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International Accounting Standards Board
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Preliminary Views on Revenue Recognition in Contracts with Customers

Sir,

With great interest I have studied your Discussion Paper on “Preliminary Views on Revenue Recognition in Contracts with Customers”. I appreciate the opportunity to provide you with my comments and suggestions and answering your questions.

Chapter 1

In § 1.10 it is remarked that the IASB’s definition of an asset “depends on control of the good, not the risks and rewards of owning the good”. The IASB’s definition of an asset refers to “economic benefits are expected to flow to the entity”. If rewards are considered an equivalent of benefits or at least a form of benefit, than the definition does depend on rewards as well. Furthermore, the remark suggests control as being a notion opposing ownership, while ownership is merely a form of control. Risks and rewards of ownership are no more than a subset of benefits of control and the inconsistency the Boards refer to in the paragraph is not true. The problem that the Boards label as an “inconsistency” is in fact the unnecessary introduction of the concept of “risks and rewards of ownership”.

Chapter 2

I do not agree with the definition of a customer as presented in § 2.21. It ignores the essence of the function of any entity namely to exchange goods and services (assets) and the role a customer has in that exchange process. In §2.23 it is stated that “a contract … conveys rights to an entity to receive a consideration”, whereby the Boards implicitly acknowledges this point. The Boards’ definition would also lead to labeling an activity as revenue if the entity gives up assets but gets nothing in return. Using the word “right” in §2.23 might suggest that the Boards refer to the pure legal meaning of the word. I would propose that the Boards avoid
the use of the term “right”. The reference to “ordinary activities” (re-) opens the door to the 
useless discussion on the difference between ordinary activities and other activities or extra-
ordinary activities; it also might suggest that for other than ordinary activities another income 
recognition model might exist. Furthermore, I would suggest “has contracted” be replaced by 
“to a contract”.

Apart from disagreeing with your definition I question the usefulness of having a definition of 
a customer. The way the Boards use their definition of a customer is an unnecessary detour 
for reaching a revenue recognition principle. It is not really needed for a revenue recognition 
principle, as it is merely a name for the contract party.

I believe that a definition of a revenue contract would be far more useful for the purpose of 
setting a revenue recognition principle, than a definition of a customer. Such definition could 
be as follows:

*A revenue contract is a contract to give up the control over a resource that represents output 
of the conversion process the entity is engaged in, in exchange for control over another 
resource.*

The other party to a revenue contract could be called “customer”.

The revenue recognition principle as described in § 2.35 is not very useful as it refers to an 
ocurrence leading to increases or decreases without describing which occurrence would lead 
to the increase or decrease. Consequently the Boards cannot but make the observation in § 
2.36 that not all increases represent revenue, evidencing this weakness in the principle. In § 
2.40 the Boards give an indication of what they mean: “that occurs when an entity performs 
by satisfying an obligation in the contract”. Why not include this description in the principle?

A revenue recognition principle could be worded as follows:

*Revenue is recognized when the entity has fulfilled its performance obligation in accordance 
with the revenue contract.*

Q1

I do agree with the basic ideas behind the Board’s proposals. With reference to the above I do 
not agree with the way the Boards describe and define underlying concepts of their revenue 
recognition methodology.

Q2

With reference to my earlier comment letters I will refrain from answering a question on 
decision usefulness.

Q3

Yes! I believe it is an excellent definition and I urge the Boards to ensure consistent 
application of this definition in all IFRS.
The question could be raised if a “constructive obligation” constitutes a contract. I believe the answer to that question is affirmative, because a constructive obligation has all the characteristics of a contract: two or more parties, obligation and enforceable (“valid expectation that it will discharge those responsibilities”). A constructive obligation is just one of the many forms of a contract can have.

Chapter 3

In § 3.13 thru § 3.16 the Boards explain that services are assets. The example (or: rationale?) used by the Boards is in itself correct, but it falls short of demonstrating that a service is an asset, because it approaches the question from the perspective of the service receiver in stead of the service provider, the entity. Actually, the following is recorded by the service providing entity:

Dt. Stock of (legal) services to be rendered
Cr. Expense

If the service is not rendered, because there is no revenue contract, than the entity records:

Dt. Expense
Cr. Stock of (legal) service to be rendered

Q4

No.

The definition of a performance obligation offered in § 3.2 has some shortcomings. Firstly, it uses the word “promise” as a type of obligation, suggesting that there are other types of obligations, but that these other types are not relevant for revenue recognition. Why not simply state: “... performance obligation is an obligation ...”? Secondly, it uses the word transfer, while in § 3.20 and § 4.5 the Boards explain that they actually mean that control over the resource is no longer with the entity. Thirdly, the definition ends with “... to that customer” which is unnecessary given the reference in the definition to a contract. Accordingly I would suggest the following definition:

An entity’s performance obligation in a revenue contract is an obligation to give up the control over (a) resource(s) that represent(s) output of the conversion process the entity is engaged in

For practical purposes “to give up control over a resource” could be labeled “to transfer an asset”.

Q5

No. Refer to the revenue recognition principle described above.

The essence of revenue recognition is that the entity has fulfilled its performance obligation. Separation of performance obligations should not be based on “when”, i.e. timing of the
transfer of the asset. Separation should be based on the contractual conditions the entity needs to fulfill in order to obtain control over the customer’s resources.

Q6

An entity’s obligation to accept a returned good and refund the customer’s consideration is indeed part of the entity’s performance obligation. The question is whether it represents a separated or separable performance obligation.

* A performance obligation is a separate performance obligation in a revenue contract if by fulfillment of that performance obligation the entity obtains control over customer resources. *

* A performance obligation is separable if it is a separate performance obligation in other, present revenue contracts of the entity. *

The obligation to accept a returned good and refund the customer’s consideration is a performance obligation if it is a separated or separable performance obligation. If it is not a separated or a separable performance obligation, this obligation should be measured, taking into account the probability that a good will be returned, and recognized as a liability.

Q7

The question is phrased too generally. Sales incentives, which are an obligation to give up assets, are a performance obligation. Sales incentives that do not create such obligations, e.g. discounts on future sales, are not performance obligations.

Chapter 4

Q8

Yes

Q9

The question states: “The Boards propose that an entity recognize revenue only when a performance obligation is satisfied”. In § 2.35 the revenue recognition principle is described as “For a contract with a customer revenue is recognized when a contract asset increases or a contract liability decreases (or some combination of the two)”. Confusing, if not contradicting statements, at least leaving readers wondering what exactly the Board’s proposals are.

With reference to my earlier comment letters I will refrain from answering a question on decision usefulness.

Chapter 5

In § 5.8 it is stated that with respect to measuring performance obligations “the measurement
is meant to quantify the amount of assets required to satisfy the performance obligations at the financial statement date. I fully support this view. However, given the definition of an asset is it strange, if not wrong, that the Boards state in § 5.9 that that amount includes a margin. The statement would be correct if it is meant to describe the performance obligation of the customer. The Boards confirm this explanation in § 5.26.

In other words, the value of an entity’s performance obligation at any point in time is the value of assets it is required to transfer to fulfill its performance obligation, not the value of that assets plus the margin. The value of the obligation performed between two points in time is the value of the assets transferred. It is the value of the assets received from the customer in exchange that includes the margin.

I disagree with using “simplicity of measurement” as in § 5.27 as an argument for preferring some method over another method.

In § 5.52 it is stated that product C has a unique nature and no competitor sells it. Yet in the next sentence reference is made to “similar” products. This contradiction makes the example less relevant.

An alternative approach for the example in §5.65 and § 5.75 would be:

During the first year up to December 31st ConstructorCo recognizes 50,000 revenue, 40,000 costs and 10,000 margin. At December 31st a new estimate of the contract cost and margin is made: 91,000 costs and 9,000 margin. At that date the costs incurred amount to 40,000, progress to completion is 40,000/91,000, i.e. approx. 44%, hence 44% of the margin should be recognized in the first year.

Q10

a. No. The performance obligation of the entity is the transfer of assets and the value of those assets plus the costs to transfer those assets depicts the value of the entity’s performance obligation; the value of the customer’s performance obligation is the transaction price.

b. If the value of the entity’s performance obligation is considered the value of the assets to be transferred plus the costs of transfer, than remeasurement is not necessary.

c. With reference to my earlier comment letters I will refrain from answering a question on decision usefulness.

d. See my answer to (a).

Q11.

a. No. Refer to my answer on Q10.

b. The question suggests that decision-usefulness argument might be a criterion for capitalizing expenses, i.e. labeling such expense as an asset. That would be fundamentally wrong. Capitalizing expenses because is provides (perceived) decision-useful information would ignore that an asset is a resource from which benefits are expected to flow to the entity.

Q12/13.
I disagree with the boards view to allocate the transaction price to each performance obligation in proportion to the stand-alone selling (=transaction) price as described in § 5.46.

The Boards do not offer any rationale why they have the view that the transaction price should be allocated and why, if allocation is necessary, to use the stand-alone selling price as a basis for allocation. If no stand-alone selling price of a good or service exists, than application of alternative approaches would require all kinds of assumptions and would lead to representation of a transaction price that does not exists; I doubt whether the Boards would be able to demonstrate that such information would be (decision) useful to anyone.

Furthermore, allocation of the transaction price on the basis of stand alone selling prices might lead to recognizing revenue for one of the products being transferred at an allocated transaction price, which is below its costs, while the revenue contract as a whole might be profitable. Suppose that the product concerned is the only one transferred in a certain reporting period, then a loss would be reported in that period. In my opinion that would be a terrible misrepresentation of reality.

Division of the transaction price to performance obligations could be done on the basis of the concept of separated/separable performance obligations as described above.

As a closing remark I would suggest that the Board in their further studies on the subject of revenue recognition addresses the issue of allocating revenue over reporting periods. I urge the Boards to consider the value of the assets transferred and the probability that the performance obligation, to which these assets relate, will be fulfilled as a basis for such allocation.

Please note that the above views are my personal views, not the views of any of the organizations I am related to.

Sincerely Yours,

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