Please note that the comments expressed herein are solely my personal views

International Accounting Standards Board
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- Your Ref: Comment letter on Exposure Draft ED/2011/6
- Revenue from Contracts with Customers

Dear Sir,

Thank you for giving us the opportunity to comment on your Exposure Draft ED/2011/6, Revenue from Contracts with Customers.

The main objective of the Exposure Draft is to develop a comprehensive revenue recognition model that would apply to a wide range of transactions and industries. The current proposals meet this objective with a principles-based approach to revenue recognition that requires entities to apply the following five-step model in order to determine whether, when and how to recognise revenue:

Step 1—Identify the contract with a customer.
Step 2—Identify the separate performance obligations in the contract.
Step 3—Determine the transaction price.
Step 4—Allocate the transaction price to the separate performance obligations in the contract.
Step 5—Recognise revenue when (or as) the entity satisfies a performance obligation.

I agree with this five-step model, which provides a consistent framework for revenue recognition based on transferring goods or services to customers. However, I do have some serious concerns about the onerous performance obligations test, which I address in response to your specific questions below.

I also broadly agree with the proposed presentation and disclosure requirements, which I believe will provide more meaningful information to users of financial statements (users).
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I fully support the disclosure of “the significant judgements, and changes in the judgements, made in applying the [draft] IFRS” proposed in paragraph 109(b) of the Exposure Draft. For completeness, I would recommend that the disclosure requirements should be expanded to include sensitivity testing on the significant judgments, estimates and assumptions, where relevant. This would provide meaningful information to users of financial statements. I do not believe that these additional disclosures would be too onerous for preparers of financial statements. In fact I would argue that having a good understanding of the business and its risk drivers, including their dependencies, is vital in order to properly manage the business and its risks.
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Answers to specific questions raised by the IASB

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

I agree with the proposal. The criteria in paragraphs 35 and 36 in particular are sufficient and complete and are a reasonable proxy for transfer of control to a customer.

Question 2: Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectable because of a customer’s credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer’s credit risk and why?

I agree with these proposals, which are more transparent compared with the previous exposure draft. The proposal to present assessed losses due to customers’ credit risk as a line item adjacent to the gross revenue will provide meaningful information to users. However, I would add that this may be obscured as such assessed losses could include amounts assessed to be uncollectable in the reporting period together with experience adjustments relating to revenue that was recognised in earlier periods. I would suggest that it would be more transparent and useful if experience adjustments relating to earlier periods would be presented in a separate line item, in order to provide more meaningful information about the attribution of assessed losses due to customers’ credit risk between the reporting period (initial estimates) and earlier periods (experience adjustments).

My only other concern is that it may be difficult for entities to reliably assess customers’ credit risk. The assessment is subjective, and in many cases difficult to verify.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity’s experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?
Yes, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. This is reasonable and prudent. It contrasts with the current approach under IAS 18 Revenue that requires that revenue “can be measured reliably”\(^1\), and with the previous exposure draft that required that revenue should be “reasonably estimated”\(^2\). It is not clear whether “reasonably assured to be entitled” sets a higher or lower threshold than “can be measured reliably” or “reasonably estimated”, although given the contractual nature of entitlement, it would seem to be a more objective measure.

I agree with the proposed indicators in paragraph 82, which are reasonable and sufficient to provide appropriate guidance here.

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

*No, I do not agree with the proposed scope of the onerous test. It seems rather complicated and impractical and will not necessarily provide meaningful information to users.*

Firstly, why does the test apply only to performance obligations satisfied over time and over a period of time greater than one year? This time period sets a bright line for applying the test and it seems rather arbitrary. It would lead to very different application to performance obligations just under one year and just over one year, which may be misleading. It is also open to manipulation and abuse. Secondly, it is not clear to me that the proposed “lowest cost of settling the performance obligation”\(^3\) (a fair value approach), is more sensible than the “present value of the probability-weighted costs”\(^4\) approach from the previous exposure draft (an expectations approach). The proposed approach actually seems more complex and time consuming to perform. Finally, the test does not mention discounting, which appears to be a mistake. Clearly the liability for onerous performance obligations should be discounted if the time value of money is material. This may be implicitly assumed within the Exposure Draft, but I would prefer it if this was explicitly stated in paragraphs 86-89.

More importantly I would strongly recommend that the onerous test should apply at the contract level, not at the performance obligation level. Paragraph 8 of the Exposure Draft sets out its objective as follows:

> The objective of this [draft] IFRS is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

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\(^1\) See for example the Objective of IAS 18.

\(^2\) See in particular paragraph 38 of the previous exposure draft ED/2010/6.

\(^3\) See paragraph 87 of the Exposure Draft.

\(^4\) See paragraph 55 of the previous exposure draft.
I note the importance of the contract level, which is explicitly stated in this objective. Most entities that sell a bundle of performance obligations (goods or services) do so for a reason – that the entity prices and markets the performance obligations in this way in order to meet its business objectives, and that the customer wants to purchase the performance obligations together as a bundle, rather than individually. Such a bundle of performance obligations often contains performance obligations priced with no profit margin, or priced as a loss leader. It is not clear to me that recognising a loss on these separate performance obligations, even if the contract is expected to be profitable, would provide meaningful information to users. Furthermore, I disagree with paragraph BC207 of the Basis for Conclusions, which argues that changing the unit of account to the contract level “would add complexity”. I would rather suggest that changing the unit of account to the contract level would reduce conceptual and computational complexity here.

**Question 5:** The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity’s remaining performance obligations (paragraphs 119–121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).

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

I generally agree with the proposed disclosures regarding revenue and contracts with customers in interim financial reports. These will provide important, detailed and consistent information to users, and more meaningful information generally.

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

I agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non financial assets that are not an output of an entity's ordinary activities. This is a reasonable approach that improves internal consistency in financial reporting, and between IFRS and US GAAP.

Summary of my main recommendations to the board:

- Propose that experience adjustments to amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk that relate to earlier periods should be presented as a separate line item.

- Propose that the onerous test:
  should apply to all contracts
  should explicitly include discounting
  should apply at the contract level

- Disclose sensitivity analyses on the significant judgements, estimates and assumptions used.

Yours faithfully

C.R. Barnard

Chris Barnard