International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
UK

Oslo, 18 June 2009

Dear Sir/Madam

Preliminary Views on Revenue Recognition in Contracts with Customers

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) is pleased to comment on the discussion paper on Preliminary Views on Revenue Recognition in Contracts with Customers (“the DP” in the following). Please find our comments to the questions in the order suggested by you in the appendix to this letter. In addition to commenting on the questions in the DP, in the appendix to this letter we also comment on other issues that we believe the boards should pay particular attention to.

In summary, we support the boards’ proposal to replace existing standards dealing with revenue recognition with one based on a single revenue recognition principle. However, we do not believe the proposed customer contract-based revenue recognition principle meets the objective of financial reporting, namely to provide decision useful information to the primary users of the financial statements. Therefore, we do not support the proposal in the DP. The basis for our rejection of the contract-based revenue recognition principle is explained in our comments to Question 1 and 2 in the appendix. In particular, we challenge the reliance on the transfer of control concept.

The boards planned to conduct field visits during the comment period, and these field visits are planned to continue into the exposure draft stage of the project. We encourage the boards to consider conducting field visits in the transportation industries. In particular, our preliminary research illustrate that the proposal in the DP may have significant impact on the shipping industry and the oil service industry. Both industries are major industries in Norway, and if the boards wish, we will be willing to contribute to such field visits.

Please do not hesitate to contact us if you would like to discuss any specific issues addressed in our response, or related issues, further.

Yours faithfully,

Norsk RegnskapsStiftelse

[Signature]

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Appendix – NRS’ responses to the questions asked in the DP and other issues

Question 1
Do you agree with the boards’ proposal to base a single revenue recognition principle on changes in an entity’s contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

Question 2
Are there any types of contracts for which the boards’ proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

Conclusion Question 1
We support the boards’ attempt to develop a single revenue recognition principle to replace the principles relied on in the current accounting standards and interpretations that to some extent are inconsistent with each other. However, the proposed customer contract-based revenue recognition principle fails in our opinion the basic test all principles have to meet, namely the decision usefulness test. That is, we believe that the proposed principle is failing to provide decision useful information to the primary user of financial statements, being the investors and their advisors.

The Role of Revenue Generating Activities
According to the DP, revenue recognition should be recognised when an entity has satisfied a performance obligation under a contract with a customer. A performance obligation is satisfied when control of the asset involved, a good or a service, is transferred to the customer. The control transfer may very well be occurring at other times than the activities producing the goods or services are being transferred. Thus, the proposed principle will not necessarily reflect the revenue generating activities. We believe that information about the revenue generating activities is decision useful. Moreover, we are not convinced that control transfer information is decision useful.

An Example
Let us illustrate our concern by an example from the shipping industry:

In so-called voyage charters, the performance obligation is a promise to deliver goods at a specific site. Under current industry practice, revenue is recognised on a discharge-to-discharge basis. That is, revenue is recognised during the voyage. Thus, the revenue recognition reflects the pattern of the revenue generating activities, being the transportation service. If the entity has succeeded in attracting customers, closing contracts and performing the ordinary activities of the business conducted by the entity, the income statement will reflect that fact. If not attracting customers, closing contracts or performing the ordinary activities of the business conducted by the entity, recognised revenue will be low or nil.

On the other hand, the performance obligation is not satisfied before the goods are delivered in the agreed upon site. The customer does not gain control over the asset, being the delivery at the agreed upon site, before delivery, and revenue is to be recognised at delivery under the principle in the DP. Thus, even though the entity succeeds in attracting customers, closing contracts and performing the ordinary activities of the business conducted by the entity,
recognised revenue may be low (because delivery in the pending contracts takes place after the balance sheet date). Also, the entity may show growth in revenue, even though no contracts are closed in the accounting period, and the vessel(s) has been idle for long periods.

Under current practice, the recognised revenue is a measure of the success of the entity in carrying out its ordinary business, while recognised revenue under the proposed principle cannot be relied upon in evaluating the performance of the entity. Thus, the proposed principle produces income statements that tells the users something about completed contracts, which may be quite coincidental, but nothing about whether the entity has been good at doing the business it is set up to do. In our opinion, the information provided in this example under the proposed principle, is neither meeting the stewardship nor the resource allocation objective of financial reporting. Similar examples can be found in other industries, as for example the oil service industry and the real estate industry.

The Basis for the Proposed Principle
The boards support the proposed principle by addressing weaknesses in current practice, one being the inconsistency between current standards and the conceptual frameworks, and in particular the asset and liability definitions. We support the boards’ attempt to develop a revenue recognition principle that is consistent with the conceptual frameworks. However, for the reasons explained above, we do not believe the proposed customer contract-based principle is consistent with the conceptual frameworks, since we find that the principle fails to produce decision useful information in many contracts.

We do not rule out that the customer contract-based principle can be contributing to decision usefulness. However, in our opinion, it cannot be based on the transfer of control concept.

An Alternative Principle
It may be that a customer contract-based principle not relying on control transfer can produce decision useful information and be consistent with the asset-liability view. In our example above, control is transferred at the port of destination. However, the performance obligation is satisfied gradually during the voyage. By transporting the goods half way from port of load to port of discharge, the entity satisfies part of the performance obligation, even though control has not been passed on to the customer. Or put another way, in the example, the entity has agreed to a set of performance obligations, which includes all the activities necessary in order to be able to deliver the goods at the agreed upon site. As the activities are carried out, performance obligations are satisfied, with the effect being that revenue is recognised during the voyage, not in full at the time of delivering the goods at the agreed upon site. Thus, we suggest that relaxing or eliminating the transfer of control concept, the customer contract-based principle may be worthwhile to explore further.

Apart from the fact that the alternative principle allows for revenue recognition as the revenue generating activities are performed, it also reduces the need for distinguishing between goods and services. In the DP, the boards try to explain how one can distinguish between goods and services in 4.38-4.48. It is difficult to fully understand what the characteristics of each are, and it is not clear to us whether for instance a contract between an audit firm and a client imposing an obligation on the former to audit the latter’s financial statements is service contract or a contract for the delivery of a good (the audit opinion). As a consequence, it is unclear when the audit firm is to recognise revenue from the audit contract under the DP. Under the alternative principle, focus is directed towards the substance of the performance
obligation, namely the activities that have to be performed in order to be relieved from the obligation. In the audit firm example just mentioned, the performance obligation is to perform the audit, and as the audit is performed, the audit firm is gradually relieved from the obligation with the effect that revenue is recognised accordingly.

As presented here, the alternative principle is similar to the principle in the DP, except that satisfaction of the performance obligation is linked to the underlying activities that the seller has agreed to perform under the contract, and not transfer of control of the contract asset, being a service or a good. One may also consider it being a re-measurement approach. That is, the performance obligation is re-measured over the contract period. The transaction price is not re-measured on another basis than the original transaction price, but as the activities necessary to produce the promised asset, being a service or a good, are performed, the performance obligation is re-measured to reflect that the remaining performance is less than originally. The effect is identical whether one considers the reduced performance obligation a result of re-measurement or satisfaction of performance obligations.

The latter approach would be similar to the current measurement of financial guarantees as described in IAS 39.47(c) (the higher of the amount determined in accordance with IAS 37 and IAS 18).

In the following, our comments refer to the principle proposed in the DP.

**Question 3**
*Do you agree with the boards’ definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.*

We generally agree with the boards’ definition of a contract. However, we believe the boards’ are mistaken when concluding that the definition of a contract in the DP corresponds to the definition in IAS 32.13 (2.12).

The boards explain that performance obligations resulting from the operation of law is a promise in the contract (3.5). In IAS 32.13 “contract” and “contractual” are assumed to refer to the same type of arrangement. In IAS 32.AG12 it is stated that liabilities and assets arising from statutory requirements imposed by governments for example are not “contractual”. Thus, the assumption that the definition of a contract in the DP is the same as a contract in IAS 32 can be questioned.

**Question 4**
*Do you think the boards’ proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.*

We believe that the proposed definition of a performance obligation is conceptually sound. However, we fear that the definition combined with the fact that emphasis is put on customer control rather than customer use of the asset (4.26), will provide a platform for contract engineering allowing entities to construct revenue measures on own discretion without real economic impact.
For instance, if an entrepreneur agrees to build a road on the request of the government on land owned by the entrepreneur, and the road includes three elements, namely a bridge, a tunnel and an open road between the bridge and the tunnel, the entrepreneur may contractually construct several accounting revenue patterns. One would be to draft a contract in which the control over the three assets is transferred when the final element of the contract, the tunnel, is completed. In that case, even if the contract includes (at least) three different performance obligations, since the timing of the transfer of the promised assets is the same, the entrepreneur can account for the three promised assets as single performance obligation (3.24). Another would be to draft a contract in which the control over the three assets is transferred when the construction of each of them is completed, which then would lead to revenue recognition at “milestones”, i.e. recognition of revenue at completion of the bridge, recognition of revenue at completion of the road between, and finally recognition of revenue at the completion of the tunnel. Given that the underlying substance of these two alternatives, and variations of these, is the same, we are concerned that the definition of a performance obligation and the application of the definition for revenue recognition purposes, will allow for revenue allocation across accounting periods on the basis of contractual provisions not having real economic impact, and thus the decision usefulness of the revenue information is reduced.

It may be argued that the different contracts are in substance different. Obviously, as under the current accounting practice, the underlying economics of any contract must be analysed. Our primary concern, however, is that the DP allows for defining of different performance obligations in contracts being substantially similar or even identical, with effect for revenue recognition. In our opinion, this is at odds with the substance over form assumption relied upon in the IASB Framework.

Furthermore, the application of the performance obligation definition and the implication of identification of all deliverables is not all clear to us. For instance, a telecom entity often enter into customer contracts with several deliverables, for instance handsets at an agreed upon price, a running network for a subscription fee, and access to the network in the form of call time to be paid for per usage. In such a contract there are three deliverables and thus three performance obligations. The latter performance obligation will only be satisfied to the extent the customer request call time at a future date. Thus, generally it will not lead to any recognition before the customer actually use call time. However, even though disclosures are not addressed in the DP, we foresee that disclosures on the gross position of any performance obligations in customer contracts can be considered decision useful information. In that case, we understand that the entity will have to estimate the future expected call time usage of the customer over the contract period, or may be even over an extended period if the customer is expected to renew the subscription at the end of the original contract period. Such a requirement will be quite resource demanding on the entity, and we encourage the boards to carefully think through the implications for disclosures of the proposed model.

**Question 5**
*Do you think that an entity’s obligation to accept a returned good and refund the customer’s consideration is a performance obligation? Why or why not?*
The customer contract approach in the DP relies on the control concept. That is, the one controlling an asset should recognise the asset. The negation of that concept, is that an entity not controlling an asset, cannot recognise an asset. From this it follows that a full refund return promise does not represent a failed sale. The seller must derecognise the asset when transferred to the buyer. However, the seller has an obligation to accept returns and refund the customer’s consideration, and that performance obligation must be recognised.

**Question 6**

*Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?*

As long as the control transfer takes place at the same time, there are no convincing arguments under the customer contract-based principle to require separation of the performance obligations.

Having said that, we do foresee some practical challenges in the application of the exemption from the requirement to account for performance obligations separately. In order to take advantage of the exemption, one must at least in principle be able to identify the different performance obligations in a contract. Thus, even though the exemption is attractive from the perspective of the producers of the financial statements, it may not play a major role in practice.

**Question 7**

*Do you think that sales incentives (eg discounts on future sales, customer loyalty points, ‘free’ goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?*

In both the TuneCo and the SongCo example in 3.27-33, the entity incurs and obligation to provide the customer with music download access in the future when selling the music player. One may argue that in the SongCo example, there is no net obligation assuming that the discounted price exceeds SongCo’s costs in providing the music download. However, if that view was to be adopted, customer consideration exceeding cost of providing an asset would on a general basis have to be recognised at the time of contract entry. That does not seem to be the approach adopted in the DP.

**Question 8**

*Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.*

We refer to our comments made to Question 1 and 2 above, and our concerns with the transfer of control concept in particular. Also, in our response to Question 2, we have suggested an alternative approach to the transfer of control concept, and focusing on the performance of the activities that lead to the transfer of control.
Question 9
The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

As explained in our comments made to Question 1, 2 and 4, we believe there are several contracts in which the proposed customer contract-based principle will not provide decision useful information.

Question 10
In the boards’ proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

The principal difference between the original transaction price approach and the current exit price approach is that the latter allows for up front recognition of revenue associated with costs incurred in securing the contract. A third party would be willing to take on the performance obligation for less than the value of the contract rights since consideration for contract costs is included in the contract rights. The boards are "(...) uncomfortable with an approach that allows and entity to recognise revenue before the entity transfers to the customer any of the goods and services that are promised in the contract" (5.20). The boards also list complexity and risk of errors as arguments for not adopting the current exit price approach.

As explained before, we believe decision useful information is provided when revenue is recognised as the revenue generating services are performed. In principal therefore, consideration for activities performed to achieve customer acceptance for the terms of the contract, should be recognised as these activities are carried out. However, in ordinary customer contracts arrangements, we, as the boards, believe the signing represents a minimum threshold for revenue recognition. Thus, we would in principle argue that consideration for the pre-contract activities should be recognised as revenue at contract inception.

Having said that, we, as the boards, believe application of the principle explained above will be complex, and the risk of pre-mature revenue recognition is significant. Therefore we support the proposal of the boards to initially measure performance obligations at the transaction price.

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity’s expected cost of satisfying the performance obligation if that cost exceeds the initial measurement of the performance obligation? Why or why not?

In the DP, remeasurement of performance obligations should only be done when deemed onerous. The boards discuss to triggers for identifying onerous contracts, the cost and the current price trigger. The boards conclude in favour of the cost trigger, primarily because it is
more consistent with the original transaction price approach and leads to less frequent re-measurement. We support the cost trigger. In our opinion it is consistent with the transaction-based approach adopted in the DP. However, we believe the boards must clarify whether the unit of account is each performance obligations or each customer contract. If the former applies, provisions for onerous elements must be recognised even if a customer contract is not onerous as such. Application of a disaggregated unit of account concept will be challenging in practice.

(c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.

The boards suggests that the measurement approach in the DP may not provide decision useful information about customer contracts qualifying as financial instruments in IAS 39 and some insurance contracts within the scope of IFRS 4 and has postponed an assessment of leasing contracts. Furthermore, the boards do not intend to replace the revenue recognition principle in IAS 41 (recognition of revenue pre-contract).

In our view, financial reporting should be based on consistent and sound principles across different standards and industries. That is, accounting standards should be principle-based. As explained above, we believe the transaction-based measurement approach in the DP represents a sound principle.

Having said that, we have not made any attempt to apply the principle in the DP on all customer contracts, and we do not rule out that there may be contracts that would benefit from a different approach. If so, we would encourage to the boards to carefully analyse the different contracts to identify the specific characteristics distinguishing them from the customer contracts for which the proposed measurement approach provide decision-useful information. We would not support application of different principles on economically similar contracts. For instance, we do not believe volatility in contract values alone should allow otherwise similar contracts to be treated according to different revenue recognition principles.

(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

As explained in our comment to (c) above, we principally believe the same measurement approach should be applied to all performance obligations.

**Question 11**

*The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as an expense, unless they qualify for recognition as an asset in accordance with other standards.*
(a) Do you agree that any amounts that an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity’s performance obligations? Why or why not?

We agree. See our response to Question 10 (a) for the basis for our view.

(b) In what cases would recognising contract origination costs as an expense as incurred not provide decision-useful information about an entity’s financial position and financial performance? Please provide examples and explain why.

As explained in our response to Question 10 (a), in principle we believe consideration for costs incurred in securing a contract should be recognised at contract inception, but because of complexity and risk of pre-mature revenue recognition, we support the boards’ proposal to initially measure performance obligations at transaction price.

As explained in our response to Question 2, in our view revenue recognition should reflect the timing of the revenue generating activities. With respect to consideration for costs incurred in securing a contract, that objective is in our opinion not achievable for the reasons just explained. Deferring pre-contract costs, and recognise them as expenses at contract inception would not be consistent with our view unless the current exit price approach was adopted for initial measurement of performance obligations. As explained, we do not support that approach.

Furthermore, we also note that it would be in conflict the asset-liability view adopted in the Framework to recognise pre-contract costs as assets before contract inception, and therefore we do not believe the approach is consistent with the boards’ proposal either.

Recognising pre-contract costs as an expense at the time of recognising the associated consideration as revenue, that is over the contract period is another alternative. As with the contract inception expense approach, that alternative would be in conflict with the asset-liability view the boards have adopted, since capitalised pre-contract costs does not qualify as an asset, at least under the current Framework asset definition. Furthermore, capitalising pre-contract costs incurred before the contract is close to certain would reduce the reliability of the financial statements and we are therefore sceptical to the decision usefulness of capitalised pre-contract costs on that basis.

Question 12
Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity’s stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

We support the proposed stand-alone selling price approach. Whether an entity sells an asset in one contract and a service in another contract or if it sells both in one contract, should logically not have any impact on the revenue recognition.
Question 13
Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

If an entity does not sell a good or service separately, but others do, we agree that transaction price should be allocated to the performance obligation on the basis of the observable stand-alone selling price. This is consistent with the approach commented on in Question 12.

Similarly, if a good or service is sold separately, but not the other good or service in the contract, the residual, that is the transaction price minus the observable price of the former, should be allocated to the latter.

Having said that, this allocation approach may under certain circumstances lead to pre-mature revenue recognition. For instance, telecom entities often sells telephone handsets along with subscription fees with the former apparently being heavily discounted. In certain cases, the handset discount is compensated in the subscription fee, and the proposed allocation approach is meaningful. However, on other occasions, the handset discount may be a customer acquisition cost, or a marked entrance cost, and the proposed allocation approach allows in fact for up-front recognition of subscription fee as revenue. Therefore, the allocation of the residual to the good or service with no observable prices should be constrained to situations where the value of the residual can be reliably determined by other means.

However, if more than one good or service in a contract is not sold separately in the market, the bundle of goods and services in the contract should be considered a single good or service and only one performance obligation can be identified. Thus, allocation of transaction price is irrelevant. If a contract includes a service and a good, none sold separately in the market, the performance obligation is generally satisfied over the servicing period. However, if the service element can be determined to be only a minor or marginal element of the full performance obligation, as for example in the case of a care sale including a warranty (in a marked in which warranties accompany all car sales), the performance obligation should be considered satisfied as the good is transferred to the customer.

3 Other Issues
In the following we explain major concerns we have that are not addressed in the questions asked in the DP. In addition to the two issues addressed in the following, we believe the boards should clarify what is meant by the term “ordinary activities” when defining a customer (2.21). Also, the boards should clarify whether they intend for the proposed principle to be applied to all single contracts or if substantially similar, if not identical, contracts can be treated on an aggregated basis under the proposed principle.

The Asset Concept
Throughout the DP one refers to the transfer of goods and the delivery of services as the transfer of assets. Considering a service an asset is counterintuitive. In 3.13-3.17 an explanation is provided, with reference to IFRS 2 and the FASB Concepts Statement No. 6 (the description of an asset in par. 53 following in the IASB Framework does not seem to contemplate that a service as such is an asset). In the DP one says that the difference between a good and a service is merely a difference in recognition, the former typically being
recognised as an asset, and the latter typically being recognised as an expense (because the criteria for recognising as an asset are not met).

The examples provided in the DP evaluate the services from the perspective of the buyer, not the seller whom is the object of interest in the context of revenue recognition. Even if one accepts that a service is an asset to the buyer, it may not become an asset before provided to the buyer. It seems that the IASB assumes that an asset has always been an asset. In 3.27-3.33 an example with promised music discounts is explored. A promise to transfer online music at a discount is “clearly” an asset, ref. 3.30. The promise is an asset, but is an asset transferred? The promise, the asset, does not exist before the “transfer”, and thus an asset is *created* by the contract, not *transferred*. Thus, the asset transfer concept does not seem meaningful in the context of services.

Furthermore, in 3.20 it is proposed that a transfer of an asset means that the underlying resource of the asset is controlled by the customer. What is the underlying resource of a legal service for instance? The legal counselor, we presume. Is the idea that the contract for legal service allows the customer to control the legal counselor? We encourage the boards to explore these issues further.

*The Offsetting Concept*

Customer contracts convey rights to receive consideration and impose performance obligations. According to the boards, the combination of rights and obligations gives rise to a single asset or liability, depending on the relationship between the entity’s rights and obligations. A contract is an asset if the measurement of the remaining rights exceeds the measurement of the remaining obligations. Similarly, a contract is a liability if the measurement of the remaining obligations exceeds the measurement of the remaining rights (2.23).

This offsetting concept is assumed, but no explanation for it is given in the DP. We believe the offsetting concept provides useful information, and that gross presentation of rights and obligations in a contract would not be adding useful information. Gross presentation would rather overestimate both the asset and liability side of the statement of financial position. The rights are conditional on the delivery of the promised goods or services, and the obligation to deliver is conditional on the customer’s consideration. Thus, we believe that only the net position should be included in the financial statements, and we support the offsetting concept assumed in the DP.

Having said that, we acknowledge the potential inconsistency between the offsetting concept in the DP and the gross presentation concept in the March 2009 discussion paper on lease. In Appendix C it is stated that the boards in the development of a draft standard will consider “*gross or net presentation of the rights and obligations in the contract*”. In that context, we encourage the boards to further explore the consistency between these two discussion papers.