

27 July 2009

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

Dear Sir/Madam,

Re: Preliminary Views on Revenue Recognition in Contracts with Customers

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers* ('the DP'). This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS.

Currently in IFRS we have two main standards on revenue recognition—IAS 11 *Construction Contracts* and IAS 18 *Revenue*. However, they appear to be based on inconsistent principles, and experience shows they cause a lot of implementation issues. In the US there are more than 100 standards and other pronouncements on revenue and gain recognition, many of which are industry-specific and some of which are conflicting. The IASB and FASB have decided to develop a fully converged revenue standard based on a single set of principles for recognition and measurement that would be applied to all types of revenue-generating activities. The DP focuses on revenue recognition in the context of contracts with customers only. In summary, it proposes that:

- If a contract comprises more than one performance obligation—in other words, more than one promise to transfer an asset to a customer—the performance obligations should be accounted for separately if they are satisfied at different times.
- Revenue should be recognised when an entity has satisfied a performance obligation arising under a contract with a customer. Such satisfaction will occur when control of the asset (a good or a service) involved is transferred to the customer. This proposal will result in a significant change in the timing of revenue recognition when contracts for construction and/or services are involved and no continuous transfer takes place. The DP acknowledges this difference in the case of the construction contracts, but seems to suggest that service contracts typically involve a continuous transfer. In our view there are many service contracts where the deliverable is delivered at the end of the contract (ie where there is no continuous transfer), and for those contracts revenue would be recognised later than under the current standards. Examples of such contracts include contracts for the provision of expert opinions, including audits.
- At contract inception both the rights arising out of the contract for the entity and the performance obligations involved are measured at the transaction price (that is the

promised consideration) and that measurement is not updated unless the performance obligation is deemed onerous. If a contract comprises more than one performance obligation and the obligations are required to be accounted for separately, the transaction price should be allocated based on the stand-alone selling prices of the goods and services underlying those performance obligations.

EFRAG welcomes work being carried on this subject because we believe that revenue recognition is the cause of many practical problems and that it will help all the IASB's constituents if the existing material on the subject could be enhanced. Furthermore, we recognise through our own work on the subject that revenue recognition is a subject that involves a number of extremely difficult issues and we are grateful to both Boards for considering those issues so thoroughly.

However, we have a fundamentally different view as to when revenue should be recognised to the one proposed in the paper. The DP proposes that revenue should be recognised only when a performance obligation is satisfied. We think it is unfortunate that the DP does not explain why the IASB regards revenue as an important figure because, had it done so, we might have had a better understanding of what it is that the IASB thinks revenue should represent and why it thinks that. EFRAG believes the financial statements would be most decision-useful were revenue a measure of activity carried out to fulfil a contract with a customer; in other words, if revenue was recognised as the entity progresses towards performance obligation fulfilment, rather than just on fulfilment. The model EFRAG favours is described in more detail in Appendix 2.

Putting that fundamental concern aside and focusing on the model proposed, we agree with much of what the DP proposes. Our detailed comments on the DP—which are set out in Appendix 1 to this letter—can be summarised as follows:

- We agree that a single, universally-applied set of revenue recognition and measurement principles is desirable—although whether it is achievable at the moment is another matter.
- We agree with the proposed definition of a performance obligation and the proposals on the separation of performance obligations. However, we think they will need to be supplemented by some carefully targeted further guidance if entities are to be able to apply the definitions and principles, and identify the deliverables in (or components of) a contract, in a consistent way. We are also concerned about the cost/benefits implications of applying the approach proposed in certain circumstances.
- We agree that the rights arising under the contract and the performance obligations should both be measured on initial recognition at the original transaction price.
- We also agree that, if there are separate performance obligations involved, the transaction price should be allocated to performance obligations on the basis of the entity's stand-alone selling price of the goods or services.
- We agree that performance obligations should be measured initially at the transaction price.
- We agree that performance obligations should not be remeasured, unless they are onerous. If they nevertheless are to be remeasured, we believe that this remeasurement should not affect revenue. We also agree with the paper's proposals on the identification and measurement of onerous performance obligations.

EFRAG's comment letter on IASB DP on Revenue Recognition

Our comments should be read in the context of existing IFRSs. We recognise that future developments in standards—for example derecognition of financial instruments, insurance contracts and the Framework—will have implications for the principles on which a general standard for revenue recognition in contracts with customers should be based.

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

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

APPENDIX 1

EFRAG's responses to the questions asked in the discussion paper

GENERAL COMMENTS

- 1 As is apparent from our response to questions 1, 2 and 9, EFRAG has a fundamentally different view as to what revenue is and when it should be recognised to the one proposed in the discussion paper. However, rather than making this point continually in our responses to individual questions, EFRAG has chosen to answer the remaining questions asked in the discussion paper on the basis that the revenue recognition model proposed in the discussion paper—that revenue is recognised only on satisfaction of a performance obligation—would be applied. The approach that EFRAG favours and the main differences and similarities between this approach and the model in the discussion paper are discussed in Appendix 2.

A CONTRACT-BASED REVENUE RECOGNITION PRINCIPLE

Question 1—Do you agree with the board's proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

EFRAG View

- EFRAG agrees that a single revenue recognition principle is preferable in theory to the existing two-principle model.
- However, EFRAG does not agree that this single principle should be based on changes in an entity's contract asset or contract liability.

A single, universally-applied revenue recognition principle

- 2 EFRAG agrees that a single, universally-applied revenue recognition principle is conceptually preferable to having two or more different revenue recognition principles. Under existing IFRS, it is not always clear which standard should be applied and the existence of two different principles makes it difficult to find accounting solutions for issues not explicitly dealt with in either standards.
- 3 Having said that, EFRAG also thinks that for pragmatic—principally cost-benefit—reasons it might be necessary to operationalise that single universally-applicable principle differently for different types of transactions. If that proves to be necessary, the aim should still be, however, to approximate to the single revenue recognition principle.

A focus on the contract asset or liability

- 4 EFRAG does not agree that:
- (a) revenue should be recognised only when a performance obligation is satisfied; in other words, that revenue is a measure of the fulfilment of performance obligations arising under contracts with customers; or

- (b) the revenue recognition principle should be based on changes in an entity's contract asset or contract liability.
- 5 EFRAG accepts that the discussion paper's focus on the contract asset or liability and its proposal that revenue is a measure of the satisfaction of performance obligations arising under contracts with customers is consistent with the Framework. However, in EFRAG's view there is another model that would result in more decision-useful information being provided to users and also would be consistent with the existing Framework. Under that model, revenue would be a measure of activities carried out to fulfil contracts with customers. From this conclusion, EFRAG has deduced that the focus of the revenue recognition principle should not be the satisfaction of a performance obligation (that is changes in the contract asset or liability). The assets and liabilities EFRAG believes should be considered and EFRAG's preferred model for revenue recognition are explained more fully in the response to Question 9 and in Appendix 2.
- 6 Because EFRAG believes revenue is a measure of activities carried out to fulfil contracts with customers, it follows that we believe revenue arises only when a contract with a customer is in place. That could also be different from the view expressed in the discussion paper which, though only dealing with revenue recognition in contracts with customers, does not state that revenue could not arise outside such a contract.

Question 2—Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

EFRAG View

- EFRAG does not think that the proposed principle would provide decision-useful information for certain service and construction-type contracts when performance takes place over a period of time but delivery to the customer is not on a continuous basis.
- 7 EFRAG agrees that there are many types of transactions where the proposed principle would provide decision-useful information. However, we do not think that the proposed principle would provide decision-useful information for construction-type contracts in which the asset under construction is not transferred to the customer on a continuous basis. Nor in our view would it provide decision-useful information in the case of a contract for services where there is no continuous delivery (in other words, when the service is delivered after a period of activity by the seller). In both cases the revenue recognised would cease to reflect the activity undertaken pursuant to contracts with customers, and we think that activity is what the revenue number should be seeking to measure.
- 8 For example, EFRAG understands that it is currently the case that, under some construction-type contracts consisting of only one major performance obligation, control of the contracted asset is transferred to the customer at a single point in time—at the end of the contract. Often that single point in time is in a later accounting period than the period in which most of the activities relating to the contract have been carried out. Under the revenue recognition model proposed in the discussion paper, no revenue on such contracts would be recognised until the end of the contract. That would mean that no profit on the contract would be recognised until the end of the contract, unless some other type of credit entry is made in the income statement (see the discussion in the next paragraph). That

would be the case even though the entity has in fact been very busy on activities being carried out pursuant to contracts with customers prior to that. We do not think this will result in decision useful information. We think that an entity that has progressed towards satisfying a performance obligation is 'better off' than an entity that for example has not even begun the fulfilment and that this fact should be reflected in the financial statements.

- 9 As the discussion paper focuses on revenue recognition, it does not consider the possibility that, even though revenue is not to be recognised in the above example until the end of the contract, some other type of credit entry (or entries) might be made in the income statement prior to that. For example, one possibility might be to recognise the value of the activities of the period undertaken pursuant to a contract with a customer on a line other than revenue to ensure that profit is recognised during the life of the contract. However, we think such an approach would introduce additional complexity into the financial statements and, in any case, it would mean that some key figures and ratios will no longer provide the useful information that they currently provide. For those reasons, EFRAG does not think this solution would be very satisfactory. It is our concerns about construction contracts in which the asset under construction is not transferred on a continuous basis that have caused us to question the fundamental principles on which the discussion paper's proposals are based. In EFRAG's view, the ultimate test of any principles for revenue recognition is whether they will result in the most decision-useful information of all the principles that are consistent with the Framework. We do not think the principles proposed in the discussion paper meet that test. That leaves us with two alternatives:
- (a) retain the principle proposed for most types of transaction, but develop a different principle for construction and service contracts in which the asset under construction is not transferred on a continuous basis; or
 - (b) develop a different principle that passes the 'ultimate test' and can be applied to all transactions.
- 10 As stated in response to Question 1, EFRAG would prefer that revenue recognition be based on a single principle. Therefore, EFRAG favours alternative (b). As mentioned already, EFRAG favours a revenue recognition principle that involves recognising revenue as the activity to fulfill a contract is carried out. In our view, such a principle will result in a useful measure of revenue both for construction and service contracts where no continuous transfer takes place and for other types of contracts. In practice though, recognising revenue at point of delivery (i.e. when control of the asset passes) may be—by proxy—an acceptable implementation of such a principle, for cost/benefit reasons, in industries where, for example, manufacturing processes are short.

Question 3—Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

EFRAG View

- EFRAG believes that there should be only include one definition of a contract in IFRS: either the one in IAS 32, the one proposed in the DP or another definition.
- We are not convinced that the definitions in IAS 32 and this DP are the same.
- We are not aware of jurisdictions in which it would be difficult to apply the definition.

- 11 We think IFRS should have only one definition of a contract. It would be confusing otherwise. That would be the case even if the two definitions are believed to be consistent with each other. Therefore, either the current definition in IAS 32 or the proposed new definition should be eliminated.
- 12 EFRAG notes that, although the discussion paper describes the two definitions as consistent, they are worded differently. It is not clear to us how the IAS 32 definition's reference to "clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law" could be the same as the discussion paper's reference to "that creates enforceable obligations". Therefore, if the two definitions are to co-exist or if it is going to be argued that they are the same, we think it is important that the IASB explains why that is the case despite this apparently significant difference in wording.
- 13 Also, during its discussions EFRAG has noted that different interpretations of the term 'enforceable' exist. Whilst some think it represents what would be recognised as enforceable by the courts, others think the meaning is broader and could include economic compulsion and threat. EFRAG would therefore encourage IASB to clarify this aspect of the definitions.
- 14 In response to the second part of the question, EFRAG is not aware of any jurisdictions in which the proposed definition would be difficult to apply.

PERFORMANCE OBLIGATIONS

Question 4—Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

EFRAG View

- EFRAG does not disagree with the definition of a performance obligation, but without further guidance we do not think it would help entities to identify consistently the deliverables in a contract.

- 15 Although EFRAG does not disagree with the discussion paper's definition of a performance obligation, we do not think that the definition and supporting material in the discussion paper would be sufficient to enable entities to identify the deliverables in a contract on a consistent basis. For example, when EFRAG discussed the issues raised by questions 6 and 7 (that is, whether return rights, and sale incentives are performance obligations related to the existing contract) different EFRAG members interpreted the definition in different ways.
- 16 EFRAG members also had difficulties applying the notion to warranties. For example, if a customer goes into a hi-fi shop, buys a CD player and agrees at the same time to buy the shop's extended warranty service, EFRAG is in no doubt that two things have been purchased. Perhaps the position becomes a little less clear if, rather than buying an extended warranty, the customer buys a CD player to which is attached a statutory one year warranty, although EFRAG's tentative view is that again two things are being purchased. But what if no formal warranty terms are attached to the purchase except for a general statutory requirement that the goods should meet the specifications of the contract? It could be argued that the requirement that a good should meet the specifications of the contract is just

another form of statutory warranty, although EFRAG tentatively believes that it is a necessary part of the sale of the CD player (and therefore has to be met if the transaction is not to be a failed sale). These are difficult issues and the discussion paper does not make proposals on all of them, although it does speak of all warranties – regardless of whether they are statutory warranties or extended warranties – as separate performance obligations.

- 17 EFRAG's tentative view is that, conceptually, there is no difference between an extended warranty and a statutory warranty. They are both terms of the contract and they both involve separate performance obligations. However, EFRAG thinks that a line has to be drawn somewhere to distinguish a warranty from an uncompleted or failed sale, but is not sure how (or where) to draw that line.
- 18 For example, assume that an entity provides cleaning services and it promises that, if the work is not carried out properly / a customer is not satisfied with the job, it will be done again at no extra cost. We do not believe this guarantee is a separate performance obligation. Rather an unsatisfactory job is a failed sale. On the other hand, assume a car manufacturer sells high quality cars that it and its customers expect will not need to be repaired for at least five years. Assume also that the manufacturer guarantees that, should the car require repairs in the first five years, they will be done for free. This sounds like a warranty arrangement (and EFRAG tentatively believes that warranty arrangements are separate performance obligations), yet EFRAG is not convinced there is really a difference of substance between this transaction and the cleaning transaction. We think it would be really useful if the IASB would explore further through additional guidance the difference between a sale where the entity has not transferred an asset meeting the requirements of the contract (which in our view, at least in some cases, should be regarded as a failed sale) and a sale with a statutory warranty attached where the warranty is later invoked (which we think would—at least in some cases—be treated as a (successful) sale).
- 19 EFRAG members also had problems applying the paper's notion of performance obligations to audit and legal services, primarily because they were unsure whether there would be a continuous transfer of assets to the customers during such services. According to the discussion paper paragraph 4.38, a good is typically an asset that is transferred to a customer at a point in time, whereas a service is typically a continuous transfer of assets to a customer over a period of time. However, EFRAG is not convinced that is the case; rather we believe that there could be many exceptions to this—in other words there are many service contracts that involve a transfer of an asset to a customer only at one point in time. Furthermore, EFRAG suspects that it will not always be clear whether and when a service is being transferred.
- 20 It also concerns EFRAG that IASB itself, when rejecting the so-called current exit price approach (see the discussion paper paragraphs 5.23 – 5.25), seems to acknowledge that there is a potential risk that under the proposed model entities will fail to identify performance obligations at contract inception.
- 21 For all these reasons, we do not think that the IASB's proposed definition of a performance obligation—including the focus on what has been promised—would by itself help entities to consistently identify the deliverables in (or components of) a contract. However, we think some carefully targeted further guidance and the development of practice in the area over time could eventually result in a consistent application of the proposed model.

Question 5—Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

EFRAG View

- EFRAG agrees that in principle an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer. However, EFRAG would encourage the IASB to clarify the interaction of this proposal with the onerous contract test and examine whether other approaches could be used as proxies in certain cases for cost/benefit reasons.
- 22 EFRAG agrees that, under the model proposed in the paper, the objective should be to depict faithfully the changes in the performance obligations over the life of the contract. EFRAG also agrees that, although in theory an entity should always separate performance obligations in a contract and account for them separately, this is necessary in practice only when non-separation would mean that changes in the performance obligations over the life of the contract would not be depicted faithfully.
- 23 EFRAG also agrees that one circumstance in which the changes will not be depicted faithfully if there is non-separation is when the separate performance obligations are not all satisfied in the same period.
- 24 However, EFRAG thinks another circumstance in which separation might be necessary to achieve a faithful depiction is when onerous performance obligations might be involved. Much depends on the level at which the onerous contracts test is to be performed but, under some scenarios where the onerous test is carried out on a performance obligation level, profit would be affected if performance obligations are not separated. We think therefore that the IASB needs to make it clear at which level the onerous contracts test is to be performed. However, our assumption in writing this letter has been that the IASB's intention is that the onerous contract test should be carried out at the contract level for the remaining part of the contract. If that is the case, profit would be unaffected by whether or not performance obligations had been separated, so we would support the paper's proposals on the separation of performance obligations. (Onerous contracts are discussed further under Question 10(b).)
- 25 Having said that, we are concerned that the proposed approach would lead to some contracts having to be unbundled into numerous different performance obligations. For example, the proposed approach would lead to manufacturing contracts being unbundled into performance obligations relating to the sale of each component and a performance obligation to assemble the components, were it not for the fact that such items are usually delivered in an assembled form or in the same period. However, we think there could be circumstances in which delivery in assembled form or in the same period would not take place, or perhaps could not be assumed, and in these circumstances, the proposal would result in numerous different performance obligations having to be accounted for individually. For example, it might be that components are for various technical reasons in effect delivered into the control of the customer before being assembled. Another example where the proposed approach would lead to a contract being unbundled into numerous different performance obligations is a construction contract where it is not possible to estimate reliably the timing of the completion of different activities. Accordingly, these activities will have to be recorded separately in order to be able to fulfill the

requirement of the proposed approach. EFRAG therefore encourages the IASB to explore further whether it would always result in a proper balance between cost and benefit to require entities to identify, separate and account for every single performance obligation in these circumstances.

Question 6—Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

EFRAG View

- On balance EFRAG thinks that return rights will usually be separate performance obligations.

26 EFRAG recognises that this is a very difficult issue and there are good arguments both for the failed sale approach and for the separate performance obligation solution. However, on balance EFRAG thinks that return rights will usually and perhaps always be separate performance obligations.

(a) Firstly, we believe that, if control of the good has passed to a customer, a performance obligation has been satisfied and revenue should be recognised—even if there is a return right. In that case the related return right should be treated as a sold option (in other words, as a separate performance obligation). (We discuss the issue of when control passes—and whether the existence of a return right can in some circumstances prevent control passing—further in our response to Question 8.)

(b) We are unconvinced by the argument that the existence of a return right is some sort of indication that the customer has not yet accepted the entity's proposed contractual terms. If this was the case, no contract would exist until the unexercised right expires or lapses and in that case the entity would also be able to require the customer to return the goods. The fact that the entity is not able to do so is evidence that a contract enforceable on the entity exists.

27 In our view, the return right is an option – a term included in the contract associated with the asset transferred (a sub-contract) that should be accounted for as a separate performance obligation if the service inherent in the option is transferred to the customer at a different point in time than the main asset of the contract. The fact that the performance obligation related to the return right represents the service of the option, implies that the performance obligation does not, for example, reflect costs associated with putting returned goods back on the inventory shelves or handling the cash for reimbursement.

28 On the other hand, EFRAG is also concerned about some of the practical implications of regarding return rights as separate performance obligations.

(a) We have already mentioned that a key issue for us is whether control of the goods has passed from the entity. Therefore, for us much depends on how the term 'control' is interpreted. (This is an issue discussed briefly in our response to Question 8) In this context, some would argue that the existence of return rights can affect the existence or otherwise of control, and if that is the case generalised comments about return rights could not be made.

(b) We have during our debates explored various types of consignment stock arrangement, which are standard practice in some industries (including for example car sales and book sales). It seems to us that these transactions often do not involve sales, yet if the return rights are separate performance

obligations that is how they will be treated. We think this too might be about the meaning of control.

- (c) We mentioned earlier (in our response to Question 4) that we believe that, if a good is delivered and found not to meet the specification of the contract, no sale has taken place. In which case no revenue should be recognised. In our view that should be the case regardless of whether the rejection is achieved by exercising return rights that exist. It follows that it is important to differentiate effectively between the use of return rights because the goods do not meet the specification in the contract and the use of return rights for other reasons.

Question 7—Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

EFRAG View

- EFRAG thinks that the gift card and the discount offer in the example in paragraph 3.27 of the discussion paper are separate performance obligations. However, for practical reasons we also think that the discount offer should only be recognised if it is onerous.

29 EFRAG thinks that, in the gift cards example in paragraph 3.27 of the discussion paper, the gift card is a separate performance obligation. EFRAG's reasoning is that, when purchasing a music player, the customer at the same time receives an unconditional and enforceable right to download a certain amount of music. That right could be sold separately. It follows that the transaction involves two performance obligations: one relating to the music player and one relating to the download right.

30 This is also the case for the discount in the example. EFRAG thinks that the offer of a discount on future purchases is part of the contractual terms related to the first purchase and this part of the contract has been accepted by the customer. We therefore believe that the transaction involves two elements: the sale of the music player and the sale of an option (the right to buy future downloads at a discount). We note that this option is not a contract (an obligation for the customer) to buy the music as this offer has not yet been accepted by the customer. We therefore believe the sale of the option involves a separate performance obligation. The entity would have a performance obligation to give the customer a discount on future music purchases.

31 However, we can see that practical issues could arise in trying to recognise and measure the obligation. For example, sometimes the discounts offered are discounts from a price that no transactions ever take place at. It can also be difficult to determine when exercised options have lapsed (and thus when the performance obligation can be derecognised). We would therefore suggest that this performance obligation should only be recognised if the offer is so beneficial that this part of the contract would be loss generating.

32 The issue discussed above is whether particular types of sales incentives involve separate performance obligations, but we think it is also important to consider whether sales incentives represent revenue generating activities or should be regarded as marketing. If it is marketing, EFRAG's view is that it should not lead to the deferral of revenue.

SATISFACTION OF PERFORMANCE OBLIGATIONS

Question 8—Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

EFRAG View

- EFRAG agrees that, under the existing definition of an asset, an entity should derecognise an asset when it no longer has control of that asset. However, EFRAG can foresee practical problems using this approach because the term 'control' is not well defined in existing IFRS.

33 EFRAG notes that, in the existing Framework, an asset is defined as “a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.” It follows from that that a resource will cease to be a particular entity's asset when that entity no longer has control of the resource.¹ EFRAG therefore agrees with the discussion paper that, under the existing definition of an asset, an entity should derecognise an asset when it no longer has control of that asset.

34 We also agree that the point in time in which an asset is derecognised (as a result of a transfer) is the point at which the performance obligation has been satisfied and revenue should be recognised.

35 However, we think that stating that derecognition should take place when control is lost will only take us so far, because the notion of 'control' is not well understood—and is not viewed in the same way by all people. We can foresee some problems arising if the proposal as currently drafted is implemented. For example:

- (a) some argue that the risks and rewards test in IAS 18 is simply an attempt to implement a control-based test. They would therefore argue that the discussion paper is wrong to see control and risks and rewards as alternatives. We suspect that the IASB is hearing a similar argument from some constituents commenting on the control notion in ED 10 *Consolidated Financial Statements*. It is certainly a view we share to some extent.
- (b) the recent ED *Derecognition* raises a number of issues about the control notion described in this discussion paper. For example, in the ED if one entity transfers a financial asset to a second entity in circumstances that mean that the second entity does not have the practical and unilateral ability to dispose of the transferred asset, the first entity could still have control of the asset and should continue to recognise it. One circumstance in which the second entity might not have control of the transferred asset is when the entity has a valuable put option. We think this is analogous in many ways to a transaction in which an entity transfers goods to a customer as part of a sales transaction,

¹ It will also cease to be a particular entity's asset when it ceases to be a resource, but we are only discussing sales here and a resource ceasing to be a resource—because for example it has expired—is not an issue that is relevant in this context. Also, the Framework says that an item that meets the definition of an asset should be recognised if (a) it is probable that any future economic benefit associated with the item will flow to the entity and (b) the item has a cost or value that can be measured with reliability. It could be argued that an asset should cease to be recognised if either (a) or (b) is no longer met, but again that is not an issue that has particular relevance to the issue being discussed.

but also grants that customer return rights. Yet paragraph 4.12 appears to argue that in such circumstances the second entity/customer has control of the transferred asset.

- (c) we mentioned earlier in this letter the consignment stock arrangement that is a common transaction between car manufacturers and car dealers. We also mentioned the sale-or-return arrangement that is common between book publishers and bookshops. In both these transactions, if control of the inventory has deemed to have past to the car dealer/bookshop, the discussion paper would appear to concluding that a sale has taken place and revenue should be recognised. However, at least some of these arrangements are not in our view in substance a sale. We are not sure whether that means that control has not actually passed, or whether control is not the ultimate test.

Notwithstanding the above, we agree that, unless and until IASB changes the definition of an asset, the test has to be control-based. It is just that we think the basic principle will need to be supplemented by guidance that illustrates the principle if it is to be applied consistently.

- 36 It is common for a sales transaction to involve the entity delivering, on the customer's instruction, the goods or services to a third party. In such circumstances, it might be that the customer controls the goods or services just before they are transferred to the third party or it might be that, although the goods or services are being delivered to the customer's instructions, the customer never actually controls them. We think it important that the wording the IASB uses in the ED to describe the control notion takes into account such possibilities.

Question 9—The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

EFRAG View

- EFRAG disagrees that an entity should recognise revenue when a performance obligation is satisfied. In the view of EFRAG, revenue should be a measure of the activity undertaken in fulfilling a contract with a customer.

- 37 EFRAG agrees that an act of performance by the customer (for example, paying the contract price) does not result in revenue being generated. However, as mentioned earlier, EFRAG has some fundamental concerns with the approach proposed in the discussion paper.

- 38 EFRAG notes that the proposal could result in a significant change to existing practice, with the recognition of revenue occurring much later than at present on some (but not all) construction-type contracts and service contracts. As the objective of financial statements is to provide decision-useful information to users of financial statements, we have been considering whether this accounting effect would result in more decision-useful information than existing standards. It has been difficult to do this because the paper itself does not discuss the issue. Nor does it explain why the line 'revenue' of the income statement/statement of comprehensive income is important and what purpose it is intended to fulfil. We think this is a weakness of the paper and would encourage the IASB to explain what it believes revenue should represent and why.

- 39 Our tentative view is that the proposed model results in a reduction in the usefulness of the revenue number for construction-type that do not involve a continuous transfer of the asset being constructed to the customer and service contracts that do not involve a continuous transfer of an asset to the customer. As already mentioned, we recognise that the value of the activities of the period could be reported on another line than is not revenue but we think that approach would be problematical and would not address some of the issues that would arise concerning the effect the paper's proposal would have on some key figures and ratios.
- 40 In EFRAG's view the revenue number is at its most useful when it measures the activity undertaken in fulfilling a contract with a customer (see our response to Question 2). For that reason we believe that the activity undertaken pursuant to a contract with a customer should be the underlying revenue recognition principle. This revenue recognition model is further explained in Appendix 2.
- 41 We have so far expressed our concern solely in terms of those types of construction contract and service contract in which there is not continuous delivery, because in those cases revenue recognition in accordance with the principles in the discussion paper will be significantly out of line with the activity carried out pursuant to the contract. Our concern though is a generic one; we think the most decision-useful revenue number is one that represents a measure of activity in fulfilling a contract with a customer; in all circumstances in which the discussion paper's proposals do not approximate to that number, they are in our view unsatisfactory.

MEASUREMENT OF PERFORMANCE OBLIGATIONS

Question 10(a)—Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

EFRAG View

- EFRAG agrees that performance obligations should be measured initially at the transaction price. However, we would at the same time encourage the IASB to address whether a liability that represents a performance obligation arising from a contract with a customer should be measured on the same basis as other liabilities—and if so how liabilities should be measured.
- 42 We have stated previously that we believe that revenue should be some sort a measure of activity carried out in fulfilling a contract with a customer. It follows from this that no revenue should be recognised on contract inception as a result only of the fact that a contract is profitable, which in turn means, under the proposal in the discussion paper, that on contract inception the contract asset and contract liability should be measured at the same amount. We agree with the proposal that the contract asset should be measured at the original transaction price. It follows from all of this that we believe that the performance obligations should be measured initially at the original transaction price.
- 43 We recognise however that the issue raised in this question is part of the broader issue of how to measure liabilities. We think that, in order to make the use of IFRS less complicated, it is important that IFRS standards are consistent and that issues are treated in the same way from standard to standard (cross-cutting issues). We have therefore discussed the measurement of performance obligations on initial recognition (and subsequently) in the context of liability measurement generally.

- (a) A key issue that needs to be addressed is whether a liability that represents a performance obligation arising from a contract with a customer should be measured on the same basis as other liabilities; for example, a financial liability or a litigation liability or a liability arising from an insurance contract. This issue is not discussed in the discussion paper, which is probably a missed opportunity to discuss a fundamental cross-cutting issue that underlies a number of active projects. We encourage IASB to tackle this issue.
- (b) We would nevertheless note that, at least on the face of it, the proposals in the discussion paper are rather different from those set out in the IASB's 2007 Discussion Paper *Insurance Contracts*. That paper, for example, proposed an approach to liability measurement that was a type of current exit price approach. When we responded to that discussion paper, we did not express a view on the exit value approach proposed because we thought it difficult to comment on the proposal without getting into profit recognition issues, and we did not believe the paper provided a satisfactory basis for such a discussion. It needs also to be recognised that the Insurance Contracts paper did not deal with revenue recognition (although it did address profit (or income) recognition). We recognise that recognition of income and of revenue is not the same thing.
- 44 In reaching the view that the performance obligations should be measured initially at transaction price, we have focused primarily on the conceptual arguments and the decision-usefulness of the resulting information; we have not considered the practical implications. Nor have we debated what a current exit price approach would provide in terms of information to the users. However, we agree with the comment in the discussion paper that the current exit price approach appears to be more complex than the original transaction price approach—indeed, we think it appears to be much more complex.
- 45 Incidentally, we are concerned about the second argument the boards have used in favour of the original transaction price approach; that the exit price approach would mean day one revenue if all the performance obligations are not identified. We think that, if there is a real risk of not identifying a performance obligation, there are bigger problems with the model proposed than just measurement. This issue is discussed further in our response to Question 4.

Question 10(b)—Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

EFRAG View

- We do not believe that the paper is clear as to the level at which the onerous contract test should be performed. We think the IASB needs to clarify this.
- However, on the assumption that the onerous contract test is carried out at the contract level, we support the proposed approach.

- 46 EFRAG believes that both of the triggers discussed in the paper have weaknesses. The fact that a cost trigger can result in an entity recognising adverse changes in circumstances in periods after the period in which the changes occur means that it might not result in timely information being provided to users of financial statements. On the other hand, the current price trigger approach is likely to be

costly to apply. For those reasons, EFRAG considered various other possible models for identifying an onerous performance obligation but did not identify one that seemed any better than the ones discussed in the paper.

- 47 Of the approaches discussed in the paper, EFRAG favours the cost trigger approach, because it is practicable; in other words we agree that a performance obligation should be deemed onerous if the expected cost to satisfy the obligation exceeds the carrying amount of the obligation.
- 48 Bearing that in mind, we also agree with the proposal in the paper that a performance obligation that is deemed onerous should be remeasured to the entity's expected cost to satisfy the performance obligation. However, we would wish such remeasurement to result in higher revenue being recognised when the performance obligation is eventually satisfied. Rather we think that the expected loss should be recognised as a provision that should be derecognised in periods in which the cost to satisfy the performance obligation are incurred.
- 49 In our response to question 5, we discussed briefly the level at which the onerous 'contract' test should be performed. For example, should it be at the level of the performance obligation or at the level of the contract. We stated then that we think the IASB needs to be clear about this issue. In this letter we have assumed that the paper intends the test to be applied at the level of the remaining contract. Finally, we think it is important that, whatever model IASB chooses, there is consistency between it and the model in the revised version of IAS 37.

Question 10(c)—Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristics of the obligation make that approach unsuitable? Please provide examples.

and

Question 10(d)—Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

EFrag View

- EFRAG believes that the measurement of revenue should reflect the amount an entity receives in consideration for its transfer of an asset to the customer. Therefore increases or decreases resulting from remeasurement should not be recognised as revenue.
- EFRAG also believes that performance obligations within the scope of IAS 39, insurance contracts and leases should initially not be within the scope of the revenue recognition standard.

- 50 Paragraphs 5.84 and 5.85 of the discussion paper explain that, although the IASB thinks that its proposed approach results in decision-useful information for most contracts with customers, "some are concerned that the proposed approach might not result in decision-useful information for some contracts, particularly for contracts with highly variable outcomes. In those contracts, there is a risk that the initial locked-in measurement may not continue to provide decision-useful information about the entity's performance obligations at each financial statement date.

Variability in the outcome of a contract may arise if uncertainty is a significant inherent characteristic of the contract, the prices of the underlying goods and services are volatile, or the duration of the contract is such that significant changes in circumstances are likely.” Later, in paragraph 5.90, the IASB mentions the following as examples of the contracts it was referring to in paragraphs 5.84 and 5.85:

- (a) long-term, fixed price contracts for goods and services with volatile prices, eg a take-or-pay contract for power or a commodity.
 - (b) contracts in which the outcome depends on specified uncertain future events, eg many guarantees, warranties, contracts with customer options and other stand-ready obligations, particularly if longer-term.
 - (c) long-term contracts involving ‘big ticket’ items, such as large construction projects.
- 51 Paragraph S11 explains that, as a result, the IASB has been considering whether the proposed approach would provide decision-useful information for the following contracts:
- (a) financial instruments and some non-financial instrument contracts that otherwise would be in the scope of IAS 39. In the boards’ view, because of the potential volatility in the value of those contracts, the proposed revenue recognition model might not always provide decision-useful information about them.
 - (b) insurance contracts that are in the scope of IFRS 4. In the IASB’s view, the proposed revenue recognition model might provide decision-useful information for some contracts that the insurance project is considering, but not all of them.
 - (c) leasing contracts that are in the scope of IAS 17. The IASB and FASB have a joint project on lease accounting but have not yet decided how the proposed revenue recognition model would apply to lessor accounting.
- 52 It is perhaps worth starting by reminding ourselves that a key objective of this project is to develop a single, universally-applicable revenue recognition principle. EFRAG supports this objective, as we explained in our response to Question 1.
- (a) In a principles-based financial reporting system, it would be odd to have more than one notion of what revenue represents and when it arises.
 - (b) There are also good practical reasons to have a single principle. In particular, if there is more than one principle, it will be necessary to draw some sort of line between those transactions that should be accounted for using one principle and those that should be accounted for using the other. Boundaries of this type almost inevitably lead to complexity and to comparability issues. It can also be difficult knowing which principle to apply to new types of transaction.
- 53 If it is decided that the principle in the paper does not work well for certain types of contract, we either have to find a ‘better’ principle or accept that the goal of a single, universally-applicable revenue recognition principle is not achievable in practice, at least for the time being. And, if we conclude that it is not possible at the current time to have a single, universally-applicable revenue recognition principle, we need

to consider whether it would be better, in the circumstances, to continue to use the existing IFRS model (with two principles), perhaps supplemented by additional guidance.

- 54 We have already explained that in our view it would have been preferable to adopt a revenue recognition principle that involves recognising revenue as the contract progresses. We think that principle could deal with some of the concerns underlying the types of contract referred to in paragraphs 5.90 and S11 of the discussion paper (see above). However, we accept that the principle would not eliminate the concerns.

Contracts referred to in paragraph 5.90 of the paper

- 55 EFRAG's understanding is that the concerns underlying the contracts listed in paragraph 5.90 of the paper relate to whether the approach proposed in the paper, with its focus on original transaction price and remeasurements only if obligations become onerous, is able to cope satisfactorily with contracts where there is significant uncertainty as to the outcome (in terms of overall contract profitability). It is, we understand, these types of contract that have led some IASB and FASB members to argue for a current exit price model and remeasurement of performance obligations rather than an original transaction price.
- 56 We should also state that we are not persuaded that, in every circumstance in which there is significant uncertainty, the approach that results in the most useful information will always involve remeasurement. Indeed, we think that remeasurement can sometimes have the effect of obscuring the uncertainty that exists.
- 57 Furthermore, we think it is important to differentiate, on issues such as this, between changes in performance obligations that result in revenue recognition and changes in performance obligations that result in income (or profit) recognition but not revenue recognition. For example, it might be that changes in expectations about future outcomes are an income recognition event, but not a revenue recognition event. Thus, the measurement approach that might be best for the performance obligation might not be the measurement approach that is best for revenue recognition because, although all these issues have tended to be related in the past, it does not follow that they should continue to be related—or at least related in the same way.
- 58 Bearing all these things in mind, we are not convinced that any of the types of contract mentioned in paragraph 5.90 raise concerns that cause us to believe that a different revenue recognition and measurement model to the one proposed in the discussion paper is necessary. On the other hand, we think it worth exploring whether the performance obligations themselves would in these circumstances be more usefully measured using a different alternative measurement basis. We think they may.
- 59 However, again, even though a different basis of measurement for some performance obligations would be necessary in order to provide decision-useful information, this should not affect how revenue is measured. In the view of EFRAG, the measurement of revenue should reflect the amount an entity receives in consideration for its transfer of an asset to the customer. Revenue should therefore for example not reflect increases or decreases in the costs to satisfy a performance obligation. In other words, if a performance obligation is measured using a different approach than the original transaction price, this measurement should not be used for revenue recognition purposes. Instead revenue recognition should be as if the

performance obligation had been measured at the original transaction price. This approach would require that an entity record (but not necessarily present or disclose) the original transaction price for revenue measurement purposes even when it measures its performance obligation at another amount.

Contracts referred to in paragraph S11 of the paper

- 60 We see the items listed in paragraph S11 of the paper (financial instruments, insurance contracts and lease contracts) in very different terms to the paragraph 5.90 list (contracts with significantly uncertain outcomes). That is primarily because the paragraph S11 items are industry-specific and the IASB is currently carrying out major projects to develop comprehensive standards for those contract-types. We believe, as we have said already, that for conceptual and practical reasons it would be best if a single approach applied to all transactions, regardless of industry, but we also think it would be wrong simply to assume—or to take quick decisions without considering the issues in a comprehensive way—an approach developed with more generalised types of contract will necessarily also work for these industry-specific transactions. More work is needed on the industry-specific areas first.
- 61 On the other hand, we recognise that it could be argued that, if one wants a single, universally-applicable principle, decisions in this revenue recognition project should be deferred until the insurance, leasing and financial instruments projects have got further—because otherwise we run the risk of developing principles that will need to be changed when those projects are complete. The existence of cross-cutting issues of this type is of course a fact of life for all standard-setters, and they just have to find a balance that enables them to achieve progress and at the same time an increasing degree of consistency.
- 62 Bearing all this in mind, our tentative view is that for the time being the following performance obligations should not be within the scope of a revenue recognition standard:
- (a) *Performance obligations that would be within the scope of IAS 39.* Although many financial instruments would not meet the definition of a performance obligation as defined in the discussion paper—for example because the contract is not with a customer as defined—we think some performance obligations could be financial instruments. We do not think that it would help the understandability and decision-usefulness of the information to account for financial instruments differently depending on whether they meet the definition of performance obligation.
 - (b) *Insurance contracts.* The IASB has a major project on the accounting treatment of insurance contracts, and one of the key issues being considered in that project is how to measure insurance liabilities and what implications this has for the income statement. We think that, until that work is further advanced, all performance obligations relating to insurance contracts should be scoped out of the revenue recognition standard.
 - (c) *Leasing contracts.* Again, a major project on leases is underway and our view is that, until this work is further advanced, performance obligations in relation to leasing contracts should probably be excluded from the scope of a revenue recognition standard.

Question 11—The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

- (a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?
- (b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

EFRAG View

- EFRAG agrees that, under the model proposed in the discussion paper, amounts that an entity charges customers to recover any costs of obtaining the contract should be included in the initial measurement of the performance obligation.

63 As already mentioned, EFRAG agrees with the paper's proposals that, on contract inception, both the contract asset and contract liability should be measured at the original transaction price. We further agree that an entity should recognise pre-contract costs and any costs involved in obtaining the contract (including commissions) as expenses as they are incurred unless they qualify for recognition as an asset in accordance with other standards.

64 However, we understand why some are concerned about the proposal that, even though the original transaction price will have been set so as to recover certain pre-contract costs and contract acquisition costs, none of that price will be recognised immediately to 'match' those costs. It means, for example, that losses could arise in the early years of a profitable contract. It also means that an entity that is expanding will seem less profitable than one that is shrinking. However, in our view, regardless of how the price has been calculated, it is being earned by satisfying performance obligations and should therefore be recognised only as those obligations are satisfied.

65 EFRAG has specifically considered if, for example, revenue could in some way be allocated to commissions paid to an agent in relation to the acquisition of an insurance contract. EFRAG does not think that this would be in accordance with the model proposed in the discussion paper, because no performance obligation is fulfilled at that point. Some believe that this is another reason why basing revenue recognition on the fulfilment of performance obligations is not appropriate.

Question 12—Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling price of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

EFRAG View

- We agree with the proposal.
- We also think it should be clarified that the specific customer has to be taken into account when estimating the entity's stand-alone selling price.

66 EFRAG agrees with this proposal. We also think that, generally speaking, stand-alone selling prices ought also to be readily available and the method ought to be relatively simple to apply.

67 We have, though, debated at some length what the reference to the entity's stand-alone selling price might mean in certain circumstances. For example, we think that in many cases a stand-alone selling price would depend on the customer, so it is necessary to decide whether to account for this 'customer' effect. We think the stand-alone selling price is referring to the price the entity would have charged the customer, if that particular customer—and not any other customer—would have bought the good or service separately. We have reached that conclusion because in many cases it is likely to be impossible to estimate a stand-alone selling price without taking the customer into account. However, we think it would be useful if the ED could clarify the IASB's intentions.

68 We have also considered the situation in which the stand-alone selling price does not fully reflect the cost associated with providing an unbundled good or service. For example:

Assume a translator works for an entity under conditions where the control of the work performed is transferred to the customer on a continuous basis (for example because the customer owns the computer the translator is working on). The translator charges a fixed price per page to be translated no matter how many pages are to be translated. This price is therefore the translator's stand-alone selling price per page. If a customer has more than one page to be translated, the translator will not receive payment until all pages have been translated. However, the translation of each page could be sold separately, so the proposals in the discussion paper would require revenue to be recognised on a page by page basis. In this situation the model of the discussion paper would allow the translator to choose to translate the easiest pages first (ie those that involve the lowest cost) and to recognise revenue related to the translated pages based on the fixed stand-alone selling price per page even though all pages have to be translated before the translator would receive payment.

69 In exploring this example we have asked ourselves whether the paper's proposal would provide decision-useful information under these circumstances. We think it would. Even though the translator will also have to translate the more difficult pages before receiving the payment related to the more easy pages, the revenue on the easier pages has to be recognised at the time when these pages are translated and that the profit margin is higher when these pages are translated. Accordingly, this higher margin should also be reflected in profit and loss when the translation of the easy pages occurs.

Question 13—Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

EFRAG View

- EFRAG agrees with the proposal.

70 EFRAG agrees with the discussion paper that, if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for the purposes of allocating the transaction price.

71 EFRAG thinks that what the paper then goes on to propose is reasonable and pragmatic. Indeed, we think the only practical alternatives to the proposal would be to either prohibit—or at least not require—unbundling of contracts consisting of goods and services that are not also sold separately or to base unbundling on expected cost. EFRAG does not find these alternatives more attractive than the proposal.

72 However, as we explained in our response to Question 12, we think the price the entity should be estimating is the price at which the entity would sell the item on a standalone basis to that particular customer, and this needs to be borne in mind in the estimation exercise.

OTHER COMMENTS

73 As the discussion paper explains, the existing material on revenue recognition causes many difficult implementation issues. That is our experience too. For that reason we think it is important that the IASB tests its eventual standard to ensure that it addresses the various revenue related-issues that have been raised with IFRIC over the last few years.

APPENDIX 2

An alternative revenue recognition model

Introduction

- 1 In Appendix 1 EFRAG explains that it has a fundamentally different view as to when revenue should be recognised to the one proposed in the discussion paper. The discussion paper proposes that revenue should be recognised only when a performance obligation is satisfied, which means that revenue will be a measure of performance obligation fulfilment. EFRAG believes the financial statements would contain more decision-useful information were revenue to be a measure of activity carried out pursuant to a contract with a customer. The purpose of this appendix is to expand on that statement and provide an outline of how a revenue recognition model ('the alternative model') along the lines we favour might look. We encourage the IASB to explore the approach further.

Key principles

- 2 Under the alternative model, revenue would arise and be recognised as a result of activity carried out by an entity in order to keep a promise in a performance obligation arising under a contract with a customer; in other words as the entity progresses towards the fulfilment of a performance obligation. Therefore:
 - (a) If there is no contract or no activity by the entity under the contract, there can be no revenue to recognise.
 - (b) No revenue is recognised in respect of a particular performance obligation before work commences on fulfilling it or after it has been satisfied.
- 3 The model involves allocating total revenue to the activities performed, so a measure of the progress of the entity towards the fulfilment of a separate performance obligation shall be used that best reflects the relevant fair value of consideration for the part of the performance obligation performed. Often this could be estimated as the total consideration allocated to the performance obligation minus the cost plus the original profit margin related to the activities yet to be performed in order to be able to satisfy the obligation. In the case where an entity has already produced an item before a contract is obtained, part of the contract price is therefore recognised as revenue when the contract is obtained. The remaining part is recognised as the outstanding performance—including the distribution to the customer—is carried out.
- 4 The alternative model would in addition use many of the concepts developed in IASB's discussion paper. For example:
 - (a) 'a contract' shall be defined either in the way IAS 32 defines it or in accordance with the discussion paper;
 - (b) the total amount of revenue recognised on a contract shall equal the transaction price of that contract;
 - (c) if a contract comprises more than one performance obligation, those performance obligations that are expected to be satisfied at different times from the others should be treated as separate performance obligations and accounted for separately. For this purpose, the definition of a performance obligation shall be as set out in the discussion paper and the transaction price

of the contract shall be allocated between the separate performance obligations in the way proposed in the discussion paper;

- (d) the carrying value of a performance obligation shall be re-measured only as proposed in the discussion paper.
- (e) the requirements for, and treatment of the satisfaction of performance obligations will be identical to the discussion paper.

However, contrary to the model proposed in IASB's discussion paper, the satisfaction of a performance obligation would not be the event that would trigger revenue recognition in the alternative model, although revenue recognition may coincide. In the alternative model, the satisfaction of a performance obligation will result in the recognition of a receivable (or the decrease in the liability to the customer) and derecognition of a non-financial asset representing the asset transferred including a profit margin, while revenue may have been recognised earlier.

Asset/liability approach

- 5 As the discussion paper says, revenue arises because there have been certain increases in the net assets of the entity. EFRAG believes that, as an entity carries out activity pursuant to a contract with a customer, the entity builds up/ enhances the asset (good or service) that it ultimately (or continuously) is to transfer to the customer. Revenue should measure that progression.
- 6 At the satisfaction of a performance obligation, the asset to be transferred will be derecognised (satisfaction of a performance obligation is met when the promised asset transfers to the customer) and a receivable (or a decrease in the liability to the customer if the customer performed first) will be recognised instead. Those movements would reflect in the balance sheet but do not have any impact on the income statement (unless revenue recognition coincides with the satisfaction of a performance obligation as in a retail sale, for example).

Measurement

- 7 Performance obligations and contract assets would be measured under the alternative model in accordance with the discussion paper (subject to EFRAG's comments about that measurement approach) or in accordance with a more specific standard.
- 8 The asset that is built up pursuant to a contract with a customer would be measured under the alternative model at the fair value of the consideration for the part of the performance obligation performed. Often this could for example be approximated as:
 - (a) the fair value of the consideration received/receivable from the customer for satisfying the performance obligation less
 - (b) the estimated cost to completion plus the original profit margin relating to the activities yet to be performed in order to be able to satisfy the performance obligation.

The original profit margin would be based on the entity's estimated profit related to the contract at contract inception (or the margin built up in the estimate of a stand-alone selling price, if that has to be estimated at inception).

Implications

- 9 The alternative model is not an IAS 11 model. Compared to the model of IAS 11, the alternative model results in more unbundling than the requirements in IAS 11, paragraphs 8 and 9, would require. Under the alternative model, a contract that covers a number of assets that are transferred to the customer at different points of time and could be sold separately would include more performance obligations. These performance obligations should be accounted for separately.
- 10 It should also be noted, that although the alternative model would in some cases result in a different pattern of revenue recognition than the model proposed in the discussion paper, this will not be the case for many transactions. In a cash sale, for example when a customer buys things in a supermarket, the alternative model would not result in a different timing of revenue recognition because the time span of the transaction is so short.
- 11 Also, EFRAG thinks that for pragmatic—principally cost-benefit—reasons it might be necessary to operationalise the alternative model differently for different types of transactions. For example, recognising revenue at point of delivery (i.e. when control of the asset passes) may be—by proxy—an acceptable implementation of the model, for cost/benefit reasons, in industries where manufacturing processes are short.