



Sir David Tweedie  
Chairman of the  
International Accounting Standards Board  
30 Cannon Street  
  
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United Kingdom

Düsseldorf, 13 October 2010  
540/602

Dear Sir David

**Re.: Exposure Draft 2010/6 “Revenue from Contracts with Customers”**

We appreciate the opportunity to comment on the exposure draft mentioned above and would like to submit our comments as follows:

General Remarks

The IDW acknowledges that IAS 11 and IAS 18 are based on differing principles. One could argue that a single revenue standard, based on a consistent revenue recognition model, is preferable to having two revenue standards with differing principles. However, as mentioned in our comment letter on the discussion paper “Preliminary Views on Revenue Recognition in Contracts with Customers”, dated 3 June 2009, it is an indispensable prerequisite for a major change in accounting requirements to substantiate

- that the new revenue recognition model is superior to the existing approaches and provides more useful information about all different types of contracts, including construction contracts, and
- that it is not sufficient to improve the existing standards by developing targeted amendments and additional requirements on certain critical issues without replacing the current standards in total.

We do not believe the exposure draft fulfils this prerequisite.

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The proposals draw solely on the principle of “transfer of control” in order to determine the point in time at which an entity satisfies a performance obligation, i.e. when it recognises revenue. In contrast, extant IAS 18 refers to the concept of “risks and rewards” and “control”. We are concerned that attaching less importance to risks and rewards may result in a legalistic approach. In general, we believe that the economic aspects always need to be given appropriate consideration.

In addition, we do not share the boards’ view that the definition of control should be applied from the perspective of the customer. Since the (management of the) reporting entity prepares the financial statements, the perspective of the entity should be applied to define control, thus avoiding an inappropriate pattern of revenue recognition.

Revenue is a crucial part of financial reporting and plays an important role in the assessment of an entity’s performance. Therefore, thorough discussion and definition of the terms “revenue” and “performance” should be undertaken within the conceptual framework project in advance of deliberations at standard level as to a new and comprehensive approach to revenue recognition. In this context, the question arises as to how a contract-based revenue recognition model relates to the issue of performance, since performance is not necessarily contract-based.

Additionally, the question has to be tackled conceptually whether revenue should reflect the activities that an entity undertakes in fulfilling construction contracts with customers, even if the customers have not obtained control of the goods or services. Currently, we believe that construction contracts are particular in nature and differ significantly from other contracts with customers. Accordingly, allocating revenue to the reporting periods in which work is performed often reflects the economic circumstances of construction contracts more adequately than the boards’ proposals.

Most of the existing IFRS guidance on revenue recognition works reasonably well in practice. Consequently, at present, we see no necessity to introduce a new IFRS which would require many entities to adjust their accounting and reporting structures and systems. Instead, we would prefer targeted improvements to the current standards (IAS 11, IAS 18). With regard to the lack of guidance for transactions involving the delivery of more than one good or service (multiple-element arrangements) and for other issues, it would be sufficient to integrate (and modify, if necessary) the IFRIC interpretations into IAS 18.

Given the widespread inconsistencies and weaknesses in numerous US GAAP requirements, we agree that there is a need for a fundamental change in the revenue recognition guidance in US GAAP. However, we doubt whether this is also true in

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respect of IFRS. Convergence should not be the overriding argument for developing new common standards if there is no demand for these standards under IFRS. Despite our general concerns, we would like to comment on the specific proposals as follows:

### **Recognition or 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?*

In general, we agree with the proposed principle for determining whether to combine or segment contracts. Nevertheless, we would appreciate the boards clarify why the contract segmentation principle (i.e. price independence) is needed to simplify the assessment of scope (paragraph BC38(a)). In our view, the nature of the contract should be the crucial factor in determining the scope of the standard.

In respect of contract modifications, we have some concerns about the proposals:

- First, it is complicated to understand the boards' intentions. For instance, the interrelation between paragraph 19 and example 2 (paragraph B3) remains unclear. Example 2 includes two scenarios: Scenario 1 referring to services that do not have interdependent prices and scenario 2 referring to services that have interdependent prices. In our view, based on the wording of paragraph 19, one could argue that **both** scenarios refer to services that have interdependent prices, i.e. the prices of the contract modification and the existing contract are interdependent: In scenario 2, there is no doubt that the services have interdependent prices. However, in scenario 1, the prices of the services seem to be interdependent as well because the price for the third year of the existing contract is reduced when the contract is extended for another three years and the price to be paid for the extension reflects this reduction.

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- Second, we believe that it is often difficult in practice to decide whether the prices of a contract modification and the existing contract are interdependent. In many cases an entity is prepared to accept a discount for goods or services still to be delivered or provided if a customer agrees to extend or renew the existing contract or sign an additional contract. Evaluating whether and to what extent the discount refers to the services provided before the contract modification is often impractical and artificial. We believe that, in most cases, a discount is given as part of the pricing of goods or services to be transferred in the future, since it seems highly unlikely that a discount would be given for past goods or services if the entity is neither forced to do so (for legal or other reasons) nor has future benefits from so doing.

### **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?*

According to the exposure draft, an entity shall account for a performance obligation separately only if the promised good or service is distinct. A good or service is distinct if it is sold separately (paragraph 23(a)) or if it could be sold separately because it has a distinct function and a distinct profit margin (paragraph 23(b)). In our view, the proposal in paragraph 23 and the related application guidance are ambiguous and should be modified for the following reasons:

- Paragraph 23(b)(i) states that an item has a distinct function if it has utility either on its own or together with other items. According to our understanding, the description of “distinct function” is imprecise and allows different interpretations. If “distinct” means “differentiated by individualising features”, it could be argued that an item that has utility on its own possesses a distinct function, while an item that has utility (only) together with other items does not possess a distinct function. Rather, it is the group of items that has a distinct function in this case. Instead of only referring to the ambiguous term “distinct function”, the basis for conclusions emphasises that an entity can have a performance obligation only when the fulfilment of the contractual promise results in the transfer of an *asset* to the customer (paragraph BC50 et seq.).
- Rather than requiring a “distinct function”, US GAAP requires an item to have “value to the customer on a standalone basis”. The boards decided against us-

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ing this terminology, because it could suggest that an entity must identify performance obligations on the basis of its assessment of the customer's intended use of the promised items, and it would be difficult, if not impossible, for an entity to know the customer's intention in any given contract (paragraph BC52). In our view, if utility is to be assessed from the customer's perspective, the change in terminology does not solve the perceived problem.

- Example 10 (paragraph B42) states that the technology licence has no distinct function because it does not provide utility (on its own or) together with other goods or services that the customer has received from the entity (or that are available from other entities). In contrast, based on paragraph 23(b)(i), one would assume that the licence has a distinct function since it has utility together with the research and development services that the customer has also acquired from the entity.
- Similarly, the exclusive franchise rights to the trade name, market area und proprietary know-how mentioned in example 8 (paragraph B39) are described as not having a distinct function individually although they provide utility together with other goods or services that are sold separately. According to the wording of paragraph 23(b)(i), each right would have a distinct function.
- Pursuant to paragraph 23, a good or service is distinct either if it is sold separately (by the entity or by another entity) or if it could be sold separately because it has a distinct function and a distinct profit margin. A good or service has a distinct profit margin if it is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service (paragraph 23(b)(ii)).

Consequently, if the promised good or service is sold separately it shall be accounted for as a separate performance obligation, i.e. whether it has a distinct function and a distinct profit margin is irrelevant. Nevertheless, we believe that example 11 (paragraph B43) is inconsistent with paragraph 23: In respect of construction tasks, example 11 states that the customer could contract separately with other entities to perform each of those tasks (even if these tasks are highly interrelated). Therefore, the condition of paragraph 23(a) would be fulfilled because the services are sold separately. Accordingly, all construction tasks would be accounted for as separate performance obligations. In contrast, example 11 identifies separate performance obligations depending on the question whether the construction tasks have distinct risks. This example gives the impression that "distinct risks" (and hence a distinct profit margin) is the dominant or overarching criterion.

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Furthermore, it would be helpful if the boards provided some examples of goods and services that are distinct because they could be sold separately (= criterion of paragraph 23(b)) but are not sold separately (= criterion of paragraph 23(a)).

Applying the proposals, an entity would be required to account for all goods or services that are distinct as separate performance obligations. This could, for example, result in revenue being attributed to goods or services that are currently considered incidental to the contract - for instance, to mobile phones that are provided free of charge with airtime contracts and to some post-delivery services, such as maintenance and installation. In many industries (especially telecommunications and energy) entities often deal with a multitude of contracts with customers containing numerous performance obligations. We share the concerns that the proposed identification of these performance obligations and the disconnect between billing and revenue recognition might be impracticable in some cases. Given the operational challenges, further practical expedients should be developed in order to allow further aggregation. In our view, paragraph 24 is deficient in this area.

In addition, the application of the proposed model to construction contracts might also be problematical when goods or services are transferred continuously because an entity would need to identify a lot of goods and services. In this context, we refer to our answer to question 3.

Finally, we are concerned about the challenges in relation to the accounting and financial reporting process, as the proposed model requires an increased involvement of frontend resources such as sales staff in the accounting and financial reporting process. This might add an unjustified burden to preparers of financial statements.

### **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?*

The boards believe that a focus on control

- is consistent with the definition of an asset,
- results in more consistent decisions about when assets are transferred and
- reduces the room for judgement.

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Accordingly, the linked revenue recognition concept of extant IAS 18 (using both “risks and rewards” and “control”) would be replaced by “transfer of control” as the only revenue recognition criterion. Because the concept of control is primarily related to the legal structure of the transactions, in our view, there is a danger that economic aspects might not be considered adequately.

In addition, we do not share the boards’ view that the definition of control should be applied from the perspective of the customer (paragraph BC63). Since the (management of the) reporting entity has the primary responsibility for the preparation of financial statements, the perspective of the entity should be applied to define control. That perspective helps avoid an inappropriate pattern of revenue recognition.

The proposed revenue recognition model would affect construction contracts (as defined in IAS 11) currently accounted for using the percentage of completion method when the customer does not receive goods or services continuously. Under the proposal, an entity would apply the percentage of completion method of revenue recognition only if the entity transfers goods and services to the customer throughout the contract, i.e. if the customer owns the work in progress while it is being built or developed. In several jurisdictions, including Germany, the legal environment often hinders such a successive transfer of control. We concede that the boards’ proposals are internally consistent. However, in our view, the proposed model seems to be overly legalistic, neglecting the economic substance of construction contracts:

These contracts are particular in nature and differ significantly from other contracts with customers. For instance, the transfer of the contractually promised assets from the construction company to the customer depends on facts which can often be proven only at the end of long-term construction activities. Moreover, construction contracts are managed and controlled as comprehensive projects. In these cases, allocating revenue to those reporting periods in which the work is performed reflects the economic circumstances of construction contracts adequately and allows the alignment of internal management and external financial reporting by focussing on the project activities as a whole. In contrast, recognising revenue only at the end of a long-term construction contract (because control is only transferred to the customer at this point in time) will not result in decision useful information, nor does it respond to users’ needs.

Provided that the outcome of a construction contract can be estimated reliably, we believe that the percentage of completion method pursuant to IAS 11 reflects the specific features of such contracts and the economic circumstances more adequately than the boards’ proposals, even if the customer does not receive goods or

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services continuously. In our view, the boards should try to integrate a similar concept into the final document. The same applies to service contracts.

We admit that the boards cannot address the particularities of all jurisdictions affected by the proposals. This notwithstanding, the guidance as to whether the promised goods and services are transferred to the customer continuously is not sufficient, even though the exposure draft does provide some indicators that the customer has obtained control (paragraph 30).

### **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?*

Under the proposed “allocated transaction price approach”, the transaction price reflects the probability-weighted amount of consideration that an entity expects to receive from the customer (paragraph 35). Consequently, an entity would be required to include reasonable estimates of contingent consideration in the transaction price allocated to performance obligations. In contrast to current practice, this proposal could result in an entity recognising some revenue on the transfer of a good or service even if the consideration amount is contingent on a future event.

As mentioned in our comment letter on the discussion paper “Leases – Preliminary Views”, dated 13 July 2009, we are concerned about the increasing use of probability-weighted amounts in financial reporting because they are quite complex to apply, facilitate earnings management and do not reflect a possible outcome. Nevertheless, we acknowledge that a probability-weighted amount reflects the conditions that are present at each reporting date (paragraph BC83).

According to paragraph BC81, an entity’s expectations reflect the full range of possible cash flow scenarios in the contract. We believe that it is neither feasible nor appropriate to include the “full range” of possible cash flow scenarios. The final document should clarify that some representative scenarios are generally sufficient.

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The IDW welcomes the boards' proposal to recognise all or part of the revenue only if the transaction price can be reasonably estimated. This proposal helps avoid an overstatement or the premature recognition of revenue. Furthermore, we support the proposed criteria that an entity should meet to be able to reasonably estimate the transaction price (paragraph 38 et seq.).

In this context, we wonder why the IASB did not accept a similar approach in respect of investments in equity instruments when developing IFRS 9. We refer to our comment letter on the exposure draft 2009/7 "Financial Instruments: Classification and Measurement", dated 9 September 2009.

#### **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?*

From a conceptual point of view, when the transaction price should reflect the amount of consideration that an entity expects to receive, measurement will necessarily take into account any uncertainty as to the customer's ability to pay. Hence, the transaction price should reflect the customer's credit risk.

In contrast to current practice, this proposal could result in an entity recognising some revenue when it transfers a good or service to a customer even if there is (significant) uncertainty as to the collectability of the consideration, rather than deferring revenue recognition until the consideration is collected. Nevertheless, we believe that this is consistent with the proposed model.

According to the exposure draft, if the effect of the customer's credit risk is material, the transaction price would be the probability-weighted amount of consideration that the entity expects to receive. Thus, for many contracts, recognising the (full) invoiced amount as revenue would be inconsistent with the proposals. Despite the conceptual merits of that proposal, we are afraid that the probability-weighted approach leads to considerable application problems in practice if revenue does not result from a large group of similar transactions. In this case, estimating expected losses based on a probability-weighted approach will be more difficult and less accurate than estimating losses in homogeneous portfolios. Therefore, we would appreciate practical expedients regarding the difficulties associated with the proposed approach.

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We agree that the effects of the resulting reassessment of credit risk should be recognised as (other) income or expense rather than as revenue (paragraph 43). However, guidance on the presentation of certain items should be transferred to the presentation section of the standard.

**Question 6**

*Paragraph 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?*

The IDW welcomes the boards' proposal 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). Recognising a material financing component separately within a contract provides beneficial information to the users of financial statements.

Again, guidance on presentation (paragraph 45) should be transferred to the presentation section of the standard.

**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?*

We agree that the transaction price should be allocated to the performance obligations in a contract in proportion to the stand-alone selling price of the good or service underlying each such performance obligation.

Nevertheless, the concerns relating to the practical difficulties with developing estimates of stand-alone selling prices for individual performance obligations have not been addressed sufficiently. Again, we would appreciate some practical expedients.

The boards believe that there will be fewer instances under the proposed requirements in which the transaction price will be allocated using estimates because entities will have to allocate the transaction price only to separate performance obliga-

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tions for “distinct” goods and services. In this context, we refer to our concerns regarding the proposed definition of “distinct” (question 2).

### **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?*

Contract costs should be recognised as an asset if, and only if, they fulfil the requirements of the definition of an asset. Therefore, we support the proposal that an entity should be required to recognise costs of obtaining a contract as expenses when incurred. This proposal would affect entities that currently capitalise such costs (for example, commissions and other direct costs) and amortise them over the contract period.

In this context, we would appreciate the boards explaining why

- the exposure draft on **revenue recognition** proposes to recognise costs of obtaining a contract as expenses when incurred (paragraph 59), while
- the exposure draft on **insurance contracts** proposes to include incremental acquisition costs in the present value of the fulfilment cash flows (paragraph 39).

The exposure draft also proposes that an entity shall recognise an asset for the costs of fulfilling a contract under certain conditions if such costs do not give rise to an asset eligible for recognition in accordance with another IFRS. In this context, especially IAS 2, IAS 16 and IAS 38 provide the relevant IFRS guidance. The boards decided to develop additional uniform cost guidance within their common revenue recognition standard mainly because of the lack of sufficient cost guidance under US GAAP. Within IFRS, the additional uniform cost guidance could interfere with current requirements, despite the fact that the guidance for a service provider in IAS 2.19 is to be deleted. For instance, example 28 (paragraph B90) states that the costs of design would be accounted for in accordance with paragraph 57 of the exposure draft. However, costs of design are explicitly addressed in IAS 38.57 and

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IAS 38.59. Hence, we suggest that the IASB avoids overlapping guidance in the final document.

### **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?*

In comparison with the description of “contract costs” in IAS 11, the exposure draft seems to restrict the extent of allocated costs eligible for capitalisation: While IAS 11 permits certain indirect costs to be allocated to the contract, the exposure draft only refers to costs that relate directly to a contract. The same is true in respect of IAS 2.19 which will be deleted as a consequential amendment. We suggest the boards clarify their intention and state explicitly whether and why

- measurement of contract costs recognised as an asset differs from measurement of assets eligible for recognition in accordance with other standards, in particular IAS 2, IAS 16 and IAS 38,
- only incremental costs that relate directly to a contract are addressed in paragraph 58 - as implied by the wording of paragraph 58(e): “other costs that were incurred only because the entity entered into the contract”.

### **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?*

The IDW agrees with the objective of the proposed disclosure requirements, i.e. to provide information about the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. However, some proposals seem to be overly extensive. In particular, we question the usefulness of the following disclosures:

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- performance obligations (paragraph 77) and
- determining the transaction price and allocating it to performance obligations (paragraph 83)

Both requirements might often lead to either boilerplate statements or a proliferation of extensive and detailed information, at least in case of global players.

More generally, we are concerned that most of the IASB's recent projects have led to additional disclosure requirements. It appears to us that the Board proposes new disclosures almost as a matter of routine, even though only a single group of users has expressed a desire to receive a particular piece of information. The resulting information overload makes financial statements more and more confusing. We recommend a comprehensive review of the current requirements in order to focus on the disclosures that are truly necessary.

Regarding the proposed reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities (paragraph 75), we believe that an additional example would be helpful in understanding the boards' intention. Such an example should also illustrate the required reconciliation to the amounts presented in the statement of financial position (paragraph 76).

**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?*

The IDW recognises the potential benefit the separate disclosure of the remaining performance obligations might provide in analysing trends in the amount and timing of revenue and assessing risks associated with future revenues. However, such a maturity analysis will often be too burdensome and costly for preparers because entities would be required to identify and measure a multitude of performance obligations, including those performance obligations that result from unperformed contracts / executory contracts. On balance, it is questionable whether the potential use of this analysis for users of the financial statements justifies the additional and considerable costs.

**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?*

The IDW agrees with the proposed disaggregation of revenue.

**Effective date and transition**

**Question 13**

*Do you agree that an entity should apply the proposed requirements retrospectively (i.e. 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.*

In order to maintain the comparability of financial statements, we agree with the proposed transitional requirements, i.e. entities should apply the proposed requirements retrospectively in accordance with IAS 8.

As retrospective application is burdensome for several entities, especially for entities with many long-term contracts, an appropriate lead time between issuing the final standard and its effective date needs to be provided.

**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?*

In general, as was the case for IFRS 9, we wonder why examples are an integral part of the (draft) IFRS. In our view, they should only serve to illustrate the requirements.

Apart from that, the IDW has concerns about several of the examples. We refer to our answers to the respective questions. In particular, the interrelation between the principles in the main body of the (draft) standard and the examples is sometimes

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unclear or even contradictory (e.g. paragraph 19 vs. example 2, paragraph 23 vs. examples 10 and 11).

The IDW agrees with including specific guidance on customer options for additional goods or services in the future standard (paragraph B24 et seqq.). If an entity grants a customer an option to acquire additional goods or services free of charge or at a discount, a separate performance obligation has to be accounted for provided that the option presents a material right to the customer within a contract. In contrast, discount vouchers are occasionally provided to customers on a discretionary basis and consequently, they do not form part of a sales transaction. Only when entering into a contract with the customer, will the discount voucher reduce the transaction price. Hence, at the date of distribution, no performance obligation exists and there is no impact on current accounting (e.g. no provision for contingent / future losses). We would appreciate the IASB clarifying this issue.

#### **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 the 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?*

The IDW agrees with several aspects of the proposed distinction between quality assurance warranties and insurance warranties as well as the proposed accounting for both types of product warranty.

However, in practice, it will often be difficult to differentiate between

- defects that exist when the product is transferred to the customer (quality assurance warranties), and

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- faults that arise after the product is transferred (insurance warranties).

We admit that the boards try to address this problem by describing some factors that should be considered in assessing the type of product warranty (paragraph B18). But, additional guidance is necessary from our point of view.

In contrast to paragraph B15, we believe that a requirement to repair a defective product should not always be accounted for as a failed sale of the products' components expected to be replaced in the repair process. In our view, if the product has already been delivered and will not be returned, recognising revenue for the portion of the transaction price attributable to such components and recognising a liability measured at cost would be more appropriate. In this case, the performance obligation (i.e. the unit of account) is the delivery of the product, not the delivery of the components. The performance obligation is satisfied when the customer obtains control of the product. The costs an entity will incur to meet the warranty claims are further costs directly related to items already transferred. This accounting treatment also considers the facts that it is difficult to allocate revenue to the products' components expected to be replaced and that such product warranties are often insignificant.

Moreover, paragraph B15 does not explain how to account for a quality assurance warranty if

- the products' **components** expected to be replaced in the repair process represent only a minor part of the outstanding obligation, and
- **other costs** to repair or replace the components (e.g. maintenance staff costs) represent the major part of the outstanding obligation.

While paragraph B15 states explicitly that an entity does not recognise revenue for the portion of the transaction price attributed to the products' components expected to be replaced in the repair process, it remains unclear whether the other costs to repair or replace the components should be recognised as an additional liability and further, whether such a liability should include a profit margin.

The boards intend the accounting for a quality assurance warranty to be consistent with the accounting for a right of return (paragraph BC202). However, example 4 on quality assurance warranties (paragraph B16) states that an asset that results from an unsatisfied performance obligation represents the inventory that the entity has not yet transferred to the customer and is measured in accordance with IAS 2. In contrast, we believe that the defective product should not be recognised as inventory because the defect does not preclude the customer from directing the use of, and receiving the benefits from, the defective product (analogous to paragraph BC194 on rights of return). Rather, the entity should recognise a contractual

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right to recover the product from the customer if the customer demands repair (similar to paragraph B12).

Furthermore, it is not clear how the statement in paragraph B17 that an insurance warranty gives rise to a separate performance obligation has to be interpreted and how it interacts with the definition of “distinct” in paragraph 23. We suggest the boards clarify if, in case of an insurance warranty, a general assumption of a separate performance obligation is stipulated or, alternatively the entities are still required to identify separate performance obligations on a case-by-case basis in accordance with paragraph 23.

#### **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?*

In our view, there might be application problems in respect of the unit of account and derecognition. The following example illustrates our point:

An entity owns all worldwide rights associated with an intangible asset and, by contract, provides to a third party the exclusive right to use within a single country while retaining all rights in all other countries. If the exclusive right to use within one country is granted for (substantially) all of the intellectual property’s economic life, the proposals in paragraphs B33, B34 and B37(b) seem to imply that the contract should be treated as a sale rather than a licensing of intellectual property. There is a need to clarify whether the entirety of rights is the unit of account in this case and whether a part of the intangible asset would be derecognised to reflect the sales contract. In addition, the final document should set out how the previous carrying amount of the intangible asset would be allocated between the part that continues to be recognised and the part that is derecognised.

### **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?*

The IDW agrees with the proposed consequential amendments concerning the sale of assets within the scope of IAS 16, IAS 38 and IAS 40.

### **Non-public entities**

#### **Question 18 [FASB only]**

*Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement(s) and why?*

n/a

### **Other Remarks**

#### Definition of a contract

The definition of a contract as proposed in Appendix A (“An agreement between two or more parties that creates enforceable rights and obligations”) differs from the definition in IAS 32.13 (“In this Standard, ‘contract’ and ‘contractual’ refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.”). The latter includes agreements that are not enforceable by law (paragraph BC13).

For the sake of internal consistency, we recommend the IASB adopt a single definition of a contract.

#### Scope of the proposed new standard

The proposed new standard only applies to revenue from contracts with customers (paragraph 6). Revenue that does not arise from contracts with customers would

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not be affected by the proposals. Therefore, some transactions that are currently in the scope of IAS 18 would be outside the scope of the new standard, for instance, dividends received and revenues from non-contractual royalties (e.g. as a result of copyright legislation that requires the payment of royalties to the rights holder when the copyrighted work is reproduced). The IASB should clarify which standard has to be applied to such transactions in the future.

### Onerous performance obligations

In this area of accounting, there are several conceptual differences between the exposure draft and IAS 37 (IAS 11 has another differing concept). For example, the exposure draft describes a performance obligation (= unit of account) as onerous if the present value of the probability-weighted costs that relate directly to satisfying that performance obligation exceeds the amount of the transaction price allocated to that performance obligation. In contrast, IAS 37 defines an onerous contract (= unit of account) as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

We agree with the following aspects of the proposed approach (and refer to our comment letter on the exposure draft 2010/1 “Measurement of Liabilities in IAS 37”, dated 16 March 2010):

- A cost trigger (rather than a current price trigger) should be used in determining whether the unit of account is onerous.

As mentioned above, we have concerns in respect of using probability-weighted costs (i.e. an expected value approach). Nevertheless, we concede that the proposal is consistent with how an entity would determine the transaction price (paragraph BC141).

- Once the unit of account is onerous, it should be remeasured on a basis that is consistent with the trigger (= cost).

At present, this statement is only included in the basis for conclusions (paragraph BC140), not in the proposed standard. We recommend explicit guidance be included within the main body of the future standard.

Contrary to the boards, we believe that the unit of account for applying the onerous test should be the contract (rather than the separate performance obligation). The contract level is appropriate because this is the level at which the overall price was negotiated and the overall economics of the arrangement established. If price interdependence is used as the principle for combining and segmenting contracts, it



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is inconsistent to consider any separate performance obligation being onerous as part of an overall profitable contract.

Finally, guidance on the presentation of certain items of income and expense in the context of onerous performance obligations (paragraph 56) should be transferred to the presentation section of the standard.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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