

March 13, 2012

International Accounting Standards Board

Keidanren
Business Infrastructure Bureau

Comments on IASB Exposure Draft ED/2011/6
Revenue from Contracts with Customers

We, Keidanren, submitted to the IASB a comment letter on its 2010 exposure draft on *Revenue from Contracts with Customers*. In addition, many members of our organization participated in and expressed their views at the board's outreach meeting on this issue held in Japan. As a result, the points we made regarding the 2010 exposure draft are to a certain degree reflected in the revised exposure draft and its standard, for which we are grateful. However, the present exposure draft still contains provisions that raise concern among preparers. Some provisions are so ambiguous that they may cause confusion in practice, while other provisions require overly detailed disclosures whose costs will far exceed the benefits. We request that reconsideration be made on the issues indicated below to ensure the understanding and support of market participants.

Our comments are as follows.

Question 1

We agree with the proposal in general. However, we are concerned that the draft standard contains some ambiguous provisions, in particular on the definition and scope of "performance obligations satisfied over time." For greater clarity of the standard, the following points should be reviewed and revised to maintain consistency with actual practice.

- The word "control" in paragraph 35(a) needs clarification. We consider that, in doing so, paragraph B56 serves as a useful reference, which states: "If an entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect an entity's determination of when the customer has obtained control of the good or service." By using this statement as a reference, "control" in paragraph 35(a) can be defined, for instance, as "the state in which an entity can objectively judge that the provision of a good or service is in progress in accordance with the agreed-upon specifications in the

contract.”

- We request the board’s confirmation on whether or not the criterion in paragraph 35(a) is met when a reasonable estimate of construction cost, revenue, and progress can be obtained and the certainty of the outcome is known.
- The criteria in paragraph 35(b) may cause the misunderstanding that an entity’s sale of goods and provision of short-term services must also be assessed to determine whether they fall under the category of “performance obligations satisfied over time.” We therefore request that the standard clearly state the following: the transfer of goods or services whose performance obligation is satisfied in a short period, such as the one in the example above, falls under the category of “performance obligations satisfied at a point in time,” and hence does not have to be assessed whether it should be treated otherwise.
- We are concerned that the criterion of “does not create an asset with an alternative use” in paragraph 35(b) may result in diverse judgments among entities. This is because, in the large machinery manufacturing business, work-in-process made up of common and standardized components can be used for alternative purposes, even if that is not the case with the finished products. Clarification should be made on what basis an entity’s performance is considered not to create an asset with an alternative use.
- In relation to paragraph 35(b)(ii), we deem the example of a freight logistics company provided in paragraph BC97 to be inappropriate, as the example does not consider the fact that the company has not satisfied its performance obligation to deliver the asset to the customer by the agreed-upon date, meaning that the company has recognized transportation revenue before satisfying its performance obligation in the contract with the customer.
- The closing sentence of paragraph 35(b)(ii) indicated below contains an irrational requirement and should be deleted: “In addition, an entity shall disregard potential limitations (contractual or practical) that would prevent it from transferring a remaining performance obligation to another entity.”
- Although paragraph 35(b)(iii) provides the criterion of having “a right to payment for performance completed to date,” we believe it is rare for an entity to obtain a right to payment in parallel with its completion of each task. Rather, the common practice is that an entity obtains a right to payment as it completes each milestone of the project it is engaged in. It should therefore be clearly stated in the standard that cases like

this also satisfy the criterion in paragraph 35(b)(iii). In addition, we request the phrase “has a right to payment” in the same paragraph be revised to “is reasonably assured of being entitled to payment” in order to maintain consistency with paragraph BC101, which states that an entity is not required to have a present unconditional right to payment, and with paragraph BC103(d), which stipulates that an entity “should recognize revenue subject to being reasonably assured of being entitled to the consideration.”

- When an entity accepts performance obligations that will be satisfied over time, in some cases the contract stipulates the entity’s right to demand a penalty for the unilateral termination of the contract for reasons attributable to the customer. We assume that in that case, the entity “has a right to payment for performance completed to date” as provided in paragraph 35(b)(iii), and request clarification on this point.

Question 2

We do not agree with the proposals. Although they represent an improvement from the 2010 exposure draft which required an impairment loss on receivables to be recognized as a deduction from revenue, we believe these impairment losses should be presented as an expense item, not as a separate line item adjacent to the revenue line item, for the following reasons.

- Presenting these impairment losses as a separate item from revenue does not differ in any way from presenting them independently as loan-loss expenses. It is hard to understand why they have to be presented as a separate line item adjacent to the revenue line item.
- Some impairment losses on receivables may be caused by changes in the customer’s credit risk related to the receivables recognized in previous reporting periods. Presenting the effect of these changes in a manner as if to match it to revenue for the current reporting period may cause users to make incorrect decisions so it should be avoided.
- As an entity’s sales activities are conducted separately from its activities for the management of credit risk, the entity’s revenue from sales has no direct causal relationship with its impairment losses on receivables. As such, these two items should not be presented in a manner as if to match one to the other. Instead, impairment losses on receivables should be presented together with impairment losses on other financial assets to provide users with a better understanding of the

entity's financial condition.

Question 3

We basically agree with the proposal, but request reconsideration on the following points.

- The meaning of “the amount to which the entity is reasonably assured to be entitled” in paragraph 81 is unclear. We therefore request illustrative examples and guidance that cover a wide variety of transactions. Without such examples, entities would be subject to administrative burdens related to audit documentation, verification, and other work, and accounting comparability among entities would be undermined.
- In trading minerals and other commodities, the common practice is to recognize revenue and settle the transaction based on a provisional price pending the finalization of the price. However, under the present exposure draft, an entity is not allowed to recognize revenue from transactions susceptible to “volatility in a market” (paragraph 82(a)) until the price is finalized, on the grounds that it cannot be reasonably assured of the amount of revenue to be recognized. As this accounting method is not consistent with trading practices, we request that entities be allowed to recognize revenue on the basis of a provisional price.
- Regarding variable consideration, we support the amendment in paragraph 55 that allows the use of the most likely amount as well as of an expected value. However the use of the most likely amount is restricted by the provision in paragraph 55(b), which stipulates that “the most likely amount may be an appropriate estimate of the transaction price if the contract has only two possible outcomes,” and by a similar statement in paragraph BC136. We believe that there is no valid reason to restrict the use of the most likely amount to such situations, and that entities estimating variable consideration should be allowed to choose, at their discretion, either an expected value or the most likely amount. The provision and statement mentioned above should thus be deleted.

Question 4

We agree with the proposal in general, but request two changes described below.

- The proposal requires entities to recognize losses from the contracts whose performance obligations are satisfied over a period of time greater than one year. However, there are cases in which losses are expected from the contracts under

which performance obligations are satisfied over a period of time less than one year. In those cases, entities should be allowed to judge whether or not to recognize losses from the perspective of sound corporate management on the basis of the importance of the losses. We request the board's confirmation that the proposal will not prevent entities from recognizing such losses.

- When assessing whether performance obligations are onerous or not, entities should be allowed to assess the onerousness of the contract as a whole, as well as of individual performance obligations. When considering entering into transactions, many entities assess whether they are advantageous or onerous on a contract-by-contract basis. As such, allowing entities to assess onerousness on a contract-by-contract basis leads to more accurate reflection of their business activities in financial reports, and thereby to more useful information for users.

Question 5

We do not agree with the proposal. In Japan, quarterly reporting system is adopted and companies are required to produce and submit quarterly report within 45 days after the end of each quarter. In such a tight schedule, it is impossible to satisfy the proposed disclosure requirements. Moreover, many of the disclosure requirements proposed necessitate costs that will significantly exceed the benefits, and it is inconceivable that these disclosures will improve comparability of revenue recognition practices across entities, industries, jurisdictions, and markets. For these reasons, we cannot accept such disclosures, not only for interim financial reports (which in Japan means quarterly financial reports), but also for annual financial reports.

Our understanding is that, at the IASB-FASB joint meeting held in July 2011, the Institute of Chartered Accountants of Scotland and the New Zealand Institute of Chartered Accountants made a presentation, as per the request issued by the IASB in October 2010, on the need to reduce disclosure requirements and establishing an overall principle of disclosure, and that the decision was made to discuss at future board meetings how to deal with the matters presented. We believe that these developments do not accord with the present exposure draft's proposal, i.e., amending IAS 34 and imposing new requirements for the disclosure of revenue recognition in interim financial reports.

We are especially concerned about the following five disclosure requirements.

Reconciliation of contract balances (paragraph 117)

To compile reconciliations of contract assets and liabilities, financial statement preparers would have to invest in new information systems for the management of contracts and receivables, and to closely monitor all contracts to check whether the entity has rights to payment, and its performance obligations have been satisfied. This is simply impracticable, given the enormous administrative burdens it would entail.

Another concern is that reconciliations are required to be compiled on a consolidated basis. For a corporate group made up of subsidiaries and affiliates in various sectors, the contract assets and liabilities which it would need to aggregate are highly diverse. Some subsidiaries may only have contract assets while others may only have contract liabilities. The aggregation of them would produce a reconciliation that presents numerical values meaningless to financial statement users and preparers as well as to corporate executives.

Moreover, the Illustrative Examples accompanying the Exposure Draft do not provide much help in this regard. Example 19 under paragraph IE17 shows the case of a reconciliation of contract assets and liabilities on a nonconsolidated basis. The problem is that the example presents the opening and closing balances of contracts without explaining how these numbers have been obtained. In other words, it leaves unexplained how the opening balance has resulted in the amount shown as the closing balance. This means that, as mentioned above, entities are required to compile a reconciliation of the opening and closing balances of contract assets and liabilities, in spite of the total uselessness of such data, together with enormous costs that far exceed the benefits. On top of that, it remains unexplained what the closing balance of contract assets and liabilities in the reconciliation represents (that is, how it has been obtained). Such reconciliation will not provide any useful information to users nor to preparers, resulting in a waste of resources used to compile them.

For these reasons, we are strongly opposed to the proposal requiring the disclosure of reconciliations of contract balances. We firmly oppose to require such disclosure in both interim and annual financial reports.

Maturity analysis of remaining performance obligations (paragraph 119)

Fulfilling the proposed requirement necessitates the development of new systems to disclose consolidated financial information that is not processed by accounting systems at present. Such systems must be capable of monitoring the status of contracts of all group companies and eliminating internal transactions, thus requiring significant investment. In particular, for an entity undertaking a large number of repetitive and

diverse transactions, it would be virtually impossible to comprehensively monitor all the contracts.

Even if necessary systems were to be developed, information common to various contracts would need to be compiled and summarized for disclosure, the content of which would hence necessarily be abstract and general. We do not believe such disclosure will provide useful benefits to users and preparers.

For these reasons, we are strongly opposed to the proposal requiring the disclosure of a maturity analysis of remaining performance obligations. We firmly oppose such disclosure not only in interim financial reports but also in annual ones.

Costs to obtain or fulfill a contract (paragraph 128)

We are opposed to the disclosure of assets recognized from costs to obtain or fulfill contracts stipulated in paragraph 128. As such assets are recognized frequently and repetitively during the entity's business activities, it would be very costly to compile reconciliations from the opening to closing balance of assets recognized from these costs as required in the present exposure draft. Furthermore, due to the absence of a clearly defined concept and the probable lack of comparability as a result, these reconciliations would not likely provide users with benefits worthy of the costs involved.

For these reasons, we are opposed to the disclosure of assets recognized from costs to obtain or fulfill contracts not only in interim financial reports but also in annual ones.

Disaggregation of revenue (paragraphs 114 and 115)

Entities currently provide segment information in which revenue is disaggregated based on a management approach. The enforcement of the disclosure requirements in these paragraphs would therefore impose on entities the costs to disclose disaggregation of revenue twice and would confuse users due to the lack of clear distinction between the newly required disclosures and existing segment information, causing more harm than good.

Onerous performance obligations (paragraphs 122 and 123)

These paragraphs require overly detailed disclosures, even compared to those for onerous contracts in IAS 37. We are especially opposed to the disclosure of the reason why performance obligations are onerous (paragraph 122(b)) and of the timing when the entity expects to satisfy those performance obligations (paragraph 122(c)), because we do not believe there is any benefit in disclosing them. We are also opposed to the

disclosure of reconciliations from the opening to the closing balance of the liabilities recognized for onerous performance obligations in paragraph 123, as it will not deliver benefits that justify the costs. We consider that disclosing the opening and closing balances of liabilities is sufficient.

Question 6

We agree with the proposal, but request clarification on the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities. If revenue recognition criteria were to be strictly applied, in some cases non-operating profit or loss recognition might require application of the provisions not only on "performance obligations satisfied at a point in time" but also on "performance obligations satisfied over time." However, applying the provisions to the latter in irregular transactions, such as non-core business transactions, would impose significant administration costs on entities, while producing no useful information to preparers and users. We therefore believe that the transfer of nonfinancial assets should be excluded from the application of the provisions on "performance obligations satisfied over time" and request that the standard clarify this point.

These are our responses to the questions provided by the IASB. In addition, we have identified the following issues that we request be fully considered in finalizing the standard.

Identifying performance obligations (paragraphs 27 to 29)

The unit of revenue recognition should, in principle, be consistent with the standpoint of corporate management. In this respect, we consider the addition of the provision in paragraph 29 to be an improvement from the 2010 exposure draft, because the provision to a certain degree takes into account a corporate management perspective on the unit of revenue recognition. However, due to the addition in paragraph 28(b) of the notion of identifying separate performance obligations from a customer perspective, two different perspectives—i.e., entities' and customer' perspectives—are required to be taken into account under the present exposure draft. To solve this, we request paragraph 28(b) be revised in a way to clearly stipulate that the unit by which the entity identifies and manages its performance obligations must be taken into account. This is because, even if customers are able to benefit from a particular unit, it is difficult to identify separate performance obligations using that unit unless the entity uses the same unit for management purposes. Using a unit that is more fragmented than the one used by the

entity for management purposes is impractical, because in that case all the current contracts of the entity with its counterparties and customers would need to be reviewed, causing a substantial increase in administrative burdens.

Secondly, we request that the following sentence in paragraph 27 be deleted: “In some cases, that would result in an entity accounting for all the goods or services promised in a contract as a single performance obligation.” The present exposure draft merely proposes that an entity should determine whether or not to account for the goods or services promised in a contract as separate performance obligations in accordance with paragraphs 23 to 30. It does not state which is preferable between a single performance obligation and separate performance obligations. Nevertheless, the above sentence in paragraph 27 can be construed in such a way that accounting for goods and services as separate performance obligations might be preferable, and should therefore be deleted.

Thirdly, with regard to the criterion in paragraph 29(b) that “the bundle of goods or services is significantly modified or customized,” the meaning of “modified” is unclear and needs clarification. Furthermore, this criterion should be construed in such a way that, even if a bundle contains, for example, the simple installation of standard equipment, such bundling as a whole may still satisfy the criterion. In actual business settings, contracts and performance obligations are highly diverse, and they normally involve the simple installation of standard equipment in one way or another. If a bundle containing such installation does not satisfy the criterion in paragraph 29(b) and needs to be recognized as a separate performance obligation, performance obligations for accounting purposes would greatly differ from those for corporate management purposes.

Lastly, Example 6 under paragraph IE5 explains the case in which the risk of loss during shipment is identified as a separate performance obligation. However, as the risk of loss during shipment described in Example 6 is not sold separately nor does it provide benefits to the customer on its own, the risk does not meet either of the criteria in paragraph 28 and cannot constitute a separate performance obligation. We therefore believe that this example is misleading and should be replaced with an appropriate one.

Performance obligations satisfied at a point in time (paragraph 37)

Paragraph 37 describes the indicators used to determine the point in time when an entity satisfies a performance obligation. We request to add the criterion “the design or function of the good or service is customer-specific” provided in paragraph 30(d) of the 2010 exposure draft.

Even if an entity's performance meets the criteria of "does not create an asset with an alternative use to the entity" in paragraph 35(b), it would be regarded as "performance obligations satisfied at a point in time," rather than those satisfied over time, unless at least one of the criteria in subparagraphs (i) to (iii) of paragraph 35(b) is met. An example of this is the case in which an entity manufactures a made-to-order, customer-specific good that does not take a long time to make (e.g., sale of a made-to-order, customer-specific good that the entity has made and sold to the customer repeatedly).

In cases like this, by adding to paragraph 37 the criterion that "the design or function of the good or service is customer-specific," the entity will be able to accurately determine the point in time when it satisfies a performance obligation. Moreover, it will become possible to ensure consistency with the revenue recognition criteria applied to performance obligations satisfied over time.

Output methods (paragraph 43)

Whereas the provision in paragraph 40 treats output and input methods equally without prioritizing one over the other, paragraph 43 states that: "Hence, an input method may be necessary." This sentence may mislead preparers into thinking that they have to prioritize output methods. To prevent such misunderstanding, the paragraph 43 should be revised by deleting the sentence above.

Licensing agreements (paragraphs 85 and B33 to B37)

The present exposure draft stipulates that revenue from a fixed-term licensing agreement should be recognized at the point in time when the customer obtains control of the rights to use the licensed asset. However, it can be considered that, in the case of a fixed-term licensing agreement, the customer obtains benefits with the passage of time and the entity also satisfies its performance obligation with the passage of time. For this reason, entities should be allowed to recognize revenue over the term of the licensing agreement.

As for consideration on licensing, paragraph 85 stipulates that if an entity is not reasonably assured to be entitled to the amount of consideration from licensing, revenue should not be recognized until the entity is reasonably assured to be entitled to the amount. We request careful reconsideration on the appropriateness of having rigorous exception to the provisions on variable consideration applied only to licensing agreements.

Costs to fulfill and obtain a contract (paragraphs 91 to 93 and 94 to 97)

We request that the following revisions be made to the provisions concerning concepts and accounting methods for costs to fulfill a contract (paragraphs 91 to 93) and incremental costs to obtain a contract (paragraphs 94 to 97).

- A sales commission is the only example of costs to obtain a contract given in the present exposure draft. However, whereas costs to obtain a contract are defined as “costs that an entity incurs in its efforts to obtain a contract,” a sales commission is the cost incurred at the final stage of an entity’s effort to obtain a contract. As such, providing a sales commission as the only example of costs to obtain a contract is not helpful for preparers. We therefore request that another example be provided using paragraph 59 of the 2010 exposure draft as a reference. In this paragraph, “the costs of selling, marketing, advertising, bid and proposal, and negotiations” are listed as examples. Of these costs, costs that can be regarded as “costs to obtain a contract” under the present exposure draft should be selected and given as additional examples. In addition, it should be clearly stated in the standard that, as only the costs directly related to individual contracts should be regarded as meeting the criterion in paragraph 95, personnel and other expenses incurred in divisions involved in contract activities do not satisfy the criterion.
- We are opposed to the provision that “requires” an entity to recognize as an asset the incremental costs of obtaining a contract if the entity expects to recover those costs. The provision should be revised to “allow” an entity to recognize such costs as an asset. Assuming that the revision is made as we suggest and then an asset is so recognized, the next steps should be that the asset is amortized and recognized as an expense, and that if the performance obligation is determined onerous, an impairment loss on the asset is recognized, all in a manner ensuring consistency with revenue. However, paragraphs 98 to 103 do not clearly state that the capitalization of costs to obtain or fulfill contracts as assets, and subsequent amortization, and impairment should be made in a manner consistent with revenue recognition. These paragraphs should be revised to clarify this requirement.

Principal versus agent considerations (paragraph B18)

Paragraph B18 of the present exposure draft simply lists the five indicators used to determine when an entity is acting as an agent. However, even if these indicators are applied to determine whether an entity is a principal or an agent in any given transaction, there may be cases where the entity seems to fall into both of these categories.

Therefore, it should be clearly stated in the standard that, in cases like these, entities may make a comprehensive judgment based on the degree of the risks and effects involved, in accordance with the principles of the standard.

Retrospective application (paragraphs C1 to C4 and BC326 to BC335)

The definition of “the date of initial application” in paragraph C3 is not sufficiently clear. For greater clarification, the definition should be revised to “the beginning of the most recent period presented in comparative financial statements.” Assuming the revision is made as suggested, we request that the following points also be revised.

First of all, we are strongly opposed to restatement. As the criteria for recognizing revenue constitutes the foundation of corporate management, restatement would require an entity to doubly manage its entire activities and to process a vast amount of related data. We are firmly opposed to such impracticable requirements.

The present exposure draft attempts to facilitate retrospective application, stipulating that “for contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period” in paragraph C3(a). However, this alone is hardly sufficient.

We are especially concerned about the following two cases. Firstly, under paragraph C3(a), contracts must meet two criteria to be exempted from restatement: having been completed before the date of initial application; and beginning and ending within the same annual reporting period. This means that restatement would be required for the contracts that include performance obligations satisfied over a period crossing the beginning of comparative annual period(s).

Secondly, under the transition provisions, a performance obligation completed before the date of initial application would have to be restated if the performance obligation is a part of a contract that includes either a performance obligation satisfied over a period across the date of initial application or multiple performance obligations satisfied at different points in time over a period crossing the date of initial application.

As a result, in both cases, entities would be required to doubly manage the contracts entered into before the date of initial application, without easing any burden.

We therefore request the following two revisions. First, the criterion of “begin and end within the same annual reporting period” should be removed from paragraph C3(a). Second, the transition provisions should be revised so that restatement will not be required for performance obligations satisfied over a period crossing the date of initial application. These performance obligations should continue to be subject to the standard applied before the date of initial application.

Clarification of the concept of contract assets, etc. (Example 17, paragraph IE16)

The concepts of contract assets, liabilities, and receivables are unclear and vary from between paragraphs within the exposure draft. In paragraph 106, a receivable is defined as a “right to consideration that is unconditional” while a contract asset is defined as such right that “is conditioned on something other than the passage of time.” On the other hand, in Example 17 under paragraph IE16, a receivable is recognized before an entity satisfies its performance obligation by transferring goods or services to the customer—that is, despite the fact that the entity’s right to consideration is not unconditional. This is not consistent with the definition provided in paragraph 106. We request that the board clarify the concepts mentioned above by providing examples that accord with the definitions in the standard. Furthermore, we call for clarification how contract assets, liabilities, and other relatively new concepts should be treated in cases where foreign currency transactions are involved.