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EFRAG
Attn. EFRAG Technical Expert Group
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Our ref : AdK
Date : Amsterdam, 26 November 2007
Re : Comment on PAAinE Discussion Paper relating to Revenue Recognition

Dear members of the EFRAG Technical Expert Group,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to respond to the PAAinE Discussion Paper on revenue recognition.

We are positive about the initiative of PAAinE to stimulate the debate on important issues at an early stage in the IASB's standard-setting process. Although it is PAAinE's intention to stimulate the debate in a principle based way we feel this might be emphasised even more in the papers drafted.

In principle we support the continuous approach (approach D) because we believe that the activity towards completion should measure the revenue. However, in our view in this approach other criteria than just the completion of activities have to be met before revenue is recognized (see also our answer to Q4). In our view, this approach leads to more relevant information about the economic activity undertaken pursuant to more complex customer contracts than critical event approaches. We also believe that the continuous approach is easier to apply to contracts involving multiple deliverables.

The discussion paper focuses mainly on the differences between the critical event approaches and the continuous approach and how the progress of contracts can be measured. The discussion paper focuses less on the discussion how to measure the performance obligations. Currently the IASB and the FASB are working together to develop two models for revenue recognition:

- the fair value model; and
- the customer contract.

We are of the opinion that to be pro-active this discussion paper should also focus on this issue.

In the appendix to this letter we have included our specific answers to the questions and our other comments.

Of course we would be happy to discuss our reaction with you.

Yours sincerely,

A handwritten signature in black ink, consisting of a vertical line on the left that curves into a horizontal line extending to the right, ending in a small hook.

Hans de Munnik
Chairman Dutch Accounting Standards Board

Appendix Answers to the questions and other comments

Q1 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. In particular, the standards do not address certain types of transaction (for example they say little about multiple-element arrangements), they are based on different principles (which leads to inconsistencies and uncertainties and makes it difficult to know how to use the standards to fill the gaps) and there are internal inconsistencies within IAS 18. The paper goes on to say that these gaps, inconsistencies and uncertainties are causing real practical problems. 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.)

Yes. IAS 18 is to a large extent based on income statement based approach and not on the balance sheet. Therefore IAS 18 relies to a large extent on the concepts of prudence and matching. This is not consistent with the current conceptual framework of the IASB, that is focused on the balance sheet.

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

IAS 18 does not explicitly address:

- *transactions involving multiple deliverables;*
- *gross versus net issues; and*
- *regulatory assets and liabilities: e.g. reduction of future prices revenues so as to return to customers excess amounts collected in the current period.*

Q2 Paragraph 1.20 states that the objective of the paper is to develop a framework within which to address revenue recognition issues in a consistent way. Paragraph 1.26 explains further that the ultimate objective of the revenue recognition debate should be to develop a set of principles that can be applied to all kinds of industries and business. In other words, rather than have different, competing principles like we do now, we would have a single principle or a single set of principles that apply generally and can be used to address any future gaps in standards.

(a) 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.)

Yes, in principle we agree. We can follow the arguments but we also noted the framework doesn't address the issues in regard to our response to Q1 with respect to regulatory assets and liabilities.

(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; the analysis and discussion is generic and not based on any particular sector. (For example, the paper's only reference to financial institutions is to note, in paragraph 1.26, that banks and insurers do not present a revenue number and to observe that it is outside the scope of the paper to consider whether such entities should present a revenue number and what such a number should represent were it to be provided.) Do you believe this approach is appropriate? If you do not, please could you explain which sectorspecific issues the paper should explore and why you think that would improve the quality of the analysis.

Yes, we agree.

Q3 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.

Yes, we agree.

(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.

Yes, but there could be an issue whether to record revenue gross or net. This issue can occur because of the difficulty of deciding whether the parties involved in any particular agreement are acting as principal or agent. The current guidance in IAS 18 on 'gross versus net' issues is limited.

(c) Revenue does not necessarily arise only from enforceable rights and obligations.

Yes, we agree

(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.

Yes, we agree. However the term 'contract' is a comprehensive term with different meaning in different jurisdictions. As is stated in footnote no. 11 of the Discussion paper it refers to an agreement between two parties and this does not need to be a written agreement. Therefore we prefer the term 'agreement'.

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.

No, we do not agree entirely. There could be situations in which entering into a contract can lead to a revenue because selling the contract can be considered as an activity. Based on an assets/liabilities approach it can be argued that, when certain conditions are met, entering into a contract leads to a contract asset that is higher than the contract obligation.

(e) Revenue does not necessarily involve an exchange.

Yes, we agree.

(f) Revenue is something that arises in the course of ordinary activities.

Yes, we agree.

(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.

We agree, but refer also to our comment under (d).

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.)

We suggest to introduce the notion that the recognized/presented revenue is based on the risks and rewards of an entity in a transaction. The notion of risks and rewards could be helpful to decide if an entity is acting as an agent or as a principal in a transaction.

Q4 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). This issue arises again and again in the paper and is the main issue that separates the critical event approaches discussed in Chapter 3 from the continuous approaches discussed in Chapter 4. The authors believe that a very important test of any proposed accounting solution is whether it is the most useful approach from a user perspective.

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.)

The activity towards completion should measure the revenue, although certain criteria should be met before revenue is recognized. For example these can 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. We believe that this approach leads to more relevant information about the economic activity undertaken pursuant to more complex customer contracts than critical event approaches. We also believe that the continuous approach is easier to apply to transactions involving multiple deliverables.

Q5 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.

(a) Do you believe the discussion of Approaches A to C is fair and complete? For example, do you believe that one of the approaches has some additional benefits or weaknesses that have not been mentioned? Or that some of the weaknesses mentioned are not weaknesses? (If you do, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.)

Yes, we believe that the discussion of approaches A to C is fair and complete.

(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.)

No.

Q6 Chapter 4 continues the discussion of when revenue arises by introducing and exploring another type of approach to revenue recognition: 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.)

Yes.

Q7 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. The examples are set out in Appendix IV. 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?

Other examples of contracts involving multiple deliverables and contracts in which it can be argued that signing the contract already leads to recognition of part of the revenue and profit. The discussion paper focuses mainly on how the progress of the contract can be measured and to a lesser extent on the discussion how to measure the performance obligations. Currently the IASB and the FASB are working together to develop two models for revenue recognition:

- *the fair value model; and*
- *the customer contract.*

We are of the opinion that to be pro-active PAAinE should also focus on this discussion.

Q8 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.)

Yes, we believe that approach D is preferable to the others as starting point in a principle based way for solving revenue recognition issues from a conceptual point of view. However, to apply the continuous approach it should be possible to measure the outcome of the contract reliably and other conditions mentioned in our answer to Q4 should be met. For simple agreements, approach D may not lead to impractical measurement issues at the end of a period. We believe that an amended approach D as indicated above can help to solve issues relating to the revenue recognition of longer and more complex agreements, like agreements involving multiple deliverables.

Q9 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? For example:

(a) the issue is first mentioned in paragraphs 3.36-3.39, where it is explained that one perspective is not necessarily better than the other, although one may be better suited (or even an inherent feature) of one particular approach, whilst another might be better suited or a feature of another approach;

(b) the issue is also discussed in paragraphs 4.4(c), 4.5(b) and 5.7(c), where it is explained that critical event approaches generally (but not necessarily always) apply a customer perspective whilst continuous approaches tend to apply a supplier perspective.

We are of the opinion that performance should be assessed from the perspective of the suppliers. That perspective leads to more relevant information about the performance relating to agreements with customers during a period.

In your opinion is this discussion complete and sufficiently conclusive? If you think it is not, could you please explain what more you think should be said and why.

Yes.

Q10 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?

Yes. See our answers to Q1, Q3 and Q7.