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## Exposure Draft (ED/2011/6) "Revenue from Contracts with Customers"

Dear Hans,

We appreciate the opportunity to review and comment on the 2011 Exposure Draft (ED) "Revenue from Contracts with Customers". We applaud the IASB and the FASB for the wise decision to re-expose their revised proposals for a common revenue recognition standard.

While we continue to support the Boards' approach of developing a high-quality principles-based revenue recognition standard, and acknowledge the significant improvements achieved since the publishing of the Discussion Paper in 2008 followed by the first exposure draft in 2010, there still are certain areas that need improvement. Our major concerns relate to the following:

- The application of the 'transfer of control' notion to intangibles such as software licenses is not always straight-forward, specifically, the question whether performance obligations are satisfied over time. In the appendix to this letter we are making specific recommendations on how this area could be further improved to faithfully depict the economics of certain contracts.
- The requirement to estimate the stand-alone selling prices of goods or services for the purpose of allocating the transaction price to the separate performance obligations of a contract needs further clarification, particularly with regard to performance obligations with highly variable or uncertain sales prices which are very common in our industry. The appendix to this letter includes concrete proposals for such clarification.
- To measure progress towards complete satisfaction of certain performance obligations such as stand-ready obligations, we believe that the act of standing ready to perform should drive the pattern of revenue recognition and we recommend a related clarification which would also better align the revenue recognition standard to the Boards' insurance project.
- For transition, we would like to raise the Boards' attention that without further reliefs and additional practical expedients preparers will incur significant costs through the retrospective application that may not be outweighed by the benefits. We request further progress here to balance the costs with the benefits.

Attached, please find our detailed responses to the specific questions raised by the Boards as well as further comments on the exposure draft. We would be pleased to discuss our comments at your convenience.

Sincerely,

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## Appendix:

### Answers to the questions of the exposure draft and further comments

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

We agree with both,

- the basic notion that revenue shall be recognized over time if an entity satisfies a performance obligation over time,
- the basic principles underlying the criteria that are used in paras 35 and 36 to specify when an entity satisfies a performance obligation over time.

We believe, however, that the criteria proposed in paras 35 and 36 were developed with the transfer of tangible assets and services in mind. Thus, it is not sufficiently clear how these criteria apply to the transfer of intangible assets. We particularly see lacking clarity with regard to

- (a) the notion of '*asset that the customer controls as the asset is created or enhanced*' in para 35(a) because it is unclear to us how it applies to customer-specific enhancements of a software product that the customer owns a license to,
- (b) the notion of '*does not create an asset*' in para 35(b) because it is not clear whether this guidance only refers to assets that the entity is obliged to transfer to the customer,
- (c) the relationship between the guidance in paras 35 and B34, i.e. how the guidance in para 35 on satisfaction of performance obligations over time relates to the guidance in para B34 that provides that granting a license is a performance obligation "*that the entity satisfies at the point in time when the customer obtains control of the rights*" (emphasis added).

*Ad (a): The notion of 'asset that the customer controls as the asset is created or enhanced' in para 35(a)*

We believe that there is no substantive difference between enhancing a tangible asset owned by the customer (e.g. adding a floor to a building owned by the customer) and enhancing an intangible asset (e.g. adding new software functionalities to a license owned by a customer). We therefore believe that para 35(a) of the ED should apply to intangible assets as much as it applies to tangible assets.

Currently, para 35 provides only one example for an asset that the customer controls while it is produced or enhanced. We believe that there should rather be a list of examples and that such list is better presented in a separate para rather than in brackets in para 35. We therefore propose the following change:



Current wording	Proposed modified wording
<p>35 An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if at least one of the following two criteria is met:</p> <p>(a) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced.</p> <p>(b) ...</p>	<p>35 An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if at least one of the following two criteria is met:</p> <p>(a) the entity's performance creates or enhances an asset (<del>for example, work in progress</del>) that the customer controls as the asset is created or enhanced.</p> <p>(b) ...</p> <p><u>35a Depending on the contract, assets that the customer controls as the assets are created or enhanced may include, but are not limited to, the following:</u></p> <p><u>(a) work in progress,</u></p> <p><u>(b) licenses owned by the customer to use software or other intangibles,</u></p> <p><u>(c) ... [add further examples]</u></p>

*Ad (b): The notion of 'does not create an asset' in para 35(b)*

When SAP contracts with a customer to develop software functionalities to the specific desires of the customer, our efforts usually result in two assets: (a) the intellectual property (IP) to the developed software and (b) the non-exclusive license granted to the customer. Our performance obligation to the customer is to grant a license. The IP remains with us and is not transferred to the customer.

While the creation of intellectual property may be particularly prominent in our industry it is not limited to our industry. If a carpenter produces a table to the specific desires of the customer, the specifics of the table may well be intellectual property that resides with the carpenter. The same may, for example, also apply to the construction of houses. We therefore believe that the final revenue recognition standard should clarify that the focus of the analysis under paras 35 and 36 is limited to the assets that are subject to the transfer to the customer. This can be achieved by wording para 35(b) as follows:



Current wording	Proposed modified wording
<p>35 An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if at least one of the following two criteria is met:</p> <p>(a) ...</p> <p>(b) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and at least one of the following criteria is met:</p> <p>(i) ...</p> <p>(ii) ...</p> <p>(iii) ...</p>	<p>35 An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if at least one of the following two criteria is met:</p> <p>(a) ...</p> <p>(b) the entity's performance does not create an asset <del>with an alternative use to the entity (see paragraph 36)</del> <u>that meets both of the following conditions:</u></p> <ul style="list-style-type: none"> <li>• <u>the entity is obliged to transfer the asset to the customer, and</u></li> <li>• <u>if no transfer took place, such asset would have an alternative use to the entity (see paragraph 36)</u></li> </ul> <p>and at least one of the following criteria is met:</p> <p>(i) ...</p> <p>(ii) ...</p> <p>(iii) ...</p>

*(c) The relationship between the guidance in paras 35 and B34*

Para B34 provides that granting a license is a performance obligation " *that the entity satisfies at the point in time when the customer obtains control of the rights*" (emphasis added). This could be read as providing that wherever a license is granted the respective performance obligation is a performance obligation satisfied at a point of time, thus under no circumstances qualifying for an accounting under the guidance for performance obligations satisfied over time in paras 35 and 36.

We do not believe that such an accounting would be appropriate and we doubt that such an interpretation of B34 was intended by the Boards. The grant of a license is a legal act with not more nor less importance than the transfer of legal title to a tangible asset. It would therefore not be consistent to treat the transfer of legal title to a tangible asset only as an indicator of transfer of control (as currently provided in para 37) while the grant of the license is treated as a condition rather than an indication for transfer of control resulting in a control transfer at a point in time. We also believe that making the grant of a license a condition for transfer of control would be a 'form over substance' condition as a software vendor could easily grant to a customer a license to an incomplete customer-specific software product at the end of every day thus meeting the condition on a daily basis.

We ask the Boards to clarify that the act of granting the license is no condition for transfer of control and that granting licenses to customers may well qualify as a performance obligation satisfied over time if the criteria under paras 35 and 36 (modified as proposed above) are met.



We believe that this can be achieved as follows:

Current wording	Proposed modified wording
<p>B34 [IG34] If an entity grants to a customer a licence or other rights to use intellectual property of the entity, those promised rights give rise to a performance obligation that the entity satisfies at the point in time when the customer obtains control of the rights.</p>	<p>B34 [IG34] If an entity grants to a customer a licence or other rights to use intellectual property of the entity, those promised rights give rise to a performance obligation that the entity satisfies <del>at the point in time when the customer obtains control of the rights.</del> <u>when the entity transfers the control of the rights to the customer. The entity shall apply the criteria in paragraphs 31 to 37 to determine whether such transfer occurs over time or at a point in time (e.g. at the time of transfer of the legal title to the license).</u></p>

Additionally, we recommend to add to the illustrative examples an example that illustrates how paras 35 and 36 are applied to the production of customer-specific software functionalities. We believe that the examples provided in the comment letter from the European Software Accounting Group (ESAG) would qualify as such examples.

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

It is our understanding that the Boards have not finalized a proposal for the guidance for the accounting for trade receivables to be provided under IFRS 9 and that in its February 2012 meeting the IASB took the following tentative decision (taken from the February 2012 IASB Update):

*Trade receivables without a significant financing component*

...

*The IASB tentatively decided that a simplified form of the three bucket model shall be applied. The approach for trade receivables accounted for as not having a significant financing component in accordance with the Revenue ED would be twofold (affecting both initial measurement of the receivable and the general three bucket model):*

- the receivable shall be measured at the transaction price as defined in the Revenue ED (ie the invoice amount in many cases) on initial recognition in IFRS 9 Financial Instruments; and*
- those receivables shall be included in Bucket 2 or 3 on initial recognition, thus recognising lifetime expected losses on initial recognition and throughout the life of the asset.*

We would need further detail on this proposed approach before being in a position to comment whether this proposal is appropriate.



We agree, however, with the principle to not consider collectability in the transaction price but rather present it outside revenue. Clarification is, however, needed in the following areas:

- Clarification around the naming of the income statement lines, i.e. that revenue is the number prior to the correction line and there is no total presented after the correction (or if a total is presented, this total should not be called “revenue”).
  - Clarification that wherever disclosure requirements refer to revenue numbers such reference is to the revenue number prior to the correction line.
  - Highlighting that the correction line is limited to scenarios of collectability issues, i.e. where the customer is willing but unable to pay. In contrast, scenarios where the entity expects to collect less than the agreed-upon fee due to customer dissatisfaction or concessions granted to the customer should be accounted for under the guidance for variable consideration under paras 53 et seq. (unless they represent a warranty case). We believe it would be appropriate for the Boards to specifically acknowledge, in the Basis for Conclusion, that significant management judgment may be required to determine whether a customer is unwilling or unable to pay the agreed-upon fee.
3. Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity’s experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

We agree with the idea of a constraint on the amount of revenue that an entity would recognize for satisfied performance obligations.

We believe, however, that additional guidance is needed on the term ‘reasonably assured’. We struggle to understand how the ‘reasonably assured’ threshold differs from the ‘more likely than not’ threshold, the ‘highly probable’ threshold and the ‘virtually certain’ threshold used in other IFRSs. We do not believe that the guidance in paras 82 et seq. is helpful in this respect as it deals with the datapoints to be considered but not with the threshold to be derived from these datapoints.

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

We agree that a liability and a corresponding expense should be recognised if a performance obligation is onerous. We also agree that the onerous test should be performed on the level of the individual performance obligation as such approach is consistent with the general notion of allocating the transaction price to the individual performance obligations to then account for these performance obligations as if they were separate contracts.

We do, however, not agree with the notion that the onerous performance obligation test is performed based on the remaining rather than the total performance obligation. We believe that readers of financial



statements interpret onerous losses as an indication for a performance obligation provided below cost. This is, however, not correct if the onerous test is performed based on the remaining performance obligation. Under such approach, even if the transaction price initially allocated to a performance obligation is significantly higher than the total cost of satisfying the performance obligation, an onerous loss may occur if towards the end of the arrangements the expected remaining cost increase in a way that the total cost still stay below the transaction price initially allocated to a performance obligation but above the remaining amount of that transaction price.

We also believe that limiting the recording of onerous losses to performance obligations satisfied over more than one year should be a practical expedient rather than a requirement. I.e. entities should be allowed but not required to also record onerous losses for performance obligations satisfied at a point in time or satisfied over less than one year.

5. The Boards propose to amend Topic 270 on interim reporting and IAS 34, Interim Financial Reporting, to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial statements. The disclosures that would be required (if material) are:
  - A. The disaggregation of revenue (paragraphs 114 through 116)
  - B. A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
  - C. An analysis of the entity's remaining performance obligations (paragraphs 119 through 121)
  - D. 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)
  - E. A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

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

We disagree that an entity should be required to provide each of those disclosures in its interim financial statements. We rather support the dissenting views expressed by Mr. Engström (see para AV3) that it is inappropriate to require the listed disclosures about revenue and contracts with customers in interim periods without a holistic review of IAS 34.

6. For the transfer of a non financial asset that is not an output of an entity's ordinary activities (for example, property, plant, and equipment within the scope of Topic 360, IAS 16, or IAS 40), the Boards propose amending other standards to require that an entity apply the proposed guidance on control to determine when to derecognize the asset and apply the proposed measurement guidance when determining the amount of gain or loss to recognize upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement guidance to account for the transfer of nonfinancial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

We agree that an entity should apply the proposed control and measurement guidance to account for the transfer of nonfinancial assets that are not an output of an entity's ordinary activities.



We believe, however, that clarification should be provided regarding the scope of such analogy. To our understanding

- revenue generating transactions are mostly recorded gross as shown in the following exemplary postings
  - Dr Receivable
  - Cr Revenue
  - Dr Cost of revenue
  - Cr inventory
- transfers of nonfinancial assets that are not an output of an entity's ordinary activities are recorded
  - Dr Receivable
  - Cr Asset
  - Cr income

The Boards should clarify that the application of the revenue recognition guidance to the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities does not result in a requirement to record such transfers gross.

We also believe that clarification should be provided that the application of the revenue recognition guidance to the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities does not include classification and presentation.

Both of these clarifications can be provided by amending (for IFRS purposes) para BC349 of the Basis for Conclusions as follows:



Current wording	Proposed modified wording
<p>BC349 In IFRSs, an entity selling an asset within the scope of IAS 16 Property, Plant and Equipment, IAS 38 or IAS 40 Investment Property applies the recognition principles of IAS 18 to determine when to derecognise the asset and, in determining the gain or loss on the sale, measures the consideration at fair value. However, the IASB understands that there is diversity in practice when the sale of those assets involves contingent consideration. Accordingly, to improve the accounting in IFRSs and ensure consistency with US GAAP, the IASB decided to amend those standards to require an entity to apply the recognition and measurement principles of the proposed requirements to sales of assets within the scope of those standards. The IASB decided that a reasonably assured constraint on the amount of consideration used in determining the gain or loss recognised should also apply to the sale of assets that are not an output of the entity's ordinary activities. This is because an entity faces similar if not greater challenges in determining the transaction price when the asset is not an output of the entity's ordinary activities than when the asset is an output of its ordinary activities.</p>	<p>BC349 In IFRSs, an entity selling an asset within the scope of IAS 16 Property, Plant and Equipment, IAS 38 or IAS 40 Investment Property applies the recognition principles of IAS 18 to determine when to derecognise the asset and, in determining the gain or loss on the sale, measures the consideration at fair value. However, the IASB understands that there is diversity in practice when the sale of those assets involves contingent consideration. Accordingly, to improve the accounting in IFRSs and ensure consistency with US GAAP, the IASB decided to amend those standards to require an entity to apply the recognition and measurement principles of the proposed requirements to sales of assets within the scope of those standards. <u>No similar application of the revenue recognition guidance is intended for presentation, classification and disclosure, neither for determining that a sale should be recorded gross (by recording the transaction price in income and the cost of the sold asset in expense) rather than net (by recording the difference between carrying amount and transaction price in income or expense)</u> The IASB decided that a reasonably assured constraint on the amount of consideration used in determining the gain or loss recognised should also apply to the sale of assets that are not an output of the entity's ordinary activities. This is because an entity faces similar if not greater challenges in determining the transaction price when the asset is not an output of the entity's ordinary activities than when the asset is an output of its ordinary activities.</p>



7. Other Comments

*Identifying the contract – Combining contracts*

We agree with the list of criteria in para 17 for determining whether two or more contracts need to be combined. We also support the use of criteria as opposed to indicators.

We also agree with the notion that the requirement to combine contracts is limited to contracts that are entered into at or near the same time and that the ‘at or near the same time’ criterion needs to be met in addition to at least one of the other criteria. We request, however, the following clarification:

- We have become aware of comments that interpret the requirement in a way that the ‘at or near the same time’ criterion is deemed to be met whenever contracts are negotiated as a package. We would therefore welcome further clarification in this regard.
- We fear that significant diversity in practice will occur with regard to how ‘at or near the same time’ is interpreted. We acknowledge that the Boards should not provide rule based guidance in this respect. We believe, however, that the Boards should acknowledge that this interpretation is subject to an accounting policy decision to be applied consistently to similar contracts.

We believe that both of these two clarifications could be provided by adding the following sentence to para BC53 in the Basis for Conclusions:

Current wording	Proposed modified wording
<p>BC53 ...The boards decided to add a further criterion—that the goods or services promised in the contracts would be a single performance obligation in accordance with paragraphs 27–30. The boards added this criterion to avoid the possibility that an entity could effectively bypass the proposed requirements on identifying separate performance obligations depending on how the entity structures its contracts.</p>	<p>BC53 ...The boards decided to add a further criterion—that the goods or services promised in the contracts would be a single performance obligation in accordance with paragraphs 27–30. The boards added this criterion to avoid the possibility that an entity could effectively bypass the proposed requirements on identifying separate performance obligations depending on how the entity structures its contracts.</p> <p><u>The boards considered whether to add guidance on the term ‘at or near the same time’. The boards decided not to provide such guidance as it would necessarily be rules-based. The boards therefore acknowledge that the term is subject to an entity-specific accounting policy to be applied consistently to similar contracts.</u></p> <p><u>The boards acknowledge that due to requiring both, entering into contracts at or near the same time and at least one of the additional three criteria there may be scenarios where two or more contracts are negotiated as a package but nevertheless not combined because they are not entered into at or near the same time.</u></p>



We would also welcome further clarification around the correct interpretation of the term 'entered into' in the phrase 'entered into at or near the same time'. It is not clear to us whether there is a difference between this 'entered into' and the meeting of the criteria listed in para 14. But we believe that both should be identical. We therefore propose adding a paragraph 17a after current para 17 to provide a respective clarification:

Current wording	Proposed modified wording
n/a	<u>17a For the purpose of para 17 a contract is deemed 'entered into' if it meets the criteria outlined in para 14.</u>

*Contract modifications – original sale below stand-alone selling price*

Under para 21 a contract modification can only be accounted for as a separate contract if the modification provides for a consideration for the additional goods or services that reflects their stand-alone selling prices and any appropriate adjustments. we request clarification how para 21 should be applied if the prices for the goods or services added through the modification are below the respective estimated stand-alone selling prices but equal the prices in the original contract. Take for example a contract under which an entity provides one unit of a distinct good for a fee that is below the estimated stand-alone selling price. This contract is later modified to provide a second unit of the distinct good for the same price as the first good. We believe that it would be appropriate to account for the modification as a separate contract although the consideration for the additional unit is below its estimated stand-alone selling price.

We believe that the required clarification can be provided by modifying para 21 as follows:

Current wording	Proposed modified wording
21 An entity shall account for a contract modification as a separate contract if the contract modification results in the addition to the contract of both of the following: (a) ...; and (b) an entity's right to receive an amount of consideration that reflects the entity's stand-alone selling price of the promised good(s) or service(s) and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity would adjust the stand-alone selling price for a discount that the customer receives because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer.	21 An entity shall account for a contract modification as a separate contract if the contract modification results in the addition to the contract of both of the following: (a) ...; and (b) an entity's right to receive an amount of consideration that reflects the entity's stand-alone selling price of the promised good(s) or service(s) and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity would adjust the stand-alone selling price for a discount that the customer receives because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer. <u>An entity would also adjust the stand-alone selling price for a good or service to align it with the respective selling price agreed with the customer for an identical product or service in the original contract.</u>



### *Identifying separate performance obligations – Distinct performance obligations*

Through discussions with the IASB Staff we have learned about the notion that it may depend on the order of delivery whether a performance obligation is distinct. We have understood this notion to mean that if an entity promises two goods or services of which the one delivered first meets the criteria for 'distinct' outlined in para 28 both goods or services are deemed distinct regardless of whether the good or service delivered second meets the criteria in para 28. We believe that this is an important notion that we fully agree with. But we also believe that this notion does not become clear in the current ED. We therefore request that the Boards add specific language that clarifies this notion.

One typical example where this notion is important to our industry is the scenario in which a software vendor sells to a customer a standard software product and additionally promises to deliver, as a specified free-of-charge upgrade, a specific future functionality that the customer desires. Assuming that the standard software product is generally sold without such future functionality it would meet the definition of a distinct performance obligation under para 28(a) ("*the entity regularly sells the good or service separately*"). In contrast, the specified upgrade may neither be sold separately nor provide a benefit without the standard software product. As the standard software product is delivered first the notion outlined above results in the conclusion that the contract consists of two distinct performance obligations. Absent the notion, guidance would be needed how to account for a contract consisting of more than one performance obligation is to be accounted for if some but not all performance obligations meet the 'distinct' criteria in para 28.

### *Identifying separate performance obligations – Combining performance obligations under para 29 (integration service)*

Para 29 provides for an exception from the general guidance on distinct performance obligations under para 28. We understand that this guidance was added to the ED to mitigate the concerns the construction industry had with regard to an 'atomization' of contracts. We believe, however, that the guidance is unclear and, while it may help the construction industry, may create issues for our industry, at least if interpreted in a certain way.

We frequently enter into contracts under which we sell standard software together with services to customize or modify the software. In most of these scenarios the customer has the choice between

- purchasing from us both, the software and the customization/modification service,
- purchasing the software from us and the customization/modification service from a third party unrelated to us.

Under para 28, the standard software and the customization/modification service would be distinct performance obligations because para 28(a) ("*the entity regularly sells the good or service separately*") is met. We believe that this is the appropriate way of accounting for such a contract but worry that para 29 may prevent this appropriate way of accounting for two reasons:

- As currently worded, para 29 only results in accounting for multiple performance obligation as one if "*the goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services*" (emphasis added). Taking the word 'require' literally one could conclude that para 29 is not applicable to the contracts outlined above because there is obviously no requirement to contract the standard software and the service together as shown by the alternative where the entity sells the software stand-alone and the customer purchases the service from a third party. This way of interpreting para 29 is, however, not supported by Example 4 in the illustrative examples because this example does not consider whether the entity could alternatively sell the software without the customization service. Example 4 appears to rather indicate that para 29 applies whenever the contract requires the entity to provide a significant service of integrating the goods or services



regardless of whether the nature of the goods and services would alternatively have allowed a separate sale of the goods or services without the integration service.

- We read para 29 to only apply if a contract consists of at least three performance obligations: two goods or services and an integration service to integrate these two goods or services with each other. Again, this way of reading para 29 is not supported by Example 4 because in this example the integration service is provided "to significantly customise the software to the customer's information technology environment". This information technology environment is, however, not a performance obligation under the contract.

We request that the Boards clarify that para 29 only applies

- if it is not feasible for the entity to sell the goods or service without a significant integration service (rather than wherever the contract requires the entity to provide an integration service),
- if the integration service is to integrate other performance obligations provided under the same contract.

This can be achieved by modifying para 29 as follows:

Current wording	Proposed modified wording
<p>29 Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both of the following criteria are met:</p> <p>(a) the goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted; and</p> <p>(b) ...</p>	<p>29 Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both of the following criteria are met:</p> <p>(a) the goods or services in the bundle are highly interrelated and <del>transferring them to the customer requires that the entity also provide</del> <u>due to this high interrelation it would not be feasible for the entity to transfer them to the customer without also providing</u> a significant service of integrating the goods or services <u>in the bundle with each other</u> into the combined item(s) for which the customer has contracted; and</p> <p>(b)...</p>



Additionally, Example 4 would need to be modified as follows:

Current wording	Proposed modified wording
<p>An entity licences customer relationship management software to a customer. In addition, the entity promises to provide consulting services to significantly customise the software to the customer's information technology environment for total consideration of CU600,000.</p> <p>The entity is providing a significant service of integrating the goods and services (the licence and the consulting services) into the combined item for which the customer has contracted. In addition, the software is significantly customised by the entity in accordance with the specifications negotiated with the customer. Hence, the entity would account for the licence and consulting services together as one performance obligation. Revenue for that performance obligation would be recognised over time by selecting an appropriate measure of progress towards complete satisfaction of the performance obligation (assuming the criteria in paragraph 35 are met for satisfaction of a performance obligation over time).</p>	<p><del>An entity licences customer relationship management software to a customer. In addition, the entity promises to provide consulting services to significantly customise the software to the customer's information technology environment for total consideration of CU600,000.</del></p> <p><u>Under one contract, an entity licences to a customer both, customer relationship management software and and a piece of industry specific add-on software. The nature of the software products is such that the entity needs to provide, for total consideration of CU600,000, consulting services to significantly customize the software products to function together to provide the customer with the functionalities that the customer desires. The customization goes significantly beyond what is ordinary for the two pieces of software. The customsation service is not available from other vendors and it would not be feasible for the entity to sell the two software products as a bundle without the customization service.</u></p> <p>The entity is providing a significant service of integrating the goods and services (the licence and the consulting services) into the combined item for which the customer has contracted <u>and it would not be feasible to sell the goods or services without this integration service.</u> In addition, the software <u>bundle</u> is significantly customised by the entity in accordance with the specifications negotiated with the customer. Hence, the entity would account for the licence and consulting services together as one performance obligation. Revenue for that performance obligation would be recognised over time by selecting an appropriate measure of progress towards complete satisfaction of the performance obligation (assuming the criteria in paragraph 35 are met for satisfaction of a performance obligation over time).</p>

Should such modification result in issues for other industries we recommend to position para 29 as a practical expedient rather than a requirement to allow entities to apply the principles in para 28 without being forced into an accounting under para 29 that may not be appropriate for their industry.

Additionally, we recommend adding that when para 29 is evaluated the relative complexity (relative significance) of a service (e.g. software implementation service) and not the absolute complexity/significance must be assessed. The implementation of an ERP system is always a significant undertaking and generally significantly more complex than the implementation of, for example, a piece of retail word processing software. What should count is whether the modification or customization goes significantly beyond what is ordinary for the respective good or service. This can be achieved by modifying



para 29 as follows:

Current wording	Proposed modified wording
<p>29 Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both of the following criteria are met:</p> <p>(a)...; and</p> <p>(b) the bundle of goods or services is significantly modified or customised to fulfil the contract.</p>	<p>29 Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both of the following criteria are met:</p> <p>(a) ...; and</p> <p>(b) the bundle of goods or services is significantly modified or customised to fulfil the contract <u>and this modification and customization goes significantly beyond what is ordinary for the goods or services in the bundle.</u></p>

*Satisfaction of performance obligations – Stand-ready obligations and when-and-if available deliverables*

Para 26(d) of the ED acknowledges that stand-ready obligations may be goods or services promised under a contract and that when-and-if-available software products are one example of a stand-ready obligation. In the following, however, the ED does not provide guidance on how to recognize revenue for stand-ready obligations or when-and-if-available software products. We request that such guidance is added because without such guidance

- it is unclear whether the act of standing ready to provide goods or services or the act of providing the goods or services when required should drive the revenue recognition pattern;
- entities may not be allowed to recognize revenue at all because they do not meet the requirement in para 47 of being able to reasonably measure their progress towards complete satisfaction of the performance obligation.

We believe that it is more appropriate to have the act of standing ready drive the revenue recognition pattern as this is what the entity is obliged to under the contract and as such an approach that best aligns the accounting for stand-ready obligations under the revenue recognition standard with what may likely be the pattern of income recognition under the future insurance standard. Additionally, such an approach avoids issues like the accounting for a scenario in which an entity does not expect to be required to provide the goods or services that it is standing ready for.

Under an approach that focuses on the obligation to stand-ready, the most appropriate way of recognizing revenue for stand-ready obligations (including when-and-if-available software products) is to recognize the revenue ratably over the period of the stand-ready obligation assuming that the obligation to stand-ready equally exists on every day of the period.



We believe that the required guidance could be provided in a para 40a following the current para 40 of the ED:

Current wording	Proposed modified wording
n/a	<p><u>40a For stand-ready obligations as listed in paragraph 26(d) progress should be measured with reference to the obligation to stand-ready rather than with reference to the delivery or probability of delivery of the products or services that the stand-ready obligation relates to. Consequently, ratable revenue recognition is appropriate where the obligation to stand-ready equally exists continuously throughout the period.</u></p>

#### *Satisfaction of performance obligations – Relevance of customer perspective*

It is unclear to us whether the entity should, when evaluating the satisfaction of a performance obligation, take the customer's perspective and ask itself whether the customer contracts for the performance of the entity or whether the customer contracts for the result of the performance. Para 35(b)(i) appears to indicate that the customer's perspective is relevant when determining the pattern of transfer of control – which typically implies that the result of the performance is relevant; but para 46 and Example 8 (IE 7) around measuring progress based on input methods seem to focus on the entity's performance. Para 38 appears to clarify the principle by stating "*The objective when measuring progress is to depict the transfer of control of goods or services to the customer – that is, to depict an entity's performance.*" But paras 41 and 42 use the term "*...measurement of the value to the customer...*". We would welcome clarification on the definition of "value", how it relates to the performance of the entity and how value to the customer can be measured in an objective manner.

#### *Satisfaction of performance obligations – Customer acceptance versus right of return*

Para B55 defines acceptance clauses as clauses "*that allow the customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed-upon specification*". We wonder how a right to return a product differs from a right "to cancel a contract". Such differentiation would, however, be needed under the ED as the accounting for customer acceptance clauses (para 37 and B55-B58) differs from the accounting for rights of return (para B2-B9). We therefore request that the Boards either align the accounting for acceptance clauses and rights of returns or provide guidance on how to determine whether a clause that entitles the customer to rather cancel the contract than accept/keep the product is an acceptance clause or a right of return.

#### *Determining the transaction price – Estimated stand-alone selling price as a range*

Current non-authoritative US GAAP literature on both, the concept of 'best estimate of the selling price' (ESP) and 'vendor specific objective evidence of fair value' (VSOE) acknowledges that an ESP and VSOE may be a price range rather than a price point. In contrast, the ED does not address this topic at all. We believe that the ED should address the topic and acknowledge that, at least where stand-alone selling prices of a good or service are highly variable or uncertain, an estimate of the stand-alone selling price may be a price range rather than a price point for several reasons:

- We see the risk that absent of guidance on the topic in the final revenue recognition standard there may be significant diversity in practice. Under US GAAP the current approach of accepting ESP to be a range may be continued while similar approaches may not be followed in other parts of the world due to their lacking history.



- By accepting that an estimate of the stand-alone selling price may be a range the final standard would acknowledge that the stand-alone selling price is the result of an estimation process that reflects management judgment. Forcing such estimate in a price point rather than a price range would create a spurious accuracy, particularly where the stand-alone selling prices are highly variable.
- Allowing an estimate of the stand-alone selling price to be a range would reduce the efforts of allocating the transaction price in a manner that differs from the prices stated in the contract. The allocation of the transaction price could reflect the contractual prices whenever these contractual prices are within the estimated range of stand-alone selling prices.

Acknowledging that estimate of the stand-alone selling prices may be a price range could be achieved by adding a para 73a following the current para 73 as follows:

Current wording	Proposed modified wording
n/a	<p><u>73a If the stand-alone selling price of a good or service is highly variable or uncertain, it may be more appropriate to use a range of prices rather than an individual price point as the stand-alone selling price provided that the range reflects reasonable pricing of that good or service on a stand-alone basis.</u></p>

#### *Determining the transaction price – Practical expedient re. time value of money*

We would welcome clarification that the practical expedient around the time value of money (para 60) – and in general all practical expedients – must be applied or not applied consistently. In the case of the time value of money, a consistent application should mean that the practical expedient is either applied to both, prepayments and payments in arrears or not applied to either. We believe this requirement is in-line with the principles of consistency of IAS 8.

#### *Allocating the transaction price – Customer options for additional goods or services*

When software is licensed to a customer it is not uncommon in our industry to grant the customer an option to purchase at a pre-defined discount level (a) additional copies of the software licensed under the current arrangement and/or (b) additional software products. Under current US GAAP such options are only considered an element under the arrangement if the option is for additional software products and the discount at which the customer can license the additional software products by executing the option is significant and incremental to the discount granted in the current transaction. In contrast, options to license additional copies of the software licensed in the current transaction are not considered an element to be accounted for because the software vendor does not have to deliver anything (the customer already has access to the software).

It is not clear to us how such options are to be accounted for under the guidance of the ED. Considering that our software is sold at highly variable selling prices we struggle with identifying how to apply the guidance in para B22 which provides "*If a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only because of entering into a previous contract.*" Para 73(c) presents the residual approach as a method of estimating the stand-alone selling price rather than a method of allocating the transaction price. One could therefore argue that no material right exists as long as the discount granted in the purchase option does not exceed the discount implied in the stand-alone selling price derived through the residual approach. We believe that such an approach is feasible as it allows to identify material rights even in scenarios with highly variable selling prices. We believe, however, that the Boards should specifically mention this line of thinking as it is not



obvious. This could be achieved by expanding para B22 as follows:

Current wording	Proposed modified wording
<p>B22 [IG22] If a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only because of entering into a previous contract. In those cases, the entity has merely made a marketing offer that it shall account for in accordance with the proposed revenue requirements only when the customer exercises the option to purchase the additional goods or services.</p>	<p>B22 [IG22] If a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only because of entering into a previous contract. In those cases, the entity has merely made a marketing offer that it shall account for in accordance with the proposed revenue requirements only when the customer exercises the option to purchase the additional goods or services. <u>Where the residual approach under para 73(c) is applied to estimate a stand-alone selling price, the price of an additional good or service would reflect the stand-alone selling price for that good or service if it reflects the residual amount identified under the residual approach.</u></p>

It is also unclear to us how the guidance on customer options should be applied when volume discounts come into play. Imagine a scenario in which a vendor regularly sells a good for € 1 per unit up to 100 units and for € 0.90 per unit for each unit above 100 units. This vendor sells 100 units to a customer and offers the customer an option to buy further 10 units at a price of € 0.90 per unit. One could alternatively argue that

- View A: the stand-alone selling price of 10 units is € 1 per unit and consequently a material right was granted under para B21
- View B: the customer could have purchased the 10 incremental units in the initial transaction for a price of € 0.90 per unit and consequently the option does not represent a material right
- View C: the option does not represent a material right only if the entity regularly sells for € 0.90 per unit incremental units to existing customers who already own 100 units or more.

We believe that View B is most appropriate and would welcome a respective clarification which can be achieved by adding an illustrative example along the lines of the example presented here.

#### *Allocating the transaction price – Reverse residual method*

While the Basis for Conclusions mentions in para BC 181 that the reverse residual method is also an appropriate method of estimating the stand-alone selling price, we would prefer that also the standard itself acknowledges this (in para 73) for the following reasons:

- Under current US GAAP the residual method is allowed while the reverse residual method is not allowed and thus not considered one form of the residual method.
- As the Basis for Conclusions is not considered authoritative literature, we want to assure that the reverse residual method will be accepted in practice.



### *Allocating the transaction price – More than one performance obligation with highly variable selling prices*

By its nature the residual approach is only a feasible method for estimating the stand-alone selling price of a good or service where a contract includes not more than one performance obligation that represents the residual. Thus, the residual approach does not work if a contract includes more than one performance obligation with highly variable or uncertain selling prices. The ED does not provide guidance on how to allocate the transaction price in such scenarios. In our industry such scenarios are very common and include, but are not limited to arrangements that comprise (a) software products and rights to specified future upgrades or (b) software products and options to purchase further products at incremental discounts.

We do not believe that the final IFRS should provide that two or more performance obligations should be accounted for as one if their individual stand-alone selling prices cannot be estimated reliably. We believe, however, that allocating the transaction price to a number of performance obligations with highly variable or uncertain selling prices may need to be highly judgmental and sometimes even arbitrary. We believe that the Basis for Conclusions should acknowledge this to prevent unreasonable efforts of estimating stand-alone selling prices in such scenarios. Additionally, the standard should provide that in such scenarios a multi-step approach may be appropriate. Under such an approach, in a first step, the residual approach is used to estimate a deemed stand-alone selling price for the bundle of performance obligations with highly variable or uncertain selling prices. In a second step either a further residual approach or other reasonable method is used to estimate, based on the residual amount from step 1, the stand-alone selling prices of the individual performance obligations with highly variable or uncertain selling prices. Such guidance could be provided by adding a para 73b following the para 73a proposed above.

Current wording	Proposed modified wording
n/a	<p><u>73b For a contract that has more than one separate performance obligation with highly variable or uncertain stand-alone selling prices an entity may estimate the stand-alone selling prices for these performance obligations in a multi-step approach. Under such an approach, in a first step, the residual approach is used to estimate a deemed stand-alone selling price for the bundle of performance obligations with highly variable or uncertain stand-alone selling prices. In a second step either a further residual approach or another reasonable method is used to estimate, based on the residual amount from step 1, the stand-alone selling prices of the individual performance obligations with highly variable or uncertain stand-alone selling prices.</u></p>

We also believe that accepting that an estimated stand-alone selling price can be a range of prices rather than an individual price point (see respective proposal above) would greatly help the allocation of the transaction price in scenarios with multiple performance obligations with highly variable or uncertain stand-alone selling prices because such an approach would better consider the highly judgmental nature of the allocation and prevent that the transaction price allocation differs from the contractual prices although the contractual prices are as good an estimate as the estimated stand-alone selling prices used for the allocation.

### *Allocating the transaction price – Residual approach when the residual amount is zero*

Under the ED it is unclear whether and how the residual approach is feasible if the residual amount resulting from its application is zero. Imagine a scenario where a vendor sells two distinct goods A and B for a total



price of CU 100 and where the estimated stand-alone selling price of good A is CU 100 while the estimated stand-alone selling price of good B is highly variable. Applying the residual approach would result in allocating the entire transaction price to good A. We believe that such an allocation would not be appropriate which should be stated explicitly in the standard as follows:

Current wording	Proposed modified wording
<p>73 ...</p> <p>(a) ...</p> <p>(b) ...</p> <p>(c) Residual approach—if the stand-alone selling price of a good or service is highly variable or uncertain, then an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. A selling price is uncertain when an entity has not yet established a price for a good or service and the good or service has not previously been sold.</p>	<p>73 ...</p> <p>(a) ...</p> <p>(b) ...</p> <p>(c) Residual approach—if the stand-alone selling price of a good or service is highly variable or uncertain, then an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract <u>except where such approach results in unreasonable estimated stand-alone selling prices (e.g. estimated stand-alone selling prices of zero)</u>. A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. A selling price is uncertain when an entity has not yet established a price for a good or service and the good or service has not previously been sold.</p>

Again we believe that accepting that an estimated stand-alone selling price can be a range of prices rather than an individual price point (see respective proposal above) would help to achieve a reasonable allocation of the transaction price in such scenarios.

#### *Contract costs – Amortisation of a contract cost asset*

Para 98 provides that an asset recognised for the incremental cost of obtaining a contract "shall be amortised on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates. The asset may relate to goods or services to be transferred under an anticipated contract that the entity can identify specifically (for example, services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved)." We would welcome further clarification on when and how renewals of a contract must be considered when amortizing such contract cost assets. Such guidance should clarify whether, similar to the IASB's tentative decisions on lease accounting, renewals should only be considered when there is a significant economic incentive for the customer to renew.

#### *Disclosure*

We believe that the disclosure requirements of the ED are often very burdensome, time consuming and accordingly a significant cost driver of the implementation of the standard. Some of the disclosure requirements require to produce information that is not used by management which we view as an indicator for lacking relevance of the information to investors. Further, while the objective of the disclosure requirements is clarified in paras 109-113, we struggle to understand why the following (flood of) paras 113-123 require so much detailed information. There are many circumstances where the requirements of paras 113-123 do not generate information that is in-line with the objectives as stated in paras 109-113, i.e.



requires the disclosure of not relevant information. This approach appears to be a rules-based approach rather than principles-based.

### *Effective Date*

We prefer an effective date of 2016 to grant preparers sufficient lead time for the system implementation of IT solutions, to negotiate amendments of customer contracts, adjustments of business models, etc.. An earlier effective date (i.e. 2015) should be compensated by further reliefs in the area of transition (i.e. by dropping the requirement of a retrospective application or by significant simplifications and practical expedients).

### *Transition*

We welcome the Boards' intent to reduce the preparation costs through the introduction of practical expedients available for the transition to the new standard. We believe, however, that additional practical expedients are needed to balance the cost of retrospective application with its benefits.

We agree that a fully prospective application of the future standard is neither desirable nor practicable as contracts that are uncompleted at the time of transition would need to continue to be accounted for under the previous guidance even if they will not be completed for a long time. Thus, such a fully prospective approach would result in the requirement to apply the old and the new guidance in parallel for a significant number of years.

On the other hand we believe that it would not be appropriate to require a retrospective application of the new guidance

- (a) to contracts that were either fully satisfied a long time ago or
- (b) to contracts that are not expected to re-occur in the future due to changes in business practice in response to the changes in accounting guidance.

Ad a): There may be contracts that are fully satisfied under the current accounting policies but not yet fully satisfied under the new guidance. Such contracts may be very difficult to identify because the reporting entity discontinued tracking them once they were fully satisfied under the current accounting policies. One example for such scenarios is a contract under which a software vendor grants an option to purchase additional copies of a licensed software product. Under current US GAAP such an option is not considered an element under the contract and is therefore not accounted for. Under the new guidance such option may represent a material right that qualifies as a separate performance obligation. If such an option was granted years ago the reporting entity may have discontinued tracking the contract as it was fully accounted for under the existing accounting policies. Under a full retrospective accounting approach the entity would now need to go back several years to identify all the options that may have been granted in the past and that may have not expired yet.

Ad b): Changes in business practice in response to changes in accounting guidance are common in our industry as evidenced by the changes SAP experienced when it moved from German GAAP to US GAAP. One potential example for such a change in business practice is the requirement under para 35(b)(iii) of the ED that the entity must have a right to payment for performance completed to date. Current contract exit clauses may not be worded in a manner that meets the requirement of para 35(b)(iii) but an entity may be confident to have appropriate clauses in its future contracts. In such a scenario it would not be appropriate to restate the accounting of the old contracts as such restated numbers would not be indicative of the respective future numbers.



We believe that the two issues outlined above can be addressed by expanding para C3 of the ED and adding para C3a as follows:

Current wording	Proposed modified wording
<p>C3 [133] An entity may use one or more of the following practical expedients when applying this [draft] IFRS. For the purposes of the expedients, the date of initial application is the start of the reporting period in which an entity first applies this [draft] IFRS.</p> <p>(a) ...</p> <p>(b) ...</p> <p>(c) ...</p> <p>(d) ...</p>	<p>C3 [133] An entity may use one or more of the following practical expedients when applying this [draft] IFRS. For the purposes of the expedients, the date of initial application is the start of the reporting period in which an entity first applies this [draft] IFRS.</p> <p>(a) ...</p> <p>(b) ...</p> <p>(c) ...</p> <p>(d) ...</p> <p><u>(e) An entity need not restate contracts completed before the earliest comparable period presented in the financial statements for the period of initial application.</u></p> <p><u>(f) An entity need not restate performance obligations the future re-occurrence of which are reasonably expected to be immaterial due to changes in business practice in response to the adoption of this IFRS.</u></p> <p><u>C3a [133a] For the purpose of paragraph C3 [133] a contract is deemed completed when no uncompleted performance obligations exist that need to be accounted for under both the guidance of this IFRS and the accounting policies applied previously.</u></p>