

Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2010:15

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

Dear Sirs,

Re: ED/2010/6 Revenue Contracts with Customers

The Swedish Financial Reporting Board is responding to your invitation to comment on the above Exposure Draft (ED).

Revenue is an important item in the financial statements. Revenue is often used as a measure of activity in a firm and a starting point for making predictions of profits and cash flows. There are some problems within this area, mainly related to multi-element arrangements and long-term contracts, which have to be addressed.

However, we don't believe that there are sufficient evidence presented about the negative effects of the existing standards, IAS 11 and IAS 18, to justify the fundamental changes in revenue recognition which are proposed. We believe the proposal will result in a separation of financial accounting and management control within companies and less comparability across companies.

We do not agree with the arguments for a new standard as presented by IASB/FASB. IAS 11 and IAS 18 are said to be difficult to apply and understand. The only example given initially of what is not working properly is multi-element arrangements. The objectives of a new standard are said to be to remove inconsistencies and weaknesses in the current standards and to provide a more robust framework. In our opinion such statements should be followed by an analysis of what the negative effects are of those inconsistencies.

Furthermore, the proposal is said to improve comparability across industries and capital markets and facilitate the preparation of financial statements by reducing the number of requirements to which entities must refer. Some of these objectives apparently are referring to US GAAP which doesn't have a single standard on revenue recognition, but are not arguments for fundamentally changing IFRS.

The work on improvement should start with what is not working rather than alleged inconsistencies across standards or across standards and framework. We thus consider a new single view standard on revenue recognition **should not be Introduced**. Instead the required changes in these areas could be achieved by keeping, IAS 11, with certain modifications, and amending IAS 18. An amended IAS 18



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should be based on a further developed risk and rewards approach, the customer consideration approach and the concept of performance obligations as the unit of account.

Our main concerns with the current proposal are as follows:

- Reliance on transfer of control to establish when revenue is recognised means replacing economic considerations by legal considerations
- The legal concept of control is ambiguous and not well-suited to use as a basis for revenue recognition
- One single view could not be expected to capture earnings processes that are substantially different
- There is insufficient analysis of long-term contracts and the concept of continuous transfer is dubious
- Detailed application guidance has resulted in a rule-based approach.

Reliance on transfer of control to establish when revenue is recognised means replacing economic considerations by legal considerations

Our major concern with the proposal relates to replacing the risks and rewards concept by the control concept to decide when there is a transfer and thus when revenue is recognised. This means replacing economic considerations by legal considerations. Of course, the legal implications are one aspect of the economics of a transaction, but the economics of a transaction are much broader than that.

We are not convinced by the argument against the risks and rewards notion as it was provided already in the DP, that if the risks are shared by more than one party in a contract, that makes the risks and rewards notion difficult to apply. According to the DP, this requires an entity to judge whether the risks and rewards have been transferred and this judgement could vary from one transaction to another. While we acknowledge the existence of such judgements, we do not share the reluctant attitude towards them. In a principle-based standard there will always be a need and room for professional judgement, and we can think of many other accounting issues where more difficult judgements are required. We believe that much effort will be spent on clarifying legal status, at a high cost and not necessarily of any bearing to the economics of transactions.

We agree that the customer perspective should be emphasised. Activities of an entity that don't satisfy customer needs don't increase economic value. However, we disagree with the way the customer perspective is represented. The problem is the control definition applied to the customer perspective.

In our opinion the shift away from the risks and rewards notion doesn't improve financial accounting. In fact, such a change might lead to new problems, more serious than the problems associated with the present practice. We believe that an alternative approach to solving the problems associated with present practice would be to conduct a thorough analysis of the risks and rewards concept and the application of it to make it possible to apply the concept more consistently.



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The legal concept of control is ambiguous and not well-suited to use as a basis for revenue recognition

Legal control is a control indicator that has limited usefulness when deciding when a performance obligation is satisfied, for several reasons. It is clear from the ED that there is a need for exceptions, i.e. when legal title is not a useful indicator, see e.g. paragraph 28. Legal title is also not a useful control indicator concept for services. Further on, a focus on legal title will not achieve greater comparability, if legal title passes from vendors to customers at different times in different jurisdictions in identical transactions.

We also think that there might be confusion between legal title to a contract object and the fulfillment of legal contractual obligations in the ED. When legal title, in the meaning of some or all legal rights attached to the contract object (e.g. a good), passes to the customer is dependent on how the contract is structured and the law in a jurisdiction. It should also be pointed out that the meaning of legal title is ambiguous. It might refer to the right for the customer to (legally) direct the use of the asset etc at some point in time but it might also refer to a (different) point in time when the customer is protected from the vendors' creditors.

Obligation to pay for a good or service arises from what is legally stipulated in a contract. But the timing of payments might in many contracts (other than simple delivery of goods) not be aligned with satisfaction of a performance obligation as defined in the ED but instead of the fulfillment of a single or a number of legal contractual obligations by the vendor. The definition of performance obligations in the ED is not based or aligned with the legal obligations in a contract. While they might in some cases be similar or identical, it is by no means so in every contract with a customer. Therefore, it is very confusing that the ED uses legal indicators (obligation to pay, legal title, physical possession) to solve the question of when performance obligations are satisfied. By creating a definition in the ED of performance obligations that is independent from legal (contractual) obligations, how then can legally based indicators solve the question of satisfaction of a performance obligation (the "building-blocks" are not identical)? The logical answer seems to be that also the concept of satisfaction of a performance obligation must be defined or explained in a non-legal way. Using legally based indicators or "proxies" for satisfaction of performance obligations only works from a practical point of view when contract obligations and performance obligations are identical or at least very similar to each other.

One single view could not be expected to capture earnings processes that are substantially different

The question is whether it is possible to have one single view on revenue recognition. Leasing, insurance and financial instruments are scoped out of this standard (agriculture seems to fall outside the standard too, at least when there is no contract with a customer), and it's not very easy to see how the accounting in these areas would be consistent with the view in the ED, which to us is a further indication that there are problems with one single approach. The focus on one single view apparently has been at the expense of spending time on addressing the specific problems with the existing standards.



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There is insufficient analysis of long-term contracts and the concept of continuous transfer is dubious

The analysis in the DP is primarily about multi-element arrangements. However, we are concerned that the problems related to long-term contracts are not analysed to the same extent. We noted in our analysis of the DP that many of the topics then not covered have a specific bearing on long-term contracts. Although these issues are addressed in the ED, the treatment of long-term contracts has to be further developed.

The ED presents two situations where revenue is recognised before the completion of a contract. The first is where separate performance obligations are identified and revenue recognised for each of them. This does not work for e.g. the building of a ship where handover is at completion. The other situation where revenue is recognised before completion of a contract is when there is a continuous transfer of control. Continuous transfer is a dubious concept to base revenue recognition on and would restrict revenue recognition before completion of a project to very few situations. The ED disregards the common situation, that these contracts normally only include one performance obligation. The main issue should be whether future payments could be estimated with sufficient reliability to justify revenue recognition based on the economic value created by the contract activity.

The IASB needs to work more with the examples in this area. B43 p.57 purportedly illustrates segmentation and continuous transfer, but assumes that the latter is at hand. In BC66 p.27 referring to IFRIC 15, the board state that they "think that applying the proposed definition of control and the proposed indicators of control to a construction contract would be consistent with the requirements...(in) IFRIC 15", which is much too vague. BC73-75 once again assumes continuous transfer of control and long-term contracts is given as an example of when continuous transfer could exist.

Detailed application guidance has resulted in a rule-based approach

We note that the application guidance (part of the standard) includes guidance that to a certain extent can be traced back to SEC's SAB 104. This and the detailed nature of the guidance lead us to conclude that the present principle-based IAS 18 is to be replaced by a standard based on a rule-based approach. We question the extent of this guidance and how the IASB, considering this new approach, will deal with new revenue recognition issues as they are identified.

If the IASB should decide not to follow our recommendations but pursue its work in line with the ED, the attached exhibit sets out some further aspects that also should be considered.



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If you have any questions concerning our comments please address our Executive member Carl-Eric Bohlin by e-mail to: carl-eric.bohlin@radetforfinansiellrapportering.se

Stockholm, 1 November 2010

Yours sincerely


Anders Ullberg
Chairman

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Exhibit

Remarks related to ED/2010/6

Unperformed contracts

The proposal requires disclosure of unperformed contracts (order stock information). There is considerable uncertainty about this kind of information, for example due to renegotiation regardless of whether this is spelled out in the contract or not. We have noted instances of companies which have supplied information of their order stock restricting the information to one year, because of this uncertainty.

Stand-alone selling prices

We believe, that some of the problems related to identification and measurement remain when transaction prices have to be estimated. A good could often be seen as a bundle of functions and especially for business-to-business transactions these functions are dependent on more specific seller-customer relationships. This fact will have consequences related to the separation of performance obligations applying the concept of the distinction of a good, when there is a reference to what other sellers offer. We are concerned by this reference to what other companies do, which we think are of limited value when compared to the price charged when the entity sells something separately.

Allocation of price to performance obligations

The difference between the total of the stand-alone selling prices and the contract amount should be allocated logically to the performance obligations. Instead of the proposed method, the allocation of the difference should be made on the basis of the gross profit of the individual performance obligations, a method which in our view better reflects the commercial aspects of a contract.

Separation of financial accounting and management control

Related to long-term contracts, the proposal will most probably lead to a separation of financial accounting and management control. Even though the alignment of financial accounting and management control is not self-evident, one has to take this as a signal that some parts of the proposal have to be reconsidered. In general, the activity part (the perspective of the company) is more apparent for long-term contracts. Listed construction companies in Sweden applying IFRIC 15 consider that the interpretation does not support how they are monitoring their performance. The consequence is that



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In the financial reporting the focus is on segment information, where IFRIC 15 is not applied.

IASB and FASB initiated the project to clarify the principles for revenue recognition and to develop a common revenue standard that would improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. As the ED includes the same accounting principle as IFRIC 15 we consider that the ED will not improve comparability of revenue recognition, it will instead reduce comparability.

