Re: ED “Revenue from contracts with customers”

We welcome the opportunity to comment on the IASB’s exposure draft dealing with “Revenue from contracts with customers” (the ED).

Vinci is one of the biggest construction companies in the world with a major implication worldwide in the contracting sector (construction, roads, energy (electrical and communication technologies, facility management)), real estates and the concession sector. We deal each year with more than 240,000 contracts with our customers. Vinci’s revenue in 2009 was € 32 billion, in more than 100 countries. Vinci recognises construction contract income and expenses using the stage of completion method defined by IAS 11. This accounting for construction contracts is consistent with the monitoring and reporting of the contract performance for management purposes by our operational management. For the construction division, the stage of completion is usually determined on a physical basis, according to partial acceptance of work in progress by the customer. For the road and energy divisions (with smaller contracts, for a shorter period), the revenue is determined on the basis of the percentage of total costs incurred to date.

According to us, IAS 11 is a well functioning standard. It has a long application record based on well-known practical concepts. It is well established among the various stakeholders of the construction process, including financial parties such as banks, investors, analysts, rating agencies and owners. Until the Board decided to suppress IAS 11 and IAS 18 to create a single standard for revenue recognition, users of our financial statements had not expressed any peculiar incomprehension or criticism toward our method of revenue recognition.

This ED is based on the new concept of “transfer of control to the customer”. This concept is not used to measure revenue in our contracting division. We deeply believe that accounting rule for revenue should reflect the entity’s performance and the amount of activity carried out during the period.

Although we recognise that the IASB has made some improvements and clarified some matters compared with the Discussion Paper on revenue recognition (the DP), we do not believe that the ED represents an improvement in accounting for construction revenue as compared to current IAS 11. Moreover, the ED in its current form is hardly applicable. As a result, if the IASB does not apply a specific treatment for construction contracts, then important amendments would need to be made to this ED in order to better translate the economic substance of construction contracts.

Our answers to the ED question are detailed in the appendix. However, we wished to draw the Boards’ attention to four issues in particular.
1) **Identification of distinct performance obligations**

We understand the goal of the identification of performance obligation as defined in the ED, which is to create greater transparency and comparability among products sold by entities, independently from the way contracts are structured. Yet we do not agree with this proposal.

No identification of performance obligation should take place when neither the contract nor the business model of the company follows distinct segments. Such segmentation would be subjective and arbitrary. When the contract is specific and negotiated with a single client as a whole, unbundling the contract by artificial performance obligations on a non-contracual “subjective” basis is not relevant, and would probably create a risk of allocating revenue and margin to segments on an artificial basis.

The adoption of the new standard, as currently drafted, would lead companies which do not identify separate performance obligations within a contract, to have a disconnection between their management accounts and their financial statements.

As a result, we recommend that identification of distinct performance obligation be based on the contractual agreement or to companies’ business practices.

2) **Indicators of control**

Another concern is the application of transfer of control to the customer, and the indicators proposed in the ED. Even though we recognize that the ED introduces improvements compared to the DP, we believe that the final standard will need much more indicators and more guidance, in particular relating to construction services transfer of control, and work in progress (WIP).

For example, the indicator of “construction on the customer’s property” would be more practical to apply in the construction sector.

3) **Onerous test at the performance obligation level**

We do not agree with the use of the onerous test at the individual performance obligation level rather than at the overall contract level. The contract price is generally determined according to the overall costs and the global margin, which includes compensations. Risks and margins are mutualised in order to be profitable at a global level. As a result, the onerous test at the performance obligation level is not relevant in our contracting activities. Recognising accounting losses for separate virtual partial contracts and/or performance obligations in the financial statements while the overall contract is profitable would not be a fair representation of the economic effect of the contract.

In addition, applying onerous test at the performance obligation level will create another discrepancy between financial statements and management accounts, and could result in the wrong message for users.

This is why we recommend using the onerous test at the overall contract level.

4) **Contract costs**

We are not comfortable with the definition and the list of direct costs as defined in paragraphs 57 to 59. We do not understand if we will still be allowed to allocate mutualised direct costs to contracts with the future standard. The ED lacks guidance on a certain number of costs that are explicitly dealt with in IAS 11.18 (construction overheads...).

Paragraphs 57 and 58 propose a very limited number of direct costs. We believe that in many contracting businesses a certain level of indirect costs should also be eligible as direct costs to the contracts, and be included in the onerous test. Indeed, construction activities are often decentralized, and it is a current practice to use local
agencies and subsidiaries to pool operational costs. An important part of these indirect costs incurred by agencies are operational direct contract costs which are pooled together only because of the small size of some contracts. Only purely indirect and non-operational costs, as headquarter expenses, should be excluded from the test, according to each group organization.

With such a limited number of direct contract costs, the ED proposals would mean going back to previous practices, which had been greatly improved by IAS 11. Indeed, limiting the amount of direct costs for contract accounting and losses for onerous contract consideration would not be relevant, and even not cautious.

We also would like to draw the Boards’ attention to the fact that the cost of the modifications in systems and all the other additional costs (such as, for example, operational risks) would be considerable.

We would like the Boards to have in mind that considering the very large number of contracts we deal with every year, the application of this new standard would take us a lot of time, including for restating contracts which have been started for a long period of time. This is why we also wish the application of this future standard to be prospective.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact our Budget and Consolidation Department.

Yours sincerely,

Christian Labeyrie
Executive Vice-President and Chief Financial Officer, VINCI
Appendix

Recognition of revenue

| 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 it 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?

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a) Combination and segmentation

We agree with the proposed principle for the combination of contracts, since it is similar to those evidenced by IAS 11.9. We believe those principle are relevant and operational.

We do not agree however with the proposed principles for the segmentation of contracts. We think that the reference to other market participants as the primary factor in determining whether an element of a contract is price-interdependent is not relevant. Since the purpose of revenue reporting is to provide information about the specific performance of an individual entity in the context of its business model, we think that the appropriate deciding factor should be the goods or services sold by the reporting entity, not those sold by other entities whose business model may be completely different.

We think that the principles of the existing IAS 11 are equally valid and present the advantages of being understood and currently applied by preparers. In addition, the existing criteria are, in our view, clearer and helpfully symmetrical in the way they distinguish between the contracts to be aggregated and those to be disaggregated. It is not clear to us therefore, why the new principle has been developed. In order to allow a proper interpretation of the standard it would be appropriate to confirm IAS 11’s conditions that explain exhaustively the matter of combining and segmenting a contract.

b) Contract modification

IAS 11 mentioned three types of contract modification [IAS 11.13-14-15] specific to construction services. Those cases have not been specifically renewed in the ED.

It appears that these revenue components could represent “contract modifications” but such conclusion is not well defined by the ED itself. If they represent contract modification the consequent revenue recognition is subject to paragraph 10 of the ED. In this case there could be frequent situation whereby the revenue recognition is postponed while the costs are incurred because the work started without the approval of the “contract modification”.

IAS 11 allows the recognition if it is probable that the customer will approve the modification. In order to avoid misunderstanding with users it would be advisable to maintain the probabilistic concept for recognising, revenue as well as the best estimate’s concept for measuring revenue.

Finally it is important to consider that for a number of companies a contract modification (the three cases of IAS 11.13,14,15) in construction industry is not a separate contract but a natural element of the original contract, therefore on this respect it could be useful if the application guidance of the new IFRS should cover specific industry topic like “variations in contract work, claims and incentive payments” as is in IAS 11.11-15.
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?

a) Identification of performance obligations

The two-level segmentation system proposed in the ED (segmentation for dependant prices, and identification of distinct performance obligation) is very complex to implement and does not correspond to the way construction contracts are internally managed by most construction companies. We ask the Boards to simplify those concepts in order to allow for a more operational approach to segmentation.

We disagree with the proposed principles for the identification of performance obligations in a contract. Unlike other sectors, there is generally no market to sell a specific performance in the construction industry. We prefer the current IAS 11 principles (IAS 11.8-9-10), where a contract is accounted for as a whole under the percentage of completion method, with the combination / segmentation requirement mentioned in Question 1.

However, if the IASB were to maintain its project in its current form and principles, we do not believe this identification of distinct performance obligation as mentioned is the ED conveys relevant information about the activity and the performance of the entity. The ED principles are not precise and operational enough to be applicable. Reading paragraph 23 of the ED, it seems to us that there is no limit to this segmentation.

In the construction industry, a large part of the work can be sub-contracted. Works done by subcontractors can be seen as a performance obligation sold by third parties in the market, and therefore represent a first level of segmentation. But then, for each subcontractor, it is possible to go more deeply in the distinction, as it is always possible to find a third party to sell a part of the entire performance. Even the raw material (including paint) can be sold and delivered on the site by third parties, and could therefore represent distinct performance obligations.

Our analysis of our business is different. As a general constructor, we sell in many of our contracts a single performance that our customer cannot find in a fragmented market. The customer has the possibility to (and in some contracts does) split the general performance into distinct lots. In this case we compete for some lots, propose independent prices for each one, and the customer acts as a coordinator.

In other cases however (conception-construction contracts), the customer wants to buy a single performance/service, from the design to the final construction, without having to deal with the management of the works. In this case, we consider our performance as a global and unique one that cannot be offered on the market by a competitor. It is the very value-added of this type of activity to provide a single and global contract. Even though several construction companies may compete for the same project, each proposal - from the design to the financing, the construction, our proposed deadlines - is different. Once the project is chosen the selected constructor offers a global and unsplittable performance, even though some of the work may be subcontracted.

We recommend that identification of performance obligation be based on the contractual agreement or to companies’ business practices.

We would like to submit the following examples, which are characteristic of our business:

- In our contract to build a new safe container on Chernobyl reactor, we could consider two phases, which one taking several years: the first one for the conception and design and the second one for its construction on the site. We initially proposed two parts for the contract corresponding to these two phases. The customer however refused to separate the phases, and asked for a unique and global contract, with a unique price.

- When we submit an offer for the construction of a building, each proposal is unique, and is assessed according to several criteria. The selected tender will be the one that best matches all the criteria. For the Olympic Nice Stadium where we currently are preferred bidder, we have been assessed according to seven criterions, including integration within the site and architectural quality, sustainable development, adequacy to the
functional program and the global cost of the offer. Since the customers requires a global and single project that best matches all its demands, our service is to provide a single performance obligation.

We would like to add that we reject any reference to third party practices. Only the entity's own business practice is relevant in matters of segmentation and relevance of information.

b) Onerous test at the performance obligation level

We do not agree with the assessment of onerousness at the individual performance obligation level rather than at the overall contract level. Please refer to our comments in the cover letter, Part 3.

What is more, the segmentation (in the first step of the analysis described in the ED) is based on the interdependence of prices; it would not be coherent to calculate contingent losses for performance obligations whose prices are interdependent.

Question 3 — Do you think that the proposed guidance in paragraphs 25–30 and related application guidance is sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

We do not think that management uses the notion of transfer of control when assessing its performance for the period; but instead the level of activity which will result in revenue is used. In addition, the ED appears to us to approach the notion of transfer of control from the viewpoint of the customer, that is, whether the customer has obtained control. This seems to us to be inconsistent with what we think should be the purpose of the revenue recognition standard, which is to depict the performance of the reporting entity.

We would find more logical to look at the issue from the perspective of the entity - that is, has the entity given up control. Should the IASB decide to continue with the model based on the transfer of control, we would urge that this be defined from the point of view of the entity and not the customer.

We do not know how to interpret paragraph 31. One way to understand it is that only one of the indicators is not sufficient to qualify the transfer of control. This message is very unhelpful, because it calls into question all the indicators previously listed without providing any guidance as to how to judge the relevance of each indicator. We recommend that the future standard should require judgement to complete this list with indicators relevant for the different activities. In this case, it should be made explicit in the standard that any relevant criteria can be used to qualify the transfer of control.

The ED introduces improvements compared to the DP concerning indicators of transfer of control. However, we believe that the final standard will need much more guidance on the way to apply this concept.

Indeed, the requirements concerning the transfer of control to the customer in the case of a continuous transfer along the construction process need some clarification. This concerns in particular the “customer acceptance” as a requirement for transfer of control to the customer. We also believe that a larger guidance is necessary, in particular relating to construction services transfer of control, and work in progress (WIP).

• The customer has an unconditional obligation to pay: this indicator is not systematically adapted to our contracts. In many of our contracts, if the construction is stopped by the customer, then the customer often has the contractual obligation to indemnify the constructor for the work performed (according to customer acceptance and physical observation up to this point), with sometime an additional contractual compensation. However, other contracts do not mention such clauses.

• The customer has legal title: this indicator is not always adapted to our contracts. In many jurisdictions, the owner of the land is automatically the owner of any construction on that land. We need to go through this kind of legal analysis to attribute control, because some contracts do not mention the owner of the building during
the construction period. However, in jurisdiction where no such legal clause exists, we will generally not be able to conclude on this indicator.

In our real estate sector in France for instance, the customer becomes the owner of a percentage of the future construction from the very moment of the initial signature.

- **The customer has physical possession**: this indicator is not adapted to work in progress. However, the DP previously mentioned the “construction on the client’s property” as indicator of continuous transfer. This criterion is important for construction companies in the way that it clearly indicates that buildings built on the client’s property are not owned by the construction company – who cannot take back the building and send it to a third party – and the client has control on the building being built on his property. This indicator should therefore be reintegrated amongst the other indicators of continuous transfer.

- **The design or function of the good or service is customer-specific**: this indicator is generally well adapted to our contracts. The indicator “customer-specific” represents the ability to direct the use of, and receive the benefit from WIP because every WIP is subject to the power (ability to direct use) of the customer to customize it for its own purposes. The new accounting standard could be improved for construction industry by introducing a precise reference to the meaning of WIP’s control suggesting that this reference should consider the indicator “customer-specific”.

Should the IASB decide to continue with the model based on the transfer of control, we would urge that this be defined from the point of view of the entity and not the customer’s. It would imply less judgment from us to assess if whether or not we have control on the construction we are building, rather than if the customer has obtained this control.

We agree with example 11 “Construction Contract”, which introduces the notion of “contract management service”. We would like however to find in the future standard a reference and an articulation with this notion in the body of the standard, in order to enhance robustness and provide a strong argumentation.

**Measurement of revenue**

**Question 4** — The boards propose that if the amount of consideration is variable, an entity should recognise 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 recognise revenue on the basis of an estimated transaction price? If so, do you agree with the criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

The principle of recognising revenue only if the transaction price can be reasonably estimated seems appropriate in these circumstances. Nonetheless, we have two concerns in this area:

The first is the requirement in this respect and in other areas of this ED to use probability-weighted estimates to measure items. As in the case of the proposed changes to IAS 37, we do not think that such a requirement is appropriate. In our view, the requirement should be for the entity to make its best estimate of the amount to be received or refunded. In some cases the probability-weighted average may be the most appropriate, but in other cases it will not be. The entity should be allowed to make its judgement as to what the best estimate is, taking into account all relevant factors, including cost/benefit considerations, rather than there being a systematic requirement for the probability-weighted approach.
Question 5 — Paragraph 43 proposes that the transaction price should reflect the customer’s credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

We disagree with this approach, which is not adapted to our business. A construction contract is negotiated and signed with a single customer. In contrast to other industries dealing with a significant amount of undefined customers, it is not relevant to evaluate the credit risk for a specific customer in the construction sector, since no statistics are available for the calculation. The customer credit risk is taken into account when contracting with him and no agreement would be made if there were issues about his solvency. We therefore consider irrelevant to deduct any credit risk “discount” from revenue. We would value our customer’s credit risk as null at the time of the signature of the contract.

Further, we believe revenue should be the measure of the activity and output of the entity. It should reflect the consideration the entity is entitled to under the terms of its contracts with customers. The risk of non-performance of the customer is of a completely different nature, and we do not agree that it should be mixed with the revenue figure. The combination of the two results in a figure for revenue which does not reflect activity and is inconsistent with the entity’s internal control and invoicing systems.

We also disagree with the fact that payments finally made by the customer should not be recorded in the revenue line, but in other products. This means that we will never recognise in revenue the entire revenue we are entitled to based on the contractual terms that set our compensation for our performance obligation. This, we believe, does not convey relevant information, and is the cause of another discrepancy between internal reporting and accounting.

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?

Even though we agree with this principle, we believe it is too complex to be systematically implemented. For the reason explained above, the recognition of an implicit interest income instead of contract revenue will distort the amount of contract revenues (the fair value) and creates misunderstanding for users.

What is more, the notion of materiality is vague. The customary business practice in the context of the entity’s business model and the sector in which it operates would be better references.

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?

In the light of our answer to Question 2, this principle is not relevant.

- If no distinct performance obligation exists, then the principle does not apply,
- If the contract consists of distinct performance obligations, then the relative prices are known to the entity because they have been previously budgeted for the purpose of the contract.

The fact that the entity is unable to automatically find the distinct price of a segment is another illustration that there is no reason to identify a distinct performance obligation.

As explained in our response to Question 1 above, we do not agree that subsequent changes in contract price should be allocated to all performance obligations on the same basis as the initial allocation, and in particular, completed performance obligations should not be changed unless the price change relates directly to them. We
think that it is more logical to allocate the changes to the specific performance obligations that are directly affected by the change. Allocation of subsequent changes to all performance obligations should be the “fall-back” approach where no more rational basis exists.

**Contract costs**

**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?

This matter is an important issue for us. Please refer to our comments in our cover letter, in paragraph 4, where we ask for more guidance on the subject.

We believe that costs incurred for obtaining a contract should not systematically be treated as expenses. Instead, the existing IAS 11.21 rule should apply: costs incurred for obtaining a contract can be capitalized if they can be measured reliably and if it is probable that the contract will be obtained. In our sector, deadlines can be very long between the moment a contractor is chosen as preferred bidder, and the closing of the contract. This is especially true in the concession sector, because of the financial set-up with all the banks ($1 to 3 billion). In those cases, the closing of the contract can take up to one year (depending on the size of the project and contact), and design works have already started to keep in time with contractual deadlines generally at the request of the grantor despite the contract has not yet been closed and signed by both parties.

In this context, the treatment of costs linked to the beginning of the works incurred before the signature of the contract is not clearly dealt with in the ED. Those costs should be eligible for capitalisation, as they would have not be incurred had the entity not assessed the activity had started. However, they do not match the definitions in paragraphs 57 and 58, as they might be considered as precontractual costs.

We also reject the notion of costs of “abnormal amounts of wasted materials, labour or other resources” that are mentioned in the ED as specific costs and cannot be capitalized. This notion was not present in the DP and was introduced in the ED. This notion seems vague and difficulty applicable. Moreover, this is not the way they are dealt with internally by a company. This proposed notion should not appear in the final standard.

**Question 9** — Paragraph 58 proposes the costs that relate directly to a contract for the purpose 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 and why?

In the line of our answer to Question 8, we believe that the exclusion of indirect costs from the onerous test is not relevant, and is even not cautious.

With such a limited number of costs eligible for recognition, the ED proposals would mean going back to previous practices, which had been greatly improved by IAS 11. Indeed, limiting the amount of eligible costs for the onerous test would not be relevant, and even not cautious. The margin level would be higher, which is less cautious in a high volatility and vagary activity.

Because of the decentralization of our construction activity, indirect operational costs need to be taken into account in the onerous test, because they are considered as costs by the site managers and by the top management. Only purely indirect and non-operational costs, as headquarter expenses, should be excluded from the test, according to each group organization.
We also disagree with the use of probability-weighted costs for the onerous test. We believe that such a method is too complex to implement and to use at an operational level.

**Disclosure**

**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?

The proposed disclosures are too heavy and burdensome. This is true in particular for the reconciliation from the opening to the closing contract balances required by paragraph 75. We are currently not able to provide this level of information, and it would be very long and costly for us to adapt our systems. These disclosures would therefore increase accounting costs, whereas it is doubtful that this extensive information will provide additional useful decision-making information to the users of financial statements.

What is more, the proposed disclosures are not adapted to the number of contracts we are dealing with (240,000). Such detailed information will be lost among the large number of very different contracts, from many sub-sectors and activities. Indeed, we believe this information is too heavy for the user of financial statements to be efficient, and to meet its goal of transmitting relevant information.

**Question 11** — The Boards 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?

Our order book and remaining performance obligation are a key performance indicators in our business. However, we do not think their place belong in the financial statements. Such disclosures would heavily rely on management plans and many underlying assumptions, particularly in terms of ageing of the remaining performance obligations. The required process would be difficult and heavy to put in place.

This is why we believe this information belongs to the management report (where we currently report it) instead of the financial statements.

**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?

We disagree. IFRS 8 already provides a breakdown of revenue according to the disaggregation followed by the management. We do not believe that requiring other breakdowns, which have not been assessed relevant for internal reporting, is not necessary.
Effective date and transition

**Question 13** — Do you agree that an entity should apply the proposed requirements retrospectively (that is, as if the entity applied the proposed requirements to all contracts in existence at the effective date and in the comparative period)? If not, why? Is there an alternative transition method that would preserve trend information about revenue but at a lower cost to preparers? If so, please explain the alternative and why you think it is better.

As we said above, our group is dealing with 240,000 contracts. In this context, a fully retrospective application would be very difficult and costly to implement. Indeed, we need to comprehensively review our systems, to adapt them to the new standard (performance obligation segmentation).

We need time to reprocess the data, and all of this implies a comprehensive review for the adaptation of our systems.

Moreover, the method described in the ED implies a contract by contract analysis. In our group were we have hundreds of active projects, we need to proceed to individual analysis, in order among other to determine:

- Segmentation / combination of contracts
- Performance obligations
  - The contract price, including:
    - Customer credit risk
    - Time value of money
    - Different scenarios in case of a variable price
- Standalone selling prices for each performance obligation
- The amount differed for the legal guarantee

Therefore, if the Boards were to maintain a retrospective application, we would need several years before the first application, in order to allow us to prepare the pro-forma.

Application guidance

**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 proposal operational? If not, what additional guidance do you suggest?

The link between the principles in the body of the ED, and the examples in the appendix, is not always well articulated. We agree with some of the example in appendix B (example 11 — “Construction contracts”) for the existence of a Contract Management service (see our answer to Question 3) but do not really understand how this example ties in the principles underlying the body of the ED.

What is more, we need much more guidance, in particular relating to:

- indicators of transfer of control
- modification of construction contracts (see our answer to Question 1)
- particularities of the construction sector
**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?

We do agree with the proposed distinction between types of product warranties.

However, we do not agree with how a product warranty should be accounted.

For instance, for a non-commodity industry, it is difficult to make a precise estimate of the cost to be incurred for warranty costs at inception. In the case of the construction industry, every project is unique and warranty cost cannot be estimated according to statistics. Also, product warranty is a complex issue which exposes the contractor to liability years after the contract has been completed, in particular in the case of the decade warranty.

A fair presentation would be obtained if product warranties are considered as separate liabilities, rather than separate performance obligations.

**Question 16** — Do you agree that the pattern of revenue recognition should depend on whether a licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

n/a

**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?

Even though we do not agree with the principle of transfer of control for a basis for revenue recognition, we believe the principles applied should be consistent among standards.