

Document No. 352
March 12, 2012

Accounting & Tax Committee
Japan Foreign Trade Council, Inc.

To the International Accounting Standards Board

Comments on “Revenue from Contracts with Customers”

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) made in response to the solicitation of comments regarding the International Accounting Standards Board Exposure Draft “Revenue from Contracts with Customers”. The JFTC is a trade-industry association with trading companies and trading organizations as its core members, while the principal function of its Accounting & Tax Committee is to respond to developments in domestic and international accounting standards. (Member companies of the Accounting & Tax Committee of JFTC are listed at the end of this document.)

I. General Comments

We highly appreciate the fact that the IASB has revised the 2010 Exposure Draft in response to feedback from various stakeholders and published the revisions for public comment. It is our view that the present ED contains a number of revisions that take into consideration the administrative burden on preparers in such areas as identifying separate performance obligations, and the treatment of customer’s credit risk and product warranties. We also note that the FASB has issued a nearly identical ED (Topic 605), and take this opportunity to express our support for well-coordinated joint projects.

However, in certain parts, the present ED does not reflect the comments submitted on the previous occasion. For example, we believe that the disclosure requirements remain overly detailed. Therefore, in the process of finalizing the standard, we request that further and careful attention be paid to the administrative burden placed on preparers.

II. Specific Issues (Comments on Questions)

Question 1

Response:

We agree with the proposal.

Reason:

In the 2010 ED, the timing of recognition of revenue was defined solely on the basis of “transfer of control.” On the other hand, the present ED distinguishes between cases in which performance obligations are satisfied at a point in time and cases in which performance obligations are satisfied over time. In our estimation, this clear separation between revenue recognized under the percentage of completion method and others represents a significant improvement.

Question 2

Response:

- (1) We appreciate the fact that comments on the 2010 ED have been reflected in the present ED, such that the impact of customer’s credit risk is not deducted from revenue, but is instead recognized separately as profit or loss. However, we do not agree with the proposal to present impairment loss as a separate line item adjacent to the revenue line item. Instead of directly deducting from the revenue line item, we believe that, as in the current standard, this should be treated as an expense.
- (2) We believe that impairment losses on receivables should be presented under a single item.

Reason:

- (1) The significance of presenting impairment loss as a separate line item adjacent to the revenue line item is unclear. As indicated in paragraph BC172, impairment losses may relate to amounts of uncollectible consideration recognized as revenue in previous reporting periods. As such, a relation does not necessarily exist between revenue recognized in a certain reporting period and impairment loss recognized in that reporting period. Moreover, because an entity’s sales activities are separate from its activities for the collection of receivables, we believe that the outlook for collection activities should not be reflected in revenue, which represents sales activities. Consider a case in which a change has occurred in the customer’s credit risk with regard to receivables recognized in previous reporting periods. An example of this would be a case in which loan-loss reserves are reversed to account for the receivables that had been assessed to be uncollectible in a previous reporting period but have then been collected in the

current reporting period. Under the proposal, the effect of this change in customer's credit risk would be reflected in revenue for the current reporting period, which would undermine the meaning of revenue. Furthermore, whereas the original intent is to present risk separately, the actual outcome may be the disclosure of ambiguous numerical values.

- (2) It is impractical to separately present impairment losses on short-term receivables and those on long-term receivables (paragraphs BC174 and BC175). Therefore, we believe that impairment losses on receivables recognized as a result of recognizing revenue in accordance with the present ED should be presented under a single line item.

Question 3

Response:

We request that the following indicators be reconsidered.

We appreciate the intent of the provision stipulating that the cumulative amount of revenue recognized should not exceed the amount to which the entity is reasonably assured to be entitled. However, the definition of "reasonably assured" remains unclear, which can be expected to give rise to various difficulties in the process of audit. Therefore, we request that more illustrative examples be provided.

When uncertainty about the amount of consideration is not expected to be resolved for a long period of time

In the case of, for example, sales-based royalties where the entity is not reasonably assured to be entitled to the amount of consideration until sales are made, we agree with the proposal that revenue should not be recognized until the uncertainty is resolved at the time of subsequent sales. However, we request that the calculation of variable consideration be reexamined as indicated below.

Paragraph 81 stipulates that an entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met: (a) the entity has experience with similar types of performance obligations, and (b) the entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. However, this should be restricted to customer contracts that contain explicit provisions for payment obligations regarding specific variations in consideration resulting from discounts, incentives, and other similar items in the normal course of transaction. For example, paragraph 53 refers to such possibilities for variation in the amount of consideration as penalties and

contingencies. If the provision of paragraph 81 were to be applicable to all of these causes of variation, we are concerned that the standard would be rendered dysfunctional in complex cases. Furthermore, in cases involving new transactions where the entity does not have prior experience (including both the entity's own experience and access to the experience of other entities), we believe that revenue should be recognized when the entity has satisfied its performance obligations and that the recognition of revenue should not be conservatively postponed by reason of absence of prior experience.

When the amount of consideration is highly susceptible to volatility in a market

In transactions of minerals and other commodities, it is common practice for revenue to be recognized and settlement to be undertaken on the basis of a provisional price pending the finalization of the formal price. Once the price is finalized, revenue is revised and all differences are adjusted. In the present ED, reasonably assured recognition of revenue is considered to be impossible in cases where the amount of consideration is highly susceptible to market volatility. This implies that in such transactions, revenue cannot be recognized until the price is finalized. However, this does not accord with current business practices and accounting methods. We request that the standard be reconsidered to allow the following. Regardless of market volatility, on the condition that an agreement has been reached with the customer, an entity should be allowed to recognize revenue when performance obligations have been satisfied at the price agreed upon in advance with the customer.

Question 4

Response:

- (1) We agree with restricting the onerous test to performance obligations that an entity expects at contract inception to satisfy over a period of time greater than one year. However, we do not agree with specifying performance obligations as the unit of onerous testing and believe that contracts should serve as the unit.
- (2) We request clarification on what standard applies when losses are expected from a performance obligation satisfied at a point in time.

Reason:

- (1) In onerous testing, entities normally base their judgment on an entire contract rather than on its component performance obligations. Because a contract can be profitable even if some individual performance obligations are onerous, using performance obligations as

the unit of onerous testing may not accurately reflect an entity's economic activities.

- (2) For cases where losses are expected from a performance obligation satisfied at a point in time, paragraph BC210 refers the matter to paragraph 31 of IAS 2, which in turn refers the matter to IAS 37. However, it is unclear whether the provisions of IAS 37 apply to recognition of revenue.

Question 5

Response:

All of the disclosure requirements necessitate gathering and analysis of a broad range of revenue-related information, which would prove excessively burdensome to preparers. We believe these disclosure requirements are unnecessary for both interim and annual financial reports.

From the perspective of management, entities formulate and manage strategic goals to increase revenue based on business segments defined by products and services. Therefore, we believe that the need for revenue disclosure is fully and sufficiently met through the current disclosure of segment information that is founded on this management approach. Hence, we request that the disclosure requirements of the present ED be reconsidered.

Reason:

- (1) Disaggregation of revenue (paragraphs 114 and 115)

Some entities, especially trading companies, handle very large numbers of highly diverse contracts on a daily basis. For such entities, disaggregation of revenue would result in a wide variation of criteria and disaggregation by meshing. Further detailed disclosure will make it more difficult to gain an overall picture of revenue sources and will undermine comparability.

- (2) Tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)

We are opposed to disclosure of tabular reconciliation for the following reasons. (a) This requirement will prove excessively costly because it necessitates major changes in accounting systems and the development and operation of analysis workflows and tools. (b) In some cases, preparers do not gather the information required in this paragraph because knowledge of such information is not particularly

useful from a management control perspective. Therefore, we believe that the usefulness of this disclosure will also be limited for users.

Furthermore, because consolidated disclosure would be required, we are concerned that this requirement would prove particularly burdensome for entities with numerous affiliates and subsidiaries.

(3) Analysis of the entity's remaining performance obligations (paragraphs 119–121)

Disclosure of the analysis of an entity's remaining performance obligations necessitates the development and operation of analysis workflows and systems for timely monitoring of contract information. We believe the required costs would exceed the benefit to users. Furthermore, because consolidated disclosure would be required, we are concerned that this requirement would prove particularly burdensome for entities with numerous affiliates and subsidiaries. Moreover, because performance obligations are highly diverse, the estimation of this information may undermine comparability among entities. For these reasons, we are opposed to disclosure of the analyses of remaining performance obligations.

(4) 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)

We are concerned that this requirement would be burdensome for preparers and that the benefits would not justify the cost. Another concern is that paragraph 87 (b), which stipulates the criteria for the calculation of the lowest cost of settling a performance obligation, may be interpreted to relate to the details of contracts entered into with customers. For instance, entities may enter into an onerous contract as part of a broader business strategy. We are opposed to the proposal on the grounds that it may require entities to disclose the details of such contracts.

(5) Tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128)

For entities undertaking a large number of repetitive and diverse transactions whose performance obligations are satisfied at a point in time, the costs incurred in obtaining or fulfilling contracts reach large amounts in the course of daily operations. We do not believe that tabular reconciliation of movements of the assets recognized from these costs would prove beneficial to users of financial reports.

Direct labor expenses to be included in the costs of fulfilling a contract would presumably include such specific items as sales personnel expenses from the time the contract is obtained to the time of sale (personnel expenses related to attending on the delivery and installation of products, etc.). However, from a practical perspective, it is nearly impossible to calculate these personnel expenses. Even if some cost allocation formula were to be used for this calculation, the administrative burden would be immense. Moreover, we believe that calculation and disclosure on a consolidated basis would prove to be almost impossible.

(6) Information about the entity's performance obligations in contracts with customers (paragraph 118)

Performance obligations vary from one contract to another. For an entity undertaking a large number of repetitive and diverse transactions, it is impossible to cover its performance obligations in all contracts. An alternative approach would be to compile and disclose information that is common to the contracts. However, the content of this disclosure would necessarily have to be abstract and macroscopic. We do not believe that the disclosure of such information would prove beneficial to the users of financial reports.

Question 6

Response:

We agree with the proposal.

Reason:

Even in the case of a transfer of a nonfinancial asset that is not the output of an entity's ordinary activities, various disparities in timing of recognition and reporting method would arise due to differences in revenue recognition from the present ED. Because this would not appropriately represent financial conditions, we believe that entities should be required to apply the proposed control and measurement requirements.

Other Comments

Revenues from licensing agreements

In the case of fixed-term licensing agreements, performance obligations may be satisfied over time. Therefore, in addition to recognizing revenue at a point in time, we believe that entities should also be allowed to recognize revenue over the duration of the licensing agreement.

The reason given for recognizing revenue from a licensing agreement at a point in time is that performance obligations are satisfied at the point in time when the customer obtains control of the rights (paragraph B34), where control is defined as the ability to direct the use of and obtain substantially all of the remaining benefits from the goods and services (paragraph 32). However, in the case of fixed-term licensing agreements, the period of time during which the customer can obtain benefits is limited, and it can be assumed that benefits accrue with the passage of time. Hence, cases may exist in which performance obligations are satisfied over the duration of the agreement, so that the customer does not necessarily control the right to use at a point in time. Therefore, in the case of fixed-term licensing agreements, in addition to recognizing revenue at a point in time, we believe that entities should be allowed to recognize revenue over the duration of the licensing agreement.

Retroactive application

Short-term contracts should not be subject to retroactive application because the review of very large numbers of contracts would create significant administrative burdens. With regard to long-term contracts, from the perspective of the impact on transactions and administrative burden and the usefulness of financial reports, we request reconsideration allowing entities to choose either retroactive or prospective application.

Time value of money

Regarding the reflection of the time value of money, paragraphs 59 and BC147 state that a payment in advance or in arrears in accordance with the typical credit terms in an industry and jurisdiction may have a primary purpose other than financing. We request the presentation of more concrete explanations of this matter. For instance, is it necessary to account for the effects of the time value of money regarding deposits and retentions in plant construction agreements? We request that a multiple number of illustrative examples be given.

Other

With reference to paragraphs BC219 and BC220, for advertising expenses and other costs that are subject to the provisions of existing standards (such as intangible assets), a decision has been made not to reconsider all cost requirements comprehensively. However, we request that these also be comprehensively reconsidered as soon as possible.

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