

## China Accounting Standards Committee

October 21, 2010

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

Dear Sir David Tweedie,

**Subject:** Exposure Draft 2010/6 "Revenue from Contracts with Customers"

Thank you for offering the Chinese Ministry of Finance and China Accounting Standards Committee an opportunity to comment on the Exposure Draft on *Revenue from Contracts with Customers*.

We appreciate IASB's effort to set up a single revenue recognition principle and we consider that the new revenue recognition model is more theoretically robust with a starting point on the definition of revenue, a basic principle on the concept of balance sheet and a core premise of control transfer.

At the same time, we are strongly concerned about the application influence of the new model, including two major issues: (a) for the revenue recognition of long term contracts, to what extent that the percentage of completion method can be allowed to be used; and (b) the volatility of revenue measurement influenced by customers' credit risk.

Please refer to the attachment for our detailed feedback on listed questions.

Yours Sincerely,

Yuting Liu

Director-General of Accounting Regulatory Department

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Member of China Accounting Standards Committee

中国会计准则委员会

China Accounting Standards Committee

**Attachment:** 

I. General comments on the ED

We appreciate IASB's effort to set up a single revenue recognition principle and we consider that the new revenue recognition model is more theoretically robust with a starting point on the definition of revenue, a basic principle on the concept of balance sheet and a core premise of control transfer. At the same time, we are concerned about the impact of the new model on the accounting practice, including the two major issues as follows:

(1) The revenue recognition of continuous transfer of goods or services. We are wondering to what extent that the percentage of completion method can be allowed to be used, which is widely used currently. The ED proposes that suitable methods of recognizing revenue to depict the continuous transfer of goods or services to the customer shall be applied, including output methods, input methods, and methods based on the passage of time. In the contracts terminated to deliver the completed assets to the customer (for example, construction-type, production-type and software development contracts), the entity shall recognize revenue only when the customer obtain control of the completed asset.

Based on the current principle description and examples, we believe it is uneasy to use control transfer method for long term service contracts (including construction contracts). The entity can only wait until the completed completion of the contract to recognize revenue once, which causes great volatility of revenue measurement from year to year so that it can not reflect the actual operating results.

(2) The volatility of revenue measurement influenced by customers' credit risk. The ED proposes that the entity shall estimate the probability-weighted amount of consideration to recognize revenue. It maintains the internal consistency with the San Li He St., Xicheng District, Beijing 100820, People's Republic of China

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concept of the impairment of financial instruments. However, we have three concerns

about this proposal: (a) It leaves the management possibility to manipulate the profit

as the result of subjectivity in revenue recognition; (b) It requires that the entity to

estimate the probability-weighted amount of consideration, which relies on a lot of

historical data or industry data, leaving smaller enterprises, or business from emerging

markets uneasy access to reliable data; (c) It would lead to inconsistency among

revenue, contracted consideration and invoice, the accounting information of which

can be very hard to explain to taxation department or other regulators.

Hence, it is our suggestion that collectability should not be considered when revenue is

recognized, whereas it should be referred as the issue regarding the quality of assets

and treated by subsequent impairment of account receivables. This treatment is easier

for entities to apply with the same impact on the net incomes.

II. Comments on listed questions

**Recognition of revenue** 

**Question 1:** Paragraphs 12-19 propose a principle (price interdependence) to help an

entity determine whether:

a) to combine two or more contracts and account for them as a single contract;

b) to segment a single contract and account for it as two or more contracts; and

c) to account for a contract modification as a separate contract or as part of the

original contract.

Do you agree with that principle? If not, what principle would you recommend, and

why, for determining whether (a) to combine or segment contracts and (b) to account

for a contract modification as a separate contract?

**Answer 1:** We believe that pricing is an important consideration, but should not be the

only judgment. As mentioned in IAS27, whether multi-arrangement should be treated

as a single transaction needs to consider comprehensively the terms, the conditions,

and the economic effect of these arrangements. For example, whether these

arrangements process simultaneously or affect each other, whether an arrangement depend on the occurrence of other arrangements, an arrangement considered separately is not economic but considered with other arrangements is not economic and so on.

**Question 2:** The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

**Answer 2:** We agree with the ED's proposals.

**Question 3:** Do you think that the proposed guidance in paragraphs 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

**Answer 3:** In our view, the guidance of control transfer is not sufficient in the ED.

- (1) The four indicators of control focus more on formal evidence (eg. legal title or unconditional obligation to pay, etc) without considering relations between each indicator. The confusing issue is that a reporting entity might be unable to appropriately weigh each indicator to determine whether control is completed or not.
- (2) It is lack of guidance on continuous transfer. The fact that the customers can continuously gaining control directly relates to whether the revenue is recognized once or being recognized accordingly. There are only some isolated cases provided in the ED, but no principle as guidance.
- (3) We suggest coordinate different defined revenues in various standards. As the core concept in revenue recognition, the definition is broadly scattered in different principles, including Business Combinations, Consolidation, and Related Parties. The only difference is: the "control" in revenue recognition model emphasizes on control over commodity or service, while the "control" in other principles emphasizes on

San Li He St., Xicheng District, Beijing 100820, People's Republic of China Tel: (86 10) 6855 2542 Fax: (86 10) 6855 3022 control over an entity. Those two definitions are fundamentally the same and the criteria should be internally consistent.

## Measurement of revenue

**Question 4:** The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

Answer 4: We agree with the ED's proposals. At the same time, we are strongly concern about the application issues. The ED proposes that when the consideration amount is highly susceptible to external factors, the transaction price reflects the probability-weighted amount of consideration that an entity expects to receive from the customer based on the calculation results of different situations, probabilities and the expected discount rate. The probability-weighted amount of consideration relies on a lot of historical data or industry data, leaving smaller enterprises, or business from emerging markets uneasy access to reliable data. Thus, There are two results may bring, one is that the entity recognize revenue optionally, another is that the entity recognize revenue until the completely elimination of uncertainty. Either of the results is considered as violation of the standards.

**Question 5:** Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than

whether the entity recognises revenue? If not, why?

**Answer 5:** We consider it inappropriate to take customer credit risk into account in revenue recognition. There are three reasons to support this statement:

- (1) It leaves the management much more possibility to manipulate the profit as the result of subjectivity in revenue recognition.
- (2) It requires that the entity to estimate the probability-weighted amount of consideration, which relies on a lot of historical data or industry data, leaving smaller enterprises, or business from emerging markets uneasy access to reliable data.
- (3) It would lead to inconsistency among revenue, contracted consideration and invoice, the accounting information of which can be very hard to explain to taxation department or other regulators.

Hence, it is our suggestion that collectability should not be considered when revenue is recognized, whereas it should be referred as the issue of the quality of assets and treated by subsequent impairment of account receivables. This treatment is easier for entities to apply with the same impact on the net incomes.

**Question 6:** Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

**Answer 6:** We agree with the ED's proposals.

**Question 7:** Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

**Answer 7:** We believe that the allocation method is appropriate. At the same time, we suggest that alternative allocation method is needed when stand-alone selling price can hardly be estimated, because it is uneasy to estimate in many cases. Not only in San Li He St., Xicheng District, Beijing 100820, People's Republic of China

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emerging market economies, but also the developed market, it is difficult to allocate

the transaction price to all separate performance obligations in proportion to the

stand-alone selling price underlying each of those performance obligations at contract

inception. It would lead to allocate the transaction price to all separate performance

obligations optionally and manipulate the revenue subjectively.

**Contract costs** 

**Question 8:** Paragraph 57 proposes that if costs incurred in fulfilling a contract do not

give rise to an asset eligible for recognition in accordance with other standards (for

example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible

Assets or ASC Topic 985 on software), an entity should recognise an asset only if

those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a

contract are operational and sufficient? If not, why?

**Answer 8:** We agree with the ED's proposals.

Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the

purposes of (a) recognising an asset for resources that the entity would use to satisfy

performance obligations in a contract and (b) any additional liability recognised for an

onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or

exclude and why?

**Answer 9:** We agree with the ED's proposals.

**Disclosure** 

Question 10: The objective of the boards' proposed disclosure requirements is to help

users of financial statements understand the amount, timing and uncertainty of

revenue and cash flows arising from contracts with customers. Do you think the

proposed disclosure requirements will meet that objective? If not, why?

**Answer 10:** We agree with the ED's proposals.

Question 11: The boards propose that an entity should disclose the amount of its

remaining performance obligations and the expected timing of their satisfaction for

contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any,

information do you think an entity should disclose about its remaining performance

obligations?

**Answer 11:** We agree with the ED's proposals.

**Question 12:** Do you agree that an entity should disaggregate revenue into the

categories that best depict how the amount, timing and uncertainty of revenue and

cash flows are affected by economic factors? If not, why?

**A12:** We agree with the ED's proposals.

Effective date and transition

Question 13: Do you agree that an entity should apply the proposed requirements

retrospectively (ie as if the entity had always applied the proposed requirements to all

contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about

revenue but at a lower cost? If so, please explain the alternative and why you think it

is better.

**Answer 13:** We prefer the perspective method with the following reasons: (1) the new

revenue recognition and measurement model would significantly affect the entity's

performance in some cases. For existing contracts with customers, the reporting entity

has already developed treatments for such contracts, and related stakeholders have

also developed their strategies accordingly. If revenue has to be adjusted

retrospectively just because of the change of revenue recognition principles, such treatment is not fair for both the entity and the stakeholders. (2) From the perspective of cost-benefit analysis, it's more costly to apply retrospective method, in contract, whether more effective and useful information is provided or not is in doubt.

## **Application guidance**

**Question 14:** The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Answer 14: In our views, the current application guidance is not enough to deal with most practical issues, especially on determination of control transfer, revenue recognition of long time contracts and estimate of separate pricing. Besides, regarding the product warranties, sometimes it's difficult and in need for more detailed guidance to distinguish whether it's for replacing defective products or it's for faults arising after the product is transferred to the customer.

**Question 15:** The boards propose that an entity should distinguish between the following types of product warranties:

- a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
- b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract. Do you agree with the proposed distinction between types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

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**Answer 15:** We agree with the ED's proposals.

Question 16: The boards propose the following if a licence is not considered to be a

sale of intellectual property:

a) if an entity grants a customer an exclusive licence to use its intellectual property,

it has a performance obligation to permit the use of its intellectual property and it

satisfies that obligation over the term of the licence; and

b) if an entity grants a customer a non-exclusive licence to use its intellectual

property, it has a performance obligation to transfer the licence and it satisfies that

obligation when the customer is able to use and benefit from the licence.

Do you agree that the pattern of revenue recognition should depend on whether the

licence is exclusive? Do you agree with the patterns of revenue recognition proposed

by the boards? Why or why not?

**Answer 16:** We agree with the ED's proposals.

**Consequential amendments** 

Question 17: The boards propose that in accounting for the gain or loss on the sale of

some non-financial assets (for example, intangible assets and property, plant and

equipment), an entity should apply the recognition and measurement principles of the

proposed revenue model. Do you agree? If not, why?

**Answer 17:** We agree with the ED's proposals.