequential amendments should be improved. In addition, the IASB should carefully analyse how the proposals will change accounting practice.

- 41 EFRAG agrees that the proposals should be applied to the transfer of non-financial assets that are not an output of an entity's ordinary activities, as this is consistent with the current approach under IFRS.
- 42 We are, however, concerned that the wording of the amendments will not always result in transfer of non-financial assets, that are not an output of an entity's ordinary activities, being accounted for similarly to output of an entity's ordinary activities. We note, for example, that:
- (a) The amendments to paragraph 72 of IAS 16, paragraph 116 of IAS 38, and paragraph 70 of IAS 40 limit the recognition of income to the amount to which the entity is reasonably assured. When accounting for an entity's ordinary activities according to the ED that constraint only applies when the amount of consideration is variable. As noted in our response to Question 1,

we consider that revenue should be limited to the amount that is reasonably assured when accounting for an entity's ordinary activities according to the ED. The amendments to paragraph 72 of IAS 16, paragraph 116 of IAS 38, and paragraph 70 of IAS 40 state that subsequent changes to the estimated amount of consideration that is reasonably assured shall be recognised as a gain or loss in the period of the change in accordance with IAS 8. By referring to IAS 8 instead of the ED, it seems unclear whether the proposed requirements for allocating subsequent changes in the transaction price to separate performance obligations that applies for output of an entity's ordinary activities should also apply when selling assets included in the scope of IAS 16, IAS 38 or IAS 40.

- 43 To enhance consistency when accounting for the sale of assets that are not output of an entity's ordinary activities and sale of output from an entity's ordinary activities, EFRAG suggests the references in IAS 16, IAS 38 and IAS 40 to the requirements of the ED be made more general. This can be done by simply stating that the requirements of the ED should be applied when determining when control has passed (and an asset should be derecognised), and when measuring the amount of gain or loss to recognise upon derecognition of the asset.
- 44 In addition, we have some doubts as to whether the consequences of the proposed amendments have been considered in sufficient detail as this is not apparent from the Basis for Conclusions. The proposed principle for derecognition, based on the transfer of control, may change the derecognition of PP&E, derecognition of intangible assets and the accounting for contingent (variable) consideration. We note that current practice is based on a risks and rewards approach rather than a control approach as required by the ED (which treats risks and rewards only as indicators of a transfer of control). We also note that the derecognition of financial assets continues to be based on a risks and rewards approach, which raises concerns about potential inconsistencies if other types of assets were to be derecognised based on a control approach.
- 45 In order for the IASB's constituents to be able to assess the impact of the proposed consequential amendments, we recommend the IASB to analyse how the proposals will change current practice.

APPENDIX 2

Additional comments

- 1 In addition to commenting on the specific questions raised in the ED, EFRAG would like to comment on the following issues:
 - (a) scope;
 - (b) allocation of contingent amounts;
 - (c) offsetting contract assets and advances received;
 - (d) right of return;
 - (e) disclosures;
 - (f) early application and effective date;
 - (g) time value of money;
 - (h) telecommunication industry; and
 - (i) estimating stand-alone selling prices.

Scope

EFRAG's view

EFRAG thinks the guidance is unclear on determining whether or not a contract is a contract with a customer or a contract with a partner or collaborator.

- 2 EFRAG notes that paragraph 10 of the ED explicitly states that the proposals do not apply to a contract with a collaborator or a partner. We appreciate that it could also be argued that the current requirements in IAS 18 *Revenue* and IAS 11 *Construction Contracts* do not apply to such contracts. However, we note, for example, that paragraph 85 of the ED deals with the case where an entity licences intellectual property to another party and consideration varies based on that party's subsequent sales. Whether one regards such counterparty as a customer rather than a collaborator or partner is a matter of considerable debate.
- 3 Therefore, EFRAG believes that to avoid divergence in practice – for example when part of the consideration is variable and depends on the success of the counterparty – the IASB should provide further guidance on when a counterparty is considered to be a collaborator or a partner rather than a customer.

Allocation of contingent amounts

EFRAG's view

EFRAG agrees that discounts and contingent consideration shall sometimes be allocated to particular performance obligations within a contract. However, EFRAG disagrees with the ED that contingent amounts of consideration should only be allocated to one or all performance obligations within a contract.

- 4 In its comment letter in response to the 2010 ED, EFRAG disagreed with the requirements that the transaction price, and changes in the transaction price, should in all cases be allocated to different performance obligations based on the initial standalone selling prices. EFRAG thought that facts and circumstances should be considered in making the allocation. EFRAG is therefore pleased that the IASB has introduced exemptions to the strict allocation based on standalone selling prices in cases of discounts and contingent consideration. However, we disagree with the ED that contingent amounts of consideration should only be allocated to one or all performance obligations within a contract.
- 5 Paragraph 76 of the ED states that if the transaction price includes an amount of consideration that is contingent on a future event or circumstance, the entity shall allocate that contingent amount entirely to a distinct good or service if certain criteria are met. EFRAG thinks that in some cases, it would only be possible to reflect the economics underlying a transaction by allocating a contingent amount to more than one (but not necessarily all) performance obligations included in a contract. Where the contingent amount directly relates to the cost of several inputs (e.g. number of user licenses in an IT system), EFRAG believes that the contingent amount should be allocated proportionately to the underlying performance obligations using this input (even if there is more than one). However, paragraph 76 of the ED does not allow this as it states that the entity shall allocate the contingent amount entirely to a distinct good or service.
- 6 We note that paragraph 75 of the ED allows an entity to allocate a discount to several separate performance obligations, as it states that ‘an entity shall allocate a discount entirely to one (or some) separate performance obligation(s) in the contract.’ EFRAG does not see any reason why a rebate can be allocated to several (but not all) performance obligations, but a contingent amount cannot.

Offsetting contract assets and advances received

EFRAG’s view

EFRAG disagrees with the ED that the remaining rights and performance obligations in a contract should always be presented on a net basis.

- 7 Paragraphs 104 and BC235 to BC237 of the ED explain that the remaining rights and performance obligations in a contract shall be presented on a net basis, as the interdependencies are best reflected by presenting the remaining rights and obligations net in the statement of financial position.
- 8 EFRAG considers that offsetting should happen in many cases – but not in all cases. EFRAG believes that in circumstances where an entity does not have a legal right or intention to offset advances received against any assets recognised as a result of a transfer of goods or services, offsetting should not be permitted. Offsetting in these cases could, in EFRAG’s view, result in financial statements not presenting an entity’s liabilities (and assets) appropriately.

Right of return

EFRAG’s view

EFRAG is concerned that it is difficult to distinguish between sale with a right of return, customer acceptance and repurchase agreements.

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- 9 EFRAG notes that the Application Guidance identifies three situations in which the customer has not irrevocably taken control of assets provided by the entity:
- (a) sales with a right of return;
 - (b) sales subject to customer acceptance; and
 - (c) repurchase agreements (put options).
- 10 The ED proposes different guidance for each of these three situations. It is therefore important whether a contractual clause is considered to be:
- (a) a right of return, which means that if the entity has experience with similar contracts, revenue should be recognised when the good is transferred to the customer, but the measurement should reflect the value of the goods the entity expects to be returned, based on its experience; or
 - (b) a customer acceptance clause, which means the entity cannot recognise any revenue until either the customer accepts the product or the trial period lapses (see paragraph B58 of the ED);
 - (c) a put option, in which case the contract should be accounted for as a lease, provided the entity has an unconditional obligation to repurchase the asset at a price that is lower than the original selling price and the customer has significant incentive to exercise the option.
- 11 EFRAG is concerned that it may be difficult in many cases to determine whether a contract includes a customer acceptance clause, a return right or a put option. For example, it is not clear whether goods ordered over the Internet are subject to customer acceptance or a right of return if the customer can deliver the product back and not be obliged to pay the consideration
- 12 EFRAG has considered paragraph B58 of the Application Guidance. From this paragraph it appears as if payment terms matter when distinguishing a return right from a customer acceptance clause. That is, if the customer is not obliged to pay the consideration before the trial period lapses, or the customer accepts the good, the contract includes an acceptance clause and not a return right. However, in cases where acceptance clauses and return rights are included in contracts, EFRAG does not think this distinction is operational as it is difficult to distinguish payment of the consideration from payment of a deposit that will be returned if the asset is not accepted or is returned. Accordingly, this guidance will not always be helpful when assessing whether a contract includes an acceptance clause or a return right. EFRAG therefore considers it necessary that the IASB addresses the operability of the proposals by clarifying when something should be considered a return right, an acceptance clause, or a put option.

Disclosures

EFRAG's view

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 outweigh the costs.

- 13 EFRAG agrees with the disclosure objective in the ED, and that the proposed disclosures provide information that is helpful in meeting the objective. We are, however, concerned about the costs of providing the information. To ensure that preparers are not incurring disproportionate costs in preparing disclosures that are not widely used, or where the relevant information could have been provided in a less costly manner, EFRAG suggests further analyses. More particularly, EFRAG suggests the IASB to host meetings in which users and preparers with the same industry background discuss the information needs of users and the way in which those could be met by preparers in a cost effective manner. This activity and resulting guidance should enable disclosure requirements to be targeted to ensure that benefits outweigh costs.

Early application and effective date

EFRAG's view

<p>EFRAG thinks that the effective date should be three years from the publication of the standard.</p>
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- 14 As a starting point, EFRAG thinks that the effective date should not be earlier than the beginning of the first annual period starting three years after the publication of the standard as:
- (a) collecting comparative information under the new standard would often require entities to make the required judgements at the time that the underlying transactions occur, as there may not be a straightforward way to convert information from the old to the new standard; and
 - (b) in many jurisdictions, the new standard would need to be translated and endorsed or may require amendments to the legal or tax framework.
- 15 However, we note that there are several factors to take into consideration, and our final view on the issue will therefore, among other things, depend on:
- (a) whether prospective or retrospective application (or something in between) will be required. EFRAG considered that the standard has pervasive effect on the financial statements and would need to be applied largely retrospectively. However, we note that it would be difficult for entities (e.g. those with long-term contracts) to apply the proposals retrospectively as they would have to make certain new estimates relating to past periods. Apart from being potentially costly, it introduces a considerable risk that entities might apply hindsight in making those estimates. Therefore, we think the IASB should consider a modified form of retrospective application that takes into account the approach required by paragraphs 14 to 17 of IFRS 1. That is, entities would be required to use estimates made under their current accounting policies to the extent these estimates are also necessary to apply the new standards. However, to the extent entities are required to make estimates that are currently not made, these estimates shall reflect the conditions as of the date of the earliest comparative figures included in the first financial statements prepared in accordance with the new requirements.
 - (b) whether other projects have been finalised. In this regard we are particularly interested in the lease project as the revenue standard and the proposed leases standard consider accounting treatment for economically similar transactions. We consider it important that the requirements are consistent.

- 16 EFRAG is not in favour of allowing early adoption, because this – together with a deferred effective date – could lead to an extended period during which comparability of financial information would be considerably reduced. In addition, as we noted in our response to the IASB’s Request for Views on Effective Dates and Transition Method, permitting early adoption of the revenue recognition standard for an extended period would result in standard setting complexities in connection with overlapping consequential amendments and conflicting scope requirements.

Time value of money

EFRAG’s view

EFRAG thinks that an entity should not be allowed to apply the practical expedient of paragraph 60 in cases where there is evidence that the time value of money is significant to the contract.

- 17 EFRAG supports adjusting the transaction price to reflect the time value of money of contracts that include a financing component that is significant to the contract. We also agree that it is necessary to introduce a practical expedient in order to achieve an appropriate balance between costs and benefits of the adjustment.
- 18 We note, however, that the financing component of a contract can be significant even for contracts where the period between payment by the customer and the transfer of the promised goods or service to the customer will be less than one year. This will be the case when the interest rate is high. To ensure that the transaction price is adjusted to reflect the time value of money in such circumstances, we think the practical expedient should be limited to cases where there is no evidence that the effect is significant to the contract.

Telecommunications industry

EFRAG’s view

EFRAG encourages the IASB to try to develop a pragmatic approach to revenue recognition that results in information that is relevant to users without resulting in disproportionately high costs for preparers.

- 19 EFRAG is aware that constituents in the telecommunications industry believe that the proposals in the ED are costly to apply and that users of their financial statements have said that they prefer the information they receive under the current revenue recognition standards. The latter seemed to be confirmed in interviews of users of financial statements of telecommunication companies organised by IASB staff. Many users appeared to prefer the current accounting unless the proposed model was supplemented by additional disclosure.
- 20 EFRAG is not in favour of industry exemptions as such a rules-based approach would not result in an improvement of financial reporting. Nevertheless, we are cognisant of the fact that the proposals in the ED are costly and complex to apply when most or all of the following conditions are present:
- (a) contracts are frequently modified in response to circumstances outside an entity’s control, such as customer requests, competitive pressures, regulatory requirements and changes in technology;

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- (b) an entity has a very large number of contracts that are individually small in size;
 - (c) an entity offers a broad range of pricing plans and options;
 - (d) the stand-alone selling prices for particular goods or services are highly variable and depend on the specific customer; and
 - (e) the customer churn rate is high.
- 21 We are aware that the ED under certain circumstances allows entities to apply the proposed requirements on a portfolio level and that it could be assumed that such an approach could reduce the costs of applying the proposals. However, telecommunication companies participating in the European field-test have not been able to operationalise such an approach in the context of the field-test. They considered that they would have too many different portfolios of contracts in order for a portfolio approach to be more cost effective than accounting for each contract separately.
- 22 We would therefore encourage the IASB to try to develop a pragmatic approach to revenue recognition under the circumstances described in paragraph 20 above that result in information that is relevant to users without resulting in disproportionately high costs for preparers.

Estimating the stand-alone selling price

EFRAG's view

EFRAG believes the IASB should develop an approach for dealing with circumstances in which an entity cannot determine stand-alone selling prices.

- 23 The ED relies on an entity's ability to estimate stand-alone selling prices for distinct goods or services. However, we note that when:
- (a) the marginal cost of providing a good or service is close to nil;
 - (b) the price charged for the good or service varies considerably from customer to customer; and
 - (c) the contract includes several goods and services with the characteristics mentioned above,
- the estimation methods listed in paragraph 73 of the ED do not provide any help, and it is unclear how the stand-alone selling prices should be estimated.
- 24 The factors listed in paragraph 23 are present in many contracts of software providers, and it is therefore difficult for these entities to apply many of the requirements of the ED.
- 25 EFRAG therefore believes the IASB should develop an approach for dealing with circumstances in which an entity cannot determine the stand-alone selling prices.

APPENDIX 3

Clarification issues

- 1 From input received during our field-test activities and from comment letters received in response to our draft comment letter, we have noted that the guidance provided by the ED is not always considered sufficiently clear. We are aware that it will always take time to understand a new principles-based standard. In some cases, however, we consider clarification to the ED needed either because we think the standard is unclear or the standard does not reflect what we understand is the intention. Some of these issues have already been mentioned above, but the following paragraphs include additional issues.

ED does not reflect the intention

- 2 In the following two cases, we do not think the ED reflects what we understand to be the IASB's intention:
 - (a) **Delivery of identical items.** We understand, from paragraph BC78 in the ED and IASB staff, that it is the intention that if an entity receives an order for the construction of a number of identical but specialised items (for example forty specialised defence aircraft), the delivery of these items should be considered as one performance obligation. However, while these aircraft are significantly customised (and meet the condition in paragraph 29(b) of the ED), they would not necessarily meet the condition in paragraph 29(a). Therefore, the ED would seem to require that each aircraft be treated as a separate performance obligation. We therefore believe the IASB should clarify the drafting to ensure that the construction of a number of identical but specialised items is treated as a single performance obligation.
 - (b) **One performance obligation satisfied over time or multiple performance obligations satisfied at a point in time.** Some services (for example, the connection to an electricity network for two years) can be regarded as bundle of very short-termed distinct performance obligations or as one performance obligation for two years. We understand that it is the intention that such contracts should be considered as a bundle of distinct performance obligations, but that paragraph 30 of the ED would probably allow entities to account for the bundle as one performance obligation. However, we also understand that if the bundle can be accounted for as one performance obligation under paragraph 30 of the ED, the intention is that when considering, for example, the practical expedient in relation to the onerous test and the requirements on how to account for contract modifications, the service should for these purposes be regarded as a bundle of short-termed distinct performance obligations. We do not think that the ED reflects this clearly.

Requirements could be clarified

- 3 Below we list some requirements we think could be clarified. Except for the issue raised in point (f) below, it is not our intention that additional guidance should be provided, but that the wording should be clarified taking the listed issues into consideration. We also refer to the issues raised by participants of our field-tests and the feedback statements hereof which constitute an integrated part of this comment letter.

- (a) **Criteria for when a good or service is distinct.** We think the criteria for when a good or service is distinct according to paragraph 28 of the ED should be clarified. In particular:
- (i) It is unclear for us what terms can result in a customer not being able to benefit from a good or service on its own or together with other resources that are readily available to the customer. We understand that it is the intention that:
- the fact that a customer can only use certain coffee capsules (or razor blades) for its coffee machine (or razor) does not preclude a customer from being able to benefit from a coffee machine or razor on its own or together with resources that are readily available to the customer, and
 - a customer can benefit from a price of land, that a developer has transferred to its customer, on its own although the customer is obliged to have the developer to construct buildings and infrastructure on the land as specified and at the expense of the customer.

However, we also note that paragraph B36 of the ED specifies that a licence is not distinct if the customer cannot benefit from it without an additional service that the entity promises to provide. Considering the examples above, we find the ED unclear on what circumstances could result in an entity not being able to benefit from the licence without an additional service. For example, we think it is unclear which of the following circumstances would result in a customer not being able to benefit from a licence without additional services:

- contractual requirements that the customer would have to buy ingredients from the entity when producing the pharmaceuticals covered by the licence (even when the ingredients could be purchased from another company);
- lack of know-how, requiring the customer to learn from the entity how to produce the resulting pharmaceuticals;
- lack of approved production facilities, resulting in the customer having to pay the entity to produce the pharmaceuticals until the customers' production facilities were approved.

We also find it unclear:

- whether it matters whether the entity (regularly) sells licences and necessary service separately (in that case the criterion of paragraph 28 (a) seems to be met);
- to what extent the customer's ability to resell a licence would result in the customer being able to benefit from the licence on its own; and
- whether the fact that the customer's competitors could not use the licence if the rights were provided to the customer (blocking) would result in the customer being able to benefit from the licence on its own.

In addition, we consider it unclear how to account for the licence, if in the first part of the licence period, an entity cannot benefit from the licence without additional services promised by the entity, but after some time it can use the licence without additional services from the entity.

- (b) **When is a significant service or integration provided?** It is not clear to us under what circumstances the criteria of paragraph 29 are met. We understand that it is the intention that in a case, where the customer orders a building to be constructed on the entity's land, the bricks and the windows are not distinct; however, the land is. It is difficult for us to see why the integration service from inserting windows into the house is different from 'inserting' the fundament of the building into the land. During our field-testing activities we also noted that participants found it difficult to assess whether, for example:
- (i) an entity's service of installing software for a customer would mean that the entity provides a significant service of integration. This would mean that the software and the installation should be accounted for as one separate performance obligation;
 - (ii) whether the development of a series of relatively specialised items followed by an installation of these items into assets belonging to the customer should be considered as one or two performance obligations. In the relevant case, the customer could only use the items when they were installed in the relevant assets. In addition, the installation was complex and it was unclear whether another company would be able to do the installation.

We note that clarification of the meaning of the 'significant service or integration' also impacts when a new contract should be combined with an existing contract because the goods or services promised in the contracts are a single performance obligation (paragraph 17 (c) of the ED). In this relation, we understand from our field-tests that our constituents are uncertain on the effects of having to integrate additional goods and services into goods and services already transferred to the customer.

- (c) **When do goods or services have the same pattern of transfer?** Our field-testing activities have shown that it is not clear what is meant by 'the same pattern of transfer' in paragraph 30 of the ED. Participants in the software industry have, for example, been unsure whether post-contract customer support and bug-fixes could be accounted for as a single performance obligation.
- (d) **When are warranties separate performance obligations?** The ED provides separate guidance on how to account for warranties in paragraphs B10 to B15 of the ED. Similar to participants of our field-test, we think it is unclear whether an entity should account for a warranty as a separate performance obligation when the warranty could be purchased separately but is considered significantly interrelated with, for example, a maintenance service provided and a performance guarantee (and the criteria of paragraph 29 of the ED therefore seem to be met).
- (e) **When are performance obligations satisfied over time?** We note that some participants of our field-testing activities found the criteria of when

performance obligations were satisfied over time unclear. We think that some of the confusion is caused by:

- (i) The fact that the entity and its customer may regard a performance obligation differently. For example, when considering when-and-if-available upgrades from the entity's point of view, the performance obligation could be considered satisfied over time, as the entity is standing ready to provide any new version of the software to the customer. However, from the customer's perspective, nothing is received until new software is available.
- (ii) Difficulties in understanding what asset the alternative use criterion should be assessed against. Often when constructing an asset, it is easy to redirect the asset under construction in the first phases – for example the wheels of a fighter plane may easily be used as wheels for another type of plane. However, it may be impossible to redirect the final air-fighter. We think it should be considered to specify that in cases where an asset is being constructed, it is the final asset that should be considered when assessing the alternative use criterion. What asset to be considered has also caused problems when dealing with intangible assets. For example, some software companies participating in our field-test noted that when developing software for a particular customer, the right of the intellectual property would remain with the entity – and could therefore be used to satisfy performance obligations with other customers. The customer would only receive a licence to use the software and it was difficult to read from the ED whether it was the intellectual property or the licence that should be considered when assessing the requirement.
- (iii) Difficulties in understanding what role a limited number of potential customers have when assessing whether an asset has an alternative use. For example, if an entity is ordered to produce ten wind turbines that would only be useful for a particular geographical area. The entity could sell the produced wind turbines to another customer, as long as it would meet its obligation to the initial customer, however, it would be unlikely that another customer would order wind turbines for the particular geographical area.
- (iv) Potential circularity in the criterion in paragraph 35(b)(ii). The criterion states that in evaluating whether another entity would not need to substantially re-perform the work the entity has completed to date, assets presently controlled by the entity should be disregarded. We understand that some have interpreted the requirement as if assets transferred to the customer could be taken into consideration when performing the assessment. We believe that this interpretation of the requirement is unintended as it in some cases would result in the criterion becoming self-fulfilling.
- (f) **How should cancellation options be accounted for?** We do not think the ED provides a clear picture of what should be considered the contract period and how to account for cancellation options. We understand that if a contract is entered into for a 24 months period with an entity, but local law dictates that the customer can cancel the contract within 12 months by paying a fee or penalty, the contract period should be considered to be 12 months. We think this view is in accordance with paragraph BC300 of the ED that states that a renewal option can both be described as a renewal

option within a relatively short contract or a cancellation option within a longer contract. However, we think this needs to be clarified as the ED could be read as only considering what is explicitly presented as renewal options. We also think it needs to be clarified whether something is a cancellation option (and a fee for using this option) or a breach of a contract (and a penalty for breaching the contract). We note that if there is a fee attached to using a cancellation option, it is our understanding that this fee should be factored into the transaction price. We understand that in these cases, the transaction price will be increased, but the contract will also include a favourable renewable option to which a part of the transaction price should be allocated. We consider that it will be possible for a customer to cancel almost any type of contract by paying a sufficiently high penalty. However, we do not think that these situations should be accounted for as renewal options.

- (g) **How should payments be linked to revenue?** When adjusting revenue for the time value of money under the model proposed in the ED, it is necessary to allocate the total revenue from a contract to the various cash inflows. EFRAG understands that the IASB's intention is that the financing component should be considered on the net contract asset or liability (that is the payments should be allocated to the various transfers on a FIFO basis), but we do not think this appears clearly from the ED.
- (h) **How should revenue from non-refundable upfront fees be allocated?** The guidance on over what period a non-refundable upfront fee should be allocated may seem inconsistent. Paragraph B30 states that the revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as specified in paragraph B21 of the ED. On the other hand, in Example 16 in paragraph IE15 of the Illustrative Examples it is stated that the revenue from the initial fee should be recognised over the period that an entity expects to provide service to the customer.
- (i) **Reference to US GAAP.** We note that some of our constituents have been confused about the reference to US GAAP in paragraph BC160 of the Basis for Conclusions. Some constituents have understood this as requiring familiarisation with US GAAP in order to be able to interpret the IASB proposal. To avoid this potential misunderstanding, we suggest that references to US GAAP should be removed from the Basis for Conclusions.
- (j) **Revenue from transfer of items with an alternative use.** We think paragraph BC93 of the Basis for Conclusions of the ED should be amended as follows: 'The boards decided that an entity's performance would not result in a transfer of goods or services over time to the customer if the entity's performance creates an asset with an alternative use to the entity...'. Otherwise we think the Basis for Conclusions could leave the impression that revenue cannot be recognised at all for items with an alternative use to the entity.

APPENDIX 4

Field-testing activities

EFRAG has, in co-operation with some European national standard setters, performed field-tests of the ED. The results of these field-tests have been considered by EFRAG when finalising its comment letter and will be published in feedback statements. These feedback statements constitute an integral part of EFRAG's comment letter.

In addition to the field-tests for which workshops and feedback statements were prepared, the Italian standard setter has collected input from Italian companies on application difficulties, effects on financial statements and costs of applying the proposals. EFRAG staff has concluded that the issues identified by these entities were similar to those of other entities participating in the field-tests coordinated by EFRAG.