

## Summary of comments

PAAinE Discussion Paper

Revenue Recognition

A European Contribution

## **About the PAAinE**

EFRAG and the European National Standard Setters have agreed to pool some of their resources and work together more closely so that Europe as a whole can participate more effectively in the global accounting debate. It was agreed that this initiative should in the beginning concentrate on long-term pro-active work. The objective of the initiative is to stimulate debate on important items on the IASB agenda at an early stage in the standard-setting process before the IASB formally issues its proposals. The initiative has the joint ambitions of representing a European point of view and exercising greater influence on the standard-setting process. This initiative is known as the 'Proactive Accounting Activities in Europe' (or PAAinE) initiative.

Several projects have commenced under the PAAinE initiative, and this paper was the result of the PAAinE project that relates to the joint IASB/FASB project on Revenue Recognition in Contracts with Customers.

Work carried out under the PAAinE initiative can take a number of different forms and the full objectives of the initiative are:

- to stimulate, carry out and manage pro-active development activities designed to encourage the debate in Europe on accounting matters and to enhance the quality of the pro-active input to the IASB;
- to co-ordinate and resource monitoring work of IASB and FASB projects; and
- to try to ensure, as far as is practicable, that the messages Europe gives the IASB are consistent.

A further description of the PAAinE initiative is available on the EFRAG website ([www.efrag.org](http://www.efrag.org)).

**A summary of the comments received in response to  
the PAAinE Discussion Paper  
*Revenue Recognition: A European Contribution***

**Overview**

- 1 The European Financial Reporting Advisory Group (EFRAG), the Deutsches Rechnungslegungs Standards Committee (DRSC) and the Conseil National de la Comptabilité (CNC) jointly have issued a discussion paper on revenue recognition (Revenue Recognition – A European Contribution) as part of the initiative Pro-active Accounting Activities in Europe. The paper has been developed against the background of a joint project of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) on the issue of revenue recognition.
- 2 The objective of the IASB/FASB project is to develop a comprehensive set of conceptually-based principles that will eliminate existing inconsistencies, fill voids that have emerged and provide guidance that will be useful in addressing issues that may arise in the future. The project will take at least until 2011 to complete.
- 3 Recognising the need for Europe to get involved now if it is to participate effectively in the revenue debate, the DRSC and EFRAG decided to work together to prepare a paper that would stimulate debate within Europe and to encourage the development of European views on the subject. The paper “Revenue Recognition: A European Contribution” is the result of that work. It examines revenue recognition from first principles, with the aim of establishing a framework within which to address in a consistent way the revenue issues that are arising and will arise in the future.
- 4 A summary of the PAAinE paper is set out in Appendix A.
- 5 The paper included an Invitation to Comment; 18 comment letters were received. The comment letters are posted on the websites of EFRAG ([www.efrag.org](http://www.efrag.org)) and DRSC ([www.drsc.de](http://www.drsc.de)).

**Comments received on the paper**

- 6 Appendix B gives an overview of the constituents comments have been received from, and of the structure of the comments received. Half of the respondents (9 out of 18) have commented on the paper in general instead of specifically addressing the questions.
- 7 The graphs on the following pages give information on the background of the respondents.

**Backgrounds of respondents**

- 8 Comments have been received from
  - Preparers and representative bodies of preparers (7)

- Accounting Firms (1)
- Standard Setters (4)
- Accountancy Bodies (3)
- Others (3)

No comments have been received from users or representatives of users.

- 9 The following graph shows the distribution of comment letters grouped by background of respondents. The graph does not take into consideration that a single comment letter may represent the opinion of a large number of companies or individuals represented by the organisation writing the letter.

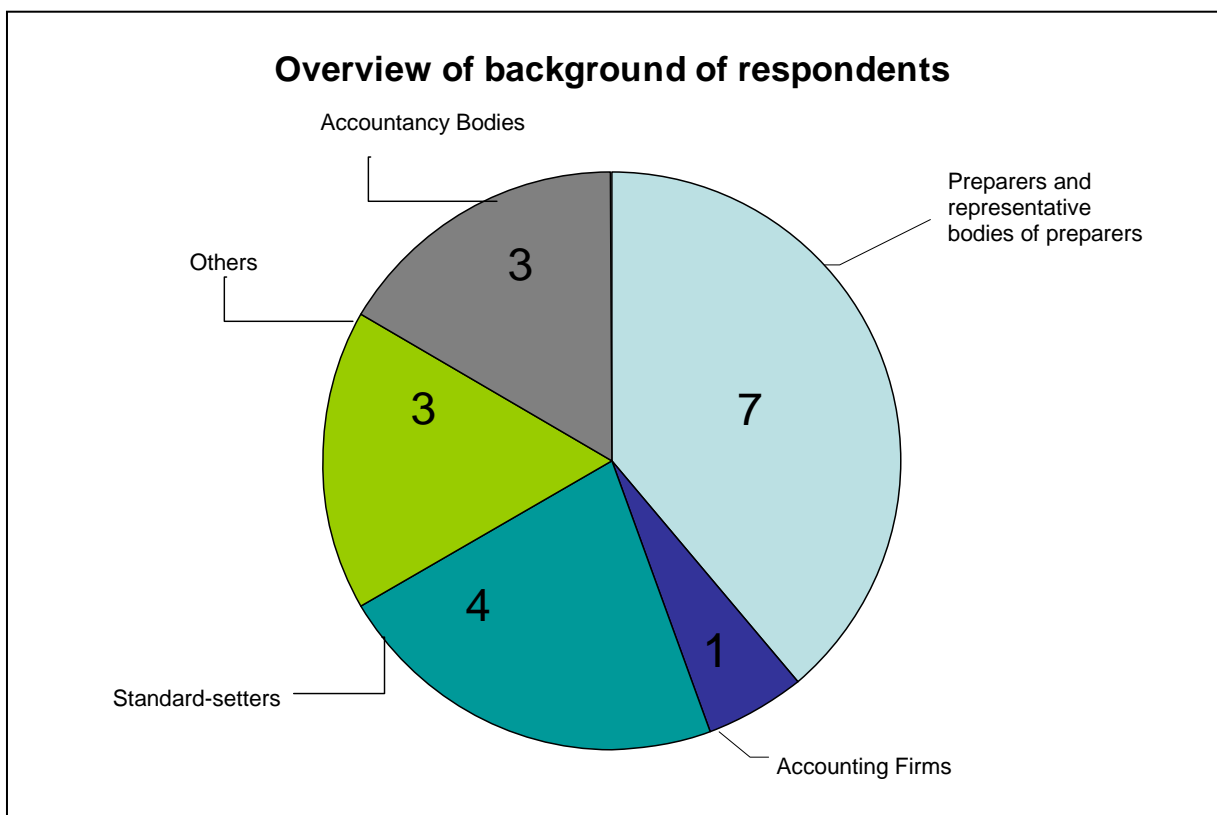


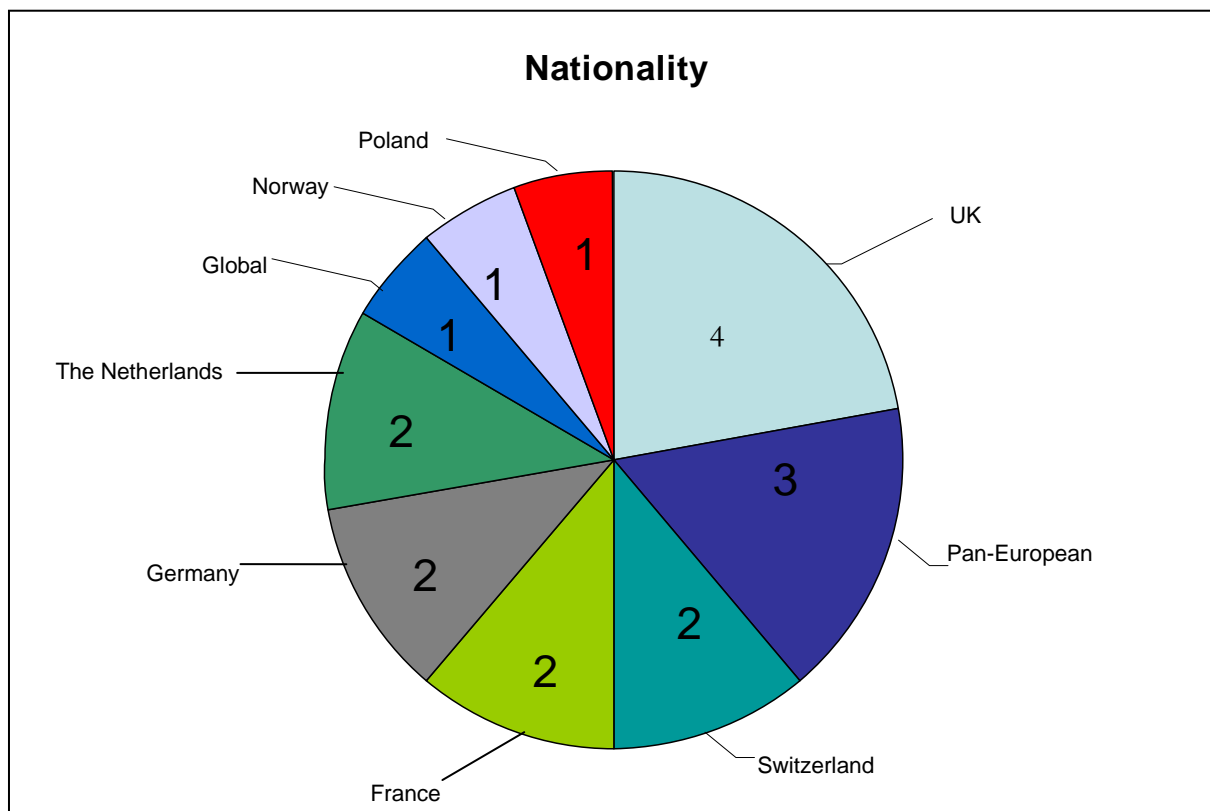
Figure 1 Overview of background of respondents

### Nationality of respondents

- 10 Comment letters have been received from respondents with the following national/geographical backgrounds:

- UK (4)
- Pan-European (3)
- Germany (2)
- France (2)

- Switzerland (2)
- The Netherlands (2)
- Poland (1)
- Norway (1)
- Global (1)



**Figure 2 Nationality of respondents**

- 11 This graph, too, does not take into consideration that a single comment letter may represent the opinion of a large number of companies or individuals represented by the organisation which has sent the letter.

### **General Comments on the PAAinE Project Revenue Recognition**

- 12 The vast majority of respondents support the initiative to develop a paper on revenue recognition and to analyse issues currently discussed by IASB and FASB.
- 13 However, some respondents, for example Ernst & Young, although supporting the initiative in general, have doubts regarding the focus of the initiative and the focus of the paper. In particular, a thorough discussion of the models currently developed by IASB and FASB is considered necessary (which the paper does not provide).
- 14 One respondent (P.A. Pieterse van Wijck) argued that the general approach of the paper is ill advised since it modifies the definition of revenue given by the

framework. Because of this, the discussion of revenue is not within the current framework and therefore not within the boundaries already set by IASB. Any suggestions for the modification of a revenue definition should be presented within the Framework project of the IASB rather than within the revenue project.

### **Comments to Questions**

(Note: The following analysis also considers comments which - although technically not stated as answers to specific questions - relate to those questions.)

#### *Question 1*

*It is stated in the discussion paper (paragraphs 1.4 - 1.10 and Appendix II) that there are weaknesses in the IASB's existing revenue recognition standards, IAS 11 and IAS 18.*

*Do you think these comments about the existing standards are fair? (If you do not, could you please explain which comments you think are not fair and why.)*

*Do you have any additional concerns about existing standards? (If you do, please could you explain them.)*

- 15 Respondents generally agree that there are weaknesses in the IASB's existing revenue recognition standards, IAS 11 and IAS 18. These weaknesses include the virtual absence of guidance on how to account for multiple-element arrangements (MEAs). This issue is the one most respondents want to see solved in the future.
- 16 Another issue mentioned that needs clarification is that current standards on revenue recognition (IAS 11 and IAS 18) distinguish between different categories of transactions (which are accounted for differently). In practice it is not always clear under which category a transaction falls. This is proved by the necessity to issue interpretations like IFRIC D21 Sale of Real Estate. However, all in all, the issue of classification of (single element) transactions is considered a minor one.
- 17 Further issues include:
  - When to recognise an (expected) gross or a net inflow as revenue. It is sometimes not clear if the entity acts as an agent or as a principal under the contract.
  - How to account for regulatory assets and liabilities? In some cases, for example, excess amounts collected in the current period later have to be returned to customers, so future revenues need to be reduced.
- 18 However, although agreement exists among respondents that current standards on revenue recognition are in need of repair, there are different views on how the IASB should address the existing weaknesses. Many respondents made clear that they would very much prefer added guidance on specific issues (like MEAs) over a complete revision of IAS 11 and IAS 18. That is, most respondents are against fundamental changes to revenue recognition. Comments from preparers and organisations representing preparers particularly stressed this point. In their view, the expected costs of such a change are too high and the benefits doubtful. Every

new principle would give rise to new grey areas which would need to be clarified. As SwissHoldings state in this respect: “while there are occasional problems with [the percentage-of-completion method] for recognising revenue from services under IAS 18, especially in multiple-element arrangements, the present separation between recognition on the basis of the critical event approach for sales of goods and on the basis of percentage-of-completion method for construction contracts works pretty well – indeed perfectly adequately for the overwhelming majority of transactions -, and we find it difficult to accept under these circumstances that anything more than the development of practical, pragmatic solutions for the few, very specific grey areas like sales of real estate sales (IFRIC D21) and multiple-element transactions is necessary or would lead to more meaningful and useful information for financial statement users.”

*Question 2(a)*

*The paper explains that the ultimate objective of the revenue recognition debate should be to develop a single principle or a single set of principles that can be applied to all kinds of industries and business. Do you believe this is an appropriate and realistic objective? (If you do not, please could you explain your reasoning and what you believe is an appropriate and realistic objective.)*

- 19 Many respondents point out that developing one principle that fits all transactions is a very ambitious – and as some say, unrealistic - goal. Respondents are divided on the question if it is desirable to have a single set of principles (or even a single principle) to be applied to all types of transactions.
- 20 A large part of respondents reject the development of *one* principle to cover all types of transactions. They consider the existence of different principles underlying IAS 11 and IAS 18 as appropriate and even necessary. A simple sale of a piece of butter has a very different economic substance than the building of a bridge. To reflect this difference in substance the two transactions need to be accounted for differently.
- 21 In addition, having just one principle for all transactions would mean a fundamental change to current accounting standards and practice. In the opinion of the majority of respondents there is no need for such a significant change. As mentioned earlier, many respondents would simply prefer getting additional guidance on, for example, how to account for multiple element arrangements. Respondents also argue that a new principle would create new grey areas that would need to be clarified. QCA said they are looking for “simple rules which work and are understandable, taking a pragmatic approach to recognising revenue, which may be applied by all.”
- 22 With reference to the continuous approach discussed later in the paper, GEFIU (Chemical) said:

It seems also to be an illusion to have one principle for all revenue recognition issues, because also under the Continuous Approach the Discussion Paper gives guidance to the various types of contracts for the delivery of goods and providing of services. The accountants need clear principles and guidance with regard to revenue recognition as in IAS 11 and IAS 18.

- 23 In other words, the view of these respondents is that, from a practical standpoint, a narrow fix that focuses specifically on the existing issues that are causing practical difficulties (like accounting for MEAs) is all that is necessary. It is not necessary to depart from the current approach of distinguishing between different types of transactions and their respective accounting treatment. Indeed, even if a single principle was to be developed, it might be necessary to identify differences in transactions and adapt the principle in order to be applicable and to take into consideration the differences in economic substance that distinguish transactions (like over-the-counter transactions and long-term construction contracts). SwissHoldings are of the opinion that “it would be contrary to the basic cost/benefit principle to impose the enormous systems changes implied just for the sake of having one conceptual revenue recognition principle without significant practical advantages in better information for users being identified.”
- 24 In contrast, another large group of respondents are in favour of the one principle approach, although they acknowledge it is an ambitious task. For example, ACCA supports the idea of having one single set of principles that can be applied to all industries and businesses:
- We strongly believe that due to the considerable range of transactions that those principles would need to encompass, actual standards themselves should not be prescriptive. We believe that the goal should be a set of principles which would enable sound judgement to be made by preparers, appropriate to their circumstances, but whose treatment could be verified and substantiated.
- 25 Similarly, CNC state that it “would like to see a global standard on revenue recognition, applicable to any business sectors as it does not support the creation of separate approaches by sector (i.e. one standard for banks, one for insurance, etc.), or even by product (construction services, other services, derivatives and other financial assets or liabilities). Consequently, the CNC supports the idea of defining a general principle for revenue recognition.”

*Question 2(b)*

*Although the objective is to develop principles that can be applied to all kinds of industries and businesses, the paper does not explore sector-specific issues in any detail. Do you believe this approach is appropriate? If you do not, please could you explain which sector-specific issues the paper should explore and why you think that would improve the quality of the analysis.*

- 26 Respondents not supporting the single principle approach generally did not have a problem with sector specific standards or guidance.
- 27 Nevertheless, overall respondents supported the approach taken by in the PAAinE paper, although a number emphasised that it would be necessary to prove the applicability of any single set of principles to the different sectors and industries.
- 28 CNC noted that insurance companies and banks do not present a top line of the income statement and to that extent revenue as defined by the paper does not address those industries.



Question 3

Chapter 2 of the paper discusses what revenue is. It does so by examining what the Framework says about revenue (paragraphs 2.5 - 2.13) and what other attributes revenue should have (paragraphs 2.14 - 2.33). It concludes that:

- (a) Revenue is a particular type of increase in assets or decrease in liabilities.
- (b) Revenue is a gross notion. In other words, if an entity sells an item for €10, making a profit of €2, it will be the €10 rather than the €2 that will be recognised as revenue.
- (c) Revenue does not necessarily arise only from enforceable rights and obligations.
- (d) Revenue is some sort of measure of activity undertaken pursuant to a contract with a customer. Therefore, without a contract there can be no revenue. Furthermore, revenue will not arise simply from entering into the contract, because at that point there will have been no activity undertaken by the supplier pursuant to the contract.
- (e) Revenue does not necessarily involve an exchange.
- (f) Revenue is something that arises in the course of ordinary activities.
- (g) On the basis of the conclusions summarised above, a working definition of revenue is that revenue is the gross inflow of economic benefits that arises as an entity carries out activities pursuant to a contract with a customer.

*Do you agree with these conclusions? (If you do not, please could you state which conclusion you do not agree with and explain your reasoning.) Do you believe that revenue has some additional attributes that should have been referred to? (If you do, please could you describe those additional attributes and explain your reasoning.)*

- 29 As pointed out earlier, P.A. Pieterse van Wijck criticises the paper for modifying the Framework definition of revenue. Since an explicit goal of the IASB/ FASB project is to develop a revenue recognition principle that is deduced from the Framework definition of revenue, he thought it strange to start a European discussion on the subject by modifying the definition. He argued that, if the authors of the paper think the Framework's revenue definition needs modifications, they should express their concerns in the context of the Framework discussion rather than the revenue project.
- 30 The following issues regarding the revenue definition were raised by those supporting the approach taken by the paper:
- The need for further analysis of the gross notion. This should include a review of transactions carried out as an agent.
  - The need for the definition to be more specific as to the increases of which kind of asset are considered revenue.

- The possibility that revenue might arise at contract inception.
- Is an exchange of promises needed before revenue can be recognised?
- What role should the existence of a right to consideration play in revenue recognition?
- Whether the term “contract” should be replaced by “agreement” because “contract” might mean different things under different jurisdictions.
- The need for more consideration of the distinction between revenue and profit.
- What are “ordinary activities”?

**Question 4**

*As mentioned in Q3(d), revenue is some sort of measure of activity undertaken pursuant to a contract with a customer. However, the paper’s analysis is not conclusive as to exactly what “sort of measure of activity” revenue measures; it could for example be a measure of completion activity (in other words, a measure of the things the supplier has completed) or a measure of activity towards completion (in other words, a measure of the things the supplier has done under the contract). (...) Which activities do you believe the revenue number should measure: completion, or activity towards completion? Or are there other alternatives that need to be considered? (Please give your reasons for the answer you have given.)*

31 Respondents were divided on this question. All in all, four groups can be identified.

Revenue should generally measure completion activity

32 Some respondents think revenue should generally measure completion activity. Such respondents are generally in favour of a critical events approach. GEFIU (Automotive) argued that the reliability of information provided would decrease significantly if revenue was to measure activity towards completion. In its view application of some sort of percentage-of-completion method should be the exception, not the rule.

Revenue should measure activity towards completion

33 Some respondents think revenue should measure activity towards completion. Respondents who share this view generally also support some sort of continuous approach. However, they do so under certain conditions. For example, FEE—although supporting the notion of revenue reflecting activity towards completion—argues that there might be a case for reflecting completion activity as well:

However, views are split about the importance of the right to consideration in the revenue recognition definition and the fact that from the perspective of financial statements’ users, it may be more important to know what can be hauled out than what efforts have been made to date (independent of whether the efforts are successful).

- 34 Similarly, the DASB supports the idea of revenue reflecting activity towards completion but also points out that certain criteria need to be met in order to apply such an approach. These additional criteria could be:

...(the existence of) an agreement with a third party, a transfer of risks and rewards, a reliable measurement of both revenue and costs associated with the transaction and the probability that economic benefits associated with the agreement will flow to the entity.

- 35 The ACCA also supports measuring activity towards completion but suggests adding “milestones” in order to make the information more reliable:

However, although this implies a continuous recognition of revenue, we believe that this should be supportable by a series of contractually determined events. This appears to be akin to Approach C in Chapter 3, which is described as a critical event approach, which includes disaggregating the contract into part-outputs that have value to the customer.

Depending on the type of transaction, revenue can either measure completion activity or activity towards completion

- 36 Some respondents believe that, depending on the type of transaction, revenue can either measure completion activity or activity towards completion. Such respondents are generally in favour of keeping the current distinction as set out in IAS 11 and IAS 18. In case of construction contracts and services revenue shall measure activity towards completion. In case of sales of items it shall reflect completion activity. For example, although ASCP states that is in favour of measuring activity towards completion, it goes on to say that this:

...does not mean that in some sorts of economic activities (e.g. groceries retail) revenue will not be the measure of the final fulfilling of the contract with a customer. It will depend on the duration and the provisions of the contract.

- 37 Many respondents share this view. Indeed, if we include respondents who have not answered the question itself but have stated in their cover notes a preference for keeping the status quo of IAS 18 and IAS 11, this group is the biggest one.

More work is necessary to decide on this issue

- 38 Some respondents did not state a preference and seemed to tend to the view that more work is necessary before a decision can be taken on how to proceed. This view was based on a range of reasons. For example:

- (a) ASB “doubt if the dilemma is as sharp as that presented in the question. Obviously financial statements should attempt to give a full and informative picture of both the economic activity of the period and the inflows achieved as a result of economic activity.”
- (b) ACTEO et al. note that the analysis given in the paper does not cover the question of whether relevant and reliable information is generated that serves users’ needs.

*Question 5(a)*

*Chapter 3 discusses when revenue arises and, in doing so, introduces various critical event approaches to revenue recognition and explores three of them (Approaches A, B and C) in detail. Do you believe the discussion of Approaches A to C is fair and complete? ... If you do not, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.*

- 39 Overall, respondents considered the analysis given in the paper fair and complete and a good basis for discussion.
- 40 However, ASB thought the analysis focuses too much on legal form and too little on economic substance. In its opinion, the paper should have considered “more carefully notions of ‘exchange’ and ‘customer consideration’ to see if such an approach might be workable, and even, perhaps, provide a useful approach to the accounting for construction contracts.”
- 41 CNC said that more work needs to be done on the question of how to disaggregate a contract.

*Question 5(b)*

*Do you believe there are any critical event approaches other than Approaches A to C that have merit and are worth exploring in greater detail? (If you do, please could you describe those approaches and explain why you think they are worth exploring further.)*

- 42 Besides the issues already addressed under (a), no other critical events approaches were mentioned by respondents.

*Question 6*

*Chapter 4 continues the discussion of when revenue arises by introducing and exploring ... the continuous approach (Approach D). Again, do you believe the discussion is fair and complete? (If you do not, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.)*

- 43 All in all, respondents agree that the analysis of the continuous approach is “fair and complete”. However, most of them listed certain issues that they thought needed further clarification.
- 44 Acteo et al noted that, even if the continuous approach was made the general, overriding principle, exceptions would still be needed to avoid an unfavourable cost/benefit ratio for changes in accounting for simple sales transactions and boundaries for those exceptions would need to be defined. FEE considers it necessary to give further guidance on how to measure the progress of contracts for non-specified or non-identifiable goods. It was also concerned about the need to measure progress reliably. In a similar vein, ACCA thinks it important to be clear to which assets and liabilities the approach (which measures revenue as changes in assets and liabilities) refers.

- 45 CNC discussed the continuous approach at length. One of the questions it raised is how activities which, though being necessary for overall contract fulfilment, are carried out before signing a contract are taken into consideration under the continuous approach. It wondered whether there would be an immediate recognition of revenue at contract inception for such activities.
- 46 ASB criticised the paper for not addressing what the “boundaries of performance towards completion” are. According to ASB it is not clear from the paper’s discussion of the continuous approach which of the following activities carried out under a contract would give rise to revenue: (i) locate and recruit staff with the appropriate skills and availability; (ii) locate and purchase equipment; (iii) cancel another contract that could not be performed together with the swimming pool contract; (iv) cancel a personal holiday. ASB furthermore questions if the continuous approach is indeed an assets/liabilities approach, and suggests that there needs to be further discussion of the relationship between “activity that reflects performance towards completion of a contract” and a “gross inflow of economic benefits”.
- 47 As will be discussed further under question 8, some respondents do not believe it appropriate for the general principle to be based on the continuous approach. For example SwissHoldings is concerned that a user would be faced “with a less understandable, mixed pattern of revenues which he would require substantial further information to properly understand and to compare between firms and on which he could place less reliance because of the subjective elements included in the measurements.”
- 48 In a similar vein, GEFIU (Automotive) sees the reliability of the information provided being a concern if revenue is determined following the continuous approach. It argues that the practical implementation issues that would arise from the approach are not covered sufficiently by the paper. It concluded that the application of the continuous approach would, for the majority of preparers, change accounting for the worse.

*Question 7*

*The discussion in the paper is about concepts and principles — and not at this stage practicalities — and the paper uses a variety of simple examples to illustrate the various approaches and various conceptual discussion points. (...) Do you believe there are other examples that would illustrate or highlight issues of concept or principle that are not so far identified in the paper? If you do, what are those examples and what new aspect of the debate is it that you think they illustrate or highlight?*

- 49 Responses to this question are mixed. Some respondents point out that the paper addresses only simple transactions, and practical problems typically arise in connection with more complex transactions. However, the majority said that, all in all, the examples covered key types of transactions companies face.
- 50 Regarding additional examples, ASB suggests:

It would be interesting to test the approaches by reference to an example where performance will clearly take a long time (longer than one accounting

period), and where the supplier's right to payment is clearly contingent (both in substance and in form) on the product being completed and meeting pre-established performance conditions. We would agree that such a contract will rarely arise in practice because it leaves all the risk with the supplier and none with the customer. But this might suggest it is all the more important that revenue is not recognised until it is assured, and permit debate as to whether safeguards such as requiring a reliable estimate of outcome are sufficient.

- 51 DASB suggests a further analysis of issues currently discussed by IASB and FASB.
- 52 FEE would like to see more examples of multiple element arrangements.

*Question 8*

*What are your views on the relative merits of the approaches discussed in the paper? Do you believe that one approach is preferable to the others and could — perhaps after some further development work—be applied satisfactorily in all circumstances? (Please explain your reasoning.)*

- 53 This question has two aspects: what are the respondent's preferences regarding the approaches discussed; and should one approach be applied to all transactions. Some respondents therefore answered – in accordance with the earlier discussion on one principle – that the approaches have their merits in different situations. For simple sales transactions, the critical events approach is favoured by many; and, if an entity enters a long-term construction contract, application of the continuous approach would be preferred. Therefore responses cover the whole spectrum of possible views. However, the discussion focussed on critical events approach versus continuous approach rather than on the merits of different critical events approaches.
- 54 Some respondents, such as the ACCA, DASB or FEE, support the continuous approach— at least as a starting point for defining one leading principle. However, additional criteria are needed to, for example, ensure reliability. In this respect ACCA actually favours a continuous approach that is similar to a modified approach C; in other words, an approach that includes certain “milestones”. Respondents who support the continuous approach generally noted that further analysis is necessary.
- 55 In the view of the ICAEW the paper “perhaps makes the most persuasive case for Approach D: it is presented as aligned better with the Framework than the alternative approaches and as having the broadest applicability—being capable, in principle at least, of being applied satisfactorily in a range of circumstances.” However, ICAEW has not yet reached a conclusion on the various alternatives and does not consider the paper provides a sufficient basis for reaching such conclusions.
- 56 Some respondents (GEFIU (Automotive), GEFIU (Chemical), Swiss Holdings, Nestec Ltd) reject the continuous approach as the leading principle, mostly on the grounds of the costs associated with its implementation and application and the low reliability they believe the resulting information will have. For example GEFIU

(Chemical) analysed the implications of the continuous approach for the Chemical industry in mainly negative terms. GEFIU (Chemical)'s suggestion:

...is to develop an appropriate Critical Events Approach with approach A remaining the principle for normal delivery of goods without any revenue recognition in the course of production for intermediate products. For multiple-element arrangements a split up in part-contracts is economically necessary, based on principles that can be implemented and adopted consistently.

57 Business Europe see the continuous approach:

...as being suitable for some industries (...). However, it would be less suitable to reflect revenue recognition for short-term contracts and revenue-generating transactions that have a variable term, e.g. value adding chains that starting from raw material produce large quantities of a product and –if the customer asks for it- might include financial services. For these transactions, the continuous approach would increase complexity without creating additional value to the readers of financial statements. Since it must be widely based on assumptions and subjective judgement information would possibly even become less useful for financial statement users as a basis for decisions.

58 Some, such as ASB and CNC, state no preference because they consider that further work is necessary before a decision is taken as to which if any single approach should be the leading principle. ICA suggests carrying out some field testing, arguing that every conceptually sound approach needs to be tested for applicability.

*Question 9*

*At various points in the paper the authors discuss the issue of perspective; from whose perspective or point of view (ie through whose eyes) should performance be assessed? The suppliers or the customers?...*

59 Overall, respondents favour the assessment of performance from a supplier's perspective. However, some point out that, although generally the supplier's view should be taken, the customer's perspective is important too. For example, ASB states:

...if revenue is to represent an inflow (and not merely the expectation of an inflow) it will be necessary for there to be evidence that what has been done has resulted in a claim on the customer. For this reason, the position of the customer is clearly relevant.

60 In a similar vein, ACCA:

...equally support the use of contractually determined events in verifying the various critical stages in the continuum of a contract, which would include the customer perspective also, if only to substantiate the supplier outlook.

*Question 10*

*Do you believe there are particular aspects of the revenue debate that have not been covered in this paper but are worthy of consideration. If you do, what are they and why do you believe they are worth exploring further?*

- 61 Some respondents think that, now that the PAAinE paper has been issued and been discussed, the focus should now shift to an evaluation of the approaches to revenue recognition being discussed by IASB and FASB, rather than on developing and issuing further own material.
- 62 However, respondents also suggested that, if further original material were to be developed as part of the PAAinE initiative, the following issues already discussed in the paper are worth exploring further:
- Status of the contract
  - What constitutes revenue if, under a contract, presently there is less than an enforceable and unconditional right to consideration?
  - How the assumption and transfer of risks and rewards under the contract interacts with the continuous approach
  - Analysis of the nature and effect of rights and obligations under the contract; for example, in relation to specific performance
  - A clear exposition of how rights to consideration differ from activity
  - How to allocate activity under a contract; in other words, when does contract activity start and how is it distributed under the contract?
  - How multiple-element transactions should be dealt with
  - The significance of customer acceptance
  - What perspective should be taken of activity: supplier's or customer's?
  - Issues relating to the reversal of previously recognised revenue.
- 63 In addition, respondents would like to see a discussion of the following issues that are not discussed in the PAAinE paper:
- Measurement
  - How can ordinary activities be defined?
  - Definition of a unit of account
  - Where to draw the boundary between goods and services.



*PAAinE paper on Revenue Recognition: Summary of Comments*

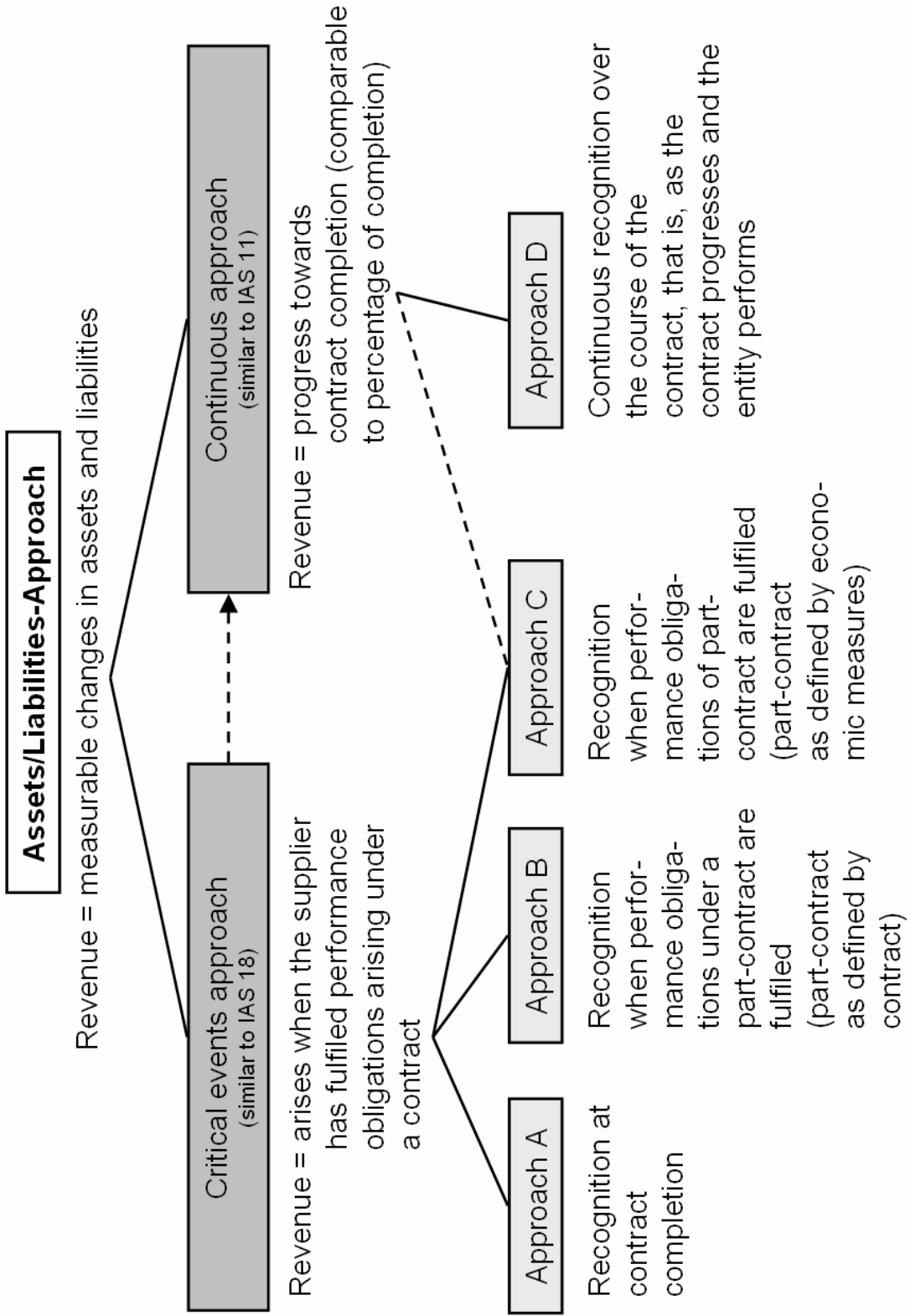
- Significance of customer's promise to pay
- Notion of exchange and the transfer of risks and rewards
- Contingent contracts.
- How to account for bill and hold-sales under the approaches
- Transactions carried out as an agent vs. those carried out as an principal

**APPENDIX A**  
**SUMMARY OF “REVENUE RECOGNITION: A EUROPEAN CONTRIBUTION”**

*(The following is the summary in the PAAinE Discussion Paper)*

- a Revenue issues have increasingly been the source of discussions amongst those applying, interpreting or enforcing accounting standards. This is partly due to the fact that new business models have evolved and new transaction types have emerged (such as multiple element arrangements) for which current IFRSs do not offer sufficient guidance. It is also because there are conceptual inconsistencies between IAS 18 *Revenue*, IAS 11 *Construction Contracts* and the IASB’s *Framework for the Preparation and Presentation of Financial Statements*. The result is that different practices have been adopted and inconsistencies and uncertainties have arisen.
- b Yet revenue—by which we mean the top-line of the income statement—is a very important number for users; one for which we need clear, consistent and comprehensive principle-based standards.
- c Against this background the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) decided in 2002 to start a joint project on revenue recognition and measurement. The objective of the project is to develop a comprehensive set of conceptually-based principles that will eliminate existing inconsistencies, fill voids that have emerged and provide guidance that will be useful in addressing issues that may arise in the future.
- d Recognising the need for Europe to get involved now if it is to participate effectively in the revenue debate, the DRSC and EFRAG decided to work together to prepare a paper that would stimulate debate within Europe and to encourage the development of European views on the subject. This paper is the result of that work. It examines revenue recognition from first principles, with the aim of establishing a framework within which to address in a consistent way the revenue issues that are arising and will arise in the future.
- e The existing conceptual frameworks of the IASB and FASB provide the basis both for the work being undertaken by the IASB and FASB in their joint project and for this paper. At the core of those frameworks—and therefore of this paper—is the so-called assets/liabilities approach.
- f The paper develops, through deduction and analysis, a working definition of revenue: revenue is the gross inflow of economic benefits that arises as an entity carries out activities pursuant to a contract with a customer (see Chapter 2).
- g Concluding that revenue should be recognised as soon as it arises and is measurable, the discussion in Chapters 3 and 4 then focuses on the question: when does revenue arise? The paper approaches this issue by considering some simple transactions and exploring, modifying and further exploring various views of revenue. Through this process, four possible views of revenue and approaches to revenue recognition are highlighted—Approaches A to D—and the paper analyses those approaches in detail.

- h It emerges through this work that there are two very different types of revenue recognition approach—the critical events approach and the continuous approach—and they are based on very different views of how revenue arises.
- i Under a critical events approach, revenue reflects fulfilment of all or just some of performance obligations entered into through a contract with a customer. Under such an approach, no revenue arises under a contract until a particular event or threshold in the contract (the critical event) has been reached; then all the revenue arises either on the critical event occurring or between that point and the end of the contract. IAS 18 is based largely on a critical event approach. Different critical events result in different critical event approaches. The critical event approach is explored in Chapter 3, and three particular approaches (Approaches A, B and C) are discussed in detail. All those approaches are based on the basic premise that revenue is what an entity gets when it has done something it promised to do for a customer—although they are based on different views as to what that ‘something’ should be.
- j The continuous approach (Approach D) takes a different route; revenue is something that arises as the supplier does something, not once it has done it. Under this approach revenue arises continuously over the course of the contract as the contract progresses and the supplier performs. As a result, rather than having to focus on critical events, the approach adopts the simpler approach of asking how far the contract has progressed. Various measures can be used to determine progress. The underlying principle is very similar to the percentage-of-completion method described in existing IAS 11.
- k The chart on the next page summarises the approaches covered by this paper. It shows the basic nature and major characteristics of the two types of approach and the four specific approaches explored in detail.
- l The paper’s discussion of the differences between and merits of the various approaches described will, the authors believe, provoke plenty of debate within Europe and elsewhere on this important issue—and provoking debate and encouraging Europe to develop views is what this paper is primarily about. However, for the record, the DRSC, having discussed the issues in detail and at length, has concluded that the continuous approach offers a solution for the accounting for multiple element arrangements as well as for the problem of conceptual inconsistencies among current standards and the Framework. For that reason it would propose in effect applying the ‘percentage-of-completion method’ generally, rather than limiting its application to long-term construction contracts. EFRAG and the CNC, on the other hand, have decided not to state a preference in this paper, although they do agree that a single approach needs to be applied to all transactions.
- m The authors would welcome comments on the discussion in this paper. An Invitation to Comment is set out in the next section of the paper.



## APPENDIX B Overview of respondents and structure of comment letters received

The table on the following pages gives an overview of the constituents, comments have been received from, and the structure of the comments received. Half of the respondents (9 out of 17) have rather commented on the paper in general instead of specifically addressing the questions.

Comment Letter		Constituent		Comments on PAAinE Paper										
Nr.	Date	Name Abbreviation	Country/ Geographical Area	Cover	Q 1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10
<b>Preparers and representative bodies of preparers</b>														
1	17.10.2007	<i>Representatives of the Chemical Industry in the Working Group “Externe Rechnungslegung” of GEFIU (Gesellschaft für Finanzwirtschaft in der Unternehmensführung e.V.)</i> GEFIU (Chemical)	Germany	x										
2	23.10.2007	<i>Representatives of the Automotive Industry in the Working Group “Externe Rechnungslegung” of GEFIU (Gesellschaft für Finanzwirtschaft in der Unternehmensführung e.V.)</i> GEFIU (Automotive)	Germany	x	x	x	x	x	x	x	x	x	x	x
3	17.12.2007	<i>BusinessEurope</i>	Pan-European	x										
4	12.12.2007	<i>Nestec Ltd.</i>	Switzerland	x										

		Nestec Ltd.												
5	10.12.2007	<i>Swiss Holdings – Federation of Industrial and Service Groups in Switzerland</i> SwissHoldings	Switzerland	x										
6	13.12.2007	<i>The Quoted Company Alliance</i> QCA	UK	x										
7	14.01.2008	<i>Association pour la participation des entreprises françaises à l'harmonisation comptables internationale/ Mouvement des Entreprises de France/ Association Française des Entreprises Privées</i> ACTEO/ AFEP/ MEDEF	France	x	x	x	x	x	x	x				x
<b>Accounting Firms</b>														
8	11.12.2007	<i>Ernst&amp;Young Global Limited</i> E&Y	Global	x										
<b>Standard-setters</b>														
9	14.12.2007	<i>Accounting Standards Committee in Poland</i> ASCP	Poland	x	x	x	x	x	x	x	x	x	x	x

10	26.11.2007	<b><i>Dutch Accounting Standards Board</i></b> DASB	The Netherlands	x	x	x	x	x	x	x	x	x	x	x
11	11.12.2007	<b><i>Conseil National de la Comptabilité</i></b> CNC	France	x	x	x	x	x	x	x	x	x	x	x
12	10.12.2007	<b><i>Accounting Standards Board</i></b> ASB	UK	x	x	x	x	x	x	x	x	x	x	x
<b>Accountancy Bodies</b>														
13	17.12.2007	<b><i>Association of Chartered Certified Accountants</i></b> ACCA	UK	x	x	x	x	x	x	x	x	x	x	x
14	11.01.2007	<b><i>Federation des Experts Comptables Européens (European Federation of Accountants)</i></b> FEE	Pan-European	x	x	x	x	x	x	x	x	x	x	x
15	22.02.2008	<b><i>The Institute of Chartered Accountants in England and Wales</i></b> ICAEW	UK	x	x	x	x	x	x	x	x	x	x	x

**Others**

16	10.12.2007	<i>International Controllers Association</i> ICA	Pan-European	x												
17	10.12.2007	<i>P.A. Pieterse van Wijck</i>	The Netherlands	x												
18	26.09.2007	<i>Erlend Kvaal</i>	Norway	x												

**Users and representative bodies of users**

No comments have been received from users or representative bodies of users.