IASB – International Accounting Standards Board

IFRS – International Financial Reporting Standard

Mainzer Landstrasse 47a DE – 60329 Frankfurt am Main

Contact: Claudia Stinnes Direct number: +49 69 26 4848 300 Fax number: +49 69 26 4848 335 Email: Claudia.Stinnes@effas.com

Internet: www.effas.com

13 March 2012

Revenue from Contracts with Customers

ED /2011/6

Comments by the European Federation of Financial Analysts Societies (EFFAS) Financial Accounting Commission – FAC

Dear Madam, dear Sir,

The European Federation of Financial Analysts Societies is the European umbrella organization of national analysts' societies. It comprises 27 members representing more than 16,000 investment professionals in the areas of equity and bond research, asset management as well as investment advice. The European Federation of Financial Analysts' Societies through its Commission on Financial Accounting has reviewed the ED, Revenue from Contracts with Customers.

As revenues are the starting point for financial analysis they are of utmost relevance and concern for analysts. IASBs eagerness to establish a standardized measure for revenue recognition and develop common standards with the US is an encouraging step towards accounting harmonization.

However, as mentioned in our previous comment letter we think—that the complexity of the subject is compounded by a dense and bewildering wording. EDs written in a simple and uncomplicated language facilitate a direct and straightforward discussion of the subject.

As requested, we are commenting to the six specific questions as follows:

Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

We believe that paragraphs 35 & 36 are confusing. It took the Accounting Commission a great deal of time to understand what was meant. We had to create examples to get the logic of the text. Therefore, we would suggest that these paragraphs are rewritten in a more understandable manner to facilitate the reader a clear understanding without too much difficulty. This is particular true for paragraph 35 b (ii) and (iii).

Question 2: Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

We agree with the proposition. We think that it does add value to the reader to understand and assess the level of uncollectible consideration amounts related to customer's credit risk.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

We disagree with this approach. The main reason for our disagreement is that the estimation of the variable part can be easily manipulated by management to improve revenues, e.g., a bad financial year when forecasted revenues figures are not met.

We understand that in certain cases accounting standards rely on estimates. For example, provisions for litigations or impairment calculations need to be estimated by management.

However, we think that comparing provision estimates for litigations and estimates for a variable amount of revenues is different. We believe that it is easier for auditors to obtain from a third party law firm a reliable opinion on the level of provisions for litigation than a pure estimate from management on variable revenues for the company, as it is also more difficult to query the customer for business reasons.

EFFAS Comments

As analysts, we often hear that calculation for goodwill impairment is based on estimates. Why do we not like estimates for the variable amount of revenue if we accept estimates for goodwill impairment? We consider that impairment of goodwill is a one-off transaction and therefore not recurring for valuation models whereas actual revenues are the basis for revenue estimates for each of the coming years. Estimate variable revenues and estimate provisions for litigation and impairment of goodwill are different and, we believe, not comparable.

Moreover, we consider that conditions in the standard to prevent from management adjustments are not sufficiently clear and therefore difficult of being properly applied and controlled by auditors. Therefore, based on the above, we suggest not allowing the recognition of the variable part of revenues.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

Yes we agree with the proposition.

<u>Question 5:</u> The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. * The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119– 121) Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that The proposed disclosures do not appropriately balance those benefits and costs; please identify the disclosures that an entity should be required to include in its interim financial reports.

We believe that it is appropriate to question the relevance of these disclosures for the interim financial statements, in particular the tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities, the analysis of the entity's remaining performance obligations, the information on onerous performance obligations and the tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfil a contract with a customer.

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However as such disclosures are relevant only for certain industries (construction, extraction industries, machines), we propose the IASB to introduce - as it is already the case for certain corporate governance rules e.g. in the UK - the concept of "comply or explain". It will allow solve the problem without having to propose an exhaustive list of industries where this type of disclosures should be required.

Question 6: For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset.

Do you agree that an entity should apply the proposed Control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

Yes, we agree with this proposition.

Yours sincerely,

Giampaolo Trasi Chairman EFFAS Javier de Frutos Chair, Commission on Financial Accounting

EFFAS Financial Accounting Commission

EFFAS was established in 1962 as an association for nationally-based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 27 member organisations representing more than 16,000 investment professionals. The Commission on Financial Accounting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. FAC members are Javier de Frutos (Chairman, Spain), Friedrich Spandl (Vice-Chairman, Austria), Jacques de Greling (SFAF, France), Henning Strom (NFF, Norway), Ivano Mattei (AIAF, Italy), Taras Koval (USFA, Ukraine), Jérôme Vial (SFAA, Switzerland) and Rolf Rundfelt (SFF, Sweden).
