International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

22 October 2010

Dear Sir/Madam

Re: Exposure Draft: Revenue from Contracts with Customers

We are pleased to be able to present our comments on the Exposure Draft ED/2010/6 on Revenue from Contracts with Customers. We set out below our responses to the questions posed in the ED.

Recognition of revenue (paragraphs 8–33)

Question 1

Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether:
(a) to combine two or more contracts and account for them as a single contract;
(b) to segment a single contract and account for them as two or more contracts; and
(c) to account for a contract modification as a separate contract or as part of the original contract.
Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

Response
We agree with the principle. We are particularly pleased that IASB has considered business practice and has added the phrase “An entity shall consider those practices and processes in determining whether a contract exists” in paragraph 9.

Question 2
The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Response
We agree with the approach. The addition of paragraph 20 “An entity shall evaluate the terms of the contract and its customary business practice” represents well the principle-based approach and should be accepted by entities.

Question 3
Do you think that proposed guidance in paragraph 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transformed to a customer? If not, why? What additional guidance would you propose and why?

Response
We believe the guidance is enough. However, paragraph 31 might need to be clarified. Meeting only one indicator does not mean that we do not obtain control of the good or service, but rather four indicators should be reviewed in considering the economic substance of the transaction.

We also appreciate the addition of paragraphs 32-33 which define the approach to be used where goods or services are transferred continuously. We welcome this further clarification from the discussion paper.
Measurement of revenue (paragraphs 34–53)

Question 4
The boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

Response
We agree with the approach to estimate the transaction price and appreciate paragraph 38’s clarification on this ("reasonably estimated").

However, we are concerned at the second half of paragraph 35 which requires a probability-weighted amount of consideration. We do not believe this theoretical approach is practical nor do we believe it will provide useful or reliable information.

Question 5
Paragraph 43 proposes that the transaction price should reflect the customer’s credit risk if its effect on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

Response
We do not agree with the approach. There is no consistency between deducting credit risk from revenue at initial recognition and impairing receivables by applying IAS39 in subsequent measurement. Revenue should be fully recognized as the contract amount with the customer. Credit risk is already addressed under a different accounting standard.

Even if we were to take the proposed approach, the deducted revenue at initial recognition should be reversed in revenue (not income) when the customer’s credit risk had been recovered – we believe the discussion in BC101 needs to be revisited.
Question 6
Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Response
We agree with this approach.

Question 7
Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

Response
We agree with the approach.

Contract costs (paragraphs 57–63)

Question 8
Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

Response
We welcome the inclusion of guidance on contract costs as we believe this is an essential element of considering the recognition of revenue. The proposed requirements in paragraph 57 are sufficient.
Question 9
Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Response
We agree with the specification of costs.

Question 10
The objective of the boards’ proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Response
This objective could only be achieved if the large cost to prepare is ignored. We believe the proposed disclosure will overload entities especially in addressing the detail of paragraph 75 “reconciliation of contract balances”. We appreciate that the Board has recognized, as in the latter part of BC177, (a) the high cost and (b) the high level of judgment required in producing a gross reconciliation of contractual rights and performance obligations and (c) that the information may not be useful. We do not, however, agree with the argument in BC178 to prepare a reconciliation of (net) figures as this would have to be based on the gross reconciliation anyway.

The preparation would involve considerable work to gather information from outside the core reporting systems with the added complication of multiple locations and inter-group transactions as well as the need for extensive estimation. We believe that the reliability of the presented information would be questionable, rendering any comparative analysis of little value, and the high cost of preparation could not be justified. Because of these issues, we do not believe that the proposed disclosure of reconciliation of contract balances would help users in any meaningful way to understand future trends in revenue and cash.
Question 11
The boards will propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

Response
We do not agree with the proposal. Taking into account the difficulties described in BC177, entities will have no alternative than to make discretionary judgments as to the measurement of performance obligations thus reducing the usefulness of the disclosure.

Question 12
Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

Response
We do not agree with the proposal. We believe the information required in IFRS8 “Operating Segments” is already enough and the disclosures by category proposed in paragraph 74 should be voluntarily selected by each entity.

Effective date and transition (paragraphs 84 and 85)

Question 13
Do you agree that an entity should apply the proposed requirements retrospectively (i.e. as if the entity had always applied the proposed requirements to all contracts in existence during any reporting period presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.
Response
We do not agree with the retrospective application. It is not at all practical to make a retrospective application to some long-term contracts, and even if we do so it does not provide useful information compared with the cost of reviewing a large number of existing and already recorded contracts. Prospective application to any new contracts after the application date would be enough.

Application guidance (paragraphs B1–B96)

Question 14
The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Response
Guidance needs to be kept to a minimum in order to follow the principle-based approach. There is some guidance that will help entities for application, but they have a risk to limit the width of interpretation. We believe that the focus should be made more on emphasizing the core principle described in paragraph 2.

Question 15
The boards propose that an entity should distinguish between the following types of product warranties:

(a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

(b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?
Response

We do not agree with the proposed distinction between a quality assurance warranty (BC198) and an insurance warranty (BC204) as set out in the question. The differentiation between a latent defect and a defect that develops in the early part of a product life but after it has been sold is not a helpful one and is very difficult or impossible to determine in practice. We do not believe in the importance of making the distinction.

We also do not agree with the proposed accounting methodologies. Warranty should be treated as a cost accrual as under current practice. There are two principal reasons for this:

1) The proposed model does not align with management direction or motivation – the more a failure of products occurs, the more revenue for repair services would be recorded by the Company. But the Company should be motivated to reduce repair costs and increase customer satisfaction which is a fundamental goal of Quality.

2) No independent price exists for warranty as it is never “sold” to the customer. It is different in nature from the offering of “free” repair services which are normally charged. Repairs under warranty fulfill a company’s commitment to replace or fix products that fail in spite of the company’s promise that they will not fail. The Company cannot and will never charge such a repair cost to the customer.

We thus believe the reason the boards rejected the view to recognize warranty as a separate liability described in BC203 is not applicable. Indeed, as the cost of the warranty repair is accrued at the time the revenue is recognized the margin is in fact reduced under the current method. No margin should or is recognized when the warranty repair cost subsequently arises.

We further believe that it is wrong to call any part of the warranty a separate performance obligation as claimed in BC204. The ED states that a separate performance obligation should only be recognized if it is distinct (paragraph 22). It would qualify as set out in paragraph 23(b) if it has a distinct function and a distinct profit margin. It will not pass the second test as it is never sold and without a sales value there can be no profit margin.

Question 16

The boards propose the following if a licence is not considered to be a sale of intellectual property:

(a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and
(b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

Response
We do not think that the distinction between an exclusive and a non-exclusive license is useful and it could be misleading. For example, it is quite possible for software licenses to be sold to a number of customers (i.e. non-exclusive) where there is a continuing obligation on the supplier. In such cases, revenue should be recognized over the period in which the performance obligation is satisfied.

Consequential amendments

Question 17
The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

Response
We agree with the proposal to apply the recognition and measurement principles of the proposed revenue model to an entity’s disposal of own assets which are not part of its ordinary trading activities as explained in BC252. It is sensible to use the model to determine the timing and amount of any gain or loss. However, we believe it is important to emphasize that such disposals should not give rise to the recognition of revenue. Disposal transactions that do not arise from an entity’s ordinary trading activities should not be reflected in revenue.

Yours faithfully

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